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UKRAINE'S FIGHT AGAINST CORRUPTION: THE ECONOMIC FRONT

KYIV – 2018

ECONOMIC
ASSESSMENT
OF ANTICORRUPTION
MEASURES
IMPLEMENTED
2014-2018



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**UKRAINE'S FIGHT AGAINST CORRUPTION: THE ECONOMIC FRONT
ECONOMIC ASSESSMENT OF ANTICORRUPTION MEASURES IMPLEMENTED
2014-2018. RESEARCH REPORT. KYIV – 2018.**

In this report, the Institute for Economic Research and Policy Consulting has primarily focused its attention on the anticorruption measures, which are brought about by reforms aimed at enhancing transparency and openness in the work of the government and increasing the efficiency of public administration. For the purpose of the analysis a limited number of measures were chosen in the sectors where corruption was traditionally considered as Ukraine's calling card.

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ABBREVIATIONS

CC	Criminal Code of Ukraine
CEPS	Centre for European Policy Studies
GDP	Gross domestic product
EU	European Union
IER	Institute for Economic Research and Policy Consulting
MEDT	Ministry of Economic Development and Trade of Ukraine
MN, BN, TN	million, billion, trillion
NABU	National Anticorruption Bureau of Ukraine
NACP	National Agency on Corruption Prevention
NJSC	National Joint Stock Company
PGO	Prosecutor General's Office
PJSC	Public Joint Stock Company
RACMS	risk assessment criteria-monitoring system
RUE	RosUkrEnerg
SAPO	Specialized Anticorruption Prosecutor's Office
SFS	State Fiscal Service
SOE	state-owned enterprise
SPV	special purpose vehicle
SRSU	State Regulatory Service of Ukraine
TI	Transparency International
VAT EAS	VAT electronic administration system
WTO	World Trade Organization
USA	United States of America
VAT	Value-added tax

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EXECUTIVE SUMMARY

Ukraine is perceived as a highly corrupt country where political, large-scale and small (petty) corruption has become an integral element of social interaction. Corruption causes losses to both the state and its population due to inefficient use of budget funds and low level of government services, as well as creating uncertainty in the environment where economic agents and households function. Yet, judgments about this phenomenon made by the unbiased researcher may encounter problems, because international ratings measure corruption perceptions, while economic assessments tend to focus on losses caused by corruption. So far, there has been little effort to calculate economic benefits achieved by Ukraine's anticorruption reforms.

Fighting corruption in 2014-2018 was established as a key priority of Ukraine's government policy. The measures implemented over this period enabled Ukraine to move from being 144 in 2013 to 130 in the TI Corruption Perceptions Index.

Two main driving forces to lower corruption levels have been established:

- 1) Narrowing corruption opportunities through reforms in different sectors
- 2) Creation of efficient corruption fighting institutions

In this report, the IER has primarily focused its attention on the first line of changes, which are brought about by reforms aimed at enhancing transparency and openness in the work of the government and increasing the efficiency of public administration. For the purpose of the analysis a limited number of measures were chosen in the sectors where corruption was traditionally considered as Ukraine's calling card.

For many years, the natural gas market remained one of the most corrupt sectors of Ukraine's economy. It is from this sector that oligarchs extracted rents. From 2014, the government started gas sector reforms, which narrowed opportunities for corruption and reduced government losses. This included the following:

- Quality changes were introduced into PJSC Naftogaz Ukrainy's (Naftogaz) governance system and its functioning principles.
- The investment and legal framework required for the functioning of a fully-fledged gas market based on free pricing was established. In addition, the natural gas price for households was increased. This reduced rent-seeking opportunities in the sector due to price differences.
- Import sources were diversified and Ukraine stopped making direct purchases of Russian gas.

On the whole, the implemented **measures made it possible to liquidate the government losses in the amount approximately 3 BN USD per annum, and** for the first time over the recent years PJSC **Naftogaz Ukrainy (Naftogaz)** has become profit making. Yet, the gas sector reform process has not been completed yet, and going forward the new rules will be tested for their anticorruption resilience.

So called «tax holes» have traditionally been one of the problems with Ukraine's tax system.

According to assessment performed by Ukraine's Ministry for Revenues and Duties in 2014, the scope of so-called tax holes in 2013 amounted to more than UAH 300 BL, which resulted in a UAH 50 BN loss of revenues to the State Budget¹. On the whole, based on the government estimates, the aggregated amount of tax holes over 2010-2013 reached UAH 600 BN. In 2014, Ukraine's government announced closing tax holes as one of its priorities. Tax holes mostly involve practices where fictitious enterprises

¹ "Міндоходів дістало з "податкових ям" 2,6 мільярда гривень". 1 червня 2014 р., <https://www.epravda.com.ua/news/2014/06/1/460931/>.

provide schematic VAT credit to other entities. In 2014, closing tax holes was uneven, whereas from 2015 to 2017 government implemented a series of systemic steps aimed to root out such corrupt schemes, including:

- Introduction of electronic administration of VAT starting from 2016
- Introduction of automatic VAT refund starting from April 2017
- Introduction the special risk assessment criteria monitoring system (RACMS) starting in April 2017 in test mode, with the fully featured system operational from July. Yet, system operations were suspended starting January 2018 in order to improve the invoice blocking criteria

From 2014 to 2017, several measures were implemented to close down conversion platforms (money laundering systems), which in previous years escalated to «state capture» schemes used by government bureaucrats. **The IER calculates that tax revenues resulting from liquidation of conversion platforms and fighting schematic tax credits amounted to approximately USD 3 BN.** However, Ukraine still has much to do to increase its efficiency in administrating taxes and reforming its SFS as a whole.

Public procurement has traditionally been one of the main areas of corruption at all levels of the state. As a result, the government has always incurred significant financial losses. According to the data of the State Security Service of Ukraine, annual losses from corrupt schemes implemented in the area of public procurement reached 10-15% (UAH 35-52.5 BN) of State Budget expenditures². That is why in 2014 public procurement system reform became a priority area in Ukraine's economic policy. In 2014, under the framework of budget consolidation measures with the support of the IMF and EU, the law On Public Procurement Practices was passed, and in 2015 the government launched a pilot project on the introduction of an electronic system of public procurement - ProZorro³. In December 2015, parliament approved the government draft law On Public Procurement, provisions of which mostly comply with Directives 2014/24/EU and 2014/25/EU. All central executive authorities and natural government monopolies switched to using ProZorro in their procurement process starting from April 1 2016, while other government enterprises (including local budgets) followed suit from August 1 2016. **Introduction of the ProZorro system has contributed to lowering corruption in the procurement system and saving of funds as a result of the switch to close to market prices.**

According to MEDT methodology, the switch to a new procurement procedure has already resulted in about UAH 40 BN of savings, while estimates in price savings may amount to additional UAH 10-24 BN. The reform of the public procurement system is still a work in progress. For example, additional improvements are needed to the rules and procedures, which regulate responsibilities of the parties as well as the appeals procedure against the decisions passed and dispute resolution in the procurement process.

Until recently access to most of state registers and other data collected and stored by state entities was monopolized by bureacrats. Receiving many different types of information (including from the registers) required filing requests to state agencies. Data in most of the registers were closed to the public. This facilitated shadow schemes for such data usage as well as creating an environment conducive for corruption at different levels of public administration. The lack of transparency also prevented likely abuse on the part of officials from being detected. That is why the 2014-2017 Anticorruption Strategy established access to information needed by the public as a priority area in corruption prevention activities. The access related matters have been regulated by legislation. **The open data portal was created and access was provided to a vast number of state registers. Yet, to**

² Див. Закон "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2014-2017 роки", №1699-18 від 8 липня 2015 р., <http://zakon2.rada.gov.ua/laws/show/1699-18>.

³ Веб-сайт Прозорро: <http://prozorro.org/>.

protect such achievements and ensure further advance in provision of open information, the pace of reform must be maintained.

Deregulation has become one of the government policy areas, which aims to reduce the corruption opportunities for bureaucrats. The intent of deregulation is to create a favorable business climate by removing excessive administrative burdens on business and reducing excessive control over entrepreneurial activities through simplification in the respective regulatory procedures. In the four years that followed the Revolution of Dignity and the change of political regime, Ukraine has moved up 38 positions in the World Bank's Doing Business - from 112 in 2014 to 76 in 2018. This was made possible, specifically, as a result of reducing the number of mandatory licenses and permits, especially in the construction industry and due to simplified tax administration. At the end of 2017, the government introduced simplified registration of drugs already registered by the competent authorities of the USA, Switzerland, Japan, Australia and Canada, as well as drugs registered in accordance with EU procedures. At the same time, however, deregulation procedures should be invigorated. According to information provided by the State Regulator Service of Ukraine (SRSU)⁴ on the implementation status of Ukrainian the Government Action Plan on deregulation, of 112 Action Plan items only 48 had been implemented, while nine more were in the process of being implemented. The remainder, about half of the items planned, had not been implemented.

According to the National Anticorruption Bureau of Ukraine (NABU) and Transparency International Ukraine, state-owned enterprises are the most corrupt institutions in Ukraine. It should be pointed out that in Ukraine the number of state-owned enterprises is much higher (3,392), compared to Eastern European countries, while their operational efficiency is extremely poor. In the first nine months of 2017 only 1,611 companies were still in operation, with 1,056 being profit making. The remaining enterprises were loss making, leading government to begin reforming governance of **state-owned enterprises (SOEs). The reforms aim to prevent political interference in the operations of SOEs, liquidate the respective corruption schemes, separate the function of regulator and owner and implement internationally acceptable corporate governance standards.** Privatization of the SOEs is an important element to the reform. It should be underscored that small-scale privatization will be carried out with the help of ProZorro sales system, which has already proved its effectiveness.

Improvement of the supervision of Ukraine's banking system is another line of actions aimed at narrowing the opportunities for corrupt practices. A considerable number of banks have either failed to comply with respective regulatory requirements or functioned as components in shady financial schemes. In this context, approval has been given for requiring disclosure of information on **the ownership structure of banks. Banking sector restructuring was carried out (not without problems, however), as well as other measures undertaken to reduce the corruption risks in the banking sector.**

With regard to corrupt actions detection and punishment of 'corrupt officials,' a system of special anticorruption agencies is today nearing completion. Ukraine has established the National Anticorruption Bureau of Ukraine (NABU), the National Agency on Corruption Prevention (NACP) and the Specialized Anticorruption Prosecutor's Office (SAPO). On March 01, 2018, the draft law on establishing an Anticorruption Court was passed in the first reading. The bill was adopted in full in June 2018.

⁴ Стан виконання Плану заходів щодо дерегуляції господарської діяльності, затвердженого розпорядженням Кабінету Міністрів України від 23 серпня 2016 р. № 615-р.на 20 травня 2018 року, <http://www.drs.gov.ua/deregulation/plan-deregulyatsiyi-2016-2017-rr/>.

We estimate that aggregate economic gain from anticorruption measures **amounts to** nearly **6% of GDP, or approximately USD 6 BN**. Even with the above-mentioned positive achievements, the fight against corruption has only just started. To date, Ukraine has had to adequately respond to a double challenge - to prevent the roll-back of the reforms that have brought about these achievements and to further strengthen the process of fighting corruption.

INTRODUCTION. WHAT WE ARE WRITING AND HOW

The world perceives Ukraine not merely as highly corrupt country but as a country where political, large-scale and small (petty) corruption have become a natural component of social relationships. At the same time, a consensus has emerged that it will be impossible for Ukraine to be successful without eradicating widespread corruption.

Corruption and fighting corruption is a complex and multi-dimensional process. Hence, assessments as to corruption scale and willingness to fight it (political will) and the efficiency of different types of anticorruption measures vary greatly. It should be noted, however, that it is corruption perception that all currently known international ratings measure. Economic estimates of corruption-caused losses and gains from fighting corruption are indeed rare.

Measurement of corruption scale and adequate assessment of the efficiency of anticorruption measures is a challenge for experts, politicians and society. Without such an analysis it is impossible not only to measure the degree of success in anticorruption strategy but also to adequately adjust its contents, timeframes and mechanisms for respective steps implementation. It is in this context that the National Reform Council has approached the Institute for Economic Research and Policy Consulting with the request to provide this economic assessment, most notably of the measures aimed to lower political corruption at the national level.

To accomplish the task we have structured our research in the following way.

1. Traditionally corruption is broken into three functional types, such as:

- a) Political corruption – which is the manipulation by politicians with political decisions, rules, procedures and institutional activities in the area of resource allocation and financing, and also abuse by politicians of their powers to retain and increase their authority, assets and private gain
- b) Large-scale (grand) corruption covers actions committed by the top level officials to obtain the benefit at the expense of society by means of exercising the distortive influence on the government policy and the government functioning mechanisms at the central (national) level
- c) Small-scale, or petty, corruption is a daily abuse of powers by the mid and low-level officials in the process of their interaction with citizens seeking to solve personal problems

We restricted ourselves to analysis of the measures aimed to overcome, mainly, political corruption. At the same time, we do understand that the strategic goal is to create zero tolerance of society to corruption at all levels.

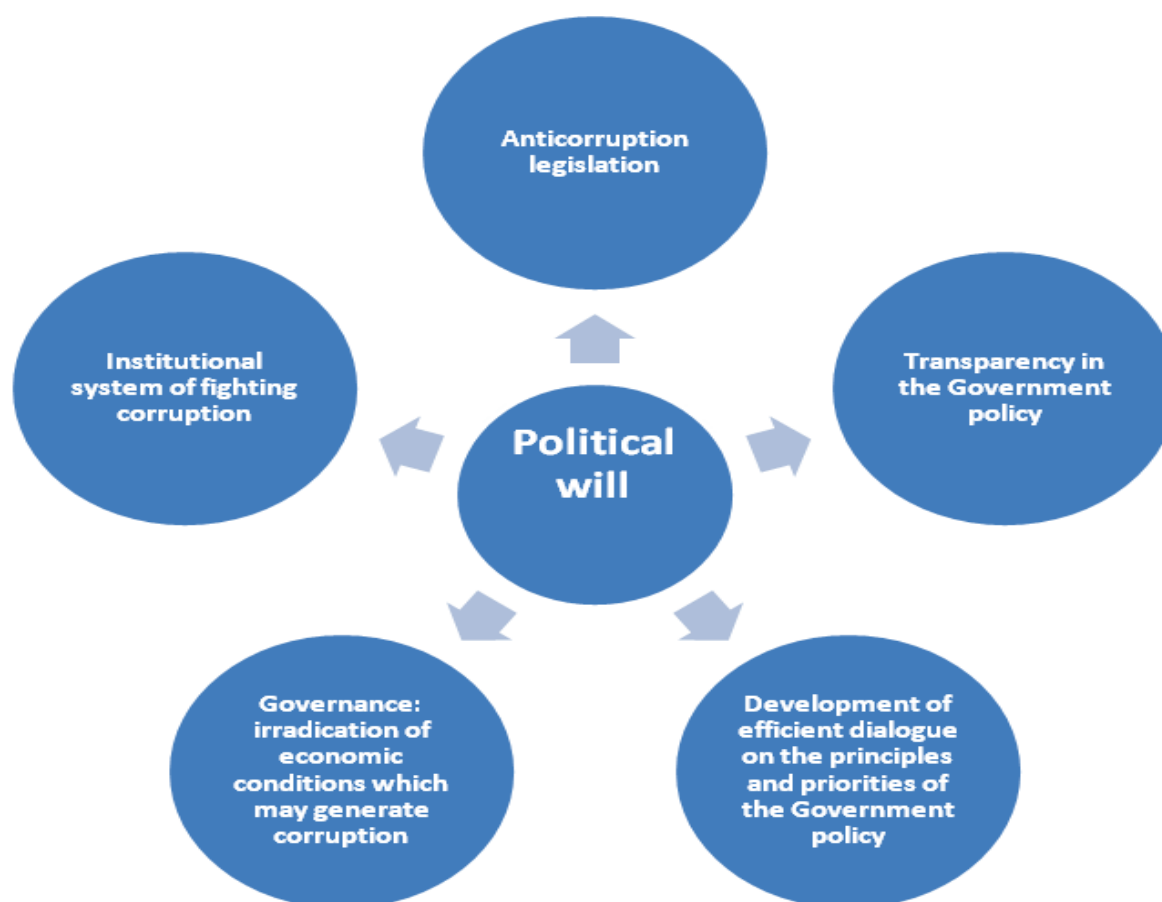
2. Corruption itself, and, accordingly, the fight against this phenomenon, is a complex and multi-dimension phenomenon (Figure 1.) All anticorruption measures may be, tentatively, broken down into two groups: a) detection of corrupt actions and punishment of the guilty, and b) eradication of corruption generating circumstances.

The primary subject of this report is to assess the changes in the system of economic governance, which aims to eradicate conditions favoring the existence of political corruption and to ensure transparency of respective regulatory mechanisms as a prerequisite to successful prevention of corrupt practices. At the same time, a separate section of this report is devoted to development of an institutional system for fighting corruption.

3. We believe assessments of changes in public administration system in the broad meaning of this word are important not only to evaluate the efficiency of measures applied in this sphere, but also to protect reforms from active attempts to revise already existing achievements and, either directly or indirectly, to slow down Ukraine's anticorruption advances.

4. Due to objective reasons, we have not tried to analyze neither all possible corruption schemes (participants, scope, tools), nor efficiency of the currently created corruption fighting system. These problems require separate analysis.
5. In the process of our work, we have encountered the problem of availability of the data needed to perform the analysis and its authenticity. Lack of access to - and the quality of – relevant statistics and information objectively constrained our capabilities to assess the economic effect of respective steps and changes.

Figure 1. Corruption fight: main components



Given the goal of our work and availability of relevant information, we tried in each section to describe the problem (description of corrupt phenomenon/scheme), to mention respective anticorruption steps (decisions) and to assess the anticorruption effect of respective changes, as well as listing pending issues and presenting recommendations on future steps.

Section 1 of our research presents a brief overview of the history of corruption and a description of the methodology we used to measure economic effect of anticorruption changes. Section 2 deals with establishment of institutions tasked with fighting corruption. Section 3 is devoted to anticorruption effects of reforms of the gas market, where hefty opportunities for corruption and rent-seeking behavior have been existed for decades due factual “state capture.”

As the success of any State depends upon its fiscal system efficiency, we analyzed anticorruption effects of tax administration (Section 4) and public procurement reforms (Section 5). Section 6 presents an overview of the steps called to increase transparency in governance, measures which narrow

corruption generation opportunities. Section 6 covers the various issues of deregulation. This is important for improving the business climate, since, among other things, it has an absolutely clear anticorruption effect. Section 7 is devoted to the reform of corporate governance of state enterprises as these entities traditionally have been some of the most corrupted institutions in Ukraine. Putting things in order in the banking system was this year's victory. This was facilitated by the establishment of the NBU's independence (Section 8). The report ends with conclusions and recommendations about the next steps which should be taken.

SECTION 1. INSTITUTIONAL CHANGES AS A TOOL TO FIGHT CORRUPTION

CORRUPTION HERITAGE: POLITICAL AND LARGE-SCALE CORRUPTION AS AN ELEMENT OF GOVERNANCE IN UKRAINE.

Corruption in Ukraine is not merely a social and economic phenomenon characteristic of many countries in the world. Before revolutionary events in 2014, despite loud political statements and some anticorruption decisions, levels of corruption increased, as reflected in respective international ratings (Table 1).

Table 1. Transparency International corruption perceptions index and sources used for its calculation, 2012-2014

CORRUPTION PERCEPTION INDEX: Ukraine						
Year	2017	2016	2015	2014	2013	2012
Position in the rating	130 ¹³¹	130	142	144 [±]	144	
Corruption perception index: general assessment (relative score)	30 ⁺¹	29 ⁺²	27 ⁺¹	26 ⁺¹	25 ⁻¹	26 ⁻³
SOURCES OF DATA USED FOR CALCULATION OF CORRUPTION PERCEPTION INDEX (relative score)						
World Economic Forum	29 ⁺²	27 ⁻¹	28 ⁻³	31 ⁺⁷	24 ⁻⁵	29 ⁺⁸
Global Insight Country Risk Ratings	22 ⁻¹²	34 ⁺²	32 [±]	32 [±]	32 [±]	32 ⁻⁶
Bertelsmann Foundation Transformation Index	41 ⁺⁸	36 [±]	36 ⁺⁸	28 [±]	28 [±]	28 ⁻⁶
IMD World Competitiveness Center Yearbook	26 ⁻²	29 ⁺³	26 [±]	26 [±]	26 ⁺¹	25 ⁺⁷
World Justice Project Rule of Law Index Expert Survey	36 ⁺⁴	32 ⁺¹⁰	22 ⁺²	20 ⁺²	18 [±]	18 ⁻⁴
Political Risk Services International Country Risk Guide	32 ⁺¹²	24 ⁺³	21 [±]	21 [±]	21 ⁻¹⁰	31 ⁺⁵
Varieties of Democracy (V-Dem)	30 ⁺⁷	23				
Economist Intelligence Unit Country Risk Service	20 ⁺¹	19 ⁻²	21 [±]	21 [±]	21 [±]	21 ⁻²
Freedom House Nations in Transit	36 ⁺³	33 ⁺⁴	29 ⁺³	26 ⁻³	29 [±]	29 ⁺¹

Note: green figures show improvement in the ratio compared to previous year, while red figures show worsening. Source: <https://www.transparency.org/research/cpi/overview>

According to the data above, on the eve of the Revolution of Dignity, Ukraine was perceived as one of the most corrupt countries in the world, ranked 144th in the corruption perception rating (Note that a lower index on this scale reflects greater corruption). A similar situation is observed with respect to other ratios used to calculate the corruption perception index.

In economic terms, corruption has become a serious drag for Ukraine's economic development. In addition, without overcoming corruption Ukraine will simply not be able to catch up to advanced countries and regions in the world (Box 1).

Box 1. Economic effect from eradicated corruption in terms of economic growth.

If Ukraine is unable to lower corruption, per capita GDP will still be only about 30 percent of the EU average in 2040.

If corruption is lowered to the highest level prevailing among EU countries, Ukraine's per capita GDP will reach about 40 percent of the EU average in 2040.

Finally, if Ukraine is able to reduce corruption to the EU average, per capita GDP will exceed 50 percent of the EU average in 2040, sharply converging afterwards.

Source: International Monetary Fund. IMF Country Report No. 17/84. Ukraine, Selected Issues. March 7, 2017.

The large size of Ukraine's shadow economy has been a traditional feature (Table 2). In 2014, Ukraine's shadow economy comprised 43% of its official GDP.

Table 2. Ukraine's shadow economy

Year	Level of shadow economy in % to Ukraine's official GDP	Change in the amount of Ukraine's real GDP % to respective period of the previous year
2010	38	4,1
2011	34	5,5
2012	34	0,2
2013	35	0,0
2014	43	-6,6
2015	40	-9,8
2016	35	2,4
9 місяців 2017	33	2,3

Source: * Calculations of the Ministry for Ukraine's economic development:
<http://www.me.gov.ua/Documents/List?lang=uk-UA&id=e384c5a7-6533-4ab6-b56f-50e5243eb15a&tag=TendentsiiTinovoiEkonomiki>

It is clear that other conditions being equal the shadow economy is both the source and outcome of corruption. While the scale of Ukraine's shadow economy began shrinking in 2015, it remains large, replete with the respective negative political and economic consequences. At the same time, it should be remembered that the size of shadow economy is also explained by the fact that “shadow operations” themselves are viewed as strategies allowing businesses to mitigate the impact of the economic crisis (therefore, naturally, the level of shadow economy has increased during the crisis)

A special note should be made about Ukrainian society's traditionally high level of tolerance to petty corruption, which is not a uniquely Ukrainian phenomenon. All societies at this stage of institutional development share the same characteristic. This, specifically, is reflected in the prevalent view that the state machine is simply cannot work without corruption. For the sake of fairness, we should say this opinion has also received support among economic development experts.

INSTITUTIONAL CHANGES: ECONOMIC ASSESSMENT OF ANTICORRUPTION CHANGES

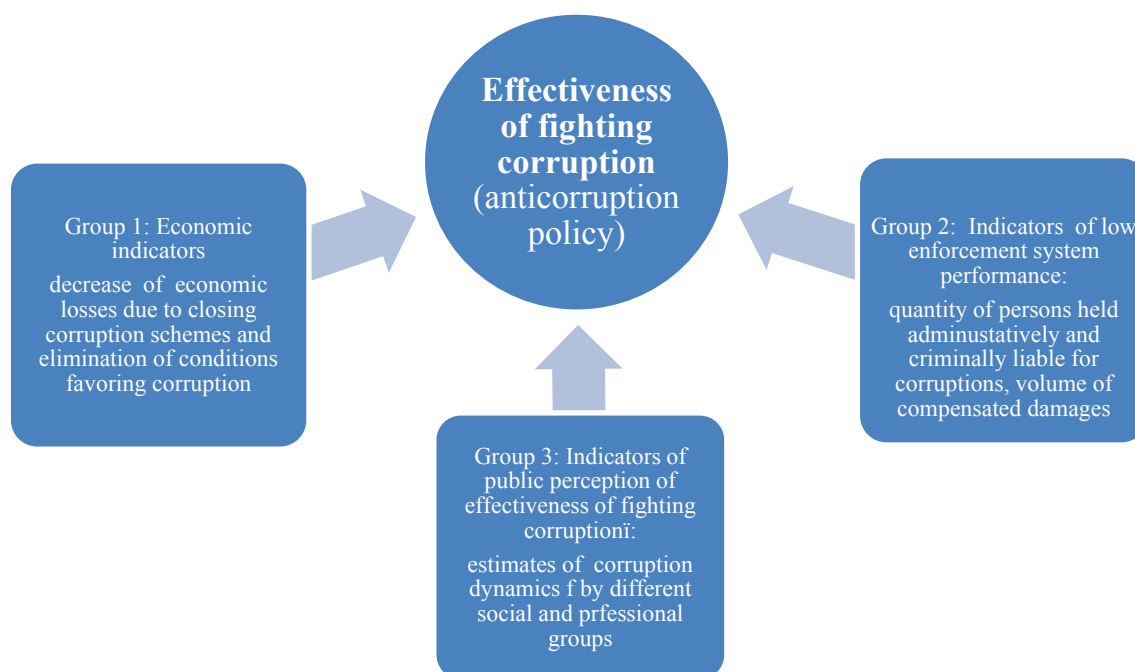
Assessing the effectiveness of anticorruption measures is a rather complicated problem. To accomplish this task we based our study on the approach described below:

1. It is virtually impossible to accurately determine the real volume of corruption (and, therefore, it is impossible to determine exactly the respective economic losses of society), since any assessment of this phenomenon depends on the methodology and the initial assumptions of the analysis. This is also true for the assessment of the economic impact of anticorruption measures. Under such conditions, when discussing the magnitude of the relevant phenomena, the question of underestimation or overestimation arises while the perception of the correctness or incorrectness of such assessments is mostly subjective.

In view of this, we clearly define the limitations that objectively affect the quality and completeness of the results obtained and their (results) interpretation.

2. Technically speaking, the effectiveness of the fight against corruption can be estimated using several indicators, each having its own specific scope of use (Figure 2).

Figure 2. Assessment of effectiveness of the fight against corruption: main indicators.



Obviously, these indicators are interrelated. However, each group at the same time has its own scope of use. It should be noted that traditionally participants of anticorruption policy discussions operate exclusively with the indicators of the second and third groups, or they contrast indicators of these groups against indicators of the first group. In our opinion, such an approach is not conducive to adequately assessing the state of affairs in battle against corruption.

The subject of our work is the economic assessment of the impact of changes in the governance system (Group 1 Indicators). Group 2 and 3 indicators are also very important, and they are quoted in the relevant sections of the work. But our analysis is based on the following premise: changes in the system of state governance aimed at eliminating the conditions that give rise to, first and foremost, political corruption, in one way or another, affect the social perception of the scale and dynamics of corruption. Regarding the work of law enforcement bodies and agencies, in the context of this work their task is

defined as the protection of anticorruption changes in economic governance by ensuring the inevitability of punishment for committing relevant corruption offenses and crimes.

3. In one form or another, corruption is present in many spheres of Ukrainian life. And, of course, without a detailed sectoral analysis of corruption and an objective assessment of the effectiveness of the relevant anticorruption measures (e.g., in education, medicine, health care, military procurement, etc.), it is difficult to talk about the real pace and extent of the country's anticorruption progress. It should also be kept in mind that society is extremely sensitive to reforms in these areas. This objectively complicates discussion on the effectiveness/inefficiency of the relevant anticorruption measures.

But given the objective complexity of such an analysis, problems with the search and verification of relevant information (especially in the defense sector), the subject of this work is limited to only few basic areas of governmental activity. These areas were chosen for the following reasons: the importance of the sector for the Ukrainian economy, the existence of large-scale political vertically integrated corruption before 2014, the existence of real tangible changes in the system of state regulation of the relevant sphere and accessibility and completeness of the necessary information.

4. The subject of this report is an assessment of the effect of the fight against corruption, based on the manipulation of public funds in the process of implementing the functions of public administration. At the same time, corruption also includes various types schemes aimed at capturing private funds belonging to citizens and businesses, where the beneficiaries are government officials and employees of the budgetary sphere of various levels. This sector of corruption requires a separate analysis.

5. In this paper, we mostly analyzed the measures whose effect can be “measured” economically. At the same time, we also pay great attention to changes in economic governance with proven anticorruption effect, which for objective reasons is either impossible or very difficult to be assessed in monetary terms. Such changes are an important prerequisite for overcoming corruption and preventing emergence of corruption schemes in the future.

6. It should be noted that we analyze a limited number of areas where, in our opinion, real large-scale changes have taken place. We did this for two reasons: first, large tangible changes to a certain extent “simplify” the evaluation of the corresponding effects, and, secondly, because the existence of large-scale changes is compelling evidence that “traditional” corruption schemes in Ukraine can be effectively overcome through reforms of economic governance.

7. To implement the stated goal, we determine the institutional conditions that give rise to corruption, analyze the mechanism of the corresponding anticorruption measure (instrument) and, accordingly, provide an assessment of its effectiveness. It is this three-component approach that makes it possible to determine the specific result of the changes (what has changed) and its magnitude.

8. The issue of the stability of anticorruption transformations has not been specifically addressed in the paper. It is clear that the protection of the already made changes and ensuring irreversibility of anticorruption progress is one of the key prerequisites for the success of the relevant reforms. Therefore, the problem of the irreversibility of reforms in general and the formation of a stable immunity to corruption in the Ukrainian context require separate analysis. First of all, it is about securing the irreversibility of anticorruption changes.

9. For the purposes of this report, anticorruption measures are classified as follows (Annex 1, Table 1). In our opinion, such a scheme quite accurately reflects the scope, the nature (content) of changes and the tools of their (changes) implementation, as well as the corresponding interconnections. In general, it should be noted that the purpose of all these measures is to build a system of state management of the relevant areas on the basis of economic feasibility and transparency and to ensure their functioning in full conformity with the public interests in the strict sense of this term.

10. Only direct anticorruption effects of relevant changes in economic governance are assessed in the paper. At the same time, we are fully aware that direct effects can be offset by corruption risks in other related areas. Thus, the transfer of certain powers and financial resources in the process of decentralization to the local level objectively limits the corruption space in the "center-regions" relations in terms of the distribution and use of financial resources. However, without an effective system of counteracting corruption at the local level, the anticorruption effect of decentralization will not live up to expectations.

11. For obvious reasons, only certain aspects of the functioning of the state are considered in the context of counteraction to corruption, such as public procurement, where the very fact of corruption abuse is proven. At the same time, according to public finance management practices, misuse of budget funds takes place in other areas that require adequate anticorruption measures. Ordinary citizens and experts say the problem of inefficient use of budget funds can often be attributed to the poor quality of public financial management at various levels. If unaddressed, this circumstance can feed corruption.

12. The average annual economic gain from anticorruption measures was calculated as the sum of estimates of the average annual economic gains resulted from individual anticorruption measures: reducing Naftogaz losses, reducing budget losses in the tax area, reducing inefficient expenditures related to public procurement, ensuring economic growth due to open data. The assessment of the impact of the measures is based on both own calculations and the results of other studies. In this report the data used is given in actual USD prices. The average annual indicator is calculated as the result of the division of the total amount of gains in the respective period (years) where losses or additional revenues were registered. To assess the total scale of economic gains, the sum of the average annual gains is divided by the average Ukraine's GDP in actual prices for 2015-2017 (about USD 98 BN).

SECTION 2. DEVELOPMENT OF INSTITUTIONAL FRAMEWORK TO FIGHT CORRUPTION

Corruption prevention system includes the anticorruption behavior rules applicable to all subjects covered by anticorruption legislation, plus special rules covering selected groups of subjects (elected officials, public servants, judges, law enforcement officers, managers of the state enterprises etc.), selected areas and means for control, monitoring and other means which facilitate compliance to the said rules and envisions a replacement option, should respective indicators point out the necessity of doing that.

To overcome mass violations of anticorruption rules and regulations the whole number of corruption criminalization measures is to be implemented, including establishment of criminal responsibility for corrupt violation and corruption related violation of the law and establishing such a law enforcement system that would effectively counter corrupt actions.

IMPLEMENTATION OF INTERNATIONAL ANTICORRUPTION STANDARDS

National legislation corruption fighting framework is formed on the basis of respective international anticorruption conventions and other international legal documents. They include clear internationally accepted definitions as to what actions are deemed corruption offences, which subjects are to be held responsible for them, and what sanctions and other criminal and legal measures (such as special confiscation and special measures with respect to legal entities) need to be established.

In support of its Euro integration aspirations, over the recent decade Ukraine has ratified Council of Europe Criminal Law Convention on Corruption of January 27, 1999 (Law №252-V of 18.10.2006 p.), Supplemental Protocol to this Convention of May 15, 2003 p. (Law №253-V of 18.10.2006), Civil Law Convention on Corruption of November 4 1999 (Law №2476-IV of 16.03.2005), UN Convention against corruption of December 11, 2003 (Law №251-V of 18.10.2006), Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Law №2698-VI of 17.11.2010), the United National Convention against Transnational Organized Crime of November 15, 2000 (Law №1433-IV of 04.02.2004) and Council of Europe's Convention Against Manipulation of Sports Competitions of September 18, 2014 (Law №1752-VIII of 16.11.2016 p.). Upon ratification of Council of Europe Civil Convention on Fight against Corruption, Ukraine has joined a Group of countries against corruption (GRECO).

The standards determined in the above mentioned and other international documents were used as the basis for passage of numerous laws:

- a) *of general nature and on responsibility* for corruption offences and offences related to corruption: «On the Grounds of the Government Anticorruption policy (Anticorruption strategy) for the years 2014–2017,» «On Corruption Prevention» «On Cleansing the Authorities,» and individual provisions of Criminal, Criminal Procedural, Civil, Civil Procedural Codes of Ukraine, Code of Ukraine on Administrative offences and Code on Administrative Procedure Rules in Ukraine
- b) *on the activities of the specialized corruption fighting bodies*: «On the National Anticorruption Bureau of Ukraine,» «On General Prosecution Office,» «On National Police,» «On the State Investigation Bureau,» «On the State Security Service of Ukraine,» «On Operation and Search Activities,» «On Organization and Legal basis of Fight Against Organized Crime»
- c) *on ethical rules, anticorruption restrictions and bans for some officials, and on political corruption prevention*: «On Public Service,» «On Judiciary and Status of Judges,» «On Political Parties in Ukraine,» «On Election of the President of Ukraine,» «On Election of People's Deputies of Ukraine,» to selected provisions of Ukraine's Code of Labor Laws

d) *on corruption prevention in economy and sports*: «On Public Procurement,» «On Protection of Economic Competition,» selected provisions of Economic and Economic and Procedural Codes of Ukraine, «On Prevention the Impact of Corruption Offences on the Outcomes of Sports Competition» and others

e) *on access to information*: some provisions in the Civil, Budget and Land Codes of Ukraine, laws «On the National Agency of Ukraine on Detection, Search and Management of Assets Obtained through Corruption or Other Crimes,» «On the State Registration of Legal Entities, Sole Traders and public and Civil Organizations,» «On the State Registration of Property Rights on Real Estate and their Encumbrances,» «On Road Traffic,» «On the State Land Cadaster,» «On Television and Radio Broadcasting,» «On the Transparent Use of Public Funds,» «On Information,» «On Access to Public Information,» and «On Access to Court Decisions» etc.

Based on the above listed laws, dozens of acts of secondary legislation were adopted by the Cabinet of Ministers of Ukraine, National Agency on Corruption Prevention (NACP), Ministry of Justice of Ukraine and others. All this enables us to state that, overall, a legislative framework for corruption prevention has been created in Ukraine. Yet, in spite of the fact that many good laws were passed, 35% of 200 anticorruption measures, which, according to the State Program for Anticorruption Strategy Implementation were supposed to be implemented by the end of 2017, have not been implemented. There is no Anticorruption Strategy or its implementation program for the year 2018. Also not passed are many important anticorruption laws, which could have helped the further recovery of Ukraine's economy, finances, social protection systems etc. These include laws on transparency with respect to allocation of budget expenditures and usage of natural resources, administrative procedures, lobbying⁵, integrity checks, protection of whistleblowers, establishment of the office of Business Ombudsman⁶ etc.

Numerous controversial corruption prevention provisions of Criminal and Criminal Procedural Codes of Ukraine turned into a feeding trough used by criminal justice officials. The statistics below confirms this.

THE FIRST STEPS OF MAIN ANTICORRUPTION INSTITUTIONS

Efficiency in the application of provisions of the Criminal Code of Ukraine, on the whole, and with respect to corrupt actions, in particular, hinges on the presence of specialized (i.e. professional) politically independent law enforcement authorities assigned with appropriate powers and resources as per current anticorruption conventions and other international legal documents.

Over 2015–2017 there were several such bodies in Ukraine, including the National Anticorruption bureau of Ukraine (NABU)⁷, the Specialized Anticorruption Prosecutor's office (SAPO), acting as an independent structural unit within the structure of Prosecutor General's Office (PGO)⁸, State Investigation Bureau (hereafter – SIB)⁹ and the National Agency for Corruption Prevention

⁵ Проект Закону "Про забезпечення прозорості та законності комунікації з суб'єктами владних повноважень" (реєстр. №7129 від 20.09.2017 р.) 22 вересня 2017 р. надано для ознайомлення.

⁶ Проект Закону "Про Установу бізнес-омбудсмена" (реєстр. №4591 від 05.05.2016 р.) 31 травня 2016 р. прийнято за основу.

⁷ Указ Президента України "Про утворення Національного антикорупційного бюро України" №217/2015 від 16 квітня 2015 р.

⁸ Наказ Генерального прокурора України від 22 вересня 2015 р.

⁹ Постанова КМ "Про утворення Державного бюро розслідувань" №127 від 29 лютого 2016 р.

(NACP).¹⁰ In June 2018 Ukraine's parliament adopted the long-awaited Law on AntiCorruption Court. The process was difficult. Overall, the newly established institutions are vested with the powers required to counter corruption. In the longer term, specialized criminal police divisions (units) must be established to investigate corrupt offences in accordance to Criminal Procedural Code's determined jurisdictions, as well as a special pretrial investigation body within the system of Ukraine's Ministry of Finance.

The National Agency on detection, search and management of assets obtained through corruption and other crimes (APMA) is to take an important place within the system of anticorruption institutions. Although the decision on its establishment was passed back in 2016, the agency has not still started its work.

The above-mentioned institutions are called to ensure irreversible criminal and administrative responsibility as well as punishment (sanctions) for corrupt offences and corruption-related offences, compensation for losses and other damage, and to do what is appropriate for them to be doing in order to restore the rights and lawful interests of persons damaged by corruption.

The new institutions were established, staffed and took their first steps under severe political fights and active opposition from representatives of Ukraine's political elite/law enforcement bodies and judges, who, on their part, had an interest in retaining the status-quo.

The work of the newly established institutions has fallen short of public expectations. In our opinion, this can be attributed to both the functional weakness of the specialized anticorruption institutions and (in many cases, direct resistance from the) non-reformed judiciary. (Box 1)

Box 2. E- declarations is a good idea which, as yet, has not been fully implemented

Over 2015–2017 only eight persons have been convicted in Ukraine for making false declarations or failing to make declarations (Article 366-1 of the Criminal Code of Ukraine [CC]) . Two persons were exempted from punishment, and no person was convicted for illicit enrichment (Article 368-2 CC). The two said provisions were introduced into the CC specifically with the purpose of better preventing corrupt crimes, but are not yet practically enforced. At the same time, more than 70 persons investigated pursuant to Article 366-1 CC were actually exempted from criminal responsibility. After public servants filed their first e –declarations by April 1, 2017, pretrial investigation bodies initiated 853 criminal proceedings under Article 366-1 CC. Only 116 of them (13, 6%) were sent to the court with indictments. The remaining 703 (82, 4%) cases were closed due to the absence of event or criminal elements of crime.

NABU has been operating for two years. As of December 31, 2017, courts had handed down only 19 guilty verdicts based on NABU's completed proceedings (which is less than 1% of the guilty verdicts made under corruption crimes articles of Ukraine's Criminal Code). Only 107 of such proceedings involving 165 defendants are being examined by the courts. Causes for the delays are obvious: judges are overloaded with work, judges are biased, there is no unified judicial practice, difficulties and controversy related to establishment of new anticorruption bodies, massive resistance from corrupt persons, etc.

¹⁰ Постанова КМУ "Про утворення Національного агентства з питань запобігання корупції" №118 від 18 березня 2015 р.

NACP has been operating for two years as well. As of March 1, 2018, records on 152 corruption related administrative offences (Articles 172-4–172-9 of the Code of Ukraine on Administrative Offences) were sent to courts. Based on these records, the courts convicted only 35 persons (23.0%). National Police statistics are somewhat better than those of anticorruption agencies. During 2017, the National Police sent 5,040 cases involving corrupt offences to courts, which imposed sanctions in 2,150 (42.7%) of them.

Given the scale and pervasiveness of corruption, «anticorruption» statistics show punishment for corruption offences to be an exception rather than the rule. That said, the data requires thoughtful analysis and an immediate response (Table 4). Conviction rates for the most dangerous and common corruption crimes over the recent seven years have dropped by almost six-fold, in particular: for misappropriation of assets via office abuse (Parts 2–5 of Article 191 CC) – from 1,641 of convicted persons in 2010 to 204 convicted person 2017 (eight-fold drop), for improper advantage (bribery) – from 774 persons in 2010 to 218 persons in 2017 (3.5-fold drop) and for abuse of power or office (Article 364 CC) – from 708 persons in 2010 to 16 persons in 2017.

At the same time, the percentage of acquittals for the said crimes is on the rise. For example, if over 2010–2012 it amounted from 0.2 to 1.1%, in 2016–2017 acquittals ranged from 4.0 to 16.7%, (when overall courts acquit no more than 0.3% of all persons tried).

Over the last four years, the prevailing majority of those convicted for corruption crimes have been released from punishment (abuse of office—over 90%). Of those who were subject to punishment, half (49.9%) paid the fine. Although deprivation of the right for holding public office constitutes an additional punishment for such crimes, 10–20% of convicted persons remained in office. This means persons who committed egregious corruption crimes may pay a relatively small fine from his or her corruption-brought revenues (currently its cap amounts to 25,500 UAH) and have the opportunity to commit similar crimes.

Very few persons face real imprisonment. For example, only 39 persons were imprisoned in 2017 (Parts 2–5 of Article 191 CC), for misappropriating assets via abuse of power or office (Article 364 CC) - two persons, for improper advantage (bribery) – 24 persons and for providing improper advantage— four persons.

Even though the number of those convicted for corruption crimes dropped six-fold over the recent seven years, the number of investigators and prosecutors performing such investigations remained almost the same, as have the number of criminal investigations. If back in 2013 there were 19,037 registered crimes under Articles 191, 364, 368 and 369 CC, the number of such crimes in 2017 was 17,393, a drop of 8.6% less (Table 2).

Prosecutors in 2017 sent 5,606 guilty indictments to courts, in 2015 - 4,737 and in 2016 – 4,386. According to court statistics over the same period the number persons convicted are the following: in 2015 – 1,112 persons, in 2016 – 672 persons, and in 2017 – 561 persons, which is by 4–6–10 times less than the number of criminal proceedings received by the courts (only 20% of such crimes were committed by a group of persons) Hence, there is a question as to the fate of several thousands of proceedings, which «vanished» on their way from prosecutors' offices to the courts.

NEXT STEPS

The experience with the creation of special anticorruption institutions and their first steps show the process of establishing such institutions requires time and the implementation of an array of politically complicated measures, which should:

- ensure real political independence of anticorruption law enforcement bodies. Apparently, solving this task is next to impossible without a real consensus of major political forces as to Ukraine's anticorruption agenda. In practice, this means that it is the principle of anticorruption institutions independence that has to determine legislative and resource support of such bodies' activities on the part of the state.
- (urgently) ensure effective coordination among anticorruption agencies. To achieve this, NACP must finally in practice become the state agency that determines anticorruption policy, coordinates anticorruption strategy and implements of Ukraine's respective international obligations by all state authorities. In addition, it should detect corruption risks in the activities of authorities and seek to eliminate them, etc.
- Priorities in further development of anticorruption legislation should include «closing» opportunities to avoid punishment for corrupt actions, ensuring consistency in respective primary and secondary legislative documents, clarifying the grants of authority of anticorruption bodies, specifically as it they relate to operative and search activities etc... It is vital that a single transparent system of criminal statistics is created, because the absence of such a system makes it impossible to assess adequately respective trends in law enforcement.
- Creation of anticorruption court has been an urgent priority for anticorruption reform.
- Introduction of automatic e-declarations checks is of critical importance
- Successful reform of criminal justice system. Priorities must include reduced discretion of judges, prosecutors, investigators, enhanced oversight and responsibility, as well as public participation in disciplinary proceedings. Without such measures, the «simple» replacement of judges and prosecutors with new ones and the replacement of regular courts with specialized anticorruption courts will not be able to produce substantial changes in the system of criminal justice.

It should also be noted that high-level and efficient cooperation between reformers and civil society remains a key precondition for successfully reforming and establishing an effective system of corruption fighting institutions. Attempts by the parties concerned to use the fight against corruption in their own narrow political and economic interests should be avoided because they discredit anticorruption reform.

SECTION 3. GAS MARKET

For many years, natural gas market operation has remained one of the most problematic spheres of Ukraine's economy in political, economic and social dimensions. On the one hand, the low energy efficient economy inherited from the USSR has largely determined Ukraine's excessive dependence on the price and conditions for hydrocarbons supply (mostly gas). In addition, Russia – until recently the main supplier of «blue fuel» – leveraged the supply natural gas to Ukraine as an advantage to exercise its external political influence¹¹. As a result, import, transit and gas distribution transactions inside Ukraine became a source for enrichment for many Ukrainian oligarchs. Moreover, the fact of corrupt gas schemes only strengthened Ukraine's dependence upon the sole supplier.

It should be underscored that Ukraine's indigenous natural gas production was also used in different types of blatantly shady transactions, which did not serve the public interest. Availability of cheap gas and other types of fuels in addition to the existence of parallel energy markets enabled to generation of economic rents which in some years reached 5% of GDP, or almost 4 BN EURO¹². All this incentivized the formation of a stable system of political control over the gas market segment of Ukraine's economy.

Gas market functioning was a classic example of political corruption, where government authorities representing political forces competed for the right to appoint the PSJC Naftogaz Ukrainy's management, and through it to control the respective goods and financial flows for the purposes of enriching the respective politicians, financial and industrial groups.

Intermediary schemes of natural gas supply existed in Ukraine since the end of the 1990s. One of the most famous was the company RosUkrEnergo (RUE), which supplied gas to Ukraine from 2005 to 2008. The company was created in July 2004 based on the agreement reached between Ukrainian and Russian leaders, and «Gazprom» and NJSC «Naftogaz Ukrainy». RUE was owned by «Gazprom» and Ukrainian businesspersons Dmytro Firtash and Ivan Fursin. The Company has immediately become a monopolist supplier of natural gas to Ukraine (at first Turkmenian produced gas, and starting with 2006 Russian gas). On average every year RUE was selling to Ukraine (both directly to «Naftogaz» and through «UkrGazEnergo,» which is an expressly set up joint venture of RUE and "Naftozas")¹³ about 50 BL m3 of gas¹⁴, which cost for respective period has grown from 95 to 180 USD per 1000 cubic meters¹⁵. At the same time, the price at which the RUE was buying gas from Russia (both Russian and Turkmenian) is not known, and, therefore reliable estimates of losses resulting from difference in purchase and selling price are impossible to make. Yet, it is still possible to have some approximate

¹¹ Francis, Diane, "Why Putin needs a corrupt and divided Ukraine," Newsweek, June 15, 2016, <http://www.newsweek.com/why-putin-needs-corrupt-divided-ukraine-459338>;

Dempsey, Judy, "Naftogaz is Ukraine's Achilles' Heel," Carnegie Europe, November 03, 2014, <http://carnegieeurope.eu/strategieurope/57102>.

¹² Balmaceda, Margarita, "Ukraine's gas politics," Open Democracy, May 08, 2014, <https://www.opendemocracy.net/od-russia/margarita-balmaceda-peter-rutland/ukraines-gas-politics>.

¹³ Компанія "УкрГаз-Енерго" була монопольним постачальником природного газу для промислових споживачів із квітня 2006 року до квітня 2008 року. Більше див. інформаційний бокс у підрозділі "Договори спільної діяльності".

¹⁴ Товстиженко Андрій, ""Газпром" остаточно позбувся "РосУкрЕнерго"", Дзеркало тижня, 13 липня 2016 р., <https://dt.ua/ECONOMICS/gazprom-ostatochno-pozbuvsya-rosukrenergo-213557.html>.

¹⁵ Стратегічні цілі реформування "Нафтогазу", березень 2015 р., http://www.naftogaz.com/files/Information/Reform_Naftogaz_Long-UA_2015.03.30.pdf.

estimates of such losses based on the overpaid amount for gas in comparison to previous contract prices. According to such estimation Ukraine lost USD 38.6 BN¹⁶.

In addition, the government also incurred significant losses due to artificially understated gas prices. According to some experts, Naftogaz losses from 2005 to 2015 amounted to UAH 620 BN (UAH 400 BN in losses from selling gas to households and UAH 170 BN to heat generation enterprises caused by artificially understated gas prices.¹⁷). According to other data, government losses over the period amounted to USD 53 BN¹⁸. According to IMF calculations, Ukraine in 2012 indirectly subsidized gas and communal (heating) sector at the level of 5% of GDP annually. In 2012, for example, the subsidy amounted to USD 9.1 BN¹⁹. Gas prices have been one of the main factors of significant energy subsidies amounting almost to 8% of GDP²⁰.

Low gas prices were used as the basis for price arbitrage and production sharing agreements (PSA). As a result, from 2009 to 2013 Naftogaz had a shortfall of almost USD 2 BN. Finally, the government incurred substantial losses because of contracts concluded with Gazprom in January 2009. According to the Naftogaz, over 2009-2014 Ukraine overpaid about USD 14.1 BN for Russian gas²¹. Formally, payments were made according to the contract in force, but the way the contract was signed clearly showed that national interests were simply traded for private political and economic interests. Government losses may be measured in dozens of billions of dollars.

PJSC NAFTOGAZ UKRAINY (NAFTOGAZ)

Naftogaz exemplified inefficient government management and for years was a primary source of political corruption. Established by the government by presidential decree in 1998²² the company combined major government owned assets of Ukraine's oil and gas industry, specifically through its subsidiaries Ukrkazvydobuvannya, Ukrtransgaz, Ukrnafta, etc. In practice, the monopoly turned into the Achilles' heel of Ukraine's economy²³.

On January 19, 2009, a direct Contract was signed between Naftogaz and Gazprom, removing RUE as an intermediary in the gas trade. This, however, did not improved the financial situation in Naftogaz. Because of rampant corruption schemes in the gas market (specifically, it was possible for private

¹⁶ Товстиженко Андрій, "Из-за решений Ющенко в газовой сфере Украина потеряла \$ 38,6 млрд", Дзеркало тижня, 20 серпня 2011 р., https://zn.ua/ECONOMICS/iz-za_resheniy_yuschenko_v_gazovoy_sfere_ukraina_poteryala_38,6_mlrld.html.

¹⁷ Башко Василь, "Обсяг втрат групи "Нафтогаз України" за останні 10 років становив 620 млрд грн", Дзеркало тижня, 14 травня 2016 р., <https://dt.ua/ECONOMICS/obsyag-vtrat-grupi-naftogaz-ukrayini-za-ostanni-10-rokiv-stanoviv-620-mlrd-grn-208262.html>.

¹⁸ Буклет про політику дешевого газу, розміщено на сайті НКРЕКП, http://www.nerc.gov.ua/data/filearch/lystivka_gaz.pdf.

¹⁹ Mitra, Pritha & Atoya, Ruben. Ukraine Gas Policy Pricing: Distributional Consequences of Tariff Increases. IMF 2012, p. 18, http://www.journal.esco.co.ua/2012_11/art12_1.pdf.

²⁰ Press Release: IMF Executive Board Concludes 2013 Article IV Consultation, First Post-Program Monitoring, and Ex Post Evaluation of Exceptional Access with Ukraine, December 19, 2013, <https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr13531>, Aslund, Anders. Ukraine: What Went Wrong and How to Fix It. Peterson Institute for International Economics. 2015, p. 92.

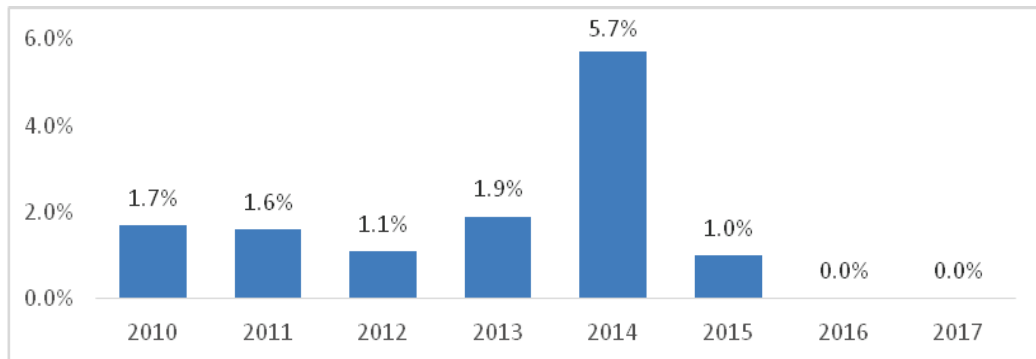
²¹ ПАТ "НАК "Нафтогаз України"". Скорочена консолідована проміжна фінансова звітність станом на та за дев'ять місяців, які закінчилися 30 вересня 2017 року, не перевірено аудитом. С. 37, <http://www.naftogaz.com/files/Zvity/9m2017-Naftogaz-FS-Consolidated-ukr.pdf>.

²² Постанова КМУ від 25 травня 1998 р. №747 "Про утворення Національної акціонерної компанії "Нафтогаз України", <http://zakon2.rada.gov.ua/laws/show/747-98-%D0%BE>.

²³ Francis, Diane, "Why Putin needs a corrupt and divided Ukraine," June 15, 2016, <http://www.newsweek.com/why-putin-needs-corrupt-divided-ukraine-459338>; Dempsey, Judy, "Naftogaz is Ukraine's Achilles' Heel," November 03, 2014, <http://carnegieeurope.eu/strategieurope/57102>.

individuals to receive rents resulting from difference in gas prices), Naftogaz for many years had remained loss making and required high scale government support. In 2013, Naftogaz's net loss amounted to UAH 18.8 BN, and in 2014 reached UAH 90 BN (see figure 4). The company's deficit was covered Ukraine's State Budget. In 2014, the deficit of Naftogaz amounted to 5.7% of GDP, exceeding the State Budget deficit (5.1% of GDP)²⁴. It should be underscored that the company's deficit has traditionally been covered through the State Budget funds.

Figure 3. Government funding of the NJSC «Naftogaz Ukrainy» (GDP %)



Source: IMF

Minimizing corruption schemes in the gas sector has proved an important factor to ensure that Naftogaz becomes a profit-making company, thus reducing the load on Ukraine's State Budget. The IMF Memorandum of April 22, 2014 On Cooperation between Ukraine and IMF noted the need of gradual increases in retail gas and heating tariffs and to improve the transparency of Naftogaz, as well as starting the restructuring of the monopoly.²⁵ As a result, it was determined that over several years Naftogaz would reduce losses (initially, by 2018, and then by 2017²⁶), but this result was achieved in 2016.

Naftogaz restructuring (in accordance to EU Third energy package requirements) was included into the list of major measures under the Program of Ukraine's energy independence as a part to Ukraine's 2020 sustainable development strategy «Ukraine – 2020»²⁷. In addition, in July 2016 Ukraine's Cabinet approved a restructuring plan for Naftogaz that called on the monopoly to unbundle its gas transportation and gas storage operations²⁸.

In November 2016, PJSC «Main Gas Lines of Ukraine» was created, which will be an independent operator of Ukraine's gas transportation system. In February 2018, the Cabinet adopted a measure

²⁴ Ukraine : Request for Extended Arrangement Under the Extended Fund Facility and Cancellation of Stand-By Arrangement. IMF. March 12, 2015, <http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Ukraine-Request-for-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-Cancellation-42778>; "Дефіцит держбюджету за рік становив 5.1% ВВП – Мінфін", УНІАН, 13 березня 2015, <https://economics.unian.ua/finance/1055278-defitsit-derjbyudjetu-za-rik-stanoviv-78-milyardiv-griven-umanskiy.html>.

²⁵ Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding. April 22, 2014, <https://www.imf.org/external/np/loi/2014/ukr/042214.pdf>.

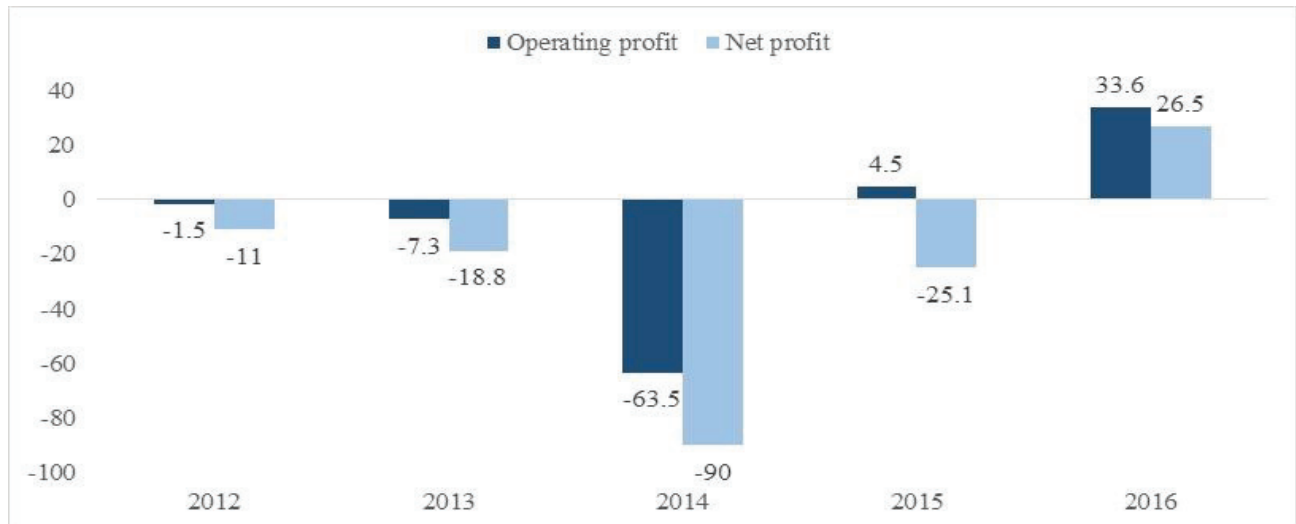
²⁶ Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding. February 27, 2015, <https://www.imf.org/external/np/loi/2015/ukr/022715.pdf>.

²⁷ Указ Президента України від 12 січня 2015 року "Про Стратегію сталого розвитку "Україна – 2020", <http://zakon0.rada.gov.ua/laws/show/5/2015>.

²⁸ Постанова КМУ від 1 липня 2016 р. №496 "Про відокремлення діяльності з транспортування та зберігання (закачування, відбору) природного газу", <https://www.kmu.gov.ua/ua/npas/249240258>.

establishing a clear mechanism and timeframe for transferring Ukrtransgaz assets to a new operator of gas transportation system²⁹.

Figure 4. Dynamics in financial performance of Naftogaz over 2012-2016, BN UAH



Source: Naftogaz Ukrainy

Establishment of independent Supervisory Board was an important stage in the improvement of Naftogaz's corporate governance. In December 2016, the Cabinet approved a new version of the Naftogaz³⁰ Statute, and also a new version of Supervisory Board Statute, which actually expanded the Supervisory Board powers, specifically in what regards the control over activities of its subsidiaries³¹.

Naftogaz is the largest taxpayer in Ukraine. Back in 2016, for the first time since 2011,³² Naftogaz as a legal enterprise has made a profit and has become a «net» donor to the State Budget³³. In addition, for the first time since 2006 Naftogaz did not receive direct financial support from the government, which used to be provided either by means of its recapitalization through the issue of t-bills or payment of compensation for price difference³⁴. In 2017, Naftogaz paid UAH 106 BN into the budget (about 14% of the total amount of State Budget revenues), including UAH 14.3 BN of CIT, UAH 33.9 BN of

²⁹ "Уряд схвалив документ, який веде до завершення анбандлінгу "НАК "Нафтогаз "України"", <https://www.kmu.gov.ua/ua/news/uryad-shvaliv-dokument-yakij-vede-do-zavershennya-anbandlingu-nak-naftogaz-ukrayini>.

³⁰ Постанова КМУ від 14 грудня 2016 р. № 1044 "Питання публічного акціонерного товариства "Національна акціонерна компанія "Нафтогаз України", <http://zakon2.rada.gov.ua/laws/show/1044-2016-%D0%BF>.

³¹ Звіт Наглядової ради Нафтогазу. Наглядова рада у 2016 році, <http://annualreport2016.naftogaz.com/ua/jak-mi-pracjujemo/zvit-nagljadovoji-radi/>.

³² "Відкрите звернення НАК "Нафтогаз України" до депутатського корпусу Верховної Ради України", Нафтогаз України, 7 вересня 2016 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/6BCAF4E0070F0942C22580270050416A>.

³³ "За підсумками 2016 року Нафтогаз планує сплатити державі понад 15 млрд грн дивідендів та авансового внеску з податку на прибуток", Нафтогаз України, 11 квітня 2017 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/BA49538D4D84E6D7C22580FF0025266F?OpenDocument&year=2017&month=04&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>.

³⁴ Річний звіт НАК "Нафтогаз України" за 2016 рік, http://www.naftogaz.com/files/Zvity/Anual_report_ukr_170608.pdf.

royalties and UAH 13.3 BN of dividends. By comparison, government spent UAH 51.1 BN to fund subsidies provided for the used natural gas³⁵.

The above-described achievements of Naftogaz are evidence of measures implemented to eradicate corruption generating conditions in the gas sector.

The Naftogaz reform process has not been completed and talking about its anticorruption resilience is premature. At the same time, it should be noted that performance of Naftogaz as a whole, and in the context of corruption fighting, should be analyzed through the prism of Ukraine's energy sector reform.

PRICE ARBITRAGE

Substantial opportunities for corruption abuse were created by artificial differences in prices for natural gas paid by household (including by heat producing utility Teplocomunenergo (TCE), which produces heat for the households) and commercial consumers. In particular, the understated price for households and TCE, which produced heat for households, contributed to emergence of shadow schemes under which the gas bought at the understated price was used for commercial manufacturing purposes³⁶.

As of the end of 2013, the lowest prices for gas were paid by household consumers (who used meters and consumed no more than 2,500 cm per year)³⁷ – 255 UAH/1,000 cm (see Figure 5). The highest price among all the categories of Ukraine's households was established for those who burned more than 12 K cubic meters of gas, - 2,041 UAH /1000 cm.

The price for commercial consumers amounted to 3,459 UAH/1,000 cm, which is 1,356% and 169% of the prices established for the above-mentioned categories of household consumers. Up to March 2015, this gap remained large, and reached its peak of 1,878% and 316%, respectively. But, starting on April 1, 2015, new prices for natural gas were established. They reduced the gap between prices for commercial and household consumers to about 300% (for household consumers who consumed the gas within the range of social norm for gas consumption³⁸) and 130% (the price for the gas consumed in excess of the social gas consumption norm). In May 2016, a single price for gas – which is equal to commercial consumer price - was established for household consumers and TCE (for household needs), and for a short period of time this had almost canceled out the gap between different categories of consumers³⁹.

³⁵ "Нафтогаз у 2017 році сплатив до державного бюджету більше 100 млрд грн податків та дивідендів", Нафтогаз України, 3 січня 2018 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/B5B831D282E20FEDC225820A00294657?OpenDocument&year=2018&month=01&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>.

³⁶ Антоненко Галина та ін.. Чи повинна ціна на газ бути ринковою. Аналітична записка. 26 серпня 2015 р., С.4, http://ces.org.ua/wp-content/uploads/2015/07/ces_paper_gas_prices_ukr.pdf.

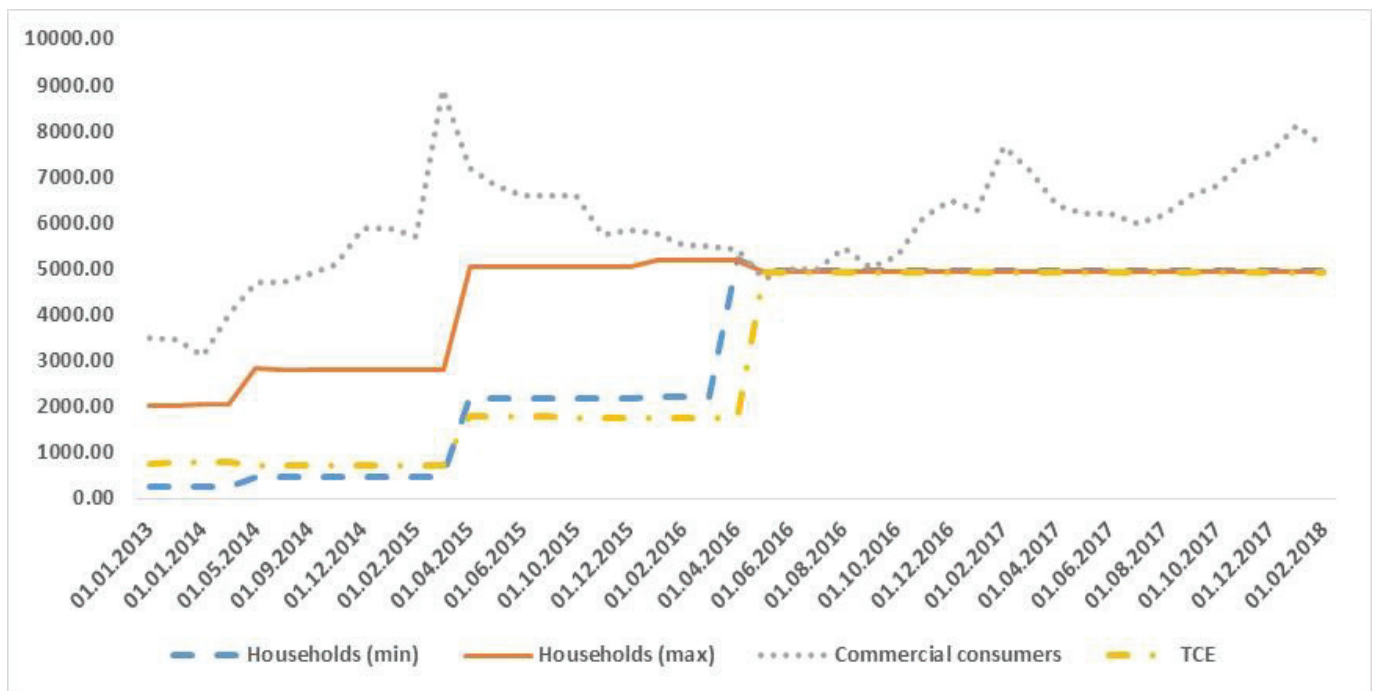
³⁷ Until April 1, 2015, household consumers, depending on the consumption scope, were broken down into four categories: up to 2500 cubic meters per year, up to 6000 cubic meters per year, up to 12 cubic meters per year, more than 12 cubic meters per year. It should be underscored that the price was also dependent if the gas meter was used. Since April 1, 2015 separate winter and summer prices were established for household consumers.

³⁸ Since April 1, 2015, a special (privileged) rate for individual heating or complex consumption during autumn-winter season (from October 1 till April 30) was established at the level of 200 cubic meters a month (for special price). Subsequently, a new period of special (privilege) rate (from October 1 to March 31) was introduced (at the level of 1200 cubic meters for the whole autumn-winter season). Therefore, de facto the preferential price was effective from October 1, 2015 till March 31, 2016.

³⁹ Постанова КМУ від 27 квітня 2016 року №315, <https://www.kmu.gov.ua/ua/npas/249005214>.

Despite positive changes in pricing, the price difference remains: in 2017, the price for natural gas for commercial user was on average by 35% higher than that for household consumers. This fact could be explained by Naftogaz's switch to market pricing for commercial consumers (in accordance to the Law of Ukraine «On Natural Gas Market,»⁴⁰) yet, the level of gas prices for household consumers (including for TCE to produce the heat for household needs) is restricted in accordance to the provision on public service obligations of Naftogaz (PSO)⁴¹.

Figure 5. Dynamics in the natural gas prices for different consumer categories without VAT, UAH/K cubic meters



Note: Households (minimum) – is the category of household consumers for which the minimum price for natural gas was established; households (maximum) – is the category of household consumers for which the maximum price for natural gas was established;
Source: Naftogaz Ukrainy

Shadow schemes established before the Revolution of Dignity were based on location factor abuse. According to Naftogaz estimates, price difference between different groups of consumers made it possible for regional gas distribution companies (RGD) to incorrectly distribute more than 0.6 BN cubic meters of gas every year⁴². In particular, such opportunities could have been utilized by the entities belonging Group DF, owned by Dmytro Firtash, who has reached a dominant position in the

⁴⁰ Закон України "Про ринок природного газу" № 329-VIII від 9 квітня 2015 р., <http://zakon2.rada.gov.ua/laws/show/329-19>.

⁴¹ Introduced by Постанова КМУ від 1 жовтня 2015 року №758, <http://zakon2.rada.gov.ua/laws/show/758-2015-%D0%BF/ed20151010>. As of day, PSO has been prolonged until August 1, 2018. See Постанова КМУ від 30 травня 2018 року №415, <http://zakon2.rada.gov.ua/laws/show/415-2018-%D0%BF>.

⁴² Роздрібне постачання газу в рамках ПСО: Маніпуляції з обсягами та субсидіями регіональними газопостачальними компаніями. Нафтогаз України, http://www.naftogaz.com/files/Information/170926_Report_re_RSCs_v2-pdf_UA.pdf.

natural gas distribution system and retail supply (70% of the market) in 2007-2012⁴³. Firtash also consolidated the assets of four of the six largest Ukrainian chemical production enterprises.

Deviations in the official statistics on the natural gas usage per unit of ammonium produced accompanied with the parallel increase in the output may be indicative to some manipulations. However, after differences in gas prices for households and commercial users shrank, volumes of gas used in this industry have approximated the level of 2009, while ammonium output decreased⁴⁴. This brings us to conclusion that equalization of prices for different categories of gas consumers substantially reduces opportunities for nontransparent gas distribution schemes. At the same time, price increase was of substantial importance to make Naftogaz profit making. Owing to only to this factor, the company received additional UAH 4.3 BN (after royalties were paid)⁴⁵.

Illustrative is the situation around Kirovohradgas company controlled by DF Group for ten years. With the government being a major shareholder it was able to regain operational control over the company only in July 2017. According to the documents, Regional Gas Company Kirovohradgas was selling large volumes of gas to «ghosts». That means from 2009 to 2016 over 384 fictitious accounts of household consumers were opened in the region, making it possible to overstate the scope of natural gas consumption by households. For example, in 2015 natural gas shown as consumed by the holders of such accounts amounted to 1.5%,. In 2016, it reached 2.6%.⁴⁶. Actually, such schemes could have been practiced by other regional gas companies. In addition, in January 2018 information emerged about a household needs gas embezzlement scheme at TCE. NABU detectives have established that from 2013 to 2015 enterprises owning Novoyavirsk and Novorozdolsk TPP could have illicitly purchased more than 300 MN cm of gas at the “privileged price” for the amount of UAH 1.4 BN. In addition, the gas obtained in such a way could have been used for the purpose of electricity production. Selling electricity at the tariff based on the market price for fuel eventually reached the 60% level of profitability⁴⁷.

These examples are compelling evidence that approximation of gas prices for households and commercial consumption is an important prerequisite for limiting opportunities for corrupt abuse in the gas market. Kirovohradgas data shows that over January-August 2017 the share of gas consumption by fictitious consumers grew to 6%, which corresponds to insignificant restoration in the difference of gas prices for households and commercial consumers⁴⁸. As of February 1, 2018, the price for gas for commercial consumers already exceeded the household price by 55%⁴⁹. It should be underscored that

⁴³ Концентрація активів в системі розподілу та роздрібного постачання газу розпочалася у 2007-2008 роках, коли структури Group DF отримали контроль більш як над десятком українських облгазів. У 2009 році Group DF вже контролювала близько 2 десятків облгазів. В часи Януковича компанії вдалося збільшити свою частку в облгазах, придбати декілька нових та низку пакетів акцій низки дрібніших міськгазів. Окрім цього, у серпні 2012 року уряд Азарова передав державні газорозподільчі системи на господарське відання облгазів.

⁴⁴ Роздрібне постачання газу в рамках ПСО: Маніпуляції з обсягами та субсидіями регіональними газопостачальними компаніями. Нафтогаз України, http://www.naftogaz.com/files/Information/170926_Report_re_RSCs_v2-pdf_UA.pdf.

⁴⁵ Вітренко Юрій, "Не дамо міфам принижувати нашу гідність", Новое время, 15 грудня 2017 р., <https://biz.nv.ua/ukr/experts/vitrenko/ne-damo-mifam-prinizhuvati-nashu-gidnist-2375947.html>.

⁴⁶ Роздрібне постачання газу в рамках ПСО: Маніпуляції з обсягами та субсидіями регіональними газопостачальними компаніями. Нафтогаз України, http://www.naftogaz.com/files/Information/170926_Report_re_RSCs_v2-pdf_UA.pdf.

⁴⁷ "Викрито схему розкрадання газу на 1,4 млрд грн", НАБУ, 17 січня 2018 р., <https://nabu.gov.ua/novyny/vykryto-shemu-rozkradannya-gazu-na-14-mlrd-grn>.

⁴⁸ Роздрібне постачання газу в рамках ПСО: Маніпуляції з обсягами та субсидіями регіональними газопостачальними компаніями. Нафтогаз України, http://www.naftogaz.com/files/Information/170926_Report_re_RSCs_v2-pdf_UA.pdf.

⁴⁹ Прейскуранти на природний газ. Нафтогаз України, <http://www.naftogaz.com/www/3/nakweb.nsf/0/486E117B34CF13EEC2257BCE0041B995?OpenDocument>.

the household gas price will stay restricted to at least August 1, 2018 (according PSO)⁵⁰. As a result, the price difference for different consumer categories will also remain. Therefore, introduction of principles of free pricing in the gas market is the main strategic direction for reducing corruption risks.

Ukraine has already reached first positive results by eliminating multibillion corruption rents due to ensuring uniform prices for all consumers. This means that going forward - in spite of populist statements made by some political forces and attempts to return to old corrupt schemes - Ukraine has to proceed with the policy that aims to ensure uniform prices for different consumer categories.

PRODUCTION SHARING AGREEMENTS

Production sharing agreements (PSA) is one of corruption schemes in the sphere of natural gas extraction and sales. A number of private companies concluded PSA with Ukrgezvybodyvannya,⁵¹ a subsidiary to Naftogaz (back in 2002 one such agreement was concluded, in 2004 - one PSA agreement, and both 2007 and 2014 had one such agreement concluded)⁵². PSA enterprises provided up to 8% of the total scope of the Ukrgezvydobuvannya's⁵³ production.

The selling price for indigenously produced gas was established lower than the market price. The price left out the cost of geologic exploration and new field developments⁵⁴. Accordingly, given the fixed low selling price for gas, entering into PSAs was declared as a necessity to attract the flow of investments. Meanwhile, Ukrgezvydobuvannya was unable to perform operational control over shared assets, because the number of its votes in the higher body for agreement management did not exceed 50%⁵⁵.

Box 3. Example of Joint venture UkrGas-Energo

Following the gas conflict between Naftogaz and Gazprom at the end of 2005 and start of 2006 and the signing of an agreement to regulate the relations in gas sphere, RosUkrEnergo (RUE) became a monopoly supplier of gas to Ukraine⁵⁶. In February 2006, the negotiating process on establishment a joint venture Closed Joint Stock company UkrGasEnergo, which had to supply gas from RUE to Ukraine's domestic market was completed. The parity basis founding members of the company were Naftogaz and RUE.⁵⁷ From March 2006 to April 2008, UkrGasEnergo was a monopoly supplier of gas to the domestic market. It's intermediary activity was wound down after Yulia Tymoshenko became prime minister. Naftogaz tried and failed to liquidate the company. Instead, through a number of court decisions Naftogaz was stripped of its package of UkrGasEnergo shares⁵⁸. As

⁵⁰ Постанова КМУ від 30 травня 2018 року №415, <http://zakon2.rada.gov.ua/laws/show/415-2018-%D0%BF>.

⁵¹ PJSC "Ukrgezvybodyvannya" "is Ukraine's largest gas production company, subsidiary of NJSC "Naftogaz Ukrainy".

⁵² "Ukrgezvydobuvannya" хоче розірвати всі угоди про спільну діяльність", Економічна правда, 22 червня 2016 р., <https://www.epravda.com.ua/news/2016/06/22/596664/>.

⁵³ Річний звіт НАК "Нафтогаз України" за 2015 рік, <http://www.naftogaz.com/files/Zvity/Naftogaz-Annual-report-2015.pdf>.

⁵⁴ "В Україні ціна на газ одна з найнижчих в Європі", Економічна правда, 11 травня 2016 р., <https://www.epravda.com.ua/news/2016/05/11/592251/>.

⁵⁵ Річний звіт НАК "Нафтогаз України" за 2015 рік, <http://www.naftogaz.com/files/Zvity/Naftogaz-Annual-report-2015.pdf>.

⁵⁶ "Текст соглашения между "Нафтогазом" и "Газпромом", Українська правда, 5 січня 2006 р., <https://www.pravda.com.ua/rus/articles/2006/01/5/4395629/>.

⁵⁷ "Нафтогаз України" і "РосУкрЕнерго" успішно завершили переговори щодо створення СП", Нафтогаз України, 2 лютого 2016 р.,

<http://www.naftogaz.com/www/3/nakweb.nsf/0/DDD2C01E61E1E4C1C225710F004E4291?OpenDocument&year=2006&month=02&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>.

⁵⁸ Судова справа №32/44. 01.02.2017 постановою Вищого господарського суду України було залишено без задоволення касаційну справу НАК "Нафтогаз України", <http://www.reyestr.court.gov.ua/Review/64531553>.

a result, Naftogaz suffered a number of financial losses. In particular, the company has not succeeded to receive almost UAH 1 BN in dividends paid from 2006 to 2008⁵⁹. UkrGazEnergo loaned UAH 580 MN to Ukrtransgaz for blue fuel transportation⁶⁰. Finally, in November 2017, the proceeding in the case on ownership right to 4 BN cm in Ukrtransgaz storages resumed⁶¹. If the court rules against Naftogaz, potential losses could total more than UAH 32 BN.

Gas produced under PSAs was sold at the understated prices to shell companies and to final consumers (in particular to industrial enterprises) at market price, while received funds were siphoned off via fictitious entities. Such schemes, first, caused losses to the State Budget. For example, in the investigation on the case of corrupt schemes which included enterprises controlled by parliament deputy Volodymyr Onyschenko (who fled abroad) losses are estimated at almost UAH 3 BN of government losses (including, UAH 1.6 BN of gas resale and UAH 1.3 BN in unpaid royalties). Government incurred these over the period starting January 2013 through January 2016⁶². PSAs also presented a danger, with Ukraine's indigenous gas production dropping, because the private partners have not made sufficient investments into infrastructure modernization and support⁶³. Enterprises under PSAs failed to fulfill the production plans. For example, in 2015 only 1.16 BN cm of gas was produced, with the plan target figure being 1.5 BN cm. The failure on the part of private investors to meet their obligations under PSA was detected by an audit conducted by a new management of Ukgazvydobuvannya⁶⁴.

To date, PSAs have been terminated. In 2015 management of Ukgazvydobuvannya conducted pretrial talks with the partners under PSAs, yet such talks did not prove successful. As a result, Ukgazvydobuvannya filed court claims on PSA termination⁶⁵. In addition, the company lodged a claim to the Arbitration Institute of the Stockholm Chamber of Commerce against two companies for PSA termination. In May 2018, Stockholm Court of Arbitration will pass its partial decision on termination the agreement between Ukgazvydobuvannya and LLC Carpatygas and Misen Enterprises AB (shareholder of Carpatygas)⁶⁶.

The fights against the PSAs contributed to establishing a market price for Ukrainian gas. PSA schemes became economically inappropriate in the form in which they were concluded before⁶⁷. One again, this indicates the need to equalize prices for different categories of consumers, which limits the possibility of corruption schemes.

⁵⁹ "Суд відмовив компанії Фірташа у володінні газом в ПСГ України". Дзеркало тижня. 16 липня 2015 р., https://dt.ua/ECONOMICS/sud-vidmoviv-kompaniyi-firtasha-voloditi-gazom-v-psg-ukrayini-179033_.html.

⁶⁰ "Суд начал банкротство "УкрГаз-Енерго", Интерфакс-Україна, 22 вересня 2017 р., <http://interfax.com.ua/news/economic/450427.html>.

⁶¹ Судова справа №5011-74/9393-2012, "Суд відмовив компанії Фірташа у володінні газом в ПСГ України", Дзеркало тижня, 16 липня 2015 р., https://dt.ua/ECONOMICS/sud-vidmoviv-kompaniyi-firtasha-voloditi-gazom-v-psg-ukrayini-179033_.html.

⁶² "Схема розкрадання коштів під час видобування та продажу газу за договорами спільної діяльності з ПАТ "Укргазвидобування", НАБУ, <https://nabu.gov.ua/open-office/biblio/schemes/shema-rozkradannya-koshtiv-pid-chas-vydobuvannya-ta-prodazhu-gazu-za>

⁶³ Люта Ганна, "Укргазвидобування": такі СД-ки нам не потрібні!", Дзеркало тижня, 5 лютого 2016 р., https://dt.ua/energy_market/ukrgazvidobuvannya-taki-sd-ki-nam-ne-potribni-.html.

⁶⁴ Річний звіт НАК "Нафтогаз України" за 2015 рік, <http://www.naftogaz.com/files/Zvity/Naftogaz-Annual-report-2015.pdf>.

⁶⁵ Люта Ганна, "Укргазвидобування": такі СД-ки нам не потрібні!", Дзеркало тижня, 5 лютого 2016 р., https://dt.ua/energy_market/ukrgazvidobuvannya-taki-sd-ki-nam-ne-potribni-.html.

⁶⁶ "Стокгольмський арбітраж ухвалить часткове рішення у справі про розірвання СД між "Укргазвидобуванням" і "Карпатигаз", Интерфакс- Україна, 30 січня 2018 р., <http://ua.interfax.com.ua/news/economic/480966.html>.

⁶⁷ Вадим Макеев. "Останні півтора року ми реактивували і фактично створили новий ринок сервісних послуг - голова Укргазвидобування", Нафтогаз України, 30 травня 2017 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/F790F2A01335AC70C2258130004BEC2F>.

NONTRANSPARENT CONTRACTS WITH RUSSIAN FEDERATION

A new agreement between Gazprom and Naftogaz was concluded in January 2009. This contract removed the intermediary role of RUE and established direct contract relations between two companies with respect to selling and buying of natural gas. According to this contract, the basic gas price amounted to 450 USD per 1,000 cm. Yet, the price itself was not transparent, because it was only the price indexation formula, which was included into the contract, while the formula used to calculate basic price was not there. In addition, the Ukrainian side took upon itself the obligation to purchase from Gazprom 52 BN cm of gas every year, starting with 2010. In addition, annual contract volume could not be more than 20% different from the volume determined by the agreement document.^{68,69}

Following the Russia's annexation of Crimea and invasion of eastern Ukraine, Naftogaz has gradually opted out from Russian gas imports⁷⁰. In 2015 only 37% of the imported gas was purchased from Gazprom, with the remainder coming from European suppliers. As early as in 2016 Naftogaz has purchased no gas from Gazprom. Hence, opting out of Russian gas and switch to gas purchase from EU enabled Naftogaz to save UAH 121 BN (more than USD 4 BN)⁷¹ over 2016. The decision of Stockholm Court of Arbitration cancelled the requirement to observe the principle «take -or- pay» provision, which made it possible for Naftogaz to use legitimate grounds for not paying UAH 56 BN of Russian state claims⁷². At the same time, Stockholm Court of Arbitration dismissed Ukraine's claim to compensate the amount overpaid over the previous year. According to Naftogaz estimates, the amount overpaid reached USD 14.1 BN (based on the data available as of May 2017)⁷³.

Russian gas transit using Ukraine's gas transit system was been also based on a tariff established in political agreements, Ukraine was one of the cheapest gas transiting countries in Europe. For example, in 2008 the Russian gas transportation price amounted to 1.7 USD per 1,000 cm for 100 kilometers. Yet, according to expert estimates, the transit tariff could have amounted from 5.11 to 9.32 USD per 1,000 meters for 100 km⁷⁴. Under the 2009 contract, the basic gas transit tariff was 2.04 USD per 1,000 cm for 100 km, yet, in exchange for a gas price discount it was established at the level of 1.7 USD⁷⁵. In February 2018, the Stockholm Court of Arbitration passed its decision in favor of Naftogaz, and in so doing confirmed violation by Gazprom, of its transit volumes obligations. Given the already made

⁶⁸ "Газова угода Тимошенко-Путіна. Повний текст." Українська правда, 22 січня 2009 р., <http://www.pravda.com.ua/articles/2009/01/22/3686613/>.

⁶⁹ "Контракт о транзите российского газа + Допсоглашение об авансе "Газпрома", Українська правда, 22 січня 2009 р., <http://www.pravda.com.ua/rus/articles/2009/01/22/4462733/>.

⁷⁰ De facto, gas bought from the EU is also Russian, but it is owned by European traders.

⁷¹ Вітренко Юрій, "Не дамо міфам принижувати нашу гідність", Новое время, 15 грудня 2017 р., <https://biz.nv.ua/ukr/experts/vitrenko/ne-damo-mifam-prinizhuvati-nashu-gidnist-2375947.html>.

⁷² "Рішення Стокгольмського арбітражу врятувало Україну від сплати "Газпрому" \$56 мільярдів - "Нафтогаз", УНІАН, 20 грудня 2017 р., <https://economics.unian.ua/energetics/2309136-rishennya-stokgolmskogo-arbitrazu-vryatovalo-ukrajinu-vid-splati-gazpromu-56-milyardiv-naftogaz.html>.

⁷³ ПАТ "НАК "Нафтогаз України". Скорочена консолідована проміжна фінансова звітність станом на та за дев'ять місяців, які закінчилися 30 вересня 2017, не перевірена аудитом, <http://www.naftogaz.com/files/Zvity/9m2017-Naftogaz-FS-Consolidated-ukr.pdf>

⁷⁴ Вітренко Юрій, "Экономическое обоснование расчета ставки транзита газа и стоимости импортного газа", 18 січня 2008 р., https://zn.ua/ECONOMICS/ekonomicheskoe_obosnovanie_rascheta_stavki_tranzita_gaza_i_stoimosti_importnogo_gaza.html, Ковалко Олександр, Вітренко Юрій, "Ставка транзиту важливіша за ціну на газ", Економічна правда, 5 січня 2009 р., <https://www.epravda.com.ua/publications/2009/01/5/176402/>.

⁷⁵ "Контракт о транзите российского газа + Допсоглашение об авансе "Газпрома", Українська правда, 22 січня 2009 р., <http://www.pravda.com.ua/rus/articles/2009/01/22/4462733/>.

payments for gas delivered over 2014-2015, the court obliged Gazprom to pay Naftogaz USD 2.56 BN in compensation⁷⁶.

Since opting out of Russian gas purchases in 2015, Ukraine has succeeded to diversify its gas supply sources. If in 2016 there were 34 companies importing gas to Ukraine, in 2017 there were already 67. Naftogaz remains Ukraine's main gas importer. The number of its European gas suppliers in 2017 was 13, two less than in 2016. At the same time, the law On Natural Gas Market⁷⁷ has somewhat de-monopolized the gas market and strengthened the role of public traders. In 2017 they imported 5.4 BN cm (38.3% of the total volume of gas imported), which is almost twice as much as in 2016 (2.9 BN cm or 26.1%)⁷⁸. Ukraine succeeded in reducing the risks of its dependence on the sole supplier. The Stockholm Court of Arbitration is compelling Naftogaz to again buy Russian gas in the volumes proportionate to market needs— 4-5 BN cm. Even if Ukraine resumes such purchases, the volume shall not exceed one third of total gas imports, and the contract between Naftogaz and Gazprom» expires in 2019⁷⁹.

Given the non-transparency of 2009 Gas Contract, and multibillion losses related to it, Naftogaz victory over Gazprom in Stockholm Court of Arbitration is a significant, yet underrated, anticorruption step taking into account the non-transparent 2009 gas contract and related multibillion losses.

Apparently, diversification of fuel sources and full-fledged operational natural gas market makes an objective precondition in the reduction of corruption in the gas market.

ECONOMIC EFFECT OF MEASURES IMPLEMENTED IN GAS MARKET

Narrowed scope of opportunities for abuse is one of the main anticorruption achievements in the gas market over recent years. The results with respect to gas sector reformation include the following:

- Narrowed scope for arbitrage based on price differences which existence resulted in Naftogaz shortfall of UAH 7 BN (USD 0.9 BN) over 2009-2013. Government annual losses on average amounted to UAH 1.4 BN (USD 0.18 BN).
- PSAs were terminated. Only within one criminal case, it was established that over 2013-2015 Ukraine lost UAH 3.1 BN or UAH 1 BN per year.
- Because of the contract between Naftogaz and Gazprom, from 2011 to 2015 Ukraine overpaid USD14.1 BN, resulting in an average annual loss to Ukraine's government of USD 2.82 BN.

Summing up, we may say that government discontinued incurring annual losses in the amount approximately USD 3 BN. The above mentioned measures allowed Naftogaz, whose deficit in 2014 amounted to 5.7% of GDP or more than UAH 90 BN (USD 7.6 BN), to become profit making,

⁷⁶ "Нафтогаз виграв у Газпрому арбітраж щодо транзиту: Газпром заплатить Нафтогазу 2,56 млрд дол.", Нафтогаз України, 28 лютого 2018 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/B456789DD956569AC2258242007460F0?OpenDocument&year=2018&month=02&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>.

⁷⁷ Закон "Про ринок природного газу" № 329-VIII від 9 квітня 2015, <http://zakon3.rada.gov.ua/laws/show/329-19>.

⁷⁸ "У 2017 році Україна закупила 14,1 млрд куб. м газу з європейського напрямку", Нафтогаз України, 31 січня 2018 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/898ABF94AE07BADAC2258226005ABA88?OpenDocument&year=2018&month=01&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>.

⁷⁹ Зануда Анастасія, "Життя після арбітражу: чи купуватиме Україна російський газ знову?" BBC Україна, 29 січня 2018 р., <http://www.bbc.com/ukrainian/features-42835898>.

NEXT STEPS

Over the several recent years, changes in gas market proved one of the key reforms in Ukraine. In particular, Naftogaz corporate governance reform was launched, the Law «On Gas Market» was passed and free pricing principles at gas market were partially implemented. Yet, in spite of large scope of government losses being discontinued, the following steps are vital going forward:

- Completion of Naftogaz reforms, including, consistent implementation of the adopted unbundling plan for the company (according to the Third energy package of EU regulations). At the same time, independence in the work of Naftogaz Supervisory Board is to be maintained, as it is a key factor of positive changes in Naftogaz functioning. Along similar lines, the company which will be operating the Gas Transportation System, which will start its operation after unbundling process is completed, must be guaranteed. Efficient work of the company is a essential for increasing profitability and the amount of taxes paid. Such budget revenues may be further used to pay subsidies, which, given the further growth in gas price for the households, will likely increase.
- Ensuring the gas market functions on the free pricing basis, which will make it possible to fully offset price arbitrage related risks. In particular, it is crucial to reduce difference in gas price for households and commercial consumers. It should be kept in mind that interference in pricing (with the help of Public Service Obligations) is also affecting Naftogaz's profitability. Naftogaz has already stated that as a result of its fulfillment of the Cabinet of Ministers-assigned PSO it has already experienced a shortfall of more UAH 110 BN⁸⁰.
- Ensuring transparent distribution of licenses to develop Ukrainian gas fields, as from time to time conflicts occur with respect to noncompetitive distribution of licenses among private companies. The license distribution mechanism needs to be reformed to bring real competition to the country's gas production sector.
- Ukraine has to further diversify gas import sources in order to avoid its reliance on the sole supplier. This being said, it is important that competition be in place not only among suppliers but also among importers.
- Ukraine needs to ensure competition in the domestic market in the gas distribution supply sector. To do this end, it is necessary to abolish the regional gas monopolies (oblgas), which for many years have been instrumental in making profits from price arbitrage.

⁸⁰ "Укргазвидобування і Нафтогаз звернулися до Кабінету Міністрів щодо компенсації витрат, пов'язаних із виконанням спеціальних обов'язків", Нафтогаз України, 23 січня 2018 р., <http://www.naftogaz.com/www/3/nakweb.nsf/0/81124715DABDC9CFC225821E002482E9>.

SECTION 4. TAX ADMINISTRATION

“TAX HOLES” IN UKRAINE

So-called “tax holes” have been traditionally one of the problems inherent to the Ukrainian tax system. The Ministry of Revenues and Duties estimated in 2014 that in 2013 the value of tax holes exceeded UAH 300 BN and resulted in almost UAH 50 BN of income not received by the State Budget⁸¹. According to the government’s estimates, the cumulative volume of tax holes from 2010 to 2013 was nearly UAH 600 BN. Tax holes exist in various forms. They take the form of different arrangements under which some taxpayers use other entities to obtain tax benefits, reducing their tax payments (primarily VAT, corporate income tax and excise taxes) or to receive unlawful VAT refunds.⁸²

In addition to export transactions, VAT refunds can also be unlawfully received under “artificial” transactions where the selling price is lower than the purchase price of goods. The counterparties of tax holes that use these schemes either to increase gross expenditures, or to arrange a tax credit scheme, are most often companies registered to a shell company and exist a short period of time.

Box 4. Official definition of tax holes

In accordance with the **official definition** given in Order of the State Fiscal Service (SFS) No.543 “On Ensuring the Comprehensive Control of VAT-related Risks,” dated July 28, 2015, “a benefit generating entity (“tax hole”) is a taxpayer of VAT, who does not recognize but does not pay VAT liabilities, while the counterparty declares the amounts of a tax credit with no real economic or other economic activity underlying such transactions, and consequently forms a tax credit with characteristics of risks”⁸³. Meanwhile, the “beneficiary is a VAT payer, who receives unwarranted tax benefits due to the reflection in the tax reporting data of inaccurate data of economic transactions using the benefit-generating (“tax holes”) and benefit-transmitting entities (transmitters), including in the supply chain.”

In 2014, the government of Ukraine declared that one of its top priorities is fighting the tax holes, which are most often related to the provision of VAT credit scheme to other enterprises by fake companies. Thus, according to SFS estimates, in Kyiv, the volume of the VAT credit schemes reached about 4% of total tax liabilities in late 2016 and early 2017.⁸⁴ In June that year, First Deputy Minister of Revenues and Duties Ihor Bilous reported on the first successes in the elimination of the tax holes, which facilitated UAH 2.6 BN of revenues to the state budget.⁸⁵ According to Prime Minister Arseniy

⁸¹ “Міндоходів дістало з “податкових ям” 2,6 мільярда гривень”, Економічна правда, 1 червня 2014 р., <https://www.epravda.com.ua/news/2014/06/1/460931/>.

⁸² на See more on “tax holes”, Олег Іванов. “Податкові ями”: Ліквідувати чи Очолювати”, VoxUkraine, 11 червня 2015 р., <https://voxukraine.org/uk/podatkovyi-yamy/>.

⁸³ The first official definition of the “tax hole” was coined in 2008: “*The tax hole* (a benefit-forming entity) is a business entity, which is included in the list of tax credit generators of a counterparty and forms a tax benefit to the beneficiary (producer, recipient), including through benefit-transmitters”. In this case, “*a benefit-transmitting entity (a transmitter)* is a business entity (a VAT payer), performing an intermediary function between a benefit-generating entity and a beneficiary, who, in accordance with its tax reporting, has tax liabilities equal to the tax credit either for all transactions or for individual transactions; or who has a negligible difference between tax liabilities and tax credit ($\pm 0,5\%$), meanwhile there is no economic benefit from the operations they perform, or from individual transaction they effect.” (Order of the State Tax Administration of Ukraine No.266 of April 18, 2008, lost effect due to the order of the Ministry of Revenues and Dues of Ukraine No. 165 of June 14, 2013).

⁸⁴ Непряхіна Наталія, “До чого дійшов прогрес: в Україні запущена автоматична система відшкодування ПДВ”, 5 квітня 2017 р., <https://daily.rbc.ua/ukr/show/ukraine-zapushchenna-avtomaticheskaya-sistema-1491312402.html>.

⁸⁵ “Міндоходів дістало з “податкових ям” 2,6 мільярда гривень”, Економічна правда, 1 червня 2014 р., <https://www.epravda.com.ua/news/2014/06/1/460931/>.

Yatsenyuk, these results were achieved thanks to the efforts of the tax authorities to curb VAT shenanigans, to reduce the illegal circulation of excisable goods and to improve customs control.⁸⁶

In 2015-2017, the government introduced a series of systematic steps to combat tax holes. The SFS Order No. 543 of July 28, 2015, established personal accountability of the heads of the State Fiscal Service (SFS) territorial divisions for properly working with the VAT payers registered in the territories they oversee, and who, based on results of the reporting period, engaged in risky operations, manipulated with tax reporting indicators, drastically expanded operations and were involved in tax evasion schemes. Heads of the SFS territorial divisions were also made accountable for the detection and reporting of tax holes and probable tax evasion schemes by SFS territorial bodies, where "transmitters" and beneficiaries are registered. Although courts did not report on any cases with regard to heads' of the SFS units, personal accountability thus far, some allegations against detained former SFS head Roman Nasirov were related to tax hole shenanigans.

The most significant of the measures introduced in the last three years aimed at tightening control over the full payment of VAT and eliminating tax holes is the restriction of conversion platforms, introduction of the electronic VAT administration system and the end of automatic registration of tax invoices. These steps have strengthened control over VAT payments, having narrowed the possibilities for the formation of tax credit schemes. Meanwhile, they allowed the government to introduce automatic VAT refunds in 2017.

CONVERSION PLATFORMS (MONEY LAUNDERING PLATFORMS)

Conversion platforms/sites provide services of illegal encashment of funds and have been one of the most common types of illegal business. These platforms (that is special purpose vehicles or SPVs) submit tax reports on behalf of the enterprises under their control, to the state tax inspectorates at the place of registration. SPV-tax holes formed false tax credit while SPV-transmitters "transmit" tax credit in favor of the beneficiaries without actual economic activity behind the documents. The platforms receive a profit as a percentage of the "cashed in" funds (5-12%).

According to the Chief Military Prosecutor's Office of the General Prosecutor's Office of Ukraine, in 2011-2013, conversion platforms operated under full control of the tax authorities, namely, ex Minister of Revenues and Duties Oleksandr Klymenko. In fact, we are talking about an intentionally created vertically integrated system, through which businesses were practically forced to carry out the relevant operations. There are various estimates of the scale of operations of conversion platforms. Ukraine's Prosecutor General's Office (PGO) estimates that between 2011 and 2013, the scheme-based credit formed by means of conversion platforms resulted in UAH 43.8 BN in revenue losses for the State Budget from non-payment of VAT and UAH 52.1 BN from the non-payment of corporate income tax. A study of the Institute for Social and Economic Transformation (ISET) suggests that the annual volume of the scheme-based credit due to the operations of the conversion platforms was nearly UAH 40-50 billion, which, according to expert estimates, led to UAH 12-15 BN of under received budget revenues per year.⁸⁷

As conversion platforms help other companies create a tax credit scheme and receive cash to finance operating activities without paying taxes, the fight with them was recognized as a priority in 2015-2016. In 2016, ex SFS head Nasirov said that during 2015 60 conversion platforms terminated their

⁸⁶ "Арсеній Яценюк: Усі схеми попередньої влади ліквідуються", Економічна правда, 14 травня 2014 р., <https://www.epravda.com.ua/publications/2014/05/14/452304/>.

⁸⁷ Дубровський В., Черкашин В. "Порівняльний аналіз фіскального ефекту від застосування інструментів ухилення/уникнення оподаткування в Україні", Інститут соціально-економічної трансформації, <http://iset-ua.org/ua/doslidzhennya/item/111-porivnialnyi-analiz-fiskalnoho-efektu-skhem>.

operations.⁸⁸ In the first two months of 2016, another 13 platforms were closed, through which UAH 10.7 BN had been encashed. During 2016, SFS operational units closed 77 conversion platforms with an annual turnover of UAH 27 billion. The SFS estimated that the closure of such platforms in 2016 helped to save for the state UAH 4 billion.⁸⁹ In 2016, a system of electronic VAT administration was introduced which also contributed to eliminating the conversion platforms. In order to further limit the activities of conversion platforms operational search actions continued in 2017- 2018.

ELECTRONIC VAT ADMINISTRATION SYSTEM

In 2016, the electronic VAT administration system (VAT EAS) was launched, which worked in the test mode in the first half of the year and was fully up and running in July 2016. This system is designed to limit manipulations with VAT, specifically, to help control completeness of VAT payments, eliminate tax holes and slash the market of tax minimizers. VAT EAS implies that each VAT payer has a unique account in the State Treasury, where VAT obligations are accumulated, which are reduced by the amount of the tax credit. VAT payers must register all VAT invoices in the Unified Register of Tax Bills.

Since the official announcement of VAT EAS launch, businesses were protesting this innovation as they thought it might affect operating expenses of companies in the recession. To reduce this negative impact, all companies were granted a tax credit in the system, equal to one twelfth of the annual amount of VAT in 2014. Although VAT EAS is burdensome for businesses compared to similar systems in the EU countries, according to ISET experts, the introduction of VAT EAS was instrumental for the elimination of marginal tax holes, pushing up the price for services for benefit-generating entities and considerable savings of budget revenues from VAT minimization.⁹⁰ Thus, according to SFS, in the first few months of 2016, when the VAT EAS was operating in the test mode, UAH 5 BN was withdrawn from the shadow turnover.⁹¹ In general, the SFS's report on the implementation of 2016 Work Plan⁹² states that they prevented formation about UAH 11 BN scheme-based tax credits that year. Myroslav Solda, the acting head of SFS estimated that the VAT EAS helped to remove the problem with conversion platforms from the SFS's agenda completely⁹³.

In 2015 and 2016, the effective VAT rate increased, which may be explained by improved administration.

VAT ADMINISTRATION: RISK MONITORING SYSTEM

Given the large share of the scheme-based tax credit in tax holes, in 2017 the government introduced a special risk assessment criteria-monitoring system (RACMS), which initially worked in the test mode

⁸⁸ Прес-реліз ДФС "Роман Насіров: конвертаційні центри мають залишитися в минулому", 29 лютого 2016 р., <http://sfs.gov.ua/media-tsentr/novini/238872.html>.

⁸⁹ Звіт про виконання Плану роботи Державної фіскальної служби України на 2016 рік, <http://sfs.gov.ua/data/files/199244.pdf>.

⁹⁰ Дубровський В., Черкашин В. "Порівняльний аналіз фіскального ефекту від застосування інструментів ухилення/уникнення оподаткування в Україні", Інститут соціально-економічної трансформації, <http://iset-ua.org/ua/doslidzhennya/item/111-porivnialnyi-analiz-fiskalnoho-efektu-skhem>.

⁹¹ Прес-реліз ДФС "Роман Насіров: конвертаційні центри мають залишитися в минулому", 29 лютого 2016 р., <http://sfs.gov.ua/media-tsentr/novini/238872.html>.

⁹² ДФС "Звіт про виконання Плану роботи Державної фіскальної служби України на 2016 рік, <http://sfs.gov.ua/data/files/199244.pdf>.

⁹³ "Мирослав Продан: Система блокування ризикових накладних стосується тих, хто досі будує схеми ухилення", 6 липня 2017 р., <http://sfs.gov.ua/media-tsentr/zmi/302343.html>.

starting from April and in the mode of blocking tax invoices from July.⁹⁴ The system was designed to reduce the scheme's tax credit by blocking tax invoices with risky counterparties. Riskiness is determined based on the defined criteria.

The SFS estimated that the introduction of the RACMS produced positive economic effect right after it was launched in the test mode: the scheme-based credit reduced by about UAH 1 BN monthly.⁹⁵ Meanwhile, the system of automatic blocking of tax invoices launched in July 2017 was different from the system that was tested. This was primarily due to the fact that the Ministry of Finance identified the risk criteria for tax bills on June 13 (the order to that effect came into force only on June 20). Therefore, in fact, the test mode lasted only a few days, not three months, as predicted earlier. Moreover, the Petya virus cyber-attack exacerbated the existing problems.

The new risk criteria, along with a few other factors (in particular, conflicts with other tax laws and inconsistent codes for inputs and ready products in the Ukrainian Classification of Goods for Foreign Economic Activity (UKTZED) led to situations where even diligent taxpayers faced problems. The number of blocked tax invoices exceeded the SFS estimates reported on the eve of the RACMS rollout: in the first months of operation, 0.5% of all filed tax invoices/adjustment calculations were blocked versus the expected 0.1% of all invoices.⁹⁶ In addition, the SFS data for Kyiv demonstrate that 36% of the blocked tax invoices can be tracked to the real sector, not the entities engaged in tax schemes, therefore a lot of good faith companies faced losses and fines from counterparties.⁹⁷

In order to resolve these problems, in November 2017 the Ministry of Finance introduced changes to the criteria for recognizing a risky taxpayer.⁹⁸ The new criteria, however, failed to fully address the problems faced by the businesses, and the parliament's Committee on Taxation and Customs Policy continued criticizing the government for failing to put the tax administration on a right track. **Lack of consensus with regard to the criteria for identifying highly risky transactions between the Ministry of Finance and members of the Committee led to a temporary suspension of the system of automatic blocking of tax invoices.**⁹⁹ Therefore, effective as of January 2, 2018, the system stopped functioning.

During January and February, efforts are being made to streamline the RACMS. The launch of a fully-fledged system is crucial for the elimination of scheme-based tax credits and unjustified VAT refunds. In March, the new mechanism of the RACMS was launched. The SFS estimates that the new mechanism will reduce the number of automatic blocking of tax invoices and minimize fake tax credit.¹⁰⁰

⁹⁴ As per clause 74.2 article 74 of the Tax Code of Ukraine of December 02, 2010, №2577-VI with changes and amendments.

⁹⁵ "Мирослав Продан: Система блокування ризикових накладних стосується тих, хто досі будує схеми ухилення". 6 липня 2017 р., <http://sfs.gov.ua/media-tsentr/zmi/302343.html>.

⁹⁶ "Мирослав Продан: СМКОР заблоковано лише 0,5% податкових накладних", 4 вересня 2017 р., <http://sfs.gov.ua/baneryi/zupinennya-reestratsii-pn/308789.html>; "ДФС: Роботу СМКОР удосконалено". 21 листопада 2011 р., <http://sfs.gov.ua/media-tsentr/novini/317328.html>; "Мирослав Продан: Система блокування ризикових накладних стосується тих, хто досі будує схеми ухилення". 6 липня 2017 р., <http://sfs.gov.ua/media-tsentr/zmi/302343.html>.

⁹⁷ "Блокування податкових накладних: схеми і скрутки надалі у тренді", <https://taxlink.ua/ua/news/blokuvannja-podatkovih-nakladnih-shemi-ta-skrutki-j-nadali-v-trendi.html>.

⁹⁸ "ДФС: Роботу СМКОР удосконалено", 21 листопада 2011 р., <http://sfs.gov.ua/media-tsentr/novini/317328.html>.

⁹⁹ Міністерство фінансів "Систему ризиків з ПДВ буде тимчасово зупинено до моменту узгодження оптимального рішення, що відповідатиме інтересам всіх сегментів бізнесу та попереджуватиме розкрадання бюджету", 12 липня 2017 р., <https://goo.gl/Tfy1td>.

¹⁰⁰ ДФС "Новий механізм СМКОР в десятки разів зменшить кількість блокувань податкових накладних", 21 березня 2018 р., <https://www.facebook.com/SFSofUkraine/posts/1884006494966665>.

AUTOMATIC VAT REFUND

Every year businesses traditionally complain about delays in VAT refunds and corruption schemes in this area. To receive VAT reimbursement timely businesses were often required to pay kickbacks to tax officials.¹⁰¹ According to ex Finance Minister Oleksandr Danyliuk, 50-60% of all corruption in the SFS has traditionally been linked to non-transparent tax refunds for businesses.¹⁰² Chronical arrears of VAT refunds were from time to time formally reduced by the provision to businesses of VAT bonds, which the businesses often sold with 25% haircut. At the same time, for the introduction of automatic VAT refunds, it was imperative to eradicate scheme-based tax credits in the first place.

Therefore, the first step towards the introduction of automatic VAT refund (regardless the additional criteria such as the size of the tax credit, the size of the average monthly salary, etc.), was made by the government in 2016 when the VAT EAS was launched. However, in 2016, the automatic VAT refund was not launched, as the Tax Code provided for two registers of applications for VAT refund from the budget, and therefore the control over the reimbursement remained in hands of the SFS authorities.

Hence, in 2017, another attempt was made to switch to a truly automatic VAT refund. Thus, since April 2017, in parallel with the introduction of RACMS in the test mode, the government introduced an open electronic VAT register (which ran for three months in the test mode)¹⁰³. Under the new procedure, the application for VAT refund is filed with to the register in the chronological order. The office check should be completed within no more than thirty days. In some cases, the SFS may conduct a documentary check, but its duration is also limited to thirty days. If no breaches found, the Treasury should reimburse VAT automatically within five business days. Meanwhile, the Register records the date of submitted application for reimbursement, as well as the dates of inspections, their completion, as well as the amount of the application and the VAT refunded. A company may appeal to court if it disagrees with the SFS decision not to refund the VAT.

Analysis of the Register's open data reveals that the SFS indeed began to reimburse VAT in due time, and the scheduled dates for conducting office and documentary checks are adhered to. According to the SFS, the total VAT reimbursement debt decreased from UAH 15.3 BN on April 1, to UAH 0.93 BN on October 1, 2017.¹⁰⁴

ASSESSMENT OF REFORM PROGRESS

During 2014-2017, the government made a lot of effort to improve the efficiency of tax administration, and, above all, VAT. **The problem of conversion platforms, that existed in fact as a state-sponsored withdrawal scheme for tax evasion purpose, was resolved, and even though the platforms may exist somewhere, the scale of their operations has significantly decreased. As a result of taken actions, budget revenues increased, reflecting an increase in the effective VAT rate. According to the IER, additional revenues from the elimination of conversion platforms and the fight against scheme-based tax credit amounted to approximately USD 3 BN.**

¹⁰¹ It was emphasized by Hanna Derevyanko, the CEO of the European Business Association, that some SFS officials earned money on VAT Refunds <https://daily.rbc.ua/ukr/show/ukraine-zapushchenna-avtomaticheskaya-sistema-1491312402.html>.

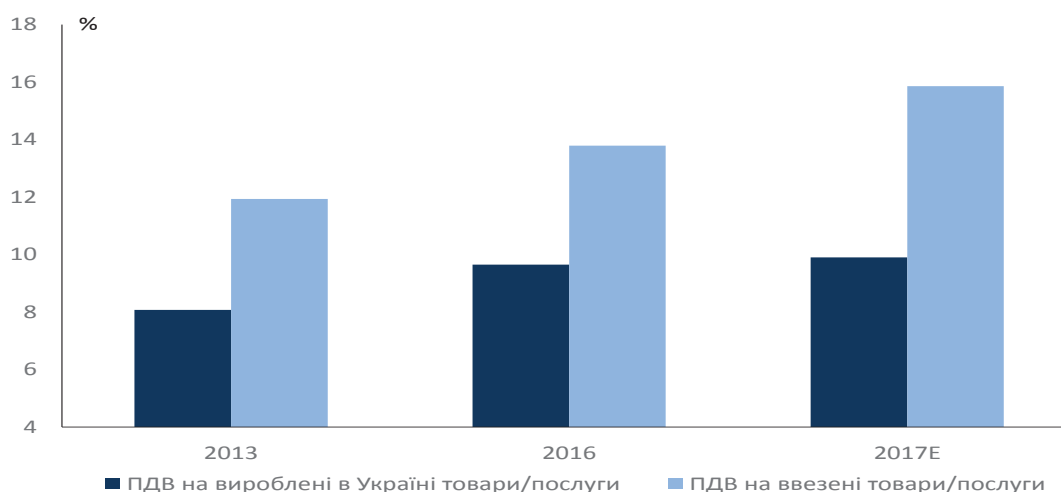
¹⁰² Данилюк Олександр, "Ми запускаємо відкритий електронний реєстр відшкодування ПДВ...", 1 квітня 2017 р., <https://www.facebook.com/o.danyliuk/posts/1808330762820706>.

¹⁰³ Реєстр заяв на відшкодування ПДВ доступний за посиланням: <https://www.minfin.gov.ua/reestr>.

¹⁰⁴ "ДФС: Заборгованість з відшкодування ПДВ скоротилась на 94%", 3 жовтня 2017 р., <https://www.ukrinform.ua/rubric-economy/2317083-dfs-zaborgovanist-z-vidskoduvanna-pdv-skorotilas-na-94.html>.

Changes in the administration of taxes, increased transparency and introduction of e-office for taxpayers contributed to positive assessments of the SFS tax administration procedures.¹⁰⁵ According to TADAT¹⁰⁶ mission experts assessments the SFS has received the highest score «A» for such areas as transparency in the SFS work, relevance of electronic services which are developed in accordance to payers' requests, high level of measures applied after disputes were resolved at courts, and also for timeliness of tax returns filing and payment of tax liabilities. At the same time, the «B» score was given for reliability level of performance, which is somewhat lower than the best international practices and to such indicators as efficient feedback with payers, macro forecasting of tax revenues, internal control and external supervision over the SFS activities.

Figure 6. Effective VAT Rate



Source: in-house estimates based on data of the State Treasury and State Statistics

In addition, the introduction of automatic VAT refund improved the financial condition of the business, since earlier "kickbacks" for facilitated refunds reached as much as 20-30% of the amount of VAT subject to reimbursement. The companies received additional resources to finance their investment projects, which is critical for accelerating economic growth in the medium and long term.

Box 5. Customs experiment

Since September 2015, government has conducted a so called customs experiment, under which half of the amount in excess of monthly target for customs proceeds, such as duty, excise tax on excisable goods brought into Ukraine, value added tax on goods brought into Ukraine, is sent to the Special Funds of respective regional budgets to finance, modernize and repair the roads. In 2017, as a result of customs experiment, 7 BL UAH was sent to the road repair, and 6 BN UAH of such funds is expected in 2018. Overall, there is an opinion that the experiment contributed to reduced corruption at the customs, as the local authorities have become more interested in high proceeds from the customs fees.

¹⁰⁵ "TADAT: Окремі процедури податкового адміністрування в ДФС відповідають найкращим світовим практикам", 27 лютого 2018 р., <http://sfs.gov.ua/media-tsentr/novini/328580.html>.

¹⁰⁶ TADAT – діагностичний інструмент оцінки ефективності податкової системи, розроблений МВФ, Єврокомісією та Світовим банком, <http://www.tadat.org/>.

NEXT STEPS

In general, steps to increase control over completeness of payment of VAT and other taxes were reasonable. They resulted in less room for rent-seeking activities in the tax area. At the same time, the available evidence suggests that these successes are limited in nature, which is primarily due to the failure to reform the SFS. The importance of such reform cannot be overestimated as 62% of businesses' complaints to the ombudsman relate to various aspects of the tax system.¹⁰⁷

Taking this into consideration, in June 2017, the Ministry of Finance and the SFS began implementing a comprehensive SFS reform project.¹⁰⁸ The tax administration diagnostics determined four main areas of reform, as follows: switching to the mainly electronic means of servicing the taxpayers, increasing the efficiency of tax audits, increasing efficiency of tax debt recovery procedures, and improving performance of tax service personnel. The directions of the SFS reforms were determined correctly, and their implementation will further contribute to curbing graft in the SFS and reducing the opportunities for abuse of the tax system. But in January 2018, the Cabinet cancelled its own decisions on SFS reform adopted in 2017. New vision of reform has not been proposed so far, although the reform remains as urgent as ever.

¹⁰⁷ Бугрімова Яна, "Чому не можна відкладати реформу ДФС", Економічна правда, 26 грудня 2017 року, <https://www.epravda.com.ua/columns/2017/12/26/632531/>.

¹⁰⁸ Данилюк Олександр, "Державна фіскальна служба має надавати більшість послуг он-лайн", 9 травня 2017 р., <https://minfin.gov.ua/news/view/oleksandr-danyliuk-derzhavna-fiksalna-sluzhba-maie-nadavaty-bilshist-posluh-onlain?category=novini-ta-media>.

SECTION 5. PUBLIC PROCUREMENT

PUBLIC PROCUREMENT REFORM

For many years, Ukraine has been trying to reform its public procurement system¹⁰⁹. But the first attempt to streamline this area in a systemic way was made in 2010, when the law "On Public Procurement" was adopted.¹¹⁰ Having this law in place was a condition for the signing by the government of ex Prime Minister Mykola Azarov of the Memorandum on cooperation with the IMF and deepening of cooperation with the EU. However, shortly after the adoption it was amended in a way that brought to nought the principles of transparency and competition. In particular, the resulting loopholes in the law made it possible to procure for the Euro-2012 football championship¹¹¹ without the competitive procedures prescribed by the law. Moreover, later on a special procurement process was introduced in the energy sector. In addition, amendments were made that actually gave way to corrupt practices in the procurement for state-owned enterprises¹¹². Such steps resulted in the suspension of EU support anticipated by the government.

Public procurement was one of the areas mostly affected by corrupt practices at all levels of the government and a source of the country's significant financial losses. Ukraine's SBU Security Service claimed annual losses from corrupt practices in the field of public procurement reached 10-15% (UAH 35-52.5 BN) of state budget expenditures¹¹³. However, if we were to analyze public procurement on a case by case basis, then the state could have lost in fact a much larger percentage of funds allocated for procurement. So, in the case of Euro-2012, officials could have embezzled almost a third of the multibillion-dollar budget for the championship preparation (according to Freedom House)¹¹⁴. Due to the legislative changes in 2012, corrupt practices threatened to permeate the market of procurement for state-owned enterprises with the annual volume of about UAH 300 BN. In 2013, the value of the procured goods, works and services reached almost UAH 186 BN and almost half of them were purchased through a noncompetitive procedure (single-source supplier)¹¹⁵.

In 2014, as part of fiscal consolidation measures and with support of the IMF and EU in Ukraine, a new Law on Public Procurement¹¹⁶ was adopted which was to a large extent harmonized with the EU provisions. This law was designed to increase transparency and openness of the procurement, increase the number of customers, limit the grounds for non-competitive procedures and reduce the list of exclusions from the law. The Ministry of Economic Development and Trade (MEDT) was appointed the main public procurement agency, and the Antimonopoly Committee the appointed to deal with grievances related to procurement. The adoption of a new law became a strategically correct step, but the law itself was not able to solve all problems with procurement. In particular, the practice of non-transparent selection of winners was still in place, as was the possibility to make changes to the tender

¹⁰⁹ "Поглиблення відносин між ЄС та Україною: Що? Чому і як?", ред. М. Емерсон, В. Мовчан, ISBN 978-617-7393-38-1, <http://www.ier.com.ua/ua/publications/books?pid=5330>.

¹¹⁰ Закон №2289-VI від 1 червня 2010 року (набрав чинності 30 липня 2010 року).

¹¹¹ By estimates of the Freedom House, a third of the budget for preparation to EURO 2012 was pilfered by the government officials (See <http://news.liga.net/news/economics/844016-chinovniki-razvorovali-tret-deneg-na-evro-2012-freedom-house.htm> та <https://www.epravda.com.ua/columns/2013/05/13/374398/>).

¹¹² Закон "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2014-2017 роки", №1699-18 від 8 серпня 2015 р., <http://zakon2.rada.gov.ua/laws/show/1699-18>.

¹¹³ Ibidem.

¹¹⁴ "Чиновники разворовали треть денег на Евро-2012, - Freedom House", 19 квітня 2013 р., <https://goo.gl/L2Zc51>.

¹¹⁵ Закон "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2014-2017 роки", №1699-18 від 8 серпня 2015 р., <http://zakon2.rada.gov.ua/laws/show/1699-18>.

¹¹⁶ Закон №1197-VII від 10 квітня 2014 року, <http://zakon5.rada.gov.ua/laws/show/1197-18>.

documentation after all participants had already submitted their bids. Thus, according to MEDT estimates, in 2014 corrupt practices and low competition in the public procurement sector precluded from saving almost 20% of the total budget allocations for procurement in 2014.¹¹⁷

In order to solve these problems, in 2015, the government launched a pilot project on the introduction of ProZorro's electronic procurement system¹¹⁸. In January 2015, the law "On State Procurement" was amended to facilitate conduct of electronic procurement. Shortly thereafter, in February 2015, the Ministry of Justice, the Ministry of Defense, the State Management of Affairs and the state-owned company Energoatom conducted pilot electronic purchases through the ProZorro system. During the pilot, the system was tested on subthreshold electronic purchases of goods and services up to UAH 200,000 and UAH 1.5 million, respectively (by October 1, up to UAH 100,000 and up to UAH 1 MN, respectively). To perform transactions, the procurement participants could use the services of six e-commerce markets. Later that year, other central executive authorities joined the electronic procurement system. According to the MEDT, the system was running effectively and during 2015 alone, enabled to achieve 14% of savings (saving is understood as the difference between the declared and actual prices).

In December 2015, parliament adopted the law On Public Procurement drafted by the government and largely aligned with the EU Directives 2014/24 /EC and 2014/25 /EC. All central government bodies and natural state monopolies switched to procurement through ProZorro on April 1, 2016, while other government entities (including local budgets) did so on August 1, 2016. ProZorro should be used for the purchase of goods and services worth over UAH 200,000 and works over UAH 1.5 MN (in case of natural monopolies the thresholds are higher: UAH 1.0 MN and UAH 5.0 MN, respectively). Meanwhile, the data proves that customers use the ProZorro system also for sub threshold purchases, which is explained by the desire to get the lowest possible price. Transparency and openness of the procurement data are ensured by the clause in the law mandating that all purchase agreements over UAH 50,000 (but below the threshold) should be made public in the ProZorro system. Obviously, benefits of the new system include clear-cut procurement procedures and the introduction of an electronic appeal mechanism¹¹⁹.

An important element of the public procurement reform is the establishment of a monitoring system. In December 2017, parliament passed the law On Amendments to the Law of Ukraine On Public Procurement and some other laws regarding monitoring of procurement¹²⁰, authorizing the State Audit Office of Ukraine (SAOU) to monitor the processes and prevent abuse at all stages of procurement. In particular, the law provides for the establishment of an automatic risk management system that will flag any violation to supervisory authorities¹²¹. In addition, a specialized monitoring portal for Procurement called Dozorro was built. It is an online platform where anyone can leave their comments and information to a state customer, supplier, public and law enforcement authorities about the procurement procedure, discuss and evaluate the terms of a specific procurement, and analyze procurement of an

¹¹⁷ See

http://reforms.in.ua/sites/default/files/upload/docs/7.1_20150514_nrc_public_procurement_presentation_v9_a4_dr_0.pdf.

¹¹⁸ See Сайт Прозорро: <http://prozorro.org/>.

¹¹⁹ "Поглиблення відносин між ЄС та Україною: Що? Чому і як?", ред. М. Емерсон, В. Мовчан, ISBN 978-617-7393-38-1, <http://www.ier.com.ua/ua/publications/books?pid=5330>.

¹²⁰ Закон "Про внесення змін до Закону України "Про публічні закупівлі" та деяких інших законів України щодо здійснення моніторингу закупівель", № 2265-19 від 21 грудня 2017 р., <http://zakon3.rada.gov.ua/laws/show/2265-viii>.

¹²¹ Президент підписав Закон про внесення змін до Закону України «Про публічні закупівлі» та деяких інших Законів України щодо здійснення моніторингу закупівель / <http://www.president.gov.ua/news/prezident-pidpisav-zakon-pro-vnesennya-zmin-do-zakonu-ukrayi-45562>; Президент підписав законопроект №4738-д про моніторинг закупівель / <http://www.me.gov.ua/News/Detail?lang=uk-UA&id=8d386b16-691d-44c1-a590-9a1bb5d9a3fb&title=PrezidentPidpisavZakonoproekt4738-dProMonitoringZakupivel>

individual customer¹²². The Dozorro portal runs the Best Practices Index in the pilot mode (<http://index.dozorro.org/>). **The availability of procurement data contributes to reducing corruption in this area**¹²³.

OUTCOMES OF PUBLIC PROCUREMENT REFORM

In general, both Ukrainian and international experts recognized the reform of public procurement as the most successful in 2016. The introduction of ProZorro electronic procurement system and the accessibility of the module for the Platform's Data Analysis (bi.prozorro.org) were major contributors to the transparency and openness of information related to public procurement of both central and local government authorities, state-owned enterprises and natural monopolies. **According to the Center of Excellence in Procurement (Kyiv School of Economics), as a result of the introduction of ProZorro's electronic procurement system, the number of single source supplier transactions dropped, which may also to some extent evidence the reduced fraud due to public scrutiny and increased competition.**¹²⁴ Greater transparency and credibility of the system helped to significantly increase the number of suppliers, which also led to better procurement terms. The number of small enterprises (including individual entrepreneurs) among public procurement participants has increased. This was also due to a reduced administrative burden in the form of less paper work and shorter timeframes in the ProZorro electronic system. In May 2016, the ProZorro Electronic Procurement System won the World Procurement Award 2016.¹²⁵

Box 6. Ukrposhta case: price saving effect

To see what benefits may be secured by price competition let's look at the following case of Ukrposhta. In late 2017, the company reported their success in the purchase of fuel. The prices for fuel directly bought by the company from the country's top three refuelling chains were on average UAH 1-1.5 lower than the price in the cheapest chain and UAH 4-5 lower than the price of the most expensive chain. Soon after, in February, Ukrposhta took advantage of price saving when purchased equipment and machinery (the price savings in this case were defined as the difference between the purchase and market price). Thus, buying a multi-functional Xerox product they secured a 45.8% discount, which allowed the company to save UAH 8.4 million on the purchase of 2000 units. Saving on the purchase of different types of scanners ranged from 30.9% to 60.5%, while savings in the tenders for the purchase of WiFi routers reached 70.8%. Buying 120 cars for mail delivery, the company managed to save UAH 21.8 MN due to 14.4% difference between the purchase and market prices. Ukrposhta representatives underscored that price openness and clarity of the tender conditions and high competition ensured by the ProZorro system were the key to their successful and frugal procurement.

Source: "ProZorro: how to buy good product for less", by Oleksandr Nakhod¹²⁶, <https://goo.gl/9PgLjJ>

Transparency of procurement is also facilitated by quarterly reports on public procurement outcomes prepared by the Ministry of Economic Development and Trade. According to the MEDT, the percentage of savings (the difference between the expected value of the purchase and the contract value) in the first quarter of 2017 amounted to 7.6% via open bids (or UAH 4.4 BN) and

¹²² "Громадський контроль держзакупівель", <https://dozorro.org/>; the portal was built by the Transparency International Ukraine with support of the Open Contracting Partnership, EBRD, Omidyar Network and International Renaissance Foundation".

¹²³ This corresponds to the international experience proving that openness of information on public procurement is a prerequisite for curbing graft in this area. Modul 1, Fiscal Transparency, <http://siteresources.worldbank.org/PUBLICSECTORANDGOVERNANCE/Resources/285741-1326399585993/ModuleFiscalTransparency.pdf>.

¹²⁴ "Вплив ProZorro", Центр вдосконалення закупівель при Київській школі економіки, http://cep.kse.org.ua/assets/img/articles/Prozorro_report_ua.pdf.

¹²⁵ See World Procurement Awards 2018, www.procurementleaders.com/world-procurement-awards/winners.

¹²⁶ Oleksandr Nakhod is a deputy CEO of Ukrposhta in charge of procurement and assets management.

almost 13% at sub threshold bids (UAH 0.8 BN)¹²⁷. In the second quarter of 2017, procurement savings reached 7.53% or UAH 9.34 BN.

Meanwhile, research of the Center of Excellence in Procurement (Kyiv School of Economics) demonstrated that there are gaps in the ProZorro system that need to be addressed. In particular, efforts should be made to prevent upward revisions of the purchase price through the conclusion of additional agreements after the winner has been identified.¹²⁸ Also, the Center recommends teaching the lesson learned after the successful experiment introduced within the framework of procurement for the defense sector, whereby participants of public procurement were allowed 24 hours to correct mistakes¹²⁹. As part of fulfillment of the commitments undertaken within the EU-Ukraine Association Agreement, the government plans to take additional steps to reform the public procurement system to improve its efficiency even more¹³⁰.

Box 7. ProZorro. Sales

Positive impacts after the introduction of ProZorro also pushed the government to introduce an electronic system for the transparent sale of state property via the "ProZorro.Sales" system, currently operating on the pilot basis¹³¹. Effective as of February 1, 2017 the government launched on the pilot basis the sale of assets of bankrupt banks under the leadership of the ProZorro team, the MEDT, NBU, the Individual Deposit Guarantee Fund (IDGF) and Transparency International Ukraine¹³². On June 1, the electronic sales system reported surpassing the first UAH BN in sales.¹³³

On March 31, 2017, state and municipal enterprises began using the system of transparent auctions to sell their assets, as well as the leaseholds. Several ministries, central government authorities, local authorities, state and municipal companies have already joined the system.

February 27, the e-platform for state auctions ProZorro.Sales received the international anticorruption award from the C5 Accelerate and the US Institute of Peace within the framework of the competition "the Shield in the Cloud Innovation Challenge".¹³⁴

An important element of the public procurement system reforms was Ukraine's accession to the WTO Agreement on Government Procurement in 2016. This means that Ukrainian companies have access to public procurement markets in 45 countries with a total volume of USD 1.7 TN¹³⁵. Fulfillment by Ukraine of its obligations arising from this Agreement is an important tool for improving the efficiency of the national public procurement system.

¹²⁷ Звіти сфери публічних закупівель, <http://www.me.gov.ua/Documents/List?lang=uk-UA&id=ca5d0012-c7f9-4750-b1f8-cf5550ecb270&tag=Zviti>.

¹²⁸ Policy Brief "Додаткові угоди в Україні: причини виникнення та методи упередження", Центр удосконалення закупівель при Київській школі економіки, <http://cep.kse.org.ua/article/amendment-to-the-contract/amendmentsv.pdf>.

¹²⁹ Policy paper "Чи потрібно давати учасникам публічних закупівель 24 години на виправлення помилок?", Центр удосконалення закупівель при Київській школі економіки, <http://cep.kse.org.ua/article/24-hodyny-na-poryatunok-policy-paper/pdf.pdf>.

¹³⁰ Relevant steps were stipulated in the Agreement implementation plan, drawn by the Government.

¹³¹ Web-site ProZorro.Продажі, <https://prozorro.sale/>.

¹³² First lots was entered into the system on October 31, 2016, and the cooperation agreement between the system and the IDGF began in June 2016.

¹³³ Мета та принципи реформи "ProZorro.Продажі". <https://prozorro.sale/aim>.

¹³⁴ This award is awarded to projects that achieve significant anticorruption effect and may become an role model for other countries worldwide, <https://prozorro.sale/news/prozorproprodazhi-peremogla-v-globalnomu-konkursi-antikorupcijnih-proektiv>.

¹³⁵ Ukraine joined WTO Agreement on government procurement (GPA), <https://goo.gl/n3H4yS>.

In general, the reform of public procurement, namely the transfer of public procurement to the ProZorro electronic procurement system, was recognized as the biggest victory of 2016. The ProZorro Electronic Procurement System received the 2016 International Procurement Award in the nomination Public Sector, and the 2016 Open Government Award. It was also included in the list of e-Procurement models recommended by the EBRD and the Open Contracting Partnership

PUBLIC PROCUREMENT: CASE OF NAFTOGAZ

According to the results of 2016, Naftogaz became the largest user of the ProZorro system, and was also recognized as the best bidder by the number of trades and the amount of savings¹³⁶. For 11 months of 2016, 13 companies of the Naftogaz used the ProZorro system. In total, there were 43 customers from the Group, which performed 8237 procurement procedures worth UAH 59.8 billion¹³⁷. Their savings achieved in the relevant period amounted to about UAH 1.5 BN which was 23% of the total ProZorro savings¹³⁸.

In 2017, the Naftogaz enterprises were the leaders of the public procurement system by the amount of saved funds. In particular, in August 2017, PJSC Ukrtransgaz ranked first in terms of savings (UAH 2.3 billion) among all customers of the ProZorro system, and PJSC "Ukrgezvydobuvannya" ranked second (UAH 2.0 billion). The cumulative savings of just these two companies of the Naftogaz Group make up more than a third of the total savings generated by the ProZorro system¹³⁹.

One of the key priorities for the development of the Naftogaz enterprises was the reform their internal procurement policy. The group improved its internal procurement system, specifically, its transparency and standardization. Each procurement is done through the ProZorro system or through a 2-step bidding. Under the new methodology, a detailed analytical note is prepared for each purchase, which is used as a reference point for repeated procurement. In addition, new qualification requirements were introduced that favor product manufacturers and official dealers. Naftogaz reserves the right of input control and technical audit of the supplier, while disputes with counteragents are regulated by conflicts resolution commissions.¹⁴⁰ Similar innovations were introduced at individual enterprises of the group, and this produces a cumulative positive effect on the group in general.

PHARMACEUTICALS PROCUREMENT BY INTERNATIONAL ORGANIZATIONS

It is important to note that the government chose a completely different way to eradicate high-level corruption in the field of centralized procurement of pharmaceuticals, which has traditionally been a jurisdiction of the Ministry of Health. Thus, in 2015, it was decided to transfer procurement of pharmaceuticals to international organizations¹⁴¹. Prior to 2015, the Ministry of Health (MOH) was responsible for centralized public procurement of medicines and

¹³⁶ Річний звіт Нафтогазу за 2016 рік, http://www.naftogaz.com/files/Zvity/Annual_report_ukr_170608.pdf.

¹³⁷ Матеріали з Конференції "Група НАФТОГАЗ – прозорі закупівлі", 7 грудня 2016 року, <http://www.naftogaz.com/files/Activities/Presentations-Conference-zakupivli.pdf>.

¹³⁸ Річний звіт Нафтогазу за 2016 рік. http://www.naftogaz.com/files/Zvity/Annual_report_ukr_170608.pdf.

¹³⁹ ProZorro Awards: найуспішніші користувачі системи публічних закупівель. 16 серпня 2017 р., https://24tv.ua/prozorro_awards_nayuspishnishi_koristuvachi_sitemi_publichnih_zakupivel_n853580.

¹⁴⁰ Річний звіт НАК "Нафтогаз України" за 2016 рік. Операційна ефективність, <http://annualreport2016.naftogaz.com/ua/chogo-mi-dosjagli/operacijna-efektivnist/>.

¹⁴¹ Закон "Про внесення змін до деяких законів України щодо забезпечення своєчасного доступу пацієнтів до необхідних лікарських засобів та медичних виробів шляхом здійснення державних закупівель із залученням спеціалізованих організацій, які здійснюють закупівлі" №269-VIII від 19 березня 2015 р., <http://zakon5.rada.gov.ua/laws/show/269-19>.

medical supplies. Annual audits performed by the Accounting Chamber traditionally detected serious problems and high corruption risks in this area. As the corrupt scheme embedded into the “body” of the Ministry was difficult to eradicate from the inside, it was decided to transfer centralized procurement of medical products to specialized international organizations. Centralized procurement of pharmaceuticals for Ukraine in 2015-2017 was delegated to the selected organizations such as the United Nations Development Program, the UNICEF Children's Fund and the UK Procurement Agency Crown Agents. In 2017 alone, these international organizations were responsible for procurement of medicines under 39 state programs for a total of UAH 5.9 BN.

The audit of the effectiveness of the use of state budget funds for procurement by these organizations, undertaken by the Accounting Chamber in 2017,¹⁴² attests to a more efficient use of funds compared to the previous period when the MOH was in charge of its own procurement. **Total savings of the public funds for this period, according to the calculations of the Accounting Chamber, amounted to UAH 379.3 MN or about 39% of the value of audited purchases (the audit covered the procurement worth UAH 939 MN, while in 2016 alone, the procurement expenditures were UAH 3.9 BN). At the same time, the Accounting Chamber stresses the need to take further steps to reduce the time from payment to delivery, as well as to enhance transparency of procurement.** The Charity Fund "Patients of Ukraine" claims, that the delegation of pharmaceuticals procurement to international organizations contributed to greater efficiency of procurement, which enabled the purchase a lot more medications for the same budget.¹⁴³

Effective as of 2019, public procurement of medicines and medical products should be performed by a specialized procurement organization that has not yet been established. The main challenge associated with this step will be the introduction of transparent procurement mechanisms and effective safeguards against corruption.

IMPACT ASSESSMENT

The following are among key achievements of the public procurement reform:

- Greater transparency of the procurement process by providing public access to data necessary for monitoring and evaluation of procurement
- Higher efficiency of procurement due to the development of competition between trading platforms, procurement organizations and bidders
- Increased number of individual entrepreneurs among participants (42% in 2016)
- An improved suggestions and complaints system regarding procurement

According to MEDT methodology, the savings from the transition to the new procurement procedure, which is estimated as the difference in the tender's declared value and the contract price, is already about UAH 40 BN.

Moreover, additional savings were secured as a result of the transition to near-market prices. Thus, the price savings in purchases for major sectors (road repair, construction, purchase of petroleum products) are estimated at about 5% -10%, which means UAH 10-24 BN (USD 0.4-0.9 BN) of additional gains for the state budget.

¹⁴² Звіт Рахункової палати "Про результати аудиту ефективності використання коштів держбюджету, виділених у 2015 – 2016 рр. та 1 півріччі 2017 року МОЗу для здійснення державних закупівель із залученням спеціалізованих організацій". 2017 р., <https://goo.gl/2MKB64>.

¹⁴³ Див. Сайт БФ "Пацієнти України", <http://patients.org.ua/>.

NEXT STEPS

The reform of the public procurement system is not complete and needs to be continued.

Improvements must be made to rules and procedures that govern the obligations of the parties, the procedures for challenging decisions and resolving conflicts arising in the procurement process. The draft Government Action Plan for the implementation of the Ukraine-EU Association Agreement put forth next steps in the field of public procurement regulation, which will further raise efficiency of the procurement.

However, in future, it is imperative to refrain from making changes to the public procurement system. This may undermine the basic principles of ProZorro operations, such as: transparency and non-discrimination. In particular, Ukraine should refrain from fully adopting the bill "Buy Ukrainian" (№7206), which was adopted in the first reading in December 2017. This bill defies the principle of equality of all public procurement participants and is not in line with the provisions of the WTO Public procurement Agreement, as well as the Ukraine-EU Association Agreement.¹⁴⁴

In addition, the requirement in the bill to present a large number of documents to confirm the Ukrainian origin of products has a big room for corruption. Reduce participation of small businesses in public procurement may be anticipated as another negative consequence. Once adopted this bill may also create legitimate reasons for inefficient spending of public funds.

¹⁴⁴ Бураковський Ігор, "Купуй українське і наші зобов'язання", 14 лютого 2018 р., <https://www.facebook.com/IER.Kyiv/posts/2228879693793488>.

SECTION 6. TRANSPARENT GOVERNANCE AS PRECONDITION FOR CURBING CORRUPTION

CLOSED INFORMATION - PATH TO CORRUPTION

Until recently, access to most state registers and other data kept by state agencies was actually monopolized by these government agencies. At the end of 2013, there were only a handful of registers open for public (for example, the Unified State Register of Legal Entities and Individual Entrepreneurs¹⁴⁵). Obtaining of information (including from the registers) required sending formal inquiries to government agencies, while the data of most registries remained closed for the public. This practice was conducive for shadow schemes based on the use of this data. For example, information about registered ownership titles to real estate has always been available only for owners and authorities themselves. This situation contributed to frauds in the real estate sector, in particular, illegitimate sale and purchase of residential property, because it was difficult to verify who in fact owned the traded assets. Meanwhile, hiding behind the argument about protection of citizens' privacy, the government limited the public's ability to control the authorities and detect corruption cases¹⁴⁶.

Corrupt practices also involved the use of public registers in the interests of commercial entities. The biggest reverberations were produced by a scandal with the electronic registries of the Ministry of Justice, administered and managed for two years by two private entities. The government procured these entities' services without an open tender, and committed not only to pay for maintenance of the registries, but pay additional monthly royalties for every inquiry sent to the registry's software. In this way, powerful corrupt arrangements were built around the operations of the civil relationship registries that allowed private entities and their partners to earn monthly royalties in amounts bigger than the cost of the registries.¹⁴⁷ During 2006-2013, the amount of royalties for these private entities exceeded UAH 760 MN¹⁴⁸. And only in 2014, the Ministry managed to stop payments under the false contracts¹⁴⁹.

Over the years, information on public finances remained largely closed. Separate aggregated figures on the implementation of state and local budgets were published by the State Treasury and the Ministry of Finance. Meanwhile, detailed information on the financing of certain budget items at the state level was traditionally inaccessible. Data on fulfillment of individual local budgets was even less accessible, which allowed the authorities to use public funds inefficiently and secure additional benefits for themselves. Closeness of procurement information generated and fueled corruption schemes in this area.

TRANSITION TO OPEN DATA

The spread of open data is today one of the main tools for fighting corruption globally, which emphasizes the importance of Ukrainian reforms in this area. In 2015, the G20 governments

¹⁴⁵ "Інформація про власників компаній стала загальнодоступною", Українська правда, 22 жовтня 2013, <http://www.pravda.com.ua/news/2013/10/22/7000429/>.

¹⁴⁶ Відкриття Державного реєстру речових прав на нерухоме майно – довгоочікуваний крок, але поки що цей процес не завершено, <http://kmp.ua/uk/analytics/exclusive/vidkrittya-derzhavnogo-restru-rechovih-prav/>.

¹⁴⁷ Бутусов Юрій, "Замах на держреєстри: історія однієї з найзухваліших обфудок в Україні", Дзеркало тижня, 4 жовтня 2013, <https://dt.ua/internal/zamah-na-derzhreyestri-istoriya-odniyeyi-z-nayzuhvalishih-oborudok-v-ukrayini-.html>.

¹⁴⁸ "Нардеп Дроздик призвал НАБУ и ГПУ возбудить против депутата Деревянко дело "за отмывание денег", LB.ua, 9 червня 2017, https://lb.ua/news/2017/06/09/368644_nardep_drozdik_prizval_nabu_gpu.html.

¹⁴⁹ "Петренко запевняє, що всі реєстри Мін'юсту надійно захищені", Укрінформ, 20 червня 2017, <https://www.ukrinform.ua/rubric-society/2251014-petrenko-zapevnae-so-vsi-reestri-minustu-nadijno-zahiseni.html>.

agreed the G20 Anticorruption Open Data Principles. They are simple: in order to stop corruption, essential information should be public. Such openness is a prerequisite for the formation of an effective anticorruption policy aimed at overcoming bribery and nepotism¹⁵⁰.

Disclosure of information was recognized as one of the priorities under the Anticorruption Strategy for 2014-2017, which was voted into law in October 2014. The Strategy claims that access to information of public interest is "a necessary tool for conducting journalistic investigations, and encouraging civil society's anticorruption activities." The anticorruption strategy envisaged implementation of a number of measures: changes to the legislation, inventory take of public registers, dissemination of information through a Unified state open data portal and Ukraine's participation in international initiatives¹⁵¹.

Box 8. Article 10¹ of the law On Access to Public Information

1. Public information in the form of open data is the public information in a format enabling its automated processing by electronic means, the unhindered and free of charge access to it, and its further use.

Information managers are required to provide public information in the form of open data upon request, and to disclose and regularly update it on the Unified state open data web portal and on their websites.

4. The list of data sets subject to disclosure in the form of open data, requirements for the format and structure of such data sets, and the frequency of their updating are determined by the Cabinet. At the same time, the Cabinet necessarily includes such information in the list, the access to which in the form of open data is stipulated by law.

In April 2015, parliament adopted amendments to the law On Access to Public Information. The law mandates that public information officers should publish and regularly update information on the Unified public open data portal and on their websites¹⁵². In October 2015, government adopted a regulation "On Approval of the Provision on Data Sets to be released in the Form of Open Data." The annex to it listed the data subject to disclosure in the form of open data. There were over 300 top-priority data sets, including several registries operated by central and local authorities (see Annex 1)¹⁵³. In addition, in July 2015, the law On Amendments to Certain Legislative Acts of Ukraine on Enhancing Transparency in the Sphere of Property Relations with a view to Preventing Corruption was adopted¹⁵⁴. It opened access to the registries of property rights and the land cadaster. As a result, in 2015, the opening of state registries was recognized as the most successful reform effort, as it expanded the scope of possibilities to fight corruption¹⁵⁵. The placement of registry data on the Internet should have eliminated corruption around access to such information. In addition, open registries have made it

¹⁵⁰ See: Open Data: Promise, but not Enough Progress from G20 Countries, https://www.transparency.org/news/feature/open_data_promise_but_not_enough_progress_from_g20_countries; Introductory Note to the G20 Anti-Corruption Open Data Principles / <http://www.g20.utoronto.ca/2015/G20-Anti-Corruption-Open-Data-Principles.pdf>.

¹⁵¹ Закон України "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2014-2017 роки" від 14 жовтня 2014 року № 1699-VII, <http://zakon0.rada.gov.ua/laws/show/1699-18>.

¹⁵² Закон України "Про внесення змін до деяких законів України щодо доступу до публічної інформації у формі відкритих даних" № 319-VIII від 9 квітня 2015 року, <http://zakon3.rada.gov.ua/laws/show/319-19/ed20150409>.

¹⁵³ Постанова КМУ від 21 жовтня 2015 р. №835 "Про затвердження Положення про набори даних, які підлягають оприлюдненню у формі відкритих даних", <http://zakon5.rada.gov.ua/laws/show/835-2015-%D0%BF>.

¹⁵⁴ Закон України "Про внесення змін до деяких законодавчих актів України щодо посилення прозорості у сфері відносин власності з метою запобігання корупції" №597-VIII від 14 липня 2015 року, <http://zakon2.rada.gov.ua/laws/show/597-viii>.

¹⁵⁵ Білан Олена та ін.. "5 Реформ, які змінюють Україну", VoxUkraine, 7 січня 2016, <https://archive.voxukraine.org/2016/01/07/5-reform-yaki-zminiuyut-ukrainu-ua/>.

easier to detect corrupt officials, as today it's harder to hide the property that may have been acquired as a result of corrupt practices¹⁵⁶.

In June 2014, the Cabinet also created an institution responsible for disseminating open data. In accordance with the government's decision, the State Agency for Science, Innovation and Informatization of Ukraine was transformed into the State Agency for E-Governance in Ukraine. The new central executive authority was entrusted with the functions of implementing state policy in the field of informatization, e-governance, formation and use of national information resources, and the development of a digital society¹⁵⁷.

In April 2014, the Unified State Open Source Web Portal (<http://data.gov.ua/>), designed on the basis of similar Internet resources of other countries (for example, the data.gov portal in the United States created in 2009), was launched. As of January 2018, the portal contains more than 28,000 data sets from about 2,000 information administrators¹⁵⁸. All data is divided into 15 categories: construction, state, environment, economy, land, youth and sports, education and culture, health care, taxes, agriculture, social protection, standards, transport, finance, and justice. In December 2016, there were only 8,500 data sets (from almost a thousand administrators)¹⁵⁹, which can testify how rapidly the portal is filled with information.

Specific attention should be paid to specialized open source data portals that have been created over the last three years. First and foremost, it is the Unified web-portal of public funds use, in which information is published in accordance with the law On the Openness of the Use of Public Funds (adopted in February 2015)¹⁶⁰. Already in September 2015, the ministry has presented the E-data portal (<https://spending.gov.ua/>), which is an important anticorruption tool. Access to information on the use of funds by the main spending units, the Pension Fund authorities, funds of compulsory state social insurance is unlimited and free of charge, which enables monitoring and evaluation of the efficiency of public expenditures. Since September 15, 2017, the portal has moved from the test mode to production operations, and all public funds managers now must disclose the necessary information through the portal¹⁶¹. At that time already, the portal was the largest open source of data on public finance¹⁶². In addition, the State Treasury Service annually publishes data on the fulfillment of the central and local budgets on its website. The availability of public data on public finances reduces opportunities for

¹⁵⁶ Шабунін Віталій, "Відкритий реєстр власності захистить майно біженців зі Сходу та Криму", Українська правда, 22 липня 2014, <http://www.pravda.com.ua/columns/2014/07/22/7032658/>.

¹⁵⁷ Постанова КМУ від 4 червня 2014 р. №255 "Деякі питання діяльності центральних органів виконавчої влади", <http://zakon4.rada.gov.ua/laws/show/255-2014-%D0%BF>.

¹⁵⁸ Єдиний державний веб-портал відкритих даних, <http://data.gov.ua/>.

¹⁵⁹ "Уряд схвалив постанову щодо упорядкування роботи Єдиного державного порталу відкритих даних", Асоціація міст України, 1 грудня 2016, <https://www.auc.org.ua/novyna/uryad-shvalyv-postanovu-shchodo-uporyadkuvannya-roboty-yedynogo-derzhavnogo-portalu-vidkrytyh>.

¹⁶⁰ Закон України "Про відкритість використання публічних коштів" № 183-VIII від 11 лютого 2015 року, <http://zakon2.rada.gov.ua/laws/show/183-19>.

¹⁶¹ Наказ Міністерства фінансів "Про впровадження у промислову експлуатацію Єдиного веб-порталу використання публічних коштів" №771 від 14 вересня 2017.

¹⁶² "У Міністерстві фінансів України пройшла прес-конференція з нагоди другої річниці проекту e-data". 18 вересня 2017, https://spending.gov.ua/news?p_auth=6WSDiGE1&p_p_id=newsportlet_WAR_EdataPortletportlet&p_p_lifecycle=1&p_p_state=normal&p_p_mode=view&p_p_col_id=column-1&p_p_col_count=2&newsportlet_WAR_EdataPortletportlet_javax.portlet.action=actionItemNews.

abuse in the adoption and fulfillment of budgets at both central and local levels, which will contribute to more efficient use of the budget funds¹⁶³.

Work is ongoing on the integration of the Public Finance Portal, the State Treasury Service and the ProZorro system, which will allow tracking the flow of funds from a tender announcement to payment¹⁶⁴. Even today, the openness of data on public procurements through Prozorro systems allows monitoring and evaluating their effectiveness, as well as identifying possible schemes and corruption risks. A Public Procurement Analysis Module (<https://bi.prozorro.org>) was launched to evaluate data related to procurement.

An example of the anticorruption orientation of the ongoing change is the opening of data on ultimate beneficiaries of Ukrainian companies for public access¹⁶⁵. Ukraine was one of the first countries to introduce the latest FATF requirements for beneficiary owners¹⁶⁶. In October 2014, parliament passed a law that included the term "ultimate beneficiary" and disclosure requirements for end-owners¹⁶⁷. Within a few months after the change in legislation¹⁶⁸ the term "ultimate beneficial owner (controller)" (instead of "ultimate beneficiary") was introduced, and private legal entities were required to submit details of the end-owners by September 25, 2015. As of early February 2018, only about 17,000 companies in Ukraine failed to provide information about their beneficiaries¹⁶⁹. In the summer of 2017, the database of ultimate beneficiaries was placed on the Unified State Open Data Portal. In addition, Ukraine became the first country to join the Global Register of Beneficiary Owners. The Open Government's international multilateral initiative called this change "a great victory for the implementation of the principles of transparency and accountability."¹⁷⁰

Also, in an effort to raise effectiveness of the NBU's oversight over banks, in March 2015, parliament strengthened bank shareholders' and management's liability, specifically, established criminal liability of bank's related persons for any actions that led to declaring bank insolvent, if it caused significant material damage to the state or the lender. In April 2016, the NBU completed the major portion of work on the disclosure of the Ukrainian banks' ownership structure, which resulted in identifying actual

¹⁶³ Global experience proves that countries with higher fiscal transparency tend to have better credit ratings, more sound fiscal discipline and lower level of corruption. See: Farhan Hameed. Fiscal Transparency and Economic Outcomes, December 2005, <https://www.imf.org/external/pubs/ft/wp/2005/wp05225.pdf>.

¹⁶⁴ Усі відкриті дані про державні фінанси об'єднують на одному порталі. Texty.org.ua. 15 вересня 2017, http://texty.org.ua/pg/news/textynewseditor/read/79619/Vsi_vidkryti_dani_pro_derzhavni_finansy_objednaju.

¹⁶⁵ Єдиний державний реєстр юридичних осіб, фізичних осіб-підприємців та громадських формувань, <http://data.gov.ua/passport/73cfe78e-89ef-4f06-b3ab-eb5f16aea237>.

¹⁶⁶ Свінцицький Андрій, "Розкриття бенефіціарних власників: формальність на формальність", ЛігаЗакон./ http://uz.ligazakon.ua/ua/magazine_article/EA007997.

¹⁶⁷ Закон України "Про внесення змін до деяких законодавчих актів України щодо визначення кінцевих вигодоодержувачів юридичних осіб та публічних діячів" №1701-VII від 14 жовтня 2014 року, <http://zakon5.rada.gov.ua/laws/show/1701-18/ed20141014>.

¹⁶⁸ Закон України "Про внесення змін до деяких законодавчих актів України щодо забезпечення діяльності Національного антикорупційного бюро України та Національного агентства з питань запобігання корупції" №198-VII від 12 лютого 2015 року, <http://zakon5.rada.gov.ua/laws/show/198-19>; Закон України "Про внесення змін до деяких законів України щодо відомостей про кінцевого бенефіціарного власника (контролера) юридичної особи" №475-VIII від 21 травня 2015 року, <http://zakon3.rada.gov.ua/laws/show/475-19>.

¹⁶⁹ Компанії без бенефіціарів: хто за це відповідає, Opendatabot, 6 лютого 2018, <https://opendatabot.com/blog/147-no-beneficiaries>.

¹⁷⁰ Ukraine opened up its beneficial ownership data: why it matters and how your country can be next, Open Government Partnership, June 08, 2017, <https://www.opengovpartnership.org/stories/ukraine-opened-its-beneficial-ownership-data-why-it-matters-and-how-your-country-can-be-next>.

controllers of each bank, and even imposed on some banks disciplinary measures prescribed by legislation.¹⁷¹

Some experts opine, that disclosure of information about beneficiary owners is a rare case where Ukrainian legislation is ahead of the global transparency standards¹⁷². The introduction of the relevant changes into Ukrainian laws was an edge over the EU Money Laundering Directive, which introduced a requirement to establish a register of ultimate owners in member countries (adopted in May 2015).¹⁷³ Meanwhile, unlike in Ukraine,¹⁷⁴ in the EU, access to such information may be limited by online registration, payment of administrative fees and the need to provide rationale for the inquirer's legitimate interest.¹⁷⁵ In the USA, such legislative initiatives are still in the process of discussion, whereas Ukraine has become a role model of reform implementation. In particular, examples of a few other countries and Ukraine are mentioned in the justification to the bill S. 1454 (presented to the US Senate in May 2017), which addresses, among other issues, the disclosure of businesses' beneficiary owners¹⁷⁶. At the same time, Ukraine still lacks the tools for verifying beneficiary owners, which is an important prerequisite for transforming existing information into a genuine tool for fighting corruption. For example, some types of data that have been included in the "Provision on the data sets to be published in the open source format" has yet to be made public.

It should be noted that open data not only enhances the possibilities of combating corruption, but also contributes to economic growth. According to some estimates, in 2017, open data has already brought the Ukrainian economy USD 700 MN. At the same time, if the pace of the relevant developments is maintained, this indicator may grow to USD 1.4 BN by 2025 (0.92% of GDP).¹⁷⁷ Therefore, support of the open data dissemination and the development of tools for their analysis should remain a priority in the field of combating corruption in the coming years. The Anticorruption Strategy for 2018-2020 should also include specific steps to that effect, but none of these have been included in the published draft document.¹⁷⁸ Consequently, open data directly and indirectly will contribute to Ukraine's economic growth.

UKRAINE'S OPEN DATA RATINGS

The progress made by Ukraine in reforming the area of open data has been reflected in the improvement of the relevant international ratings. According to the Open Data Barometer study (prepared by an international non-governmental organization World Wide Web Foundation), Ukraine ranked 44th in their rating in 2016, which is 18 ranks higher than in 2015.¹⁷⁹ The organization's experts highly praised Ukraine for the introduction of open data in the areas of business registration, primary

¹⁷¹ "НБУ заявив про завершення основного етапу розкриття власників українських банків". УНІАН. 4 квітня 2016. <https://economics.unian.ua/finance/1309261-nbu-zayaviv-pro-zavershennya-osnovnogo-etapu-rozkrittya-vlasnikiv-ukrajinskih-bankiv.html>.

¹⁷² Розкриття бенефіціарних власників, Sayenko Kharenko Newlaw Firm, <https://www.sk.ua/ua/news/2906>.

¹⁷³ Розкриття бенефіціарних власників: формальність на формальність, http://uz.ligazakon.ua/ua/magazine_article/EA007997.

¹⁷⁴ Розкриття бенефіціарних власників, Sayenko Kharenko Newlaw Firm, <https://www.sk.ua/ua/news/2906>.

¹⁷⁵ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849>.

¹⁷⁶ S. 1454, Congress.gov, <https://www.congress.gov/bill/115th-congress/senate-bill/1454/text>.

¹⁷⁷ Ковальчук Артур, Ханжин Віктор, Кудлатський Ярослав. Економічний потенціал відкритих даних для України. ТАРАС, 2018, <http://tapas.org.ua/wp-content/uploads/2018/04/1524641131.pdf>.

¹⁷⁸ Проект Закону України "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2018 - 2020 роки", <https://nazk.gov.ua/proekt-zakonu-ukrayiny-pro-zasady-derzhavnoyi-antikorupciynoyi-polityky-v-ukrayini-antikorupciyna>.

¹⁷⁹ The Open Data Barometer, http://opendatabarometer.org/?_year=2016&indicator=ODB.

and secondary education, criminal statistics and the state budget.¹⁸⁰ Meanwhile, serious issues with the openness of data on land ownership, geographic maps, healthcare system performance and a number of other areas still need to be addressed.

The progress of Ukrainian reforms in the open data field was recorded in the Global Open Data Index (GODI) rating, which is prepared by experts of an international non-governmental organization Open Knowledge International¹⁸¹. In their rating today, Ukraine ranks 31st (54th in 2015) and is one of the world leaders in the possibilities of using open data.¹⁸² GODI includes 15 categories of data in its assessment (i.e., state budget, state statistics, purchases, etc.). In several spheres (state budget, national legislation, and company registration) Ukraine ranks first,¹⁸³ since it made these data available for free use.

In addition, Ukraine outperforms the clear majority of countries worldwide in the disclosures on draft laws (7th place), state procurement (11th place) and state statistics (38th place). At the same time, serious gaps still exist in some other areas (i.e. air and water quality, geographic maps, and government expenditures).¹⁸⁴ Thus, future reform efforts should be aimed at the industries, where the biggest challenges with the openness of data are identified. This will allow Ukraine to go up further in the international ratings and improve its international image.

E-DECLARATION AS AN ELEMENT OF PUBLIC CONTROL

One of the key anticorruption innovations was the creation of the Unified State Register of Declarations of persons authorized to perform functions of the central or local government.

Previously, the system of declaring incomes of officials existed in a paper form¹⁸⁵. Paper declarations were submitted to the HR department of the state authority, where the employee worked, and were kept there. The tax service checked and validated the declarations, but for obvious reasons, the effectiveness of this work was rather low. In addition, Ukrainian legislation did not criminalize the submission of knowingly false data, therefore officials could underreport their property and income.

In view of these and other circumstances, the 2014-2017 Anticorruption Strategy set as priority the need for introduction of the electronic declaration system and the unified electronic database of declarations¹⁸⁶.

The new format of the declaration has considerably expanded the categories of assets subject for declaring. Whereas earlier a paper declaration consisted of six chapters, the present one consists of 16. In particular, new sections have appeared on the beneficiary ownership in legal entities and on property, intangible assets, and unfinished construction sites.¹⁸⁷ In addition, the electronic format of declarations and the launch of the unified portal expanded public access to information on government officials, which is an important anticorruption tool.

¹⁸⁰ Ukraine. Country Detail. The Open Data Barometer, http://opendatabarometer.org/4thedition/detail-country/?_year=2016&indicator=ODB&detail=UKR.

¹⁸¹ Methodology. The Global Open Data Index, <https://index.okfn.org/methodology/>.

¹⁸² Places. The Global Open Data Index, <https://index.okfn.org/place/>.

¹⁸³ A few countries may share one rank.

¹⁸⁴ Places. The Global Open Data Index, <https://index.okfn.org/place/>.

¹⁸⁵ Хоменко Святослав, "Що таке е-декларування і в чому його проблема?", BBC Україна, 28 жовтня 2016, http://www.bbc.com/ukrainian/politics/2016/10/161028_e_declarations_sx.

¹⁸⁶ Закон "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2014-2017 роки" від 14 жовтня 2014 № 1699-VII, <http://zakon0.rada.gov.ua/laws/show/1699-18>.

¹⁸⁷ "Що таке е-декларація і чому їх подача так лякає високо посадовців", CorruptUA, 15 липня 2016, <http://corruptua.org/2016/07/shho-take-e-deklaratsiya-i-chomu-yih-podacha-tak-lyakaye-visokoposadovtsiv/>.

The register became operational in August 2016 in accordance with the law On Prevention of Corruption.¹⁸⁸ Responsibilities for keeping the register were entrusted to the National Agency for the Corruption Prevention (NACP),¹⁸⁹ a central executive body in charge of the formation and implementation of the anticorruption policy. The NACP was established in March 2015 (under the CMU Regulation "On the Establishment of a National Agency for the Prevention of Corruption"¹⁹⁰ and the Law of Ukraine "On Prevention of Corruption"), and launched in March 2016 after appointment of the quorum of the agency's members.¹⁹¹

Despite technical problems, in September-October 2016, the first stage of submission of e-declarations for 2015 took place. The registry claimed that documents were filed by more than 118,000 persons¹⁹². Meanwhile, effective as of January 1, 2017, the circle of subjects of e-declaration has been substantially expanded.¹⁹³ **As result over 1.5 MN of electronic documents have been uploaded, including 1.2 MN documents to be presented annually, As of April 2018 the quantity of uploaded documents has already exceeded 2.5 MN declarations and clarifications to declarations.**

It should be noted that in March 2017 parliament Rada adopted amendments to the law "On Prevention of Corruption", which obliged anticorruption activists to submit e-declarations. Such changes caused criticism of the activists themselves and international partners of Ukraine. Various draft laws cancelling electronic declaration for anticorruption activists or changing the law in force have been submitted to parliament. However, Ukrainian lawmakers did not resolve this issue until the end of the period of electronic declaring (by April 1, 2018).¹⁹⁴

The Unified State Register of Declarations portal provides online access and search tools for open data contained in electronic declarations. With time, the Registry will be integrated with other databases,¹⁹⁵ which will enable automated cross-checks of the submitted declarations. However, the system of automated verification of declarations is not yet operational. As a result, the NACP was able to check only a few thousands declarants (mainly the declarations of those hired as civil servants¹⁹⁶), which is only a small part of the total number of documents filed. Therefore, many problems still need to be addressed to enable effective use of the data. In addition the problem of mandatory e-declarations for anticorruption activists has to be finally resolved.

¹⁸⁸ Закон України "Про запобігання корупції" від 14 жовтня 2014 року № 1700-VII, <http://zakon5.rada.gov.ua/laws/show/1700-18>, Рішення НАЗК "Про початок роботи системи подання та оприлюднення декларацій осіб, уповноважених на виконання функцій держави або місцевого самоврядування" №958/29088 від 15 липня 2016 року, <http://zakon5.rada.gov.ua/laws/show/z0958-16>.

¹⁸⁹ НАЗК, <https://nazk.gov.ua/>.

¹⁹⁰ Постанова КМУ "Про утворення Національного агентства з питань запобігання корупції" від 18 березня 2015 року № 118, <http://zakon5.rada.gov.ua/laws/show/118-2015-%D0%BF>.

¹⁹¹ "З обранням ще двох членів було запущено роботу НАЗК", Демократичне врядування, права людини і розвиток громадянського суспільства: Портал практик, 17 березня 2016 р., <http://dhrp.org.ua/uk/news/1109-20160317-ua>.

¹⁹² "Перший етап подання е-декларацій за 2015 рік завершився – понад 118 тисяч документів", Радіо Свобода, 31 жовтня 2016 р., <https://www.radiosvoboda.org/a/news/28084759.html>.

¹⁹³ "НАЗК: з 1 січня 2017 року значно розшириться коло суб'єктів е-декларування", НАЗК, 16 листопада 2016 р., <https://nazk.gov.ua/news/nazk-z-1-sichnya-2017-roku-znachno-rozshyrytsya-kolo-subyektiv-e-deklaruvannya>.

¹⁹⁴ "НАЗК підтримує скасування е-декларування для громадських активістів", Дзеркало тижня, 1 лютого 2018 р., <https://dt.ua/POLITICS/nazk-pidtrimuye-skasuvannya-e-deklaruvannya-dlya-gromadskih-aktivistiv-267916.html>; "Рада може розглянути скасування е-декларування для громадських активістів", Радіо Свобода, 3 квітня 2018 р., <https://www.radiosvoboda.org/a/news/29141432.html>.

¹⁹⁵ Єдиний державний реєстр декларацій. Про реєстр, <https://public.nazk.gov.ua/>.

¹⁹⁶ "У НАЗК говорять, що не перевірили жодну декларацію в повному обсязі", Еспресо, 29 березня 2017 р., https://espresso.tv/news/2017/03/29/u_nazk_govoryat_scho_ne_perevirly_zhodnu_deklaraciyu_v_povnomu_obsyazi.

NEXT STEPS

The Anticorruption Strategy for 2014-2017 states that the provision of open access to publicly important information was recognized as a priority area for action in the field of preventing corruption. The necessary legislation was adopted, an open source portal was created and access to a number of databases was granted. These changes have been reflected in the improvement of several Ukraine's international ratings. However, the reforms must keep up their impressive pace in order to safeguard these achievements and attain further progress in ensuring openness of information. Open data should remain one of the priorities of the anticorruption policy, in particular to be included in the new anticorruption strategic documents. It should be noted that the draft Anticorruption Strategy for 2018-2020 (published in September 2017)¹⁹⁷ no longer contained measures to ensure access to information, although reforms in this area are far from being complete. What should be done now is the following:

- Legislative changes are needed to have in place guarantees of the proper quality of open data and access to it. In particular, it is necessary to remove overlapping functions of the registries and toughen responsibility for failure to comply with the requirements of the relevant legislation.¹⁹⁸
- Monitor the dynamics of international ratings (Open Data Barometer and Global Open Data Index) to determine the priorities for disclosures. Ukraine is the world's leader in providing access to information on certain parameters (i.e. state budget, national legislation, and company registration), while significantly lags behind on others (environmental data, geographic maps, and health care). Filling the "white spots" should be a priority in maintaining transparency of governance. In some cases, this requires changes to the legislation and creation of the appropriate infrastructure.
- Properly (financially and technically) provide for operations of the state registries, which should facilitate the increase in the data volume and quality. Today, some state registries are incomplete, which makes using them difficult. For example, only 7% of the cultural landmarks have been recorded in the State Register of Immovable Cultural Heritage¹⁹⁹.
- Design appropriate data analysis tools, to allow effective use of a body of open data that became available as a result of the reform. In addition, it is necessary to ensure the integration of databases, which will improve data analysis capabilities.

¹⁹⁷ "Проект Закону України "Про засади державної антикорупційної політики в Україні (Антикорупційна стратегія) на 2018-2020 роки", НАЗК, <https://nazk.gov.ua/proekt-zakonu-ukrayiny-pro-zasady-derzhavnovyi-antikorupciynoyi-polityky-v-ukrayini-antikorupciyna>.

¹⁹⁸ Дар Грищенко. "Руководитель портала публичных финансов E-data Александр Щелоков: открытые данные в Украине вроде бы есть, но на деле все они – фикция". Українські новини. 1 грудня 2017 р., <https://ukranews.com/interview/1821-aleksandr-shhelokov-otkrytye-dannye-v-ukrayne-vrode-by-est-no-na-dele-vse-ony-fykcyya>.

¹⁹⁹ "До Держреєстру занесені трохи більше 7% пам'яток – Мінкульт", Укрінформ, 15 лютого 2018 р., <https://www.ukrinform.ua/rubric-culture/2403838-do-derzreestru-zaneseni-trohi-bilse-7-pamatok-minkult.html>.

SECTION 7. DEREGULATION IN THE SYSTEM OF ANTICORRUPTION MEASURES

International studies demonstrate that excessive regulation of business activity promotes corruption. The more procedures a business needs to go through and the longer these procedures take, the more likely it is that the level of corruption in the country is high. This assumption is backed by findings of the 2009 World Bank Investment Climate Research Study.²⁰⁰ The cause and effect link here works in both directions: government regulation of business generates corruption, and corruption can lead to the government introducing a regulation promoting one company or sector at the expense of others or at the expense of the population in general²⁰¹. That is why deregulation is an important tool in the anticorruption framework, as it reduces the possibilities for abuse. In this section, we will focus on the achievements and challenges of deregulation as a policy measure aimed at curbing corruption in the country.

DEREGULATION AND BUSINESS ENVIRONMENT

According to the 2020 Strategy, deregulation is designed to create a comfortable business climate by eliminating excessive administrative burdens on business and reducing excessive business control by simplifying procedures and is one of the key areas of the state's economic policy.

Deregulation directly translated into the reduction of corruption. According to the analytical report "2016/2017 Annual assessment of the business climate: National and regional dimensions," entrepreneurs often complain at complicated and obscure regulations, that one can't follow, at burdensome procedures, pushing entrepreneurs to seek "relief" through informal and excessive payments to the decision-making officials. Therefore, it is not surprising that the deregulation, which is the reduction in the number of documents required from entrepreneurs, ranks first among the reforms that SMEs consider to be of paramount importance. This was quoted by 81.8% of the respondents.

In the four years since the Revolution of Dignity and the change in the political regime in the country, Ukraine has risen in the World Bank Doing Business ranking by 38 positions from 112 in 2014 to 76 in 2018. It is expected that Ukraine may improve its ranking further.

During 2014-2017, significant efforts were made to simplify terms of doing business. Principal achievements of deregulation in 2014-2017 were the reduction of regulations and regulatory requirements, fewer administrative services and their improved accessibility for both general public and business. In particular, MEDT²⁰² reported cancellation of over 15,000 Soviet-era GOSTs and revocation of over 90% requirements for mandatory certification, which enabled agribusinesses save about UAH 7 BN per year on certification procedures, and the adoption of the Strategy of the technical regulation system reform. The quantity of "mandatory" administrative services dropped from 116,000 to 1,000. In addition, a public database of comprehensive inspections was created and the reform of the supervisory (control) bodies was initiated. Through liquidation of the state company Ukrecoreursy, a corrupt scheme was eliminated.

²⁰⁰ Madani D. "Restrictive regulation is positively correlated to corruption," October 12, 2009, <http://blogs.worldbank.org/psd/restrictive-regulation-is-positively-correlated-to-corruption>.

²⁰¹ Bédard M., Less regulation and more competition to curd corruption, MEI, May 2016, https://www.iedm.org/sites/default/files/pub_files/lepoint0816_en.pdf.

²⁰² Презентація МЕРТ на XXI засіданні Національної ради реформ, 29 серпня 2016 р., https://issuu.com/mineconomdev/docs/nrc_deregulation_print_2016-08-27.

The Government's 2017 Performance Report²⁰³ mentions cancellation of 450 obsolete regulatory acts that limited and imposed additional administrative burden on the Ukrainian business. The editorial paper of the analytical center VoxUkraine²⁰⁴ of December 22, 2017, claims that in the four years the number of licensed activities reduced from 56 to 33. In addition, the number of activities requiring permits decreased from 143 to 85. Moreover, in July 2017, a network of administrative service centers was set up with 701 local operational centers.

In late 2017, at long last, simplified registration of the pharmaceuticals that were registered with the competent authorities of the United States, Switzerland, Japan, Australia, Canada and registered centrally by the competent authority of the EU, was introduced. This happened as a result of the Law (No. 1396-VIII dated 31.05.2016) enacted in 2016 and the adoption of relevant regulations. Such changes are intended to increase access of Ukrainian patients to medicines and to reduce corruption in the field of registration of new medical products.

As noted above, contacts between business people and representatives of the supervisory bodies during inspections represent a significant source of corruption in the business environment. In late 2016, the government built a legal foundation for the reform of state supervision (control). In particular, the law On Amendments to the Law of Ukraine On the Basic Principles of State Supervision (Control) in the Area of Economic Activity regarding liberalization of the state supervision (control) system in the field of economic activity" of 03.11.2016, the law On Amendments to Certain Legislative Acts of Ukraine on Improvement of Legislation in the Area of State Supervision (Control) of 03.11.2016, and the law On Temporary Features of Implementing State Supervision (Control) Measures in the area of economic activity of 03.11.2016 were adopted. The authors of the "2016 Monitoring of the Progress of Reforms" report prepared by the National Council of Reforms²⁰⁵ estimated that "the reduction in the number and duration of inspections alone will save UAH 0.5 BN per year for Ukrainian businesses, not to mention fines and bribes." A number of regulatory acts on deregulation of economic activity adopted in 2017 also targeted this area of state supervision. Of particular interest here is the launch of an integrated public database of inspections, giving all interested persons free on-line access to information about state supervision (control) measures. Moreover, a methodology was adopted to help the control authorities determine the permissible frequency of business inspections, as well as the procedure for implementing comprehensive planned state supervision (control) measures. The latter sets the procedure for holding comprehensive scheduled control measures on a business simultaneously by all supervisory bodies. In addition, other important normative acts were approved, including: economic entities were allowed to engage the MEDT and DRSU to inspections, to make sure the supervisory bodies adhere to legislative requirements during their inspections; the procedure for submitting documents to the licensing body was simplified (according to a unified procedure, documents are submitted in an electronic format through the Uniform State Portal of Administrative Services, and should not be duplicated in paper form); and public access to information about urban planning documentation was opened through a new web-based service on the Ministry of Regional Development, Construction and Housing and Communal Services website.²⁰⁶

In addition, the development of e-governance, as a mechanism for reducing the frequency of contacts between an individual and an official should be mentioned, as it also mitigates the risks of corruption. In particular, the State Agency for E-Governance is now up and running, portals through which

²⁰³ Звіт Уряду про результати роботи у 2017 році, <https://www.kmu.gov.ua/ua/news/zvit-uryadu-za-2017-rik>.

²⁰⁴ "Three Years of Reforms. Has Ukraine Reformed Enough for Surviving," VoxUkraine, 2017, <https://voxukraine.org/longreads/three-years-of-reforms/index-en.html#form>.

²⁰⁵ Моніторинг прогресу реформ 2016, http://reforms.in.ua/sites/default/files/upload/full_ukr_20_02_2017.pdf.

²⁰⁶ Information borrowed from clarification on the portal LigaZakon "On certain aspects of the state economic activity deregulation policy– 2017" http://uz.ligazakon.ua/ua/magazine_article/EA010404.

administrative services can be used are evolving, and individual identity systems, such as BankID and MobileID are spreading. Thus, according to MEDT in mid-2016, 16 administrative services were accessible for businesses in an electronic format. In 2017, the intensive implementation of e-services continued, granting the possibility to register a business, obtain licenses and many other official documents on-line. Today, by our estimates there are 39 administrative services that can be obtained electronically.

Meanwhile, it is necessary to deepen the implementation of deregulation measures. According to DRSU information²⁰⁷ on the progress of implementation of the Government's plan for deregulation of economic activity²⁰⁸ out of 112 points of the plan, 48 were executed, 9 are a work in process, while the rest, and this is about half of the planned, have not been fulfilled. The need to proceed with deregulation more aggressively was demonstrated by the findings of the 2nd wave of the "Annual Assessment of the Business Climate", where 73.2% of SME managers reported they did not feel the effect of deregulation on their own business, however, 9.8% indicated their life became slightly easier thanks to the deregulation. Those who felt the positive impact of deregulation quoted specifically the moratorium on inspections, less bureaucracy and fewer permits, the creation of an electronic paper flow system, the simplification of tax administration and streamlined registration procedures as most successful measures.

One of the markers of deregulation is the time that entrepreneurs spend on dealing with government officials, the so called "time tax." According to the 2nd Annual Assessment of the Business Climate, managers of SMEs spent 14.3% of their time on average to communicate with the authorities, which does not differ from 14.6%, found out in the first wave.

There is a statistically significant difference in this indicator between enterprises of different forms of ownership. While individual entrepreneurs spend on dealing with state authorities 10.9% of the time on average, legal business entities spend 15.6% of their time. Recalculated per employee, the smaller is the enterprise, the more time tax it faces. Thus, for microenterprises the time tax is 5.7% on average, for small companies - 0.8%, and for medium-sized - 0.2%. According to the first wave results, these figures were 2.9%, 0.6% and 0.2%, respectively. Similar to the cost of regulation, the time tax has slightly increased for microenterprises and has not actually changed for small and medium enterprises, which once again testifies to the need to intensify deregulation measures primarily affecting micro and small enterprises.

BUSINESS CLIMATE AND CORRUPTION ASSESSMENT

In 2017, the IER completed the analysis of findings of a major study of small and medium-sized enterprises (SMEs) in Ukraine as part of the second wave of the Annual Business Climate Assessment conducted by the IER within the USAID LEV Program²⁰⁹. Despite the common perception that the business climate in the country does not improve or even worsens, the IER's findings, based on the estimates and expectations of SMEs representatives across all regions of the country, indicate the opposite.

The respondents "perceive" that the business climate is gradually improving. The national business climate index, measured on a scale from -1 (very poor) to +1 (very good), in the 2016/2017 wave of "Annual Business Climate Assessment" rose to +0.06 compared to +0.01, reported in the 2015/2016

²⁰⁷ Звіт "Стан виконання Плану заходів щодо дерегуляції господарської діяльності, затвердженого розпорядженням Кабінету Міністрів України від 23 серпня 2016 р. № 615-р. на 20 травня 2018 року", <http://www.drs.gov.ua/deregulation/plan-deregulyatsiyi-2016-2017-rr/>.

²⁰⁸ План затверджено розпорядженням №615 Кабінету Міністрів України від 23 серпня 2016 р.

²⁰⁹ See details at USAID LEV Program, <http://www.lev.org.ua/abca>.

annual evaluation. This index is a complex indicator, which consists of four assessments: the business environment in general, business activity in the short and long term, and regulatory procedures. Three of the four index components have improved. And although negative assessments of the business environment outweighed positive ones, they look better than a year ago. The most important driver in this assessment is business's optimism. Despite all problems faced by SMEs, they are optimistic about their production plans with 47.8% of respondents intending to expand their operations in the next two years, and only 10.2% anticipating contraction of their business within this term. Of note, this is the best of all expectations measured in this study and this trend has signs of sustainability. Thus, in the first wave of the "Annual Business Climate Assessment" in 2015/2016, "optimists" also outnumbered the "pessimists" significantly: 53% of SMEs planned to expand their activities in the biennial prospect, and 8% planned to reduce it. Most optimists can be found among small and medium enterprises. Although the balance of "long-term" optimism has somewhat deteriorated in the 2nd wave of the study compared to the 1st wave (+45 vis-a-vis +38), and there are reasons for that, which will be discussed below, let's admit the fact that business climate in the perception of the SMEs is gradually improving.

The SMEs optimism/pessimism is affected by a number of problems. Among the 22 issues that are included in the Business Impact Assessment, according to the "Annual Business Climate Assessment" 2016/2017, the top ten include a lack of demand, political instability, high tax rates, complex tax administration and accounting, inflation, frequent changes in the business-related legislation, high regulatory pressure, corruption, the war in the East, and the lack of qualified personnel. In one year between the 1st and 2nd waves the top 10 have changed: the political and macroeconomic situation has stabilized, and business as a part of society is adapting to the war. Meanwhile, the importance of such factors as lack of demand and shortage of labor force have increased significantly. This shows that, benefiting from somewhat stabilized general political and macroeconomic environment, SMEs began realizing their business expansion plans, while suffering from a lack of production inputs and the customer demand, primarily, domestic, which is too weak to let them implement their ambitions. Obviously, this problem is complex and is rooted both in the demand (limited resources) and supply sides (quality of goods and services).

Observing the situation in the Ukraine's SME sector we can't but should say a couple of words about corruption. Both in the 1st and 2nd waves of the Annual Business Assessment, corruption steadily ranked eighth in the rating, and the number of SMEs that choose it as a barrier has not virtually changed with 23.4% in the 1st wave and 22.6 % in the 2nd. Very often SMEs are compelled to try to "fix" the situation with informal payments due to complex and contradictory regulations, obscure rules and procedures and high fines for minor mistakes. Thus, in the 1st wave of the "Annual business climate assessment," 56% of SMEs agreed that entrepreneurs tend to avoid real inspections and therefore give bribes.²¹⁰ Some 44% of the interviewed SMEs are convinced that it is necessary to have informal relations with representatives of the authorities in order to run business successfully. This indicator has gone down compared to 2015: according to the " Business Opinion Survey " conducted by the IER quarterly,²¹¹ in 2015, 48.5% of the surveyed business managers believed that "friendly terms" with representatives of the government bodies and supervisory bodies were crucial if one was to succeed in business.

By results of the 1st wave of the "Annual Business Climate Assessment," between 6% and 24% of the interviewed representatives of SMEs reported they paid bribes and "voluntary contributions" in 2015 while passing through certain regulatory procedures. Moreover, unlike the established legislative rules

²¹⁰ Кузяків О. Беспалько В. Дубровський В. Федець І. "МСП та держава: як відновити взаємну довіру?", Консультаційна робота, Київ 2017, http://www.lev.org.ua/ua/articles/pp_SME_state_trust.html.

²¹¹ "Дослідження ділової думки", Інститут економічних досліджень та політичних консультацій, http://www.ier.com.ua/ua/proekt_dilova_dumka.

and procedures, corrupt "practices" did not make them feel uncomfortable,²¹² with only 8% of the respondents in the quantitative survey reported difficulties related to the need to pay bribes, that is, everything was quite understandable and predictable. Results of the Annual Business Climate Assessment of 2016/2017 demonstrate that in 2016, these quantitative characteristics did not change substantially, and the share of SMEs reporting bribes and voluntary contributions in 2016 with the passage of certain regulatory procedures ranged between 5.5 and 26%.²¹³

The data provided earlier testifies to the need for further steps to tame the bribe-taking officials, and the urgent need for systematic measures towards the creation of zero-level tolerance for corruption among businesses.

The time and money spent by SMEs on regulatory compliance represent the same regulatory pressure that ranked 8th in the rating of barriers included in the Annual Business Climate Assessment. The IER analytical report Annual Business Climate Assessment 2016/2017: National and Regional Dimensions evaluated this burden based on the SMEs' responses regarding time and money they spend on completing main regulatory procedures (including administering of taxes). The resulting figure was UAH 27,412, which is somewhat lower than UAH 29,761 derived in the first wave of the study, one year earlier. At first glance, it may not look as a heavy load. However, the picture will be completely different if take this figure recalculated on a per employee basis. The numbers will be quite impressive with UAH 6,853 per employee for a micro business, UAH 1,142 for small and UAH 264 for medium-sized. This means that a micro business carries a much bigger load than small and medium-sized companies, on top of its costs related to its direct business. Meanwhile, let's remember, that in quantitative terms, microbusiness represents the largest share of the local SME sector.

NEXT STEPS

Along with the need of stepping up the implementation process for deregulation in accordance to Government Plan, it is essential to use the tools of social influence and control over implementation of appropriate regulation practice and to implement EU practices for assessment of regulatory acts impact on business. In particular, wide use of M-test²¹⁴ to perform the systemic assessment of impact of new regulations on business will make it possible to detect and cancel the regulations in a timely manner if they generate corruption opportunities and add more burden on business. An important thing for assessment and measurement of deregulation measures efficiency and establishment the environment conducive for doing business would be an assessment of deregulation measures effectiveness, from the business point of view, with the help of regular representative surveys of business of all sizes, with the focus on small and mid-size businesses. Special attention is to be paid to further reforming in the system of Government supervision and control, which is as a factor of corrupt pressure on business, to shifting the emphasis in the work of the state supervision bodies from punishment to prevention of legislative violations, improvement in the risk based approach to Government control and supervision,

²¹² "Щорічна оцінка ділового клімату 2015", Київ 2015, <http://www.lev.org.ua/abca>.

²¹³ An exception here is one of the procedure related to recommissioning of premises after a major repair, which grew to 46%. This, however, required further scrutiny in 2017 results. Business are expected to recognize effects of a significant reduction in the number of permits for construction, which was reflected in the World Bank's Doing Business 2017 Rating for Ukraine. Source: Analytical Report "Annual Business Climate Assessment 2016/2017.

²¹⁴ "М-тест - інструмент державної регуляторної політики", 2015, <http://www.dkrp.gov.ua/files/d83dc3efae.pdf>.

and creation and launch of the integrated automated system of government supervisions and control. Making the tax administration simpler and customs reform are also important from the standpoint of reducing the regulatory pressure on business. Relevant are also the steps towards zero tolerance to corruption among all strata of Ukraine's population.

SECTION 8. GOVERNANCE OF STATE-OWNED ENTERPRISES (SOES)

Although Ukraine has been making privatization efforts for many years, its public sector is still quite large. According to the Ministry of Economic Development and Trade (MEDT), today there are 3,392 public companies with aggregate assets worth of UAH 1.6 TN.²¹⁵ EU countries with the largest public sectors are Poland and Hungary (with 301 and 371 public companies, respectively). The number of SOEs in other countries does not exceed a hundred. There are 71 SOEs in Germany, 74 in Latvia and 90 in the Czech Republic.

According to MEDT, monitoring data for the first nine months of 2017, only 1,611 companies are operational, of which 1,056 enterprises make profits.²¹⁶ 1,362 enterprises ceased operations and no information is available on the remaining 419 companies. Meanwhile, only 22 management entities (out of 84 entities that manage state-owned objects) had their management effectiveness assessed as 'positive'. Another 22 were assessed 'negative,' and 37 as 'adequate.' The inefficient work of state-owned enterprises results in losses for the nation. IMF estimated that in 2017 subsidies, tax privileges and financial aid to state enterprises amounted to about 5% of GDP.²¹⁷ These enterprises are a source of social problems: they are responsible for UAH 848 MN of wage arrears.

Inefficient work of the enterprises is often explained by their management's low interest to work more efficiently, while many of them use these companies as an instrument for building corrupt schemes. In fact, this phenomenon is known as "state capture."²¹⁸ For example, directors of companies or the so-called "controllers-coordinators" often use companies to generate additional income on top of their official salary, which, moreover, is not often based on the enterprise's performance. According to the website "Nashi Groshi (Our Money)," the most common corrupt schemes are non-transparent tenders with overstated value of purchases or purchasing through intermediary firms, which increases the tendered price. It is important to remember that SOEs are a source of corruption risks and losses for the state primarily due to inadequate controls and non-transparency of their operations.²¹⁹ Thus, according to NABU and Transparency International Ukraine, state-owned enterprises are among the largest corrupt "feed boxes" in Ukraine.²²⁰

Government began taking more active efforts to improve corporate governance at state-owned enterprises in 2016. At that time, as a result of the initiative led MEDT with the support of experts from EBRD, the World Bank, the IMF and the EC, the legislative framework for the reform of public enterprise governance²²¹ was established. To implement the legislation, the Cabinet adopted a number of regulations in March 2017. **The purpose of the reform of SOE governance was defined as the prevention of political interference and corruption, the delimitation of the roles of the regulator and the owner and the introduction of globally recognized corporate governance standards.**

The new model of SOE governance is based on three pillars:

²¹⁵ Моніторинг ефективності управління об'єктами державної власності, <https://goo.gl/WmgmNv>.

²¹⁶ Of note, according to MEDT, 33 of the largest 100 public companies were loss-makers. <https://www.kmu.gov.ua/storage/app/media/reforms/top-100-naybilshikh-derzhpidpriemstv-ukraini.pdf>

²¹⁷ "Як державні підприємства отруюють економіку. Що ховається за "простими" заявами про переваги та недоліки роботи державних підприємств", УКМЦ: Case-Ukraine, Ціна держави, проект "Захальна книжечка", <http://longread.uacrisis.org/dp>.

²¹⁸ *State capture* refers to efforts of businesses to shape laws, policies and regulations to receive private benefits by government officials.

²¹⁹ Реформа управління державними підприємствами, <https://www.kmu.gov.ua/ua/diyalnist/reformi/prodazh-neefektivnogo-derzhavnogo-majna>.

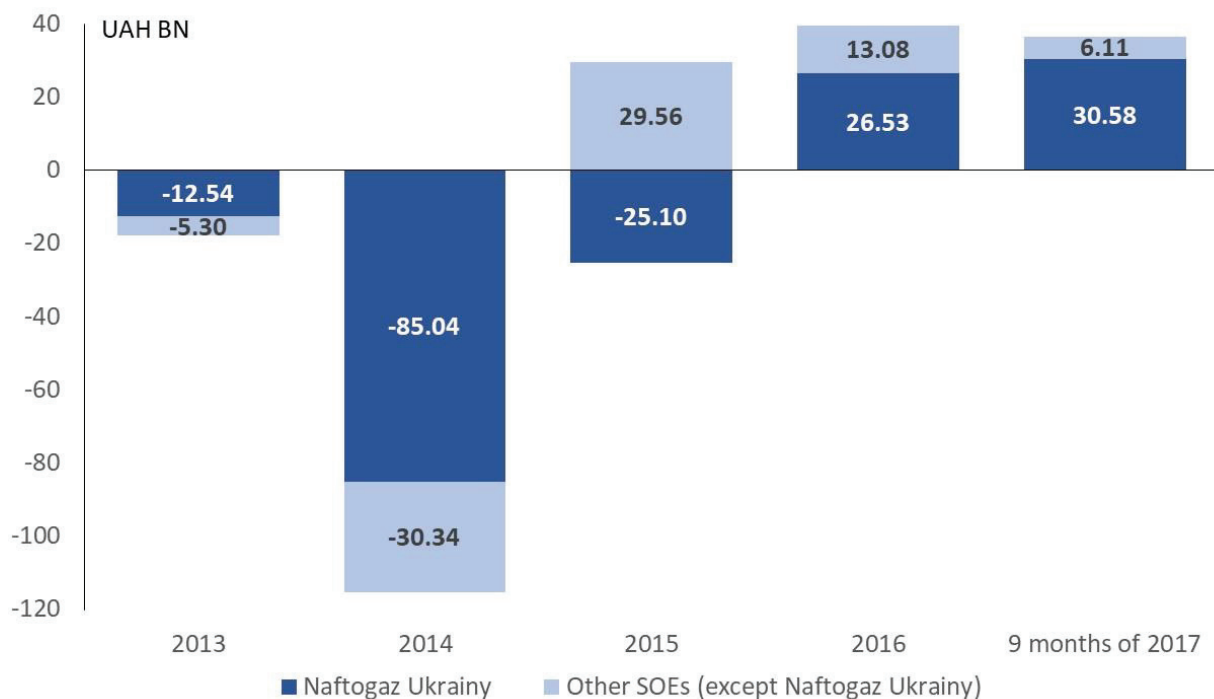
²²⁰ Юрчишин Ярослав, <https://goo.gl/wWPpDr>.

²²¹ Закон України № 1405-19 від 2 червня 2016 року, <http://zakon2.rada.gov.ua/laws/show/1405-19>.

1. **Strategic planning.** Effective strategic planning enables to set forth clear and understandable commercial and non-commercial goals for state-owned companies. This, in turn, will enable the evaluation of performance in proper way. In addition, of crucial importance is the issue of transparency in the enterprise. To this end, a requirement was introduced whereby companies have to disclose their financial and non-financial information of material importance. However, only 70% of state-owned companies have registered at the public funds use portal²²².
2. **Setting up independent supervisory boards.** Formation of independent supervisory boards (for the top 40 SOEs), which will take over the key HR and control powers currently exercised by the ministries and government agencies, is an extremely important element of the reform. It is the supervisory boards that will be responsible for appointing company managers, conduct of company's performance evaluation, and selecting the auditor.
3. **Development of an incentives system for members of supervisory and management boards.** Members of already functioning supervisory and management boards (in particular, at Naftogaz) were offered competitive wages, which helped to recruit high-caliber professionals to the boards.

Naftogaz and Ukrposhta may be recognized as successful pilot companies in the field of corporate governance reform.

Figure 7. Net financial results of state-owned enterprises for 2013 - 9 months 2017, UAH BN



Source: MEDT, Naftogaz

Over recent years, we observed improved financial performance of state-owned enterprises because of better management, and, in the case of Naftogaz, due to increased natural gas prices. This contributed

²²² Індекс неперозорості державних підприємств. Проект "Ціна держави", <http://cost.ua/dp/>.

to an increase in revenues to the State Budget in the form of taxes and dividends paid by state enterprises.

Further efforts as part of the SOE governance reform will ensue from the privatization law passed in January 2018.²²³ When the government was drafting this law, they wanted to build state property management on the principle of triage where some companies would be sold, some - liquidated and the remainder will have their corporate governance considerably enhanced. Accordingly, it is expected that the government will approve special decisions regarding these three groups and will take appropriate steps. Of note, by January 1, 2021, the buyers of privatized SOEs will be entitled to demand that the privatization body includes a clause into the sale contract stipulating that the relations between the parties should be governed by the law of England and Wales. Also, under the law, the government should prepare a list of small-scale privatization objects (i.e. companies with assets for the last year, worth no more than UAH 250 MN) within five months, and a list of large privatization objects - within eleven months. Small-scale privatization will be carried out with the help of ProZorro.Sales, which has already proved its effectiveness in providing the best selling price at transparent tenders. Prime Minister Groisman is confident that privatization of SOEs will become a strong anticorruption step.²²⁴

NEXT STEPS

In general, SOE governance reform has only begun. It is imperative for the government to successfully privatize state-owned enterprises, which will narrow the opportunities for corruption and state capture. The corporate governance at companies remaining in the state ownerships should be improved. An important prerequisite for success of this reform is the clear division of powers among various authorities, which in one way or another regulate the activities of state-owned enterprises. These steps are long awaited in Ukraine. Ukraine's international partners, in particular the IMF and the European Commission are looking forward to them, too.

²²³ Закон "Про приватизацію державного і комунального майна", №2269-19 від 18 січня 2018 року, <http://zakon3.rada.gov.ua/laws/show/2269-19>.

²²⁴ Ефір 112 каналу. "Ексклюзив. Гройсман о принятии закона о приватизации госимущества", 18 січня 2018 р., <https://goo.gl/D8bx74>.

SECTION 9. NBU EFFORTS: THE ANTICORRUPTION CONTEXT

BANKING SYSTEM: CLEANUP AND REHABILITATION

Prior to 2014 crisis, a large portion of Ukrainian banks did not work as traditional banking institutions. Usually a bank attracts free deposits from the public (or other bank lenders) and loans the funds to enterprises and individuals in need of liquidity. Ukrainian banks employed additional bank business models. Some banks were instruments for carrying out such illegal actions as converting cash in Ukrainian hryvnias into US dollars. A number of banks actually worked as "vacuum cleaners:" they *sucked in* depositors' money to use them mainly for making cheap loans to businesses run by the bank owners.

Loans were generally provided at rates lower than market rates and, as a rule, without adequate collateral. Often, these loans were collateralized with illiquid objects (such as a stadium) or securities of the companies which might have a "market value" formally, but had no physical assets. Another option was to use a "friendly" assets evaluator, who could "inflate" on paper the actual value of the collateral. Credits were also often issued to "void" companies, which, as in the previous case, did not own any assets. All this made it possible not to repay loans, for example, if the bank became insolvent, or when the owner lost control over it. Under such conditions, when the economic situation turns bad, the owner of the bank faces a conflict of interests with its depositors, as the owner is interested in saving his own business, including at the expense of the bank and its depositors. Even if the owner of the bank is an honest person, the bank's fate depends directly on the financial condition of the bank owner's other business, which is borrowing from the bank.

This was exactly the case notwithstanding the limitations imposed on loans to insiders (no more than 30% of a bank's capital,²²⁵ or 4-5% assets of the bank).²²⁶ Although NBU conducted hundreds of inspections of banks annually,²²⁷ banks belonging to so-called "oligarchs" until 2014 continued operating without changes. Many of these banks circumvented these limitations thanks to their opaque ownership structure²²⁸ or by taking advantage of the unclear legislative written definition of "insider." At that time, however, the NBU did not make changes to its regulations or propose amendments to the law "On Banks and Banking." It may be an indication of existing corrupt practices in NBU's banking supervision framework.

Significant changes in adequate identification of bank owners occurred in 2015. Amendments to the law On Banks and Banking were adopted²²⁹ and the appropriate regulation was released by the NBU²³⁰. By the end of 2015, over 90% banks disclosed their owners, and in 2016 the process of establishing bank owners was completed and this information was disclosed by the NBU.²³¹ In parallel, in 2015 and 2016, the NBU conducted audits of the volume of loans issued to related parties. A significant part of

²²⁵ Інструкція про порядок регулювання діяльності банків в Україні (редакція чинна на 1 січня 2013 року) затверджена постановою НБУ № 368 від 28 серпня 2001 р., <http://zakon.rada.gov.ua/go/z0841-01/ed20130101>.

²²⁶ Значення економічних нормативів по системі банків України за 2018 рік, <https://bank.gov.ua/doccatalog/document?id=34661578>.

²²⁷ For example, 511 inspection audits in 2013 and 536 audits in 2012 according to NBU's annual reports

²²⁸ For example, Ukrainian LLCs with offshore owners registered as owners of a bank, or banks reported they did not have majority shareholders with stakes over 10%, and instead registered ownership to a bank in the name of 11 or more people (a whole football team).

²²⁹ Див. Закон №2121-III від 07 грудня 2015 р., <http://zakon.rada.gov.ua/go/2121-14/paran91#n91>.

²³⁰ Положення про визначення пов'язаних із банком осіб затверджене постановою НБУ №315 від 12 квітня 2015 р., <http://zakon.rada.gov.ua/go/v0315500-15>.

²³¹ Структури власності банків України, https://bank.gov.ua/control/uk/publish/article?art_id=6738234&cat_id=51342.

banks with opaque ownership structure and a large portfolio of related parties' loans shut down before these audits were finished. In total, out of 180 banks operating in Ukraine in early 2014, only 82 remained in the market in March 2018. Of the 99 banks, where the NBU was able to complete the audit by January 1, 2017,²³² 44 banks had their portfolios of related party loans in excess of the allowed maximum. Privatbank is the best-known example of such a bank; it had 97% of related party loans by the NBU's estimates. Of the 44 banks with large portfolios of related party loans, most are working with the NBU on fulfillment of three-year plans to bring the level of loans to related parties to the level prescribed by regulatory requirements.

Table 3. Findings of the banks diagnostics in terms of related party loans

# Banks that underwent diagnostics	99
# Banks with exceeded maximum identified, of these	44
Withdrew from the market	4
Compliant with regulatory requirements	4
Regulator approved three-year plans to reduce the related party exposure	8
Three-year plans to reduce the related part exposure is under review of the regulator	15
Three-year plans are in the process of preparation	13

Source: NBU 2016 Annual Report

In general, the transparent ownership structure of banks has significantly mitigated the corruption risks for banking supervision and may potentially boost growth of loans to enterprises not related to the owners of banks. The Credit Register Law²³³ recently adopted by the parliament will enable the NBU to control loans to related parties in a close to real time mode.

NEXT STEPS

Most of the "oligarchic" banks remaining in the market are still working on reducing their exposure to related parties. To supervise fulfillment of these obligations and prevent the restoration of this modus operandi in banks is a key component of the NBU's mandate as the banking regulator. To this end, it is important to preserve the independence of the NBU and continue working on expanding its institutional capacity, because compliance with the law is impossible without professional and uncorrupt banking supervision.

²³² Річний звіт НБУ за 2016 рік, <https://bank.gov.ua/doccatalog/document?id=49064031>.

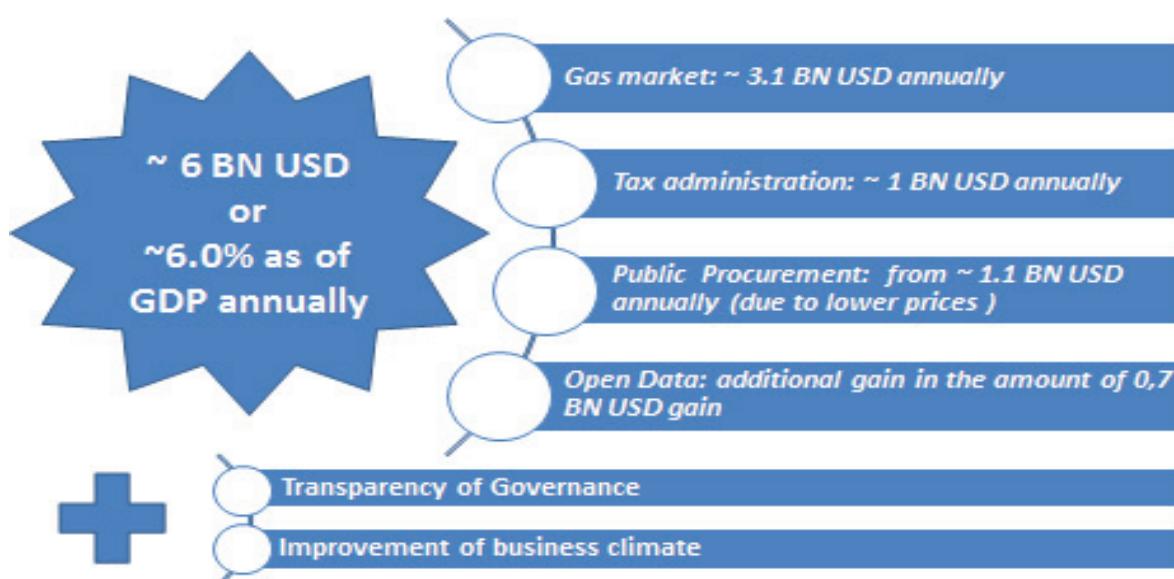
²³³ Закон № 2277-VIII від 6 лютого 2018 р. про внесення змін до деяких законів України щодо створення та ведення Кредитного реєстру Національного банку України та вдосконалення процесів управління кредитними ризиками банків, <http://zakon.rada.gov.ua/go/2277-19>.

GENERAL REMARKS/CONCLUSIONS

The preliminary findings of the analysis demonstrate that Ukraine has made significant progress in overcoming corruption through a radical change in the rules of the game in the public procurement and gas markets, improvement of tax administration and the introduction of the unparalleled in the history of Ukraine public access to information.

The Institute for Economic Research and Policy Consulting stated that the total economic gain from anticorruption measures is preliminarily estimated at 6% of GDP, or USD 6 BN.

Figure 8. Economic effect of anticorruption measures undertaken in 2015-2017



Source: own calculations

For detailed description of the effects see Appendix 3, Table 1.

This work is the first attempt to evaluate anticorruption measures quantitatively and qualitatively. Given the scale and complexity of the task, and the availability of reliable information, we had objective reasons to limit the scope of our analysis. Meanwhile, we can already draw some conclusions that must be taken into account in the development of medium- and long-term anticorruption policy in Ukraine and in further analysis.

1. In the historic dimension, between 2014 and 2018, Ukraine made an unprecedented large number of anticorruption steps. The analysis proved that where there is political will, one may take difficult political and legal decisions and truly change principles and form of the public administration in a manner that will enable it to at least substantially limit rent-seeking activities, if not eliminate corruption altogether.

Risks:

- The slow down in Ukraine's reforms is the greatest threat to the country today, as unreformed and corrupted state has no historical perspective;
- The transformation of a real fight against corruption into an instrument of unfair political (e.g. requiring mandatory declaration of the status of anticorruption activists) and economic competition;
- Lack of a comprehensive strategic approach to fighting corruption: elimination of conditions (reform of state governance), punishment of corrupt officials (reform of the law-enforcement system as a whole and ensuring the effective work of newly created anticorruption bodies) and maintaining zero tolerance to corruption in the society.

2. In general, today we can say that Ukraine is successfully overcoming inherited political corruption in the form of vertically integrated schemes, the totality of which was the basis of the public administration previously.

This process took place under extremely difficult political conditions, and therefore the achieved results without exaggeration can be considered unprecedented in the history of Ukrainian reforms.

Risks:

- Lack of "sustainable" political consensus on the content and tools for fighting corruption
- Stakeholders' attempts to establish and pursue political control over bodies of state power (state capture) and anticorruption institutions in particular.

3. This progress in the period 2014-2017 is reflected in Ukraine's improved position in the Corruption Perception Index and a number improved indicators assigned by various international organizations (Table 1). Of course, the pace of overcoming corruption and observance of the principle of the rule of law does not yet meet the expectations of the Ukraine society and international partners. Nevertheless, Ukraine has, in fact, started to fight corruption. It is now up to the authorities and society to do their utmost to make this process powerful and irreversible.

Risks:

- Establishment of political control over anticorruption bodies or discrediting their activities through manipulations with civil society initiatives and discrediting public activists
- Failure to settle a number of problems that newly established anticorruption bodies have already run into (for example, the inability to check electronic declarations of civil servants, etc.)
- Lack of adequate response to the emergence of new corruption schemes

4. Meanwhile, the scale of large-scale and petty (small) corruption continues to be substantial. Counteracting the relevant schemes, in our opinion, is among the top priorities of the anticorruption agenda.

As Ukrainian practice shows, overcoming, or, at least, minimizing, "decentralized" corruption remains a strategic challenge for Ukraine. The effectiveness of the relevant anticorruption measures will directly determine the level of trust or distrust of the society to the government with all relevant political consequences.

Risks:

- Lack of effective actions to combat large-scale and petty corruption
- Low efficiency of anticorruption bodies activities in the medium term
- Public disappointment with the ability of the state (government) to effectively fight corruption

5. With the creation of the Anticorruption Court in Ukraine, the formation of a full institutional framework for detecting acts of corruption and punishing corrupt officials will be completed. Obviously, it takes time to build an anticorruption law enforcement system. Until it begins operating effectively, changes in the mechanisms and procedures of economic government will not be enough to overcome corruption, as the new corruption-free rules of the game will require solid legal protection.

Risks:

- Transformation of anticorruption law enforcement agencies into hostages of political struggle
- Lack of proper coordination among law-enforcement agencies
- Failure to ensure the inevitability of punishment for those responsible for corruption crimes

6. Adequately "designed" and implemented reforms are the best tool to prevent corrupt behavior at all levels of government. Therefore, anticorruption audits of relevant decisions (strategic documents of economic policy, laws, regulations, orders, and orders) should become an integral part of the political process. Their absence or mere formal existence will discredit both the results achieved in the fight against corruption and of the state's anticorruption policy as such.

Speaking about reforms, in our opinion, the following areas have the largest anticorruption potential today: public administration, public finances, energy sector, and governance of state-owned enterprises, control functions of the state, regulatory environment, digital public services, and stakeholder engagement with the government.

Risks:

- The slow down in Ukraine's reforms in general and anticorruption measures in particular
- Inconsistency of legislative and executive actions
- Loss of support from the international community (Ukraine fatigue syndrome)

7. Ukrainian practice shows that, although almost all Ukrainian political forces recognize the fight against corruption as one of the key challenges facing Ukraine today, the adoption of appropriate decisions becomes a matter of political struggle with opponents and an instrument of political self-defense.

The lack of a real anticorruption consensus within the Ukrainian political elite compromises the effectiveness of anticorruption policy, threatens the achievements of the anticorruption fight and slows down the anticorruption progress of Ukraine.

Risks:

- Forthcoming presidential and parliamentary elections provoke politicians to increasingly resort to populist rhetoric and work mainly for their own political image;
- Lack of strategic vision of the Ukrainian politicum and society, which should view anticorruption reforms as a long and complicated process, the success of which is conditioned by the adoption of politically unpopular and difficult decisions, while the positive effect of these actions can only materialize in the medium and long term;
- Underestimation of the fact that combating corruption is not only a political but also an intellectual challenge for the authorities.

8. The successful struggle against corruption is impossible without the support of civil society. Nowadays, civil society plays an increasingly more important role in the life of Ukraine as a whole and in the fight against corruption, a circumstance not always adequately perceived by many influential political players. Taking into account Ukrainian realities, constructive cooperation between politicians, government officials and civil activists is not only a prerequisite for a successful struggle against corruption, it is also an instrument for securing the sustainability of anticorruption policies in the medium- and long-term and the irreversibility of resulting changes.

In conclusion, strategically, Ukraine must nurture zero tolerance of its people to all manifestations of corruption. To achieve this, it is necessary to change the ideology and state governance framework in such a way that all Ukrainian citizens could be confident that being honest is prestigious, rewarding and safe.

Table 4. Anticorruption measures: economic effect

Nº	Sector	Goal	Measure (what was done)	Anticorruption effect
1.	Gas market	Creation of a full-fledged gas market	1.1. Gas prices equalization for different categories of consumers	1.1.1. Reduction of price arbitrage opportunities
			1.2. Tearing up product sharing agreement	1.2.1. Reduction of price arbitrage opportunities
			1.3. Revision of gas supply contracts with RF	1.3.1. Depoliticization of gas relations with Russia
			1.4. Use of alternative sources of gas supply to Ukraine	1.4.1. Minimizing opportunities to enjoy corruption rent due to existence of monopolistic supplier
			1.5. Reforming corporate governance of Naftogaz	1.5.1. Reducing intracompany corruption space 1.5.2. Strengthening company's resilience to external political influences that finally result in appearance of various corruption schemes
2.	Tax administration	Elimination of tax holes and conversion platforms	2.1. Introduction of VAT electronic administration	2.1.1. Deshadowing of financial flows 2.1.2. Minimizing the scale of "scheme-based" (fictitious) tax credits
			2.2. Introduction of risk monitoring system related to VAT administration	2.2.1. Deshadowing of financial flows 2.2.2. Minimizing the scale of "scheme-based" (fictitious) tax credits
			2.3. Introduction of automatic VAT refund	2.3.1. Deshadowing of financial flows

				2.3.2. Minimizing the scale of “scheme-based” (fictitious) tax credits 2.3.3. Reduction of corruption tax
3.	Public procurement	Creation of transparent, open and competitive public procurement market	3.1. Introduction of ProZorro electronic public procurement system 3.2. Creation of public procurement monitoring system under Ukraine's State Audit Office 3.3. Creation of Dozorro - specialized monitoring portal for procurement 3.4. Procurement of medicines by international organizations	3.1.1. Ensuring direct competition among the suppliers 3.2.1. Identification of risks of abuse related to public procurement and risk minimization <u>throughout all stages</u> of procurement process 3.3.1. Public control over public procurement by all the parties concerned 3.4.1. Break-up of political corruption
4.	Public Governance	Opening of state registers and other data related to public governance and ensuring equal access to data for all interesting parties	4.1. Compilation of the list of Data Sets to be released in the Form of Open Data 4.2. Creation of Unified state open data portal and specialized open data portals 4.3. Creation of Unified State Register of Declarations of Persons Authorized to Perform Functions of the Central or Local government	4.1.1. Minimizing opportunities to manipulate and abuse the data 4.1.2. Broder opportunities for public control over <u>regulatory and administrative authorities</u> 4.2.1. Ensuring equal access to data for all interesting parties. 4.3.1. Prevention of abuses by officials
5.	Regulatory climate	Elimination of excessive administrative burden and excessive control over business operations through the simplification of the relevant procedures	5.1. Deregulation 5.2. Provision of administration services in electronic format 5.3. Simplification of procedures related to registration of <u>pharmaceutical products</u> of foreign origin in Ukraine	5.1.1. Decrease of compliance costs for business 5.2.1. Automatic provision of administrative services without «intermediation» of authorized representative of the state 5.3.1. Reducing procedures related to bringing foreign pharmaceuticals to Ukrainian market

6.	Management of state enterprises	Preventing political interventions and corruption in the sector, delimitation of the function of the regulator and the owner, implementation of internationally recognized corporate management standards	6.1. Corporate governance reform	<p>6.1.1. Reducing intracompany corruption space</p> <p>6.1.2. Strengthening companies' resilience to external political influences that finally result in appearance of various corruption schemes</p>
7.	Banking sphere Goal:	Cleaning up banking sector from the institutions serving for their owners as a tool to implement various schemes of abuse	<p>7.1. Introduction of mandatory identification of ultimate beneficiaries</p> <p>7.2. Resolving the problem of third party lending</p>	<p>7.1.1. Transparency of ownership structure of banking institutions as a factor of increasing banking supervision efficiency</p> <p>7.2.1. Prevention of various abuses by bank owners</p>

APPENDIX 2

Table 5. Some conviction statistics for the most wide spread corruption crimes (2010-2017)

Years	Cases closed/ persons acquitted	Convicted	Including those who were convicted			
	Of those who faced the court		Sentenced to prison / fine	Released from punishment	Deprived of holding the office right as additional punishment	Inflicted the softer than law prescribed punishment
Misappropriation of assets via office abuse (Parts 2–5 Article 191 CC)						
2010	388 (19%)/ 6 (0, 3%)	1641 (80,6%)	130 (7,9%) / 122 (7,4%)	1349 (82,2%)	839 (51,1%)	394 (24,0%)
2011	569 (26,6%) ²³⁴ / 8 (0,4%)	1560 (73,0%)	215 (13,8%) / 170 (10,9%)	1104 (70,8%)	1014 (65,0%)	326 (20,1%)
2012	415 (22,7%) / 3 (0,2%)	1411 (77,1%)	263 (18,6%) / 104 (7,4%)	961 (68,1%)	978 (69,3%)	356 (25,2%)
2013	248 (18,6%) / 12 (0,9%)	1072 (80,5%)	132 (12,3%) / 104 (9,7%)	814 (75,9%)	905 (84,4%)	245 (22,9%)
2014	265 (22,9%) / 14 (1,2%)	876 (75,9%)	91 (10,4%) / 66 (7,5%)	689 (78,6%)	637 (72,7%)	149 (17,0%)
2015	163 (21,8%) / 13 (1,7%)	571 (76,5%)	59 (10,3%) / 47 (8,2%)	448 (78,5%)	446 (78,1%)	83 (14,5%)
2016	111 (26,3%) / 17 (4,0%)	294 (69,7%)	39 (13,3%) / 25 (8,5%)	208 (70,7%)	237 (80,6%)	43 (14,6%)
2017	95 (29,4%) / 24 (7,4%)	204 (63,2%)	33 (16,2%) / 6 (2,9%)	150 (73,5%)	176 (86,3%)	17 (8,3%)

²³⁴ Of 569 – 144 due to the change in situation , 66 –released on bail, and 302 – amnesty.

Years	Cases closed/ persons acquitted	Convicted	Including those who were convicted			
	Of those who faced the court		Sentenced to prison / fine	Released from punishment	Deprived of holding the office right as additional punishment	Inflicted the softer than law prescribed punishment
Abuse of power or abuse of office (Article 364 CC)						
2010	397 (35,8%) / 4 (0,4%)	708 (63,8%)	45 (6,3%) / 85 (12,0%)	559 (79,0%)	374 (52,8%)	195 (27,5%)
2011	499 (39,6%) / 4 (0,3%)	757 (60,1%)	131 (17,3%) / 81 (10,7%)	502 (66,3%)	506 (66,8%)	169 (22,3%)
2012	370 (40,2%) / 8 (0,9%)	543 (58,9%)	79 (14,5%) / 53 (9,8%)	378 (69,6%)	390 (71,8%)	121 (22,3%)
2013	115 (25,8%) / 14 (3,1%)	317 (71,1%)	38 (12,0%) / 14 (4,4%)	253 (79,8%)	252 (79,5%)	48 (15,1%)
2014	137 (48,7%) / 11 (3,9%)	133 (47,3%)	14 (10,5%) / 9 (6,8%)	102 (76,7%)	105 (78,9%)	14 (10,5%)
2015	64 (56,6%) / 6 (5,3%)	43 (38,0%)	4 (9,3%) / 2 (4,6%)	33 (76,7%)	37 (86,0%)	1 (2,3%)
2016	46 (59,7%) / 9 (11,7%)	22 (28,6%)	0 / 1 (4,5%)	20 (90,9%)	20 (90,9%)	1 (4,5%)
2017	24 (50%) ²³⁵ / 8 (16,7%)	16 (33,3%)	2 (12,5%) / 1 (6,2%)	11 (68,7%)	13 (81,2%)	0
Acceptance of proposal, promise or obtainment of improper advantage by an official (Article 368 CC)						
2010	126 (13,8%) / 10 (1,1%)	774 (85,1%)	99 (12,8%) / 175 (22,6%)	488 (63,0%)	464 (59,9%)	163 (21,1%)

²³⁵ In 2017, there were 19,654 persons against whom criminal charges were dropped, or 20.2% of all persons arraigned in court.

Years	Cases closed/ persons acquitted	Convicted	Including those who were convicted			
	Of those who faced the court		Sentenced to prison / fine	Released from punishment	Deprived of holding the office right as additional punishment	Inflicted the softer than law prescribed punishment
2011	273 (26,0%) / 9 (0,9%)	767 (73,1%)	131 (17,1%) / 182 (23,7%)	429 (55,9%)	559 (72,9%)	151 (19,7%)
2012	103 (11,7%) / 5 (0,6%)	702 (79,7%)	137 (19,5%) / 183 (26,1%)	363 (51,7%)	594 (84,6%)	130 (18,6%)
2013	49 (6,2%)/ 7 (0,9%)	731 (92,9%)	103 (14,0%) / 193 (26,4%)	420 (57,5%)	638 (87,3%)	99 (13,5%)
2014	34 (7,0%) / 11 (2,3%)	439 (90,7%)	41 (9,3%) / 134 (30,5%)	267 (60,8%)	376 (85,7%)	45 (10,2%)
2015	8 (2,0%) / 11 (2,8%)	375 (95,2%)	59 (15,7%) / 178 (47,5%)	128 (34,1%)	334 (89,1%)	30 (8,0%)
2016	18 (5,9%) / 21 (6,9%)	264 (87,2%)	30 (11,4%) / 196 (74,2%)	29 (11,0%)	238 (90,1%)	11 (4,2%)
2017	13 (5,2%) / 18 (7,2%)	218 (87,5%)	24 (11,0%) / 163 (74,8%)	16 (7,3%)	194 (89,0%)	2 (0,9%)
Proposal, promise or giving improper advantage to an official (Article 369 CC)						
2010	36 [14] ²³⁶ (27,9%) / 0	93 (72,1%)	1 (1,1%) / 33 (91,7%)	19 (20,4%)	-	3 (3,2%)
2011	38 [4] (43,2%)	50 (56,8%)	3 (6,0%) /	18 (36,0%)	-	2 (4,0%)

²³⁶ In square brackets under Article 369 - the number of persons freed from criminal liability due to their voluntary confession statements sent to a pretrial investigation agency.

Years	Cases closed/ persons acquitted	Convicted	Including those who were convicted			
	Of those who faced the court		Sentenced to prison / fine	Released from punishment	Deprived of holding the office right as additional punishment	Inflicted the softer than law prescribed punishment
	/0		27 (54,0%)			
2012	13 [5] (13,7%) /0	82 (86,3%)	1 (1,2%) / 29 (35,4%)	44 (53,7%)	-	6 (7,3%)
2013	16 [11] (16,8%) /0	79 (83,2%)	4 (5,1%) / 37 (46,8%)	34 (43,0%)	-	5 (6,3%)
2014	46[41](30,2%) /1 (0,6%)	106 (69,2%)	7 (15,2%) / 38 (35,8%)	56 (52,8%)	-	12 (11,3%)
2015	42[34] (24,0%)/1 (0,6%)	123 (70,4%)	3 (2,4%) / 79 (64,2%)	35 (28,4%)	-	5 (4,0%)
2016	25 [21] (21,0%) / 2 (1,7%)	92 (77,3%)	1 (1,1%) / 84 (91,3%)	4 (4,3%)	-	1 (1,1%)
2017	19 [15] (13,4%) / 5 (3,5%)	123 (86,6%)	4 (3,2%) / 110 (89,4%)	6 (4,9%)	-	0

Source: Court statistics: https://court.gov.ua/inshe/sudova_statystyka/

Table 2. Some statistics on the flow of criminal proceedings in the most common corruption crimes (2013-2017)

Years	Registered number of crimes	Number of crimes with the suspicion notification made	Number of crimes for which the proceedings with guilty verdict are sent to the court	Crimes for which the proceedings were closed under Points 1, 2, 4, 6 of Article 284 of the Criminal Procedural code of Ukraine
Misappropriation of assets via office abuse (parts 2–5 Article 191 CC)				
2013	13193	7926	7440 (56,4%)	5983 (45, 3%)

2014	10397	5651	4892 (47,0%)	3002 (28,9%)
2015	10211	4989	3672 (36,0%)	2255 (22,1%)
2016	9787	4741	3545 (36,2%)	1641 (16,8%)
2017	10756	5923	4701 (43,7%)	1660 (15,4%)
Abuse of power or office (Article 364 CC)				
2013	3810	697	636 (16,7%)	6753 (177,2%)
2014	2567	312	233 (9,1%)	2352 (91,6%)
2015	3078	261	187 (6,1%)	1847 (60,0%)
2016	3360	133	99 (2,9%)	1587 (47,2 %)
2017	3995	248	189 (4,7%)	1662 (41,6%)
Acceptance of proposal, promise or obtainment of improper advantage by an official (Article 368 CC)				
2013	1683	1114	1060 (63,0%)	1687 (100,2%)
2014	1535	990	859 (56,0%)	969 (63,1%)
2015	1588	909	730 (46,0%)	985 (62,0%)
2016	1578	758	594 (37,6%)	1069 (67,7%)
2017	2086	680	481 (23,1%)	878 (42,1%)
Proposal, promise or giving improper advantage to an official (Article 369 CC)				
2013	351	264	202 (57,5%)	315 (89,7%)
2014	390	282	183 (46,9%)	428 (109,7%)
2015	286	190	148 (51,7%)	389 (136,0%)
2016	430	207	148 (34,4%)	416 (96,7%)
2017	556	299	235 (42,2%)	312 (56,1%)

Source: Prosecutors statistics: <https://www.gp.gov.ua/ua/stat.html>

Table 6. Anticorruption measures: economic effect

№	Sector	Measure (what was done)	Anticorruption effect	Annual average economic effect in 2015-2017
1.	Gas market Goal: Creation of a full-fledged gas market	<p>1.1. Gas prices equalization for different categories of consumers</p> <p>1.2. Tearing up product sharing agreements</p> <p>1.3. Revision of gas supply contracts with RF</p> <p>1.4. Use of alternative source of gas supply to Ukraine</p> <p>1.5. Reform of corporate governance of Naftogaz</p>	<p>1.1.1. Reduction of price arbitrage opportunities</p> <p>1.2.1. Reduction of price arbitrage opportunities</p> <p>1.3.1. <u>Depoliticization</u> of gas relations with RF</p> <p>1.4.1. Minimizing opportunities to enjoy corruption rent due to existence of monopolistic supplier</p> <p>1.5.1. Reducing intracompany corruption space</p> <p>1.5.2. Strengthening company's resilience to external political influences that finally result in appearance of various corruption schemes</p>	<p>Measures undertaken resulted in elimination of annual losses in the amount of circa USD 3 BN:</p> <ul style="list-style-type: none"> - circa USD 2.82 BN due to overpayment for gas; - Naftogaz annual losses in the amount of USD 0.18 BN due to price arbitrage; - Annual losses from production sharing agreements in the amount of UAH 1 BN (up to USD 125 MN)
2.	Tax administration Goal: Elimination of tax holes and conversion platforms	<p>2.1. Introduction of VAT electronic administration</p> <p>2.2. Introduction of risk monitoring system related to VAT administration</p>	<p>2.1.1. Deshadowing financial flows</p> <p>2.1.2. Minimizing the scale of "scheme-based" (fictitious) tax credits (мінімізація схемного податкового кредиту)</p> <p>2.2.1. Deshadowing of financial flows</p> <p>2.2.2. Minimizing the scale of "scheme-based" (fictitious) tax credits</p>	<p>Additional budget revenues due to close up of conversion platforms and fight against scheme-based (fictitious) tax credits in the amount of USD 3 BN in 2015-2017</p>

		2.3. Introduction of automatic VAT refund	2.3.1. Deshadowing financial flows 2.3.2. Minimizing fake tax credit (мінімізація схемного податкового кредиту) 2.3.3. Reduction of corruption tax	
3.	Public procurement Goal: Creation of transparent, open and competitive public procurement market	3.1. Introduction of ProZorro electronic public procurement system 3.2. Creation of public procurement monitoring system under the State Audit Office of Ukraine 3.3. Creation of Dozorro - specialized monitoring portal for procurement 3.4. Procurement of medicines by international organizations	3.1.1. Ensuring direct competition among the suppliers 3.2.1. Identification of risks of abuse related to public procurement and risk minimization <u>throughout all stages of procurement process</u> 3.3.1. Public control over public procurement by all the parties concerned 3.4.1. Break-up of political corruption	Economy due to transition to new public procurement system makes saves USD 40 BN in 2015-2017 (USD 1.5 BN). Annual economy due to lower prices makes up USD 0.4-0.9 BN
4.	Public Governance Goal: Opening of state registers and other data related to public governance and ensuring equal access to data for all interesting parties	4.1. Compilation of the list of Data Sets to be released in the Form of Open Data 4.2. Creation of Unified state open data portal and specialized open data portals 4.3. Creation of Unified State Register of Declarations of Persons Authorized to Perform Functions of the Central or Local government	4.1.1. Minimizing opportunities to manipulate and abuse the data 4.1.2. Broder opportunities for public control over <u>regulatory and administrative authorities</u> 4.2.1. Ensuring equal access to data for all interesting parties. 4.3.1. Prevention of abuses of officials	According to some calculations, the economic effect of transition to open data made up USD 700 MN in 2017 while by 2025 this indicator may grow up to USD 1.4 BN <u>on an annualized basis</u>
5.	Regulatory climate Goal: Elimination of excessive	5.1. Deregulation 5.2. Provision of administration services in	5.1.1. Decrease of compliance costs for the business 5.2.1. Automatic provision of administrative services without «intermediation» of	SME regulatory compliance costs decreased from USD 1.363 to USD 1.073

	administrative burden and excessive control over business operations through the simplification of the relevant procedures	electronic format	authorized representative of the state	
		5.3. Simplification of procedures related to registration of pharmaceutical products of foreign origin	5.3.1. Reducing procedures related to bringing foreign pharmaceuticals to Ukrainian market	
6.	Management of state enterprises Goal: Preventing political interventions and corruption in the sector, delimitation of the function of the regulator and the owner, implementation of internationally recognized corporate management standards	6.1. Corporate governance reform	6.1.1. Reducing intracompany corruption opportunities 6.1.2. Strengthening company resilience to external political influences	Financial result of SOEs improved
7.	Banking sphere Goal: Cleaning up banking sector from the institutions serving for their owners as a tool to implement various schemes of abuse	7.1. Introduction of mandatory identification of ultimate beneficiaries 7.2. Resolving third party lending issues	7.1.1. Transparency of ownership structure of banking institutions as a factor of increasing banking supervision efficiency 7.2.1. Prevention of various abuses from the side of bank owners	
	Total			Est. USD 6.0 BN

