

**REGIONAL ECONOMIC DEVELOPMENT
PROGRAM IN EASTERN UKRAINE**

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PHASE I REPORT

**SUMMARY AND ANALYSIS OF THE KHARKIV
ECONOMY BY SECTOR**

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SUMMARY AND ANALYSIS OF THE KHARKIV ECONOMY BY SECTORS

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PREFACE

This report is a description and analysis of the Kharkiv regional (oblast) economy. The data presented are principally based on official statistics augmented from other sources when available. The primary breakdown of the economy is industry or sector. The regional economy Sector definitions are inevitably somewhat arbitrary. In this report, sector definitions are largely based on “common Glossary, Sectors of the national economy of Ukraine (Kyiv, 1994)” because these definitions are those used in reporting official statistical data in Ukraine. A summary of the overall Oblast economy and Current Trends of the Oblast Economy are presented as the first two profiles followed by 17 sector profiles.

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The Annexes contain non-sector reports on small and medium business, the legal framework for business and an analysis of labor data in five Eastern Ukraine oblasts. Also included is a compilation of approaches to economic development strategic planning.

The report is available in English and in Ukrainian and in several forms and formats: CD ROM disks containing the entire report in both languages from the organizations whose addresses are given below and downloadable files on the following web sites: www.usaid.kiev.ua, www.kmci.com.ua, and www.mendezengland.com. However, paper copies of individual sector profiles and individual annexes can be obtained from:

KMCI, 5 Petrovskoho St. Kharkiv, UA, (0572,28 20 11), and from

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**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**PROFILE OF THE KHARKIV OBLAST ECONOMY
(Introduction to the Sector Profiles)**

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

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Kharkiv - 2001

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1. Historical Stages of Kharkiv Oblast Economy Development

Kharkiv Oblast (Ukrainian for “province”; the Ukraine State Statistics Committee also uses the term “region”) was created as an administrative unit in 1932, when Kharkiv was the capital of Ukraine (1917-1934).

The first written document mentioning the City of Kharkiv is dated 1655. In 17th and 18th centuries Kharkiv Oblast was a typical agricultural region having a low urbanization level. However, the region’s favorable geographical position assisted rapid growth of its intermediate trade role between Eastern and Central Europe, the Black Sea frontier, the Caucasus, and central Russia. Kharkiv fairs were one of the factors that contributed to the region’s importance in the broader historical, cultural and geographical region of Slobidska Ukraine. Slobidska Ukraine now consists of the present territories of Sumy, Poltava, Luhans’k, and Donets’k oblasts of Ukraine, and the Belgorod and Voronezh Provinces of Russian Federation. [1, p. 11-12]

In the XVIII century Kharkiv College was the main educational center of Slobidska Ukraine. It is important to note its contribution to professional education: in 1765 additional classes were opened in engineering, artillery, geodesy, and cartography. The founding of Kharkiv University (now Kharkiv National University, named after V.N. Karazin) was an epochal event, not just for Kharkiv and Ukraine, but for the whole Russian Empire. Its grand opening occurred on January 29, 1805. In the 19th century, Kharkiv University played key role in the culture and education of the Left-Bank Ukraine. Moreover, it was the predecessor of almost all of the higher education institutions of the City of Kharkiv which, during the industrial period of society development, was the largest higher education center in Ukraine. [2, p. 17-20]

During last third of the 19th century, rapid industrial development of Kharkiv City and Kharkiv Oblast began. That was the period when the Kursk-Kharkiv-Azov railway was built (1869) and a number of large enterprises were founded in the city, including the railway-carriage repair works (1869), an iron foundry (1870), a farming machine plant, a steam-locomotive plant (1897), a rope plant (1895), a confectionery (1896). In Kharkiv Oblast, enterprises included the Guta Sugar Refinery (1869), the Budy Whiteware Plant (1885), and others. Natural sciences, social sciences and humanities were in the process of development. A number of scientific associations attached to the University were also founded, including: a naturalists association (1869), a medical association, an association of physical-chemical sciences (1873), a historical-philological association (1876), a mathematics association (1879), and an association of jurisprudence (1901). Training of engineers was developed through the founding of a technological institute in 1885 (now the National Technical University “Kharkiv Polytechnic Institute”).

At all times, favorable natural conditions of Kharkiv Oblast, namely invaluable black earth and also wide open space appropriate for trade, have attracted foreign businessmen. In its turn this incited much of industry, agriculture, transportation, trade and the municipal economy. At the end of the 19th century and at the beginning of the 20th, century industrial development of the region took place with the assistance of strongly growing foreign investments. In particular, foreign economic presence during this period of time played an important role in increasing the region’s economic growth and production volumes, transforming it from an agricultural economy into a region with a powerful industrial base. During this period of intensive development Kharkiv became one of the biggest industrial centers of the country. It is worth noting that the merger of the Gelverich-Sade farming machine plant and the Belgian joint-stock company led to the foundation of a new enterprise which remains one of the national leaders in the sphere of agricultural machine-building: the “Serp i Molot” joint-stock company. In 1915, the Leitner Bicycle Plant began operations; since 1923 it has been called the Kharkiv Bicycle Plant. “General Electric”, leader of electrical industries in the USA, began production in Kharkiv in 1915; today this factory is the well-known Kharkiv Electromechanical Plant. In fact, all of the industrial sectors were created with the assistance of foreign capital in the region: distilleries, tobacco factories, sugar-beet plants, printing plants, etc.

Post-revolutionary development of the Kharkiv Oblast economy, beginning in the 1920s and especially during the 1930s, was mainly directed at building industrial giants such as the tractor plant, machine-tool construction plant, bearing plant, turbogenerator pump plant, and many other large-scale plants. The Construction sector developed rapidly. A number of R&D organizations and institutions of higher education, including technological institutes and professional schools, were founded.

2. Current Problems in Kharkiv Oblast Economic Development

The current stage in the development of the Kharkiv Oblast economy started after Ukraine received its independence in 1991. An opinion widely popularized at the official level is that “the Kharkiv Oblast economy was the most vulnerable during the current crisis” because of the specific character of its role in the division of the labor system and its geographical position compared with other regions of Ukraine. Let’s take a closer look at that argument. The example given is mainly connected with the high degree of fusion of the regional economy to the former USSR economy, with substantial ratio of enterprises and organizations which were military-industrial establishments and also with a great number of enterprises meeting a capacious, stable, non-competitive market both for their own products and for their production inputs. A unique scientific and technical complex was developed here which exceeded the needs of the region and in some cases Ukraine itself. A diversified transportation infrastructure was created to serve industries located not only in Kharkiv Oblast but also in the neighboring economically developed regions. Activity of the construction sector had spread far beyond the bounds of Ukraine. In some cases these moments turned out to be the reasons of production reduction, of low level of current capacity usage, degradation of skilled potential. [3]

However, there was no fatal irreversibility of such losses, which are due mainly to erroneous trends in public economic policy and activities in the economic sphere of public administration. Once again the economy became a hostage of ideological policy and economic ignorance. In fact, one could foresee the consequences of the breakup of co-operative production relationships with enterprises of the republics of the former USSR. However, instead of developing efficient methods to preserve these connections, impractical projects for entering Western markets were suggested and accepted, and rapid fusion with the Western economy was attempted.

As for the attitude towards science and education, it should be mentioned that a great number of national leaders inherited a certain economic ignorance from the USSR administrative elite. They kept ignoring the fact that, according to modern scientific ideas, those employed in non-material production (teachers, professors, academics, cultural workers, doctors etc.) are occupied with productive work and make a huge contribution to the creation of the national product and income. Science, education, and health care still remain competitive, and are potentially the most effective sectors of the national economy. It is certain that a unique scientific and technological complex in Kharkiv Oblast that meets world standards can be regenerated. However, this will require fundamental changes in attitude and advancement of this sector into the center of economic policy and strategy of regional development. The same concerns apply to other key sectors of the Kharkiv Oblast economy.

3. Economic Results of Kharkiv Oblast in 2000

It should be noted that moderate growth in production volumes of industrial products was observed for two consecutive years. Production of consumer goods showed high dimensioned positive dynamics, with production growth rate 300% higher in 2000 in comparison with 1999. However, the real breakthrough was in food manufacturing, where growth rate in 2000 exceeded the corresponding index of 1999 by more than 500%. At the same time, there was a continued decrease in the production of the main types of cattle breeding products, including meat and milk. Threatening negative dynamics continued in the sphere of railway transport consignments. This circumstance has both functional and psychological aspects (which is to say, symbolic

meaning), because Kharkiv inhabitants have always been proud of the fact that Kharkiv was the third-largest transport center in the USSR, after Moscow and Leningrad.

Table 1. Main Economic and Social Indicators in Kharkiv Oblast: 2000 [4]

	Current Prices (2000)	Comparative Prices	
		2000 vs. 1999 (%)	1999 vs. 1998 (%)
Volume of industrial production (1000 UAH)	7,346,017.0	103.7	103.9
Total production of consumer goods (1000 UAH)	2,545,092.1	137.9	112.1
Food processing (without alcoholic beverages)	961,523.1	117.9	103.4
Main cattle breeding products in all categories of businesses:			
- meat (1000 tons)	128.2	96.4	97.6
- milk (1000 tons)	538.7	91.0	97.5
- eggs (million pieces)	474.2	100.2	99.4
Carriages consigned with Southern Railway Transport (1000 tons)	19,084	93.3	86.9

4. Industrial Structure of the Kharkiv Oblast Economy

The structure of the Kharkiv Oblast economy may be characterized using the Gross Value Added (GVA) indicator. GVA is defined as the value of gross output less the value of intermediate consumption. It contains primary income generated by production participants and distributed among them. In the Ukrainian national accounts, there are two equivalent indicators and two methods of estimation. For the economy as a whole, the results of economic development are measured by goods and services produced and by gross domestic product at market prices. For the sectors and industries, outputs are measured with gross value added at basic prices [5, c. 601]. The indicator of gross value added for analysis of industrial (sector) structure of economic output at the regional level is considered to be the main one [6, c. 11].

According to GVA volumes, the tertiary (services) sector was a bit larger than the primary and the secondary sectors together (the sphere of goods production). There were no essential changes concerning correlation of shares of these two spheres of economy of the region in the second half of the 1990s.

The contribution of some most influential sectors in GVA created by economy of the region, calculated in current prices, was the following in 1998:

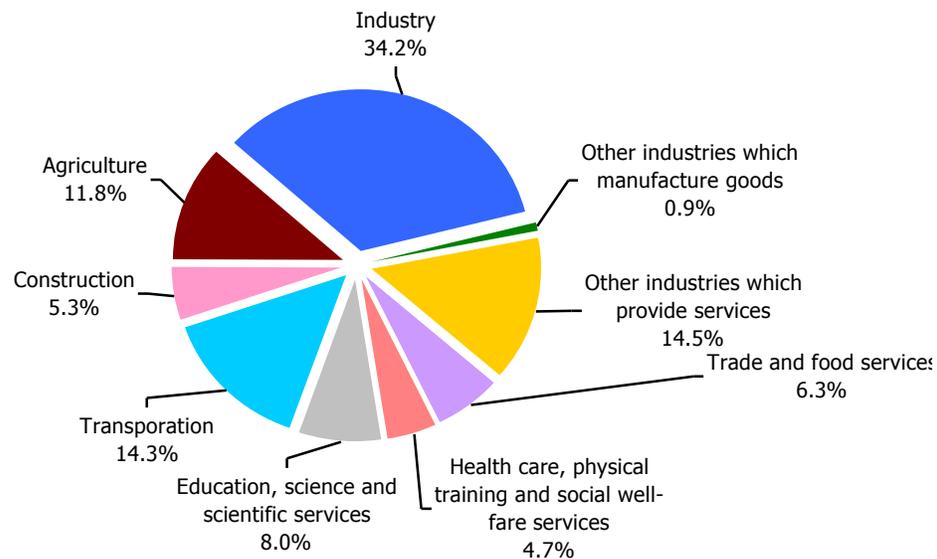
1. Industry:	34.2%	6. Education:	4.7%
2. Transportation:	14.3%	7. Health Care Services:	4.7%
3. Agriculture:	11.8%	8. Science and Scientific Services:	3.3%
4. Trade and Food Services:	6.3%	9. Housing:	3.1%
5. Construction:	5.3%	10. Municipal Services:	2.4%

As can be seen, Communication (1.7%) fell outside of the top ten. The contribution of each of the rest distinguished by the Kharkiv Oblast Statistics Administration sectors of economy was less than 1% of the total volume of GVA created in the Kharkiv Oblast economy.

Table 2. Kharkiv Oblast Economy Gross Value Added by Sector (at Current Prices) [6]

	1995		1998	
	Million UAH	%	Million UAH	%
Agriculture	414	14.3%	628	11.8%
Forestry	11	0.4%	16	0.3%
Industry	970	33.6%	1814	34.2%
Other industries that produce goods	12	0.4%	30	0.6%
Total Goods Production	1,407	48.7%	2488	46.9%
Construction	173	6.0%	282	5.3%
Transportation	326	11.3%	760	14.3%
Communication	31	1.1%	92	1.7%
Trade and food processing	149	5.2%	337	6.3%
Material-technical supply and sales	24	0.8%	33	0.6%
Procurement of agricultural products	15	0.5%	18	0.3%
Consumer services	11	0.4%	30	0.6%
Housing	137	4.7%	165	3.1%
Municipal services	33	1.1%	130	2.4%
Health care, physical training, social welfare services	156	5.4%	249	4.7%
Education	173	6.0%	251	4.7%
Culture and fine arts	12	0.4%	27	0.5%
Science and scientific services	93	3.2%	173	3.3%
Other industries supplying services	149	5.2%	274	5.2%
Total Services	1,482	51.3%	2821	53.1%
Total Economy	2,889	100%	5,309	100

The most essential changes in branch structure of the GVA of Kharkiv Oblast during the second half of the 90s included a sharp decrease in the share of Agriculture (by 2.5%), Housing (by 1.6 %), and Education (by 1.3%) and a sharp increase in the share of Transportation (by 3.0%) and Trade and Food Services (by 1.1%). As a result, Transportation and Agriculture exchanged places in the first three positions, while Trade and Food Services rose from the 7th to the 4th position. A substantial decrease in the shares of Construction and Health Care Services (by 0.7%) and increase in the share of Communication (by 0.6%) should also be mentioned.



Kharkiv Oblast Economy--Gross Value Added by Sector at Current Prices in 1998

5. Activity of the Largest Sectors of the Kharkiv Oblast Economy in 2000 (As of January 1, 2001)

It is important to note that since the beginning of 2001, the Classification of Sectors of Economic Activities (CSEA) [7, c. 3] replaced the "General Classification of National Economy Industries". The CSEA was patterned after the Classification of Sectors of Economic Activities of the European Union Statistics Committee (NACE) at the level of classes, that makes it possible to use this Classification for comparing national statistics data with EU statistics committee data without the use of transition keys. The column "ISIC code" [8, c. 2] is given for comparison of national statistics data with the data of International Standard Industry Classification of the types of economic activities (ISIC) of the UN in the structure of the CSEA. The correspondence of industries of economic activities distinguished in Ukrainian statistics and North American Industry Classification System (NAICS) [9] developed by the governments of the USA, Canada, and Mexico is consistently applied within the present research.

According to the new classification the volume of **Industrial Production** is formed by the production, works, and services costs of: a) Mining; b) Manufacturing; c) Utilities. In January of the current year, industrial production of the region (not taking into account small enterprises) in current prices totaled 650.7 million UAH. In comparison with January 2000, industrial production grew by 21.7%. (Here and further statistics data for 2001 is given according to [7], for 2000 – according to [4], if nothing is specially presupposed.)

Manufacturing made up the overwhelming share of industrial production (63.5%). Production grew by 31.3% over 2000, 9.6% more than in the whole branch. Machine-building made up 40.2 % of the manufacturing production, food industry and agricultural products processing, at 36.5%.

Utilities (production and distribution of electric power, gas, heat, water) in the industry of the region made up 27.7%. In January of this year this sector produced 15.1% more products (works and services) than in the first

month of the last year.

Mining made up 8.8% of the industrial production of Kharkiv Oblast. It increased production volumes in comparison with January 2000 by 8.7%, and energy materials mining by 9.2%.

Transportation in the region in came to 7.2 million tons of carriage and 605.7 million passengers. In comparison with 1999 the volumes of truck and passengers transportations decreased by 17.9% and 1% respectively.

In January 2001 transport of all types came to 0.5 million tons of carriage. In comparison with January 2000 the volume of truck transport decreased by 1.6%.

The Southern Railway transported 19 million tons of carriages in 2000, with transport volumes decreasing by 1.4 million tons, or 6.7%. The total number of passengers transported by the Southern Railway during this year made up 66 million passengers, up 5.8% over 1999. In January of this year the total utilized capacity of the railway made up 1,122,000 tons of carriages. In comparison with correspondent period of the last year the volumes of transportations decreased by 102,000 tons, or 8.3%. During the month 2,236 freight trains, 14,012 local trains and 1,312 passengers trains carried out transportations.

Branch motor transport enterprises of the region in 2000 transported 3.8 million tons of carriages and 77 million passengers. In comparison with 1999 transportation of carriages decreased by 33%, while passenger transportation fell by 8%. In January of this year motor transport enterprises transported 241,000 tons of carriages, while bus transportation made up 5,578,400 passengers. In comparison with the last year carriage and passenger transportation decreased by 9% and 6% respectively.

Kharkiv airlines transported 15,000 passengers in 2000, down by 5,300 people or 26% from 1999. In January of this year, 600 passengers were transported from Kharkiv airport, that is, by 100 people, 14% less than in the corresponding period last year.

The Kharkiv subway transported 233 million passengers in 2000, 1 million more passengers than in 1999, an increase of 0.4%. In January of this year the subway transported 16.3 million passengers, down 2.3 million people or 12.6% from January 2000.

Trolleybuses and trams of the city transported 249.2 million passengers in 2000. Paid transportations increased by 10% and made up 146.6 million people. In January 2001 trams and trolley-buses transported 23.4 million passengers, of which more than 40% were so-called privileged passengers.

As for **Agriculture**, it should be noted that crops planting prevails in plant cultivation as well as corn, sugar beet, and sunflower cultivation [10, p. 52]. Experts are forecasting big harvests in 2001.

In the cattle-breeding Agriculture subsector, meat and milk cattle-breeding, pig-breeding, and poultry-farming are being developed. Different subbranches of cattle-breeding showed disputable, sometimes different tendencies of development. On the whole, production of eggs in the region grew by 11.9%. This includes an increase of 20.4% at agricultural enterprises, which produce 61% of this product, as well as an increase of 0.8% at private enterprises. The volume of milk remained at the level of the previous year, showing an increase of 3.9% at private enterprises and a decrease of 2.7% at agricultural enterprises. Meat production decreased by 3.1% overall. This includes a decrease of 1.5% at private enterprises, which are the main producers of meat (84% of the total volume), as well as a decrease of 11.1% at agricultural enterprises

Construction enterprises of all property forms executed works amounting to 49.4 million UAH according to contract prices, or 42% of the volumes stipulated by contracts concluded for the year. The volume of contract

works in comparative prices increased by 29% in comparison with the corresponding period last year. During the current year there was no dwellings constructed according to the contract for 66,100 m².

6. Current Role of Kharkiv Oblast in the Ukraine Economy

It is well known that Kharkiv Oblast is one of the most industrially developed regions in Ukraine. In the second half of 1990s the enterprises of the region provided all the national output of steam turbines, more than half of the tractors and rolling bearings, almost half of machine tools, half of ceramic tiles for interior walls lining, almost a quarter of roofing slates, and almost one fifth of the national output of cement, bridge cranes, and asbestos-cement pipes and sockets. The production of alternating current engines, TV sets, washing-machines, electric vacuum cleaners, and cameras were also of national importance. The fuel and energy complex of the region is unique in that Kharkiv Oblast produces almost 50% of all natural gas of Ukraine. [10]

The list of achievements of Kharkiv scientists is significant. They include atomic fission, superconductivity experiments, construction of radio telescopes, and contribution to the theories of vibration in plasma and scattering of slow neutrons in crystals. Schools of tank and tractor engineering and turbine manufacture were also established.

The region's scientific establishment possesses a high-powered material and technical basis, a radio telescope, radar atmospheric sounding plants, a crystal growth plant, an electrostatic accelerator, and other equipment unique to the region. This technological base enabled a number of developments to be performed in the region which have been recognized all over the world. First of all, there are technologies and equipment for production of structural materials with unique operating characteristics, high temperature super-conductive materials, unique control systems for rocket-carriers and space vehicles, airboard cooling systems in aviation and cosmonautics, cryogenic low temperature optics, use of cold and cryopreserved biological objects in clinical conditions, remote soil probing from aerocosmic objects, creation of monocrystals and equipment for detecting of nuclear emissions.

The scientists of sectoral research institutes have developed wasteless technologies in metalworking, methods of hardening and metal corrosion protection, resource saving technologies of rolled stock production, ecologically pure sources of power, methods and systems of communications, automatization of production and control, diagnostic and medical equipment, new remedies and others. The scientists of the region worked on the program problem of increasing of steam and hydraulic power plants functioning and also on the development of Ukrainian petroleum and gas resources. The scientists of Kharkiv participate in many international projects, such as creation of supercollider, nuclear center in Cerne (Switzerland), research on laser and thermonuclear synthesis. There are 6 academies and about 200 sectoral research institutes in the region where 80 academicians and corresponding members of the National Academy of Sciences of Ukraine, 1,200 doctors of science and 6,500 candidates of science work.

Kharkiv Oblast is a large medical center of the country that currently has about 200 medical institutions. A large-scale network of specialized centers has been established to conduct scientific investigations and render qualified medical aid for inhabitants. There are a number of famous universities, including: the RI of Therapy of the Academy of Medical Sciences of Ukraine, the Institute of Cryobiology and Cryomedicine Problems of NAS of Ukraine, the Ukrainian RI of Children and Teenagers Health Protection, the State Scientific Center of Remedies, the Kharkiv Oblast Charitable Anticancer Fund, the Kharkiv RI of Medical Radiology, the Kharkiv RI of Orthopedics and Traumatology, the Kharkiv RI of Neurology and Psychiatry, among others. The region is also home to the Berezivski Mineralni Vody and Ray-Olenivka health resorts, where the local mineral water is used for medical treatment.

Kharkiv Oblast has some of the best institutions of higher education in Ukraine. Training of specialists in higher

educational institutions satisfies the demands of practically all branches of production, science, social and humanist spheres of the region's life and also partly in Ukraine as a whole.

Higher education institutes carry out a considerable volume of research work in fundamental sciences such as mathematics, physics, chemistry, biology, sociology, psychology, economics, and also in the fields of radioelectronics, mechanical engineering, construction and architecture, municipal economy and agriculture, engineering ecology, jurisprudence, pedagogics and others.

Kharkiv Oblast Share in National Economic Indicators: 1999 (%) [5]

Territory and Population	
Territory	5.2
Total population	6.0
Urban population	6.9
Rural population	3.9
Financial-Economic Activity	
Gross value added in current prices (1998)	6.4
Accounts receivable	3.4
Accounts payable	3.9
Total credit given by commercial banks to economic subjects	4.7
Credits in national currency, given by commercial banks to economic subjects	7.0
Fuel and Lubricants	
Coal consumption	4.9
Natural gas consumption	7.1
Motor spirit consumption	5.8
Diesel oil consumption	4.5
Furnace fuel oil consumption	2.1
Firewood consumption	4.5
Industry	
Number of industrial enterprises (associations), that were on separate balance (without small enterprises)	6.2
Cement production	6.1
Production of consumer goods	8.2
Production of foodstuffs	6.1
Production of nonfood consumer goods	11.7
Light industry products production	4.2
Granulated sugar production	8.2
Production of whole milk products	9.9
Production of animal oil	3.9
Production of vegetable oil	16.5
Agriculture	
Agricultural products production	5.2
Gross grain harvesting	5.6
Gross sugar beets harvesting	6.8
Gross sunflower seeds harvesting	9.3
Gross potato harvesting	4.9
Gross vegetables harvesting	5.3
Grain sales	6.0
Grain sales to purchasing organizations	8.7
Sugar beets sales	7.5
Vegetable oil containing crops sales	9.5
Potato sales	5.1
Vegetables sales	4.7

Fruits and berries sales	2.4
Livestock of cattle	5.1
Livestock of pigs	5.1
Livestock of pigs and goats	4.2
Meat production	5.1
Milk production	4.4
Eggs production	5.4
Poultry and and cattle sales	5.9
Milk and milk products sales	7.5
Eggs sales	4.5
Wool sales	2.6
Number of agricultural (farmer's) enterprises	3.1
Area of agricultural (farmer's) enterprises	4.2
Sewing area of agricultural crops at agricultural (farmer's) enterprises	4.5
Livestock of cattle at agricultural (farmer's) enterprises	1.0
Sugar beets sales by agricultural (farmer's) enterprises	5.7
Vegetables sales by agricultural (farmer's) enterprises	4.4
Investment and Construction Activity	
Investments to the fixed capital (in comparative prices)	4.8
Construction and assembly works (in comparative prices)	3.8
Introduction of fixed assets	5.1
Investments to the fixed capital into dwelling construction	5.8
Dwelling construction	5.0
Telecommunications	
Main telephone sets for general use in cities	6.8
Main telephone sets for general use in villages	4.8
Main home telephone sets for general use in cities	7.0
Main home telephone sets for general use in villages	4.8
Intercity taxophones of the telephone network for general use	7.0
Launching of automatic telephone stations	5.2
Trade and Food Services	
Retail goods turnover	7.0
Number of retail trade enterprises	6.5
Number of food services enterprises	6.4
Trade area of shops	6.4
Number of places at food services enterprises	6.2
Foreign Economic Activity	
Exports of goods	2.7
Imports of goods	5.6
Direct foreign investments, total	1.8
Direct foreign investments into joint ventures	2.6
Small and Medium Enterprises (SME)	
Number of small enterprises	6.8
Number of small industrial enterprises	7.5
Cash Income, Expenditures, and Savings of the Population	
Cash income of the population	6.4
Cash expenditures and money savings of the population	7.3
Deposits of the population in commercial banks of Ukraine	3.4
Higher education	
Number of higher educational institutions of the I-II levels of accreditations (2-yr. Institutions)	5.9
Number of students of higher educational institutions of the I-II levels of accreditations	6.0

Number of higher educational institutions of the III -IV levels of accreditations (4-yr. Institutions)	12.1
Number of students of higher educational institutions of the III -IV levels of accreditations	12.9
Health Care	
Number of doctors of all specialities	6.8
Number of beds at hospitals	6.2
Ecological Aspects	
Fresh water consumption	3.0
Water polutions of natural reservoirs	0.8
Air polutions by stationary sources of polution	4.7
Air polutions by vehicles	7.7

It is important to note that population density in Kharkiv Oblast is noticeably higher than the Ukraine average, as is the overall level of urbanization. Accordingly, the specific weight of the Kharkiv Oblast urban population is noticeably higher, and the rural population lower, compared with the Ukraine population overall.

It should be stressed that in the second half of the 90s, Kharkiv Oblast's share in the national GVA increased from 6.3 % in 1996-1997 to 6.4 % in 1998.

The situation concerning accounts receivable and accounts payable in Kharkiv Oblast was noticeably better than in Ukraine overall, due primarily to the skill of local authorities and business managers. It should be also noted that, while the general level of credit granted by banks was noticeably lower than the national average, the overall credit situation showed an increase, which is evidence of the positive impact of Kharkiv Oblast banks on Ukraine's financial-economic system and the strengthening of the national currency as an economic instrument.

As regards consumption of fuels and lubricants, it should be noted that, due to natural reasons, the specific character of the sector in Kharkiv Oblast mainly concerns the role of natural gas.

With respect to industrial products, we should note that Kharkiv Oblast enterprises made an important contribution in production of consumer goods. The specific weight of Kharkiv Oblast is especially large in domestic manufacture of nonfoods consumer goods, except for light industry goods. The Kharkiv Oblast Statistics Administration has singled out laundry washers, vacuum cleaners, electric irons, tape recorders, radio receivers, television sets, cameras, bicycles, and wallpaper as being the most important products of this type. [6, c. 80]

Within the sphere of industrial foodstuffs production, Kharkiv Oblast also made an important contribution in the production of sunflower seed oil, condensed milk, and granulated sugar. A similar orientation of food services is confirmed by the corresponding structure of agricultural production in the region. It is also worth underscoring a limited measure of success in the adaptation of agricultural enterprises of the region to market conditions, with most the sales specific weight of most products exceeding production share. Kharkiv Oblast farms had a comparative advantage in agricultural holdings and area under cultivation, which had a positive effect on sales volumes of such products as sugar beets and vegetables.

As we can see Kharkiv Oblast underperformed in the sphere of investment and construction activity in 1999, compared with Ukraine overall. Installation of telephones in the region was rather higher than the national average; however, a number of negative indicators in Telecommunications activity have aroused alarm. The sphere of Retail Trade and Catering performed quite well at the national level.

Things were rather bad at the end of 90s in terms of foreign economic activity. In spite of its significant production potential, Kharkiv Oblast made a rather small contribution to the export of Ukrainian goods, while a serious backlog was observed in the attraction of foreign investment, and particularly in the creation of joint ventures.

Finally, the indicators presented above prove that the region's system of higher education plays an important role in the Kharkiv Oblast economy and in its society as a whole. Kharkiv Oblast's share in the number of "senior" higher educational establishments per capita is more than twice the Ukraine average.

7. Market Transformation Trends in the Kharkiv Oblast Economy

It should be noted that the main trends of market transformation in the Kharkiv Oblast economy, which are presented in part 4 of "Strategy of Economic Growth" of the regional program "Kharkivshchina - 2010" [1, p. 73-75], were formulated by Y.O. Chernetskiy, the President of Kharkiv Management Consulting International. They are based on the corresponding elements of the national program "Ukraine - 2010". At the same time, they take into consideration regional specifics. **The main components of the market transformations program** of the Kharkiv Oblast economy are:

- optimization of restoring proportions in the regional economy
- stimulation of savings as the determining factor of long-term development
- development and implementation of efficient investment strategy
- ensuring competitiveness of the commodities of the region's material and non-material production
- definition and implementation of market-oriented priorities of structural rebuilding of the economy
- consistent adaptation of regional budget and tax policy to market conditions of management
- improvements in the regional banking system
- development of the regional finance market
- introduction of the system of state program-object governing in the sphere of scientific and innovation activity at the regional level
- formation of regional mechanism of state support of innovation activity
- ensuring orientation on establishment of regional innovation "centers of growth"
- upgrading of technological basis of the region's material production branches
- ensuring forestalling development of the organizations of spiritual production (educational institutions, scientific organizations, cultural institutions, etc.) as the basis of Kharkiv Oblast economic improvement
- change of organization management forms and property status
- development of competition and anti-monopolistic regulation at the region's level
- promotion of the development of corporate self-government institutions by local authorities
- implementation of the program of state support of small and medium businesses in the region
- use of mechanisms of administrative reform, training, retraining and qualification improvement of personnel in the interests of the regional economy development
- development and implementation of the program of regional legalization of "shadow" economy
- development of cooperation with neighboring states
- consistent activating and optimization of external economic activity in the interests of increasing efficiency of the regional economy functioning

8. Phase 1 Methodology of the Strategic Planning Project

The implementation of this project was regarded by KMCI team as the development of realization mechanisms of regional strategy of social and economic development as stated in the program “Kharkivshchina - 2010”. Revision of certain theses of the program not only seemed possible but was in fact planned according to the results of the analysis carried out during Phase 1 by American and Ukrainian experts. The analysis efforts were concentrated on the implementation of the algorithm used in the USA for strategic planning of the region’s economic development (see Appendix A).

For the successful realization of Phase 1 of the project, the KMCI team used the following research instruments:

- Exploration and systematization of all available **sector (industry) studies**
- Investigation of publications in the **business press** devoted to the sectors under analysis
- Collection of published **statistical data**
- Extraction of appropriate information from various **government sources** (surveys, memos and so on), **company directories and documents, local newspapers, etc.**
- Performance of work with individual **industrial experts** on technological and other sector related issues
- Evaluation by American and Ukrainian experts of information on **business plans, investment proposals, etc.**
- Use of additional sources of information, mailing **enterprise questionnaires, and team enterprise visits**

The final results of these comprehensive sector analyses have been presented in the form of the **Sector Profile** documents structured in accordance with the “Criteria for Establishing Sector Priorities” developed by Dr. Paul Hoover, Chief of the Project Party. The Sector Profiles combine text, tables, figures, etc.

Structure of the Sector Profile Document

Summary 1. Sector Role in the Kharkiv Oblast Economy 2. Strength of Kharkiv Oblast Sector 3. Economic Condition of Sector Enterprises and Organizations 4. Sector Development: Raw Materials Base 5. Sector Development: Technological Base 6. Investment Activities in the Sector 7. Employment and Personnel Potential in the Sector 8. Sector Exports	9. Competitive Environment of Sector Enterprises and Organizations 10. Ownership in the Sector 11. SME Growth in the Sector 12. Sector Infrastructure 13. Management Capabilities of Sector Enterprises and Organizations 14. Administrative Impact on the Sector 15. Social Issues of Sector Development 16. Evaluation of Investment Proposals of Sector Enterprises and Organizations Conclusions
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Most of sector profiles also include a list of the most important enterprises and organizations of the sector.

TABLE OF ACCORDANCE

English and Ukrainian Designations of the Sectors Analyzed During Phase 1 of the “Comprehensive Economic Analysis”

#	Sector Designation	????? ????????	Profile Editor
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PRODUCTION

Address: 5 Petrovskoho Str. Kharkiv 61002 Ukraine	Tel.: +38 (0572) 282011 Fax: 282015 E-mail: kmci@kmci.com.ua Http://www.kmci.com.ua	President: Prof. Yuriy Olexandrovich Chernetskiy	Identification Code: 24665922 A/C (USD) ? 26002184830100 In “UkrSybbank” MFO 351641
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1.	Agriculture	????? ?????????	V.Dvortsov
2.	Mining	????? ?????????	S.Yaremenko
3.	Utilities	????????????	V.Dvortsov
4.	Food Processing	????? ?????????	V.Dvortsov
5.	Light Industry	???? ?????????	K.Yefremenko
6.	Chemical and Petrochemical Industry	?? ?? ?? ?????? ?????????? (?????? ?? ??-? ?????????? ??????????)	S.Yaremenko
7.	Construction Materials Industry	????????? ?????????? ???????	K.Yefremenko
8.	Machinery and Metal Manufacturing	? ? ?????????? ? ? ?????????? (???? ?? ? ??????????)	K.Yefremenko
SERVICES			
9.	Construction	????????	S.Yaremenko
10.	Transportation	????????	? Yefremenko
11.	Information	? ? ?????? ?????????? ? ? ? ? ?	D.Zubarenko
12.	Scientific Services	? ? ? ? ? ? ? ? ? ? ? ? ? ? ?	V.Dvortsov
13.	Health Care	? ? ? ? ? ? ? ?	S.Yaremenko
14.	Accommodation Services	???????? ?????????	V.Dvortsov
15.	Food Services	????????? ?????????	S.Yaremenko
16.	Finance and Insurance	? ? ? ? ? , ? ? ? ? ? ? ? ? ? ? ? ? ? ?	V.Dvortsov
17.	Trade	??????	V.Dvortsov

According to the previous estimation of the official statistics and taking into account experts' opinion certain subsectors (industries) were singled out for detailed analysis within every sector.

LIST OF SECTORS AND INDUSTRIES

**Analyzed During Phase 1 of the “Comprehensive Economic Analysis”
(Industry Titles and Codes are Represented in Accordance with the NAICS)**

#	Sector Designation	Priority Industries for Analysis
PRODUCTION		
1.	Agriculture	<ul style="list-style-type: none"> ▪ Crop Production (111) ▪ Animal Production (112)
2.	Mining	<ul style="list-style-type: none"> ▪ Gas Extraction (211)
3.	Utilities	<ul style="list-style-type: none"> ▪ Electric Power Generation, Transmission and Distribution (2211)
4.	Food Processing	<ul style="list-style-type: none"> ▪ Food Manufacturing (311) ▪ Beverage and Tobacco Product Manufacturing (312)
5.	Light Industry	<ul style="list-style-type: none"> ▪ Textile Mills (313) ▪ Textile Product Mills (314) ▪ Apparel Manufacturing (315) ▪ Leather and Allied Product Manufacturing (316)
6.	Chemical and Petrochemical Industry	<ul style="list-style-type: none"> ▪ Pharmaceutical and Medicine Manufacturing (32541)
7.	Construction Materials Industry	<ul style="list-style-type: none"> ▪ Nonmetallic Mineral Product Manufacturing (327)
8.	Machinery and Metal Manufacturing	<ul style="list-style-type: none"> ▪ Agriculture Machinery Manufacturing (33311) ▪ Industrial Machinery Manufacturing (3332) ▪ Metalworking Machinery Manufacturing (3335) ▪ Engine, Turbine, and Power Transmission Equipment Manufacturing (3336) ▪ Computer and Electronic Product Manufacturing (334) ▪ Electrical Equipment, Appliance, and Component Manufacturing (335)
SERVICES		
9.	Construction	<ul style="list-style-type: none"> ▪ Building, Developing, and General Contracting (233) ▪ Heavy Construction (234)

10.	Transportation	<ul style="list-style-type: none"> ▪ Air Transportation (481) ▪ Rail Transportation (482) ▪ Truck Transportation (484) ▪ Transit and Ground Passenger Transportation (485)
11.	Information	<ul style="list-style-type: none"> ▪ Telecommunications (5133) ▪ Information Services and Data Processing Services (514)
12.	Scientific Services	<ul style="list-style-type: none"> ▪ Scientific Research and Development Services (5417)
13.	Health Care	<ul style="list-style-type: none"> ▪ Hospitals (622)
14.	Accommodation Services	<ul style="list-style-type: none"> ▪ Hotels and Motels (721110) ▪ Recreational and Vacation Camps (721214)
15.	Food Services	<ul style="list-style-type: none"> ▪ Full-Service Restaurants (7221) ▪ Limited-Service Eating Places (7222)
16.	Finance and Insurance	<ul style="list-style-type: none"> ▪ Credit Intermediation and Related Activities (522)
17.	Trade	<ul style="list-style-type: none"> ▪ Wholesale Trade, Durable Goods (421) ▪ Wholesale Trade, Nondurable Goods (422) ▪ Food and Beverage Stores (445) ▪ Health and Personal Care Stores (446) ▪ Nonstore Retailers (454)

Besides the 17 sector profiles, which are presented in Ukrainian and English, another document on current tendencies of Kharkiv Oblast economic development was also made in two languages (Professor M.V.Afanasiev is the main author).

Structure of the Document

“CURRENT TRENDS OF KHARKIV OBLAST ECONOMY DEVELOPMENT”

1. Market situation of enterprises and organizations situated in the Province.
2. Financial-economic state of the Province enterprises and organizations.
3. Raw material base of the Province economy development.
4. Technological base of the Province economy development.
5. Investment activities in Kharkiv Oblast.
6. Employment and staff potential of regional economy.
7. International economic activities of enterprises and organizations situated in the region.
8. Ownership and SME growth in Kharkiv Oblast.
9. Infrastructure of the economic development of the region.
10. State of management of enterprises and organizations in the Province.
11. Administrative impact on economic development of the region.
12. Evaluation of the information on business plans and investment proposals of enterprises and organizations.

Conclusions

In conclusion, it should be emphasized that this Profile of the Kharkiv Oblast economy is not a generalization of the various sector profiles, although it does take into account their contents to some extent. This document has an independent importance, first of all because it depends on an informational base that is essentially different from the sector base. It is oriented toward the use of different informational materials received from official sources, and seeks to clarify the general tendencies of social and economic development of Kharkiv Oblast. In addition, it outlines the analysis methodology used in Phase 1 of the Strategic Planning Project. It should also be mentioned that the quality of governmental statistics in Ukraine as well as in Kharkiv Oblast has improved. For this reason, we believe that the “Profile of the Kharkiv Oblast Economy”, the analytical survey “Current Trends of Kharkiv Oblast Economic Development”, and the “Sector Profiles” of the regional economy created by members

of our research group can serve as a safe informational and analytical foundation for working out strategic plans for development of the entire Kharkiv Oblast economy, as well as of the separate sectors and industries of the region. If the local government is interested in this work, our team is ready to continue it.

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**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**CURRENT TRENDS OF KHARKIV OBLAST
ECONOMY DEVELOPMENT
(An Information Survey)**

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project
Under**

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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1. Market Positions of Kharkiv Oblast Enterprises and Organizations

Historically, Kharkiv Oblast was the leading center of machine-building and metal processing, not only in Ukraine, but in the Soviet Union. More than 80% of machine-building production was exported to more than 60 foreign countries. These products included turbines, tractors, generators for atomic power stations, air-crafts, tanks, different electric engines, metal processing machinery, tractor and combine engines, electric equipment, bearings, medical equipment, etc. Eventually, however, the situation changed.

Industrial production in the Chemical/Pharmaceutical sector, which is one of the most developed in the Kharkiv Oblast economy, has increased 160% during the last 3 years, in comparative prices. According to pharmaceutical enterprises, Kharkiv Oblast is second after Kiev Oblast in terms of concentration and number of pharmacological groups of medicines produced at local firms. Kharkiv chemical and pharmaceutical enterprises have the capability to produce medicines of practically of all pharmacological groups. Production at Kharkiv plants made up about 30% of all medicines produced in Ukraine, and 100% of some products (e.g., vaccines, sera, etc.).

At the same time, the position of Kharkiv pharmaceutical enterprises are not as substantial on the CIS market as they are on the Ukrainian market. According to official statistics for 1999, only 7% of sector production in Kharkiv Oblast was exported. Even exports to Russian, Kharkiv Oblast's main trade partner, have decreased several hundred percent over the last few years. Breaking into the world market is still a critical problem, not only for Kharkiv Oblast, but for Ukrainian overall. This difficulty is due mainly to the lack of proper certification for domestic goods.

2. Financial-Economic State of Kharkiv Oblast Enterprises and Organizations

During the period January-November 2000, Kharkiv Oblast enterprises (excluding cooperatives, agricultural concerns, and small enterprises) received revenues totaling 318.3 million UAH, down from 376.1 million UAH in 1999.

Industry revenues totaled 212.6 million UAH (down from 454.2 million UAH in 1999), while Trade and Food Services revenues came to 62.3 million UAH (down from 116.8 million UAH in 1999). These sectors also had the largest number of unprofitable enterprises, with 340 unprofitable enterprises in Industry (54% of the sector total) and 360 in Trade and Food Services (41% of the sector total). Unprofitable enterprises in other sectors included 120 in Transportation (83%) and 204 in Construction (57%). There were 1,490 unprofitable enterprises in the regional economy in 2000. This made up 49% of the total number of reporting enterprises, 5.7% more than in 1999. Sectors reporting substantial losses included Industry, with 386.6 million UAH; Transportation/Communication, 71.8 million UAH; and Trade and Food Services, 60.3 million UAH.

Collectively-owned enterprises were the most profitable in 2000, with profits totaling 283.1 million UAH (up from 231.7 million UAH in 1999). State-owned enterprises had losses amounting to 62.4 million UAH, though in 1999 they reported profits totaling 82.8 million UAH.

3. Raw Material Base of Economic Development of the Region

Black earth is Kharkiv Oblast's most common soil type. Mineral resources include natural gas, petroleum, bituminous and brown coal, iron ore, rock salt, phosphorites, clay, sands, and limestone. Mineral water springs are also an important resource in the region.

4. Technological Base of the Oblast Economy Development

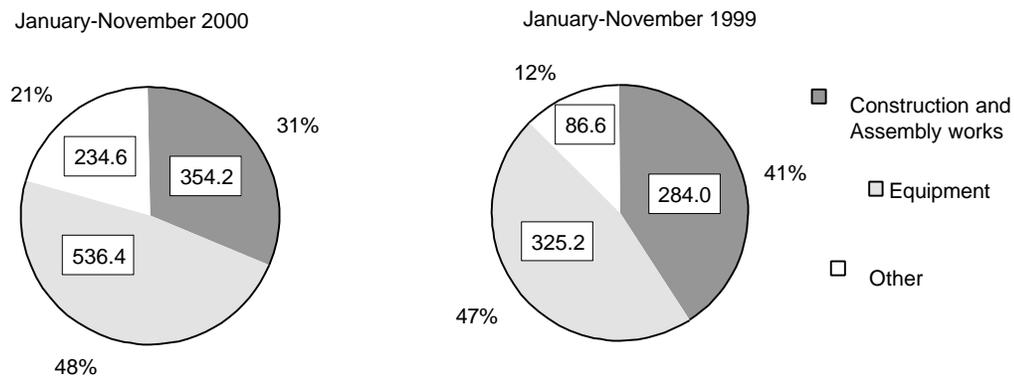
The technological base of the region's economy is rather substantial, and is gradually being renewed. Thus in 2000, industrial enterprises of the region mastered production of 810 new types of products, materials, and machines. In addition, 126 new technological processes were introduced, up from 112 in 1999; 33 of these were classified as resource-saving or low-waste/wasteless processes. New technological processes were introduced at 35 enterprises (5.2% of those examined); new kinds of machines, machinery, equipment and devices were manufactured by 22 enterprises (3.3%); new kinds of materials, goods, and products were manufactured by 64 enterprises (9.6%); and 55 enterprises mastered production of new consumer products.

It should also be mentioned that, according to the "Kharkivshchina – 2010" program [1], one of the strategic trends of economic development in the region is the introduction of energy saving technologies at all stages of the production process.

5. Investment Activity in Kharkiv Oblast

The total volume of capital investment in the Kharkiv Oblast economy came to 1125.2 million UAH, up 40% from 1999. The technological structure of capital investments is shown in **Diagram 1**.

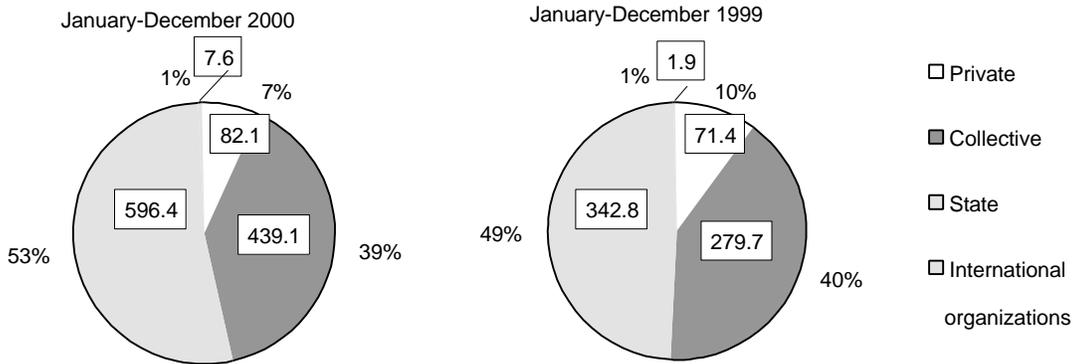
Diagram 1. Technological Structure of Capital Investment in Kharkiv Oblast: 2000 vs. 1999 (Jan-Nov) (million UAH)



In 2000, 79.1% of the total volume of investments was provided by Kharkiv Oblast enterprises themselves, while only 2.1% was provided by the State budget fund. Foreign investment accounted for an additional 2.2%. 6.2% of total registered capital investment was used for housing construction (69.6 million UAH).

Distributions of registered capital investments of enterprises and organizations by ownership form is shown in **Diagram 2**.

Diagram 2. Registered Capital Investment by Pattern of Ownership: 2000 vs. 1999 (million UAH)

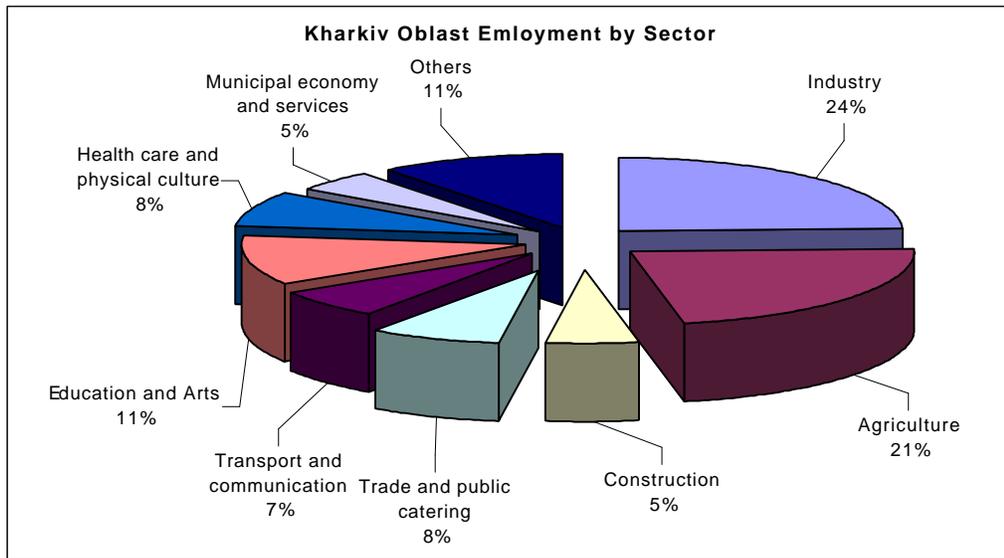


Since the beginning of November 2000, the Council on Special Regimes of Investment Activity in Kharkiv Oblast confirmed that 16 projects totaling 56.3 million USD (including 44.2 million USD in foreign investment) had been initiated. To date, Kharkiv Oblast has attracted approximately 80 million USD since Ukraine independence; enterprises that are subjects of special regimes of investment activity have attracted approximately 3.7 million USD in investments, 1.6 million USD of which was of foreign origin. The pharmaceutical industry has so far received the largest amount of investment, at 21% (774,200 USD). Other areas with significant investment include road construction, 19.4% (714,300 USD); polygraphic devices, 18.4% (676,000 USD); perfume, 16.3% (600,000 USD); transport, 13.4% (495,400 USD); and food processing, 11.5% (425,200 USD). Since the implementation of the special regime of investment activity in Kharkiv Oblast, regional enterprises have received privileges totaling 558,500 UAH, and 446 new employment positions have been created.

6. Employment and Personnel Potential of the Oblast Economy

Total employment in the region in 2000 came to 806,100 people, 600 less than in October 1999. Employment in Kharkiv Oblast by sector is shown in **Diagram 3**.

Diagram 3. Employment in Kharkiv Oblast by Sector: 2000



Average monthly wage in Kharkiv Oblast as of November 2000 was 259.45 UAH (47 USD). In this context it should be mentioned that many people in Kharkiv Oblast have science degrees. According to the latest data, there were 462 academicians and corresponding members of the National and branch academies of sciences; more than 1,460 PhDs in the sciences; and almost 6,700 doctoral candidates in science disciplines.

7. International Business Activity of Enterprises and Organizations of the Region

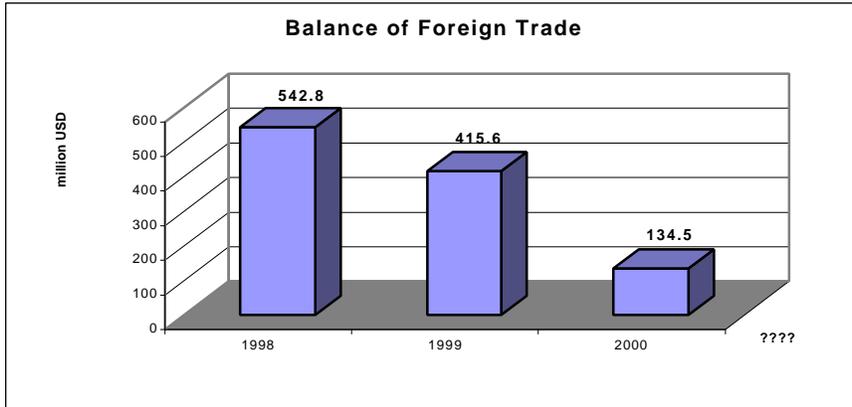
In 2000, Kharkiv Oblast enterprises exported goods and/or services to 93 countries and imported goods/services from 96 countries around the world (up from 78 and 87 respectively in 1999). While the volume of exterior trade turnover is still substantial, a steady decline has taken place over the last three years, as shown in **Table 1**.

Table 1. Dynamics of Foreign Trade Turnover in Kharkiv Oblast: 1998-2000 (million USD)

	1998	1999	2000
Foreign trade turnover	1155.3	956.4	686.5

Export supplies totaled 275.8 million USD, a decrease of 2.0% relative to the period January-November 1999, while import earnings fell to 410.7 million USD, a decrease of 41.1% from 1999. There is currently a decreasing trend in foreign trade deficit, as shown in **Diagram 4**.

Diagram 4. Balance of Foreign Trade: 1998-2000 (million USD)



The region currently has a foreign trade deficit with 69 countries, including: U.S.A., 29.6 million USD; Germany, 15.8 million USD; Austria, 11.2 million USD; and Italy, 10.1 million USD.

Kharkiv Oblast's share in total Ukraine foreign trade turnover was 2.7% in 2000, including exports, 2.2%, and imports, 3.3%. Kharkiv Oblast placed ninth among the regions of Ukraine in terms of exported goods and seventh in terms of import earnings.

In 2000, 1,797 Kharkiv Oblast enterprises effected foreign-trade operations with partners from 115 countries around the world, down from 1,877 enterprises in 1999. Exports to countries of the former USSR in 2000 totaled 208.2 million USD (75.5 %), and 67.7 million USD (24.5%) to other countries of the world. Import earnings totaled 174.8 million USD (42.6%) and 235.9 million USD (57.4%), respectively. The bulk of the region's import-export transactions were effected with the Russian Federation, totaling 57.2% and 33.5% respectively.

The region's major export product is machinery and equipment (28.5% of total exports). Major imports include machinery and equipment (15.9%) and minerals (14.2%).

In 2000, the volume of export supplies traded on barter terms decreased to 7.4 million USD, or 2.7% of total export supplies output, down from 5.9% in 1999. Import traded on barter terms totaled 6.8 million USD, or 1.6%, up from 1.5% in 1999.

The above data indicate that the state of the region's foreign trade activity is gradually worsening, although there are some positive indicators, including a smaller rate of decline in exports relative to import transactions.

8. Ownership Relations and SME Development in Kharkiv Oblast

Enterprises that have changed their pattern of ownership have recently played an important part in the economy of the region. In 2000, 277 privatized enterprises accounted for 47.1% of the total volume of industrial production, up from 37.1% in 1999.

At the beginning of 2001 there were 13,328 small- and medium-size enterprises (SME) in Kharkiv Oblast, 108,000 private enterprises, and 1,200 farms. In 2000, there were 208,000 people working at SMEs in the region. Most new

SMEs were established in the Trade and Food Services sector, which made up 49% of total SMEs in the region. SMEs have not yet enjoyed full-scale development in the primary and secondary sectors of economy.

Kharkiv Oblast SMEs have an average of six employees; 88.7% of SME employees are full-time, permanent staff. Average salary at SMEs is approximately 65% of that at larger enterprises. This is due to such factors as salary level limitations, inefficiency of enterprises, and the existence of unreported ("shadow") forms of salary payment.

9. Infrastructure of Oblast Economy Development

There are 102 banks and financial organizations in the region, including 13 commerce banks, 34 investment companies and funds, 17 exchanges, 20 insurance companies, 9 business centers, 1 leasing company, 3 business incubators, and 3 enterprise support funds.

The scientific infrastructure of the region is rather advanced. One seventh of all Ukraine scientific organizations are located in Kharkiv Oblast. These include 212 scientific organizations, 21 organizations of the National Academy of Ukraine, and 21 institutions of higher education of the third and fourth levels of accreditation. In addition, there are 109 research organizations (51.4%), 51 design offices (24.1%), and 7 planning and development organizations (3.3%) engaged in scientific and engineering research.

10. State of Enterprises and Organizations Management in the Region

The transition of Ukrainian enterprises to the principles of a market economy has been accompanied by certain regressive management trends. The reasons for this differ somewhat between older and more recently established enterprises.

As a rule, enterprises established before the economic reform realized the necessity for essential changes in management styles long ago, including the need for a gradual transition from production- to realization-oriented operations. However, only limited progress has been made in this area, not only because of the nation's general social and economic crisis, but also because of a lack of qualified personnel and scientifically grounded management methods of reform under the conditions of a transitional economy. By contrast, management techniques at enterprises established after the economic reform were developed according proprietors' own models, which were largely based on intuition, common sense, state of the market, and short-term forecasts. Now these newer enterprises are facing the problem of qualitative reconstruction of their management systems as well.

Experience has shown that foreign management methodologies can be integrated fairly easily. Efforts to improve enterprise management starts as a rule from defining the contents of the new topical specific management functions and their place in the organizing structures. These structures, however, have not yet radically changed. That is why the state of Kharkiv Oblast enterprise and organization management can be assessed as generally unsatisfactory, while state enterprise management is based on time-worn principles. Modern approaches to labor activity and enterprise management are not popular with administrators who are used to management techniques of the former central planning system.

Enterprises that have been established in the last 3-5 years differ in this respect. As a rule they tend to apply modern approaches in their daily work. But the process of introducing modern domestic management methodologies at the majority of enterprises in the region is still in progress. However, Kharkiv Oblast Chemical-Pharmaceutical sector

enterprises differ positively from most other sectors in that the managers of that sector have demonstrated an ability to make optimal use of existing personnel and technological potential to realize purposeful, step-by-step growth strategies.

11. Administrative Impact on Economic Development of the Region

The administrative impact on the economic development of the region can be generally characterized as negative. This is due to the fact that bureaucratic red tape effectively inhibits effective development of the enterprises and organizations of the region. To cite one example, an enormous number of documents and certificates are required to establish a new enterprise; and this procedure is often the source of abuse on the part of the authorities that issue these documents.

According to the expert assessment, up to 50% of the initial capital of a small enterprise can be spent on such certificates and papers, and the process can go on for months. Excessively stringent health and fire safety standards can be prohibitive for entrepreneurs as well. Often these standards are outdated and contribute to the abuse of power on the part of controlling bodies in the course of various check-ups.

One positive development has been the advantages to businessmen brought about by the simplified taxation system. However, this reform has not solved all of their problems, as businessmen are still under severe supervision on the part of various state authorities in such areas as tax inspection, militia, sanitation and public health, fire safety, and so on.

Another factor contributing to the development of the region's enterprises was the enactment of the law entitled, "On special investment activity on the territory of the City of Kharkiv". This law stipulates that enterprises operating with the Kharkiv city limits that carry out projects valued at 500,000 to 1 million USD are entitled to favorable tax treatment, as shown in **Table 2**.

Table 2. Tax Benefits for Kharkiv City Enterprises

Tax	Benefits
Customs/ duties	Enterprises participating in the investment project subject to preferential tax treatment are exempt from customs duties on raw materials, materials (in accordance with the list of the Cabinet of Ministers of Ukraine), equipment, its devices and components, brought in for the satisfaction of wants of domestic production while the investment project is in effect for a period of no more than 5 years.
VAT	The above-stated enterprises are exempt from VAT while the project is in effect for a period of no more than 5 years. For import operations into the customs territory of Ukraine, the territory of the city of Kharkiv, by the subjects of enterprise for the satisfaction of wants of domestic production connected with the realization of this investment project according to the Agreement on the equipment, its devices and components.
Profit tax	The profit of the newly established, reoriented, reconstructed enterprise realizing the project according to the agreement. Its investment development part is exempt from taxation for 3 years. The profit of such enterprises from realization of the investment project from 4 to 6 years inclusive is subject to taxation at the rate of 50% of the current rate of taxation.

12. Evaluation of Information on Business Plans and Investment Proposals of Kharkiv Oblast Enterprises and Organizations

According to the regional statistics office, most investment activity in Kharkiv Oblast is focused on the following:

- Regulation of the effectiveness of agricultural enterprises and agricultural production processing
- Regulation of the effectiveness of food industry enterprises

- Introduction of energy-efficient and resource-efficient technologies and systems of domestic waste recycling
- Expansion of informational systems
- Construction of a supermarket network in Kharkiv

The Utilities industry is considered to be of particular importance in terms of investment activity. Today, Kharkiv Oblast enterprises are ready to cooperate with other regions of the country, businessmen, and investment companies to improve production, increase energy efficiency, reconstruct the existing energy systems of the city and region, and introduce new, even more efficient systems.

A rather complete list of investment proposals in Kharkiv Oblast is presented on the informational CD "Kharkiv Oblast today", issued by the Regional Center of Business Assistance.

List of the Most Important Sources Used for the Survey Preparation

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4. Regional complex program of social and economic development of Kharkiv Oblast till 2010: Approved by resolution of the VII session of Kharkiv Oblast Council of the XXIII calling of 20 August 1999. - Kharkiv: Kharkiv Oblast State Administration, 1999. – 152 p.

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

1. AGRICULTURE

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

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Summary

Official data shows that the agricultural sector is second only to industry¹ among all of the economic sectors in Kharkiv Oblast. In value-added terms, the sector places third, with 12%, behind industry (34%) and transport (14%). Almost 18% of the region's workforce is employed in the agricultural sector. Kharkiv Oblast specializes in certain agricultural products, including cereals, industrial and oil crops, cattle breeding, and meat/milk products.

The sector has been unprofitable during the last few years, and definite indications of improvement in the economic situation of sector enterprises have emerged only recently. In this respect, barter operations play a key role.

The sector's shadow activity is substantial and complex. It is estimated that individual subsidiary farms produce about 45% of agricultural products. In addition, the sector's substantial debt, as well as its numerous privileges in the form of grants, credits, and debt deductions, tends to foster shadow profits.

At present, at least one third of sector enterprises use organic agricultural methods. This is in part due to a lack of capital for purchase of mineral fertilizers, herbicides, and pesticides, etc., rather than a deliberate focus on organic farming per se. Unfortunately, the soil is exhausted, and there is strong need of modern technological aides, including herbicides, seeds, etc. Lack of modern technology is a problem for even the few successful agricultural enterprises. However, widescale introduction of innovative equipment and technologies requires substantial investment capital.

Before 2000, no banks wanted to lend money to the agriculture sector. However, in that year, agricultural farms took out loans totaling 88 million UAH and paid back 98% of the loans on time. This year, banks are actually competing for the opportunity to lend to farms with strong economic potential; and recent reports show that only one out of three farms has a problem establishing credit. This process takes place mainly in the framework of state grant programs.

The driving force behind the investment process remains privatization of land, which results in the creation of real property for the landowner. One problem here is that the management of many former collective farms is outdated. Technically, collective farms no longer exist; however, "reformed" collective farms have inherited most of the old problems.

In short, while the present weakness of the Kharkiv Oblast agricultural sector may at first sight appear to be due to a lack of modern technology and investment capital, another, deeper cause is the lack of structural reforms and underdevelopment of market institutions governing production and sales, creation of which remains the responsibility of the state. In this respect, Kharkiv Oblast greatly depends on higher state authorities, and on Kyiv Oblast.

1. Sector Role in the Kharkiv Oblast Economy

Kharkiv Oblast specializes in a number of agricultural products. These include: grain crops (spring wheat, winter wheat, oats, barley, corn); technical and oil-bearing crops (sugar beets and sunflowers); and animal husbandry for the meat/milk complex.

According to the Kharkiv Oblast Statistics Department, during the 2000 harvest the agricultural sector produced 1,267,500 tons of crops, down 7.7% overall from 1999. [1] Of this total, agricultural enterprises produced 1,049,700 tons, and private farms 217,800 tons. On average, 18 centners of crops (1 centner = 100 kilograms) were gathered per hectare, down 1.3 hectares compared with 1999.

¹ Considering our sector definitions, industry includes two sectors: (1) Mining and (2) Machinery and Metal Manufacturing).

However, a number of crops showed increased productivity over 1999. These include:

- **Sunflower seeds.** 342,300 tons, up 31.5%. Productivity increased by 3.3 centners.
- **Sugar beets.** 155,900 tons, up 16.4%. Productivity increased by more than 30%.
- **Potatoes.** 1,511,000 tons. Productivity increased by almost 250%.
- **Vegetables.** 416,000 tons, up 150%.

Private farms gathered 99.5% of the total potato harvest, and 86.8 % of all vegetables. In addition, the fruits and berries gross harvest totaled 34,400 tons, an increase of almost 300%. Sector enterprises in all categories sold a total of 797 tons of fruit to suppliers, 330% more than in 1999.

Kharkiv Oblast husbandry production activity is shown in **Diagrams 1 and 2.**

Diagram 1. Husbandry Production Volumes: 2000

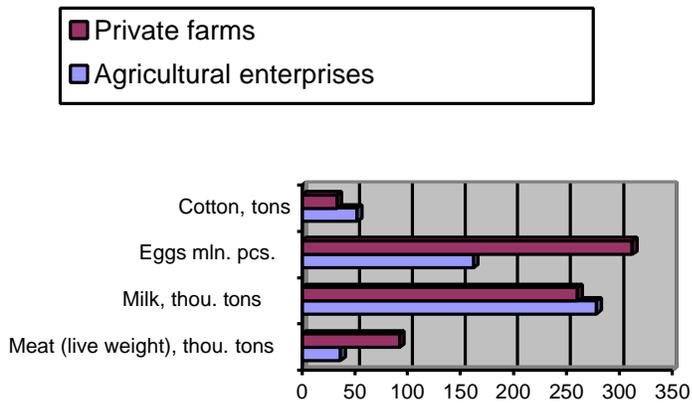


Diagram 2. Husbandry Production Relative to 1999 (%)

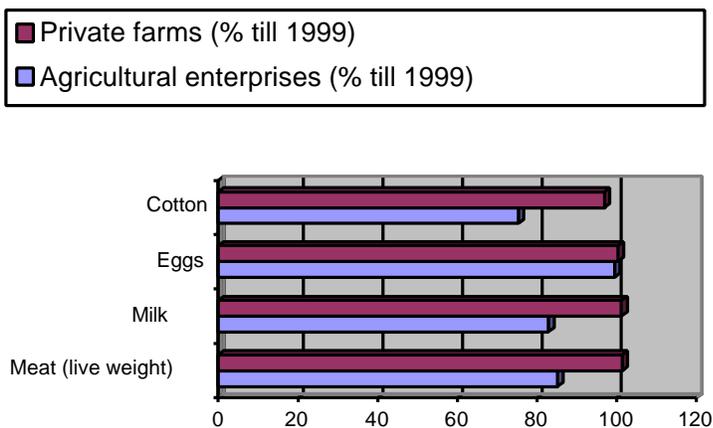


Table 1. Kharkiv Oblast Livestock as of January 1: 2000-2001 (1000 heads)

	All Categories of Farming		Agricultural Enterprises		Private Enterprises	
	2000	2001	2000	2001	2000	2001
	Cattle	538.1	455.9	426.2	336.8	111.9
Pigs	518.1	416.5	239.7	161.5	278.4	255.0
Sheep and goats	78.5	73.2	20.6	14.1	57.9	59.1
Poultry	6,136.6	6,686.7	1,386.3	1,577.9	4,750.3	5,108.8

2. Strength of Kharkiv Oblast Sector

According to the Kharkiv Oblast Statistics Department, sales of agricultural products on Kharkiv markets system decreased 12.6% in comparison with 1999. [1] Sales of animal husbandry products decreased 18.5%, and plant cultivation products fell 10.1%. One explanation for these figures is a decline in consumer demand, with milk consumption at 59% and meat consumption at 72% of the average.

At the same time, according to the GfK-USM Materials/International Center of Perspective Analyses, consumer mood in rural areas improved substantially in the 4th quarter of 2000. In fact, improvement was seen across all indices with the exception of unemployment.

In terms of total Ukraine production, Kharkiv Oblast produces about 9% of the nation's sunflowers, 6% of crops, 7% of sugar beets and vegetables, 6% of meat and fat, and more than 5% of milk. The oblast ranks third in total Ukraine agricultural production, with 5.6%.

Agricultural exports to Russia is driven primarily by high profit margins, which can be 2-2½ times higher than domestic sales on certain products, including beef, pork, vegetables, and fruit.

3. Economic Condition of Sector Enterprises and Organizations

Unprofitability in the Ukraine agriculture sector decreased 1,000% in 2000 relative to 1999. The same positive trend took place in the Kharkiv Oblast market, where sector losses totaled 258 million UAH in 1998, 187 million in 1999, and only 61.3 million in 2000. In addition, while 80%-85% of Kharkiv Oblast agricultural enterprises were unprofitable in 1999, less than half reported net losses in 2000. [1]

At the same time, accounts payable for Kharkiv Oblast sector enterprises as of January 1, 2001 came to 715 million UAH, 4 times higher than accounts receivable, with the deficit totaling almost 550 million UAH. [7]

Profitability of the main Ukraine agricultural products is shown in **Table 2**.

Table 2. Profitability of Main Agricultural Products

Product Type	2000	1999
Plant products		
Grain	63.4%	12.0%
Sunflowers	51.2%	54.5%
Sugar beets	5.8%	-14.8%
Potatoes	8.8%	-12.5%
Vegetables	-3.2%	-12.8%
Husbandry products		
Eggs (million pieces)	8.5%	0.7%
Milk	-6.1%	-36.6%
Beef	-44.2%	-57.9%
Pork	-46.7%	-51.0%
Poultry	-31.1%	-45.5%

It is worth noting that, according to some estimates, 40% of money circulating in the agriculture sector is in the form of cash, which is to say, outside of the banking sector.

Currently, a number of factors have emerged that significantly improve the financial prospects of the sector. These include a debt forgiveness totaling 10 billion UAH for agricultural and processing enterprises on the part of the state budget; and a recently enacted tax reduction that stipulates payment of only 7 UAH per 100 received. (By comparison, Russian agricultural producers pay the equivalent of 28 UAH/100.)

4. Sector Development: Raw Materials Base

The total area of Kharkiv Oblast agricultural lands is 2.4 million hectares, of which 82.6% is cultivated land, 12.5% is pasture, and 4.9% is grassland. Almost all of the region's soil is characterized by substantial humus content.

At present, at least one third of sector enterprises use organic agricultural methods. This is in part due to a lack of capital for purchase of mineral fertilizers, herbicides, and pesticides, etc., rather than a deliberate focus on organic farming per se. According to a recent survey by the Ukrainian weekly "Business," most entrepreneurs in the chemical and agriculture industry complain about a lack of raw materials. Kharkiv Oblast alone needs at least 50,000 tons of chemical fertilizers per year.

On the other hand, production of chemical fertilizers does not correspond to the domestic market demand. Even if the situation in agriculture improves, it is not capable of consuming all of the fertilizer produced by the nation's chemical plants, with the result that producers have focused on exporting their products. With the price of nitrogen fertilizers rising on the foreign market, it is more profitable for Ukrainian fertilizer producers to sell their products abroad. The Ukraine government has asked producers to refrain from exporting fertilizers until after May 15th each year; at present, it is not clear how many enterprises are complying with this request.

Fodder is an important raw material in agricultural production, and fodder preparation and processing machinery is required to build adequate reserves of forage. As of January 1, 2001, the following facilities were in working order:

- 46 cattle feed processing plants (63% of the total)
- 63 cattle feed preparation sections (43%)
- 110 pig feed processing plants (70%)
- 47 pig feed preparation sections (59%)
- 168 mixed fodder production plants (70%) [1]

The general fuel requirement for Kharkiv Oblast agricultural enterprises is 250,000 thousand tons of diesel oil and 62,000 tons of gasoline. In 2000, sector enterprises received 118,400 tons of diesel oil (down 7% from 1999) and 41,500 thousand tons of gasoline (down 29%). As of January 1, 2001, sector enterprises had 2,200 thousand tons of diesel oil and 900 tons of gasoline for their own use, an increase over 2000 of 21% and 13% respectively. [1]

According to government data, plant protection chemicals (PPCs) are plentiful on the domestic market, with prices 30% lower than last year. The nation's chemical industry is currently being developed mainly in Dneprodzerzhinsk and Cherkasy oblasts. It is estimated that domestic chemicals will be two times cheaper than foreign analogues. Currently, six chemical products are already in production, and four others are planned.

5. Sector Development: Technological Base

The last quarterly business activity poll conducted by the Ukrainian publication "Business" indicates that obsolete equipment and technologies is currently one of the most critical problems in the agriculture sector, as well as for a number of other branches of the economy.

Kharkiv Oblast has sufficient technological and material resources to mechanize all of its sowing and harvesting activity. All agricultural enterprises are provided with electric power; and sugar beet cultivation, for example, is partly or fully mechanized. On the other hand, 90% of Kharkiv Oblast agriculture enterprises have reported harvest losses due to poor machinery, compared with 25% reporting losses due to inadequate transport and/or storage.

The present fleet of tractors and machines has already completed 85% of its amortization term. As of year end 2000, approximately 55%-60% of tractors and combines and 80% of seeding machines and cultivators were in working order. According to the Kharkiv Oblast Department of Agriculture, there is a current shortage of some 11,000 tractors, 2,000 grain harvesters, 700 beet harvesters, and more than 2,000 harrows. In addition, the lack of fertilizers leads to decreased harvests. For example, in 2000, the wheat harvest totaled 19 centners per hectare, compared with 38 centners/hectare in 1990; sunflowers came to 11 centners/hectare, down from 17.6 in 1990; and sugar beets totaled 108 centners/hectare, down from 253 in 1990.

Many experts believe that last year's reduced harvests were the result of the decrease in natural fertility; in essence, the soil is exhausted. Today, the need for up-to-date technology, including modern herbicides, seeds, etc., is critical—even for prosperous and successful enterprises. Substantial investment is required to introduce the modern applications and innovations into the sector on a large scale. To take one example, significant investment from West Germany enabled East Germany to bring its agricultural production to the level of the developed countries in a very short time. Consequently, the reorientation of agricultural enterprises based on new technologies and machinery is a key priority for Kharkiv Oblast, now and in the future.

6. Investment Activities in the Sector

Foreign Investment

According to official 2000 data, direct foreign investments in Kharkiv Oblast agriculture enterprises came to 170,000 USD. [3] Foreign investment in the sector in 2000 made up 0.3% of total foreign investment in the Kharkiv Oblast economy.

Still, Ukraine's agriculture sector is considered attractive for foreign investors. The slow pace of investments can be explained by a number of other factors, including the fact that property rights are not protected.

Leasing

Leasing as a form of attracting investment to the Kharkiv Oblast agriculture sector has not caught on yet; but interest in this channel is starting to grow. A number of companies now provide farmers with acceptable terms. For example, "Ukragroleasing" leases equipment for a period of 5 years at 10% annual interest.

The policy pursued by the State leasing fund has been criticized by both budget "defenders" and agriculture "supporters". This fund, formed by the budget for agricultural machinery purchase and supply, is required to press for repayment from agricultural enterprises and direct funds for new machinery purchase; however, the requirement is not enforced. For example, 20% of funds lent must be returned to the fund every year, but in 2000, repayments came to only 6%. As a result of fund activity, the Kharkiv Tractor Plant did not sell a single tractor in 2000. And many feel that the fund's interest rate of 42% for 5 years is too high to stimulate consumer demand.

State Subsidies

The agriculture sector survives mainly on state subsidies. For example, a recent decree by the Cabinet of Ministers provides for partial compensation of commercial bank credit rates given to agricultural enterprises. The decree provides 150 million UAH for deposit grain purchases. With a compensation level of 70%, credit will cost agricultural enterprises 0.9%-1.5% per month. Taking into account 18%-20% annual inflation of recent years, these are rather profitable terms.

Deposit purchases work as follows: the storage company (e.g., last year, the public joint-stock company "Bread of Ukraine") borrows money from commercial banks and buys up grain from agricultural enterprises according to the deposit prices set by the Cabinet of Ministers (in 2000, the price of wheat was set at 420 UAH/ton). Agricultural enterprises can take back grain from storage company elevators if they find a buyer willing to pay more. In that case the agricultural enterprise must return the deposit and pay elevator storage fees; otherwise, the storage company has the right to sell the grain and pay the difference between the deposit and the market price of the product (including storage costs).

Unfortunately, the deposit purchase scheme did not work very well last year. Bread of Ukraine purchased only 200,400 tons of grain, 200,000 of which was from agricultural enterprises that produced wheat on Bread of Ukraine's own rental lands.

Commercial Banks Credits

Agriculture's share in the Ukraine gross domestic product is 18%, and the sector receives approximately 5% of the total credit available. [4, 5]. The sector's share in total non-paid credit is rather substantial.

Before 2000, no banks wanted to lend money to the agriculture sector. However, in that year, agricultural farms took out loans totaling 88 million UAH and paid back 98% of the loans on time. This year, banks are actually competing for the opportunity to lend to farms with strong economic potential; and recent reports show that only one out of three farms has a problem establishing credit. This process takes place mainly in the framework of state grant programs.

The lack of domestic sources for long-term credit remains an urgent national problem; restoration of the cattle breeding complex is practically impossible. In addition, small enterprises are basically unable to get small loans of 2,000-5,000 USD, since banks as a rule are not interested in such sums.

Currently, the investment process in the agriculture sector is hindered by the low level of return on investment, low labor productivity, and the unprofitability of many enterprises. According to one estimate, approximately 150-200 USD investment per hectare is required to reach optimum productivity; today, investment averages 73 UAH per hectare. The driving force behind the investment process remains privatization of land, which results in the creation of real property for the landowner.

7. Employment and Personnel Potential in the Sector

Today, many participants of reformed collective farms are of pension or pre-pension age. As a result of collective farms land sharing, 25% of the share fund was given to persons under 55, and 75% to persons over 55. [6] For this reason, pension-age citizens may be considered the main property owners of reformed collective farms.

The average monthly salary in 2000 in the Kharkiv Oblast sector was 150-160 UAH. According to official statistics, official salaries are higher than the actual rate paid.

The number of registered unemployed does not reflect the reality. Unreported unemployment may be as high as 30%. People in rural areas live in conditions of severe poverty, buying only the most necessary staples, such as salt, matches, and flour. Profits from personal private farms make up 60% of the gross income of the oblast's rural population, while hired labor salaries make up another 22%.

A substantial portion of the sector workforce goes outside of the region for seasonal employment. In addition, the flight of skilled workers out of rural areas is a problem, since young people who go to Kharkiv City to study tend to stay there permanently.

8. Sector Exports

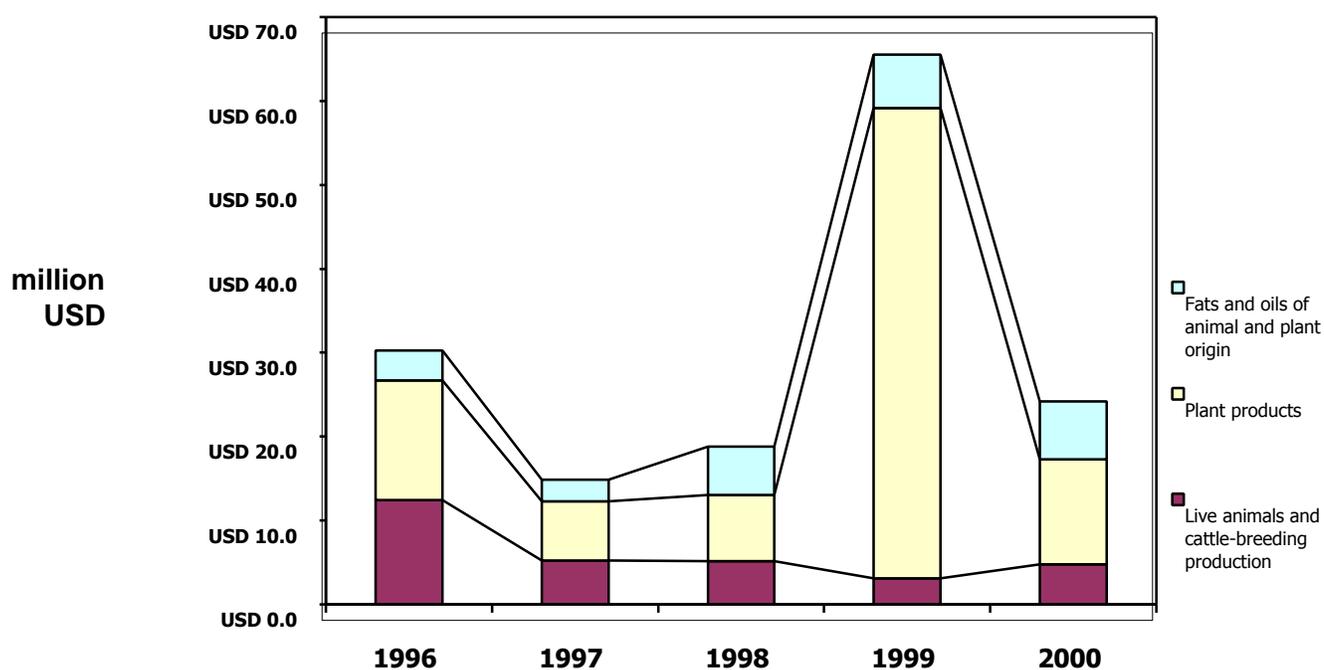
At present, there are practically no agriculture enterprises in Kharkiv Oblast that can break into the world market. Accordingly, the sector focuses almost entirely on supplying the growing domestic food processing sector—in spite of the fact that, from a global perspective, orientation toward domestic industry exclusively leads to isolation with respect to the exchange of technical and scientific information and equipment.

Grain and sunflower seeds are the main Kharkiv Oblast agricultural export products. In 1999, 13 agricultural enterprises exported 361,000 USD worth of products—0.12% of the region's total exports. The sector's export quota is a mere 0.03% of the entire agricultural gross product.

Table 3. Kharkiv Oblast Agricultural Exports: 2000 [7]

Export	Million USD	Ratio to Kharkiv Oblast Exports
Live animals and cattle-breeding production including:	4.77	1.51%
Live animals	-	-
Meat and food by-products	0.01	0.00%
Fish and fish products	0.36	0.11%
Milk and milk products; eggs	4.39	1.39%
Animal products	0.01	0.00%
Plant products including:	12.53	3.97%
Seedlings and other trees	0.00	0.00%
Vegetables, root-crops	0.13	0.04%
Fruits and nuts, citrus	0.14	0.05%
Coffee, tea, spices	0.09	0.03%
Grain crops	4.13	1.31%
Flour-grinding production	0.08	0.02%
Oil seeds and fruits	7.95	2.52%
Lacquers, tars	0.00	0.00%
Fats and oils of animal and plant origin	6.87	2.18%

Diagram 3. Sector Export Trade Structure (million USD) [7,8,9]



9. Competitive Environment of Sector Enterprises and Organizations

The following tables illustrate the Ukraine agricultural sector's present business priorities—not current volume of output.

Table 4. Ukraine Agricultural Sector Business Priorities by Oblast

Vinnitsya	Sugar, grain, sunflowers, gardening, meat/milk cattle breeding, pig breeding
Volyn'	Flax, potato, meat/milk cattle breeding, pig breeding
Dnepropetrovs'k	Grain, sunflowers, meat/milk cattle breeding, poultry farming
Donets'k	Grain, sunflowers, vegetable cultivation, poultry farming
Zhytomyr	Flax, sugar (in the south), meat/milk cattle breeding, pig breeding
Zakarpattia	Viniculture, vegetable cultivation, gardening
Zaporizhzhya	Grain, sunflowers, vegetable cultivation, poultry farming
Ivano-Frankivs'k	Meat/milk cattle breeding, flax, potato
Kyiv	Sugar, grain, vegetable cultivation, meat/milk cattle breeding, pig breeding, poultry farming
Kirovograd	Grain, sunflowers, sugar
Luhans'k	Grain, sunflowers
L'viv	Meat/milk cattle breeding, flax, sugar
Mykolaiv	Grain, sunflowers, viniculture, vegetable cultivation, gardening
Odessa	Grain, sunflowers, viniculture, vegetable cultivation, gardening
Poltava	Grain, sunflowers, sugar, pig breeding, meat/milk cattle breeding
Rivno	Sugar (in the south), flax, potato, meat/milk cattle breeding
Sumy	Sugar, grain
Terнопil'	Sugar, grain, pig breeding, milk cattle breeding
Kherson	Grain, sunflowers, vegetable cultivation, viniculture
Khmelnyts'ky	Sugar, grain, gardening, pig breeding, meat/milk cattle breeding
Cherkasy	Sugar, grain, meat/milk cattle breeding, pig breeding, gardening
Chernigov	Meat/milk cattle breeding, flax, potato, vegetable cultivation
Chernivtsi	Meat/milk cattle breeding, grain, sugar, gardening
Crimea	Viniculture, gardening, vegetable cultivation, grain, sunflowers

This is the same information reorganized according to specialization groups:

Table 5. Ukraine Agricultural Sector Business Priorities by Product Specialization Group

Sunflower	Dnepropetrovs'k, Donets'k, Zaporizhzhya, Kirovograd, Luhans'k, Mykolaiv, Odessa, Poltava, Kherson, Vinnytsya, Crimea
Grain	Dnepropetrovs'k, Donets'k, Zaporizhzhya, Kirovograd, Luhans'k, Mykolaiv, Odessa, Poltava, Kherson, Vinnytsya, Kyiv, Sumy, Ternopil', Kmelnyts'ky, Cherkasy, Chernivtsi, Crimea
Sugar	Vinnytsya, Kyiv, Rivno, Sumy, Ternopil', Kmelnyts'ky, Cherkasy, Zhytomyr, Kirovograd, L'viv, Poltava, Chernivtsi
Meat/milk cattle breeding	Ivano-Frankivs'k, L'viv, Chernigiv, Chernivtsi, Volyn', Dnepropetrovs'k, Zhytomyr, Cherkasy, Kyiv, Rivno, Ternopil', Vinnytsya, Poltava, Khmelnyts'sky

Trade barriers imposed by Russia increase the price of Ukrainian goods, making them uncompetitive with Russian products. When agricultural goods are exported to Russia, this activity is driven primarily by high profit margins, which can be 2-2½ times higher than domestic sales on certain products, including beef, pork, vegetables, and fruit.

The few Kharkiv Oblast agricultural products that are exported to the world market are represented by go-between trade companies. Currently, sunflower seeds are the most dynamically developing commodity with the most potential for exporters. In 2001, world demand for sunflower seeds is expected to be very high, since Argentina (Ukraine's major competitor in this area) has scaled back its cultivation areas, and will produce 2-2.5 million fewer tons of seeds.

10. Ownership in the Sector

In 1999, there were 536 collective- and state-owned sector enterprises, 1,172 farmers' enterprises, and approximately 52,000 individual private farms in Kharkiv Oblast. As of January 1, 2001, the number of collective farms had fallen to 27, due primarily to problems with legal registration. The overwhelming majority of the former collective farms became leased operations, private agricultural enterprises, economic associations, or agricultural production cooperatives.

The following are some of the distinguishing characteristics, both positive and negative, of the various types of ownership. [11]

Private enterprise:

- Ability to quickly reform enterprise without “confirmation” and “pressure” by other owners.
- Leasing arrangements can attract substantial capital, mostly from persons living in the same village. In the case of bankruptcy, the owner can give back the rented land, but may have problems with leasing property subsequently.
- The limited liability company (LLC) is a more attractive organizational form. Typically, a team of specialists (from two to several dozen) directs economic activity.
- LLCs offer the possibility of involving investors in the company's activity. These are often commercial structures, which may hold controlling blocks of shares.
- In comparison with joint-stock companies and cooperatives, the LLC is more dynamic, since in a small collective each member has a better chance of offering strategic and tactical ideas. Pensioners and hired workers have no legal influence, but LLCs still have to take into account their interests and positions.
- The activity of the LLC is based on leasing arrangements, which in effect put lessors' property at risk.

Open joint stock companies and closed joint stock companies have other peculiarities. Open joint stock companies were created when state farms were being privatized. Persons who bought securities for property privatization certificates (in other words, did not invest) became the shareholders of such companies. Distinguishing features include:

- Shareholders have no claim on property when leaving the company (e.g., to establish an individual enterprise). Shareholders do have the right to sell their shares, though the price can be extremely low if there is no demand.
- As a rule, Kharkiv Oblast agricultural sector open joint stock companies do not attract investment by means of securities issues.
- Open joint stock companies have practically the same problems with management and organization as collective farms. The positive distinguishing feature here is that holders of the controlling block of shares can make decisions.

The distinguishing characteristics of the closed joint stock company are:

- Enterprise heads can be overruled through one or more shareholders concentrating a controlling block of shares.
- Pensioners and juridical persons can be shareholders, so closed joint stock companies face the same problems as open stock companies.

Agricultural production cooperatives are a specific legal form of organization created for common agricultural production, and may require obligatory labor participation of cooperative members. As a rule, this form was chosen by those enterprises that did not want to make fundamental changes in the functioning of their enterprises. This change in organization form did not generally lead to changes in management personnel.

One positive feature is that, under the new form of organization, collective farm members and pensioners are considered associate shareholders.

It should be mentioned that the management system of many former collective farms has remained unchanged. And while collective farms technically do not exist any more, "reformed" collective farms have essentially the same problems.

According to the Ministry of Agricultural Policy, as of April 1, 2001, 1.08 million out of a total 6.6 million farmers in Ukraine (17%) had received governmental certificates of land ownership. The Ministry of Agricultural Policy intends to finish this documentation work by the end of 2002.

11. SME Growth in the Sector

As of January 1, 2001, 1,179 farms were registered in Kharkiv Oblast. SMEs are represented as follows:

- 51% in the general production volume of all agricultural products
- 47% in plant cultivation (with 13% of area under cultivation)
- 58% in animal husbandry

The average yield of SMEs in these agricultural categories is 300% higher than that of the reformed collective agricultural enterprises.

The complete absence of a microcredit system and high interest rates on leasing operations severely hinder the steady development of small enterprises. In addition, the property system remains less than optimal.

For many farmers, it is easier to operate a private part-time farm (PPF), without relations with taxation and other public agencies, to produce food mostly for their own use. Surplus goods can be sold at markets to recoup the costs of

production, which is more efficient than selling through the official channels. PPFs have turned out to be more viable than publicly-owned farms for a number of reasons, as noted below:

- PPFs can survive under conditions of nonpayment of wages and unemployment.
- PPFs are less susceptible to rising energy costs since they are manual labor-intensive.
- PPFs function in a different economic sphere: they do not realize deductions to special funds, do not pay VAT, and sell their products at or close to retail prices.

Some factors that would greatly stimulate development of PPFs include: development of small processing enterprises at the village level, improvement of transportation connections between rural areas and urban markets, and development of transport channels.

12. Sector Infrastructure

On the whole, Kharkiv Oblast has substantial educational and scientific resources. However, low demand inhibits full-scale technical development and introduction of new technological systems for tillage, storage, etc.

Currently there are seven research institutes in Kharkiv Oblast that perform scientific research for the agriculture sector:

- Animal Husbandry Institute
- Plant Cultivation Institute
- Soil Science Institute
- Vegetable-Growing Institute
- Silkworm Breeding Institute
- Pilot Stations of Gardening Institute
- Grain Growing Institute

In addition, a regional branch of the Agriculture Economy Institute is located in Kharkiv Oblast.

Institutions of higher education include:

- Kharkiv State Agrarian Institute
- Kharkiv Zooveterinary Institute
- Kharkiv State Technical University of Agriculture

A number of machine building enterprises host sector-related planning and design centers; the Kharkiv Tractor Plant is one example. The Kharkiv Branch of Organization of the Use of Land Institute and the Ukrainian Research Institute of Forestry and Agricultural Afforestation also deal with agrarian subjects.

In Kharkiv Oblast and in Ukraine on the whole, the agriculture sector's financial and trade infrastructure is underdeveloped. For example, there is not even a single mortgage bank, and very few credit resources.

Another infrastructure problem concerns inadequate road repair in Kharkiv Oblast's rural areas. The period during which rural roads go without maintenance averages 22 years; this state of disrepair contributes significantly to losses of goods in transport.

13. Management Capabilities of Sector Enterprises and Organizations

Management problems prevalent in the Kharkiv Oblast agriculture sector include poor labor discipline, absence of worker motivation, and an almost total absence of business education on the part of management personnel.

90% of Kharkiv Oblast agricultural enterprises do not carry out marketing research, either because of its high cost, or because management does not understand the need for it. Many business owners still believe that development of agricultural enterprises is a merely technical issue limited to such issues as shortage of equipment and manufacturing resources. Relatively few leaders have recognized the lack of structural adaptation to changing economic conditions as one of the sector's pressing problems.

14. Administrative Impact on the Sector

While the present weakness of the Kharkiv Oblast agricultural sector may at first sight appear to be due to a lack of modern technology and investment capital, another, deeper cause is the lack of structural reforms and underdevelopment of market institutions governing production and sales, which remain the responsibility of the state. In this respect, Kharkiv Oblast greatly depends on higher state authorities.

Since all stages of sector production are more or less under the control of the state, the high costs of agricultural production are attributable primarily to the defects of state institutions. Lack of competition is a critical problem. Decisions on who has the right to store, load, and transport goods are too often made on the basis of bureaucratic procedures and personal contacts. In addition, there is considerable circumstantial evidence that state officials offer preferential treatment to certain favored trade enterprises.

To all appearances, Kharkiv Oblast administrative authorities are planning to take an active part in helping to revive the animal husbandry branch. However, renewal efforts will rely mainly on private capital, with budgetary funds playing a subordinate role.

15. Social Issues of Sector Development

There are numerous ecological problems associated with intensive farming. The severity of ecological problems is categorized as follows: catastrophic, crisis, critical, poor, satisfactory, and favorable. Within the Kharkiv Oblast territory a number of situations classified as critical, poor, and satisfactory have been documented.

The use of pesticides in the region, especially from the mid 80s to the early 90s, was excessive, averaging 2.5-3.5 kg/hectare or more per year. Today, pesticide use averages about 1 kg/hectare. However, more than 1,200 tons of prohibited pesticides and compounds are still in storage at various storage facilities in Kharkiv Oblast. About 40% of the region's pesticide storehouses meet sanitary regulations.

Factory and domestic waste takes up 4,176 hectares, including 2,260 hectares of potentially valuable agricultural land. The biggest industrial polluters are the Zmiev Power Station and the "Baltsam" Joint-Stock Company. Within a 20 km radius from the Zmiev Power Station, heavy metals content exceeds natural levels by 120% to 220%, and mixtures of other metals exceed normal levels by 300%-600%, which degrades the quality of the regional environment and possibly impacts agricultural and livestock production.

Other social problems include:

- Alcoholism, which has become epidemic in the region's villages.
- Inadequate or total lack of medical care in rural areas. Social institutions such as hospitals, schools, etc. receive approximately 500%-600% less support than in urban areas.
- The flight of youth to cities and abroad, which has reached critical levels.
- Slow adaptation of farmers to new conditions, with many adhering to a subsistence farming psychology.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Most agriculture business plans and investment projects come from outside the sector, i.e., are not initiated by agricultural enterprises themselves. As a rule, these projects are developed by representatives of agrarian science and agricultural processing enterprises, and to a lesser degree, by representatives of service organizations and agricultural machine building enterprises.

A typical example of a sector business project concerned development of a seed-growing enterprise in Ukraine. A loan agreement between Ukraine and the European Bank for Reconstruction and Development (EBRD) was signed on September 28, 1995 and confirmed by the Verkhovna Rada on July 3, 1996. The project provided for the construction of several plants to increase production of high quality seeds, and also provided funds to equip laboratories at the Ministry of Agrarian Industrial Complex and at various institutes of the Ukrainian Agrarian Academy of Sciences. However, one loan totaling 10.9 million USD was canceled because of a projected low project payback. As a result, 92,000 USD in commissions for reservation of unused funds had to be paid out of the state budget. Another plant reduced production abruptly after reconstruction and became unprofitable; this facility still owes the Ministry of Finance 219,000 USD interest. A third borrower failed to complete construction of the plant within a five year period; losses totaled 200% more than revenues.

At present, production of export-oriented agricultural products (including sunflower seeds, buckwheat, and so on), and development of vertically integrated agricultural/industrial production systems are the main trends in the middle and large private investment projects being carried out today. As regards the last item, special emphasis is placed on the domestic market.

Conclusions

Agriculture is potentially one of the most promising economic sectors in Kharkiv Oblast. Development of vertically integrated agricultural/industrial systems that address all phases of production, from raw materials to finished product, has great potential.

Development of food and other agricultural product processing enterprises is one of the economy's major indexes. Achieving a high level of agricultural raw materials processing requires rational use of domestic resources, as well as attaining a high success rate in satisfying consumer needs.

The main problem facing the agriculture sector today is the absence of structural reforms underdevelopment of market institutions governing production and sales. In this respect, Kharkiv Oblast greatly depends on higher state authorities, and on Kyiv Oblast.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.	Products	Directors
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*NOT APPLICABLE

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

2. MINING

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Kharkiv Oblast is one of eight petroleum-producing regions in Ukraine. 35% of total national petroleum deposits are located in the region; the Shebelinkagazdobicha area produces 30% of the Ukrainian gas. At present, there are more than 100 industrial gas deposits in use. Though the Shebelinka deposit was opened 50 years ago, it remains the largest in Ukraine. In 2000, Kharkiv Oblast's sector share of the total volume of production of was 12.8%.

A considerable decrease in natural gas extraction volumes has been noted by fuel industry enterprises both in Kharkiv Oblast and in Ukraine as a whole. Even the application of a broad array of corrective measures, including establishment of a reliable resource base, reliable operation of existing wells, and timely development of new deposits, separate wells, and well groups cannot correct this negative trend. The decrease of gas extraction is due to natural depletion of large deposits. In a word, the amount of gas extracted from known deposits is not being fully compensated by development of new ones. Due to a number of factors, including a sharp decrease in resource boring volumes, depletion of existing wells, wear of basic production assets, etc., Kharkiv has become a large importer of energy resources, and especially, natural gas.

According to UkrNIIGas, to increase natural gas extraction from the Kharkiv deposits alone would require drilling approximately 200 new wells. Most of these would consist of deep drill holes, and would be classed as "supercomplex".

Considerable violations of the "Safety Rules of the Ukraine Gas Supplying System" have been committed by fuel industry enterprises. However, the committee has pointed out that meeting these requirements is becoming more and more difficult. For example, 46% of the Kharkivgorgas underground distribution pipelines have been in use for more than 40 years. The poor state of these pipelines led to 120 pipe faults/failures in 2000; 99 of these were due to corrosion. In addition, 1,655 gas leaks were detected at the leads-in. Four major gas leaks occurred at Kharkivgas pipelines in the Volchansk, Novovodolaga and Lozovaya districts. Lack of funding for preventive maintenance is the largest contributing factor to these leaks.

Local authorities believe that there are two possible solutions for solving these funding problems. The first is to return the status of juridical persons to fuel industry enterprises. The second is to preserve the present status of NAK Neftegas of Ukraine and make it the only taxpayer. The first alternative seems more appropriate. In addition to promoting efficiency within the oil and gas industry at the national level, a similar program should also be developed at the regional level. The minimum task for regional fuel industry enterprises in 2001 is to maintain extraction volumes and commodity output production. The longer-term strategic goal is to achieve a modern level of depth refining. There are a number of ways to transform Kharkiv fuel industry enterprises from suppliers of raw materials into suppliers of ready-made products. These include: investment, joint-stock ventures, and special free economic investment zones.

1. Sector Role in the Kharkiv Oblast Economy

Natural gas and oil play a vital role in the economy of the Kharkiv Oblast, and of the country in whole. More than 200 deposits, which have produced about 1.6 trillion cubic m of gas, have been developed in Ukraine during the last 100 years.

The largest potential resources of natural gas are in the Eastern part of Ukraine (65%). The potential gas resources in Ukraine that have not yet been prospected amount to more than 55% of the nation's total—more than three times the amount of existing deposits currently in production. Ukraine is the world's largest importer of natural gas, and third in world gas consumption (after Russia and the USA).

In February 2000, the Gashinovskoye petroleum deposit was discovered in Kharkiv Oblast; by late May oil was already being extracted at the site. JSC Ukrnafta put more than 40 such wells into production in Ukraine last year, yielding 30 tons of Gashinovskoye oil and 4000 cubic m of by-product natural gas.

During the course of the development of the Shebelinskoye gas field, its deposits were recalculated several times; each time the quantity was seen to increase substantially. The last recalculations proved that the initial gas deposits totaled 650 billion cubic m. Peak extraction volume—more than 31 billion cubic m—was reached in 1972. In 1973, extraction volumes began to decrease; according to experts, this declining trend will continue for at least two decades.

2. Strength of Kharkiv Oblast Sector

The number of fuel industry mining enterprises is limited, both in Kharkiv Oblast and in Ukraine in general.

Kharkiv Oblast is one of eight regions in Ukraine with oil and gas deposits. Kharkiv has 35% of the nation's total gas deposits; the Shebelinkagasdobycha deposit produces 30% of Ukraine gas annually.

There are currently more than 100 gas deposits of commercial importance being exploited in Ukraine. However, even half a century after its discovery in 1950, the Shebelinskoye deposit remains the largest. More than 580 billion cubic m of natural gas have been extracted over the past 50 years—a national record for the amount of gas mined at one deposit.

The newly discovered Gashinovskoye petroleum deposit is not significant in terms of Ukraine national production as a whole, but its importance for the Kharkiv Oblast should not be underestimated, especially if we take into account the Shebelinskoye and Yulievskoye gas deposits. In fact, natural gas from Shebelinskoye gas deposit has been exported the European regions of the former USSR as well as to Hungary, Czechoslovakia, Bulgaria, and Poland. Today, Shebelinkagasdobycha produces approximately one third of all natural gas extracted in Ukraine, with 1,118 wells at 31 oil deposits currently in production.

3. Economic Condition of Sector Enterprises and Organizations

In 2000, production output reached 937,226,100 UAH at current prices. Fuel industry production made up 12.8 % of total industrial production in Kharkiv in 2000.

A comparative analysis of fuel industry production during 1995–2000 is shown in **Table 1**.

Table 1. Fuel Industry Production: 1995–2000 (million UAH) [1, 2]

Index	1995	1996	1997	1998	1999	2000
Production output	386.9	540.5	503.9	692.0	922.3	937.2

A comparative analysis of fuel industry production by product type in Kharkiv Oblast for the period 1997-2000 is given in **Table 2**.

Table 2. Kharkiv Fuel Industry Production by Product Type: 1997-2000 [1, 3]

Product	1997	1998	1999	2000
Natural gas (million cubic m)	7128.9	6911.8	7103.0	6979.4
Oil (including gas condensate) (1000 tons)	125.3	131.5	133.0	148.0
▪ Oil (1000 tons)	1.0	1.9	14.3	30.2
▪ Gas condensate (1000 tons)	124.3	129.6	118.7	117.8

The year 2000 saw a trend in increasing petroleum extraction (including gas condensate) and decreasing natural gas extraction. In addition, making use of all available sources of funding, the region's fuel enterprises put the following facilities into production:

- 10 oil wells and 25 gas wells (including 6 oil wells and 7 gas wells within the Oblast)
- 1 gas distributing station with a capacity of 14,000 normal cubic m per hour
- preparation of 6 gas deposits (including 5 deposits within the Oblast)
- 116.88 km of main pipelines (including 8.72 km within the Oblast)

The total volume of sold goods (including works and services) was 881,723,100 UAH at current prices for the January-November 2000 period. By contrast, the total volume of sold goods was 842,110,200 UAH for the same period in 1999. Thus, we observe an increase of 39,612,900 UAH in the volume of sold goods in 2000.

A total of 203,929,200 UAH worth of fuel industry commodities—23.1% of total industry volume—were sold on barter terms during the period of January-November 2000. In 1999, 147,813,000 UAH worth of fuel industry commodities were sold on barter terms during the same period, which comprised 17.6% of total industry volume.

In 2000, 80,343,400 UAH worth of fuel industry commodities was sold for hard currency, which comprised 9.1% of the total industry volume. In 1999, 19,494,800 UAH worth of fuel industry commodities was sold for currency during the same period, which comprised 2.3% of total industry volume. Thus, the year 2000 saw an increase of 140% in the barter volume index. There was also a 410% increase in the currency payment index in 2000 relative to 1999.

A comparative analysis of fuel industry year-end surplus goods for the period 1997-2000 is shown in **Table 3**. [1, 2, 3]

Table 3. Fuel Industry Year-End Surplus Goods: 1997-2000*

Product	1997	1998	1999	2000
Natural gas (million cubic m)	-	-	-	-
Petroleum, including gas condensate (1000 tons)	12.8	13.6	14.8	12.2
▪ Oil (1000 tons)	-	0.2	0.3	0.6
▪ Gas condensate (1000 tons)	12.8	13.4	14.5	11.6

*Does not include raw materials given on commission.

As of January 1, 2000, fuel industry permanent assets totaled 702.5 million UAH. By January 1 2000, wear of permanent assets had reached 61.1%. In 2000, the fuel industry price index reached 70.3% relative to price levels of the previous December.

Prices continued to fluctuate during 1999-2000. A comparative analysis of fuel industry price indices for the period 1996-2000, with reference to prices of the previous December, is given in **Table 4**.

Table 4. Fuel Industry Price Indices: 1996-2000*

Index	1996	1997	1998	1999	2000
Price index	134.8	104.2	204.9	56.7	70.3

*Value added tax- and excise duty-free

4. Sector Development: Raw Materials Base

Coal is the most developed branch of the Ukraine fuel industry, and includes both coal and brown coal mining. The Donetsk Oblast is Ukraine's most important coal mining area.

Ukraine's petroleum industry is primarily located in two areas: Predkarpatye (in the Lvov and Ivano-Frankovsk regions) and Levoberezhye (Chernigov, Poltava, and Sumy regions). The Gashinovskoye petroleum deposit was discovered in Kharkiv in February 2000. Extraction volumes at this deposit total 30 tons of raw oil and 4000 cubic m of by-product natural gas per day. Shebelinskoye, in Kharkiv, is one of Ukraine's largest natural gas deposits. 35% of Ukraine's total gas deposits are located at Shebelinskoye. Almost a billion cubic m of gas flows through a 42-km pipeline to the Kharkivtransgas pipeline system annually. This procedure has been in place for six years. Some experts assert that this deposit is capable of producing 11000 ton annually for another twenty years.

5. Sector Development: Technological Base

A considerable decrease in natural gas extraction volumes has been noted by fuel industry enterprises both in Kharkiv Oblast and in Ukraine as a whole. Even the application of a broad array of corrective measures, including establishment of a reliable resource base, reliable operation of existing wells, and timely development of new deposits, separate wells, and well groups cannot correct this negative trend. The decrease of gas extraction is due to natural depletion of large deposits. In a word, the amount of gas extracted from known deposits is not being fully compensated by development of new ones. Due to a number of factors, including a sharp decrease in resource boring volumes, depletion of existing wells, wear of basic production assets, etc., Kharkiv has become a large importer of energy resources, and especially, natural gas.

The subdivisions of UkrNIIGas, with their scientific base and experience in this area, have developed a number of new approaches to solving this problem. However, it is not possible to implement dozens of new projects. Since exploration work volumes decrease rather than increase, we cannot count on the discovery of new deposits and their introduction into the economy at this time. The primary gas stream is being produced by old, highly depleted wells. At this stage, extraction rates should be reduced at these wells.

Recent developments at JSC Ukraine Innovation Technologies include an ecologically clean process that increases extraction rates through chemical impact on productive gas layers. Industrial experimental tests performed on two

wells showed that it is possible to increase well productivity by 500%-1000%, which ultimately could increase the balance of the fuel-energy complex, not only in Kharkiv Oblast, but also throughout Ukraine.

These developments are more effective for large and medium deposits. As far as small gas deposits and separate well groups with small debit are concerned, the use of autonomous schemes of natural gas and condensate might be more efficient. This problem could be solved by setting up small gas refining plants with corresponding facilities and equipment.

Significant developments are also taking place at UkrNilgas, the North-East Scientific Center of the Ukraine National Academy of Sciences, and at a number of other research centers in Kharkiv. One new technology consists of refining natural gas into methanol and other useful products, with parallel production of electricity directly at the deposit, or even at a separate well. This refinery would be backed up by a small gas refining plant.

6. Investment Activities in the Sector

A comparative analysis of fuel industry internal investments for the period 1995-1999 is shown in **Table 5**.

Table 5. Internal Investments in Fuel Industry Enterprises: 1995-1999 (million UAH)

Index	1995	1996	1997	1998	1999
Internal investments	48.9	130.9	184.3	207.7	113.9

During the first nine months of 2000, internal investment in fuel industry enterprises totaled 223.2 million UAH. A comparative analysis of direct foreign investments in fuel industry enterprises from 1998 through the first 9 months of 2000 is shown in **Table 6**.

Table 6. Direct Foreign Investments in Fuel Industry Enterprises: 1998-First 9 Months of 2000 (million USD)

Index	1998	1999	9 Months of 2000
Direct foreign investments (million USD)	0.1	0.1	0.1

Distribution of direct foreign investment by country is as follows:

Depending on investing country the direct foreign investments are distributed in the following way (information for 1998, for 1999, for 9 months of 2000 is the same):

- Great Britain – 0.05 million USD
- USA - 0.05 million USD

7. Employment and Personnel Potential in the Sector

By the end of 2000, total regular employees in the Kharkiv Oblast fuel industry was:

- 4,521 employees in October 2000
- 4,516 employees in November 2000 [2]

A comparative analysis of fuel industry employment figures for the period 1995-1999 is given in **Table 7**.

Table 7. Fuel Industry Employee Index: 1995-1999 (1000 people) [1]

Index	1995	1996	1997	1998	1999
Employees	3.9	4.7	4.2	4.1	4.4

Employment figures for the Kharkiv fuel industry increased from 0.7% in 1995 to 1.0% in 1999 relative to the Ukraine fuel industry as a whole. Employment figures for the Kharkiv fuel industry fluctuated from 0.4% to 0.5% during 1995-1999 relative to total employment in Kharkiv Oblast as a whole.

Average monthly salary of for regular employees was:

- 660.6 UAH in October 2000
- 581.9 UAH in November 2000 [2]

A comparative analysis of fuel industry average monthly salary for the period 1995-1999 is shown in **Table 8**.

Table 8. Fuel Industry Regular Employees Average Monthly Salary: 1995-1999 (UAH) [1]

Index	1995	1996	1997	1998	1999
Average monthly salary	155.6	366.5	450.0	485.4	554.4

8. Sector Exports

A comparative analysis of fuel industry exports for the period 1996-1999 is shown in **Table 9**.

Table 9. Fuel Industry Exports: 1996-1999 (million USD) [4, 5]

Index	1996	1997	1998	1999
Export volume	1.7	0.7	0.1	0.2

9. Competitive Environment of Sector Enterprises and Organizations

The number of fuel industry extraction and refining enterprises is limited, both in Kharkiv and in Ukraine as a whole. In spite of the fact that the Kharkiv Oblast has two major gas deposits (Shebelinskoye and Yulievskoye) and one major petroleum deposit (Gashinovskoye) within its territory, this branch of industry in the Oblast cannot be regarded as competitive.

Most of the resources extracted in Kharkiv Oblast are consumed within the region; and in fact, Kharkiv is a subimporter of fuel resources. Accordingly, Kharkiv fuel industry enterprises are relatively insignificant in the Ukraine, NIS, and world markets.

10. Ownership in the Sector

As of January 1, 2001, there were no private fuel industry enterprises in the sector.

11. SME Growth in the Sector

There are practically no small- or medium-size enterprises in the sector, since large investments are required for development.

12. Sector Infrastructure

Energy conservation is a critical problem for Kharkiv Oblast. Increasing the energy potential of the oblast through the introduction of more efficient technologies for extraction at small gas condensate deposits should ameliorate the current energy shortage and contribute to its future solution.

One potential means of reviving the gas industry in Kharkiv Oblast deserves special attention. It is well known that almost 30% of the gas on the world market consist of liquefied gas. This is in part due to the limited availability of gas pipelines for oblasts separated by oceans and seas. It is not cost-effective to lay pipelines from a small deposit directly to consumers, or to a gas distribution/accumulation/refining system.

Funding of research and applications for liquefying condensate on the bottom of a deposit layer would help Ukraine in self-procuring liquefied gas. Natural gas and gas condensate can also be treated as valuable chemical raw materials, especially in the production of engine fuels. Such installations are already in operation on the base of the Shebelinskoye deposit, and are being used to help meet the demand of oblast consumers for engine fuel. These techniques could be shared with Ukraine's other gas extracting regions; however, implementation is hampered primarily by underfunding, and in some cases, the complete lack of it.

According to UkrNIIGas, to increase natural gas extraction from the Kharkiv deposits alone would require drilling approximately 200 new wells. Most of these would consist of deep drill holes, and would be classed as "supercomplex". To introduce techniques that have already been used abroad, it is necessary to find domestic funding. It is here that the possibility of establishing machine-building enterprises arises. The necessary equipment is already being produced by Kharkiv enterprises.

The field of working activity is also expanding for R&D organizations. For example, the Kharkiv R&D Institute of Machine-Building Technologies is developing techniques for increasing the reliability and service life of oil and gas equipment parts through use of the gas-detonation strengthening method.

Again, in order to carry out the necessary research and development, investments are needed. The use of local funding as initial capital is vital. Other key factors include the integration of science and industry, involvement of commercial banking and financial organizations, and the privatization of gas industry concerns.

13. Management Capabilities of Sector Enterprises and Organizations

For a long time there simply was no management system in the sector, nor any efficient way of controlling the expenses and income of these branch enterprises. Mining activity did increase, but there was no working management and control mechanism. In 2000, it was suggested that a special authority be set up to oversee licensing and control of petroleum enterprises in the Ukrainian market.

14. Administrative Impact on the Sector

The following legislation concerns the regulation of Ukraine domestic oil and gas extraction:

- “On pipeline transportation”
- “On transportation”
- “On agreements on division of production”
- the law of resources; and a number of other documents

In the summer of 2000, the Verhovna Rada passed the law entitled, “On oil and gas”. Among its other provisions, this law provided for the establishment of one more authority in the sector to oversee “licensing and controlling of the activity of oil and gas extractors on the Ukrainian market”. However, the president vetoed this law.

On 11 December 2000, the Cabinet of Ministers of Ukraine passed the decree entitled, “On the Procedure of Providing the Economics Branches and the Population with Natural Gas in 2001”. One of the new features of the Procedure is that NAK Neftegas of Ukraine will be responsible supplying gas to municipal heat and power plants, and to commercial boiler houses in 2001. According to the Procedure, NAK was required to supply these facilities with gas from January 1 through April 15, 2000 only, i.e., till the end of the winter-spring period. After that, “teplocommunenergo” and boiler houses were free to decide whether to acquire gas at an auction or on works contracts. In 2001, NAK will supply any gas that remains unclaimed (after supplying the population, budget consumers, “teplocommunenergo”, and boiler houses) to thermoelectric power stations. In addition, commercial consumers will be able to purchase gas from extracting enterprises not included in NAK’s structure or from its suppliers.

One of the most important new features of the gas supplying Procedure of 2001 is the establishment of clearing accounts in authorized banks to allow for transfers from gas consumers and reimbursement of transportation costs. The money will then be distributed in accordance with the algorithm worked out by NAK and approved by NKRE.

Another principally new feature of the Gas Supplying Procedure of 2001 is that only those consumers who have paid in full are supplied with gas. The procedure also reduced the time period during which gas suppliers can give notice of discontinuing gas service. Local authorities are responsible for discontinuing the gas supply in the event of nonpayment.

15. Social Issues of Sector Development

For several years, fuel industry enterprises were the principal polluters of the Kharkiv environment, namely, the Kharkiv and Kupiansk Gas-Main Pipeline Administration, and GPU Shebelinkagasdobycha.

The Technological-Ecological Security and Emergency Committee discussed this problem and published its findings in the document entitled, “The responsibility of the enterprises and units of gas supplying complex located on the territory of the oblast and their activity compliance with the safe operation regulations”.

Considerable violations of the Safety Rules of the Ukraine Gas Supplying System have been committed by fuel industry enterprises. However, the committee has pointed out that meeting these requirements is becoming more and more difficult. For example, 46% of the Kharkivgorgas underground distribution pipelines have been in use for more than 40 years. The poor state of these pipelines led to 120 pipe faults/failures in 2000; 99 of these were due to corrosion. In addition, 1,655 gas leaks were detected at the leads-in. Four major gas leaks occurred at Kharkivgorgas

pipelines in the Volchansk, Novovodolaga and Lozovaya districts. Lack of funding for preventive maintenance is the largest contributing factor to these leaks.

The Gosnadzor Administration on Labor Protection revealed 620 violations of fenced-off areas of high-pressure pipelines in Kharkiv alone, and about 1800 violations in regional districts. A total of 56 officials were held responsible. Unfortunately, despite numerous warnings from Gosnadzor, officials of Kharkivtransgas and other organizations have not yet succeeded in fencing off the main pipeline area in Pyatikhatki and Kharkiv, where private garages are being erected in the neighborhood of the pipelines. Blackouts at gas supplying organizations are also disturbing because of the shutdown of electric-chemical protection stations. In addition, equipment embezzlement causes a number of station shutdowns: in 2000, more than 100 stations were put out of order as a result of equipment theft.

In January-February 2001, the Committee implemented a broad range of safety measures covering the safe operation of equipment, fencing-off of high pressure main pipeline areas, and enforcement of controls governing the reliable and safe operation of gas distribution networks.

In spite of the fact that Kharkiv Oblast possesses 35% of Ukraine's total gas deposits, and that the Shebelinkagasdobycha deposit contributes more than 30% of all gas produced in Ukraine annually, Kharkiv Oblast hardly benefits at all. This is primarily the fault of management of the oil and gas industrial complex, which does not ensure regular financial settlement, and which has practically divided regional interests from those of the state.

There is no centralized management of these branch enterprises of the branch. Funds received for extracted oil and gas are handled solely by NAK Nefetgas of Ukraine. As a result, regional enterprises suffer chronic shortages of funds, and the eight petroleum-producing regions receive only the minimum of funds for extracted fuel resources. There have been cases where the tax authorities have requisitioned over 60% of extracted petroleum products from Kharkiv enterprises to offset budget arrears. These arrears appear to be due to flaws in the gas payment system. In addition, the Shebelinskoye subdivision cannot function properly owing to debts of 1 billion UAH and accounts receivable in excess of 3 billion UAH.

Local authorities believe that there are two possible solutions for solving these funding problems. The first is to return the status of juridical persons to fuel industry enterprises. The second is to preserve the present status of NAK Neftegaz of Ukraine and make it the only taxpayer. The first alternative seems more appropriate. In addition to promoting efficiency within the oil and gas industry at the national level, a similar program should also be developed at the regional level. The minimum task for regional fuel industry enterprises in 2001 is to maintain extraction volumes and commodity output production. The longer-term strategic goal is to achieve a modern level of depth refining. There are a number of ways to transform Kharkiv fuel industry enterprises from suppliers of raw materials into suppliers of ready-made products. These include: investment, joint-stock ventures, and special free economic investment zones.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

The fuel industry plays an important role in overall investment in the oblast. Today, Kharkiv enterprises are prepared to work with other regions, businessmen, and investment companies in exploration and extraction of the region's gas and oil deposits. Kharkiv's energy system is separate from the national energy system as a whole, and consumes most of its production output. This is why the most important investment proposals have to do with projects dealing with conservation of energy resources, and especially those that concern gas conservation. For example, an energy saving program is being implemented at housing and communal services plants which is intended to remain in place through the end of 2005. Further measures on rational use of fuel energy resources, technologies, equipment saving are planned. Additional projects, such as autonomous installations using gas, marginal wells and well gas, and the creation of an automatic complex for state diagnostics and damage prevention, are also being developed.

Conclusions

On the basis of the present analysis, it is possible to draw the following conclusions:

- 35% of total national petroleum deposits are located in the Kharkiv Oblast.
- There are more than 100 commercially gas-bearing deposits in Ukraine in active production.
- The role of the fuel industry in the Kharkiv economy has increased relative to previous years.
- Despite all this, there is a negative trend of considerable decline in natural gas and oil extraction volumes both in Kharkiv Oblast and in Ukraine as a whole.
- There are a number of reasons for this decline, including: sharp decrease of resource boring volumes, depletion of the existing wells, and aging of basic production assets.

In light of these factors, investment in fuel resource conversation projects is the number one funding priority.

List of Sources

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List of Main Enterprises and Organizations in the Sector

Enterprise Name	Address	Telephone No.		Products	Directors
Shebelingasprom, subsidiary of Ukgasprom JSC	9, Zhovtneva Str. Chervoniy Donets' Urban Village, 64250 Kharkiv Oblast	(249) 5-43-04 (249) 9-93-15	(249) 5-20-24	Natural gas	Gorbenko Valentyn Petrovych, Director General

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

3. UTILITIES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

Electricity in Kharkiv Oblast is generated by thermal power plants (the Zmiyiv thermal power plant is one of the most powerful in Ukraine) and heat and power plants (the most powerful of which are heat and power plants #3 and #5). During the year 2000, there has been a decreasing trend in sales on barter terms and a corresponding increase in cash payments. However, cash payment is still rather low, at 38% of total sales.

The thermal power plants of eastern Ukraine, and specifically the electric power stations of Kharkiv Oblast, mainly use Donetsk coal for power production. Today, thermal power plants are inflicting significant ecological damage to surrounding areas, partly through the use of low-grade coal and heavy use of oil and natural gas for “highlighting”. At the same time, the increasing incidence of emergency stops of boilers and rising fuel rates contribute to heavy losses. Obsolescence is another factor, in that a large percentage of thermal utility equipment dates back to the 1960s.

One of the necessary conditions for sector efficiency is proper maintenance of primary equipment at electric power stations. Currently, there is a shortage of materials and spare parts due to a lack of funds, which results in a negative influence on the technical state of primary equipment.

1. Sector Role in the Kharkiv Oblast Economy

Kharkiv Oblast’s utilities make up a powerful, complicated technological complex that is the basis of the entire economic production life of the region. In addition, a number of Ukraine’s leading sector scientific, educational, and maintenance organizations are located in Kharkiv Oblast.

The oblast’s utility system has been separate from Ukraine’s national power system for a long time, and has satisfied the demands of the region with its own production capabilities (especially the Zmiyiv thermal power plant, thermal power station #5), and through overflows from Russia. But at the end of 1999, Ukrainian and Russian utility systems ceased parallel operations, which resulted in the disconnection of the Kharkiv and Sumi oblasts, as well as part of the Poltava oblast, from the Russian single utility system.

One of the reasons for the longevity of the “utility island” was the transport of Russian power to the Northern Caucasus through the territory of Ukraine. During the period of the utility systems division, direct power supplies were stopped; however, a “substitution” scheme was introduced, in which Ukraine received power to the island, and in turn provided the same amount of power to Rostov Oblast. Subsequent construction of new Russian facilities made it possible to bypass Ukraine. The renovation of the utility island in east Ukraine is currently an open question.

The importance of the utility sector in the Kharkiv regional economy is proven by the fact that its share of the total volume of production was 15.9% in 2000 (compared with 12.2% for the average oblast). In spite of this, Kharkiv remains a large industrial center that consumes more power than it produces. For this reason, the introduction of reconstruction programs and renovation of existing power generation facilities are just as important as energy saving programs.

2. Strength of Kharkiv Oblast Sector

The structure of Ukraine’s utilities sector is shown in **Table 1**.

Table 1. Sector Structure [1]

REGULATORY AUTHORITY Ministry of Energy and electrification of Ukraine, National committee of utility regulation of Ukraine POWER ENERGY SYSTEMS Dniprovsk, Donbas, Western, Crimean, Southern, Southern, Southwestern, Northern, Central	STATE ENTERPRISES “Energorinok” National utility company “Ukrenergo”
ENERGY GENERATING COMPANIES	ENERGY SUPPLYING COMPANIES
<p>OJST “Dniproenergo” Zaporizhzhya thermal power plant, Kriviy Rig thermal power plant, Pridniprovka thermal power plant</p> <p>OJST “Zahidenergo” Burshtinska thermal power plant, Dobrotvirska thermal power plant, Ladizhinska thermal power plant</p> <p>OJSC “Donbasenergo” Zuivska thermal power plant thermal power plant, Kurahivska thermal power plant, Luganska thermal power plant, Slovyanska thermal power plant, Starobeshivska thermal power plant</p> <p>OJSC “Centrenergo” Vuglegirska thermal power plant, Zmiyivska thermal power plant, Tripilska thermal power plant</p> <p style="text-align: center;"><i>(99 power units with aggregate production capability of 28027 megawatts at 14 thermal power plants of energy generating companies)</i></p> <p>“Dniprogidroenergo” Cascade Kiev hydroelectric power station, Kaniv hydroelectric power station, Kremencug hydroelectric power station, Dniprodzerzhinsk hydroelectric power station, Dniprovsk hydroelectric power station, Kahovka hydroelectric power station</p> <p>“Dnistrogodroenergo”</p> <p style="text-align: center;"><i>(Total capability of 44 hydroelectric power stations and atomic hydroelectric power station – 4708 megawatts)</i></p> <p>National atomic energy generating company “Energoatom” Zaporizhzhya atomic power station, Southern Ukrainian atomic power station, Rivne atomic power station, Khmelnytskyi atomic power station, Chornobyl atomic power station*</p> <p style="text-align: center;"><i>(Total capability of 14 power units – 12 812 megawatt)</i></p>	<ul style="list-style-type: none"> ▪ Vinnytsaoblenergo ▪ Volinoblenergo ▪ Dniprooblenergo ▪ Donetskoblenergo ▪ Zhytomyroblenergo ▪ Zakarpattiaoblenergo ▪ Zaporizhzhyaoblenergo ▪ Kievenergo ▪ Kievoblenergo ▪ Kirovogradoblenergo ▪ Krimenergo ▪ Luganskoblenergo ▪ Lvivoblenergo ▪ Mykolayivoblenergo ▪ Odessaoblenergo ▪ Poltavaoblenergo ▪ Prikarpattiaoblenergo ▪ Rivneoblenergo ▪ Sevastopolmiskenergo ▪ Sumyoblenergo ▪ Ternopiloblenergo ▪ Kharkivoblenergo ▪ Khersonoblenergo ▪ Khmelnytskoblenergo ▪ Cherkasyoblenergo ▪ Chernivtsyoblenergo ▪ Chernigivoblenergo <p style="text-align: center;"><i>(Total length of transmission facilities of all classes of power is greater than 1 million km, trunk transmission lines with the power of 220-750 kilowatt – 21,700 km)</i></p>
*Closed December 15, 2000.	

Electricity in Ukraine is also generated by 243 industrial thermal power stations (with a total production capacity of 3100 megawatts); 27 common-use thermal power stations (with an aggregate production capacity of 4104 megawatts); 8 wind power stations with a total production capacity of 14 megawatts (138 total units). Ukraine thermal power plants rely primarily on coal, fuel gas, and oil for power production. The structure of electricity consumption is shown in **Diagrams 1 and 2**. Besides electricity, the majority of large thermal power stations also produce heat for district heating.

Diagram 1. Annual Electricity Consumption in the Ukraine Economy (million kW per year) [1; 2]

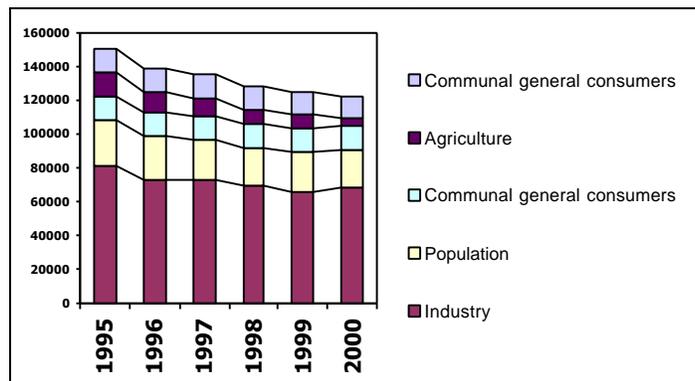
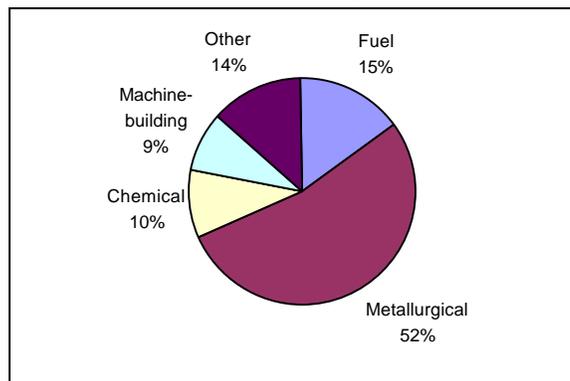
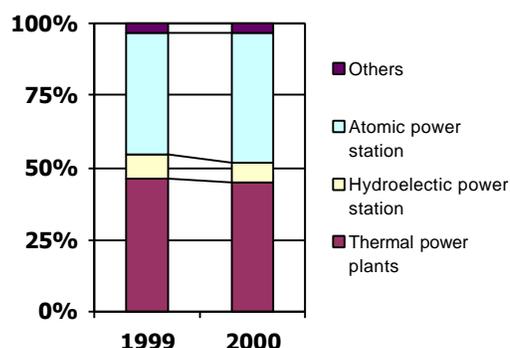


Diagram 2. Distribution of Energy Consumption in Ukraine Industry in 2000 (%) [1].



44.7% of total energy production is produced by thermal power plants; 45.3% is produced by atomic power stations; and 6.7% by hydroelectric power stations. In 1999, these figures were 46.4%, 42.0% and 84%, respectively. [1]

Diagram 3. Energy Production Structure



Kharkiv Oblast utility power production volumes for the period 1995-2000 are shown in **Diagrams 4 and 5**. Ukraine energy consumption rates by oblast for the first two months of 2001 are shown in **Table 2**.

Table 2. Ukraine Energy Consumption by Region of Ukraine: January-February 2001 [1]

Oblast	Energy Consumed (brutto)			Energy Sales (netto)		Industry		Agricultural Consumers		Population		Others	
	Fact	% till 2000	% till Ukraine	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000
Southeastern electric power station	1586	-12.6	5.5	981	-20.1	206	-9.4	93	-41.3	364	-15.3	319	-22.7
Vynnytsya Oblast	586	-20.5	2.0	340	-26.1	76	-13.0	33	-44.5	111	-5.3	121	-38.8
Temopil Oblast	279	-11.0	1.0	172	-21.0	36	-8.9	20	-47.5	59	-27.7	58	-3.4
Khmelnyskyi Oblast	452	-5.4	1.6	293	-15.7	72	-6.5	34	-33.5	91	-19.3	96	-9.8
Chernivtsy Oblast	268	-5.8	0.9	175	-12.7	22	-6.0	6	-40.1	103	-12.8	44	-10.1
Dniprovska electric power station	7855	4.2	27.3	6660	3.9	4889	10.2	121	-47.6	637	-9.6	1012	-2.3
Dnipropetrovsk Oblast	5032	6.4	17.5	4406	6.0	3368	12.0	51	-55.6	353	9.1	634	-1.8
Zaporizhzhya Oblast	2331	2.8	8.1	1895	2.4	1431	7.0	49	-46.1	191	-3.7	225	-0.5
Kirovograd Oblast	493	-8.8	1.7	358	-10.5	90	-1.8	21	-16.0	93	-20.9	154	-7.0
Donbas electric power station	6989	0.0	24.3	5611	-0.8	3956	-0.1	91	-38.5	682	10.5	882	-5.2
Donetsk Oblast	4810	-0.9	16.7	3850	-2.4	2763	-1.2	68	-35.2	445	2.2	574	-5.2
Lugansk Oblast	2180	2.0	7.6	1762	2.8	1193	2.6	23	-46.6	237	30.0	308	-5.2

Oblast	Energy Consumed (brutto)			Energy Sales (netto)		Industry		Agricultural Consumers		Population		Others	
	Fact	% till 2000	% till Ukraine	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000	Fact	% till 2000
Central power station	3531	-1.8	12.3	2693	-2.8	825	3.2	147	-30.0	786	-3.4	936	-1.2
Kiev City	1286	1.6	4.5	1022	2.2	221	6.3	2	-5.4	369	-3.2	429	5.1
Kiev Oblast	788	-1.0	2.7	581	-6.1	182	11.2	54	-31.8	140	-9.6	205	-7.3
Chernihiv Oblast	357	-4.6	1.2	295	-2.2	95	1.8	23	-27.9	85	7.3	92	-5.2
Cherkasy Oblast	647	-4.8	2.2	467	-6.8	227	-3.0	43	-30.3	97	-6.9	100	-1.2
Zhytomyr	453	-5.4	1.6	328	-5.6	100	-0.5	24	-28.6	95	1.1	109	-8.5
Crimean electric power station	1179	-6.1	4.1	774	-2.8	124	2.5	41	27.2	322	-2.4	288	-0.8
Autonomous Rep. of Crimea	996	-7.7	3.5	647	-4.4	105	-1.5	39	-28.0	288	-3.1	216	-1.9
Sevastopol City	183	3.4	0.6	127	6.3	19	32.2	2	-4.7	35	3.8	72	2.6
Western electric power stations	2306	-4.8	8.0	1614	-4.7	581	1.0	55	-23.4	441	-3.0	537	-9.3
Volin Oblast	266	-1.3	0.9	172	4.5	51	13.7	17	-18.6	56	14.7	49	-3.9
Zakarpattia Oblast	386	-6.6	1.3	224	4.0	30	-1.6	5	-28.8	105	12.3	85	-0.7
Ivano-Frankivsk Oblast	418	-12.2	1.5	320	-16.1	171	3.2	9	-31.0	81	-7.6	59	-48.9
Lviv Oblast	813	-1.0	2.8	569	-5.7	175	-3.9	11	-30.3	129	-20.2	254	4.0
Rivne Oblast	422	-4.0	1.5	329	0.2	154	1.3	14	-15.0	71	10.9	90	-6.2
Southern electric power station	2558	-2.9	8.9	1563	-1.9	341	0.9	86	-43.7	577	4.2	560	1.9
Mykolayiv Oblast	704	-3.9	2.4	476	11.3	130	-0.7	27	-46.3	165	54.3	155	10.4
Odessa Oblast	1224	-0.7	4.3	687	-10.3	146	5.9	32	-33.1	197	-26.3	311	-0.3
Kherson	630	-5.8	2.2	400	0.1	65	-6.2	27	-50.6	215	19.8	93	-3.3
Northern electric power station	2766	-3.9	9.6	2082	-4.5	888	-0.7	122	-32.9	460	-4.1	612	-1.8
Poltava Oblast	832	-11.1	2.9	676	-6.5	393	-4.8	44	-38.0	104	4.9	135	-3.6
Sumy Oblast	438	-4.9	1.5	354	1.2	168	-0.5	28	-14.7	75	16.5	84	-0.9
Kharkiv Oblast	1497	1.0	5.2	1052	-4.9	327	4.5	50	-35.8	281	-11.1	394	-1.4
Ukraine (total)	28770	-1.2	100	21977	-1.6	11810	4.0	756	-37.5	4268	-2.6	5144	-4.4

Diagram 4. Electricity Generation in Kharkiv Oblast [3, 4]

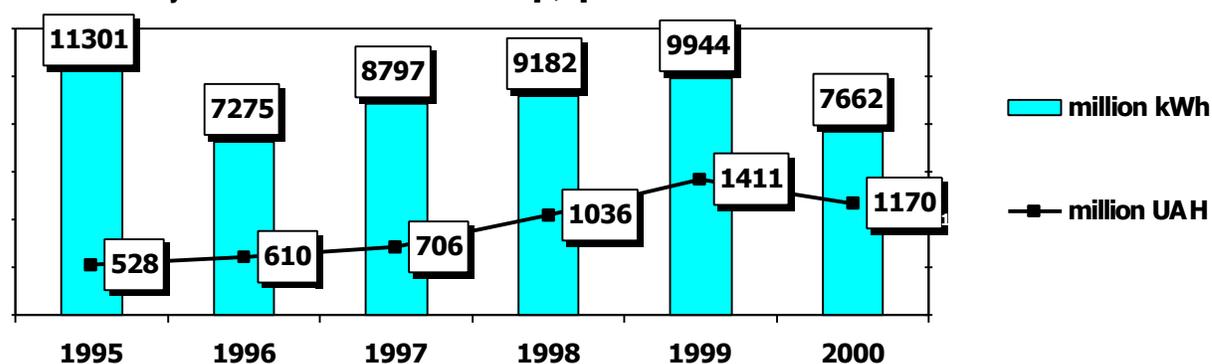
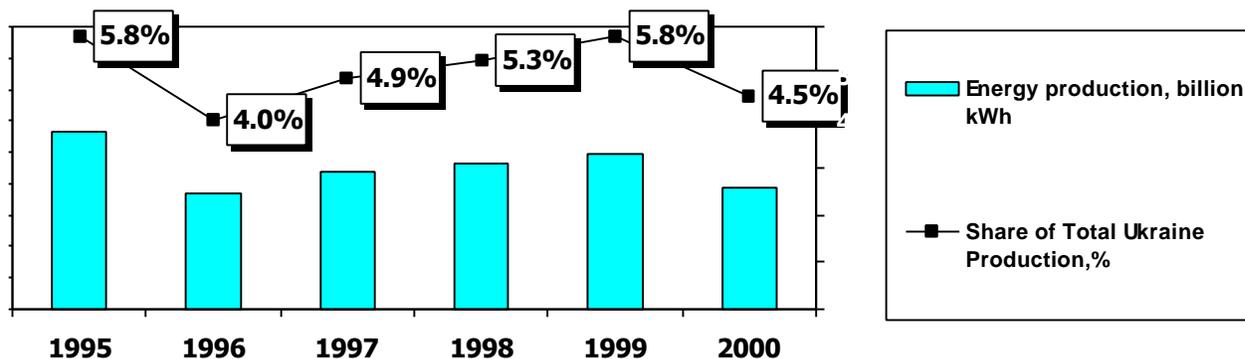


Diagram 5. Kharkiv Oblast Utilities Share of Total Ukraine Energy Production [1, 2, 3, 4]



3. Economic Condition of Sector Enterprises and Organizations

As of 1 January 2000, Kharkiv Oblast utilities had fixed assets with depreciated cost totaling 898.7 million UAH, while deterioration of fixed assets made up 53.1%. During the year 2000 there has been a decreasing trend in sales volumes on barter terms and a corresponding increase in cash payments. However, cash payment is still rather low, at 38% of total sales.

Sector accounts payable/receivable as of 1 January 2001 are as follows:

- Accounts receivable: 1.2 billion UAH
- Accounts payable: 1.6 billion UAH

At the national level, the figures are even worse: at the beginning of 2001, accounts payable were 200% greater than accounts receivable. [1]

Total utility net gain for 2000 was 72.5 million UAH, as shown below. [5]

- Profit: 99.3 million UAH
- Loss: 26.8 million UAH

4. Sector Development: Raw Materials Base

Raw materials used in electricity generation in Ukraine include: coal, oil, and natural gas. In addition, there are atomic and solar energy facilities, as well as wind and water mills. Minenergopalivo expenditures on organic fuels for power production during 1999-2000 are shown in **Table 3** (following page).

Table 3. Minenergopalivo Expenditures on Organic Fuels for Power Production: 1999-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Coal. million tons	40.8	36.6	42.6	42.9	36.6	40.0	31.1	29.5	27.1	28.3	26.7
<i>Coal. % to 1990</i>	100.0%	89.7%	104.4%	105.1%	89.7%	98.0%	76.2%	72.3%	66.4%	69.4%	65.4%
Gas. billion m3	33.8	30.3	26.3	20.2	19.5	14.3	14.1	12.9	11.7	13.1	12.1
<i>Gas. % to 1990</i>	100.0%	89.6%	77.8%	59.8%	57.7%	42.3%	41.7%	38.2%	34.6%	38.8%	35.8%
Black oil. million tons	9.8	11.0	7.4	4.8	3.0	2.4	1.7	1.4	1.4	0.6	0.2
<i>Black oil. % to 1990</i>	100.0%	112.2%	75.5%	49.0%	30.6%	24.5%	17.3%	14.3%	14.3%	6.1%	2.0%
Energy production. Billion kilowatt per year	201.7	182.7	162.3	135.5	115.8	107.6	88.1	82.8	76.6	79.6	76.3
<i>Energy production. % to 1990</i>	100.0%	90.6%	80.5%	67.2%	57.4%	53.3%	43.7%	41.1%	38.0%	39.5%	37.8%

Atomic power stations use uranium dioxide for power production. Approximately 50% of the supply is imported from Russia, and 50% is of domestic origin. Ukraine thermal power plants rely primarily on coal, fuel gas, and oil for power production. The thermal power stations of eastern Ukraine—namely, the electric power stations of Kharkiv Oblast—mainly use Donetsk coal for production. Donbas coal is characterized by high ash and sulfur content (averaging 25% and 2.5% respectively).

Today, thermal power plants are inflicting significant ecological damage to surrounding areas, partly through the use of low-grade coal and heavy use of oil and natural gas for “highlighting”. These plants are suffering significant economic losses. At the same time, the increasing incidence of emergency stops of boilers and rising fuel rates contribute to heavy losses. Obsolescence is another factor, in that a large percentage of thermal utility equipment dates back to the 1960s. Utility sales are shown in **Table 4**.

Table 4. Specific Utility Sales, kg [3]

	1995	1996	1997	1998	1999
Energy sales by electric power stations (1000 kWh)	359.0	352.4	355.1	362.2	370.5
Heat and power sales by electric power stations, geca calories	173.6	172.3	170.8	166.0	160.0
Heat and power sales by boiler-houses, geca calories	166.8	165.7	166.6	166.6	164.9

Approximately 50% of Ukraine natural gas is produced in Kharkiv Oblast. Other important potential energy resources include:

- Wind energetics
- Solar energy
- Geothermal energy
- Biogas and waste recycling

Experts believe that while Ukraine’s energy and fuel resources compare favorably with the majority of European countries, its effectiveness in making use of those resources ranks below the world average.

5. Sector Development: Technological Base

A large part of the equipment at thermal power plants was placed in operation during 1960-1970. Currently, the newest thermal power plants are about 30 years old (51.6% of total). The number of thermal power plants of 30 to 40 years is less than 46.9%. Approximately 80% of plants have exceeded their design life limit (170,000 hours), while a few did not reach their design life minimum (100,000 hours). [6]

One of the necessary conditions for sector efficiency is proper maintenance of primary equipment at electric power stations. Currently, there is a shortage of materials and spare parts due to a lack of funds, which results in a negative influence on the technical state of primary equipment.

In 1998, the Verhovna Rada of Ukraine adopted a "National utilities program" which outlines measures for utility development in Kharkiv Oblast through 2010. Its two main tasks are: reconstruction and modernization of thermal power stations and thermal power mains; and increased efficiency and ecological security of power blocks. Key technologies include the use of modern steam and superposed gas turbines, and small hydro generator development.

6. Investment Activities in the Sector

In 2000, direct investments from Liechtenstein totaling 1 million USD were made in Kharkiv Oblast utilities. Domestic investment is shown in **Table 5**.

Table 5. Domestic Investment in Kharkiv Oblast Utilities: 1995-1999 (million UAH)

Index	1995	1996	1997	1998	1999
Domestic investment	24.1	41.9	23.8	21.3	26.7

Even though all Ukraine electric utilities are state property, there are still opportunities for development. For example, a Kharkiv firm called "Turboatom" is currently developing a 24 megawatt turbine mounting at Kharkiv heat and power plant #3 that will make it possible to produce 120 million kWh per year. The renovation project for one of the power units at the Zmiyiv heat and power plant is being financed through credit; the German share of financing makes up 126 million DM of the total (170 million DM) project cost.

Another project consists of a Ukrainian-German joint venture to develop a turbine and boiler using new technology applications. A number of Ukrainian production associations, including OJST Turboatom, Electrovazhmash, Kotloturboprom and Energoprojekt are taking part in this project, together with several west European companies. The goal of the project is to renovate a steam turbine plant featuring automation and dedusting facilities, and introduce new technologies to exploit domestic low-grade coal. The turbine reconstruction is expected to increase capacity from 270 to 325 megawatts; its performance efficiency is expected to increase from 33 to 37%. According to specialists' forecasts, this will provide electricity for 15-20 years. This in turn will increase annual profit through increased energy output as well as decreased organic fuel consumption. The raising of power unit production capability will make it possible to increase production by 330 million / kW per year over current capacity—enough to provide a city of 100,000 with electric power.

Another important factor is that, with power unit production capability of 70-100%, there will be no need to consume gas or oil for "highlighting". The resultant annual saving are expected to total 105 million m³ of gas or 87,600 tons of black oil. Experts anticipate essential growth of investment activity in the sector after privatization.

7. Employment and Personnel Potential in the Sector

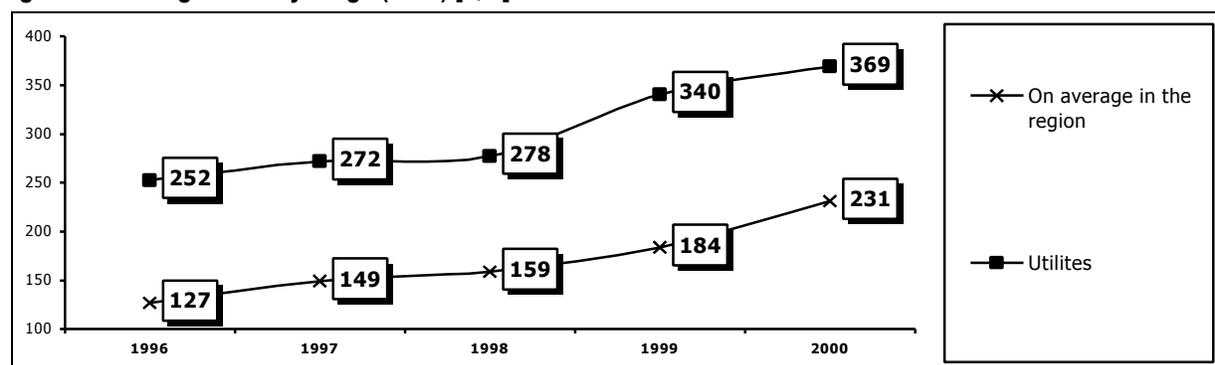
By the end of 2000, there were a total of 23,274 regular employees at Kharkiv Oblast utilities. [5] Utilities employment figures for the period 1995-2000 are given in **Table 6**.

Table 6. Utilities Employment Index: 1995-2000 (1000 persons)

Index	1995	1996	1997	1998	1999	2000
Employees	22.5	23.2	23.1	23.3	23.9	23.3

Utility employee wages have traditionally been higher than average in the oblast (see **Diagram 6**).

Diagram 6. Average Monthly Wage (UAH) [3, 5]



8. Sector Exports

Utilities exports for the period 1996-1999 are shown in **Table 7**.

Table 7. Utilities Exports: 1996-1999 (million USD)

Index	1996	1997	1998	1999
Exports	0.9	0.2	5.0	1.6

9. Competitive Environment of Sector Enterprises and Organizations

The Zmiyiv thermal power station is the largest in Kharkiv Oblast, and one of the most powerful in Ukraine. It essentially holds a monopoly in its market, since there are no competitors. In other areas, the Zaporizhzhya, Krivorizhska-2, Brushtinska, Ladzhinska, Pridneprovska, Starobeshivska, Tripolska thermal power stations are also powerful facilities. There is practically no competition among Ukraine thermal power stations of Ukraine, because all of them have found themselves in the same difficult financial situation resulting from chronic nonpayment by consumers.

10. Ownership in the Sector

Widescale utilities privatization is expected to begin in 2002, although “Kharkivoblenergo is expected to be privatized in 2001. 65% of block of shares will be sold. The nominal value of one block is 41.7 million UAH. This investment opportunity is attracting great interest from domestic as well as foreign companies.

In April 2001, the first blocks of shares of Ukrainian Oblenergo were sold on tender terms. Subsequent issues included: Kievoblenergo (75%), Zhitomiroblenergo (62%+1 share) and Rivneoblenergo (75%+1 share). The American company AES Washington Holdings B.V. and the French company EDA International both applied for Kievoblenergo shares. AES Washington Holdings B.V. won with an offer of 248,686,000 UAH. A Slovak company, Vychodoslovenske energeticke zavody, ep., won the Zhytomyrenergo issue with an offer of 190,000,000 UAH. AES Washington Holdings B.V. also offered 125,196,000 UAH for Rivnooblenergo.

11. SME Growth in the Sector

There are no small utilities in Kharkiv Oblast.

12. Sector Infrastructure

There are a number of design organizations active in the utilities sector, including the Central Design Office of the Ministry of Utilities of Ukraine, the Energoproject Institute, and the Ukrhydroproject open joint stock company. The research departments of Kharkiv Polytechnic University, «Ipmash», and many other academic and educational institutions provide scientific support for utilities and electric machine-building development. A well-developed service and repair infrastructure functions both inside Kharkiv Oblast as well as outside the region.

Kharkiv Research Institute of Complex Automation

- Produces automation control systems for thermal and atomic power plants using new microelectronics
- More than 50 power units with production capacities of 200, 300 and 800 megawatts; several atomic power stations with BBEP-440 and BBEP-1000 reactors are equipped with control systems designed by the Kharkiv Research Institute of Complex Automation
- Projects designed by the Institute are used at Russian, Czech, Bulgarian, and Chinese electric power stations
- Technical services include software development for computer-based control systems and integration in production systems; includes cooperation with foreign companies e.g., “KEMA” (Netherlands); a power unit control system with a production capacity of 300 megawatts for the Zaporizhzhya thermal power plant, Swedish-Danish consortium; and computerization of the Zmiyiv thermal power plant control system.

Kharkiv Central Design Office specializes in modernization and reconstruction of existing/creation of new technological equipment for thermal power plants. It addresses a wide range of issues, including:

- Design of new types of boilers using new technologies for power units with production capacities of 125, 200 and 300 megawatts
- Boiler construction using firing of low-grade fuel without gas or oil highlighting
- Reduction of atmospheric pollution by means of firing processes modernization
- Reconstruction of condensation turbines for use in combined electric power production
- Reconstruction of turbines to increase heat and electric production capacities in various combinations
- Modernization of turbine cylinders for increased safety, economy, and periodic overhauls, etc.

The projects designed by the Kharkiv Central Design Office have been applied at many electric power stations in Russia, Yugoslavia, Bulgaria, Germany, Hungary, Cuba, and Rumania. It also maintains joint ventures with the following German companies: ABB, Siemens, Steinmeuller, and Rotemuller.

State Design and Research Institute Ukrenergomezhprom focuses on:

- The technical and economic base of general utilities development in Ukraine and its electricity supply network; power systems development; structural parts; electricity supply schemes; structural and operational factors; and development of control and protection systems
- Design and development of new safe and economical facilities; construction technical decisions; and design of substation and transmission facility construction elements
- Research for utilities construction (geodesic and engineering-geological)
- Construction projects for network systems, technical renovation and reconstruction of active facilities with voltages from 0.4 to 750 kilovolts
- Utilities control systems design, including anticrash automatic machinery, relay protection, means of communication
- Developing measures to increase the safety of the electricity supply network, increasing use, and ecological requirements assessment
- Specialized electrotechnical calculations and building construction calculations
- Normative and technical documentation of construction and electric supply network problems

The Kharkiv Design and Research Institute Energoproekt Open Joint Stock Company's main activity is the complex development of project and estimate documentation for construction of Ukraine atomic and thermal utilities; engineering maintenance of atomic power stations; and reconstruction, modernization and technical renovation of functioning thermal and atomic power stations to enhance safety. The institute is licensed to execute special utilities projects in Ukraine and Russia, and other industrial and civil projects. [1].

The Kharkiv Energorepair Enterprise Open Joint Stock Company performs the following:

- Production of spare parts for utilities equipment
 - Equipment assembly at electric power stations (except atomic power stations)
 - Electrical equipment testing
- The enterprise has the right to carry out personnel certification (welders).

OJSC Ukrenergoteploizolatsiya performs maintenance and repair of thermal isolation equipment at active electric power stations in Ukraine. [7]

13. Management Capabilities of Sector Enterprises and Organizations

Because there was no effective mechanism for expenditures and profits control, the management accounting system did not begin to function until the third quarter of 1999. In 2000, measures were introduced for creation of a powerful state instrument to control funds on the sector market through the state enterprise Energorinok. The measures featured tightened control of the payment system through authorized banks.

14. Administrative Impact on the Sector

In 2000, the following measures concerning the power industry were enacted:

- 1) amendments to the law entitled, "On the power industry"
- 2) creation of state enterprise Energorinok, the most powerful instrument for funds control in the market; under the direct supervision of the government
- 3) designation of authorized banks to provide clearing accounts for energy supplying companies

In April 2000, the government put into effect a measure requiring 15% advance payments on the purchase electric power on the wholesale market; this was later amended to 100% cash payments. The aim of this measure was to stop the flow of transfer orders, achieve full cash payment for current energy consumption, and clear old debts through ongoing energy sales.

15. Social Issues of Sector Development

Thermal power stations are one of the largest sources of air pollution. Except for a few non-toxic products such as carbon and hydrogen, they emit a wide range of pollutants including sulfur oxide, SO₂ and SO₃; nitric oxide NO and NO₂; fluoric compounds; and products of incomplete burning of fuel, including CO and CH₄, vanadium oxide V₂O₅, sodium compounds, etc. The majority of these products are toxic and pose a threat to people, animals, and plants, even in small quantities.

For several years, power plants have been the main polluters in Kharkiv Oblast, especially the Zmiev thermal power station (Kharkiv thermal power station #5). Contributing factors include deterioration of the station's fixed assets, equipment shortages, and neutralization/utilization of production wastes. Ecological issues are a significant factor concerning the Zmiev thermal power plant reconstruction project. According to calculations, toxic emissions will be reduced by approximately 138,000 tons of sulfur (SO₂) and 2000 tons of carbon dioxide (CO₂) per 6000 hours annual unit operation.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

The fuel industry plays an important role in investment trends within Kharkiv Oblast. Today, Kharkiv enterprises are prepared to work with other regions, businessmen, and investment companies in the areas of power production and electric power conservation. For example, an energy saving program is being implemented at municipal enterprises, which will remain in place through the end of 2005. Additional measures on rational use and development of fuel and power resources, technologies, and alternative utilities are being planned.

Conclusions

On the basis of the foregoing analysis, we can draw the following conclusions:

At present, the sector's role in the Kharkiv Oblast economy is increasing relative to the last few years. In spite of this, however, a decreasing trend in production volumes can be seen, resulting in power shortages during periods of maximum consumption, especially in the evening. To solve this problem, an energy saving program is being introduced at all production sites and at a number of other municipal enterprises in the oblast. This program outlines a number of measures designed to promote rational usage and conservation of fuel and energy resources, development of alternative energy technologies, etc.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.		Products	Directors
Zmiiv Thermoelectric Power Station	63460 Komsomols'ke urban village	(247) 5-22-47 (247) 5-64-56,	5-35-85,	thermoelectric power	Grytsanuk Oleh Kostyantynovych, Director
Kharkiv Thermoelectric Power Station-5	62371 Podvirky Gor'kogo Str., 1 ?	72-00-29	72-01-07	thermoelectric power	Bryazgin Anatoliy Panasovych, Director
Kharkivoblenergo State Power Supply Stock Company	61037 Kharkiv, Plehaniv'ska Str., 149	23-10-71	12-74-86	thermoelectric power	Voronovs'kiy Gennadiy Kirylovych, Chairman

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

4. FOOD PROCESSING

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

In recent years, the food industry has been one of the most dynamically developing sectors of the Kharkiv Oblast economy, and has become a high profile industry for the region. In 2000 the Food Processing sector produced 8.1% of Ukraine's total food industry production.

Taking into account the fact that the food industry generates a significant proportion of taxable profits in the region (more than 25% in 2000) and provides more than one third of the wages paid, the sector constitutes a very important source of income to the oblast economy. About 40,000 persons are employed in Kharkiv Oblast Food Processing sector enterprises, which makes up 3% of the total number of persons employed in the economy of the region. The sector's share in the total production volume of the region in 2000 was 28.7%, while its share of the total Kharkiv Oblast economy was between 12% and 13%.

As the Food Processing industry serves as the processing base of the agro-industrial complex, all of the recent developments in the Agriculture sector are reflected in this sector as well. Accordingly, problems that beset the Agriculture sector's principal crop production areas result in a lack of raw materials for the processing branches.

For example, some agriculture sector enterprises refuse to supply their products to the processing sector, preferring instead to organize their own separate processing facilities. These agricultural producers prefer to explore vertical development of their enterprises rather than simply remain providers of raw materials. The process of vertical integration has become very popular with domestic production enterprises in general.

In the short term, this may tend to have a negative impact on both sectors' raw product utilization and effectiveness; however, the situation is likely to continue so long as agricultural producers believe that this practice provides greater profit potential for their own operations. And while this trend may continue, eventually it is expected to promote closer cooperation between commodity producers and processors, particularly in those cases where processors are willing and able to provide producers with pre-season financing.

Intensive deterioration of the sector's fixed assets is widespread in Ukraine. The majority of enterprises in the branch need substantial renovation of their technical base in order to maximize their production capabilities and profit potential. These problems are complicated by the fact that the food machinery produced domestically is severely outdated and cannot meet the needs of the nation's food processing enterprises. Accordingly, most of the modern equipment used in the domestic food processing sector is imported. Unfortunately, the price of imported equipment is so high that costs are difficult to recoup. Imported food processing and manufacturing equipment now makes up 42% of the Ukrainian market.

Direct foreign investment into Ukraine has totaled \$769 million USD since 1992, 21% of which was directed into the food industry. These investments have financed renovations that have resulted in great improvements in the quality and marketability of domestic food products. These improvements in product quality, together with favorable tax policies, have allowed domestic producers to compete much more effectively. But while Ukrainian enterprises have regained much of the domestic market that had been lost to imported products, expanding exports continues to present challenges. Greater international competition, increased state financial support in some countries, introduction of protectionist measures in others, and currency-related problems have all combined to restrict Ukraine's ability to expand exports of its processed goods. Kharkiv Oblast's relatively strong position in the export market is based in part on increased exports of manufactured tobacco products and the existence of a significant tea packaging enterprise in the region.

Although it is still in progress, privatization of government-owned food production facilities in the region is progressing, and should be complete within a relatively short time, with major production of consumer goods by privatized facilities developing without direct state interference. The Kharkiv Oblast Food Processing sector has great potential for further development, and should continue to benefit from a high level of support from the state in attracting higher levels of foreign direct investment.

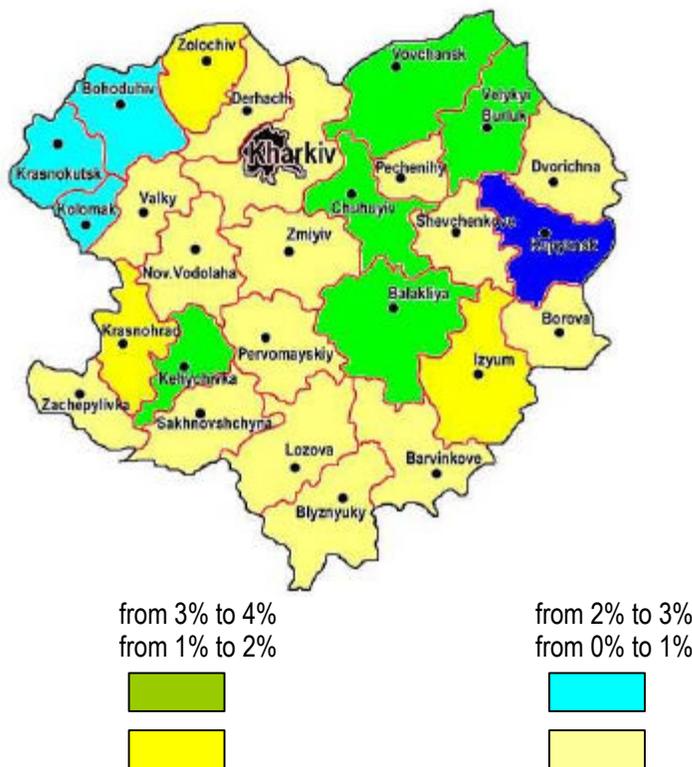
1. Sector Role in the Kharkiv Oblast Economy

The Kharkiv Oblast Food Processing sector comprises 166 large food industry enterprises and 23 flour-milling/mixed feed enterprises; SMEs number approximately 300 and 60 respectively. [1, 2] The sector's share in the total production volume of the region in 2000 was 28.7%, while its share of the total Kharkiv Oblast economy was between 12% and 13%. [1]

In recent years, the food industry has been one of the most dynamically developing sectors of the Kharkiv Oblast economy, and has become a high profile industry for the region. In 2000 the Food Processing sector produced 8.1% of Ukraine's total food industry production. This fact is even more striking when taking into account the fact that domestic producers account for 93.4% of the nation's total volume of food products sales (up from 92% in 1999). [3]

Most of the sector's output is in the form of finished food products and beverages, although some enterprises also produce non-food products such as tobacco and perfume products, soaps and detergents, etc. The distribution of food and beverage production in Kharkiv Oblast by district is shown in **Table 1**.

Table 1. Distribution of Food and Beverage Production in Kharkiv Oblast by District: 2000



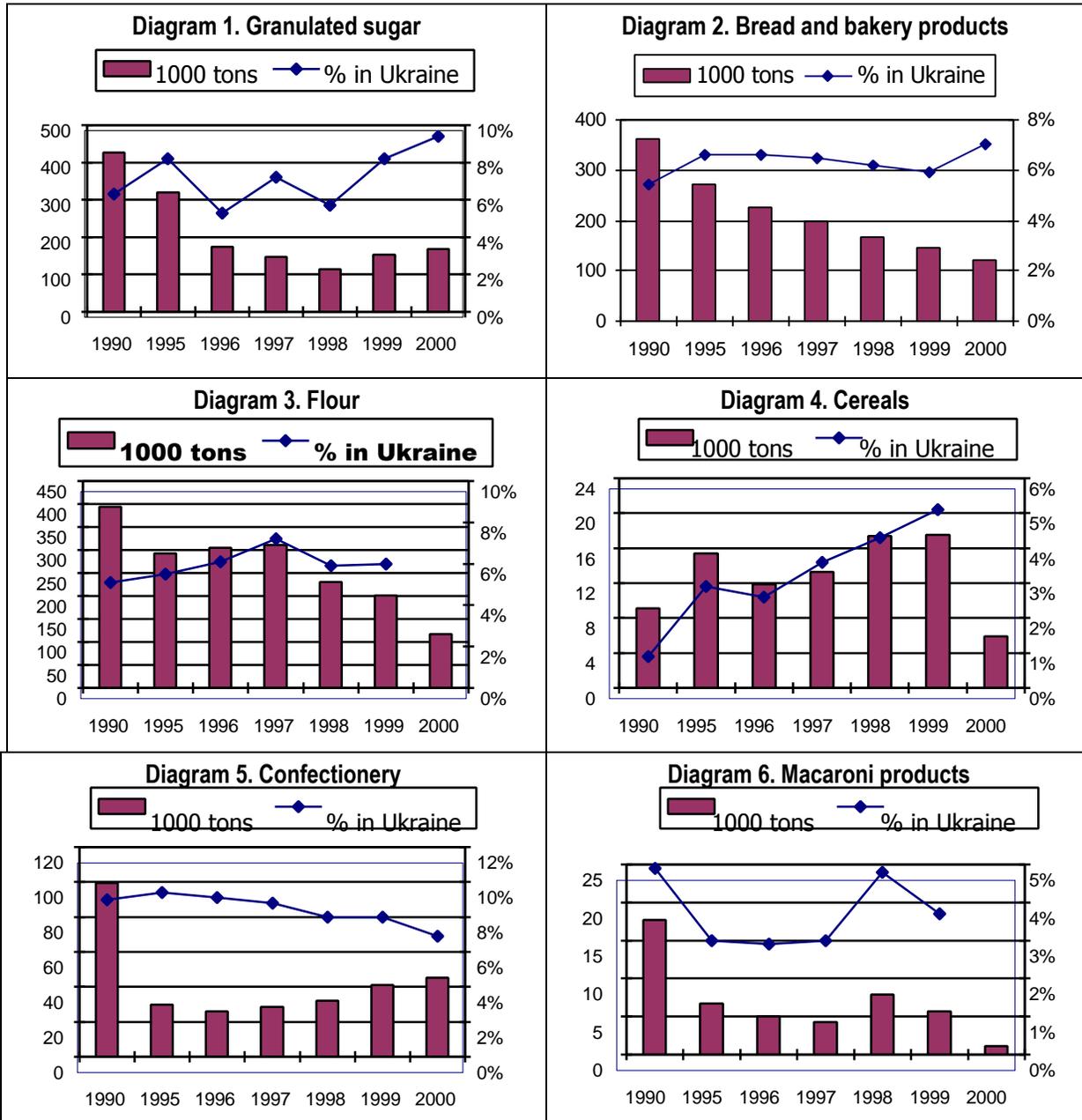
	Million UAH	%
Total	1,181.2	100.0%
Kharkiv City	633.7	53.7%
Kupyansk	150.6	12.7%
Vovchansk	46.9	4.0%
Kehichivka	43.7	3.7%
Barvinkove	43.5	3.7%
Chuhuyiv	37.8	3.2%
Velykyi Byrluk	37.8	3.2%
Bohodudiv	27.8	2.4%
Krasnokutsk	27.3	2.3%
Kolomak	25.1	2.1%
Krasnograd	22.8	1.9%
Zolochiv	20.8	1.8%
Izyum	17.3	1.5%
Derhachi	11.7	1.0%
Pervomaiskiy	8.4	0.7%
Valky	7.7	0.6%
Lozova	4.1	0.3%
Khakiv	3.1	0.3%
Zmiyiv	2.9	0.2%
Dvorichna	2.1	0.2%
Nov.Vodolaha	2.0	0.2%
Blyznyuky	1.1	0.1%
Zachepylivka	1.0	0.1%
Sakhnovshchyna	0.6	0.1%
Barvinkove	0.6	0.1%
Boriv	0.5	0.0%
Shevchenkove	0.4	0.0%
Pechenihy	0.0	0.0%

Food product revenues are an important source of state and local budget funds. In 2000, the state realized 1.5 billion UAH in excise taxes on spirits, beer, and tobacco products, an increase of 14.1% (186.6 million UAH) over 1999. 777 million UAH came from vodka and distillery production, while another 446 million UAH came from tobacco products. And given that the food industry generates more than 25% of the oblast's income, and offers an average monthly wage that is one-third higher than the regional average, the sector attracts very favorable attention from local governments.

2. Strength of Kharkiv Oblast Sector

Ukraine Market

The share of Kharkiv Oblast sector enterprises in total domestic production of various commodities is shown in Diagrams 1- 24 below.



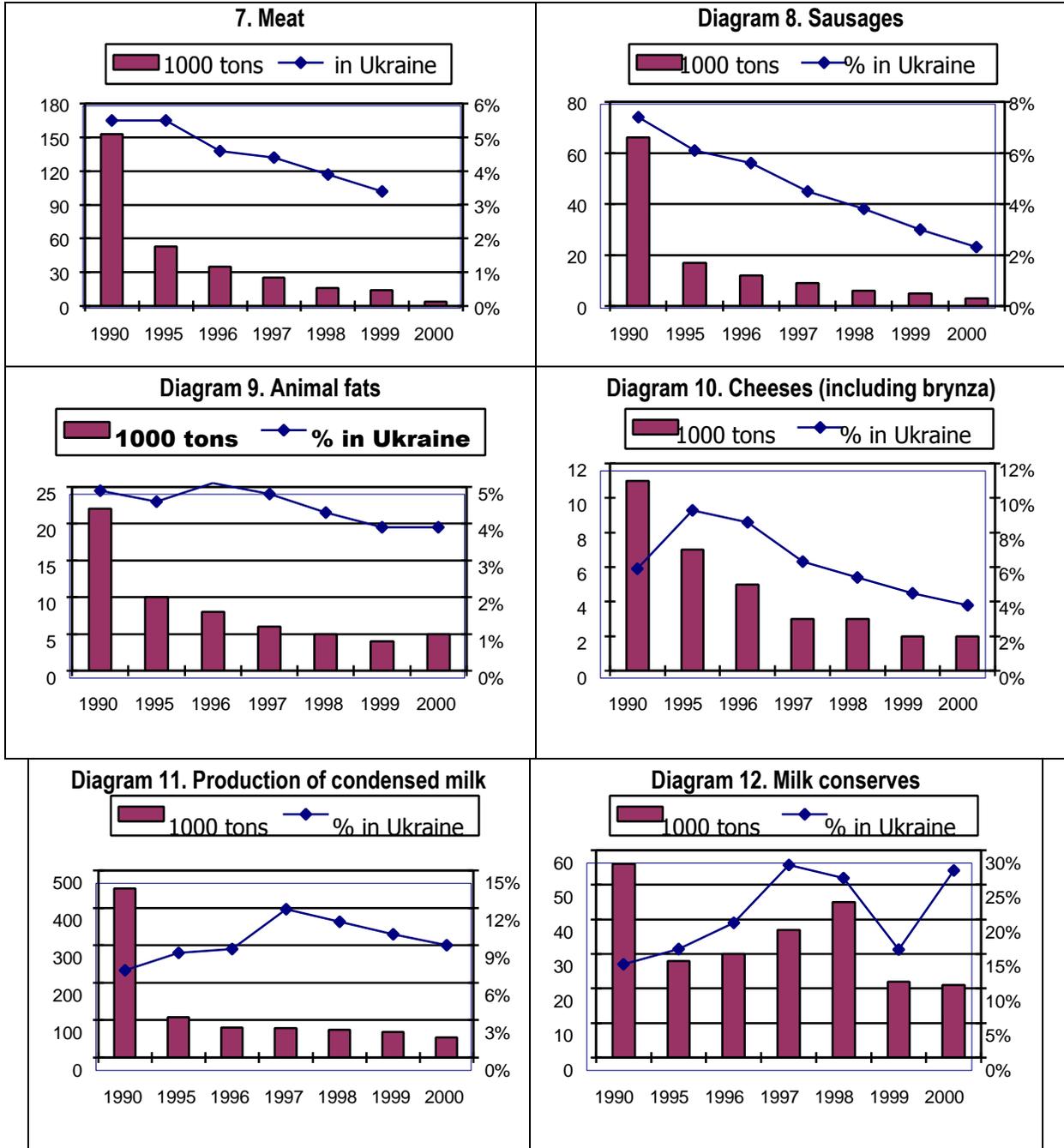


Diagram 13. Conserves

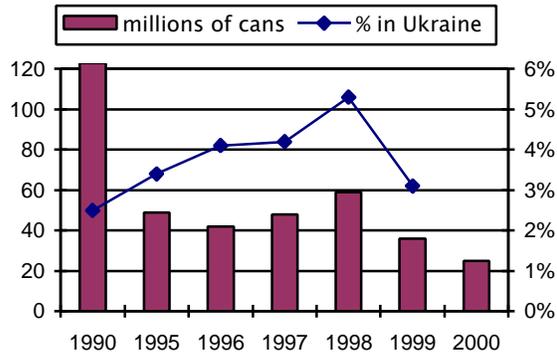


Diagram 14. Cigarettes

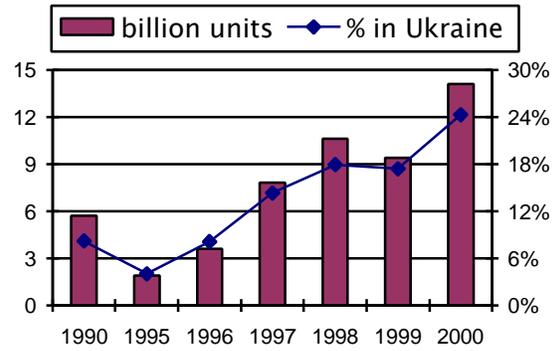


Diagram 15. Vegetable oil

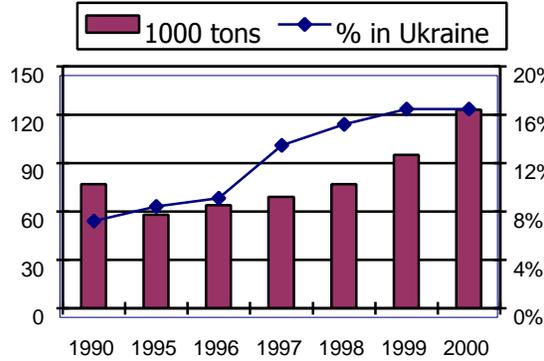


Diagram 16. Macaroni products

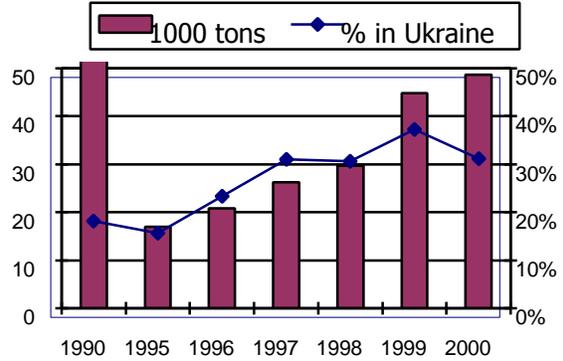


Diagram 17. Vodka and distillery products

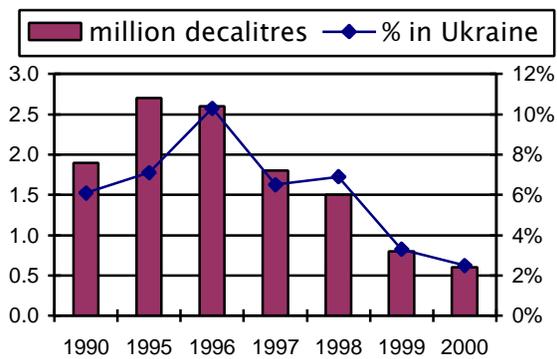
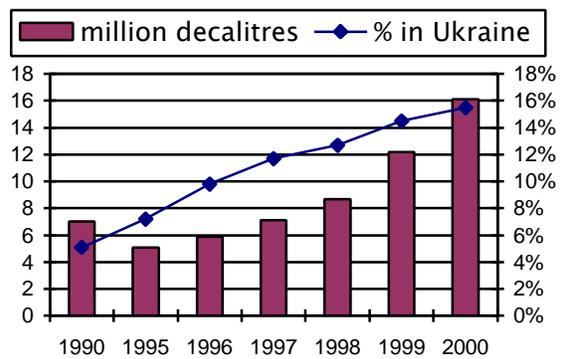
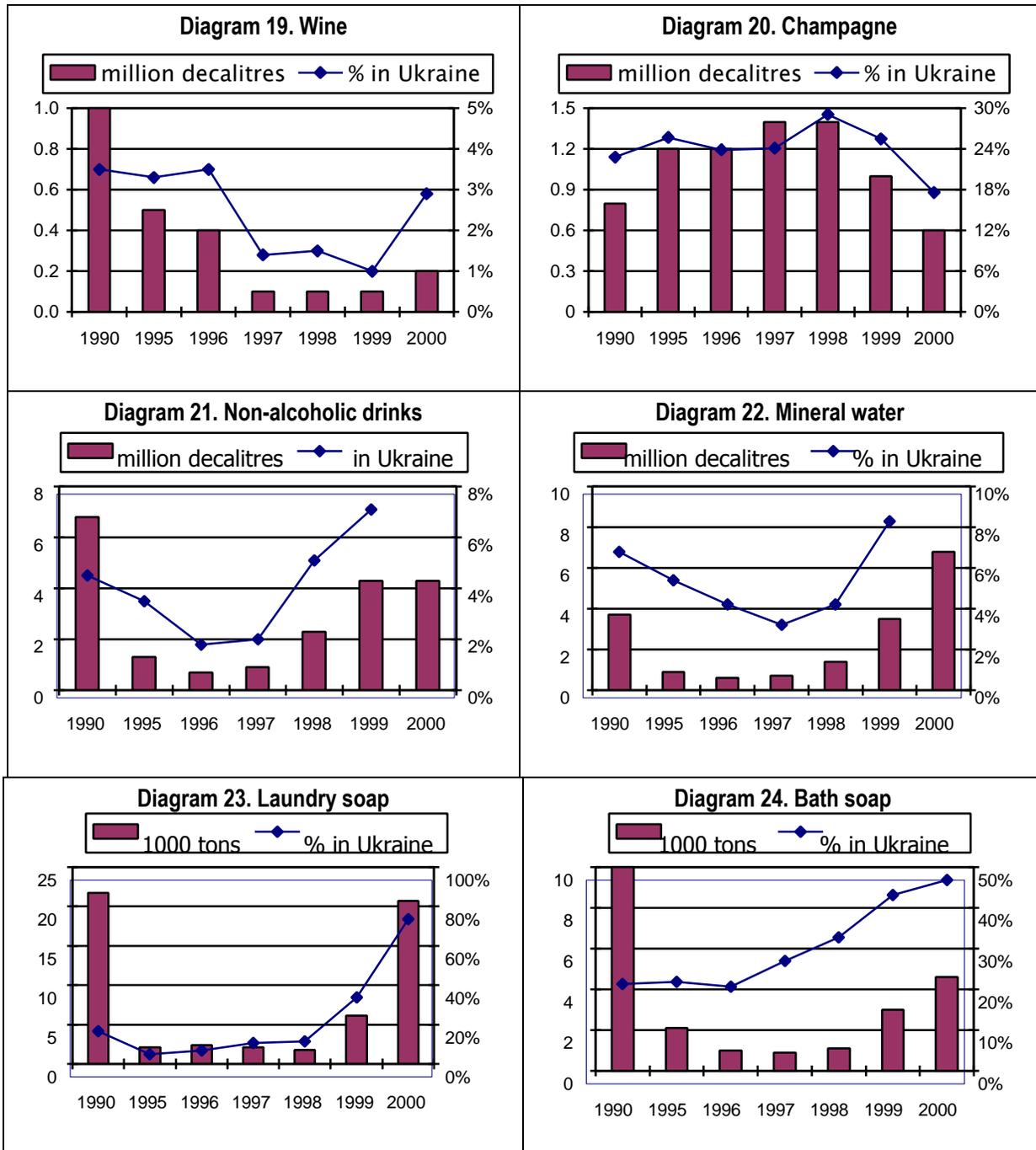


Diagram 20. Beer





CIS Market

A number of economic and political factors over the last decade have adversely affected the sector's ability to export its products. Ukraine has now lost most of its traditional markets in the former Soviet Union, particularly within the Russian Federation. These losses have resulted primarily from increased international competition, the growth of state support of exports in some countries, and the introduction of previously non-existent protectionist policies within most of these traditional former Soviet markets.

However, there has been a certain measure of gradual progress. For example, a number of sector enterprises have achieved ISO-9001 certification, resulting in increased export volumes of products to western Europe and the US.

3. Economic Condition of Sector Enterprises and Organizations

The financial results for the Kharkiv Oblast Food Processing sector in 2000 are generally more positive than for most of the other sectors of the regional economy. This is somewhat clouded by the fact that the percentage of unprofitable enterprises in the food industry is higher than average in the region; however, overall losses were not substantial, and may in fact have reflected underreporting for tax purposes rather than true operational losses. Sector profits/losses relative to the Kharkiv Oblast total are shown in **Table 2**.

Table 2. Sector Profits/Losses Relative to the Kharkiv Oblast Total: 2000

	Profit (million UAH)	Profitable Enterprises		Unprofitable Enterprises	
		% of Total Ent.	million UAH	% of Total Ent.	million UAH
Food industry	222.4	44%	288.0	56%	65.6
Kharkiv Oblast Total	179.5	51%	1,069.0	49%	889.5

Sector indices for accounts payable/accounts receivable are generally positive, compared with those of most other sectors. At the beginning of 2001, the Food Processing and Flour Milling/Mixed Feed sector had 5.5% of total regional industry accounts receivable (5.6% overdue), and 16.4% of accounts payable (8% overdue).

Table 3. Sector Accounts Receivable/Accounts Payable by Branch: 2000 (million UAH)

	Accounts Receivable As of 1.01.2001	Including Overdue	Accounts Payable As of 1.01.2001	Including overdue
Food processing	325.0	64.8	688.6	213.5
Flour milling and mixed feed	38.7	18.0	35.2	12.1

The share of barter operations in the Kharkiv Oblast food industry's total production volume has followed a downward trend in recent years. The share of food production paid for in cash in 2000 was 83.8%, roughly equivalent to the national average of approximately 82%.

Table 4. Kharkiv Oblast Barter Operations and Cash Sales of Total Sector Production Volume: 2000

	Barter Operations	Cash Sales
Food industry	17.7%	79.2%
Flour milling and mixed feed	19.5%	73.6%

While the overall state of the sector is positive, some subsectors of the food processing complex are in serious financial difficulties. Sharp rises in excise rates, changes in taxation law, and revenues that were actually less than the sum of taxes paid combined to inflict substantial losses on the spirits and distillery industry, with saturation at the lower end of the consumable alcohol market likely to lead to some industry shakeout.

The financial state of bakery enterprises also worsened substantially. The profitability of bakery branch production in 2000 was about 5%, down from 12% in 1997-1998 and 9.2% in 1999. This situation is due to the fact that prices of raw materials and power have increased, while the prices of bakery products have been deflated, both by intense competition and political pressure. Political interference in the price setting of baked goods is almost certain to continue, at least until the elections of March 2002, and may remain a problem for many years to come because of the historical role of cheap bread as a demagogic political ploy.

Sugar plants in Ukraine also have a deficit of working capital. The inability of sugar producers to attract capital to upgrade their processing plants, some of which are over half a century old, makes Ukrainian beet sugar totally uncompetitive in export markets, except in limited areas of the FSU. The combination of limited FDI, brought about by ill-advised political interference, has resulted in the sugar beet production and processing branch losing most of its position as a strategic industry of the Ukrainian economy. Cultivation areas have been drastically scaled back, productivity remains highly unsatisfactory, and volumes of sugar production have declined.

Decreases in meat/milk production volumes are due mainly to a catastrophic reduction in the volume of agricultural products available for processing. Only one sixth of the sector's cattle and poultry and no more than one fourth of the milk is processed. Other products are taken directly to market without preliminary processing, or are processed at factories that engage in substandard production. Only 15-40% of the production capacities of meat/milk enterprises are now being utilized, which adversely influences the cost/price equation.

4. Sector Development: Raw Materials Base

As the Food Processing industry serves as the processing base of the agro-industrial complex, all of the recent developments in the Agriculture sector are reflected in this sector as well. Accordingly, problems that beset the Agriculture sector's principal crop production areas result in a lack of raw materials for the processing branches.

Ukraine's agricultural enterprises have chosen, of necessity, to become more vertically oriented during recent years in order to find their way out of the continuing economic crisis. This has resulted in agricultural enterprises coming into possession of 650 meat processing plants, 410 milk processing plants, 2,100 vegetable oil mills, 1,950 hulling mills, 4,650 flue mills and 13,000 bakeries. Some government and established industry sources argue that control of production by agricultural enterprises is less efficient and leads to underutilization of existing processing capacities. However, the enterprises themselves have found that this new system works to their advantage, and have indicated that they have no interest in returning to the old government policy-oriented system of produce allocation and pricing. This will no doubt lead to a continued period of adjustment as some of the older enterprises either adjust or go out of business. However, this should be considered a healthy and natural process if Ukraine is to continue on the road to a true market economy.

One example of this trend is the production of milk. Competition for raw milk in the Ukraine market has become intense. Rather than supplying raw milk to local processors exclusively, the marketing radius for milk producers has now reached 300 kilometers, giving them greater marketing and profit potential. As might be expected, this has worked to the advantage of the larger and more efficient processing operations, while forcing smaller milk processing plants to either develop innovative responses to this problem or go out of business. For some, this will mean expansion into production of specialty cheeses and other new products; for those unwilling or unable to compete, it may mean oblivion.

Competition for malting barley has become increasingly intense as large amounts are being exported. This puts pressure on Ukraine's developing brewing industry, but thus far they have managed to develop relationships with farms and marketers that have kept the domestic industry vibrant and growing. Both the quality and volume of beer production in Ukraine has been one of the brightest spots in the economic picture and appears slated for continued development.

Sunflower seed production has expanded, although results have been erratic, largely because of political involvement in the marketing process. The development of several large, highly efficient sunflower processing plants with improved packaging and marketing has resulted in Ukrainian sunflower oil becoming a major source of export income as high quality Ukrainian oil penetrates export markets. However, the imposition of export duties on sunflower seeds continues to be a major political issue between Ukraine, the IMF, and foreign governments. A recent decision of the Verkhovna Rada has reduced the export duty rate from 23% to 17%, but this will put Ukraine under continued international pressure because of the demand of international lenders that it exceed no more than 10%.

The organization of processing, storing, and sales of raw materials by agricultural enterprises has had a number of beneficial effects:

- Agricultural enterprises enjoy greater direct income through control of their own commodities.
- Bulk sales allow greater handling efficiencies.
- Funds turnover is expedited as agricultural enterprises control the process through their own trade enterprises, making this money more readily available for their various economic activities.

It is also important to note that different subsectors of the food processing industry carry out different stages of agricultural raw materials processing, some of which serve as the raw material base for others. For example, 90% of the margarine produced is purchased by confectionery factories, bread-baking plants, and public catering enterprises. The sugar industry is one of the main raw material bases for the confectionery industry. A certain amount of antagonism arises in this area as the traditional protectionist measures in the sugar market substantially reduce the competitiveness of the national confectionery enterprises on the one hand, but increase opportunity for the most efficient sugar plants on the other. Access to cheap imported sugar on the domestic market could increase the attractiveness of domestic confectionery production on both the domestic and foreign markets. However, excessive imports of foreign sugar could also spell the death knell for the already devastated domestic sugar beet production and processing branch.

The agriculture privatization process is now formally concluded, and the opportunity for real, deep integration of the Food Processing industry with its raw materials producers now exists. For integration to progress, farm operators and processing enterprises have to reach agreements that ensure their mutual success and profitability. Experience from outside Ukraine shows that agro-industrial integration according to various organizational forms and economic models can play a role in enterprise development of food production. The different forms of organization include: financial agro-industrial groups; allied groups of agricultural enterprises; agricultural companies and corporations; and other variations of production, processing, storage, and manufacturing operations.

5. Sector Development: Technological Base

The current state of the Ukraine Food Processing sector reflects a long-term lack of investment and intensive deterioration of its fixed assets. The level of deterioration has reached 45%-50%, and at some enterprises it is higher than 60%. According to various assessments, only 15%-25% of the bulk of fixed assets corresponds to world standards. Currently, many food enterprises are experiencing serious losses and low productivity due to inadequate technology.

The majority of sector enterprises require total modernization of their technological base to compete in the current competitive market. Because of an inability to acquire the necessary funding from any source for adequate upgrading of its capabilities, the national food machine building branch is incapable of providing the processing sector with equipment of the quality and level of sophistication appropriate to its needs. In recent years, imported equipment costs have made up 58% of the total costs of national production. Currently, foreign equipment makes up approximately 42% of the equipment used in the sector.

The suspension of state financing and a lack of enterprise-generated funds have essentially halted the modernization and reconstruction of the vegetable oil processing branch. Some enterprises are only capable of producing raw oil, and lack the technical means of performing any of the post-production processes, such as refining, deodorization, and packing. Ukraine sugar processing plants are hampered by a severe lack of working capital that adversely affects their ability to maintain technical standards. In recent years, there has been insufficient funding for either major overhauls or necessary routine maintenance. Fuel expenditures in the sugar beet processing branch are twice or even three times what would be if its technological base were up to date.

6. Investment Activities in the Sector

Given Ukraine's current economic situation, food industry sector enterprises are forced to find sources of financing for modernization, reconstruction, and technical reequipment on their own. In 2000, sector enterprises spent 475.3 million UAH on modernization.

Currently, however, foreign investment in the sector is increasing. 21% of direct foreign investments (DFI) in the Ukraine economy goes to the food industry. In 2000, DFI in the sector totaled 110 million USD; the total volume of US investment since 1992 came to 769 million USD.

DFI in the Kharkiv Oblast food industry in 2000 is shown in **Table 5**.

Table 5. Kharkiv Oblast Direct Foreign Investment by Country: 2000

Country	DFI	
	Million USD	%
Food processing	26.4	44.4%
Switzerland	22.0	—
Great Britain	1.7	—
Russian Federation	0.9	—
USA	0.5	—
Turkey	0.5	—
Hungary	0.3	—
Bahamas	0.2	—
Italy	0.1	—
Germany	0.1	—
Bulgaria	0.1	—
Poland	0.1	—
Flour milling	0.1	0.2%
Hungary	0.1	—
Liechtenstein	0.0	—
Total investment into Kharkiv Oblast	59.5	100.0

7. Employment and Personnel Potential in the Sector

About 40,000 persons are employed in Kharkiv Oblast Food Processing sector enterprises, which makes up 3% of the total number of persons employed in the economy of the region. Total employees at large and medium enterprises decreased from 30,000 to 28,000 during the period 1999-2000; however, this decline was offset by an actual increase in employees at the sector's small enterprises.

Historically, the monthly wage in the Food Processing and Flour Milling/Mixed Feed sector has been higher than the regional average across all sectors, as shown in **Diagram 25**.

Diagram 25. Average Monthly Salary: 1996-2000 (UAH) [7; 5]

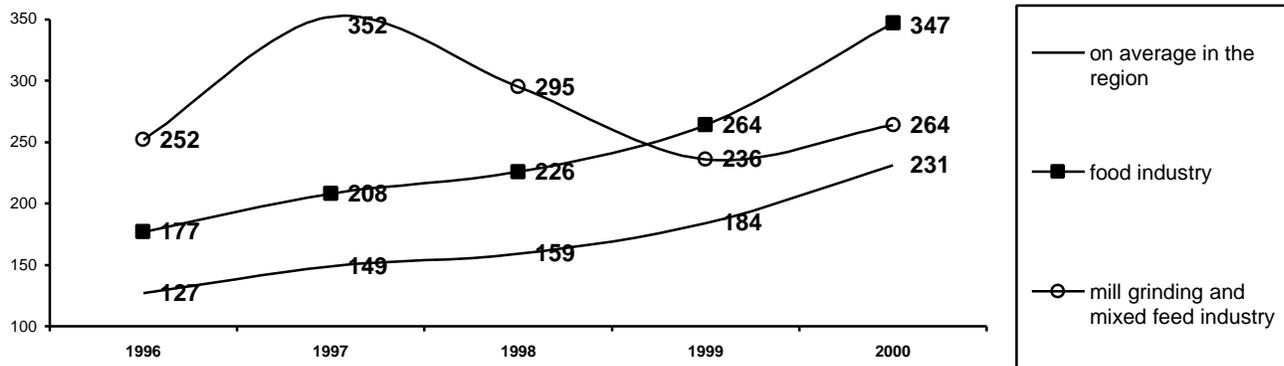
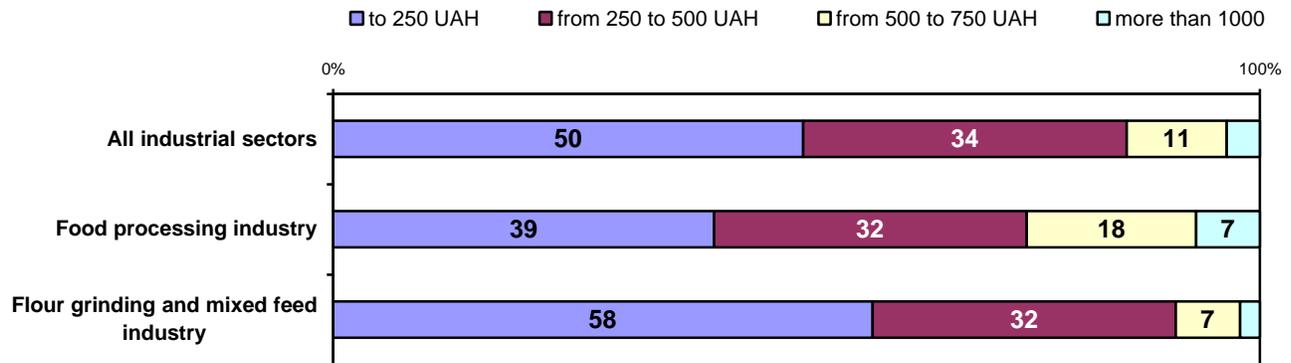


Diagram 26. Kharkiv Oblast Employees by Monthly Wage: December 2000 (%) [5]



8. Sector Exports

Ukraine continues to try to win acceptance of its food products on the world market, with mixed results. A limited number of products have been brought up to international standards and are beginning to be successfully marketed abroad. However, most Ukrainian food products were developed for the much less discriminating Soviet market; and since little improvement has been made in terms of quality and packaging, the sector has had limited success in increasing overall export volumes.

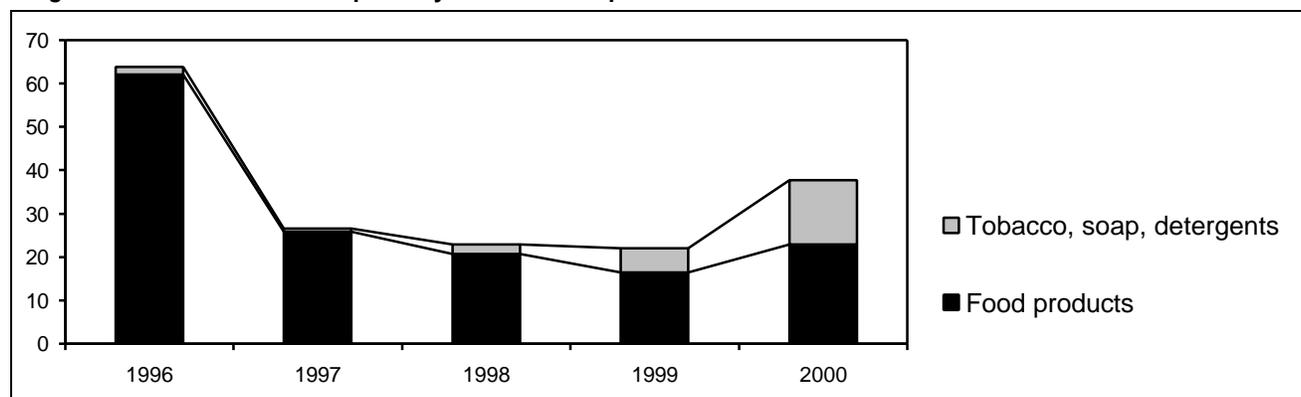
Most of Ukraine's major export markets in the former Soviet Union no longer exist as a cohesive entity. The present decrease in exports to former Soviet countries may be attributed to a number of factors, including: severing of long

established trade relationships during the early 1990s; growing intensity of international competition; increased state support for export operations in some countries; and the introduction of protectionist measures in others. Kharkiv Oblast has maintained its position as one of the top exporting regions of Ukraine mainly due to the increase of tobacco product exports, as shown in Table 6.

Table 6. Kharkiv Oblast Exports by Product Group: 1996-2000 (million USD)

Product Group	1996	1997	1998	1999	2000
Total export of Kharkiv Oblast	367.68	412.57	360.60	313.80	315.30
04 milk, milk products, eggs	8.65	4.30	4.21	1.79	4.39
09 tea, coffee, spices	0.11	0.07	0.02	0.01	0.09
11 flour-milling products	7.68	1.33	0.48	1.04	0.08
15 animal/vegetable fats and oils	3.61	2.57	5.79	6.33	6.87
16 meat and fish products	0.58	0.46	0.07	0.02	0.06
17 sugar	23.62	8.46	3.88	3.95	4.36
18 cacao and cacao products	1.49	2.07	1.23	0.69	2.56
19 wheat products	3.89	4.75	2.69	1.46	3.10
20 vegetable and fruit products	0.78	0.94	0.78	0.10	0.03
21 mixed food products	0.59	0.02	0.11	0.03	0.05
22 alcoholic and nonalcoholic drinks	8.75	0.58	1.24	0.71	0.70
23 remnants and wastes	2.43	0.34	0.20	0.35	0.58
24 tobacco	-	0.04	1.65	4.96	10.77
34 soap, detergents	1.74	0.69	0.47	0.59	4.11
Total for listed groups	63.91	26.63	22.82	22.01	37.77

Diagram 27. Distribution of Exports by Product Group: 1996-2000



9. Competitive Environment of Sector Enterprises and Organizations

The Ukraine Food Processing market is characterized by intense competition among domestic producers. While competition varies according to the different situations of various market areas, the one trend that is common to all regions is the gradual exclusion of imported food products.

Other regions compete directly with Kharkiv Oblast in various product groups, as, for example, Poltava and Dnipropetrovsk oblasts in the area of meat/milk products. In general, however, Kharkiv Oblast sector enterprises are optimistic about the future of the region's food processing market.

Exports of sector products have declined in recent years, especially of finished products. After gaining independence, Ukraine lost many of the foreign markets that had been developed over many years. Winning back these markets will be difficult, due to increasing international competition, growth state support of exports in some countries, and the introduction of protectionist measures in others.

10. Ownership in the Sector

The process of ownership reform in the Kharkiv Oblast Food Processing industry is nearing completion. The share of privatized firms in the total volume of large and medium sector enterprises has reached 52.4%, while its share in the total volume of production is 83.1%. [1]

The following branches are now completely privatized: vegetable oil, soap works, tobacco, confectionery, beer and beverages, milk conserving, milk, meat, perfume/cosmetics, macaroni, and cereals processing (excluding wheat).

Diagram 28. Privatized Enterprises vs. Total Sector (%)

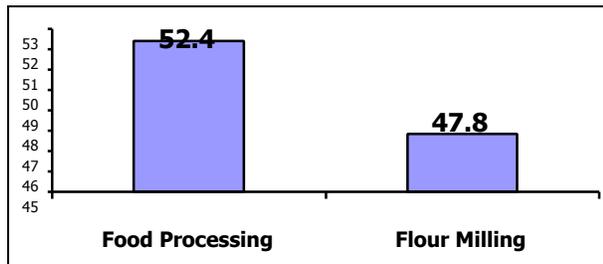
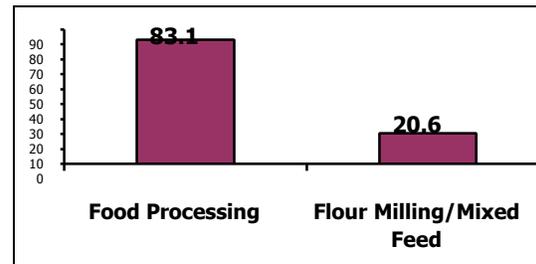


Diagram 29. Privatized Enterprise Production



As a rule, the most promising enterprises were restructured into closed joint stock companies. This form of ownership is attractive because of the degree of control it allows owners to exercise over the enterprise.

11. SME Growth in the Sector

As of January 1, 2000, 11,686 small enterprises were registered in Kharkiv Oblast. This makes up approximately 76% of the region's active independent enterprises and organizations. 69,200 people were employed at these enterprises, which makes up 9.8% of total employees at the region's independent enterprises (4% of the able-bodied population).

In 1999, 296 sector SMEs were registered in Kharkiv Oblast, 60 of which were flour-milling/mixed feed producing enterprises. Total sector SME employees and average monthly salary by branch are shown in **Table 7**.

Table 7. SME Employees and Average Monthly Salary by Branch: 1998-1999

	Total Employees		Total SMEs	
	1999	1998	1999	1998
Food industry	3,297	2,694	296	258
Flour-milling and mixed feed industry	920	787	60	68

Kharkiv Oblast SME production volume by branch is shown in **Table 8**.

Table 8. SME Production Volume by Branch: 1998-1999

	Production Volume (million UAH)	% of Total	
	1999	1999	1998
Food processing	36.7	12.7%	16.8%
Flour milling and mixed feed production	16.6	5.7%	5.2%
Total industry	288.9	100.0%	100.0%

12. Sector Infrastructure

While Kharkiv Oblast has a well-developed trade and educational infrastructure, the state of its utilities infrastructure is a serious problem for the Food Processing sector, with even large, profitable enterprises hampered by the limited supply of gas and electrical power.

13. Management Capabilities of Sector Enterprises and Organizations

In comparison with other sectors of economy, the food industry is distinguished by a relatively advanced level of management. This can be explained in part by the peculiarities of the market, and also by the fact that this was one of the first sectors to be privatized.

14. Administrative Impact on the Sector

During the period 1998-2000, more than 20 legislative and normative acts aimed at stabilizing the domestic foods market and supporting national food producers were adopted. Issues addressed included food production realization, payment of excise taxes, debt restructuring, import and export duties on raw materials, etc.

Development of the Food Processing sector progress without direct state interference. According to business activity research conducted by the newspaper "Business", introduction of regulative measures concerning the food industry lessened during the period October-December 2000.

This does not mean that Ukrainian food producers have an easy time of it. In fact, Ukrainian enterprises in all sectors face a number of substantial problems. For example, exporters are hampered by VAT compensation, which in many cases is prohibitive. These difficulties are primarily due to State Tax Administration rulings that, while not necessarily in compliance with Ukrainian legislation, are nonetheless impossible to circumvent. These difficulties sometimes lead to the erosion of working capital, resulting in even well-managed enterprises lacking the operating capital they require to prosper and grow. A number of problems specific to various branches include overregulation and certain forms of administrative pressure.

An example of a measure aimed at improvement of the investment environment in the sector concerns a special regime for investment in Kharkiv Oblast. According to this act, a list of tax privileges can be applied to various investment projects that are currently registered in Kharkiv Oblast. However, according to statistical data for 2000, only 34 such projects were registered. The special regime for foreign investment does not seem to justify expectations for attracting a substantial number of investors in the Food Processing sector.

15. Social Issues of Sector Development

As a result of supply deficits at various sector enterprises, many people were forced to make do with less than full-time employment. [5] A number of sector employment statistics for the year 2000 are shown in **Diagrams 30-34**.

Diagram 30. Sector Employees Taking Administrative Leave

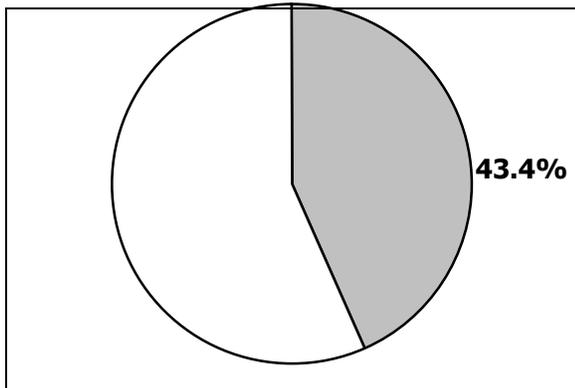


Diagram 31. Flour Milling/Mixed Feed Employee Taking Administrative Leave

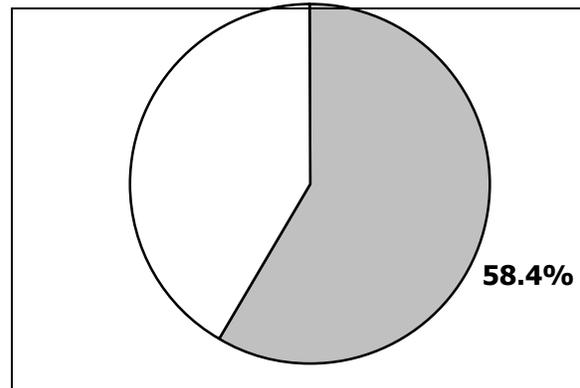


Diagram 32. Sector Employees Working Part Time

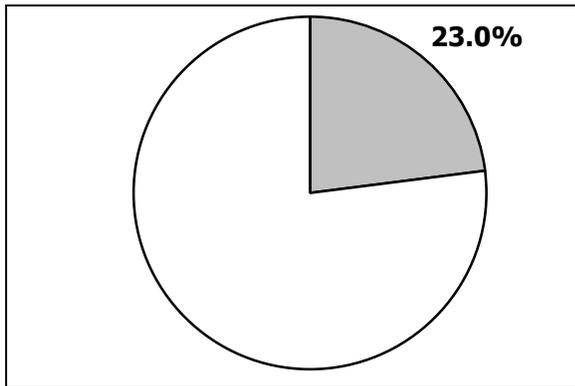
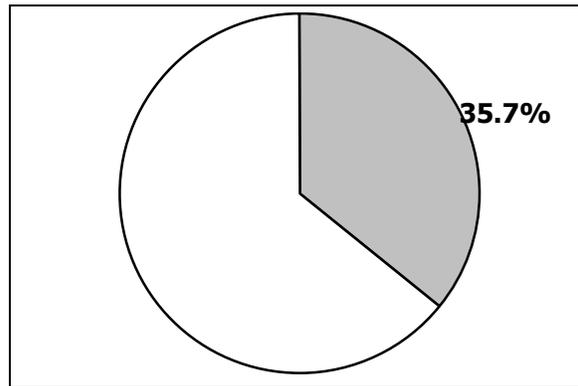


Diagram 33. Flour Milling/Mixed Feed Employees Working Part Time



As of October 1, 2001, wage debt in the Kharkiv Oblast Food Processing and Flour Milling/Mixed Feed sector totaled 7,865,000 UAH and 708,900 UAH respectively. [5] Sector wage debt for previous years is shown in **Diagram 34**.

Diagram 34. Sector Wage Debt in Previous Years as a Percentage of Total Debt Volume



16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Currently, the main trends in large- and medium-sized private investment projects concern production of export-oriented agricultural raw materials (e.g., sunflower seeds, buckwheat, etc.), as well as the creation of vertically integrated agro-industrial organizations that engage in all aspects of sector production, from raw materials to finished products. The emphasis of the latter is on the domestic market.

Some examples of recent Kharkiv Oblast investment projects include:

- “Interfud-Ukraina” Ltd., with participation of Polish partners, will produce cappuccino and sausages. Total investment over a period of six years is expected to be 686,000 USD.
- The Ukrainian-Vietnamese joint venture “Tehnokom” will invest 800,000 USD in the production of easily-prepared pasta products under the “Mivina” brand name. This operation is expected to create at least 1,000 jobs.
- The “Izum Bread Baking Plant” open joint stock company presented a business plan to a number of departments of the Ukraine Ministry of Agricultural Policy. The project’s objective is to introduce new methods and technologies to

increase production volumes and increase the enterprise's market share in Ukraine. Total investment required is 1.3 million USD.

- Reconstruction of the Pervuhinsky sugar plant requires 14.5 million USD. The project's objective is to increase the plant's daily production capacity to 3,000 tons per day, with a simultaneous improvement in the quality of the finished product.
- A business plan developed by the "Slobozhansky" agricultural enterprise group requires 3.5 million USD. The project's objective is to greatly improve both production capacity and the quality of pork products, such as high quality sausage.
- The "Kupians Milk Processing Plant" reconstruction project requires an investment of 12 million USD. The project's objective is to expand production of milk, milk products, and ice cream, as well as improve product quality.

Conclusions

The Food Processing industry has the greatest potential of any sector in the Ukrainian economy, and should remain a top priority for development. Achieving a high volume of agricultural raw materials production, and processing those commodities into high quality finished food products, should be sufficient to meet almost all of the nation's domestic food requirements. This in turn should enable Ukraine to become a major exporter of finished food products to Europe and the former Soviet Union.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.	Products	Directors
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This section is not applicable to this profile.

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

5. LIGHT INDUSTRY

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project
Under**

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

Light industry in Kharkiv Oblast, which includes production of fabrics, clothing, travel goods, and footwear, was not always in the shadow of more developed branches in the region such as machine building, utilities, and food industry. In 1990, its share in the economy of Ukraine made up 11%, but from 1991 the importance of light industry in the regional economy began to decline.

This analysis of light industry in Kharkiv Oblast has shown the following:

- At the beginning of 2001, the share of light industry in the Kharkiv Oblast economy was 1%.
- Since the beginning of 1999, an increase of production volumes can be observed relative to the UAH index—but not according to hard currency indices.
- This sector's nominal share of production in the Kharkiv Oblast economy is underscored by the fact that there are no Kharkiv light industry enterprises with products on either the world or Ukraine national markets.
- The financial condition of the majority of light industry enterprises and organizations in Kharkiv Oblast is generally classed as “difficult”.
- Sector enterprises have lost nearly 80% of the domestic market.
- 15-20% of sector enterprise production capabilities is used for processing orders of foreign and Ukrainian companies.
- 0.22 million USD were invested in the sector in 1999, that makes up 0.3% of the total volumes of investments into Kharkiv region economy.
- At the beginning of 2001, there were 8,000 people employed in light industry in Kharkiv Oblast. This amounts to more than 3% of the total employment figure for Ukraine light industry (252,000), and about 0.6% of total employment in Kharkiv Oblast (1,387,000).
- In 1999, there were 285 small enterprises with 1,648 employees in the region.
- State efforts to support national manufacturers have lacked systematic direction and depth.

To sum up: light industry will probably not recover its former importance in the Kharkiv Oblast economy anytime soon.

1. Sector Role in the Kharkiv Oblast Economy

Light industry in Kharkiv Oblast, which includes production of fabrics, clothing, travel goods, and footwear, was not always in the shadow of more developed branches in the region such as machine building, utilities, and food industry. In 1990, its share in the economy of Ukraine made up 11%, but from 1991 the importance of light industry in the oblast economy began to decline.

At the beginning of 2001, light industry market share in the Kharkiv Oblast economy was only 1%. At the same time, the share in the consumer goods index fell from 18.5% in 1990, to 2.5% in 1999.

Production in Kharkiv Oblast's light industry sector is shown in the tables and diagrams below. [1]

Table 1. Production Volume Dynamics—Kharkiv Oblast Light Industry

	1995	1996	1997	1998	1999	2000
Light industry, million UAH	82	67	58	51	59	74
Light industry, million USD	56	37	31	21	14	14

Diagrams 1 and 2. Light Industry Market Share in Kharkiv Oblast: 1999 and 2000.

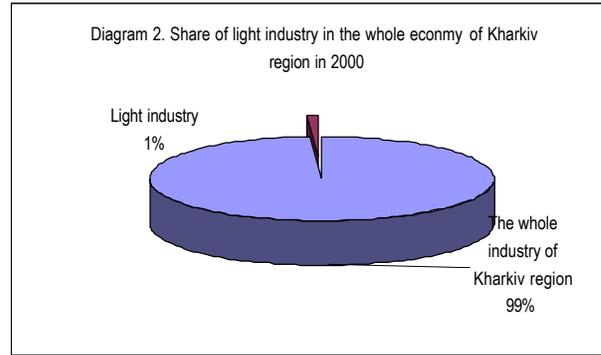
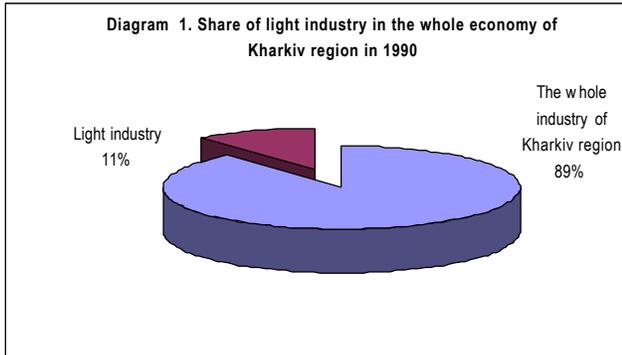
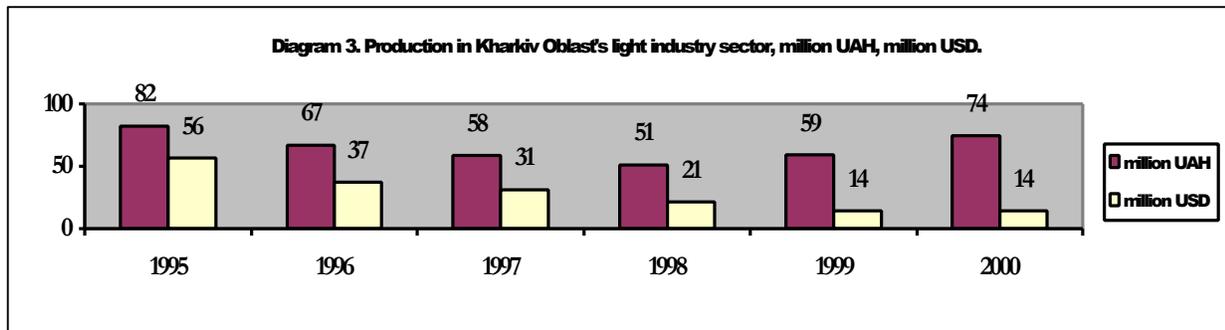


Diagram 3. Share of Light Industry in Kharkiv Oblast: 1999 and 2000.



Statistics show that Kharkiv Oblast light industry production volumes fell to a ten-year low in 1998. However, production volumes rose somewhat in terms of UAH during 1999, and further growth was recorded in 2000. But, considering production value in hard currency (USD), stabilization of production has only begun.

Table 2. Production—Kharkiv Oblast Light Industry Major Products

Main Products	1995	1996	1997	1998	1999	2000
Textile, million meters	2.6	1.4	1.0	0.7	0.56	0.2
Knitted wear, million units	2.5	0.9	0.5	0.2	0.29	0.2
Foot-wear, million pairs	0.9	0.5	0.4	0.3	0.30	0.32

Diagrams 4-6. Kharkiv Oblast Light Industry Market Share: Textiles, Knitted Wear, and Footwear.

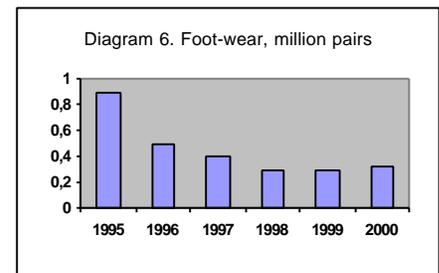
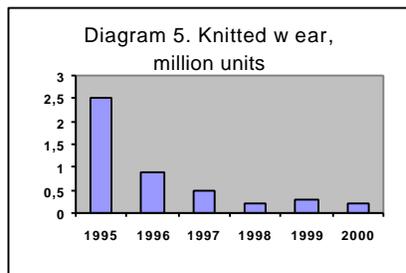
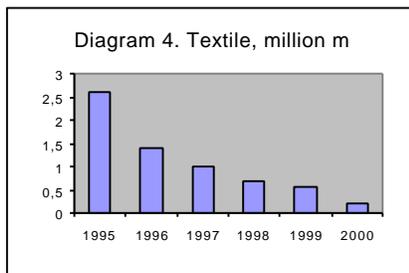


Table 3. Production Volumes—Kharkiv Oblast Light Industry Major Products

Products	1990	2000	2000 vs. 1990 (%)
Fabrics, million sq. Meters	22.1	0.2	0.9
Socks, thou pairs	50.9	1.1	2.1
Socks, for children, thou pairs	16.2	0.08	0.5
Knitted wear, thou units	31.4	0.2	0.6
Knitted wear, for children, thou units	11.6	0.04	0.4
Foot-wear, thou pairs	9.9	0.3	3.3
Foot-wear for children, thou pairs	3.2	0.002	0.6

Thus, in spite of the strong growth in light industry production volumes (in terms of UAH) in 2000, this sector is not expected to attain pre-1990 volumes in the near future.

2. Strength of Kharkiv Oblast Sector

This sector's nominal share of production in the Kharkiv Oblast economy is underscored by the fact that there are no Kharkiv light industry enterprises with products on either the world or Ukraine national markets.

In 1999, approximately 1% of Ukrainian textiles and 3% of knitted goods were produced in Kharkiv Oblast. In essence, Kharkiv Oblast light industry cannot be said to have any significance in the Ukrainian and world markets whatsoever. The few clothing, hosiery, and leather products that are available on the Ukrainian, CIS, or world markets are exceptions.

However, the clothing, hosiery, and leather enterprises, makers of footwear, and fur products producers do occupy an important position on the Kharkiv Oblast local market. Their sales combined makes up 10% to 25% of the entire Ukraine light industry market.

In one expert's opinion, Kharkiv Oblast light industry enterprises face the following problems in bringing their products to market:

- 1) Shortage of skilled workers trained in light industry product marketing.
- 2) Production costs are not equal for different players in the market (legal vs. illegal producers).
- 3) Shortage of capital, both for manufacturing and for upgrading capital equipment.
- 4) Small manufacturing and finished product volume.
- 5) Faulty distribution channels.

3. Economic Condition of Sector Enterprises and Organizations

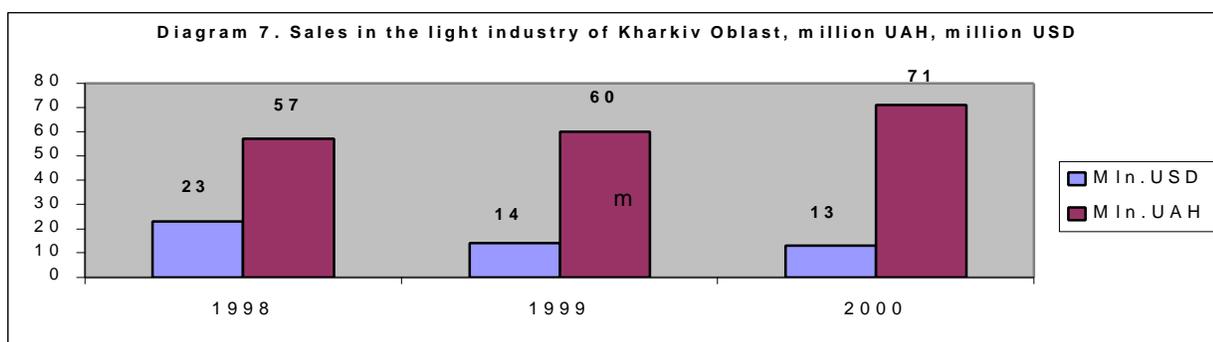
The majority of Kharkiv Oblast light industry enterprises and organizations are in financial difficulty. Given the number of unprofitable enterprises in this sector, the overall financial situation may be said to be urgent.

Sales in USD during 2000 fell by 7% in comparison with 1999, while sales in UAH increased by 18%. Sales for the period 1998-2000 are shown below.

Table 4. Sales—Kharkiv Oblast Light Industry: 1998-2000

Index	1998	1999	2000
Sales (million UAH)	57	60	71
Sales (million USD)	23	14	13

Diagram 7. Sales in Kharkiv Oblast Light Industry (million UAH vs. million USD)



The sector has reported a loss for the last four years straight. Losses in particular products: cotton fabric (-87%), wool fabric (-43.7%), men's hosiery (-40.6%), knitted linen goods (-37.6%), and footwear (-7.7%). In 1999, only children's footwear showed a profit of 15.5%.

Table 5. Profitability—Kharkiv Oblast Light Industry: 1994-2000 (%)

Index	1994	1995	1997	1998	1999	2000
Profitability (by year), %	32	27	-4	-6	-5	-2

Diagram 8. Profitability—Kharkiv Oblast Light Industry: 1994-2000 (%)

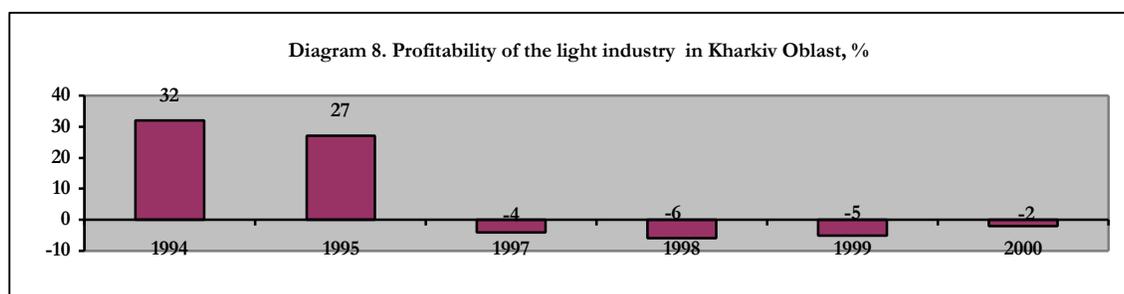


Table 6. Kharkiv Oblast Light Industry—Profit/Loss: 1997-2000

	1997	1998	1999	2000
Profit/loss of the light industry in Kharkiv region (million UAH)	-2.6	-4.5	-3.8	-1.4
Profit/loss of the light industry in Kharkiv region (million USD)	-1.4	-1.8	-0.9	-0.25

Account receivables for 2000 totaled 27 million UAH, while accounts payable were 204 million UAH—a difference of 750%.

Smuggling and counterfeit manufacturing—which, according to the state statistics, equal two thirds of light industry products sales in Ukraine—are the main cause of the decline of light industry in both Kharkiv Oblast and in Ukraine. However, in spite of these losses, figures for 2000 allow for a more optimistic forecast concerning the stabilization and successful development of Kharkiv Oblast light industry in the near future.

4. Sector Development: Raw Materials Base

The raw materials used in light industry vary greatly among the various sub-branches.

- **Hosiery:** 70% of cotton and half-woolen raw materials are available domestically (Poltava, Donetsk, Hmelnytskyi Oblasts). Elastic raw materials, especially super elastics of the “Lycra” type, are not as readily available. Except for poliamid, Ukraine does not produce chemical fibers. DuPont (USA) is the best-known producer of chemical fibers.
- **Sewing Products:** About 45% of suit fabrics are produced in Ukraine (Chernigiv and Luck oblasts). The largest foreign suppliers are Russia, Korea, Germany, and Poland. About 10% of raincoat and jacket fabrics are domestic (Cherkasy Oblast); the remaining 90% are imported from Russia, Belarus, and China. Virtually all of the fabrics used in linings are of Chinese origin. Approximately 50% of accessories are of domestic origin (Simferopol, Kiev Oblasts), while 50% are imported (Taiwan and Russia). Sheet wadding and artificial leather are produced domestically (Donetsk and Ternopil Oblasts).
- **Knitted Products:** Domestic and foreign manufacturers each supply 50% of the yarn used in knitted goods.
- **Fur Products:** About 90% of valuable furs are produced from mink (Cherkasy and Kharkiv Oblasts), 5% from fox (Lviv Oblast), 4% from polar fox (Chernigiv and Rivne Oblasts), and 1% from other animals. Other furs such as rabbit and nutria are produced in sufficient volumes.
- **Footwear:** Ukraine footwear manufacturers primarily use synthetic and artificial leather in production. Domestic footwear and leather goods are generally not competitive with imported products in terms of quality.

5. Sector Development: Technological Base

While there are a few domestic manufacturers of high quality equipment for light industry in Ukraine, on the whole the branch relies on imported equipment. The level of equipment deterioration varies, depending on the financial state of the company. The type and condition of equipment is identified by sub-branch, below.

- **Socks:** Technology includes knitting, sewing, and dyeing machines. Equipment produced in Russia, Baltic states, Czech Republic, Italy, Germany, and Japan. The average level of deterioration at all enterprises is about 40%.
- **Clothing:** Technology includes cutting and heat treatment equipment, and sewing machines. Kharkiv Oblast’s larger enterprises mostly have new machinery imported from Japan, Germany, and Italy. Smaller enterprises tend to have machinery of widely different origins.
- **Knitting:** Technology includes knitting and sewing machines. The majority of knitting machines are of German, Italian, or Swiss origin. There is also a domestic producer, OJSC “Legmash”, in Chernivci Oblast.
- **Footwear:** Technology is virtually the same as that for sewing. The majority of equipment is imported from the Czech Republic, Germany, and Italy.

6. Investment Activities in the Sector

According to statistical data, three sector enterprises in Kharkiv Oblast received foreign investments totaling 0.22 million USD in 1999, as follows:

- Czech Republic: 0.11 million USD
- USA: 0.06 million USD
- Canada: 0.05 million USD

No data on domestic investment is currently available.

7. Employment and Personnel Potential in the Sector

According to official statistics, there were 8,000 people employed in the sector in Kharkiv Oblast in 2000—a decrease of approximately 300% relative to 1995. This amounts to more than 3% of the total employment figure for Ukraine light industry (252,000), and about 0.6% of total employment in Kharkiv Oblast (1,387,000).

The average monthly wage in the sector was 107 UAH in 1999—slightly less than the national average of 108 UAH. Average monthly wage in Kharkiv Oblast across all sectors was 184 UAH.

Most qualified designers and other specialists have left Kharkiv Oblast enterprises because of non-payment of wages. In January 2001, a total of 245,700 UAH in unpaid wages were due. A total of 3,873 people left sector enterprises in 2000; the largest turnover was in the sewing sub-branch.

8. Sector Exports

According to the Kharkiv Regional Statistics Department, sector exports exceeded imports by 6% in 1999. Exports were down by 30% relative to 1998, while imports were down by 29%. About 80% of Kharkiv Oblast light industry exports are in the form of raw materials. The main importers of sector products are in Western Europe, primarily France, Italy, Germany, and England.

Table 7. Sector Exports and Imports in Kharkiv Oblast: 1994-1999

	1994	1995	1996	1997	1998	1999
Export (million USD)	4.6	11.0	15.0	12.9	11.5	8.0
Import (million USD)	45.5	7.8	14.5	12.5	10.6	7.5

9. Competitive Environment of Sector Enterprises and Organizations

The main competitors of sector enterprises in the region are the so-called “traders” (smuggled or counterfeit goods). According to many experts’ opinions, at least 80% of light industry products are of Chinese, Korean, Turkish, or Polish origin. “Trader” products are distinguished mainly by their low prices, which can be explained by the following: non-payment of customs duties and fees, both in Ukraine and abroad; and the purchase of goods in cash and without proper

documentation, which allows small entrepreneurs from China, Korea, Turkey, and Poland to avoid taxes in their own countries. Only those small entrepreneurs in Ukraine who also avoid paying taxes can compete with the “traders”. Under these conditions, large- and medium-size enterprises can only remain competitive by increasing labor productivity, product quality, and production volumes. In addition, increased exports, foreign and domestic investments (to finance modernization), and support from local government are key to the survival of these enterprises.

In the domestic market, the main competitors of Kharkiv Oblast sector enterprises are in the Lugansk, Mikolayiv, Dnepropetrovsk, Kiev, Sumi, and Poltava Oblasts.

10. Ownership in the Sector

Almost all of the large- and medium-size sector enterprises in the region have been privatized, and are owned by private or public joint stock companies. Small private enterprises are registered upon establishment. In 2000, six light industry enterprises reformed their ownership through the purchase of state property.

11. SME Growth in the Sector

A substantial number of small enterprises do not belong to any specific branch of industry, and many are not registered. In 1999, there were a total of 285 sector small enterprises and 1648 employees in Kharkiv Oblast. Total production in 1999 equaled 11.9 million UAH. This amounted to 4.1% of the total volume of production for the region, compared with 3.9% in 1998. The average economic indexes of small enterprises are shown in **Table 8**.

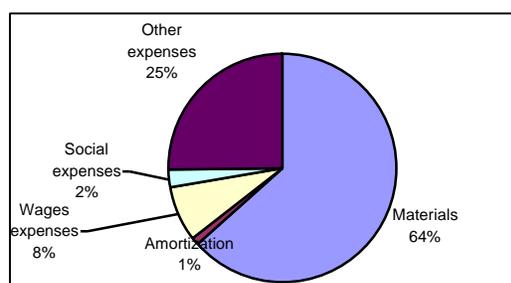
Table 8. General Indexes—Kharkiv Oblast Light Industry Small Enterprises

General Indexes	1998	1999	Deviation	
			absolute +/-	comparative %
Number of small enterprises	285	208	-77	-27.02
Volume of production, thou UAH	12272.3	11929.3	-343	-2.79
Personnel number	1648	1361	-287	-17.42
Average monthly wages, UAH	36	64	28	77.78

Small enterprises' production expenditures in light industry in 1999 are shown in **Table 9**.

Table 9. Light Industry Small Enterprise Production Costs in Kharkiv Oblast

Production Costs (1000 UAH)	1999
Materials	8613.5
Amortization of the fixed assets	150.7
Wages	1044.2
Payments for social measures	336.8
Other expenditures	3426.1
Total	13571.3



12. Sector Infrastructure

The Ukraine Ministry of Economy Department of Light Industry manages the sector with the help of oblast state administration departments. The main sector research institutions are situated in Kiev, where the institutions of higher education are located.

The Ukrainian Pedagogical Academy and the Kharkiv Textile Technical School are two organizations that train personnel for employment in the clothing sub-branch. Other vocational schools in Kharkiv Oblast include:

- Vocational School #12: trains specialists for the clothing sub-branch
- Vocational School #13: prepares sewing machine operators
- Vocational School #38: trains specialists for the leather sub-branch

A substantial number of other Kharkiv research institutes have the potential to provide branch enterprises with assistance in various areas.

13. Management Capabilities of Sector Enterprises and Organizations

The transition by Ukrainian enterprises to a market economy has been accented by a number of management crises due to the differences between state-owned and privatized businesses. Senior management at enterprises created before the economic reformation focused on a gradual reorientation from production to sales, marketing, and finance. These efforts were hampered, not only by the general social crisis, but also due to a shortage of qualified specialists and the lack of scientifically grounded management methodologies for restructuring under conditions of a transformational economy. Crisis management and short-term forecasting have been the basis of the management models at enterprises organized after the reformation of the economy. These enterprises now face the problem of qualitative restructuring of their management system.

Experience has shown that foreign management ideas are assimilated very slowly in the Ukraine economy. Attempts to improve the efficiency of domestic management traditionally begin by determining the roles of actual new management functions and their place in organizational structures—which, nonetheless, remain resistant to change. The fact that light industry has recently begun to show signs of modest growth, may indicate improvement in management conditions, although though this conjecture demands further research.

14. Administrative Impact on the Sector

State agencies try to defend domestic manufacturers. Their efforts in this area include tariffs on imports, promotion of light industry export products, and regulation of retail trade markets. A fixed tax structure intended to provide small- and medium-size enterprises with certain privileges is also being planned.

The Ukraine government's legislative initiative for restoration of national light industry is codified in the acts entitled, "On the protection of national producers import dumping practices" and "Special measures for the limitation of imports of products that can be successfully produced in Ukraine".

The state has also introduced import quotas for the protection of domestic manufacturers. One example is the resolution taken by the Interdepartmental Committee of International Trade #SP-8/1999, "Special measures concerning artificial fur imports and fabrics from Belarus, China (including Taiwan, Hong Kong, Macao), Russia, and Hungary", dated 14

September 1999. According to the Interdepartmental Committee, the import quota was introduced for two products: artificial fur (code 4304), and knitted nap fabric (code 6001). These quotas remain in effect until May 12, 2003.

Those who wish to import indicated products are required to get special licenses from the Ministry of Exterior Economic Relations, which are valid for 90 days (or less). The Ministry of External Economic Relations may issue no more than 60% of the annual quota in a six-month period. The maximum amount of an indicated product or raw material that can be imported without a license is 9.99kg.

The greatest hope of improving the situation of the light industry sector seem to rest with the act entitled, "On conditions for development of national light industry and the woodworking industry", now under consideration by the Verhovna Rada. This legislation is based on the results of economic experiments in stabilization of light industry and woodworking in Chernivci Oblast. According to the conditions of the experiment, enterprises operate according to a flat tax, as opposed to various taxes including VAT, profit tax, payment for land, transport and municipal taxes, and duties for use of natural resources. The rate of the single tax is 9% of sales and 3% of exports. Participants in the experiment have their fines written off and their debts restructured by payments to the state and regional budgets. The experiment also stipulates several other privileges.

The results of the experiment, in terms of participant activity, are impressive. During the last six months of 1999, production at current prices increased by 60%, and by 43% in comparative prices. During the same period, exports of products and services increased by almost 200%. Expenditures for modernization and technical retooling/refurbishing increased from 1.3 million to 12 million UAH, and about 400 new jobs were created. Moreover, collection of the flat tax exceeded that of standard taxes by 28%, or 2.3 million UAH.

However, in spite of this apparent success, the Verhovna Rada has not hastened to adopt this initiative, which stipulates extending the experimental conditions (with some alterations, including decreasing the single tax rate from 9% to 8%, and the export rate from 3% to 2.5%) to all regions of Ukraine.

15. Social Issues of Sector Development

According to statistics, sector enterprise production has no harmful consequences for the ecology and health of the region, with the exception of leather processing.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

There are business plans for restructuring and reconstruction being discussed at almost every privatized light industry enterprise in the region. Total investment exceeds 100 million USD.

Table 10. Investment Proposals

Enterprise	Project	Products	Investment
EPOS	Produce competitive products	Fabrics, rugs, blankets	26 million USD
EPOS	Increase production capability at the rug industrial complex	Rugs	20 million USD
Open joint stock company Kharkiv sewing factory "Tinyakov "	Purchase modern technical equipment, produce new cloths models of high quality	Sewing products	1 million USD
Closed joint stock company Velika Derzhavinska Manufacture	Create joint venture for socks production	Socks industry	1 million USD
Private enterprise "Oranta"	Produce fabric, sleeves, bands and others made of polypropylene and polythene materials	Woven materials	6 million USD
Joint stock company "Bilshovik", leather production enterprise	Produce leathercarton from remnants of leather and food-wear production	Leathercarton	4 million USD
Joint stock company "Bilshovik", leather production enterprise	Produce competitive leather products "Wey-blue", "Krast"	Leather products	2 million USD
Joint stock company "Era"	Produce various foot-wear models from synthetic and natural materials	Foot-wear	1.9 million USD.
Kharkiv factory of theatrical properties	Purchase modern technical equipment	Sewing production	400,000 USD
Logos Laum Ltd.	Create joint venture for leather and traveling products production	Leather and traveling products	500,000 USD

Conclusions

During the last ten years, the sector's role in the Kharkiv Oblast economy has declined sharply. Kharkiv Oblast light industry manufacturers have lost more than 80% of the regional market to smuggled, counterfeit, and other illegal goods. The loss of consumer markets worsened the already troubled finances of sector enterprises, which soon became unprofitable.

According to experts' forecasts, an increase in light industry production is expected in 2001 when taxation is eased. But this increased production will do little to improve the overall situation of the sector, because profitability is not expected to improve. Some positive change for Kharkiv Oblast sector enterprises may be expected after adoption of the law, "On conditions for development of national light and woodworking industries", which the Verhovna Rada will be considering in the near future. On the whole, however, it is unlikely that light industry will recover its former importance in the Kharkiv Oblast economy anytime soon.

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List of Main Sector Enterprises and Organizations

Enterprise Name	Address	Telephone No.	Products	Directors	
"Theater Requisites Factory" JSC	2, Serikovskiy Lane Kharkiv, 61017 Ukraine	+38 0572	12-86-13; 12-86-02; 12-86-03	Products: bed-clothes; ready-made garments; theater and everyday footwear; everyday clothes, uniform; theater; everyday knitted fabric	Balabanova Nina Kostyantynivna
"Era" joint-stock company	120, Akademika Pavlova Str. Kharkiv, 61104 Ukraine	+38 0572	26-97-22; 26-97-78; 26-97-35; 26-97-39	Products: bed-clothes; glue for footwear production; suits; footwear for women, men, children; clothes made of genuine leather and imitation leather	Sevastyan Galyna Ivanivna
"Kharkiv Production and Trading Enterprise 'Kommunar' OJSC	24, Engels Str. Kharkiv, 61012 Ukraine	+38 0572	12-61-17; 12-59-82; 12-59-70	Products: bed-clothes; working suits; medical and special clothes; robes	Polyshchuk Yuriy Aksentyovych
"Kharkiv Sewing Factory" closed joint-stock company	3, Shchigrovskaya Kharkiv, 61071 Ukraine	+38 0572	76-23-23; 76-25-85; 76-25-08	Products: blouse; pans; jackets for women; dresses; shirts; robes; skirts	Rybitskiy Oleksandr Prokofyovych
"Sewing Factory named after Tinyakov" OJSC	2/4 Katsarskaya Kharkiv, 61012 Ukraine	+38 0572	12-10-88; 12-39-38; 20-62-41	Products: pans for men; suits; jackets for men; coats for women	Gorina Olena Borysivna
"Krasny Nit" Subsidiary Enterprise of "Epos-Holding" OJSC	24, Shevchenko Str. Kharkiv, 61013 Ukraine	+38 0572	43-29-70; 40-66-63; 40-66-14; 40-67-25	Products: sheet wadding; gobelin; blankets; plaids; furniture cloth with special protective filtering properties as "Belting" type, which are woollen and half-woollen	Vershinina Natalya Oleksandrivna

Light Industry. Sector Profile

Enterprise Name	Address	Telephone No.		Products	Directors
"Kharkiv Rope Plant" joint-stock company	1, Kitaenko Str. Kharkiv, 61020 Ukraine	+38 0572	76-24-63; 76-23-66; 76-23-13; 76-22-61; 76-94-04; 76-94-05	Products: technical rope, hemp rope; stuffing boxes; ?????? lap sewing linen; hemp and synthetic cores; hemp and synthetic twine	Shchupak Mykolay Yefimovych
Krasnograd Fur Factory	40, Kievskya Str. Krasnograd, 313050 Kharkiv Oblast Ukraine	+38 05744	7-29-57; 7-15-54	Products: collar-????????-????????; jackets; fur clothes; fur coats; hats	Kosyak Maria Savelyovna
"Ribbon Factory" collective enterprise	26, Tekstilna Str. Kharkiv, 61157 Ukraine	+38 0572	23-11-73; 23-46-05	Products: textile notions; ready-made garments	Altukhova Nina Grygorivna
"Production association 'Bolshevik' closed joint stock company	327, Shevchenko Str. Kharkiv, 61033 Ukraine	+38 0572	45-30-32; 14-91-55; 45-23-48; 14-90-46; 47-35-36	Products: notions; inedible fats; hide glue; hard chrome leather; jackets; footwear	Kubakh Anatoliy Ivanovych
"Ukrainian Fur" closed joint stock company	93, Postisheva Ave. Kharkiv, 61020 Ukraine	+38 0572	76-01-36; 76-93-27; 76-93-42	Products: hats for women, men, children; vests; goods made out of leather; coats and vests for children and women; short coat and jackets for men	Yekimov Vasyliy Trofymovych
"Krasnograd Cotton Weaving Factory"	11, K. Marx Str. Krasnograd, 312050 Kharkiv Oblast Ukraine	+38 05744	2-24-34; 7-15-54	Products: floor strips of carpet; linen and cotton fabrics	Bakaenko Lidiya Oleksiivna
"Lozova Sewing and Trade Enterprise" closed joint stock company	14, R. Lyuksemburg Str., Lozova, 313540 Kharkiv Oblast Ukraine	+38 05745	2-57-79; 2-54-73	Products: ready-made garments; clothes for children, women, men, special clothes for Ministry of Internal Affairs and Department of Defense	Markhai Ivan Ivanovych
"Dynamo' Sewing Factory" closed joint stock company	2, K. Marx Str. Kharkiv, 61012 Ukraine	+38 0572	12-52-63; 23-59-19; 12-30-84; 12-14-57	Products: jackets for men, women, children; fencing outfit	Polulyakhov Yuriy Anatoliyovych
"Volchansk Shoe Factory" OJSC	73, Orlova Str. Volchansk, 312510 Kharkiv Oblast Ukraine	+38 05741	2-23-62; 2-22-57; 2-23-66	Products: special footwear	Uvarova Maria ??????? Khomynichna
"Detodezhda" Ukrainian-Canadian JV	235, Shevchenko Str. Kharkiv, 61033 Ukraine	+38 0572	43-30-86; 47-65-55; 45-11-52; 43-38-84	Products: Overcoat for grown-ups, overcoats for children	Govorukha Yevgen Petrovych
"Kharkov-Sherst" closed joint-stock company	99, Postysheva Ave. Kharkiv, 61020 Ukraine	+38 0572	76-39-13; 72-10-11; 76-01-77	Products: woollen quilt; knitted fabric	Vzheshch Neonila Bronislavivna
"Yaroslavna" closed joint-stock company	1 A, Serikovskiy Lane Kharkiv, 61017 Ukraine	+38 0572	12-42-79; 12-29-89; 12-33-46	Products: pampers	Tishchenko Polina Mykolaivna
"Dinamo" knitting mill	4 Marshala Koneva Str. Kharkiv, 61052 Ukraine	+38 0572	12-05-21; 12-14-40	Products: sports knitted fabric	Kashkovskaya Lyudmila Andriivna

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

**6. CHEMICAL AND PETROCHEMICAL INDUSTRY:
CHEMICAL AND PHARMACEUTICAL INDUSTRY**

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Currently, the Chemical and Pharmaceutical sector is one of the most developed sectors in the Kharkiv Oblast economy. In 1999, production increased by almost 200% in comparison with 1996. Sector enterprises are the most profitable in the region: in 1999, average profitability was 33.5%. The market share of Kharkiv pharmaceuticals is 5.7% of the total Ukrainian market. The Kharkiv Chemical and Pharmaceutical sector ranks second in Ukraine in terms of overall industrial output. Eleven sector enterprises in the oblast manufacture more than 18% of total Ukrainian chemical and pharmaceutical products.

There are a number of fast-growing small enterprises in the sector. As of January 1, 2001, there were 24 such small enterprises. In 1999, these enterprises were responsible for 2% of all Kharkiv Oblast small enterprise production.

The Kharkiv medical sector is the indisputable leader in Ukraine due to its scientific and research potential. More than 7,000 scientists work at Kharkiv Oblast scientific and medical establishments, of which 1,500 are science doctoral candidates, about 410 are PhDs, and 52 are academicians from various national and foreign academies.

According to expert assessments, the Ukraine pharmaceutical market will continue to grow, and should reach 1 billion USD in 2005. Production development at state enterprises is expected to parallel market growth, as it did during 1993-1999. In 1999, Ukrainian pharmaceutical enterprises exceeded 1991 production levels for the first time since Ukraine independence.

In 1999, Kharkiv Oblast medical industry exports decreased by 360% in comparison with 1996, due primarily to the loss of market share in the Russian market, which is now dominated by domestic Russian firms.

The main factor hampering growth of both Kharkiv and national sector enterprises is the lack of a domestic supply of raw materials of sufficiently high quality. At present, a breakthrough into export markets is not considered possible, due to the lack of Good Manufacturing Practice (GMP) standards in domestic production. It is estimated that bringing Kharkiv Oblast enterprises into compliance with GMP standards will require investment of approximately 56 million USD, most of which will have to come from foreign investments.

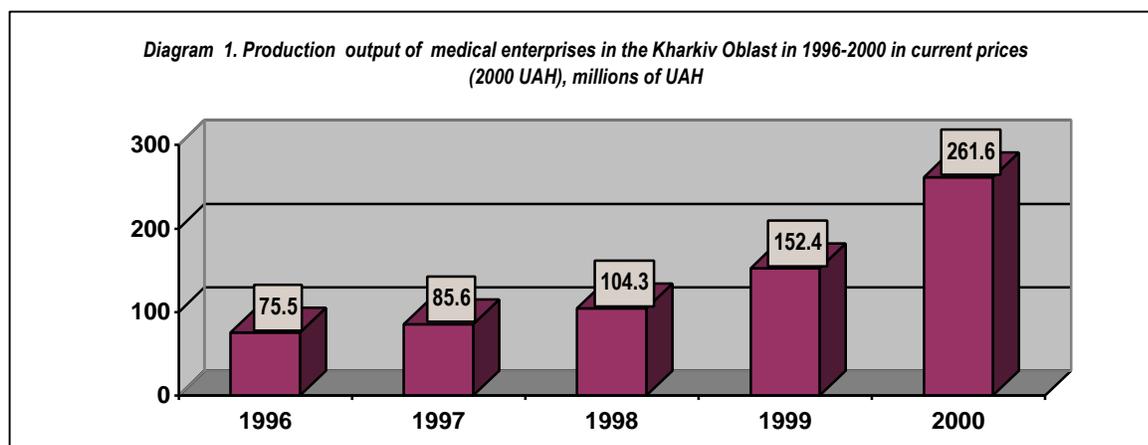
Considerable privileges have been granted investors in order to attract investments to Kharkiv Oblast sector enterprises. In the near future, the government of Ukraine is expected to introduce a number of measures designed to further support pharmaceuticals manufacturers, following the example of Russia and other neighboring countries.

In short, the Kharkiv Oblast chemical and pharmaceutical sector should prove to be one of the most promising sectors of the Kharkiv Oblast economy during the next ten years.

1. Sector Role in the Kharkiv Oblast Economy

The chemical and pharmaceutical sector is currently one of the most developed sectors of the Kharkiv Oblast economy.

Over the past three years, production output of sector enterprises has grown 160% (in constant 2000 UAH). During the same period, constant UAH in medical sector production output grew by 55%. Kharkiv Oblast medical enterprise production output over the last five years at current prices is shown in **Diagram 1**. [7].



Due to this growth, the medical sector's share of total Kharkiv Oblast industrial production output has grown from 2.1% in 1996, to 3.6% in 2000, as shown in **Table 1**. [7]

Table 1. Medical Sector Share of Total Industrial Production Output: 1996-2000

Economic Index	1996	1997	1998	1999	2000
Kharkiv Oblast sector output (million USD)	41.2	46.0	42.6	36.9	48.1
Total Kharkiv Oblast output of goods (million USD)	1,933.2	2,156.0	1,927.4	1,542.2	1,349.7
Sector share in total Kharkiv Oblast output of goods	2.1%	2.1%	2.2%	2.4%	3.6%

The Chemical and Pharmaceutical sector is also one of the most technologically advanced sectors in Kharkiv Oblast. In 2000, labor productivity at sector enterprises was two times higher than general industry productivity in the region (65,000 UAH per worker versus 32,000 UAH per worker). [7]

The Kharkiv Oblast Pharmaceutical sector is currently the second largest in Ukraine. Total production of sector enterprises makes up 18% of total Ukrainian medicine production. There are eleven companies in the oblast whose core business is the manufacture of medical products. Eight of these have been active in pharmaceutical production since pre-Soviet times, and are known as "the traditional manufacturers". As of January 1, 2000, there were also 24 small- and medium-size enterprises (SMEs) in the sector.

Today, Kharkiv sector enterprises manufacture more than 350 different kinds of pharmaceuticals, in all pharmacological and therapeutic classes. In 2000, total production exceeded 48 million USD. Over the last five years, average profitability of sector enterprises has reached 50%—the highest such index in the region's economy. During 1999, almost 1.85 million UAH was invested in developing new medicines.

Kharkiv Oblast is also the Ukrainian leader in chemical and pharmaceutical research and development. Over 7,000 medical researchers work in the oblast, of which 410 are PhDs, and 1,500 others are doctoral candidates. The State Scientific Center of Medicines (SSCM), located in Kharkiv Oblast, is Ukraine's leading research facility. The SSCM is

currently developing new pharmaceutical materials to be produced at domestic plants. By 1999, the SSCM had already developed 549 new medicines. The SSCM also served as the basis for the Pharmacopoeia Committee of the Ministry of Health Care, Ukraine's main research and regulatory body for standardization and quality control of medicines. [5]

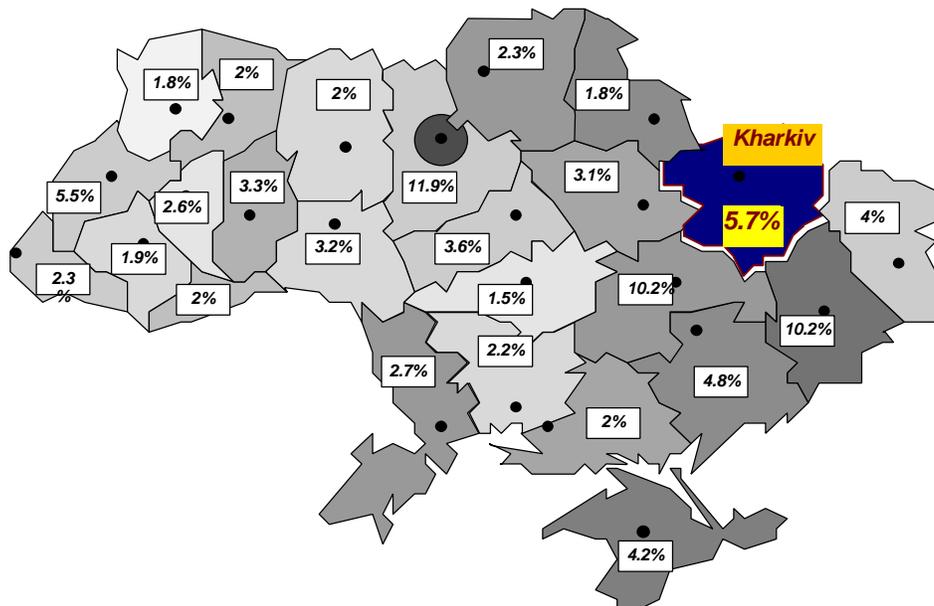
2. Strength of Kharkiv Oblast Sector

According to the estimates of the Deputy Minister of Health Care, the Ukrainian Chemical and Pharmaceutical market in 2000 totaled approximately 490 million USD. [17]

According to International Medical Statistics (IMS), the Moving Annual Total (MAT) index for the Ukrainian market increased by 48% during 1995-1999. In 1997, the MAT growth rate for the Ukrainian market was one of the highest in the world (39%). Sales in the Ukrainian market decreased significantly in 1998 as a result of the currency crisis; however, the Pharmaceutical market continued to grow in 1999-2000. According to the Business-Credit research group, the Chemical and Pharmaceutical sector market will exceed 1 billion USD in 2005.

Pharmaceutical retail market share for each of the Ukraine oblasts is shown in **Illustration 1**.

Illustration 1. Pharmaceutical Market Share by Oblast: 1999 (%)

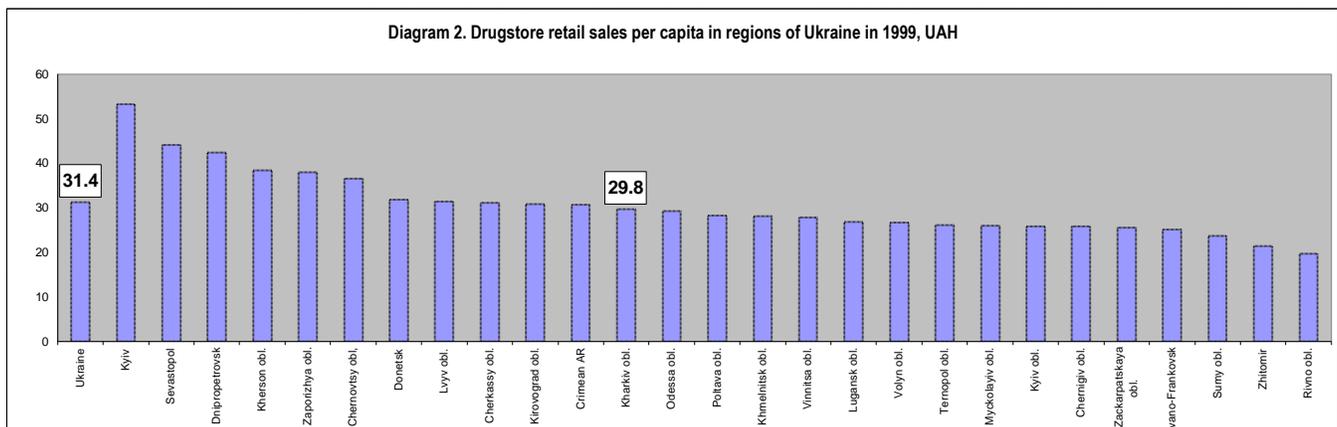


The Kharkiv Oblast Chemical and Pharmaceutical market constitutes 5.7% of the entire Ukrainian market, and ranks fourth, after Kyiv, Donetsk and Dnipropetrovsk oblasts. In 1999, retail sales in Kharkiv Oblast totaled 88.8 million UAH (21.5 million USD), as shown in **Table 2**.

Table 2. Drug Retail Sales by Oblast: 1999 (1000 UAH, 1000 USD)

Oblast	1000 UAH	1000 USD	Oblast	1000 UAH	1000 USD
Donets'k	158,694.5	38,421.1	Khmelnitskiy	41,238.0	9,984.0
Dnipropetrovs'k	158,316.8	38,329.7	Ivano-Frankivs'k	36,731.1	8,892.9
Kyiv	140,333.3	33,975.7	Kyrovograd	36,285.9	8,785.1
Kharkiv	88,859.6	21,513.6	Chernivtsy	34,289.0	8,301.6
Lviv	85,647.0	20,735.8	Myckolayiv	33,917.6	8,211.7
Zaporizhya	76,575.8	18,539.6	Chernygiv	33,362.6	8,077.3
Odessa	73,853.1	17,880.4	Zackarpatska	32,958.2	7,979.4
Lugans'k	71,307.3	17,264.0	Sumy	31,852.8	7,711.8
Crimean AR	65,246.1	15,796.6	Zhytomir	30,918.5	7,485.6
Vinnitsa	50,882.6	12,319.0	Ternopil'	30,384.2	7,356.2
Poltava	47,762.3	11,563.6	Volyn'	28,332.6	6,859.5
Kyiv	47,486.3	11,496.8	Rivno	23,577.7	5,708.3
Kherson	47,311.4	11,454.4	Sevastopil'	17,254.4	4,177.4
Cherkasy	45,337.5	10,976.5	Total Ukraine	1,568,716.2	379,797.6

At present, 6% of Ukraine's population lives in Kharkiv Oblast. In 1999, drugstore retail sales per capita was 29.8 UAH (USD 7.2), as shown in **Diagram 2**.



According to the data for 2000 produced by the Ministry of Statistics, the share of domestically produced pharmaceutical products in the Ukrainian market was 40%, up from 20% in 1991. [18; 20] During the period 1995-2000, domestic production of pharmaceutical products experienced steady growth. In 1999, pharmaceutical industry production exceeded that of 1991 in comparative prices (constant 1999) for the first time since Ukraine independence. Overall, production in 2000 exceeded 1 billion UAH, as shown in **Table 3**. [21; 17]

Table 3. Pharmaceutical Production in Ukraine: Constant 1999 UAH (million UAH)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000*
Production Volume	877.6	763.5	803.2	805.6	745.2	780.2	858.2	831.6	885.7	1140.8*
Annual growth	-	-13.0%	5.2%	0.3%	-7.5%	4.7%	10.0%	-3.1%	6.5%	28.8%

*Approximate figure.

Presently, the medical industry is one of the most dynamic branches of the Ukrainian economy. In 2000, the best year to date, overall national industrial production increased by 13%, while the medical industry increased by more than 28%. Medical industry share of national production has grown from 0.8% in 1991 to 1.1% in 2000. Ready-to-use medicines are now manufactured by 180 Ukrainian enterprises, including 22 traditional manufacturers. At the beginning of 2000, over 1,350 brands of medicines were being produced in Ukraine. [17] Kharkiv Oblast's 11 pharmaceutical companies produce approximately 18% of total Ukrainian medicine output.

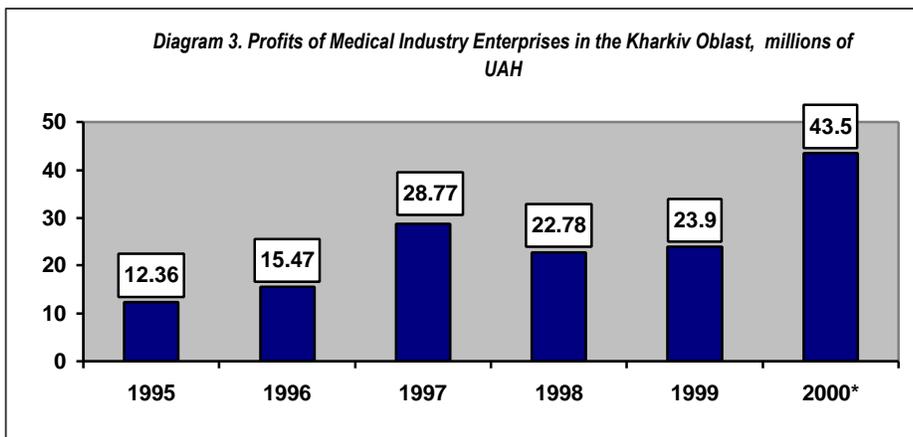
3. Economic Condition of Sector Enterprises and Organizations

Over the last five years, sector financial and economic indicators have remained strong, with enterprise profitability averaging 50%, as shown in **Table 4**. [6; 7; 8]

Table 4. Kharkiv Pharmaceutical Enterprise Profitability: 1995-1999 (million USD)

Sector Enterprise Financial Indicators	1995	1996	1997	1998	1999
Kharkiv Oblast enterprise profits (million USD)	8.39	8.46	15.45	9.30	5.79
Kharkiv Oblast enterprise profitability (%)	98.3%	61.9%	65.1%	49.1%	33.5%

Kharkiv Chemical and Pharmaceutical enterprise profits for the period 1995-1999 totaled 103.3 million UAH, while profits during the first 11 months of 2000 alone have reached 43.5 million UAH, as shown in **Diagram 3**. [6; 7; 8]



*January-November 2000

4. Sector Development: Raw Materials Base

The absence of a constant supply of raw materials is the main problem facing Kharkiv Oblast pharmaceutical enterprises.

Raw material production volumes are still very low. The Chemical Agents Plant only began production in 1997, and currently produces only 23 medical substances. In 1999, Chervona Zirka resumed its substance production operations, which had been terminated in the late 1980s. [16]

For the time being, Ukrainian domestic producers are not in a position to provide pharmaceutical enterprises with high-quality raw materials. Therefore, sector enterprises are forced to import substances, packaging, and other raw materials from China, Germany, the Czech Republic, and other countries. In 1998 alone, Kharkiv sector enterprises spent over 5 million USD on imported raw materials, which amounted to 18% of the total supply. In addition, imported substances accounted for over 75% of substance supply volume.

The imposition of the VAT on substance imports makes supply activity more difficult, and makes substance suppliers dependent on the fluctuations of the exchange market. [20]

5. Sector Development: Technological Base

Kharkiv Oblast sector enterprises are continually upgrading their operations and introducing new production technologies. These activities are primarily self-financed. When refitting, Kharkiv manufacturers are required to adhere to GMP standards, as is the case throughout the Ukraine pharmaceutical industry.

6. Investment Activities in the Sector

According to a law enacted May 11, 2000, enterprises investing over 500,000 USD on imported equipment and materials are exempt from paying import duty and the VAT. They are also exempt from property taxes for five years, and from profit taxes for three years. (50% of profit taxes are to be paid in the fourth and fifth years.)

Much of the investment activity for Kharkiv Oblast pharmaceutical enterprises has to do with bringing manufacturing processes into compliance with GMP standards. Estimated expenditures for introduction of GMP standards, as calculated by the Kharkiv Oblast Pharmaceutical Department, are shown in **Table 5**. [16]

Table 5. Kharkiv Oblast Sector Enterprise GMP Expenditures: 1998-2008 (million UAH)

Index	1999-2003	2004-2008
Necessary expenditures to meet GMP	164.6	99.6
Expected use of own funds	81.4	37.6
External investments	83.3	62.0

It is estimated that Kharkiv enterprises will need 56 million USD to introduce GMP standards. It should be noted that the new conditions for investing in the Kharkiv Oblast medical industry are quite attractive for investors. Some enterprises are already taking advantage of the tax allowances described above to attract additional investments.

7. Employment and Personnel Potential in the Sector

Today, Kharkiv pharmaceutical enterprises employ over 3,000 employees, 22% of total sector personnel in Ukraine. Employment figures for individual enterprises are shown in **Table 6**.

Table 6. Kharkiv Oblast Sector Enterprise Employment

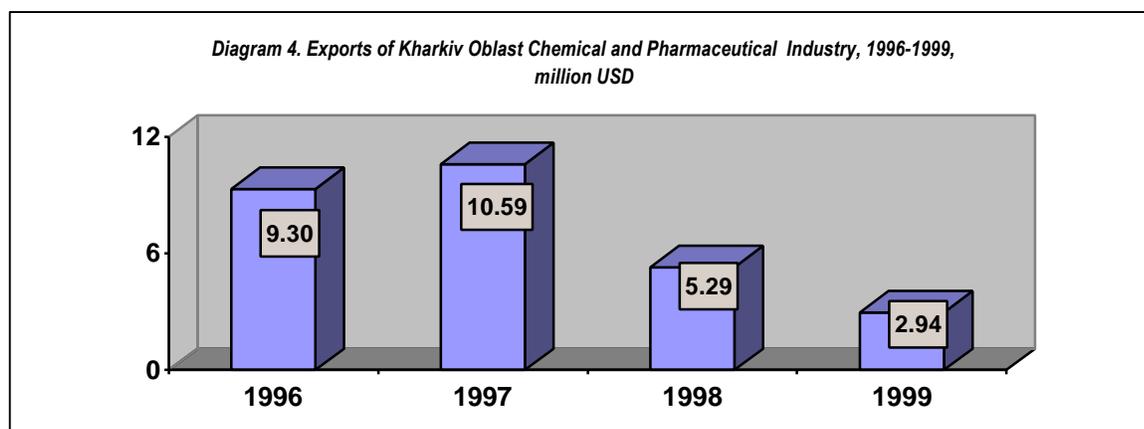
Firm	Total Employees	Notes
Zdorovie OJSC	902	322 certified specialists; 5 doctoral candidates
Stoma, CJSC	680	168 engineering/technical staff; 489 production staff
Biolek, CJSC	685	160 engineering/technical staff; 525 production staff; 147 employees with higher ed. degrees; 5 doctoral candidates
Chervona Zirka, CJSC	244	57 engineering staff
Zdorovie Narodu, state enterprise	113	55 employees with higher ed. degrees
SSCM	458	96 engineering staff; 2 doctoral candidates; 1 PhD

8. Sector Exports

Before 1991, a significant part of Kharkiv sector enterprise output was exported to the USSR. For example, the Zdorovie firm sold 80% of its output outside Ukraine, while Stoma exported 80%, and Biolek, 60-70%.

Today, the situation has radically changed. Export volume to CIS countries has decreased severalfold. As shown in **Diagram 4**, Kharkiv Oblast Chemical and Pharmaceutical industry exports have decreased 360% over the last four years.

Diagram 4. Kharkiv Oblast Sector Exports: 1996-1999



This decrease in export volumes is generally related to reductions in supplying drugs to Russia. This is due in part to the difference in exchange rates, which has persisted since the 1998 currency crisis. Another factor is the protective measures imposed by the Russian government, with the result that Russian manufacturers are now in a more favorable position than Ukrainian firms, since Russian firms pay neither VAT on imports of raw materials nor profit taxes when producing essential drugs. However, registering medicines is cheaper and easier for Ukraine firms than for foreign producers. Russian firms do not pay profit tax when producing vitally essential drugs, VAT when importing substances, and medicine registration is cheaper and more comfortable than for foreign makers. Today, almost 95% of sector output is sold within Ukraine.

9. Competitive Environment of Sector Enterprises and Organizations

The competitive environment of the Ukrainian pharmaceutical market is quite clear: foreign products account for about 60% of sales—even though foreign brand drugs are two to three times more expensive than domestic equivalents.

Ukrainian pharmaceutical imports during the first eight months of 2000 are shown in **Table 7**.

Table 7. Ukraine Pharmaceutical Imports by Country: January-August 2000 (million USD)

Country	Import Volume	Market Share
GERMANY	18,307.4	17.1%
INDIA	12,912.9	12.1%
HUNGARY	7,834.2	7.3%
FRANCE	7,489.0	7.0%
SLOVAKIA	6,819.9	6.4%
BULGARIA	5,342.3	5.0%
BELGIUM	5,216.1	4.9%
POLAND	5,093.1	4.8%
AUSTRIA	4,684.1	4.4%
DENMARK	4,667.6	4.4%
USA	4,305.9	4.0%
OTHERS	24,266.9	22.7%

During the last five years, the market share of Ukraine sector enterprises has remained virtually unchanged. According to a 2000 manufacturer survey, the Darnitsa pharmaceutical company (Kyiv) is the indisputable leader among Ukrainian enterprises, with approximately 15% of total national drug output. Darnitsa is followed by Bortschagovsk CPF, Kyivmedpreparat, and Pharmak (all from Kyiv). Zdorovie, the leading producer in Kharkiv Oblast, ranks fifth, while the SSCM is in 17th place, well ahead of such famous companies as Pfizer, Glaxo Wellcome, and other foreign firms.

Eight Kharkiv Oblast pharmaceutical companies produce approximately 18% of total Ukraine sector output, as follows: Zdorovie, 7.4%; Stoma, 3.1%; SSCM, 2.5%; Zdorovie Narodu, 2.1%; Biolek, 2.0%; Chervona Zirka, 1.2%; and Lekchim-Kharkiv, 0.2%.

10. Ownership in the Sector

Today, only three sector enterprises remain state-owned: SSCM, Zdorovie Narodu, and the Chemical Agents Plant.

Privately-owned companies are as follows:

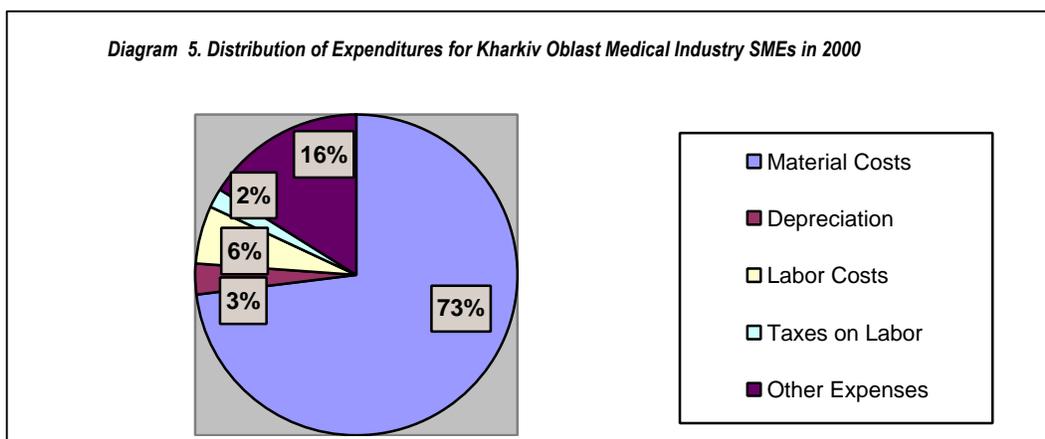
- **Zdorovie, Open Joint Stock Company**
Joint stock company since 1997; 100% privatized. Four Ukrainian investors hold 91% of shares. [20]
- **Stoma, Closed Joint Stock Company**
Privatization completed 1993; 100% privatized. The Director owns 4.5% of shares. [20]
- **Biolek, Open Joint Stock Company**
100% privatized. Employees, including management, own all shares (not more than 4% each). [20]
- **Chervona Zirka, Open Joint Stock Company**
Open joint stock company since 1995; 100% privatized. The AVEK concern is the major shareholder. [20]

11. SME Growth in the Sector

As of January 1, 2001, there were 24 small- and medium-sized sector enterprises (those having up to 50 employees) in Kharkiv Oblast. Combined total production in 2000 was 5.76 million UAH, which accounted for 2% of total SME industrial production volume in the region. Sales proceeds totaled 522,600 UAH.

In 2000, Kharkiv Oblast SME sector expenditures for production amounted to 5.23 million UAH. An itemized breakdown of these expenditures is shown in **Diagram 5**.

Diagram 5. Kharkiv Oblast SME Medical Industry Expenditures: 2000 (%)



In 2000, the sector SME average monthly wage was 199 UAH, one of the highest in the region. Average monthly wage across all Kharkiv Oblast SMEs was 122 UAH for the same period. [14]

12. Sector Infrastructure

Kharkiv Oblast has a number of established health care educational institutions with a long history of training research and technical personnel, including the Ukrainian Pharmaceutical Academy, Kharkiv State Medical University, and the Kharkiv Medical Academy of Postgraduate Education. In addition, there are several leading R&D institutions in Kharkiv, including SSCM, the Ukrainian Institute of Pharmacological Therapy of Endocrine Diseases, the Ukrainian R&D Institute of Juvenile Health Protection, and others. Of these, the Ukrainian Pharmaceutical Academy and SSCM are the best known.

Ukrainian Pharmaceutical Academy (UPA)

UPA is an educational center that has become well-known worldwide over the course of its 80-year history. Today, 920 employees work at the Academy, of which 50 are PhDs and 250 are doctoral candidates. There are currently 4,000 students, including 1,000 foreign students. During the Academy's existence over 17,000 specialists have been trained, and Academy researchers have developed over 100 new medicines and introduced 17 into production. In addition, 25 new medicines are now undergoing clinical trials, and another 34 are in the pre-clinical trials phase. [5]

SSCM

The Center was established in 1920, and was Ukraine's first scientific pharmacological institution. Today the SSCM is authorized by the Ministry of Health Care to serve as the organization responsible for standardization, metrology, and certification of drugs in Ukraine. In addition, the Pharmacopoeia Committee was patterned after the SSCM as the nation's highest institution for standardization and quality control of finished medicines. Among the Center's employees are 22 PhDs, 80 doctoral candidates, and 170 research associates, as well as one member of the International Engineering Academy and three corresponding members of the Engineering Academy of Ukraine. The registered preparations developed in the Center make up 27% of the total number of Ukraine drugs. In addition, the SSCM factory, a legally separate entity from the Center, is the second largest pharmaceutical preparation manufacturer in Kharkiv Oblast. [5]

13. Management Capabilities of Sector Enterprises and Organizations

Pharmaceutical sector enterprises and organization management differ from other sectors in that directors have been able to make good use of existing personnel and technological potential to achieve consistent and purposeful growth.

14. Administrative Impact on the Sector

The complex program for medical industry development during the 1997-2003 timeframe, expanded in 1996, has still not been fully implemented. The program provided for the production of 233 drugs of almost all pharmacological groups. 49.7 million UAH was required to finance this program; however, a mere 5.3 million UAH was actually budgeted during a four year period, only 10.7% of the projected amount.

Another major problem over the last eight years has been the uncertainty as to which state body is responsible for regulating the medical industry in Ukraine. In 1993 the concern "Ukrmedprom" was dissolved, and *Derzhcommedbioprom* was set up instead; in 1999 *Derzhcommedbioprom* was re-organized into *Commedbioprom*. In 2000 *Commedbioprom* was dissolved. Currently, the medical industry is controlled by the State Department for Quality

Control, Safety and Production of Drugs and Medical Products, an auxiliary of the Ministry of Health Care (MHC) of Ukraine.

Legislative regulation of the pharmaceutical market is failing to meet contemporary requirements. Control oversight of medicine, medical equipment, and medical products manufacture is scattered and redundant; and relations between the state and producers, and between the state and consumers, remain vague. In addition, there is no clear, logical, and consistent system of drug registration, and no uniform set of requirements as to certification and accreditation of authorized laboratories.

According to the head of the State Department for Quality Control, Safety and Production of Drugs and Medical Products, Ukrainian governmental bodies should take the following steps in the next few years:

- Bring legislative regulations governing the pharmaceutical sector into compliance with the European Union (EU) requirements.
- Coordinate the activities of the National Academy of Science, the Ministry of Science and Technology, and the MHC according to a uniform national policy on new drug development.
- Introduce obligatory government contractual work for vitally essential drugs, gradually incorporating Russian experience (see example below).
- Continue to encourage export-oriented production. In 2000, export volume increased by almost 22%, amounting to 40 million USD. The task for 2001 is to reach the 1998 level of Ukrainian pharmaceutical production exports (60.5 million USD).
- Increase exports. This can be achieved only if production facilities are brought into conformity with GMP standards, which requires considerable investment (10 to 100 million dollars for one production facility).
- Set up the State Pharmacopoeia of Ukraine in the near future.
- Create product certification procedures, and at the same time, strengthen drug quality controls. According to the MHC of Ukraine, in 2000 about 15% of drugs were imported illegally or counterfeited.

Example of State Support for a National Manufacturer: Russia

In 1996, the Russian Federation government instituted a number of proactive measures to support its domestic pharmaceutical industry:

- Russian manufacturers were exempted from taxes on profits on vitally essential drugs (which make up 60% of total production output); from VAT on raw materials; and from fiscal sanctions for non-return of foreign currency for a 120-day period.
- State registration of drug prices was introduced.
- Enterprises that developed up-to-date drugs that were less expensive than imported analogs were particularly supported.
- A system of national (regional) government contractual work was instituted.

This program of national manufacturer support has already achieved a number of positive results: for example, state expenditures on drug purchases have decreased by almost 200%. In addition, Russian pharmaceutical enterprise production output increased by 48% during nine months of 2000, compared with the same period of 1999. [22]

15. Social Issues of Sector Development

The social impact of the medical industry is extremely high for any nation. Its qualitative and quantitative condition directly affects a country's most vital resource: the health of its citizens.

According to the World Health Organization, in terms of integral criteria, the Ukraine pharmaceutical industry ranks 60th in the world. Unfortunately, average life expectancy in Ukraine is only 68 years for women and 63 years for men. The general mortality rate remains rather high, and the incidence of general sickness is increasing. The incidence of general disablement also remains high: in 2000, the number of disabled was approximately 2.5 million. These figures testify to the fact that rapid development and growth remain imperative for the nation's, and Kharkiv Oblast's, medical industry. [15]

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

The following Kharkiv sector investment proposals are currently under consideration: [19]

Stoma, Closed Joint Stock Company

- Address:
 - str. Newtona 3
 - Kharkiv, Ukraine, 61105
 - Tel.: +380-572-520151
 - Fax: +380-572-521131
- Executives:
 - President: V.G. Volkov
 - Chief engineer: A.S. Ephojan
 - Chief account: A.I. Safonov
 - Vice-president: V.V.Chebanyuk
 - Vice-president: V.B. Sosnitskij

KEY COMPETITORS

- Darnitsa Pharmacology Company (Ukraine)
- Borschagovskij Kchemical Pharmacological Factory (Ukraine)
- Zdorov'e (Ukraine)
- Stomadent (Russia)
- Raduga Rossii (Russia)
- Dentsply (USA)

Today Stoma, JSC is the only producer of medical plastics and stomatological materials. The joint stock company holds the entire issue of shares. Stoma, JSC has free production facilities (2,600 m²), that could be used for expanding its range of products, including reintroduction of a variety of previously produced childcare and maternity goods.

Biolek, Open Joint Stock Company

- Address:
Pomerki, Kharkiv, Ukraine, 61070
Tel.: +380-572-474043
Fax: +380-572-353405
- President: Yu.P. Temirov
- Vice-president: Yu.M. Krasnopskij
- Vice-president: Yu.F. Kushnarenko
- Vice-president: B.D. Koshel

Key Competitors

- Biofarma, Ukraine

This company is the only producer in the NIS countries of a number of key materials used in various applications, including antirabical immunoglobulin, cardiolipin antibodies, diclofenac natrium, ketaminium, renalgan for injections. In addition, it is the only producer in the world of such preparations as ectericid, lipin, vaccine OEMCh, and enacada solution.

The company's original technologies, high quality standards, modern equipment, highly-trained professional staff, and adherence to principal GMP requirements all contribute to making it attractive to investors. Other advantages include:

- company is financially secure
- products are exported to NIS and other countries
- medicinal forms are produced at local substations of leading foreign companies

Conclusions

In the opinion of many experts, the Chemical and Pharmaceutical sector should prove to be one of the most promising sectors of the Kharkiv Oblast economy during the next ten years. For this reason, it should play a strategic role in the development of the region. The sector's growth dynamics in Kharkiv Oblast are higher than those of any other industrial sector. And of the numerous competitive enterprises that have recently appeared, the majority should be able to realize sufficient investment resources necessary for continued growth.

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List of Main Enterprises and Organizations in the Sector

Enterprise Name	Address	Telephone No.		Products	Directors
"Kharkiv Pharmaceutical Factory"	25, Grazhdans'ka Str., Kharkiv, Ukraine	+38 0572	12-78-04	Drops; medicines	NA
Research Plant of Medicament Center	8, Vorobyova Str., Kharkiv, 61057, Ukraine	+38 0572	12-79-03; 12-78-90	Medicines	NA
"Zdorov'ya" OJSC	22, Shevchenko Str., Kharkiv, 61013, Ukraine	+38 0572	14-96-15; 14-96-14	Medicines	NA
Kharkiv Biological Factory	4, Rustaveli Lane, Kharkiv, 61050, Ukraine	+38 0572	21-36-17; 21-42-69	Veterinary compounds	NA
"Plant "Chervona Zirka" OJSC	1, Gordienkobs'ka Str., Kharkiv, 61010, Ukraine	+38 0572	23-47-88; 12-57-58	Medicines	NA
??? "Kharkiv Enterprise "Biolk" closed joint-stock company	84, Pomerki district, Kharkiv, 61070, Ukraine	+38 0572	35-34-05; 44-95-34	Vaccines; medicines	NA
?? "Stoma" JSC	3, Newton Str., Kharkiv, 61105, Ukraine	+38 0572	52-11-31; 52-10-05; 52-01-51	Plastic teeth; accessory materials	NA
"Plant of Chemicals" subsidiary enterprise of "Institute of Monocrystals" of national Academy of Sciences of Ukraine	25, Lenina Avenue, Kharkiv, 61000, Ukraine	+38 0572	32-20-32; 32-83-97; 30-93-35	Medical product substances and materials	NA

NA – Not available

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

7. CONSTRUCTION MATERIALS INDUSTRY

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

The construction materials industry in Kharkiv Oblast is well developed:

- more than 10 plants produce ferroconcrete structures and articles
- total annual production capacity of brick factories is about 650 million units
- nearly 5.4 million square meters of ceramic tiles are produced annually by the Kharkiv Tile Factory—the largest in Ukraine, and one of the largest in the CIS
- OJSC Baltsem, which has an annual production capacity of about 4 million tons, is one of the largest producers of cement in Europe

Regional sector share of total Ukraine construction materials output in 1999 was 5.3%. Within the oblast, its share of total production and services output was 1%.

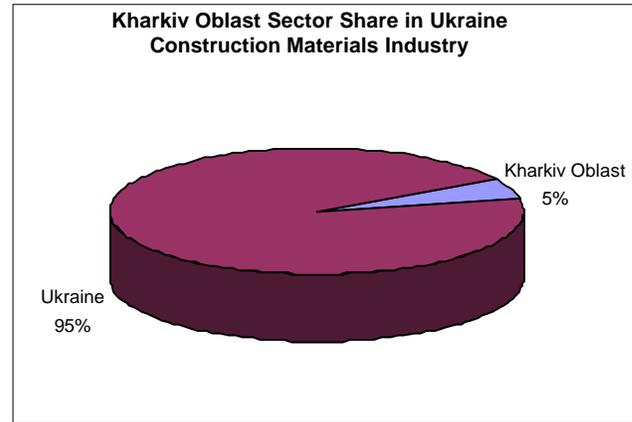
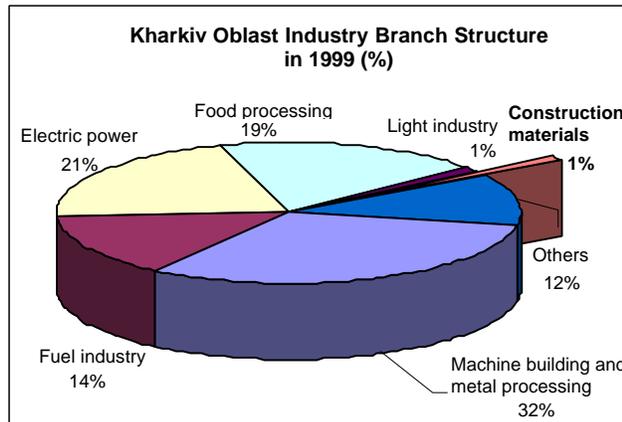
The results of the analysis of the construction materials industry in Kharkiv Oblast are as follows:

- An increase in production value (in UAH) has been observed in the Kharkiv Oblast construction materials industry since 1998. However, in USD, the production value has decreased over the same time period.
- Despite this growth, the financial-economic state of sector enterprises in the oblast remains rather complicated. Most of the companies still use old energy-inefficient equipment, which increases production costs. In addition, a shortage of working capital leads to a reliance on commission schemes that severely hamper sales efficiency.
- The three main technological problems for the construction materials sector, at both the oblast and national levels, are:
 - High depreciation of equipment
 - Energy inefficiency of outmoded technical processes and equipment
 - Decrease of demand for products of ordinary quality and design
- As of January 1, 2000, the total number of sector employees in Kharkiv Oblast was estimated at 10,000 (not including small enterprises).
- In 1999, Kharkiv Oblast's share of total sector exports was 1.5% (1.2 million USD).
- Kharkiv Oblast's sector enterprises face stiff competition from both national and foreign manufacturers, and from importers of construction materials.
- There are 30 sector small companies registered in the oblast. There were a total of 61 sector small enterprises active in 1999, compared with 69 in 1998.
- Kharkiv Oblast is known for its high quality mineral resources, including sand, refractory and ceramic clays, mineral gypsum, and chalk.

The construction materials industry plays an important role in the Kharkiv Oblast economy. The sector's role in the industry of the region will continue to grow due to its production capacity, inexhaustible mineral resources, and a growing demand for construction materials.

1. Sector Role in the Kharkiv Oblast Economy

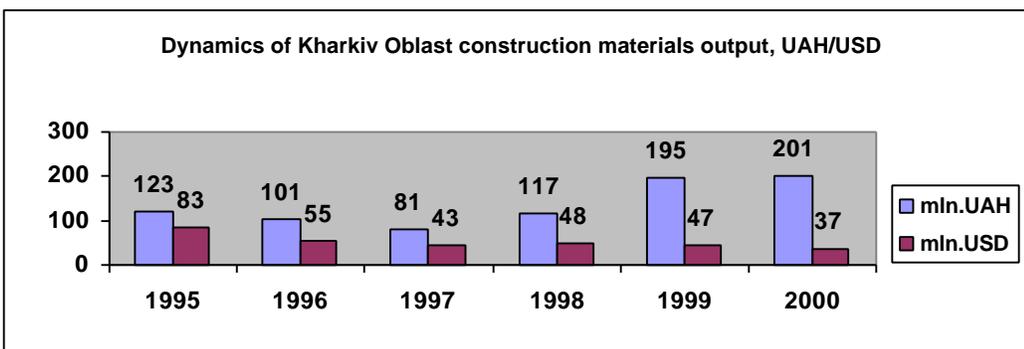
The construction materials industry in Kharkiv Oblast is well developed, and has a high potential for growth. Sector share of total Ukraine construction materials output in 1999 was 5.3%. Within the region, its share of total production and services output was 1%.



According to 2000 data, Kharkiv Oblast sector share of total regional industry has already reached 3%. In general, trends of sector output in the region practically coincide with the development of the Ukraine construction materials industry overall. The only difference is that growth has been observed at the national level since 1995, while growth within the oblast commenced in 1998.

Table 1. Kharkiv Oblast Construction Materials Industry Output: 1995-2000 (UAH vs. USD)

Industry	1995	1996	1997	1998	1999	2000
Construction materials industry (million UAH)	123	101	81	117	195	201
Construction materials industry (million USD)	83	55	43	48	47	37



The production of corresponding sector primary products in Kharkiv Oblast is shown below:

Table 2. Dynamics of Sector Primary Products in Kharkiv Oblast: 1991-2000

Production	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Cement (1000 tons)	3620	3460	3045	2308	1000	228	76	418	354	768
Ferroconcrete structures (1000 m ³)	849	878	744	438	229	150	126	118	98	64
Construction bricks (million pieces)	453	443	401	330	210	167	125	131	133	96.6
Ceramic tiles (1000 m ²)	3945	4404	4065	3450	3503	3273	3037	3749	4334	4881

2. Strength of Kharkiv Oblast Sector

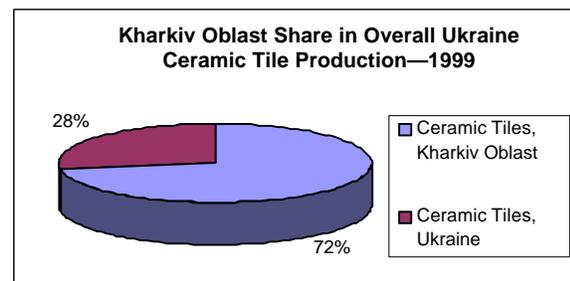
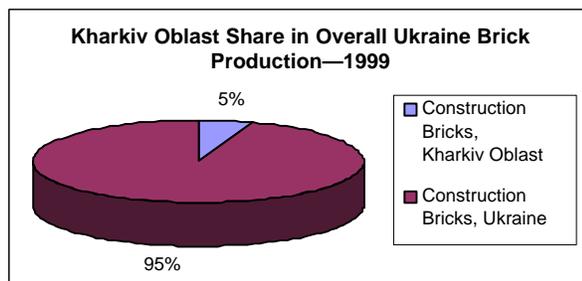
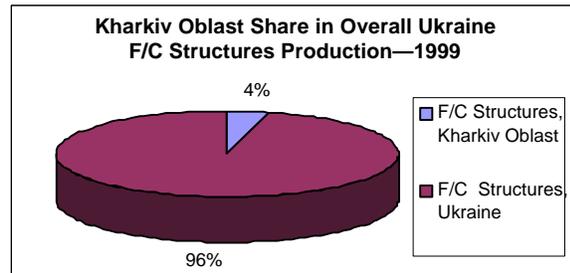
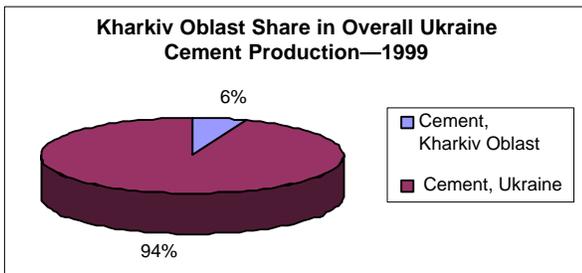
The construction materials industry in Kharkiv Oblast is well developed:

- more than 10 plants produce ferroconcrete structures and articles
- total annual production capacity of brick factories is about 650 million units
- nearly 5.4 million square meters of ceramic tiles are produced annually by the Kharkiv Tile Factory—the largest in Ukraine, and one of the largest in the CIS
- OJSC Baltsem, which has an annual production capacity of about 4 million tons, is one of the largest producers of cement in Europe

At the beginning of 2000, there were about 53 registered sector enterprises in Kharkiv Oblast. This makes up 5% of the total number of Ukrainian construction materials enterprises (1,034 companies at the beginning of 2000). However, according to the Kharkiv Oblast Statistics Committee, the number of sector companies in the region fell to 45 in 2000.

In general, only 5-20% of sector production capacities was used in 2000 (with the exception of ceramic tiles, at 85%). It should be stressed that Kharkiv Oblast plays a leading role in overall Ukraine production of ceramic tiles (72%) due to the high productivity of the CJSC Kharkiv Tile Factory.

Regional sector share of total Ukraine construction materials output for 1999 is shown below.



3. Economic Condition of Sector Enterprises and Organizations

Despite the recent growth of construction materials output and sales, the financial-economic state of sector enterprises in the oblast remains rather complicated. Most of the companies still use old energy-inefficient equipment, which increases production costs. In addition, a shortage of working capital leads to a reliance on commission schemes that severely hamper sales efficiency.

The main economic and financial indexes of branch activity are shown below.

Table 3. Sector Sales Activity: 1997-2000 (UAH vs. USD)

Branch	1997	1998	1999	2000
Construction materials industry (million UAH)	101	147	189	201
Construction materials industry (million USD)	54	60	46	37

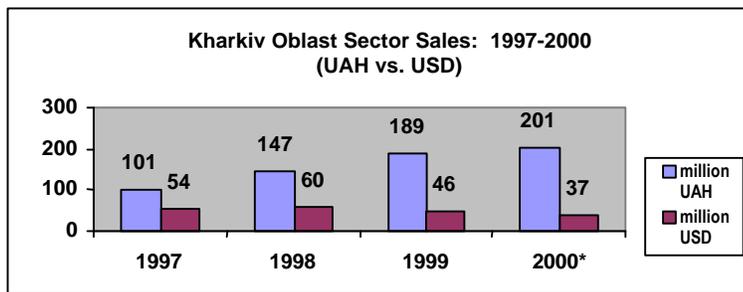
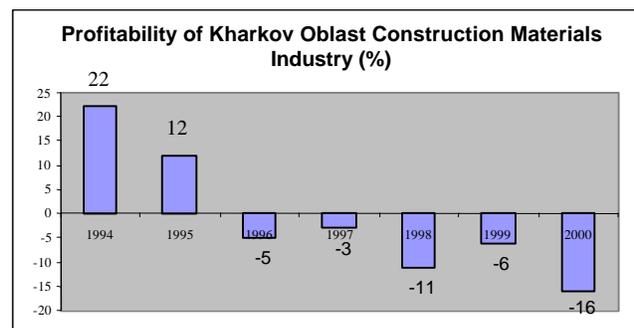
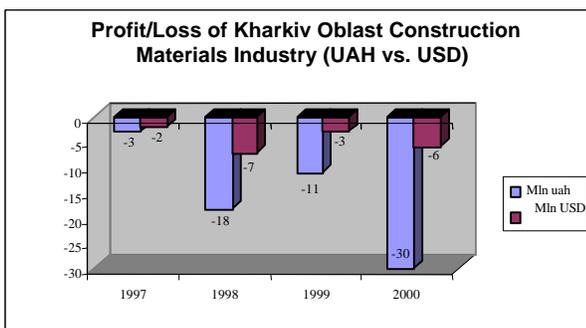


Table 4. Sector Profit/Loss: 1997-2000 (UAH vs. USD)

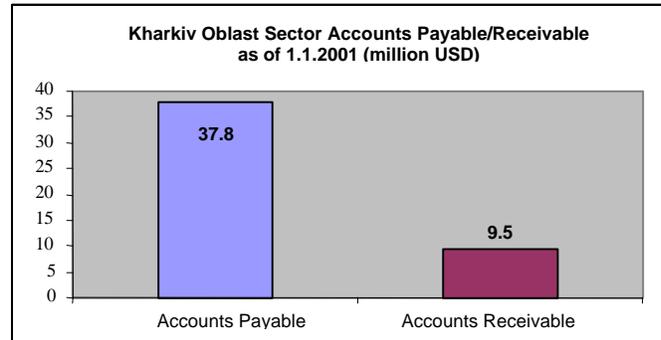
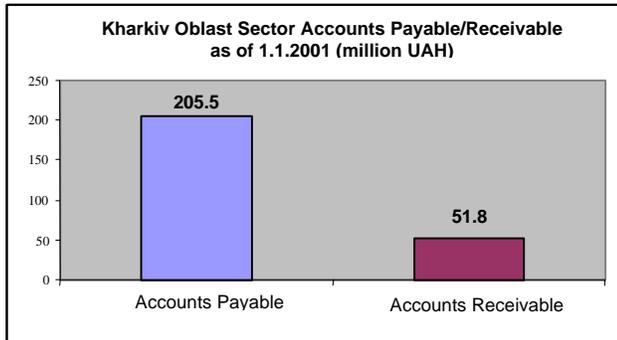
Industry	1997	1998	1999	2000
Construction materials industry (million UAH)	-3	-18	-11	-30
Construction materials industry (million USD)	-2	-7	-3	-6

Table 5. Sector Profitability: 1994-2000

Industry	1994	1995	1996	1997	1998	1999	2000
Construction materials industry	22%	12%	-5%	-3%	-11%	-6%	-16%



As of January 1, 2001, sector accounts payable exceeded accounts receivable by 400%. In addition, the value of accounts payable was equal to the annual sales of the entire sector. Energy companies make up 22% of total sector accounts payable. The accounts receivable turnover period is 92 days.



4. Sector Development: Raw Materials Base

Kharkiv Oblast is known for the high quality of its mineral resources used in the production of construction materials; these make up 14% of total regional natural resources potential. The main sedimentary mineral resources are: sand, clay, chalk, and limestone.

The following deposits are strategically important for the construction materials industry at both the oblast and national levels:

- Quartz sand: Novosyolovka and Berestovenko deposits
- Ochre: Sukho-Kamensk deposit
- Gypsum: Berezivka deposit
- Clay: Shebelinka deposit
- Chalk: Izium deposit

5. Sector Development: Technological Base

The three main technological problems for the construction materials sector, at both the oblast and national levels, are:

- High depreciation of equipment
- Energy inefficiency of outdated technical processes and equipment
- Decrease in demand for products of ordinary quality and design

Estimated wear of fixed assets is currently placed at 60-70%.

Power costs currently make up 30% of total production cost, while raw materials take up another 20%. The situation is even more complicated with cement production, where the cost of power is at least 65% of total production cost.

Implementing new, cost-saving technologies requires additional external and internal investment. Reinvestment of enterprise capital could also help defray these costs.

For example, the CJSC Kharkiv Tile Factory is currently trying to upgrade its entire operations through capital reinvestment, without recourse to outside funds. Capital reinvestments are difficult, because the company has to compete with low-priced products from Byelorussia and Russia, bringing profits to a minimum. Further development is only possible through continuously increasing production volumes, which is the course the plant has taken.

6. Investment Activities in the Sector

According to the Kharkiv Oblast Statistics Committee, there is currently no direct foreign investment in the local construction materials industry; all development is being funded entirely through domestic investments.

Some recent examples of domestic investment activity include:

Establishment of the JSC Kharkiv Industrial Union by regional industrialists to render assistance to Kharkiv Oblast sector enterprises. In one example, JSC Baltsem, one of the largest cement producers in Europe, was modernized and restarted after a two-year shutdown. In 2001, Baltsem plans to reach 100% capacity (4 million tons of cement); it is anticipated that more than 4,000 people will be employed.

The commercial bank Privatbank, Dnepropetrovsk, bought a controlling block of shares in JSC Baltsem. The bank is planning to continue investing in production facility upgrades as well as in new energy saving technologies for cement and asbestos sheeting production.

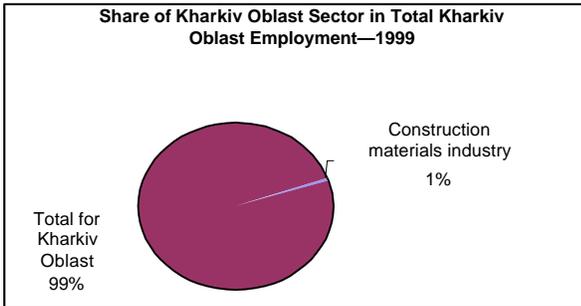
In 1999, the holding company TMM, Kharkiv, invested in the Kharkiv Dry Construction Mixtures Plant, a new 2,200 m² facility; equipment was purchased during 1999-2000. Given that the structure of the holding company includes a number of construction companies among the investors, it is that, at least during the start-up phase, TMM will be the major buyer of dry mixtures. This investment is regarded by TMM as a pilot project in which production and sales techniques will be tested for this new Ukraine product. If successful, the plant will serve as a blueprint for similar projects.

7. Employment and Personnel Potential in the Sector

As of January 1, 2000, the total number of sector employees in Kharkiv Oblast was estimated at 10,000 (excluding small enterprises). Sector employment as of January 1, 2000 for Kharkiv Oblast relative to the overall Ukraine construction materials industry is shown below:

Table 6. Construction Materials Employment: 1999

Number of Employees (1000)	1999	%
Kharkiv Oblast construction materials industry	9	-
Total Kharkiv Oblast employees	1 387	1%
Ukrainian construction materials industry	203	5%



Average monthly salary for the sector in Kharkiv Oblast is 15% higher than the regional average, and 26% higher than the industry national average, as shown below. Average monthly salary for the sector in Kharkiv Oblast in 2000 was 261 UAH (48 USD).

Table 7. Average Monthly Salary: 1999

Index	UAH	USD
Average monthly salary in the Kharkiv Oblast construction materials industry	213	52
Average monthly salary in Kharkiv Oblast	184	45
Average monthly salary in the Ukrainian construction materials industry	168	41

8. Sector Exports

According to the Ukraine Ministry of Statistics, exports of construction materials in 1999 totaled 79 million USD. The Kharkiv Oblast share of total exports was 1.5%, or 1.2 million USD.

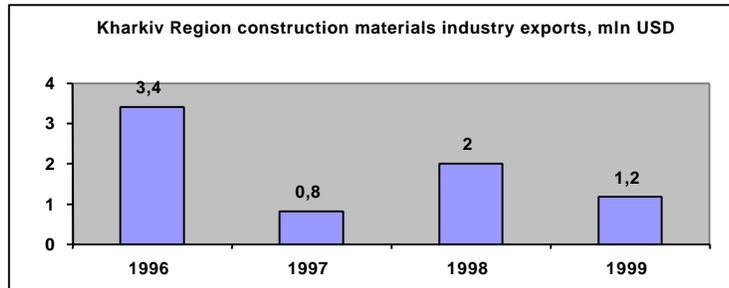
Major export items are:

- Ceramic floor tiles
- Cement

A total of nine Kharkiv Oblast sector companies exported their products in 1999. There is no clearly discernable trend in sector export activity.

Table 8. Kharkiv Oblast Construction Materials Industry Exports: 1996-1999 (million USD)

Industry	1996	1997	1998	1999
Construction materials, Kharkiv Oblast	3.4	0.8	2.0	1.2



9. Competitive Environment of Sector Enterprises and Organizations

Kharkiv Oblast's sector enterprises face stiff competition from both national and foreign manufacturers, and from importers of construction materials. This is in part due to the fact that the construction materials industry is well developed throughout all regions of Ukraine.

Table 9. Sector Enterprises by Region: 1999

Region	No. Enterprises
Kharkiv Oblast	53
Dnepropetrovsk Oblast	65
Donetsk Oblast	104
Kyiv Oblast	37
Lugansk Oblast	46
Poltava Oblast	41
Sumy Oblast	20
Kyiv Oblast	45
Total Ukraine	1034

It's worth mentioning that neighboring regions considerably exceed Kharkiv Oblast in output of most construction materials, with the exception of ceramic tiles. For the sake of comparison, cement production volumes for 1999 among the different eastern Ukraine oblasts are shown below:

Table 10. Cement Production by Oblast: 1999 (1000 tons)

Region	Cement (1000 tons)
Kharkiv Oblast	354
Dnepropetrovsk Oblast	1604
Donetsk Oblast	1168
Total Ukraine	5828

One negative influence on sales of Kharkiv Oblast construction materials is a doubling of the market price for the same product by bartering schemes that borrow the supply raw materials against future production. The difference between the producer's price and that of the raw material supplier, who receives the product in exchange for the materials, can reach 30-40%. This is primarily caused by a chronic deficit of working capital to pay for electric power and gas.

According to the State Corporation Ukrstroyaterialy (Ukrainian construction materials), approximately 30% of the national market demand is met by foreign imports. It is expected that Ukrainian manufacturers will find it increasingly difficult to maintain a strong position in both foreign and national markets; low prices will probably remain their main competitive advantage.

10. Ownership in the Sector

According to the State Committee of Statistics (SCS), 90% of Ukraine construction materials enterprises are outside of state ownership (930 companies). These companies are responsible for 80.4% of all construction materials produced in Ukraine. Given that overall industry output in 2000 totaled 3,799 million UAH, private companies produced construction materials totaling 3,054 UAH.

11. SME Growth in the Sector

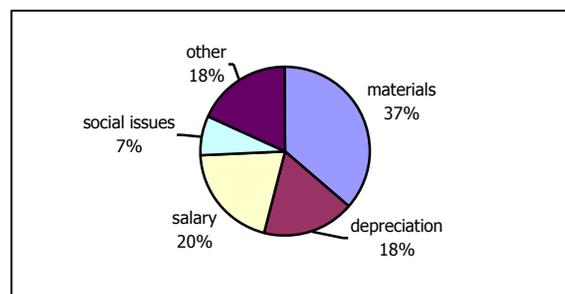
In 1999, sector small enterprises (SE) totaled 3% of total small businesses in Kharkiv Oblast (61 companies), down 11% (8 companies) from 1998. There were 30 registered small companies in the sector in 1999. According to the SCS, a construction materials industry small enterprise is defined as a company with not more than 50 employees.

Kharkiv Oblast small enterprise output totaled 288,871,500 UAH (69,937 USD) in 1999, an increase of 42% over 1998 (85,598,100 UAH). Their share of total sector output was 0.9%, or 2,586,000 UAH (626,000 USD), down sharply in comparison with 1998 (87% in UAH, 90% in USD), when Kharkiv Oblast small businesses had a share of 7.3% (14,839,000 UAH, 6,058,000 USD).

A cost breakdown for Kharkiv Oblast sector small enterprise products in 1999 is shown below.

Table 11. Kharkiv Oblast Sector SME Production Costs: 1999

Cost Item	1000 UAH
Tangible costs	1342.3
Fixed assets depreciation	651.3
Salary	754.7
Social security contributions	271.5
Other costs	682.5
Total production costs	3702.3



In 1999, there were a total of 17,624 SE employees in Kharkiv Oblast, 7% (1,167) more than in 1998. Total SE employees for the sector was 570, only 3% of total SE employees in the region, and a decrease of 31% since 1998. Sector SE average monthly salary in 1999 remained constant at 111 UAH (27 USD) relative to 1998.

Major indexes of Kharkiv Oblast construction materials industry SE development are shown below.

Table 12. Major Indexes in Kharkiv Oblast Sector SE Development: 1998-1999

Indicator	Variation (1999-1998)			
	1999	1998	Physical Indexes	%
Production output (1000 UAH)	2586	14839	-12253	-87
Production output (1000 USD)	626	6058	- 6 199	-90
Employees	570	822	-252	-31
Average monthly salary (UAH)	111	111	0	0
Average monthly salary (USD)	27	45	-18	-40
Total Kharkiv Oblast sector small enterprises	61	69	-8	-11

12. Sector Infrastructure

The Kharkiv Oblast construction materials industry R&D and educational infrastructure is well developed. There are 11 technical schools in Kharkiv, and provincial regional centers also train specialists for this sector.

Kharkiv Oblast higher educational establishments play an important role in training specialists for construction materials industry. These institutions are well known both in and outside of Ukraine.

Among them are:

- **Kharkiv State University of Architecture and Construction.** The mechanic-technological faculty has been in place since May 1971. There are two general education chairs:
 - theoretical mechanics
 - general chemistry
 and 3 special chairs:
 - construction processes mechanization
 - physical-chemical mechanics and technology of construction materials and finished products
 - automation of production processes
- **Kharkiv Polytechnic University.** The Faculty of Non-Organic Matters Technology trains engineer-chemist technologists and researchers according to three qualification levels.
- **Kharkiv State Academy of Railway Transport.** This institution maintains chairs in the following disciplines:
 - Construction mechanics and hydraulics
 - Construction materials, structures and buildings
 - Construction and lifting machines, materials handling equipment
 - Descriptive geometry and engineer graphics
 - Railroad and railroad economy

- **Kharkiv State Motor & Highway Technical University.** Maintains a chair in:
 - Technologies of road-construction materials

13. Management Capabilities of Sector Enterprises and Organizations

The construction materials industry is developing dynamically all over the world, where new materials and technologies are constantly being invented and put into use.

Under such conditions, it's hard to overestimate the importance of efficient management for the Ukraine construction materials industry. Kharkiv Oblast has the scientific, technical, and educational facilities to train highly qualified engineers and technologists for the sector. However, technological training alone does not qualify a person to efficiently manage a company. The Ukraine construction materials industry will be able to develop quickly and successfully only if these sector enterprises are led by professional managers with the required education and operational experience in working under market conditions.

As for Kharkiv Oblast sector management in particular, in general it may be characterized as "post-Soviet". Because the majority of managers in the sector have worked in these companies for many years, they know all everything there is to know about the **technological** details of production, but are not at all familiar with the principles of **marketing**. It's worth mentioning that, in Kharkiv Oblast, the most important players in solving the problem of developing efficient management techniques are the institutions of higher education, such as Kharkiv State University, Kharkiv State Economic University, etc.

14. Administrative Impact on the Sector

The Ukrainian construction materials industry requires urgent reforming. Unfortunately, existing measures are not able to qualitatively improve the situation within the industry. There is no clearly defined governmental program to support development of the sector; and while some presidential decrees and Cabinet of Ministers orders have been adopted, on the whole they are fragmentary and do not provide real support for local manufacturers.

However, decree #1714-III entitled, "On a special regime of investment performance in Kharkiv Oblast", adopted on May 11, 2000, helps open the sector to direct foreign investment. The decree stipulates establishment of taxation and customs privileges for registered enterprises in Kharkiv Oblast, and will help promote investment projects in Kharkiv Oblast in priority economic areas, as defined by an agreement with the executive committee of Kharkiv city council. It is expected that, thanks to this bill, the condition of the Kharkiv Oblast construction materials industry will be considerably improved.

15. Social Issues of Sector Development

The construction materials industry is a resource-intensive sector, and is therefore closely connected with the Ukraine mining industry. For most of the modern era, the Ukraine mining industry developed merely as a source of minerals and raw materials for the USSR, which overshadowed the development of the metallurgical, chemical, and construction materials industries, as well as other resource- and materials-intensive branches.

In time, the resource extraction volumes increased, together with the depth and area of mined areas. Intensive use of subsoil assets, as well as mining of raw materials and minerals and subsequent processing, could not but adversely affect the environment.

The result was that, after the collapse of the USSR, Ukraine inherited a crisis situation characterized by exhausted mining regions, a highly polluted environment, and obsolete, worn-out industrial machinery. The Ukraine construction materials industry in general and the Kharkiv Oblast industry in particular are no exceptions, because here too obsolete and ecologically harmful technologies are being used.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

At this time, the number of investment proposals in the sphere of construction materials is very small—although practically every sector enterprise has business plans for restructuring projects for the purpose of attracting investment capital.

The committee responsible for implementing special measures for Kharkiv Oblast investment projects is currently studying the following proposal:

Table 13. Current Investment Proposals for the Kharkiv Oblast Construction Materials Industry

Customer	Proposal	Manager	Total Investment (USD)	Investment Source
Grian & Ars	Purchasing production units to manufacture ceramic construction materials	Grigoriy Anatolievichb Kulinich President Tel. +38 0572 141-515	2, 000,000	100% foreign investment

Conclusions

The construction materials industry plays an important role in the Kharkiv Oblast economy. The sector currently makes up 3% of total oblast industry—and thanks to practically inexhaustible deposits of mineral resources, available production facilities, and growing demand for construction materials, its share will continue to grow. As a result, investment in the Kharkiv Oblast construction materials industry can be expected to rise as production increases.

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Construction Materials. Sector Profile

Enterprise Name	Address	Telephone No.	Products	Directors	
???? "Plant of Ferroconcrete Elements No. 5" closed joint-stock company	Ukraine, 61060, Kharkiv, 50 Let SSSR, 171	+38 0572	92-02-16; 91-13-56; 92-12-34; 92-13-56	ferroconcrete elements border stone; columns; balcony plates, pavement slabs, heating main coverings; piles; pipes	Marchenko Lyudmyla Anatoliivna
"Plant of Ferroconcrete Elements No. 9" OJSC	Ukraine, 61099, Kharkiv, Yenakiyivska Str, 143	+38 0572	93-21-29; 95-42-45; 95-42-77	concrete; concrete blocks; concrete garages; columns; pavement slabs	Degtyar Nadiya Mykolaiivna
"Plant of Ferroconcrete Elements No. 1" closed joint-stock company	Ukraine, 61055, Kharkiv, Industrialna Str, 3	+38 0572	93-60-47; 95-53-05	concrete; modules, concrete blocks; claydite concrete; concrete constructions	Kyrpychenko Nadiya Andriivna
"Brickworks No. 13" OJSC	Ukraine, 61000, ? Kharkiv, Yenakiyevska, 7	+38 0572	93-60-55; 94-08-45	concrete blocks; ceramic bricks,	Seina Anna Oleksiivna
"Kharkiv Tile Plant" closed joint-stock company	Ukraine, 61106 Kharkiv, Mosow avenue, 297	+38 0572	93-91-33; 99-86-57; 99-86-84; 99-86-61; 99-20-91	ceramic souvenirs; facing ceramic tiles, floor tiles	Bomdarenko Yevgeniya Oleksandriivna
"Plant of Ferroconcrete Elements No. 15" OJSC	Ukraine, 61106, Kharkiv, Moscow avenue, 299	+38 0572	99-21-37; 99-31-65; 99-10-17	concrete; concrete blocks; straight arches; pavement slabs, figured pavement slabs;	Ochyenko Dmytro Valeriyovych
"Merefa glass-works" OJSC	Ukraine, Kharkiv region, Kharkiv district, 312060, Merefa, Leonovska, 84	+38 0572	48-31-73; 48-71-22; 48-71-95	bottles; heat insulated materials, glass-ware; glass fibre	Yakovenko Vyacheslav Ivanovych
???? "Budyansk Faience" closed joint-stock company	Ukraine, Kharkiv region, Kharkiv district, 62456, Budy, Zheleznodorozhnaya, 1	+38 0572	52-41-06; 52-60-36; 52-90-69; 48-63-14	faience souvenirs; delft ware	Umantseva Lidiya Andriivna

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

8. MACHINERY AND METAL MANUFACTURING

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Machinery and metal manufacturing is the area's most developed branch of industry, and has historically played an important role in the region's economy. In 2000, there were a total of 235 sector enterprises and organizations in Kharkiv Oblast, 80 of which are located in Kharkiv City.

This sector analysis of Kharkiv Oblast has shown the following:

- Sector share of total Kharkiv Oblast industry in 2000 was 28.9%.
- Total sector production in 2000 was 2123.3 million, down 0.5% from 1999.
- Kharkiv Oblast produces 100% of steam turbines, 55% of bearings, 50% of electric machines, 50% of machines with computer control, and 40% of tractors in the total Ukrainian production of these products.
- Losses for the sector during January-November 2000 totaled 9,573,700 UAH, a profitability index of -5%.
- Relationships with raw materials and component parts suppliers were almost completely severed with the collapse of the USSR. At the same time, domestic suppliers were unadapted to the needs of machinery manufacturing enterprises.
- As of January 1, 2000, fixed assets with depreciated cost totaled 3187.7 million UAH, while deterioration of fixed assets was 56.5%.
- There has been a positive trend in direct foreign investments in Kharkiv Oblast sector enterprises during the past four years.
- As of November 2000, there were a total of 134,774 employees in the sector, which equals 11% of total Ukraine sector employees and 17% of total people employed in Kharkiv Oblast.
- Overall, Kharkiv Oblast sector enterprises are competitive. Some enterprises hold monopolies in the Ukraine market, and even among CIS countries. Asia is the main international market for Kharkiv region sector production.
- The number of sector non-state enterprises in 2000 made up 101, which equals 43% of total sector enterprises.
- Non-state enterprise production at current prices in 2000 totaled 1,157,980,000 UAH, which equals 54.5% of the total sector production in Kharkiv Oblast.
- The Kharkiv Regional State Administration promotes sector development in Kharkiv Oblast.

Sector impact on the overall ecological situation in Kharkiv Oblast is adverse, due to vast industrial resources and associated environmental emissions, depreciation of fixed assets (equipment out of compliance with world standards), and lack of investment in waste minimization and treatment technology.

The machinery and metal processing sector directly influences the production in all other sectors of the national economy. For this reason, machinery and metal processing is one of the largest, most strategically important branches for Kharkiv Oblast. Recently, sector enterprises have been regaining position in lost markets and breaking into new markets, especially in Asian countries. It should be stressed that continuation of this trend requires state support.

1. Sector Role in the Kharkiv Oblast Economy

Machinery and metal manufacturing is the oblast's most developed branch of industry, and has historically played an important role in the region's economy. In 2000, there were a total of 235 sector enterprises and organizations in Kharkiv Oblast, 80 of which are located in Kharkiv City.

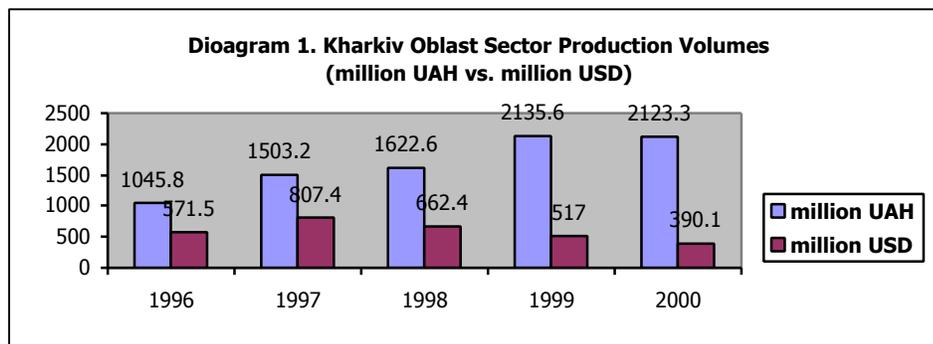
Total sector production 2000 was 2123.3 million, down 0.5% from 1999:

Table 1. Sector Production Relative to 1990: 1995-2000 (%)

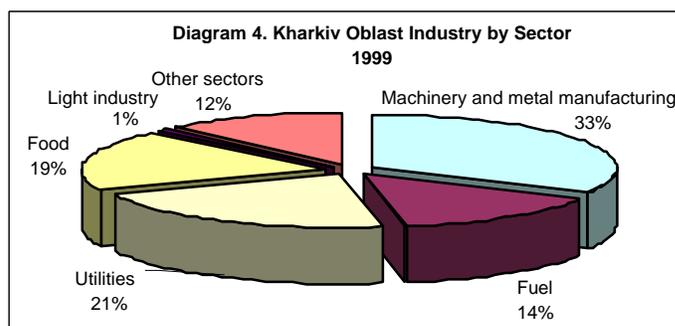
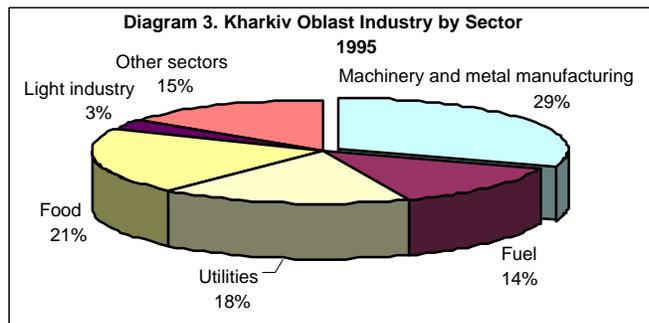
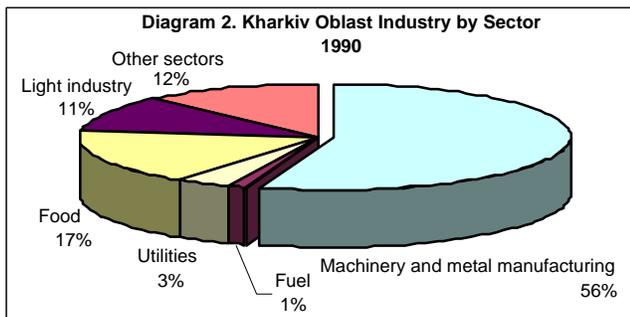
Sector	1995	1996	1997	1998	1999	2000
Machinery and metal processing	30	25	30	29	28.8	28.3

Table 2. Sector Production (million UAH vs. million USD)

Sector	1996	1997	1998	1999	2000
Machinery and metal processing (million UAH)	1045.8	1503.2	1622.6	2135.6	2123.3
Machinery and metal processing (million USD)	571.5	807.4	662.4	517.0	390.1



In spite of the fact that production volumes are down almost 300% in comparison with 1990, machinery and metal manufacturing is still the largest sector in the Kharkiv Oblast economy, and equaled 33% of total oblast industry in 1999.



According to the Kharkiv Oblast Statistics Department, the decrease in 2000 of the sector's share in overall oblast industry was not substantial, and still maintained first place with 28.9%.

As shown in **Table 3** below, the year 2000 saw an increase of production volumes in almost all main sector products in comparison with 1999. The exceptions are travelling electric cranes (-10%) and tractor and combine engines (-34%).

Table 3: Kharkiv Oblast Sector Production—Major Products: 1995-2000 (vs. 1990)

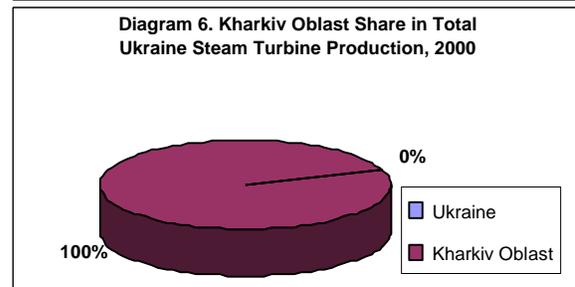
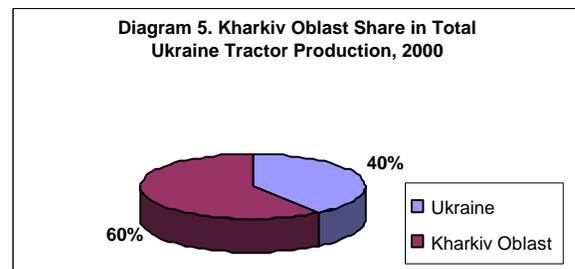
Product	1990	1995	1996	1997	1998	1999	2000
Large electric machines, pieces	3417	151	89	126	75	70	122
AC electric motor (units)	1204.9	165.2	92.4	39.6	39.4	20.8	90.3
Metal cutters (units)	1267	157	83	52	58	30	60
Press-forging machines (units)	79	35	15	17	10	3	9
Travelling electric cranes (inc. special) (units)	176	23	18	20	26	19	17
Tractors (units)	59,221	4497	2547	2456	2242	3168	3365
Bearings (excl. bicycle) (1000 pieces)	60,793	19,516	17,863	13,910	9614	3754	8831
Tractor and combine engines (units)	215.0	14.0	8.0	4.5	3.7	3.2	2.1

2. Strength of Kharkiv Oblast Sector

Kharkiv Oblast is the machine-building center of Ukraine. It is home to a powerful agricultural machine-building complex that includes the Kharkiv Tractor Plant, as well as the sole producer of crawler tractors in Ukraine and the CIS countries. Other products and enterprises include wheeled general-duty tractors, agricultural row-crop tractors, turbocompressors, tool carriers, forging, and foundry. Agricultural machine-building enterprises produce about 24% of all sector production in the oblast. Annual production varies from 30 to 45 million UAH, and approximately 30,000 people are employed in the sector. Agricultural machinery development is one of the oblast's current economic priorities.

Utilities equipment is another important product. Kharkiv Oblast is first in Ukraine, and second in CIS, in production of turbines, generators, and other utilities equipment. These products are manufactured at the Turboatom industrial research enterprise, and at the Electromashina and Electroavzhmsh plants. These enterprises produce 21.8% of total sector production; aggregate monthly production totals approximately 30-40 million UAH.

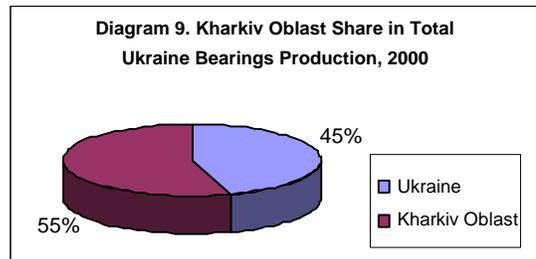
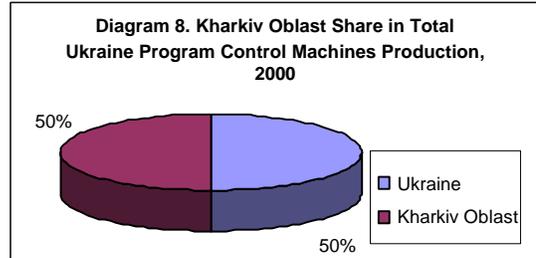
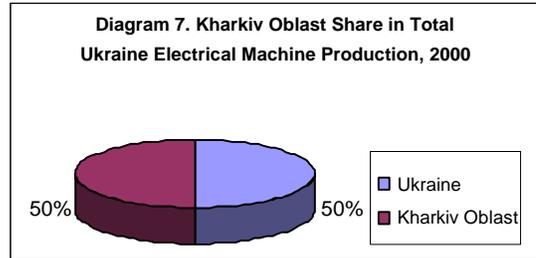
JSC Turboatom is the largest producer of turbines for thermal, hydro and atomic power stations in CIS, and one of the largest in the world. It supplies power equipment to 40% of Ukraine's thermal power stations, 85% of its atomic power stations, and 95% of its hydroelectric power stations, and exports to more than 100 countries around the world.



The Malishev plant is the largest transport machine-building enterprise in Kharkiv Oblast. The plant produces tanks and other military equipment that is among the best in the world. Powerful Malishev diesel generators are used in steamships, icebreakers and ferries, and atomic power stations, and at oil and gas deposits. The Malishev plant is currently entering into new types of production, including mining equipment, pharmaceuticals, foods, consumer goods, mini-tractors, trailers for auto and motor transport, carburetor engines, gas cylinder equipment, and others.

Kharkiv Oblast is also a center of the electrical industry, producing about 50% of all electrical machines in Ukraine. This subsector is second in overall machinery production, and includes such enterprises as the Kharkiv Electrical Plant and Electroaparat, JSC Ukrelectromash, Pivdenkabel, etc. Electroavzhmash is the only enterprise in Ukraine that produces powerful turbo- and hydrogenerators, and one of the only suppliers of complete diesel locomotive equipment.

The tool industry is also highly developed in Kharkiv City. In particular, the JSC Kharkiv bearing plant and the Teploavtomat and Tochmedpribor electric/electronic plants are leaders in this area.



Kharkiv Oblast's achievements in aircraft building are substantial. The Kharkiv Aircraft Corporation, established in 1926, built the first Soviet planes. This enterprise produces the AN-70, AN-72, AN-74, considered by some experts to be the best in the world in their classes. Currently, the Kharkiv Aircraft Corporation is working with the Antonov design office to produce the AN-140, a 52-seat airliner that was successfully tested in October 1999.

Kharkiv Oblast has also made great contributions in rocket production and space exploration. The Khartron research and production enterprise has manufactured rocket carrier and space vehicle control systems, as well as several generations of rocket complexes, that are well known throughout the world. These systems form the basis of the national space program. Khartron is the head of AEK, an interregional association made up of 25 of the leading enterprises in Ukraine and Russia. Khartron scientists and engineers are currently at work designing computer control systems for the aircraft industry, ecological monitoring systems, high-accuracy medical equipment, control systems for atomic power stations, relay protection systems for electric power stations, and petroleum industry equipment.

There were 235 sector enterprises in Kharkiv region in 2000, 156 of which were machinery enterprises. As shown in **Table 4** below, almost 8% of all Ukraine sector enterprises, and 9% of machinery enterprises, are concentrated in Kharkiv Oblast.

Table 4: Number of Sector Enterprises in Central and Eastern Ukraine: 1999

Oblast	Total	Machinery and Manufacturing	Machinery
Kharkiv	655	234	156
Dnipropetrovsk	586	188	97
Donetsk	916	237	133
Zaporizhzhya	360	150	100
Kiev	373	104	66
Lugansk	672	199	113
Poltava	382	119	68
Sumy	308	81	47
Kiev City	538	212	153
Total Ukraine	10,607	2930	1758

3. Economic Condition of Sector Enterprises and Organizations

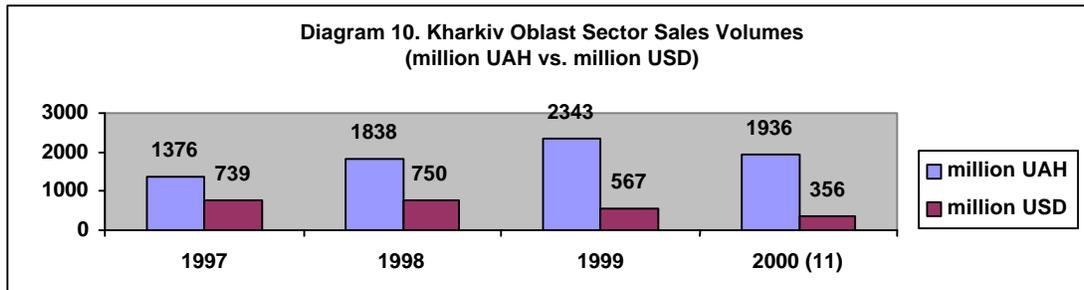
Until the 1990s, Kharkiv Oblast was famous for being a great “assembly shop”. Component parts were shipped from all over the USSR for assembly in Kharkiv plants.

After the collapse of the USSR, border controls and legislative differences between the former republics resulted in a breakdown of former cooperative trade relations. In addition, new Ukrainian policies have substantially changed the role of the state military industrial complex. On occasion, political decisions have sidelined some potentially profitable military equipment export contracts in the oblast, including a 250 millions USD contract for construction of an atomic power station in Iran.

All of these factors have combined to reduce more than half of Kharkiv Oblast sector enterprises to unprofitability. Sector accounts payable are currently 200% higher than the level of accounts receivable, while average usage of production capabilities is only 25%. In spite of these difficulties, however, the Kharkiv Oblast Statistics Department found that overall, the sector remained profitable from 1997 through 1999, and only turned unprofitable in 2000. Representative sector financial indices are shown in **Tables 5-7**.

Table 5. Kharkiv Oblast Machinery and Metal Manufacturing Product Sales: 1997-2000

Sector	1997	1998	1999	2000 (Jan-Nov)
Machinery and metal manufacturing (million UAH)	1376	1838	2343	1936
Machinery and metal manufacturing (million USD)	739	750	567	356



Sector sales during January-November 2000 totaled 1,936,260,700 UAH. Sales for the same period in 1999 were 1,952,338,500 UAH, 0.8% more than in 2000.

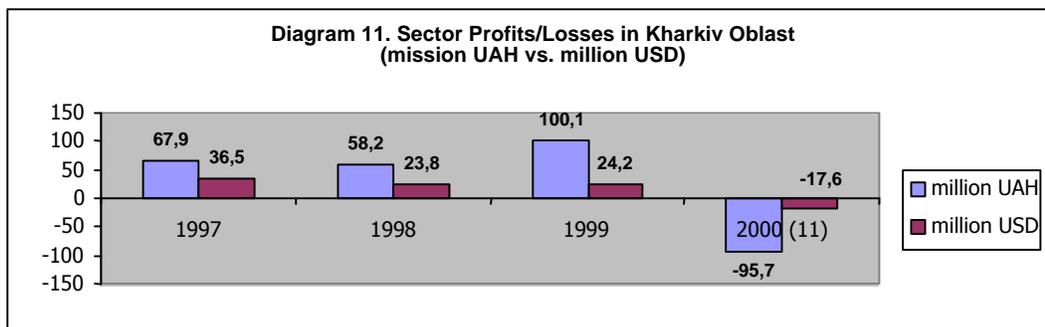
Sales on barter terms for the period totaled 701,961,000 UAH in 2000, 36.3% of total sector sales. Sales on barter terms for the same period in 1999 were 792,247,200 UAH, which equaled 40.6% of the sector total.

Cash sales for 2000 totaled 993,285,000 UAH, 51.3% of the sector total. Cash sales for the same period in 1999 were 946,223,700 UAH, which equaled 48.5% of the sector total.

Thus, 2000 saw a 113% decrease in sales on barter terms in comparison with 1999, and a corresponding increase in cash sales of 105%. The decrease in production volumes in 2000 caused losses and contributed to the overall negative profitability of the sector.

Table 6. Sector Profit (-Loss) in Kharkiv Oblast: 1997-2000 (million UAH vs. million USD)

Sector	1997	1998	1999	2000 (Jan-Nov)
Machinery and metal manufacturing (million UAH)	67.9	58.2	100.1	-95.7
Machinery and metal manufacturing (million USD)	36.5	23.8	24.2	-17.6



Net losses for the sector during January-November 2000 totaled 95,737,000 UAH. Key indicators include:

- There were 95 profitable enterprises, 43% of the sector total. Total profits for these enterprises were 150,745,000 UAH.
- There were 124 unprofitable enterprises, 57% of the sector total. Total losses were 246,482,000 UAH.

Table 7. Sector Profitability in Kharkiv Oblast (%)

Sector	1997	1998	1999	2000
Machinery and metal processing, %	4.9	3.2	4.3	-4.9

As of 1 January 2001, the correlation of accounts payable and accounts receivable is as follows:

- Accounts receivable: 739,761,000 UAH
- Accounts payable: 1,377,312,000 UAH

In other words, accounts payable are almost 200% higher than accounts receivable.

On the whole, it can be argued that the financial state of the majority of sector enterprises is directly dependent upon one-time and nonsystematic export contracts.

4. Sector Development: Raw Materials Base

The machinery and metals manufacturing sector is distinguished from other sectors by some specific peculiarities:

- it requires a substantial volume of ferrous and non-ferrous metals
- the process of production requires cooperation among different enterprises within the sector, as well as with enterprises of other sectors that provide raw materials, such as metals, plastic, rubber, etc.

As stated above, relationships with raw materials and component parts suppliers were almost completely severed after the collapse of the USSR. At the same time, domestic suppliers have not sufficiently adapted to the needs of machinery manufacturing enterprises. For example, the Kharkiv Tractor Plant refused to accept engines from the Kharkiv Serp i Molot tractor engines plant, because the engine plant was historically oriented toward Russian "Rostsilmash" tractor assembly. The Kharkiv Tractor Plant has since begun adapting their machines to German "Deuz", Swedish "Volvo", and Russian "YAMZiv" engines.

5. Sector Development: Technological Base

Machinery manufacturing complex may develop rapidly and efficiently provided that scientific achievements are put into practice. For this, integration and collaboration of research institutes with enterprise design offices and factories are essential.

As of January 1, 2000, the value of sector fixed assets, considering depreciation, totaled 3,187.7 million UAH, while deterioration of fixed assets was 56.5%. **Table 8** shows a partial breakdown of fixed assets:

Table 8. Mechanization and Automation of Sector Production: 2000

Sector Structure	Mechanized Conveyer and Automated Lines	Numerically Controlled Metal Cutters
Mining machinery manufacturing	1	2
Electrotechnical industry	3	-
Automobile industry	1	-
Agricultural and tractor machinery manufacturing	-	3
Aircraft industry	-	1
Metalware industry	1	-
Total Sector	6	9

6. Investment Activities in the Sector

Total domestic investments in Kharkiv Oblast machinery and metal manufacturing enterprises during the first nine months of 2000 was 55 million UAH. A comparative analysis of domestic investments in sector enterprises for the period 1995-1999 is shown in **Table 9**.

Table 9. Domestic Investments in Kharkiv Oblast Sector Enterprises: 1995-1999 (million UAH)

Index	1995	1996	1997	1998	1999
Domestic investments	12.4	23.7	30.3	49.1	73.2

A comparative analysis of direct foreign investment in the machinery and metal manufacturing enterprises for the period 1997-September 2000 is shown in **Table 10**.

Table 10. Direct Foreign Investments in Kharkiv Oblast Sector Enterprises: 1997-Sep. 2000 (million USD)

Index	1/1/97	1/1/98	1/1/99	1/1/00	10/1/00
Annual DFI	3.4	0.4	0	0.3	0.2
Cumulative DFI	3.4	3.8	3.8	4.1	4.3

The past four years have shown a positive trend in direct foreign investments in Kharkiv Oblast sector enterprises. Direct foreign investments for the period 1997-December 1999 are shown in **Table 11**.

Table 11. Cumulative Direct Foreign Investments in Kharkiv Oblast Sector Enterprises: 1997-1999 (million USD)

State	Value of DFI
Hungary	0.751
Virgin Islands (Brit.)	0.640
USA	0.612
Slovenia	0.457
Russian Federation	0.457
Panama	0.400
Cyprus	0.325
Austria	0.230
France	0.094
Australia	0.064
Turkey	0.024
Poland	0.010
Total	4.064

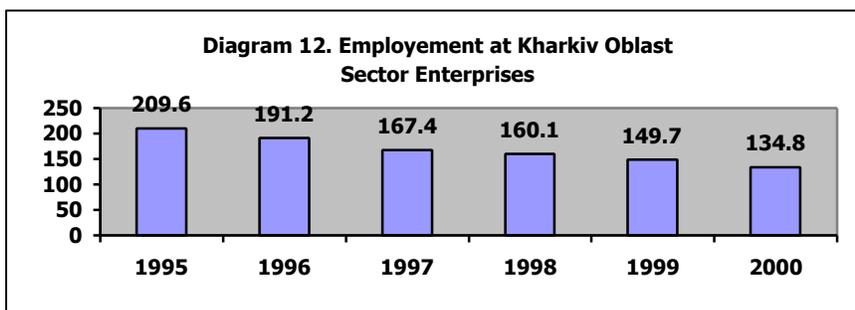
7. Employment and Personnel Potential in the Sector

As of November 2000, there were a total of 134,774 employees in Kharkiv Oblast machinery and metal manufacturing sector enterprises. Employment for sector enterprises for the period 1995-2000 is shown in **Table 12**.

Table 12. Employment at Kharkiv Oblast Sector Enterprises: 1995-2000 (1000 people)

Index	1995	1996	1997	1998	1999	2000
Employees	209.6	191.2	167.4	160.1	149.7	134.8

Employment at Kharkiv Oblast sector enterprises made up 11% of total Ukraine sector employees during 1995-1999. Sector share of total employment in Kharkiv Oblast fell from 19% in 1995 to 17.1% in 1999.



In 2000, the average monthly wage for sector employees was 234.04 UAH. The average monthly wage index for sector enterprises for the period 1995-1999 is shown in **Table 13**.

Table 13. Sector Enterprise Average Monthly Wage: 1995-1999

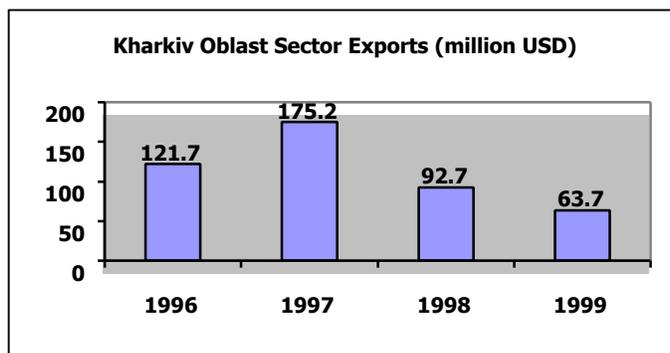
Index	1995	1996	1997	1998	1999
Average monthly wage	54.0	110.8	141.2	152.3	173.3

8. Sector Exports

Kharkiv Oblast sector exports for the period 1996-1999 are shown in **Table 14**.

Table 14. Sector Exports: 1996-1999 (million USD)

Index	1996	1997	1998	1999
Exports	121.7	175.2	92.7	63.7



9. Competitive Environment of Sector Enterprises and Organizations

Overall, Kharkiv Oblast sector enterprises are competitive. Some enterprises hold monopolies in the Ukraine market, and even among CIS countries. Asia is the main international market for Kharkiv region sector production.

Several Kharkiv Oblast enterprises that are competitive on the world market should be noted:

- **Khartron Research Production Complex.** Khartron is Ukraine's leading designer of control systems for space equipment and other industries. Khartron also created control systems for the Russian units of the American-Russian space station.

- **OJSC Kharkiv Tractor Plant.** This is one of the most unique and competitive enterprises in Ukraine and in the CIS countries. It produces crawler and general use wheeled tractors, as well as universal row-crop agricultural tractors. Its exports to Canada, Argentina, Cuba, Egypt, Poland, Bulgaria, and other countries.
- **Electrivazhmash Research Production Complex.** This is the only enterprise in Ukraine that produces powerful turbo- and hydrogenerators. It also produces the largest direct current electric machines for the metal processing sector, and is the only supplier of complete diesel locomotives equipment in the CIS countries. Its products are found throughout Ukraine, and in over 30 countries around the world.
- **Turboatom Research Production Complex.** This is the only supplier of energy equipment in Kharkiv Oblast. It is the main supplier within Ukraine, and one of the leading suppliers in CIS countries and throughout the world.
- **Malishev Plant.** The Ukraine military industry is especially proud of this plant, which produces tanks that are among the best in the world. It currently holds several substantial export contracts with a number of Asian countries, including Pakistan and China.
- **Kharkiv Aircraft Plant.** This facility is one of the leading aircraft manufacturing plants in Ukraine.

10. Ownership in the Sector

In 2000, there are a total of 101 non-state-owned sector enterprises in 2000, which equals 43% of the total number of sector enterprises.

In 2000, non-state enterprise sector production at current prices totaled 1,157,980,000 UAH, which equaled 54.5% of Kharkiv Oblast total sector production volume.

By comparison, there were 109 non-state enterprises in 1999; total production amounted to 917,991,800 UAH, or 43% of Kharkiv Oblast total production value. Thus, sector production value at non-state-owned enterprises in 2000 was up by 26% over 1999.

11. SME Growth in the Sector

There are virtually no small-to-middle-sized businesses in the machinery and metal manufacturing sector, since the required capital for such operations is beyond the means of smaller enterprises.

12. Sector Infrastructure

Scientists at sector research institutes have developed clean technologies in metalworking, and methods of metal reinforcement and corrosion protection; resource-saving technologies in rolled metal production; and automated processes for diagnostic and medical equipment production.

13. Management Capabilities of Sector Enterprises and Organizations

The transition of machinery and metal manufacturing enterprises to a market economy was marked by a number of crises. Among these were a shortage of funds for salary payment, and budget assessments in enterprise transactions and electricity payments charges following the changeover from the barter system.

As a result, sector enterprises sought changes in management methods based on a gradual transition away from a production orientation and more towards a sales orientation. And while not all of these economic crises have been resolved, there has been gradual growth in the industry, due in part to enterprise management restructuring. This has resulted in the introduction of new production technologies and developmental employee training programs that have helped increase production efficiency.

14. Administrative Impact on the Sector

With the assistance of the Kharkiv Regional State Administration, the Kharkiv Regional Center for Investments and Post-privatization was established for the purpose of attracting domestic and foreign investment in sector economic development. The main objective of this project was technical assistance for a group of Kharkiv Oblast enterprises, including several from the machinery and metal manufacturing sector. A number of projects in the areas of restructuring, conversion, transition to European standards planning systems (e.g., ISO 9000), etc. have already been carried out.

As a result, business plans for the Monolit and Khartron enterprises have been developed and ISO 9000 standards system has been introduced at these enterprises. At the same time, preparations have been made for the restructuring of a number of other sector enterprises. In addition, substantial market research for current and planned manufactured products has been carried out, professional training courses have been instituted, and negotiations with potential investors are underway.

15. Social Issues of Sector Development

Sector impact on the overall ecological situation in Kharkiv Oblast is adverse, due to vast industrial resources and associated environmental emissions, depreciation of fixed assets (equipment out of compliance with world standards), and lack of investment in waste minimization and treatment technology.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Attracting foreign and domestic investment for further development is a sector priority. Under the new market conditions, Kharkiv Oblast machinery and metal manufacturing enterprises are taking measures to improve production competitiveness and develop and apply new production technology in order to meet the domestic demand for manufactured goods, as well as increase exports.

There are a number of proposals for investment in machinery-, equipment-, and scientific instrument-production projects that are currently under consideration. The most important of these, in terms of investment value, are:

- the AN-140 passenger aircraft project
- a complex of tractor production projects, that use modern technologies and components
- manufacturing of updated diesel engines, D-80 generators, locomotives, ship and stationary engines, and diesel engine fuel equipment
- establishment of a modern packaging materials plant

In addition, a number of other projects have been suggested in the areas of transit vehicle production, including city buses; car assembly; agricultural machinery; mining equipment; and development of new types of machines.

To secure financing for these projects, the majority of Kharkiv Oblast enterprises are currently pursuing commercial development loans, while trying to attract investment through the establishment of joint-stock ventures.

Conclusions

The machinery and metal processing sector directly influences the production volumes of all other sectors of the national economy. For this reason, machinery and metal processing is one of the largest, most strategically important branches for Kharkiv Oblast. Recently, sector enterprises have been regaining position in lost markets and breaking into new markets, especially in Asian countries. It should be stressed that continuation of this trend requires state support.

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List of Main Sector Enterprises and Organizations

Enterprise Name	Address	Telephone No.	Products	Directors	
"Monolit" , and main enterprise "Malishev"	Ukraine, 61004, Kharkiv, Oktyabrskaya revoliuciya,99	+38 0572	23-11-60; 12-63-37; 23-21-32; 12-58-66	Computer control systems of atomic and thermal power station; automatic electronic telephone systems; audio players; locks; water heaters; tape recorders; equipment for space programs; household devices, heating appliances, medical production; tobacco.	Shpeyer Alexandr Panteleyevich
JSC "Khartron"	Ukraine, 61070, Kharkiv, Akademika Proskury Str. 1	+38 0572	44-98-53; 43-16-77; 44-57-70; 44-50-90; 44-51-80	Computer control systems; blocks for computer systems; sources of energy; electric equipment; systems of relay protection and automatization of energoobjects, management of atomic power stations, consumer products; automobile electronics	Bek Alexandr Vladimirovich
OJSC "Plant "Orgtehnika"	Ukraine, 61140, Kharkiv, Gagarina avenue, 20	+38 0572	21-29-21; 21-28-38; 21-36-35; 21-46-38; 21-85-22	Ball and fountain pens; mechanic pencils; desk sets; drafting machines; rapidographs, pens equipment, casting in small volumes	Zinchenko Vladimir Anatoliyevich
State enterprise "Kharkiv electrical mechanical plant"	Ukraine, 61037, Kharkiv, Moscow avenue, 119	+38 0572	26-22-16; 90-51-00; 90-51-01; 90-51-61; 26-10-10; 26-31-65	Low-voltage equipment; automatic switches; electric machines, power equipment; complete devices, electric irons, electric circling irons "Lokon"; dipping electric engines	Panasenko Nikolai Vasiliyevich
OJSC "Electromashina"	Ukraine, 61016, Kharkiv, Muranova Str.106	+38 0572	72-88-09; 72-88-23; 72-88-19	Low-voltage equipment; direct current machines; equipment for mine electrical equipment, vacuum cleaners ""Vityaz M2"; Electric pumps "Strumok"	Pushko Vera Ilinichna
Izyum instrument makin plant	Ukraine, Kharkiv region, 313850, Izyum, Lenin avenue, 66	+38 05743	2-15-48; 2-15-42; 2-21-27	Mechano-optical equipment; sun protection glasses; photo products	Manuylo Vladimir Grigoriyevich
Production association "Radiorele"	Ukraine, 61009, Kharkiv, Gagarin avenue 181	+38 0572	52-51-04; 52-81-33; 52-91-81; 51-77-30	Laser therapeutic equipment; plugs; switches; beads products; immersion heaters; special technologic equipment, wave optics; relays; sockets; safety systems; telephones	Bozhko Vadim Yemelyanovich
Production association "Komunar"	Ukraine, 61681, Kharkiv, Rudika Grigoriya Str 1	+38 0572	47-62-40; 44-01-88; 44-01-80; 44-73-54; 44-01-80	Welding equipment; video terminals for computer system; medical equipment; aircraft maintaining devices, control systems, high fidelity counters of water discharge power energy, TV sets "Beryozka"	Asmolov Alexandr Alexandrovich
CJSC "Plant Yuzhkabel"	Ukraine, 61099, Kharkiv, Avtogensnaya Str.7	+38 0572	94-68-30; 93-80-03; 93-50-77; 93-41-64; 95-55-25	Signal-blocking cable, power cable, hookup wire, magnet wire, telephone wire, heat-resistant wire, installation wire, hose wire, shielded wire; non-ferrous roll metal.	Zolotaryo Vladimir Mihailovich
State enterprise "Malishev"	310001 Kharkiv, Plehanivska Str, 126,	+38 0572	283069; 277504; 283101	Stationary, ship and diesel locomotive, diesel generators, small-sized power plants, low-capacity engines, diesel spares, special spares for transport, engines for drilling rigs	Malyuk Grigoriy Viktorovich
"JSC "Avtramat"	310038 Kharkiv, Saltivske Shose, 43	+38 0572	269910; 264051; 260263	Pistons, spares for tractor engineering, internal combustion engines of low power, aluminium casting	Kucin Mikola Andriyovich
CJSC «Serp i molot"	310825 Kharkiv Moscow Avenue, 183	+38 0572	268329; 263002; 263002	Diesel engines for agricultural engineering	Kolyada Volodimir Olexandrovich
CJSC "Turboatom"	310323 Kharkiv Moscow Avenue, 199	+38 0572	264048; 902292	Equipment for atomic, steam and hydraulic power plants, steam and hydraulic turbines, hydraulic shutters	Bugayec Anatoliy Olexandrovich
Kharkiv tractor engines plant	310662 Kharkiv Kirgizka Str.19	+38 0572	520103; 523035; 522002	Tractor engines, spares for tractor engines	Sergiyenko Mikola Andriyevich
Kharkiv bearing plant, OJSC	310055 Kharkiv Frunze Str.3	+38 0572	935114; 940679; 935114	Rolling bearings	Fedy Petro Mikitovich

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

9. CONSTRUCTION

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

The Construction sector is one of the most important sectors in the Kharkiv Oblast economy. During the period 1995-1999, fixed capital investments in Kharkiv Oblast Construction sector enterprises totaled 700 million UAH. In 2000, capital investments totaled 1.125 billion UAH, an increase of 40%. As of 2000, private investment is still the primary source of financing in Kharkiv Oblast (79% of all investments). Foreign investment totals only 2.2%, and only 0.4% comes from banks.

Following a 700% decrease in production output volumes during the period 1990 to 1995, sector enterprise production volumes stabilized from 1995-2000. Production volumes in 2000 totaled 608.5 billion UAH. The construction sector accounts for 5.5% of total employment in the region. As of January 1, 2001 there were 406 construction enterprises in the region.

However, despite certain positive growth indicators in 2000, the sector's financial and economic condition remains complicated. In 2000, 56% Kharkiv Oblast's construction enterprises were unprofitable. The sector's share of total exports in the region decreased from 3.4% in 1997 to 2% in 1999, while imports increased from 1.6% to 4.4% during the same period.

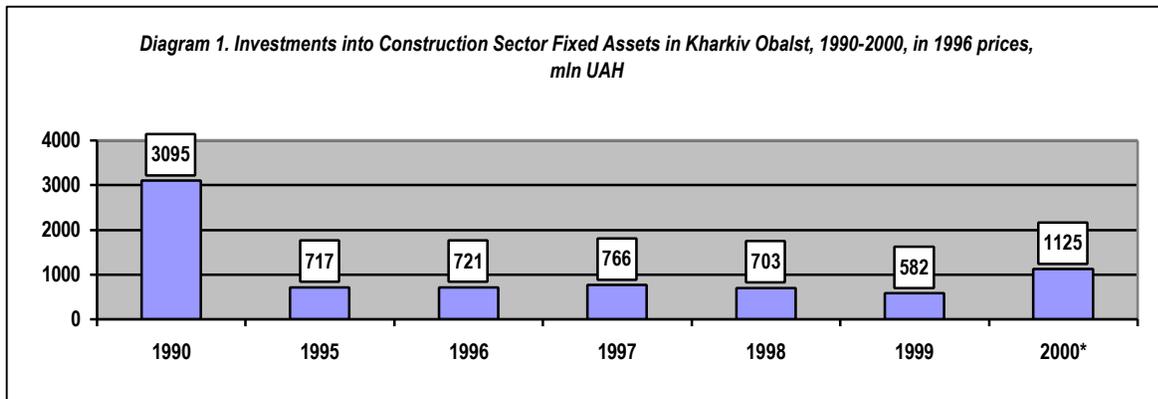
According to the opinion of many experts, the legislative steps being taken today are not enough to substantially improve the condition of the sector. However, more than 30 normative acts are planned for enactment in 2001, including the Housing Code and Mortgage Law, which will provide for long-term loans for housing construction.

Further development of the sector should resolve one serious problem: providing more Kharkiv Oblast families with housing. In 2000, there were more than 120,000 families settled in residential dwellings.

1. Sector Role in the Kharkiv Oblast Economy

The Construction sector is one of the most important sectors in the Kharkiv Oblast economy. Statistic indexes show a decrease of investments of almost 300% during the last 10 years. As shown in **Diagram 1**, aggregate investment in fixed assets in 2000 totaled 1,125 million UAH, down from 3,095 million UAH in 1990. [3; 5]

Diagram 1. Investment in Kharkiv Oblast Construction Sector Fixed Assets: 1999-2000 (million UAH)

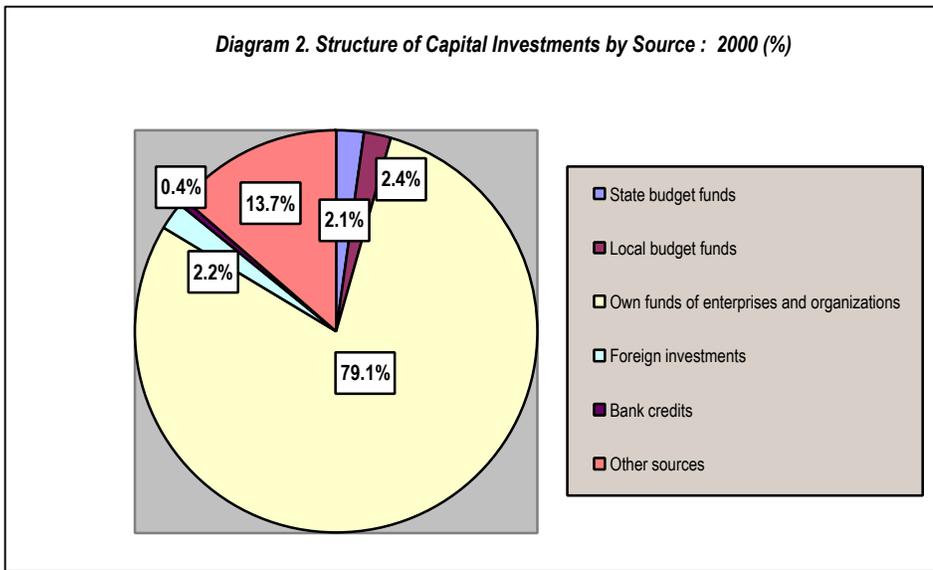


*Data in 2000 prices

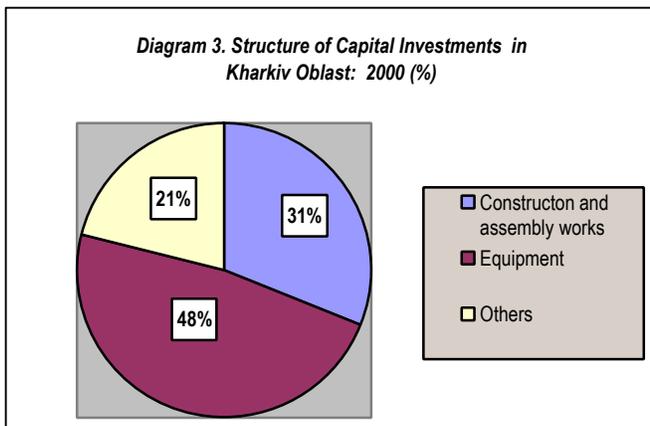
However, capital investments have stabilized since 1995, equaling 700 million UAH during a four-year period. In 1999 there was another fall of 17% relative to 1998, but this decrease had more to do with the financial crisis of 1998, after which investment expectations fell sharply. In 2000, a renewed trend of substantial growth could be seen, with the volume of capital investment in Kharkiv Oblast increasing by 40% in relative to comparative prices. [3; 5]

As shown in **Diagram 2**, most sector investment in 2000—79.1%—came from enterprises' private funds. Other sources included 2.1% from the state budget and 2.2% from foreign investments, while credit banks provided only 0.4%.

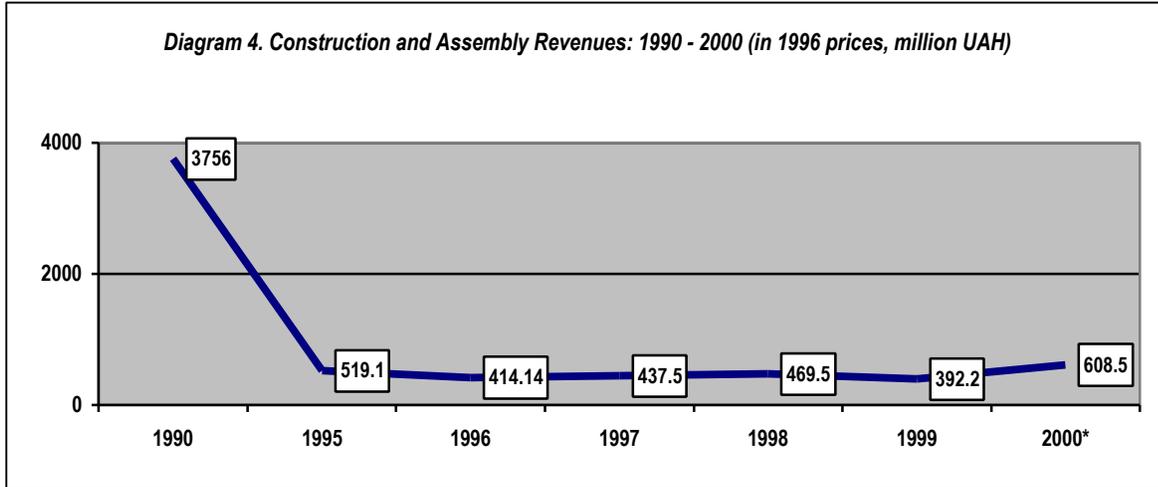
Diagram 2. Kharkiv Oblast Sector Capital Investment by Source: 2000



In 2000, 48% of this capital was invested in equipment, 31% in construction and assembly works, and 21% in other areas, as shown in **Diagram 3**. [7]



Construction and assembly economic activity during the last 10 years is shown in **Diagram 4**.



* Data in 2000 prices.

As shown in the diagram, sector revenues fell 700% during the period 1990-1995, then stabilized from 1995-1999. Total revenues in 2000 came to 608.5 million UAH, 0.1% less than in 1999, according to 1996 comparative prices. [1; 5]

Housing construction activity is shown in **Diagram 5** and **Table 1**. Before 1990, 1,000,900 m² of housing was constructed annually; in 2000, that figure had fallen to 246,500 m². [1; 7]

Diagram 5. Housing Construction in Kharkiv Oblast: 1990-2000 (1000 m²)

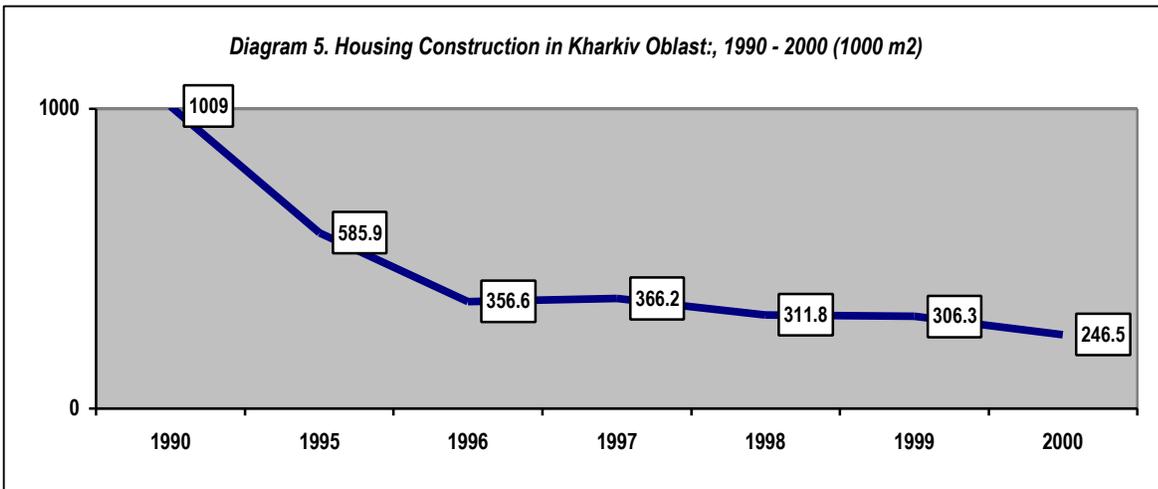


Table 1. Housing Construction by Funding Source: 1990-2000 (1000 m²)

	1990	1995	1996	1997	1998	1999	2000
Local governments	255.4	39.2	21.9	2.9	9.6	6.6	-
Enterprises and organizations	479	337.3	127.8	180.4	150.8	124.7	90.2
Building societies	72	30.4	-	11.2	13.4	21.03	2
Collective agricultural enterprises	50.2	21.5	14.6	6.31	6.4	2.12	-
Individual builders	152.5	157.5	192.2	165.3	131	150.03	154.1
Kharkiv Oblast Total	1009	585.9	356.6	366.2	311.8	306.3	246.5

During the last 10 years, the sources of housing construction financing have changed substantially. In 1990, 85% of dwelling construction was funded by non-individual sources, such as local councils, building societies, and collective agricultural enterprises; in 2000, that figure had fallen to only 38%. Most dwelling construction is now being financed by individual builders, as shown in **Table 1**.

Table 2 shows the pattern of housing construction over the last five years in the cities of the region. In 1996, Kharkiv City's share of housing constructed in the region was 19% (67,800 m²); in 2000, its share had increased to 35% (87,020 m²). [5]

Table 2. Housing Construction Activity in Kharkiv Oblast by City: 1996-2000 (1000 m²)

	1996	1997	1998	1999	2000
Izum	19.34	12.68	7.12	7.05	5.547
Kupyansk	4.98	2.66	8.12	4.36	3.809
Lozova	2.064	5.864	1.364	1.59	1.642
Lubotin	9.18	5.17	3.09	4.75	5.724
Pervomayskiy	0.42	-	1.77	1.22	1.26
Chuguyiv	8.04	1.25	1.32	1.74	2.281
Kharkiv	67.8	132.12	142.94	130.5	87.02
Kharkiv Oblast Total	356.22	366.17	295.43	306.3	246.5

As of January 1, 2001, there were 406 construction enterprises of all types in Kharkiv Oblast. Over the last six years, the Construction sector accounted for approximately 5.5%-6.0% of the Kharkiv Oblast Gross Value Added (where Gross Value Added = Gross Regional Product – Direct Costs), as shown in **Table 3**. [1] Employment in the sector accounts for approximately 5%-6% of total Kharkiv Oblast employment. [1; 5]

Table 3. Gross Value Added and Employment in Kharkiv Oblast: 1995-1999

Index	1995	1996	1997	1998	1999
Gross Value Added in the Kharkiv Oblast economy (actual prices) (million UAH)	2,889	4,331	4,893	5,309	6,370
Gross Value Added in construction (actual prices) (million UAH)	173	277	266	282	-
Share in construction (%)	6.0%	6.4%	5.4%	5.3%	-
Total Kharkiv Oblast employment (1000 persons)	1101	1036	952	916	873
Sector employment (1000 persons)	69.7	68.2	57.2	50.3	46.8
Share in construction (%)	6.3%	6.6%	6.0%	5.5%	5.4%

2. Strength of Kharkiv Oblast Sector

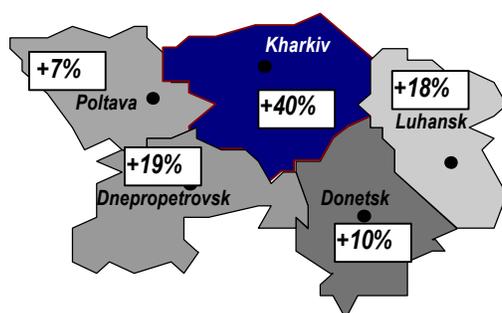
A comparison of Kharkiv Oblast and national construction sector economic indicators is shown in **Table 4**. Kharkiv Oblast sector capital investment accounts for an average of 5%-5.5% of the national total. [3; 5]

Table 4. Capital Investments in Ukraine and Kharkiv Oblast in 1996 Prices (million UAH)

	1985	1990	1995	1996	1997	1998	1999	2000*
Ukraine	44,690	55,368	16,097	12,557	11,449	12,151	12,197	19,481
Kharkiv Oblast	2,523	3,095	717	721	766	703	582	1,125
<i>Share (%)</i>	5.6%	5.6%	4.5%	5.7%	6.7%	5.8%	4.8%	5.7%

*Data in 2000 prices

As shown in **Figure 1**, Kharkiv Oblast's share of sector investments has grown substantially in 2000, due to more dynamic growth of capital investments relative to other regions of Ukraine. Investments in Kharkiv Oblast increased by almost 40%, while growth in neighboring regions ranged from 7%-19%.

Figure 1. Increase in Investments in Certain Regions of Ukraine: 2000 (%)

A number of sector economic indicators are illustrated in **Tables 5-7**. The number of sector enterprises and employees is shown in **Table 5**. [3; 5] Kharkiv Oblast construction and mounting work accounts for approximately 4%-5% of the total volume in Ukraine, as shown in **Table 6**. [3] Kharkiv Oblast sector activity accounts for approximately 5%-7% of the total volume of Ukraine housing construction, as shown in **Table 7**. [1; 5]

Table 5. Number of Sector Enterprises and Employees: 1995-1999

	1995	1996	1997	1998	1999
Sector Enterprises in Ukraine	3,980	4,240	4,524	4,734	5,119
Sector Enterprises in Kharkiv Oblast	297	295	303	310	309
Kharkiv Oblast Sector Share (%)	7.5%	7.0%	6.7%	6.5%	6.0%
Sector Employees in Ukraine (1000)	998	888	763	708	644
Share of Kharkiv Oblast (%)	5.6%	5.5%	5.5%	5.5%	5.4%

Table 6. Construction and Assembly Works: 1996 Prices (million UAH)

Oblast	1985	1990	1995	1996	1997	1998	1999
Ukraine	34,236	37,319	10,797	7,450	6,709	6,891	6,342
Kharkiv Oblast	1,691	1,788	487	369	357	292	240
Share (%)	4.9%	4.8%	4.5%	5.0%	5.3%	4.2%	3.8%

Table 7. Housing Construction: 1985 and 1990, and 1995-1999 (1000 m²)

Region	1985	1990	1995	1996	1997	1998	1999
Ukraine	19,193	17,447	8,663	6,754	6,369	5,855	6,152
Kharkiv Oblast	1,401	1,009	603	361	368	312	306
Share (%)	7.3%	5.8%	7.0%	5.3%	5.8%	5.3%	5.0%

The rate of housing construction in Kharkiv Oblast has declined over the last four years. As a result, the region's share in the overall national volume of housing implementation fell from 5.8% in 1997 to 4.7% in 2000. **Table 8** shows the rate difference of dwelling implementation in two cities of Ukraine: Kharkiv City and Kyiv City. [1; 5]

Table 8. Rate of Housing Construction in Kharkiv and Kyiv, 1996-2000 (1000 m² / %)

Cities of Ukraine	1996	1997	1998	1999	2000
Kharkiv City	68	132	143	131	87
Increase (%)	-	95%	8%	-9%	-33%
Kyiv City	419	504	603	735	859
Increase (%)	-	20%	20%	22%	17%

3. Economic Condition of Sector Enterprises and Organizations

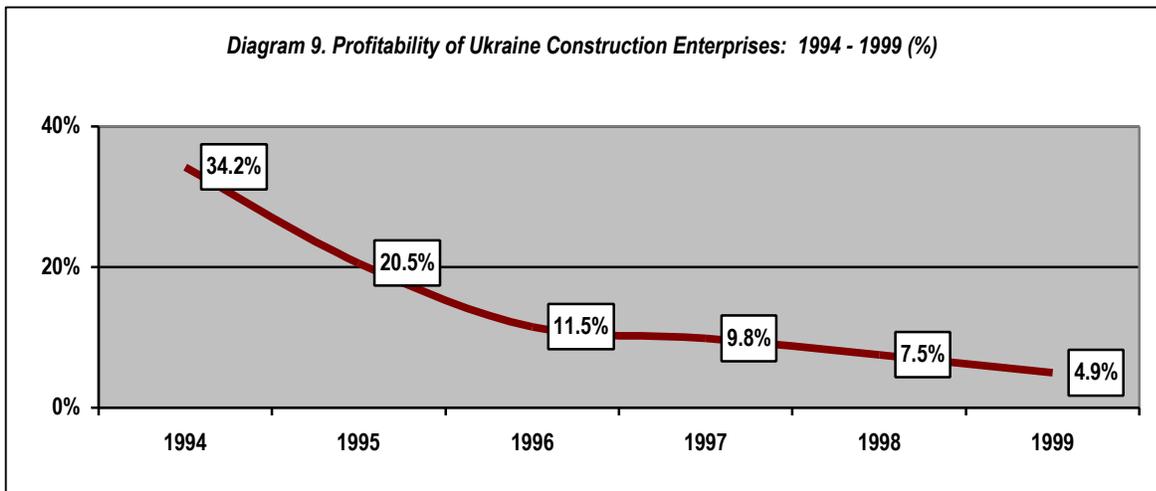
As the experience of countries with developed economies shows, the construction sector is characterized by stable but not very high indices of productivity. The sector requires considerable investment; however, profitability is generally not very high.

According to the Almanac of Business and Industrial Financial Ratios (28th Annual edition), U.S. construction enterprises showed the following financial indicators during the period 1990-1997:

- ROA: 4.3%
- ROE: 8.1%
- Profit Margin after Income Tax: 0.8%
- Return Before Interest on Equity: 20.4%
- Costs of Operations: 85.5%

In Ukraine, overall sector profitability (calculated as the ratio of profits from works and services to expenditures on production and realization) has declined over the last seven years, as shown in **Diagram 9**. [3]

Diagram 9. Profitability of Ukraine Construction Enterprises: 1994-1999 (%)



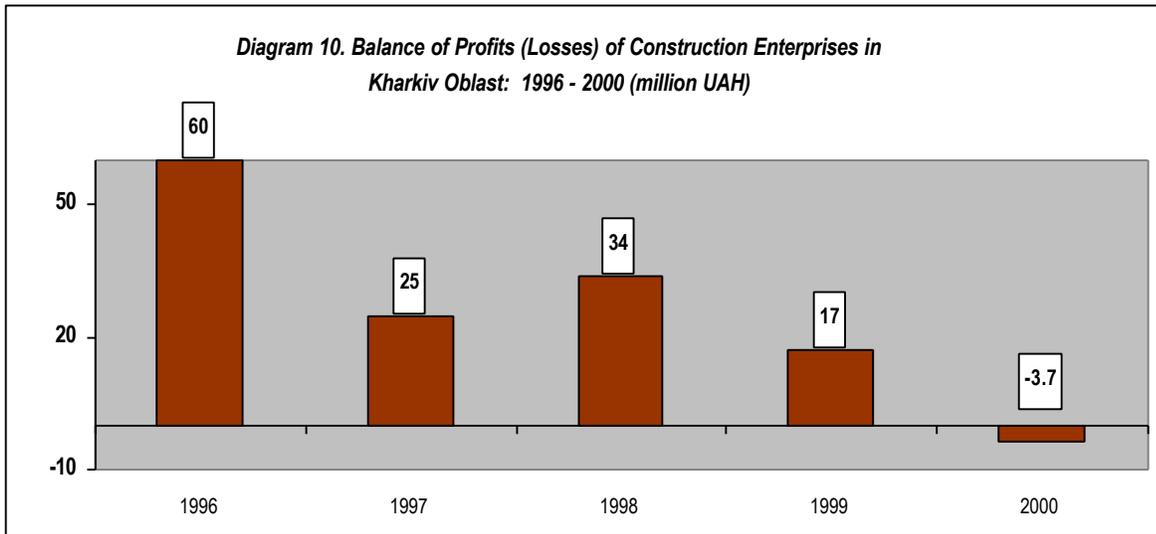
In spite of a number of positive economic developments in 2000, the overall economic and financial state of the Kharkiv Oblast Construction sector is still very complicated. Lack of demand for products and services, a deficit of investment capital, and the inability of some entrepreneurs to restructure their enterprises are some of the factors that are hampering sector activity. According to the latest financial indicators, 56% of construction enterprises are unprofitable. As of January 1, 2001, sector losses totaled 3.7 million UAH. Financial results for the first 11 months of 2000 for Kharkiv Oblast construction enterprises are shown in **Table 9**. [5]

Table 9. Sector Enterprise Profitability: January-November 2000 (1000 UAH)

Sector	Profit	Profitable Enterprises			Unprofitable Enterprises		
		# Enterprises	% Total Volume	Financial Result	# Enterprises	% Total Volume	Financial result
Construction	-843	153	43	29 161	204	57	30 004

Overall profits have also tended to decrease over the last five years, as shown in **Diagram 10**.

Diagram 10. Kharkiv Oblast Sector Enterprise Profits and Losses: 1996-2000



As of January 1, 2001, sector enterprise accounts receivable totaled 349.6 million UAH (5.9% of the Kharkiv Oblast total), while accounts payable came to 434.8 million UAH (4.3% of the regional total).

At the beginning of 2000, 52 of the 406 Kharkiv Oblast construction enterprises were idle (13%). By December, that figure had risen to 116 (29%). In 2000, 107 enterprises showed an increase in revenues, as shown in **Table 10**. [5] By contrast, 183 enterprises (45%) demonstrated a decrease in the rate of growth relative to 1999. [7]

Table 10. Sector Enterprise Revenues in 1999 and 2000 (1999 Prices)

Enterprise	2000 (1000 UAH)	1999 (1000 UAH)	Growth
JSC "Specbud -3"	4263	4004	106.0%
JSC «Puls»	3367	2195	153.0%
JSC «Otryadbud»	2500	1613	155.0%
Dwelling complex «Internationalist»	1629	824	198.0%
JSC «Pivdenspecatomenergomontazh"	270	58	470.0%
JSC «Specbudmehanizaciya»	8875	6776	131.0%
JSC «Lozovabud»	2170	1999	109.0%
JSC «Kharkivspecbud»	1394	1289	108.0%

4. Sector Development: Raw Materials Base

The Construction sector produces its own raw materials base, and is currently able to meet both regional and national demand for a number of construction materials. The main products of the construction materials industry of Ukraine are:

- Cement
- Construction brick
- Reinforced concrete segments
- Ceramic tiles
- Heat insulated materials
- Glass

The number of sector enterprises in various regions of Ukraine as of January 1, 2000 is shown in **Table 11**. [3]

Table 11. Number of Sector Enterprises by Oblast: 1999

Region	Number
Ukraine	1,034
Kharkiv region	53
Dnipropetrovsk region	65
Donetsk region	104
Kiev region	37
Luhansk region	46
Poltava region	41
Sumi region	20
Kiev	45

According to some expert assessments, construction dry mixes may become a strategically important product of the Ukraine construction materials industry. In 2000, domestic consumption of construction dry mixes increased 200% in comparison with 1999.

Kharkiv Oblast has high quality mineral resources that are used in the production of construction raw materials. The most important of these are sand, loam, chalk, and lime.

At present, there are 10 enterprises producing reinforced concrete constructions in Kharkiv Oblast. They produce up to 650 million bricks, approximately 5.4 million m² of ceramic tiles, and 4 million tons of cement per year. [3]

As of January 1, 2000, 53 sector enterprises, 5% of the total number in Ukraine, were registered in Kharkiv Oblast. Production capacity for manufacturers of most materials in 2000 was 20%, although the manufacture of ceramic tiles reached 85%. [3] However, since the standards and quality of domestic products do not always satisfy construction standards, imported materials are often used.

5. Sector Development: Technological Base

Continued development of the Ukraine Construction sector will be impossible without new equipment and technologies.

The sector's present technological base was put in place in the late 1970s and 1980s. The main technological problems currently being faced by Kharkiv Oblast sector enterprises include:

- a high level of equipment deterioration
- substantial consumption of materials and power
- a lack of construction projects that meet current quality and design requirements

The current lack of investment capital is preventing sector enterprises from modernizing equipment and introducing new technologies. Outmoded construction technologies and materials, which are still widely used, reflect the former "industrial approach" of the Ukrainian construction sector.

Today, outdated technologies no longer meet the standards of the new generation of customers. Construction enterprises have excess production capacity, both for construction of structures and for materials production. The sector's industrial base no longer completely corresponds to the requirements of its development.

Average housing construction costs per m², as an example indicator of industry based development, are shown in **Table 12.** [15]

Table 12. Housing Construction Costs by Region: 2000 (m²)

Region	Cost of 1 m ² of Total Building Area (with VAT) (UAH)	Region	Cost of 1 m ² of Total Building Area (with VAT) (UAH)
Ukraine (average)	1226	14. Mykolayiv	1199
1. Crimea	1142	15. Odessa	1178
2. Vinnytsya	1160	16. Poltava	1136
3. Volin	1077	17. Rivne	1243
4. Dnipropetrovsk	1240	18. Sumy	1146
5. Donetsk	1243	19. Ternopil	1111
6. Zhytomyr	1127	20. Kharkiv	1297
7. Zakarpatye	1339	21. Kherson	1055
8. Zaporizhzhya	1259	22. Khmelnytskyi	999
9. Ivano-Frankivsk	1208	23. Cherkasy	1170
10. Kiev	1224	24. Chernivtsi	1125
11. Kirovograd	1178	25. Chernihiv	1158
12. Luhansk	1240	26. Kiev	1386
13. Lviv	1400	27. Sevastopol	1181

6. Investment Activities in the Sector

Private investment from within the sector is still the primary source of financing in Kharkiv Oblast. Investment activity by source of financing for the last 10 years is shown in **Table 13**.

Table 13. Sources of Sector Investments: 1999-2000 (1996 Comparative Prices) (million UAH)

	1990	1995	1996	1997	1998	1999	2000*
State budget	810	180	83	86	12	18	23.9
Total volume of capital investments	26.2%	25.1%	11.5%	11.2%	1.7%	3.1%	2.1%
Local budget funds	-	-	-	19	24	19	27.4
Total volume of capital investments	-	-	-	2.5%	3.4%	3.3%	2.4%
Sector enterprise and organization funds	1758	537	633	568	566	462	889.9
General volume of capital investments	56.8%	74.9%	87.8%	74.2%	80.5%	79.4%	79.1%

*Data in 2000 prices.

According to the Kharkiv Oblast Statistics Department, at the beginning of 2000, 10 Kharkiv enterprises received direct foreign investments (DFI) totaling 1.51 million USD. Most of this investment came from Germany, as shown in **Table 14**. [13; 14]

Table 14. Direct Foreign Investments in the Kharkiv Oblast Construction Sector (million USD)

	1997	1998	1999
Total volume of foreign investments, including:	1.97	1.94	1.51
Germany	1.69	1.66	1.31
USA	0.07	0.07	-
Hungary	0.07	0.07	0.07

Capital investments in Ukraine overall increased by 11.2% in 2000 relative to 1999. In Kharkiv Oblast, investments from all sources increased by 40%, and capital investment increased by more than 30%.

Some experts attribute this growth to the implementation of the law entitled, "On a special procedure of investment activity in Kharkiv Oblast," enacted May 11, 2000. Substantial further increases of capital investments are currently expected from domestic as well as foreign investors.

7. Employment and Personnel Potential in the Sector

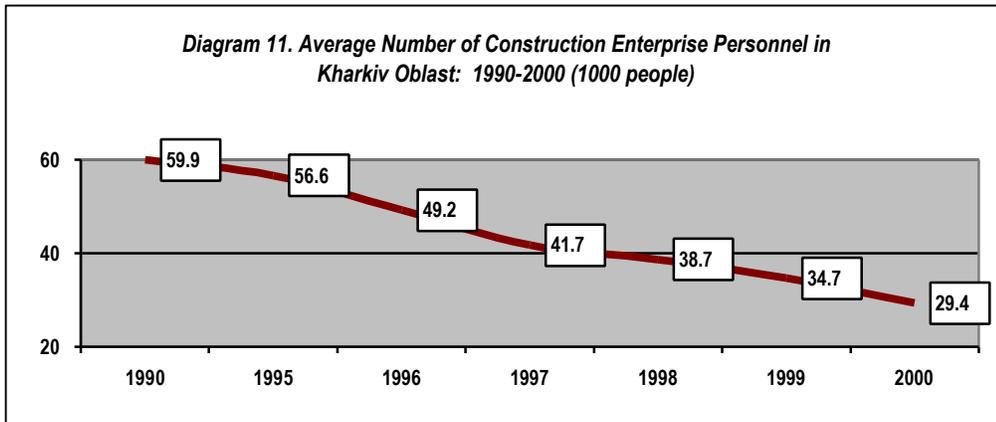
In 1990, 1,920,000 people were employed in the Ukraine Construction sector, placing it among the leaders in European construction employment per capita. [3]

However, sector employment has decreased since Ukraine independence as a result of various economic, organizational, and technological factors. Substantial numbers of employees changed professions, and some specialized enterprises went out of business.

One of the peculiarities of the Construction sector labor market is that it is oversaturated with highly educated specialists. The majority of highly qualified sector specialists are graduates of the Kharkiv State University of Building and Architecture or the Kharkiv State Academy of City Economy.

According to the Kharkiv Oblast Statistics Department, the average number of persons employed in Kharkiv Oblast construction enterprises in 2000 totaled 29,400, approximately 18% less than in 1999, as shown in **Diagram 11**. [1; 5]

Diagram 11. Average Number of Sector Enterprise Personnel in Kharkiv Oblast: 1999-2000 (1000 people)



The average monthly wage for Kharkiv Oblast Construction sector employees is notably higher than for other sectors, both in Kharkiv Oblast and in Ukraine overall. In 2000, the average monthly wage for the Kharkiv Oblast Construction sector was 307.2 UAH, compared with 230.1 UAH across all sectors in the region. In addition, at some enterprises incorporating the latest technologies and producing work on a level with European standards, the real wage exceeds the sector's average wage by 2-5 times.

As of November 10, 2001, the sector's wage payment debt totaled 23.2 million UAH; this figure has been reduced by 24.4% since the beginning of the year. Currently, the sector's wage payment debt for a single employee is 569 UAH, compared with 872.7 UAH for the region and 1,260 UAH for Ukraine overall. [7]

8. Sector Exports

Since 1997, Construction sector services and production export volumes have declined sharply. During 1997-1999, the level of exports and the number of enterprises exporting goods and services both decreased by approximately 50% relative to 1996. At the same time, the level of imports in 1999 increased by 300%-400% relative to 1997, as shown in **Table 15**.

Table 15. Kharkiv Oblast Construction Sector Imports/Exports: 1996-1999

Years	Export		Import	
	# Exporters	Volume (1000 USD)	# Importers number	Volume (1000 USD)
1996	84	12,175.06	101	11,749.25
1997	62	14,107.40	75	9,811.54
1998	47	7,181.82	66	2,4259.62
1999	45	6,321.6	70	34,259.2

These figures support the fact that the quality of Kharkiv Oblast sector goods and services is not sufficiently competitive on the international market. In addition, the quality of domestic building materials is also substandard, leading many Kharkiv building companies to use imported materials.

9. Competitive Environment of Sector Enterprises and Organizations

Historically, the Ukraine Construction sector developed along with the other branches of Ukraine's economy under the "planned administrative economy" of the former USSR. Production capacities of contract building organizations and enterprises were created on the basis of vertical integration to provide for the needs of the corresponding branches of the economy on the principles of specialization and cooperation within Ukraine and the USSR. These enterprises and organizations were subordinated to the building ministries, and carried out the construction of heavy industrial projects for different branches of industry, including motor transport, housing, etc.

The following sector reforms have been instituted over the last 10 years as Ukrainian made the transition to a market economy:

- The former construction/building ministries and departments were reorganized into state building corporations.
- Previously state-owned construction/building enterprises and organizations were privatized.

Functional management of the sector is currently carried out by the State Committee of Building, Architecture and Housing Policy of Ukraine, and by a number of state building corporations and concerns.

Following the implementation of these reforms, the state lost its monopoly on sector consumption and production, with the result that building enterprises now deal with new private consumers. Several new private companies, some of which have access to foreign capital, have entered the market.

The low production volume of Ukraine's construction industry is confirmed by per capita sales. In 1996, this figure was only 3.4 ECU—half that of the CIS countries, less than a quarter of that of the Central and Eastern Europe countries, and one twelfth of the level of Western Europe. General demand for housing construction is not expected to exceed 12 million m² in 2010. [2]

It should be pointed out that the revenue levels of Kharkiv Oblast sector enterprises do not allow them to compete effectively in the Ukrainian market, let alone foreign markets. Currently, most Kharkiv Oblast construction enterprises are experiencing negative growth, with almost 45% of enterprises showing reduced production volumes in 2000 compared with 1999.

10. Ownership in the Sector

In the process of mass privatization that took place between 1993-1995, most Ukraine construction enterprises went from state ownership to become private, independent businesses. At the same time, a gradual transition from centralized to functional management was carried out.

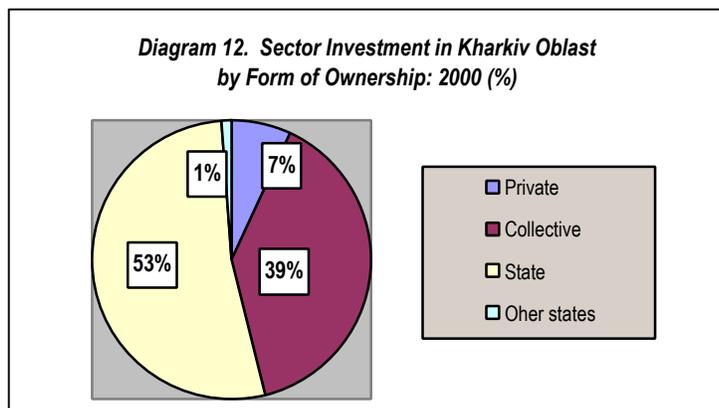
Privatization in the sector led to a decrease in the number of construction enterprises; the total number in Soviet Ukraine was about 500. As of January 1, 2000, 46% of enterprises were united into building corporations and concerns; others continued to work independently. According to Derzhkomstat, at the beginning of 2000, 86.4% of Ukrainian contract enterprises were no longer under state ownership. Collective ownership is currently the most common form of ownership in the sector, as shown in **Table 16**.

Table 16. Kharkiv Oblast Construction Enterprise Ownership: 1995-1999

	1995	1996	1997	1998	1999
Collective	230	235	251	256	255
State	66	59	52	50	50
Private	-	-	-	4	4
Foreign	1	1	-	-	-
Total Enterprises	297	295	303	310	309

The distribution of Kharkiv Oblast sector enterprise fixed capital investments is shown in **Diagram 12**. [7] As shown in the diagram, state-owned enterprises and organizations still receive most of the investment in the sector (53%). [7, p. 11]

Diagram 12. Kharkiv Oblast Sector Enterprise Fixed Capital Investments: 2000 (%)



11. SME Growth in the Sector

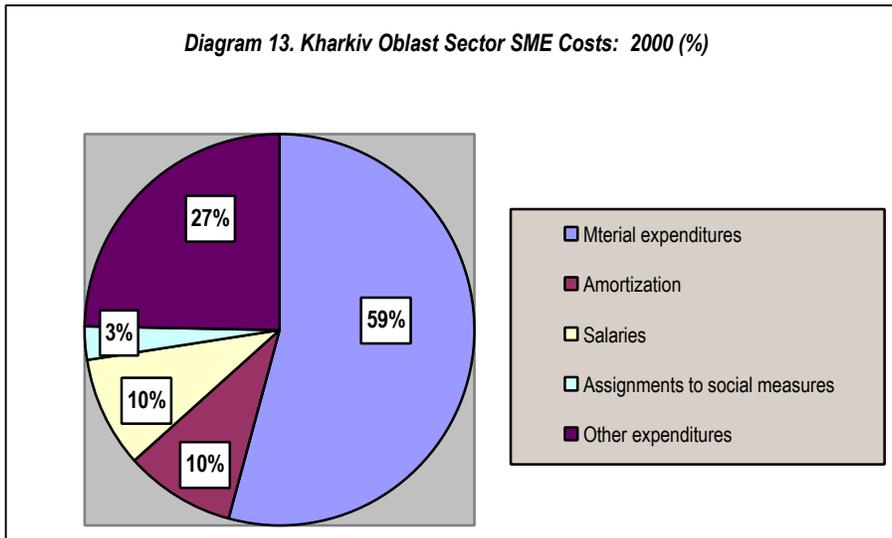
According to the Kharkiv Oblast Statistics Department, there were 1,072 sector small enterprises in Kharkiv Oblast in 1999. Sector SMEs made up 9.2% of the regional total in 1999, and 71% of the general number of building enterprises. [12]

In 1999, sector SME production volume totaled 1,441,137 UAH; this equaled 15% of total Kharkiv Oblast SME production, and 36.7% of sector large enterprise production volume. [12] A total of 8,534 workers were employed at sector SMEs in 1999 [12, p. 22].

The average monthly wage at sector SMEs was 143.4 UAH, 23% more than the average wage at other SMEs in the region. [12]

SME production costs were 139,384 UAH in 1999; the distribution of costs by type of expenditure is shown in **Diagram 13**. [12]

Diagram 13. Kharkiv Oblast Construction Sector SME Costs: 2000 (%)



12. Sector Infrastructure

The research and educational infrastructure of the Kharkiv Oblast Construction sector is well developed. Kharkiv Oblast educational establishments, which are well known in Ukraine and abroad, play an especially important role in preparing specialists for the construction industry. Among these are:

- **Kharkiv State University of Building and Architecture.** Departments include architecture, engineering, medical technology, and industrial and civil building.
- **Kharkiv State Academy of Municipal Economy.** Departments include bridge building, ecology, economics and management, housing and communal services, and electromechanical technology.
- **Kharkiv State Academy of Railway Transport.** Includes a construction department.
- **Kharkiv State Road Technical University.** Includes a road construction department.
- **Kharkiv Building Technical School.**

The number of design and research organizations has grown from 48 in 1995 to 55 in 1999. However, the volume of design and research activity and the number of employees have decreased during the last five years, as shown in **Table 17**.

Table 17. Design and Research Enterprise Economic Indicators: 1995-1999

Index	1995	1996	1997	1998	1999
Design and research organizations	48	48	51	53	55
Design and research services (million UAH)	27.6	34.2	34.0	32.6	30.0
Design and research services (million USD)	18.7	18.7	18.3	13.3	7.3
Number of personnel (1000 people)	11.9	10.9	9.5	8.3	7.5

While the volume of design and research works in UAH has remained more or less constant, at approximately 30 million UAH annually, in USD terms it has demonstrated a real decrease of 50% due to inflation. During 1995-1999, the number of workers at design and research organizations fell by 58%. [14]

13. Management Capabilities of Sector Enterprises and Organizations

While the Kharkiv Oblast Construction sector has access to significant scientific, research, and educational resources, the professional skills of an engineer or technologist are not enough for the competitive management of a construction company. The sector can continue to develop only if it also has access to professional managers with up-to-date knowledge and experience in working under market conditions.

Under the previous conditions of the centralized economy and organizational structure, Ukrainian construction companies didn't have to demonstrate commercial viability. Currently, many sector enterprises still have no sales or marketing managers. Construction contracts continue to be awarded on the basis of private contacts, with factors such as cost and quality of work playing a secondary role.

Reconstruction of the Ukraine Construction sector will take several years, and will require periodic review of long-term strategy. Specifically, more small and medium enterprises must appear in the market. In addition, establishing a number of large "trans-regional" construction companies through post-reconstruction mergers will be required, particularly for special works projects. The resulting large contractors will be more able to realize profit through larger economies of scale, and will also have a better chance at attracting investment. [2]

This reconstruction effort will require special effort on the part of government and enterprises alike. The bottom line is that many of the region's construction enterprises **must** carry out immediate reconstruction in order to survive.

14. Administrative Impact on the Sector

Ukrainian law has so far proven ineffective in regulating relations between the various Construction sector entities; this is especially true in the area of housing construction, where current reforms have almost no legislative support. The act that regulates housing maintenance, ownership, and construction dates back to 1984, and does not meet today's standards. And because there is still no basis for long-term credit for housing construction, it is impossible to offer any guarantees for the banks and other participants in the sector investment process.

To remedy this situation, the government recently presented a package of bills to the Verkhovna Rada to improve legislative regulation of housing construction. The government of Ukraine has already approved a number of additional measures on solving other construction industry problems. In particular, it is currently preparing a number of proposals to

create industrial-financial groups in this sphere, to include construction enterprises, banks, financial companies, R&D organizations, etc.

It should be pointed out that a rather nontransparent system still governs the process for issuing building permits. Although a law was enacted to regulate procedures, the reality is that everything from obtaining a plot to receiving permission to build is decided at the local level.

According to the opinion of a number of sector experts, Ukraine's taxation policy concerning the Construction sector does not promote the right environment for sector development. At the same time, however, some large companies enjoy individual tax privileges. Today, a construction company can choose from a number of different taxation procedures:

- "classical" (the enterprise pays profit tax and VAT)
- taxation according to long-term contract
- taxation according to joint action agreement
- simplified taxation system

The simplified taxation system is available only to SMEs (50 employees or less; less than 1 million UAH is annual sales). Because construction activity is almost completely disregarded by the general taxation procedure, profit taxes and VAT are key issues for any discussion of tax reform.

According to TACIS specialists, who researched Ukraine's Construction sector, the following measures are necessary for the sector's future growth:

- clarifying the tender procedure, establishing periodical bulletins about official tenders, opening the tender process to all construction companies, and codifying the official rules for invitation for tender.
- modifying the tax system to favor creation of joint enterprises between Ukrainian and foreign construction companies.
- offering incentives and tax privileges to Ukrainian institutions that invest in the Construction sector.
- creating guarantee schemes to promote foreign investment.
- adapting the Ukraine fiscal system to the practice of awarding credits to farmers that purchase housing.
- allowing farms to receive mortgage credits.
- simplifying the administrative procedures for issuing construction permits and available land.
- developing and implementing minimal legislative procedures to regulate relations among Construction sector entities.
- promoting the development of independent professional associations.
- seeking investment sources to carry out infrastructure and construction facility modernization, which should help attract investment and draw more young specialists to the Construction sector. [2]

15. Social Issues of Sector Development

Development of any nation's construction industry has a direct influence on its overall investment activity, which in turn helps drive the whole economy forward. In addition, development of the construction industry influences the overall standard of living because it provides people with housing.

The slogan, "A separate flat for every family" was popular in the Soviet era, while during the period of "perestroika" (reconstruction), the slogan, "Let's provide every Soviet citizen with a separate dwelling by 2000" was popular. Unfortunately, these slogans remained only good ideas. Many people in Kharkiv Oblast still don't have their own flats or houses, and continue to live in communal flats and hostels, or rent living space from other owners. As of January 1, 2000, 121,600 families were still waiting for separate housing. [1]

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

The distribution of Kharkiv Oblast construction proposals is as follows:

- Housing built by Kharkiv Oblast enterprises: 72%
- Housing built by groups of sector enterprises: 4.5%
- Housing built by individual builders: 23.5%

The following investment proposals for investment projects in Kharkiv Oblast have been presented in the Chervonozavodskiy District. [9]

1. Executive Committee of Chervonozavodskiy District Soviet of Kharkiv

Address: Ukraine, 310050, Kharkiv, Bogdana Khmel'nitskogo str 11.

Tel. +380 572 21-14-69, +380 572 21-6 4-66.

Aim of the project: Construction of a modern downtown business center for multifunctional activities and business cooperation.

Actuality of the project: To promote gradual integration of Ukraine cities and towns into the international economy. Establishing infrastructure is very important; Kharkiv is a city where favorable natural conditions, modern science, and culture are united.

A business center in Kharkiv can help facilitate cooperation between science and institutions of higher education; state industry and private enterprises; and local and regional government bodies; as well as render informational, consulting, publicity, and other services.

Content of the project: The project will proceed from the downtown historical district; the convenience and prestige of the location will help attract international interest. Modern scientific-technical achievements will be taken into account.

Projected Cost: 58,000,000 UAH (approximately 11 million USD).

Length of Project: 5 years.

A joint stock company was established to carry out this project. Among the stockholders are the Kharkiv municipal executive committee, the Chernosavodskiy district executive committee, and a number of other Kharkiv City joint stock companies, enterprises, and banks of the city.

2. Closed Joint Stock Company, “Macrocap Development Ukraine”

Type of investment project: Housing complex, of a type new in Kharkiv Oblast. The closed joint stock company “MCDU” carries out new, progressive cooperative projects with its clients, and offers them a number of unique services.

Project Objective: construction of a 100-flat dwelling complex with a two-level underground garage and service facilities in downtown Kharkiv City.

This housing complex meets all European standards for a light-class housing construction.

One important aspect of this project is the use of new channels for client interaction; options include gradual payment and essential reduction of expenditures while purchasing immovable property.

Competition: “MCDU” currently enjoys a great competitive advantage in the Kharkiv Oblast market. As a contractor, general investor, and realtor, it provides a high level of services compared with other building companies.

Total investment required: 6 million USD. Include the Ukrainian payment of 3 million USD. Additional investment required: 3 million USD.

Guarantee of credit payment: insurance.

Preparedness of the project: ready for production.

Construction is to be carried out with the help of contract enterprises. This approach provides for complete control of financing, building, and sales.

“MCDU” is a newly formed organization; accordingly, there is no production output.

Enterprise funds: 10,000 USD.

The founder and strategic investor of “MCDU” is the Russian closed joint stock company, “Vectris”, which has been active in the Russian real estate market for several years. “Vectris” has considerable experience in partial participation building schemes in Moscow. Other partners include the RF Ministry of Defense, several Moscow housing construction groups, and the scientific research amalgamation BUDNAUKA.

Form of property: private

Organization legislative form: Closed joint stock company

Year of foundation: 1997

Staff: 56 (40 laborers, 8 engineers, 2 managers)

Contact: Rosit Andrey, Commercial Director. Tel (0572) 30 77 20

3. Joint Stock Company, "Kharkivgas"

Ukraine, 310022 Kharkiv,
Dershprom, 4th entrance, 3rd floor
Tel/fax (0572) 433732

Head of the Board: Makarenko Anatoliy Ivanovich

Tel: (0572) 47 71 04
Fax: 42 37 32

Because the pressure of gas extracted from the Shebelinka deposit decreases 2-3 kg/sq. cm. every year, delivery of gas to Lyubotin, Berezivka, Pivdenniy and other towns is periodically interrupted. Given that the Yuliyivske gas deposit is more reliable, in 1998 the Kharkiv Oblast regional administration and the "Kharkivgas" joint stock company decided to build a high pressure gas main from the Yuliyivske deposit to the existing gas main in Karavan.

After the construction of this main, more than 1 million m³ of gas will be transported 24 hours a day, with distribution to all Kharkiv Oblast consumers. This gas main will also bring gas to a number of towns that have had no gas service to date.

Financing: enterprise private funds and budget allocation.

Type of the investment project: increasing gas service production volume.

Potential consumers: Kharkiv Oblast and Kharkiv City enterprises and population.

Competition: none.

Total volume of investment: 1.5 million USD; includes the Ukrainian payment of 300,000 USD. Additional investment required: 1.2 million USD.

Projected term of investment return: 6 years.

Preparedness of the project: almost ready.

Main service: transporting natural gas by gas mains.

Additional services: object design and gasifying; control of welding works and insulating quality; electrical and chemical protection of gas mains; branch software development; creating local networks.

Turnover on the main service: 13.3 million USD/year.

Home market: 13.3 million USD.

Turnover on additional service: 900 USD/year.

Home market: 1,300,000 USD.

Enterprise funds: 712,000 USD.

Form of ownership: collective.

State's share: 12%.

Year of foundation: 1965.

Staff: 3579 (2,771 laborers, 308 engineers, 482 managers).

Contact: Sedak Volodymyr, Chief Engineer. Tel. (0572) 43-06-30. Fax: 43-37-32.

Conclusions

Today, the Construction sector plays a major role in the economic development of Kharkiv Oblast. Its products and services make up a significant share in the industrial output of the region, and it provides a considerable number of jobs for the population.

According to the opinion of many experts, the Construction sector will continue to be strategically important in Kharkiv Oblast during the next 15-20 years as its development continues to directly influence attraction of investments into the fixed capital of the region's enterprises and organizations.

At present, however, rapid development of the sector is unlikely, given the low demand for both industrial and housing construction in the region. In addition, local enterprises of sufficient size to attract significant investment resources have not yet appeared.

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List of Main Enterprises and Organizations in the Sector

Enterprise Name	STREET	Bloc	Telephone No	Directors	Products
Intergazbud, SOE	Str. Artema	16	477182	director Valentyna P. Vovk	Construction of gas-lines
Zhytlobud No.2, JSC	Str. Sumska	39	433490	manager Yuriy Ya. Krolenko	Construction, residential, construction of establishments for social and cultural life, renovation of apartments and offices
Zhytlobud No.1, PbJSC	Str. Artema	43	433404	chairman of the Board Olexandr M. Kharchenko	Construction services, residential construction, renovation of offices interiors, reconstruction and overhaul of establishments
MZHK Internatsionalist, JSC	Str. Danylevskoho	38	451165	president Olexandr M. Nepomnyashchyi	Construction services, medical services, dental services, legal services, installing telephones
Montazh-Elektro, PE	Ave. Lenina	9	303642	president Yuriy R. Orshanskyi	Design and construction of enterprises, "turn-key" operations
Balakliyarayavtodor, SOE	Str. Vtorchormetivska	3	53771	head of the board Vasyl P. Mykulenko	Construction services, transportation, earth works
Dorozhnyk, specialised enterprise, Balakliya	Str. Pidluzhna	17	53383	leader Vasyl D. Plyushko	Development of roads
Kharkivspetsbud, PbJSC	Str. Olminskoho	14	471444	chairman of the Board Yevgen O. Grynevych	Road construction, maintenance of motor transport, civil engineering and erection, earth works
Road construction, repair and maintenance office, Kolomak	Str. Sverdlova	21	56665	chief Leonid Y. Radshev	Construction and maintenance of roads
Progres, construction and assembly PA, Kupyansk	Str. Dzerzhynskoho	17	56008	chief Sergiy M. Bilous	Road construction, overhaul work, civil engineering and erection
Agroshlyakhbud, JE, Kupyansk	Str. 8th Bereznya	7	56639	chief Olexandr M. Dronov	Transportation of cargo
Promtekhmontazh No.1, PrJSC	Str. Sumska	78	432182	General director Iliya V. Pasmurov	Construction services, service with hoisting devices, start-up operation
Yuzhspetsstroy, PbJSC	Str. Novhorodska	3	438057	general director Naum P. Vodovozov	Construction services, construction of: roads, water-way filter stations, sewage works, steel pipes for water-ways, sewage headers, construction, dams and dikes, ferro-concrete monolith.

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

10. TRANSPORTATION

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Kharkiv Oblast plays an important role in the development of the transportation and road complex. Kharkiv Oblast is situated next to a number of large Ukraine and Russian industrial centers, and has access to a multi-branch network of railways and roads, as well as warehouses and structures. Due to this favorable geographical position, Kharkiv is one of the most important nodal transportation points of Eastern Europe.

However, Ukraine's economic crisis of the last several years has affected the Transportation sector as well, and Kharkiv Oblast now faces the real threat of gradually losing its leading role in the national transportation system.

The analysis of the Kharkiv Oblast Transportation sector has shown the following:

- According to official statistics, the dynamics of cargo and passenger transportation by railway and motor transport in Kharkiv Oblast has exhibited negative tendencies during the past five years; the rather stable situation in passenger railway transport is an exception. On the whole, the economic and financial state of sector enterprises and organizations can be estimated as difficult.
- The coefficient of fixed assets deterioration of the Transportation sector in Kharkiv Oblast is 60%-70% on average, which testifies to the necessity of renovating the material and technical bases of the sector, including everything from roads and subsidiary infrastructure (repair workshops, repairing) to movable and motor stock (trains and motor transport).
- As of January 1, 2001, direct foreign investments in the Kharkiv Oblast Transportation sector totaled 137,700 USD, 77,000 USD of which came from Israel.
- The decline in Transportation sector production contributes to unemployment. In 2000, the number of people employed in the Kharkiv Oblast Transportation sector decreased by 34% in comparison with 1996, with a total of 50,000 sector employees out of work.
- As of January 1, 2000, 183 sector small enterprises were registered in Kharkiv Oblast. In 1999, these SMEs provided services amounting to 24,047,500 UAH, up 13.4% from 1998. On the whole, the prospects of sector SMEs in Kharkiv Oblast are promising.
- The Cabinet of Ministers approved the state program for development of a transportation road complex in Ukraine for the years 2001-2004. Funding for the program will total 40 billion UAH.

In spite of the economic crisis, the Ukraine Transportation sector, including that of Kharkiv Oblast, has good potential for development. The National Academy of Science has projected 150% growth in the sector over the next 15 years, while some western analysts have estimated growth at 200% over the next ten years. The main conclusion of these forecasts is that it is necessary to prepare for this growth now, using existing resources as much as possible.

1. Sector Role in the Kharkiv Oblast Economy

The steady economic development of both Kharkiv Oblast and Ukraine itself depends on the safe functioning of transportation. Good transportation allows Ukraine to make effective use of its resource potential, and contributes to the development of industrial production and agriculture.

During the Soviet period, a multi-branch transportation network with a highly developed infrastructure was created in Ukraine. After state independence had been proclaimed, Ukraine faced the task of transforming this sector into a

constant, integrated world transportation network system that is still being developed. In support of this development, over 100 international transportation agreements have been signed since 1992. Thirty-three international bilateral agreements concerned international auto traffic, and six projects have been ratified. These agreements will allow Ukraine to broaden its economic relations with the international community by means of integrating its own transportation complex into the world market.

In 1996, the Ministry of Transport of Ukraine joined the European Conference of Ministers of Transportation. Ukraine signed 16 intergovernmental bilateral agreements on cooperation in the sphere of railway transportation, and 11 more project agreements are being worked out. In 1997, Ukraine declared its intention to join the Conference on International Railway Connection, and to enter the Intergovernmental Organization of International Railway Connections.

Air transportation agreements have been signed with 50 countries, and 15 more are being worked out. Much has already been done to allow Ukraine to participate in European agreements and conventions, which will give Ukrainian transporters the right to engage in transportation activities on the territory of foreign countries, and will also help open the Ukrainian transportation services market to foreign transporters.

Kharkiv Oblast plays an important role in the development of the Ukraine transportation and road complex. Kharkiv Oblast is situated next to a number of large Ukraine and Russian industrial centers, and has access to a multi-branch network of railways and roads, as well as warehouses and structures. Due to this favorable geographical position, Kharkiv is one of the most important nodal transportation points of Eastern Europe, and Lozova one of its most important railway junctions.

A number of roads and railways connect Kharkiv Oblast with Donbas, Pridneprovye, Crimea, and the Caucasus, as well as with the Black Sea, the Sea of Azov, and the Baltic Sea ports. This is the primary cause of the city's continued economic growth, and the main reason it became one of the most important economic centers in the county. This situation is changing fundamentally, however, and Kharkiv now faces the real threat of gradually losing its leading role in the national transportation system.

2. Strength of Kharkiv Oblast Sector

Railway cargo transportation activity in Kharkiv Oblast and in Ukraine overall is shown in **Table 1**.

Table 1. Railway Cargo Transportation Activity: 1996-2000 (million tons)

Index	1996	1997	1998	1999	2000
Railway cargo transportation: Ukraine	296.0	293.0	286.0	284.0	259.0
Railway cargo transportation: Kharkiv Oblast	4.9	4.2	4.2	4.1	3.0

Roadway cargo transportation in Kharkiv Oblast and in Ukraine overall is shown in the **Table 2**.

Table 2. Roadway Cargo Transportation (million tons)

Index	1996	1997	1998	1999	2000
Roadway cargo transportation: Ukraine	104.0	N/A	150.0	125.0	114.6
Roadway cargo transportation: Kharkiv Oblast	11.0	10.0	8.0	6.0	3.8

A decreasing trend in cargo transportation since 1996 can be observed in both Kharkiv Oblast and in Ukraine overall. Kharkiv Oblast's share of railway and roadway cargo transportation is constantly decreasing relative to the total volume of cargo transportation in Ukraine, and currently makes up 1.4%-5.8% on average. In 2000, 3 million tons of cargo were

transported by railway and 4 million tons by roadway in Kharkiv Oblast, which makes up 14.2% and 7.4% of the total volume of cargo transportation respectively, as compared with 1990.

A summary of railway passenger transportation in Kharkiv Oblast and in Ukraine is shown in **Table 3**.

Table 3. Railway Passenger Transportation: 1996-2000 (millions of passengers)

Index	1996	1997	1998	1999	2000
Railway passenger transportation: Ukraine	544	N/A	504	489	245
Railway passenger transportation: Kharkiv Oblast	52	48	48	45	46

Roadway passenger transportation (autos, personal vehicles, buses) in Kharkiv Oblast and Ukraine is shown in **Table 4**.

Table 4. Roadway Passenger Transportation: 1996-2000 (millions of passengers)

Index	1996	1997	1998	1999	2000
Roadway passengers: Ukraine	2,676	2,512	2,415	2,183	1,028
Roadway passengers: Kharkiv Oblast	183	98	105	84	77

As shown in the above tables, a small decrease in the volumes of both road and rail passenger transportation can be observed. This is due to the steady demand for transportation, even in areas with lower standards of living.

Kharkiv Oblast rail passenger transportation volumes during the period 1996-1999 were rather stable, averaging 9.4% of the total volume of passenger transportation in Ukraine, while its share of total roadway passenger transportation averaged 0.49% for the same period. In 2000, these figures increased to 11.8% for railway transportation and 0.75% for motor transportation. However, this increase was the result of a decrease in the overall volume of passenger transportation in Ukraine. In 2000, 46 million people in Kharkiv Oblast used rail transportation and 77 million people made use of motor transportation, which corresponded to 40% and 17% respectively of the total volume of passenger transportation in 1990.

3. Economic Condition of Sector Enterprises and Organizations

The economic crisis that Ukraine is now experiencing has affected the Transportation sector as well. The economic and financial state of sector enterprises and organizations is in many ways determined by the economic and financial activities of other branches of industry, and by the level of demand for transportation services.

The main reasons for the decrease of sector production levels in Kharkiv Oblast have been identified as:

- a high level of deterioration of fixed assets, such as transport facilities
- considerable arrears in payment for transport services
- a low level of competitiveness on the international transportation services market
- decreased demand for cargo transportation services
- persistence of the “privileged passenger” problem: certain privileged groups have the right to travel on public transportation for free, resulting in sector losses of about 1.5 billion UAH annually
- ineffective investment activity

Transportation sector revenues in Kharkiv Oblast for the period 1996-1999 are shown in **Table 5**.

Table 5. Transportation Sector Services and Sales: 1996-1999

Index	1996	1997	1998	1999
Transportation sector revenues (million UAH)	1,630	1,417	2,121	1,111
Transportation sector revenues (million USD)	891	759	866	269

The decrease in Kharkiv Oblast sector revenues is primarily the result of decreased cargo and passenger transport volumes.

Kharkiv Oblast Transportation sector accounts receivable for the period 1997-2000 are shown in **Table 6**.

Table 6. Transport Sector Accounts Receivable: 1997-2000

Index	1997	1998	1999	2000
Transportation sector accounts receivable (million UAH)	1503.1	1887.5	126.1	113.5
Transportation sector accounts receivable (million USD)	807.4	770.6	30.5	20.8

At the end of 2000, Kharkiv Oblast Transportation sector accounts receivable came to 113.5 million UAH, a decrease of 10% in comparison with the same period in 1999. This reduction in income is attributable to a decrease in the number of barter operations.

Kharkiv Oblast Transportation sector accounts payable for the period 1997-2000 are shown in **Table 7**.

Table 7. Transport Sector Accounts Payable: 1997-2000

Index	1997	1998	1999	2000
Transportation sector accounts payable (million UAH)	1523.8	1818.6	609.1	560.4
Transportation sector accounts payable (million USD)	818.5	742.4	147.5	103.0

Sector accounts payable decreased by 8% in 2000 relative to 1999. This improvement was mainly due to the state budget debt payments, payments to the pension fund, and wage debt payments. One of the reasons the Transportation sector is unable to pay off its debts is the loss of approximately 1.5 billion UAH annually resulting from "privileged passengers" who are allowed to travel on public transportation for free.

Kharkiv Oblast Transportation sector profits and losses for the period 1996-2000 are shown in **Table 8**.

Table 8. Kharkiv Oblast Transportation Sector Profit/Loss: 1996-2000

Index	1996	1997	1998	1999	2000
Transportation sector profit/loss (million UAH)	497.0	109.0	758.0	61.0	-33.0
Transportation sector profit/loss (million USD)	271.7	58.6	309.5	14.8	-6.0

This analysis has shown that, in spite of a decreasing trend in both cargo and passenger transportation volumes, sector enterprises remained profitable until 2000.

4-5. Sector Development: Raw Materials and Technological Base

The ability of Transportation sector enterprises to serve any given market depends on the enterprises' material and technical base, which consists mainly of fixed assets. This analysis has shown that the amount of Transportation sector fixed assets in working order is decreasing. Maintenance costs are in turn causing an increase in the overall cost of products, and these rising costs are negatively impacting the sector's profitability. In addition, technical problems and deterioration of physical and supportive infrastructure make the Transportation sector one of the problem areas in foreign economic relations development.

Deterioration of sector fixed assets in Kharkiv Oblast is approximately 60%-70%. This underscores the necessity of renovating the entire material and technical base of the sector, from roads and subsidiary infrastructure (repair workshops and equipment) to movable and motor stock.

6. Investment Activities in the Sector

According to an assessment of the Transportation sector's investment potential conducted by the National Academy of Science of Ukraine, Kharkiv Oblast belongs to a group of regions exhibiting "high" investment attractiveness for domestic investors and "medium" attractiveness for foreign investors, placing third and eleventh, respectively.

In 1999, Ukrainian transportation and road complex enterprises had accumulated capital investments totaling 90 million UAH; this included credits from foreign banks. Eleven investment projects amounting to 1,168,000,000 USD have been submitted to the Ministry of Transport. For the Ukrainian railways development project, 92.6 million USD were received, including 51.8 million USD from the European Bank for Reconstruction and Development, 39.3 million USD from local financing, and 1.43 million USD from the TACIS program.

One important factor which emerged back in the Soviet era, and which could substantially reduce the importance of Kharkiv ground transportation in the future, is the increasing popularity of air transport. Since Kharkiv has not been a stop on major air travel routes, Kharkiv airport has always been of minor importance, in contrast to the importance of its railway stations. Kharkiv airport had no facilities to accommodate large modern jets.

The development of Kharkiv Oblast as a large economic and financial center is impossible without convenient connections to international air centers. Creation of an international airport with the appropriate infrastructure is imperative. In 1995, Kharkiv airport was granted "international" status, and air routes to Italy, Syria, Turkey, and Bulgaria were opened. International travel makes up 90% of the total volume of air transportation.

Construction of a world class international airport in Kharkiv, and the creation of favorable investment opportunities for its development, are problems that require special consideration. The fact that the existing airport has been reconstructed is undoubtedly a step in the right direction; but even after reconstruction, the current Kharkiv airport does not meet the majority of world standards and requirements for international air transport. Under current conditions, railway transport remains more important to the Kharkiv Oblast economy than air transport.

Direct foreign investments (DFI) in the regional economy are shown in **Table 9**.

Table 9. Kharkiv Oblast Transportation Sector DFI: 1998-2000

Enterprises Receiving Investments	Aggregate DFI							
	Total		January 1, 1998		January 1, 1999		January 1, 2000	
	1999	2000	USD	%	USD	%	USD	%
Total	188	185	41,516,040	100.0	51,352,310	100.0	59,461,710	100.0
Transportation	4	4	137.690	0.3	191.690	0.4	137.690	0.2

As shown in Table 9, investments in the Transportation sector, relative to the total volume of investment in Kharkiv Oblast, decreased by 0.2% in 2000 in comparison with 1999. A breakdown of DFI by country is displayed in **Table 10**.

Table 10. Distribution of Kharkiv Oblast Transportation Sector DFI: 1998-2000

	Aggregate Foreign Investments (1000 USD)		
	January 1, 1998	January 1, 1999	January 1, 2000
Luxembourg	0.29	0.29	0.29
Transportation	0.29	0.29	0.29
Germany	3778.63	3629.57	3002.87
Transportation	-	54.00	-
Hungary	1430.55	1633.61	1413.7
Transportation	60.00	60.00	60.00
Israel	711.53	709.18	576.77
Transportation	77.40	77.40	77.46

7. Employment and Personnel Potential in the Sector

The number of persons employed in the Transportation sector in Kharkiv Oblast and in Ukraine overall is shown in **Table 11**.

Table 11. Transportation Sector Employees: 1996-2000 (1000 people)

Index	1996	1997	1998	1999	2000
Sector employees: Ukraine	1,068	991	940	895	823
Sector employees: Kharkiv Oblast	76	69	66	55	50

The decrease in revenues for transportation services has a negative impact on sector employment. In 2000, the number of sector employees in Kharkiv Oblast fell by 34% in comparison with 1996. According to the Ministry of Transportation, the average monthly salary of a railway transportation branch employee at the end of 2000 was 580 UAH in Ukraine, while in Kharkiv Oblast the average monthly salary was 348 UAH. According to this report, railway transportation employees rank 7th in the list of highest salaries.

Employment activity in the Transportation sector is highly dependent upon the professional development of personnel. Sociological research carried out in the Transportation sector discovered the following factors having a negative impact on personnel potential: violations of payment differentiation codes for jobs requiring different skill levels; lack of creativity; decreasing knowledge of economics and marketing; deterioration of working and recreation environments; low levels of mechanization and automation in production; and rising incidence of illness and trauma.

8. Sector Exports

In 2000, Ukraine exported services to more than 150 countries. The total volume exports came to approximately 3.6 billion USD, down 206 million USD from 1999.

The share of transportation services in the total amount of Ukraine exports (goods and services) is approximately 18%, and in the volume of export services alone, it is more than 80%. The value of Kharkiv Oblast transportation services exports and imports for the period 1996-1999 is shown in **Table 12**.

Table 12. Kharkiv Oblast Sector Services Exports and Imports: 1996-1999

Index	1996	1997	1998	1999
Transportation services export	6.7	4.2	4.1	12.5
Transportation services import	19.0	25.4	39.2	28.6

As shown in Table 12, there is a definite trend in decreasing imports and increasing exports for the period. However, as a border oblast, Kharkiv is far from taking full advantage of its export potential, owing primarily to the isolationist policy that emerged after the collapse of the Soviet Union. This isolationism is the underlying cause of the creation of customs barriers between Ukraine and Russia. Since 1990, the amount of Russian exports traveling through Ukrainian territory has decreased by almost 500%. The problem for Kharkiv Oblast, as a railway junction, is that if there are no quick and radical improvements in Ukrainian-Russian relations, a full rerouting of the railway and motor transportation between the center of Russia and its southern regions to bypass Kharkiv will only be a matter of time.

According to a number of international agreements that have been adopted, the main factors hampering development of the export of transportation services and connections are:

- local taxes on transit through the country
- low level of domestic transport competitiveness
- substandard transportation services
- poor organization of services

Improving Ukraine customs control procedures and decreasing taxes on foreign transporters would aid the development of Ukraine's international cargo and passenger transportation services. According to the Ukrainian legislation, the provisions of intergovernmental agreements ratified by the Verkhovna Rada of Ukraine take precedence over national legislation on taxation. Accordingly, the Ministry of Transportation of Ukraine submitted for ratification four intergovernmental agreements on international motor transport, as well as a number of plans for its development. This legislation exempts international transporters from taxes and requisition payments on Ukraine territory when transporting passengers or cargo under the adopted international agreements.

9. Competitive Environment of Sector Enterprises and Organizations

Some competitive trends among the various modes of transportation can be seen in the Kharkiv Oblast transport services market. Motor transportation is the current leader, with a growing share of important export and import transportation business. In today's market, railways must attract customers with promises of high quality service; for this reason, increasing the competitiveness of railway transport is an issue of vital importance. Currently, motorized transportation vehicles such as buses are competing successfully with railways due to better services. Maintaining and increasing transport volumes of expensive cargo will require introduction of intermodal (mixed) transportation, which in turn would require additional capital investment.

The present competitive environment was caused primarily by the privatization process, which resulted in the creation of a number of small and medium enterprises; competition between privately-owned enterprises as well as among private- and state-owned enterprises is another factor.

10. Ownership in the Sector

Motor transportation has been affected by privatization more than any other mode of transport. To date, 93% of enterprises are privatized, 3% more than in 1999. According to the program of privatization for 2000-2001, the Ministry of Transportation has scheduled 514 entities for privatization; 493 of these have already started the privatization process.

Kharkiv Oblast's road maintenance and construction enterprises have remained state property because they belong to a list of entities that are not subject to privatization. Issues of shares for the public joint-stock venture "Aviakontrol", the Kharkiv state company "Universal Avia", and the Kharkiv Railway Carriage Repair Works, are being planned in Kharkiv for the near future.

11. SME Growth in the Sector

Because Southern Railways is a State monopoly, the creation of small and medium transport enterprises as a result of the privatization process has mostly been limited to the motor transportation branch. The number of small enterprises (less than 25 employees) active in the Transportation sector during 1998-1999 is shown in **Table 13**. Transportation sector SMEs increased by 13.7% (183 enterprises) in 1999 in comparison with 1998.

Table 13. Kharkiv Oblast Transport Sector SMEs: 1998-1999

	Number of SMEs			
	1998		1999	
	Units	%	Units	%
Kharkiv Oblast (all sectors)	11,172	100.0%	11,686	100.0%
Transport	158	1.4%	183	1.6%

The value of services produced by sector SMEs for the period 1998-1999 is shown in **Table 14**. [9]

Table 14. Value of Services Produced by Kharkiv Oblast SMEs: 1998-1999

Volume of Service Production (without VAT, excise) 1999 Prices (1000 UAH)				
	1998		1999	
	Production	Sales	Production	Sales
Kharkiv Oblast (all sectors)	631,922.3	1,924,681.6	922,296.1	3,628,884.0
Transport	11,047.9	20,833.6	22,668.1	24,047.5

Sector SME share in the total volume of production and sales of all Kharkiv Oblast enterprises is shown in **Table 15**.

Table 15. SME Share in Total Production/Sales Volumes, all Kharkiv Oblast Enterprises (%)

	Production		Sales	
	1999	1998	1999	1998
SMEs, all sectors	9.3%	6.1%	21.6%	13.4%
SMEs, Transportation sector	2.3%	0.6%	2.4%	1.2%

The value of services rendered by sector SMEs in 1999 increased by 13.4% in comparison with 1998, amounting to 24,047,500 UAH. In general, the future potential of sector SMEs can be regarded as positive.

12. Sector Infrastructure

Transportation sector infrastructure consists of:

- **Research Institutes.** In Kharkiv Oblast, the “Khardiprotrans” development institute carries out transportation research and design (railways, roads, stations, etc.).
- **Institutions of Higher Education.** In Kharkiv Oblast, these include the Kharkiv State Academy of Railway Transport and the Kharkiv Road Transport Academy.
- **Transport Equipment Manufacturers.**
- **Road Repair Organizations.**

There is no one organization in Kharkiv Oblast that performs specialized sector analysis. Useful measurements would include systematic forecasts of transit transportation, freight flow studies, and development of tariffs and other economic, technical, and organizational measures to improve the transportation system. There are branch institutes capable of performing such tasks, but they are in need of financing.

13. Management Capabilities of Sector Enterprises and Organizations

The state of sector management can generally be assessed as unsatisfactory. State enterprises are still being operated according to outmoded management principles. Modern approaches to labor activity organization and enterprise management are not supported by top officials, who are used to working under the old Soviet centralized planning system. Private motor transport enterprises prevail in competition with state enterprises primarily because they have improved service in cargo and passenger transportation.

14. Administrative Impact on the Sector

Since the majority of Transportation sector enterprises and organizations are state-owned, their development is dependent on the government. Currently, the Cabinet of Ministers of Ukraine is examining a number of proposals regarding the creation of a national committee on transportation regulation. The committee would have the tasks of regulating relations between entities in the transportation services market, promoting competition to remove obstacles and barriers that prevent potential competitors from entering the market, and eradicating discrimination.

At the end of 2000, the Cabinet of Ministers launched the state program for development of a transportation road complex in Ukraine for the years 2001-2004. Funding for the program will total 40 billion UAH. Funds from local and state budgets totaling 15 billion UAH will be used for road modernization and maintenance, purchasing train cars, and as compensation for losses from the transportation of privileged passengers. [11]

The plan for railway development in Ukraine in 2000-2004 provides for a structural reform of railway transportation, to include the following measures:

- reorganization of the state regulation of tariffs on railway transportation.
- creation of an appropriate legislative basis, and division of the state and economic functions in the railway transportation system.
- separation of the monopolistic, competitive, and potentially competitive branches in the railway transportation system; strengthening of state regulation of the remaining monopolistic branches.
- giving all potential transport entities non-discriminative access to railway transport production infrastructure; forming passenger and cargo transportation companies within the framework of the competitive sector.

15. Social Issues of Sector Development

The Transportation sector is one of the sectors that adversely affect the ecological situation in the region. The primary method of compensation for the negative ecological impact caused by transportation is the taxation of carrier owners. Local authorities also introduce requisitions on vehicle parking, passage through oblast territory, and pollution in an attempt to mitigate the problem.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

One of the largest business projects for the Kharkiv Oblast Transportation sector is the proposed reconstruction of the existing Kharkiv airport to transform it into an international facility. Project tasks include construction of:

- a 3,800 m runway
- two terminals
- a hotel conforming to international standards
- technical and service areas
- an engineering network

A total investment of 200 million USD will be required to complete the project. This work has not yet been fully completed due to a lack of funds.

A list of other investment proposals is shown in **Table 16**.

Table 16. Kharkiv Oblast Transport Sector Investment Proposals

Enterprise	Project	Investment Focus	Project value USD
State enterprise "Kharkiv Motor Repair Works"	Manufacturing of city buses	City buses	5,000,000
Private joint-stock company "Khimautomatika"	Creation of gas analyzing systems for highly explosive gas control used in transportation vehicles	Signaling devices	2,000,000
Merefa Mechanical Works	Production of modern vehicles with the carrying capacity of 1.5 tons, vans with capacity of 10 passengers	Trucks and vans	1,500,000
Private joint stock company "Energiya"	Joint enterprise engaged in vehicle assembly	Vehicle assembly	300,000,000
Kharkiv State Aircraft Works	Production of the An-140 aircraft	An-140 aircraft	230,000,000

Conclusions

In Ukraine overall, and in Kharkiv Oblast in particular, establishing a modern transportation system on the level of European standards depends on a number of prerequisite conditions, including:

- a thorough technical renovation of the sector and far-reaching organizational changes
- advanced scientific and technical research
- favorable climatic and geographical characteristics
- a sufficient number of competitive scientific and technical projects developed and ready for implementation

In spite of the economic crisis, the Ukraine Transportation sector, including that of Kharkiv Oblast, has good potential for development. The National Academy of Science has projected 150% growth in the sector over the next 15 years, while

some western analysts have estimated growth at 200% over the next ten years. The main conclusion of these forecasts is that it is necessary to prepare for this growth now, using existing resources as much as possible.

In conclusion, it should be emphasized that pursuing a policy of structural change for the Kharkiv Oblast Transportation sector is essential. Such a policy will increase sector effectiveness, solve the current transportation and transit problems, and attract both domestic and foreign investments. First steps in this effort include raising the competitiveness of sector organizations by means of state support; improving taxation, customs, and tariff policy; and continuing the privatization process.

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List of Main Enterprises and Organizations of the Sector

Enterprise Name	Address	Telephone No.		Products and services	Directors
Truck transportation company ? 16348	313020 Novoselivka, Dzerjinska Str 237	+38 (05740)	22646	transportation of cargo, transportation of passengers	Lunin Gr. Ivan
Truck transportation Company ? 16357	310038 Kharkiv, Avtostradna Str 154	+38 (0572)	260107 260169	carriage by roads	Kulbech I. Volodimir
Truck transportation Company ? 2063	313020 Nova Vodolaga, Kharkiv Str 144 ?	+38 (05740)	22542 22697	transportation of cargo	Hilchenko T. Vasiliij
State owned company "Southern Railway"	310052 Kharkiv, Chervonoarmejskaya Str 7,	+38 (0572)	204406 234720	transportation of cargo, transportation of passengers	Kruchkov M. Oleg
State owned company "Kharkivautotrans"	310035 Kharkiv, Gagarina Ave 129	+38 (0572)	275991	transportation of cargo and public conveyance, carriage of petroleum products	Kuchkov O. Mihajlovich
OJSC Kharkiv truck transportation company ? 16355,	310052. Kharkiv, Izmajlivska Str 11 a	+38 (0572)	128973 129127	transportation of cargo, training of drivers, brokering, maintenance of motor transport	Tkachenko Vasiliij
Kharkiv Subway	310012 Kharkiv, Engelsa Str 29	+38 (0572)	237406 232141	service, transportation	Isaev O. Leonid

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

11. INFORMATION SERVICES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Communications and information services are not the most significant business sectors in the Kharkiv Region. Their market share did not exceed 2% in 1996-1999.

However, the role of the communications and the information/data processing sector has dramatically increased in the past ten years, due to an increased demand for these services. This has led to development of technologies, growth of competition, development of management, and an increase in the number of enterprises.

All segments of the telecommunications market, including public national telephone and postal companies, mobile communications, TV and radio broadcasting, paging and Internet services, and information/data processing service companies, are represented in Kharkiv Oblast. Total output of all sector enterprises amounts to about 1% of the gross output of goods and services in Kharkiv Oblast.

These indicators of the Kharkiv Oblast communication sector, when compared with the whole of Ukraine, suggest that Kharkiv Oblast has one of the most developed telecommunication markets in the nation. Kharkiv Oblast ranks fifth in Ukraine in terms of income from telecommunication services (about 5%). More than 40% of income is generated by Kyiv.

The sector's financial indicators are also positive. Average profitability during 1996-2000 was 41.5%. In addition, the sector experienced a significant improvement in accounts receivable/accounts payable in 1999.

Other important points include:

- The overall condition of fixed assets is less than optimal. However, a good deal of communications equipment is currently being modernized.
- Modernization of the technological base is one of the sector's key investment areas.
- In spite of the investments already made, the sector's growth potential is fairly large. The most appropriate projects for investment are those that are both useful and cost-effective.
- Employment in the sector has remained stable. It should be noted, however, that with the emergence of a great number of small- and medium-sized businesses, employment figures have increased.

The recent growth and development of the telecommunications sector in Kharkiv Oblast has made the market attractive for national and foreign companies. This in turn enhances competition, and requires an increase in the services being delivered. For example, while Ukrtelecom currently has an 82% share of the number of installed telephones, private telephone companies are experiencing significant growth. The fiercest competition is in the Internet services and mobile communications markets, which are occupied by a large number of small- and medium-sized businesses.

In spite of this economic activity, however, the Ukraine and Kharkiv Oblast telecommunications sector is significantly behind, not only economically developed countries in the west, but Poland as well.

1. Sector Role in the Kharkiv Oblast Economy

The sector is characterized by two branches or subsectors: communications, including the postal service; and informational and data processing services.

The Kharkiv Oblast communications sector includes:

- Ukrtelecom
- a number of Ukrpochta national association member enterprises
- three of Ukraine's five cellular companies
- more than 10 Internet service providers
- regional and national TV and radio broadcasting companies
- cable TV companies

Kharkiv Oblast also has a great number of small- and medium-size businesses in the field of information services and mobile communications.

Communication (subsector of information services)

The sector's share of the total Kharkiv Oblast economy is approximately 1%.

Table 1. Communications Sector Share of Total Kharkiv Oblast Goods and Services: 1996-1999

Output—Goods and Services	1996	1997	1998
Communications sector—Kharkiv Oblast (million UAH)	93.0	128.0	144.2
Communications sector—Kharkiv Oblast (million USD)	50.8	68.8	58.9
Total output of goods and services—Kharkiv Oblast (million UAH)	9.95	12.01	13,30
Total output of goods and services—Kharkiv Oblast (million USD)	5.43	6.45	5.42
Sector share of total Kharkiv Oblast economy (%)	0.93%	1.07%	1.08%

Table 2. Key Indicators of Communications Sector Development in Kharkiv Oblast

Indicator	1990	1995	1996	1997	1998	1999
Income from key communication enterprise activity (million UAH)	118.0	5931.1	125.3	151.8	210.0	257.3
Basic telephone sets in general subscribers' network (1000 units)	401.5	469.0	481.0	496.6	512.3	544.4

Source: Kharkiv Oblast State Statistical Committee.

Information and Data Processing Services

Table 3. Share of Information and Data Processing Enterprises Subsector in Total Kharkiv Oblast Economy: 1996-1999

Output—Goods and Services	1996	1997	1998
Information services subsector—Kharkiv Oblast (million UAH)			8.98
Information services subsector—Kharkiv Oblast (million USD)			3.7
Total output of goods and services—Kharkiv Oblast (million UAH)	9.95	12.1	13.30
Total output of goods and services—Kharkiv Oblast (million USD)	5.43	6.45	5.2
Subsector share of total Kharkiv Oblast economy (%)			0.068%

2. Strength of Kharkiv Oblast Sector

Kharkiv Region market

Kharkiv Oblast communication and information/data processing enterprises more or less monopolize the regional market.

Economic activity by companies of all forms of ownership in 1999 totaled 257 million UAH, including 113 million UAH (44%) worth of goods and services delivered to the public. Trunk and city telephone communication services accounted for the greatest share of this total (57%), while postal services accounted for only 10%. Income for services delivered by increased by 14% in relative prices compared with 1998.

In addition, 28,000 home telephone sets were installed in the region in 1999; and mobile and computer communications are developing at a steady pace.

Performance of the public postal service has been steadily declining for the past ten years. Thus, relative to 1990, the number of letters has decreased by 66%; telegrams by 600%; parcels by 800%; and subscriptions to newspapers and magazines are only 3% of the 1990 level.

Table 4. Kharkiv Oblast Communications Sector Key Indicators—Telephone Services: 1995-1999 vs. 1990

Indicator	1990	1995	1996	1997	1998	1999
	MIn KRB	MIn KRB	MIn UAH	MIn UAH	MIn UAH	MIn UAH
Trunk telephone calls	43.4	43.6	37.0	41.2	45.2	41.1
Income from key enterprise business activities	118.0	5,931.1	125.3	151.8	210.0	257.3
Sector share of total services delivered to public	41.6%	25.9%	27.2%	33.4%	41.2%	44.0%
Means of communication (1000 units)						
Public telephone sets	401.5	469.0	481.0	496.6	512.3	544.4
▪ city subscribers	359.3	418.7	429.1	443.3	457.3	489.3
▪ rural subscribers	42.2	50.3	51.9	53.3	55.0	55.1

Source: Kharkiv Oblast State Statistical Committee.

Table 5. Kharkiv Oblast Communications Sector Key Indicators—Postal Services: 1995-1999 vs. 1990

Indicator	1990	1995	1996	1997	1998	1999
Products and communication services (million units dispatched)						
▪ newspapers and magazines	1,019.7	55.5	41.0	34.1	40.4	31.8
▪ letters	89.2	33.7	31.0	32.8	31.7	29.0
▪ telegrams	4.0	1.4	1.1	0.9	0.8	0.7
▪ parcels	3.2	0.2	0.1	0.3	0.2	0.4

Source: Kharkiv Oblast State Statistical Committee.

Table 6. Ukraine Communications Services Income: 2000

Service	Total Income Svc Delivery	Total Svcs Delivery to population	Total Income Svc Delivery	Total Svcs Delivery to population
	(Million UAH)	(Million UAH)	(%)	(%)
Mail	33.7	9.8	10.5	6.4
Telegraph	2.1	1.2	0.7	0.8
City telephone	100.9	55.5	31.6	36.2
Rural telephone	8.2	4.4	2.6	2.9
Trunk telephone	161.7	78.4	50.6	51.2
Wire broadcasting	4.5	3.3	1.4	2.2
Special and Field				
Communication	1.3	-	0.4	-
Transmission/Reception of Broadcast TV/Radio Programs				
Radio communication	4.8	-	1.5	-
State Electrical				
Communication inspection	0.9	0.03	0.3	0.02
Satellite	-	-	-	-
Computer	0.7	0.2	0.2	0.1
Mobile (including Paging)	0.7	0.3	0.2	0.2
Total	319.5	153.1	100.0	100.0

Source: Kharkiv Oblast State Statistical Committee.

Ukraine Market

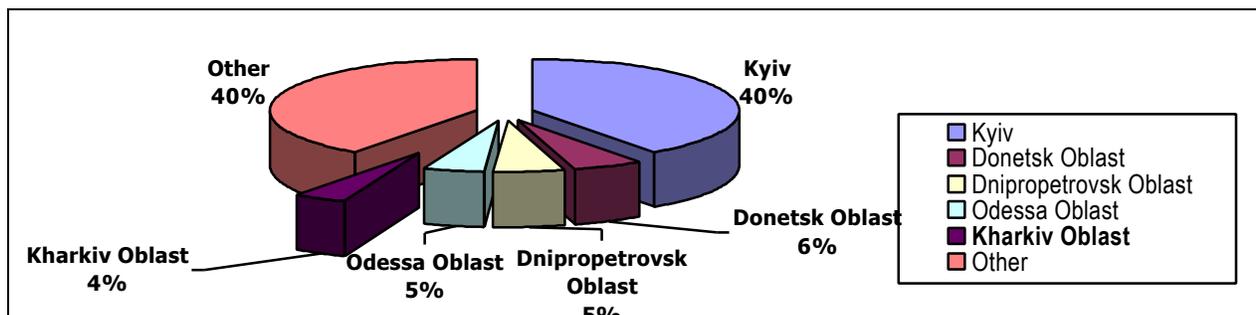
Kharkiv Oblast communications enterprises rank fifth in Ukraine, after Kyiv, Donetsk, Dnepropetrovsk, and Odessa oblasts.

Table 7. Communication Enterprise Service Delivery Income: 2000 (1000 UAH)

Region	Income			Rate of Growth (Decrease)		
	1000 UAH			vs. 1999 (%)		
	To Public	To Companies	Total	To Public	To Companies	Total
Aut. Rep. of Crimea	125,915.2	101,889.5	227,804.7	139.3	106.3	122.3
Vinnitska	54,986.6	60,893.4	115,880	125.0	106.4	114.5
Volynska	38,791	34,846.1	73,637.1	137.7	139.6	138.6
Dnipropetrovska	191,513.1	20,1884.6	393,397.7	128.1	113.6	120.2
Donetska	182,033.8	229,255.4	411,289.2	132.5	131.8	132.1
Zhytomirska	48,422.4	49,258.6	97,681	126.7	106.9	115.9
Zakarpatska	52,091.9	38,453	90,544.9	133.9	125.1	130.0
Zaporizhska	99,540.9	92,215.4	191,756.3	133.3	130.3	131.8
Ivano-Frankivska	49,918.3	49,235.1	99,153.4	125.7	115.9	120.6
Kyivska	54,921.7	69,702.9	124,624.6	121.5	90.7	102.1
Kirovohradska	46,093.2	39,313.1	85,406.3	130.5	107.9	119.0
Luhanska	106,841.8	81,026.1	187,867.9	129.8	120.3	125.5
Lvivska	148,266.8	116,340.4	264,607.2	134.2	123.3	129.2
Mykolaivska	55,171.5	50,694.2	105,865.7	129.9	123.3	126.7
Odeska	174,349.7	180,153.2	354,502.9	133.0	124.9	128.8
Poltavska	83,957.6	74,161.3	158,118.9	138.0	125.4	131.8
Rivnenska	37188.4	38,330.2	75,518.6	132.4	128.6	130.4
Sumska	41,563.2	45,403.6	86,966.8	138.6	125.7	131.6
Ternopil'ska	44,993.5	35,587.4	80,580.9	139.0	134.7	137.1
Kharkiv'ska	151,336.5	164,184.8	315,521.3	133.6	114.0	122.6
Kherson'ska	46,325.1	45,460.2	91,785.3	131.1	132.1	131.6
Khmel'nitska	60,095.2	47378,3	107,473.5	132.7	134.3	133.4
Cherkaska	65,468.8	55,566.3	121,035.1	131.2	129.9	130.6
Chernivetska	57,602.6	30,997.9	88,600.5	137.1	129.8	134.4
Chernihiv'ska	56986,4	47,887.3	104,873.7	139.7	126.9	132.6
Kyiv	1,005,290.3	1,958,594.1	2,963,884.4	137.5	150.5	145.8
Sebastopol	35,549.4	23,405.6	58,955	125.4	150.0	134.1
Total for Ukraine:	3,115,214.9	3,962,118	7,077,332.9	134.0	133.5	133.7

Note. The total data are given for enterprises of all forms of ownership. Reported by the Main Interregional Information Center of the State Statistical Committee.

Diagram 1. Communication Enterprise Service Delivery Income by Oblast: 2000 (%)



Source: State Committee for Communication of Ukraine.

CIS Market

Ukraine ranks sixth in communication development among the former republics of the USSR, according to key indicators.

World Market

“Telesens Ukraina” is one of Kharkiv Oblast’s communication and information data processing enterprises with a presence in the world market. It develops software for the telecommunications industry.

3. Economic Condition of Sector Enterprises and Organizations

Communication

Table 8. Sector Sales: 1996-1998 (million UAH)

	1996	1997	1998	2000
Total sector sales—Kharkiv Oblast	112.5	148.2	173.4	319.5

Source: State Statistical Committee.

Diagram 2. Sector Sales: 1996-1998 (million UAH)

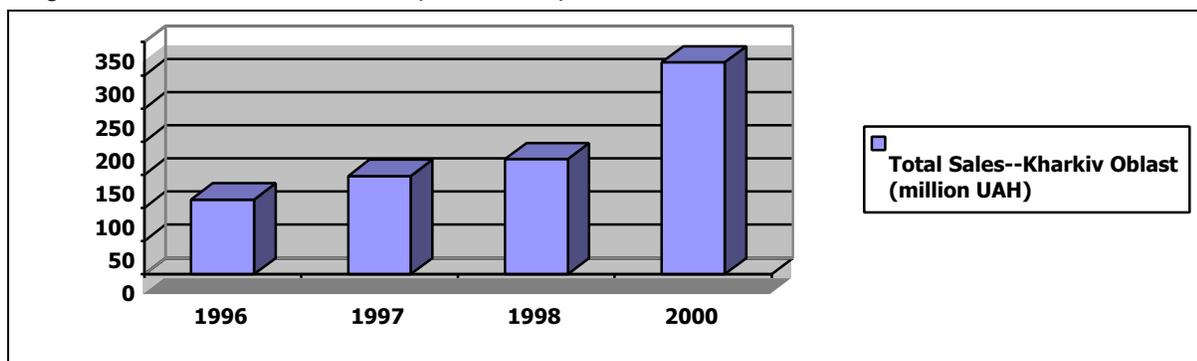
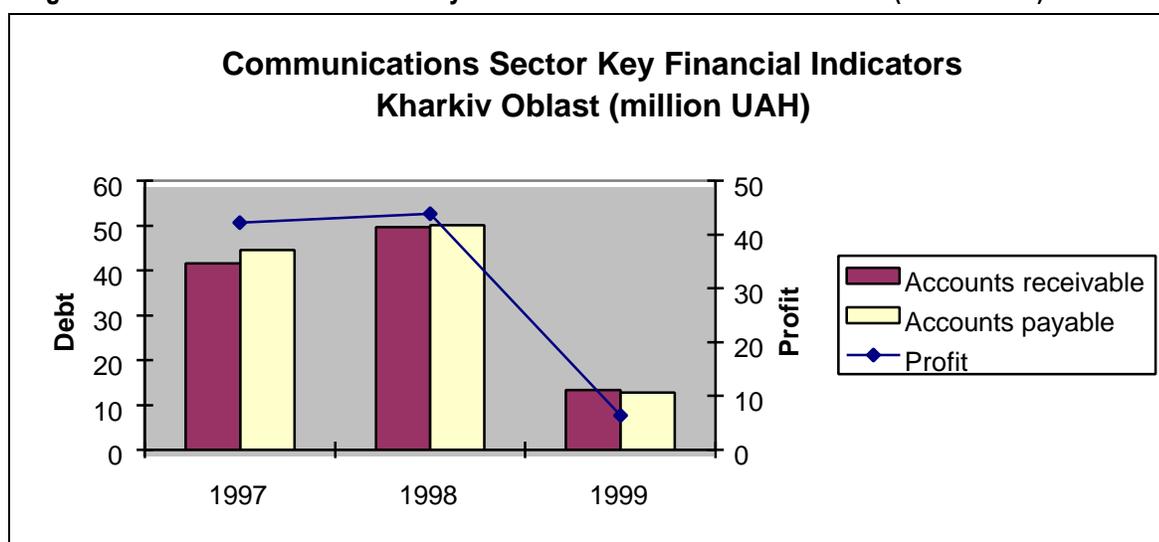


Table 9. Communications Sector Key Financial indicators—Kharkiv Oblast (million UAH)

	1997	1998	1999
Profit	42.2	43.9	6.4
Accounts receivable	41.5	49.6	13.4
Accounts payable	44.5	50.1	12.7

Diagram 3. Communications Sector Key Financial indicators—Kharkiv Oblast (million UAH)

Total economic activity for Kharkiv Oblast sector enterprises in 2000 was approximately 9,040,000 UAH. Four companies achieved net earnings (57% of the total number of companies). Total profits were 9,284,000 UAH. Three companies (43% of the total) were unprofitable. Total losses experienced by these companies were 244,000 UAH. There is no debt to the national or regional budgets, and no arrears in payment of wages at core business companies.

Table 10. Kharkiv Oblast Sector Enterprise Profitability (%)

	1993	1994	1995	1996	1997	1998	1999	2000
Profitability	16.5	41.6	56.2	34.9	31.5	49.8	42.3	48.8

Source: State Statistical Committee.

The State Committee for Communication is a special regulative body in Ukraine that controls the sector.

Table 11. State Committee for Communication Key Indicators of Activity: 2000

Indicators	Unit	Branch Total	Growth since 1999
Volume of communication services delivered	Million UAH	7,077.3	133.7
To the public	Million UAH	2,588.2	126.9
Including:			
▪ state enterprises	Million UAH	3,990.6	124.5
▪ joint ventures set up with participation of Ukrtelecom	Million UAH	2,003.3	136.4
▪ other operators of non-state form of ownership		1,083.4	175.3
Balance profit (under accountancy conditions of 1999)	Million UAH	1,050.0	138.0
Payments to the budget	Million UAH	1,318.4	120.0
Including:			
▪ state enterprises	Million UAH	810.1	109.8
▪ joint ventures set up with participation of Ukrtelecom	Million UAH	444.6	145.1
▪ other operators of non-state forms of ownership	Million UAH	63.7	116.2
Paid to the budget for issuance of licenses for business activities and using radio frequencies	Million UAH	95.8	X
Contributions to the pension fund with account of JVs and other operators	Million UAH	291.4	131.7
Receivables for communication services as of 01.01.01	Million UAH	615.3	110.7
Commissioning equipment :			
▪ automatic exchanges – total	1000 units	279.0	103.4
▪ including OJSC “Ukrtelecom”	1000 units	225.0	102.5
▪ non-state operators	1000 units	54.0	107.6
▪ radio broadcasting lines	Km	75.6	?
▪ trunk communication line cables	Km	904.0	?
▪ new and reconstructed communication facilities	units	35	?

Information and Data Processing Services

Table 12. Sales Information Services Sector—Kharkiv Oblast: 1996-1998 (million UAH)

	1996	1997	1998
Total sector sales—Kharkiv Oblast	0.829	0.577	4.193

Source: State Statistical Committee.

As of 1 January 1999, the value of total sector exports was 0.050 million USD. The value of total imports as of January 1, 2000 was 0.388 million USD. Total internal investments as of January 1, 1999 were 0.3 million UAH.

4. Sector Development: Raw Materials Base

Electricity (energy for data transmission), equipment (varies with each subsector), and data and information for transmission may be considered the “raw materials base” for the information and data processing sector. However, these categories do not have a significant impact on the sector.

5. Sector Development: Technological Base

At the beginning of the '90s, the communications industry in Ukraine, and in all of the former USSR, was significantly behind the developed countries of the west, in terms of both the technology base and in the capability of meeting demand for communications services. Telecommunications equipment was obsolete, and only metal cable trunk communication lines were in place. The value of fixed assets for the period 1997-1999 is shown in **Table 13**.

Table 13. Sector Fixed Assets—Kharkiv Oblast: 1997-1998 (million UAH)

	1997	1998	1999
Value of Fixed Assets (as of period end)	228.6	232.8	25.9

Source: State Statistical Committee.

Communications sector equipment has experienced varying degrees of deterioration. For example, mobile communications, Internet, and IP-telephony equipment is in better condition than wire telephone lines.

Among the problems that make it difficult to service public telephone networks are post-warranty repair and software support of such large switching systems as EWSD, 5ESS, S2000 and DTS 3100. At present, this issue has not been fully resolved.

Further development of telephone networks will require improvement of their circuitry and design principles. Prospective network designs will require unification, and optimization of digital-analog connections. In open market conditions, the primary task in implementing such designs will be to create gateway servers for interconnection of different operators. Networks will also have to be adapted to the 7-digit telephone numbering system for compatibility with internal zone exchange protocols.

Sector enterprises, including a number in Kharkiv Oblast, have introduced a number of technological innovations. The International Center for Communications (ICC) in Kharkiv has launched a program for transferring calls between Ukraine and the CIS countries using digital channels. 575 analog channels between Ukraine and Russia have been superseded since the ICC began this program.

6. Investment Activities in the Sector

The problem of modernizing the Ukraine public telephone network is critical. Because of the number of operators working in this sector, existing networks are being pushed beyond their capacity. This is especially true of Internet services providers whose activities, on the one hand, stimulate development of local telephone networks, but at the same time lower the quality of current service delivery as a result of network overloads.

According to experts' estimates, modernization of the information systems infrastructure for countries of the former Eastern bloc will require some 500 projects with a total cost of some 25 million USD. In addition, there are a number of cost-intensive projects in Ukraine alone. One of the most important investment projects currently under consideration is the laying of optical fiber cables over the entire territory of Ukraine, which is estimated at approximately 80 million USD. In addition, implementation of the "school program" for up to 135,000 Ukraine secondary schools could reach 175 million USD.

The level of development of the telecommunications sector depends directly on the amount of investment it can attract. According to the International Union for Electric Communication, developed countries reinvest about 20% of income generated in this branch each year, while developing countries average about 31%, and underdeveloped countries 68.5%. The current state of the Ukraine telecommunications sector can be partially explained by the fact that annual reinvestment is only 18.1% of sector income, while in Poland, for example, reinvestment is 41.2%.

Ukraine is significantly behind other countries in the area of digital communications infrastructure, including the amount of fiber optical cables laid. Many key areas still rely on copper core cables, and there are practically no intelligent (high technology) or ??? networks.

There are two schools of thought on how to bring Ukraine telecommunications up to the level of developed countries. The first is to use cheaper but rather outdated technologies (quantity over quality). The second is to use more expensive but up-to-date technologies (quality over quantity). Obviously, the situation calls for a reasonable tradeoff, to be determined by a regulating body with the vision and the ability to adequately forecast future requirements.

So far in the history of the telecommunications industry, there have been three main stages of technological development: analog systems and networks, digital systems, and batch communications. At present, the world is experiencing huge growth in the realm of digital information. If the annual growth of voice communication is 5%, annual growth of data transmission can be placed at 300%. Data transmission volumes in the US will equal voice communication sometime during 2000-2001, and in Europe in 2003-2004.

It is difficult to predict when data transmission volumes will match those of voice communications in Ukraine. In some cases, the country will have to jump from analog communications directly to batch communications. Currently, the number of Internet users is increasing by 10% a month, while mobile communications are increasing by 30% annually. Due to current trend in global integration, national operator Ukrtelecom would do well to have strategic partners in Europe, North America, and Asia; and Ukraine should enter one of the global telecommunications associations.

Ways of Attracting Investment

There are several ways to attract investment in the telecommunications sector. The safest and most effective way is to establish joint ventures. Creating concessions, as in Hungary, may result in loss of control of the telecommunications system. Attracting excessive credit is also dangerous, as evidenced by the experience of the Russian telecommunications industry, which failed to cover large quantities of attracted credit, which could lead to the bankruptcy of a number of telecommunication companies there. The national government must take a lead role in this effort, since prudent planning and stable legislation are needed to attract the level of investment required.

7. Employment and Personnel Potential in the Sector

Sector employment increased in 2000. The growth rate for October-November was 100.3%; total sector employees was 16,350 in October, and 16,399 in November. Average monthly wage was 325.90 UAH in October and 352.98 in November, a growth rate of 108.1%. Key employment indicators are shown in **Table 14**.

Table 14. Communication Sector Employment—Kharkiv Oblast: 1995-1999 vs. 1990 (1000 People)

	1990	1995	1997	1998	1999
Employees	18.1	15.1	14.8	15.0	16.6

Source: Kharkiv Oblast State Statistical Committee.

8. Sector Exports

The dynamics of Ukrtelecom's export/import volumes currently show a positive trend. As of January 1, 2000, a stable balance of mutual payments with operators in other countries had been achieved.

In 1999, financial indicators for Ukraine's communication sector showed the following:

Table 15. Communications Sector Balance of Trade: 1999

Activity	Million USD
Total exports	99.7
▪ to CIS and Baltic States	65
▪ to other countries	34
Total imports	117.4
▪ from CIS and Baltic States	70
▪ from other countries	47

9. Competitive Environment of Sector Enterprises and Organizations

Kharkiv Oblast and Ukraine Market

Ukrpost

Ukrpost, the state postal service, is represented by subsidiaries at the oblast level. Kharkiv Ukrpost consists of the Kharkiv central post office, 27 signal office centers, and 853 post offices. Total employees are approximately 6,000.

Ukrpost's services are constantly expanding. Besides traditional postal service, it provides more than 60 other types of services to Kharkiv Oblast inhabitants, including advertisement delivery, retail sales, newspaper delivery, lottery ticket sales, bill payment collection, copy services, and delivery of mail order goods.

Ukrtelecom

Ukrtelecom, the national/international telephone wire communications enterprise, consists of 30 functioning subsidiaries. 27 of these are regional offices, including one in Kharkiv Oblast.

Ukrtelecom now provides Internet connectivity to practically all regions of Ukraine. Services include:

- Access through switched lines
- Electronic mail (subscribers receive an electronic mail address and mail box)
- Teleconferencing (subscribers receive access to the server of teleconferences, where they can subscribe to different news groups)
- Collective usage center services featuring computers connected to the Internet

Telephone Market

Ukrtelecom currently has an 82% share of the number of installed telephones. In spite of a substantial number of licenses issued to local telephone service providers, Ukrtelecom still maintains 80-85% of the local telephone market share.

Table 16. Communication Services Consumption in Ukraine: 2000

Operators	Profits from Service to Population (million UAH)	Per Capita Consumption (UAH)
Enterprises and joint stock companies in the sphere of management of State communication department	1797.0	36.16
Joint ventures created with Ukrtelecom participation	791.2	15.92
Other operators	527.0	10.60
Total in 2000 :	3115.2	62.68
Total in 1999.:	2314.1	46.56

Source: State Communication Department of Ukraine.

Ukrainian Market—Internet

According to data provided by the Lucky Net company, the Ukraine Internet market is mainly concentrated in the large industrial centers: Kiev (76%), Odessa (>5%), Dnipropetrovsk (>5%), Donetsk (>3%), Lviv (>3%), Zaporizhzhya (>1%) and Poltava (~1%). Total for all other oblasts is approximately 9%. Total turnover of the ISP market in Ukraine is estimated at 25 million USD annually (market capital = 20 million USD). According to Lucky Net, the share of Internet services in total sector profits occupies last place, at 2.65%. However, the State Communication Department has stated that these figures may be nearer 90-94 million USD annually.

In 1998, there were approximately 100 ISPs in Ukraine; by 1999, the number had increased to more than 2000. Due to increasing saturation, growth began to slow during 2000, and currently there are about 270 ISPs in Ukraine. It is expected that the industry will continue to grow at a slower rate; by the end of 2001, it is estimated that there will be a total of approximately 350 ISPs in Ukraine.

According to Lucky Net, in 1998, there were approximately 30,000 ISP subscribers in Ukraine in 1998; in 1999, the number had increased to over 200,000. The number of current regular users is estimated at about 370,000. The slowdown also expected to affect this area also, with total users by the end of 2000 estimated at 465,000.

Also according to Lucky Net, the average cost of dial-up Internet connectivity decreased almost by 72% in 2000 relative to 1999. Average cost per minute decreased by 48.7% for daytime use, and by 38.5% for nighttime use. The price for unlimited access decreased by an average of 35%.

CIS market

Ukraine is in third place in the CIS countries, after Belarus and Russia, in terms of average increase in telephone service per 1000 people. However, the demand for telephone service in Ukraine is far from being satisfied. Currently, 2.7 million people are still waiting for telephones; average waiting period is seven years.

World Market

Ukraine lies directly in the way of several key transit routes between Europe and Asia. This partially explains Ukrainian involvement in many of the telecommunication projects in that area, including: ???, TEL, TAE, BSFOCS. In spite of this favorable geographical position, however, overall development of Ukraine telecommunications is behind, not only that of the developed countries, but of neighboring Poland as well.

Table 17. Telecommunications Sector Development Indices

Index	Developed Countries	Ukraine	Poland
Telephone density (number of telephones per 100 inhabitants)	60	20	24.6
Internet usage (% of population)	15	1	5
Mobile communication (telephones per 100 inhabitants)	30	0.3	7.5
Intercity/international conversations		Five times less than in Poland	
Communication services cost per capita	\$540	\$20.6	\$65.7

10. Ownership in the Sector

Most Ukrainian communication enterprises are collectively owned (55.4%). However, the state is still a leading presence in the telecommunications sector, holding as it does a virtual monopoly over mail services (98.9%), as well as the majority of telegraph service (78%), rural telephone service (78.4%), and line service (82.7%). The state also handles roughly 2/3 of intracity call volume, and more than half of intercity/international call volume.

As of year end 2000, there were 819 state-owned and 8,221 collectively-owned sector enterprises in Kharkiv Oblast, which roughly corresponds to the breakdown for Ukraine as a whole. Ukrtelecom also owns a substantial percentage in a number of joint ventures, for example: Infocom (51%), Utel (51%), Ukrainian Mobile Communication (51%), Elsacom-Ukraine (34%), and Telesystems of Ukraine (26%).

11. SME Growth in the Sector

In today's business environment, the importance of informational support for management decision making is on the rise. Modern electronic communications media cover a wider spectrum than ever before. To meet this growing demand, the number of SME companies providing telecommunication services is growing like never before, especially in the areas of Internet services, computer equipment, and mobile communications. The increase of the number of small- and medium-size companies in the telecommunications sector, that act as go-betweens in the IP-telephony, mobile communications, and ISP markets, further proves the high level of qualified management.

12. Sector Infrastructure

There are a number of significant research facilities concentrated in Kharkiv, including: the Kharkiv State Technical University of Electronics, Kharkiv Radiotechnical Technical School, and the Kharkiv Technical School of Communications.

Kharkiv Oblast institutions have participated in a number of significant recent milestones. For example, in November 2000, the Institute of Informational Technologies (Kharkiv) was awarded a certificate for a cryptographic system. In addition, a new nationally certified device for protection of information in computers and computer nets was invented in Kharkiv.

13. Management Capabilities of Sector Enterprises and Organizations

Overall, sector enterprises have significant reserves of qualified management personnel capable of carrying out high-level enterprise management. For example, Ukrtelecom has conducted 45 meetings in Ukraine, and 10 abroad, with representatives of foreign companies since July 2000.

14. Administrative Impact on the Sector

The law entitled, "On radiofrequency resources in Ukraine" provided for the establishment of the Administration of Communications and Radio Frequencies of Ukraine to regulate the national telecommunications industry. The Administration is a central executive agency responsible for overseeing licensing, distribution, and use of frequency resources and broadcast enterprises..

State management and regulation of the telecommunications sector can be realized through various methods. The most effective approach is "wise regulation", based on two principles: "interfere only in crises," and "first, do no harm". Of course, both overregulation and underregulation are harmful. The major responsibilities of any regulative body include: stimulating the development of innovation; providing at least a minimum level of services to all people; and guaranteeing the quality and safety of communications and networks.

The development of communications and information/data processing sector enterprises is influenced by state policy concerning enterprises of related branches, and especially in the electronics industry. For example, the law adopted by the Verhovna Rada in September 2000 entitled, "On the restoration of electronics industry and its development in Ukraine" included a number of provisions that directly or indirectly influence the telecommunications sector.

15. Social Issues of Sector Development

There are no acute social problems associated with the communications sector. However, a number of issues, including labor safety; Internet-based crimes, such as fraud and copyright violation; and the possible health hazards of mobile phone use are currently the subject of much research and debate. In the present environment, the truth of various rumors and theories is debated in parallel with research intended to discover and decrease risk factors.

The communications sector has 8,500 workplaces classified as “hazardous and dangerous for health labor conditions”. Of these, 96% are at Ukrtelecom and 3.6% at Ukrposhta. General expenditures on benefits and compensation to people working under hazardous conditions in 1999 totaled almost 6 million UAH (5.8 million at Ukrtelecom). During the first nine months of 2000, 74 people were injured, 5 mortally, at state-owned sector enterprises (107 and 11 respectively in 1999).

One serious liability for Ukrposhta is the fact that only 74% of employees are provided with appropriate protective equipment and clothing, including work clothes and footwear. The increase in the number of injuries at Ukrposhta as a result of assaults on personnel delivering pension payments and postal orders is cause for alarm. And unfortunately, technological measures introduced by the State Communications Department have been ineffective. The State Communications Department has also adopted a number of laws aimed at increasing departmental authority in fostering the creation of healthy and safe working conditions while economizing on annual insurance premiums.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

The negotiation with EBRD (European Bank for Reconstruction and Development) concerning pre-privatized credit are currently in progress. EBRD’s London headquarters provided a business plan of a number of investment projects to be offered to Ukrtelecom. The plan for attracting bank financing took into account the association’s recent changes in investment priorities. In addition, several projects in the area of Internet service have recently been completed in Kharkiv Oblast.

Conclusions

The information and data processing services sector cannot be considered one of the most important sectors in the Kharkiv Oblast economy at this time. However, this sector is currently enjoying a high rate of growth, and its importance in the region’s economic and cultural development is increasing. The rapid development of the information and data processing sector coincides with the general tendencies of the telecommunications market both in Ukraine throughout the world. The branch is attractive for both small- and large-scale investment; and the development of IP-telephony, mobile communications, Internet services, and information/data processing services is contributing to the appearance of a large number of small- and medium-enterprises.

In conclusion, this analysis has found that the role of the information and data processing services sector will continue to grow in Kharkiv Oblast in the near future, although it is unlikely to have a decisive influence on general market development in the region.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.		Products	Directors
"Alkatel Network Systems Ukraine", Closed Joint Stock Company????	310681, Ukraine Kharkiv, Rudika Str, 1	+38 (0572)	140804; 140808	-	Lanshya Jan-Claud, General Director
"Ukrainian Mobile Communication", Kharkiv branch (joint venture)	310166, Ukraine Kharkiv, Lenina Ave,15	+38 (0572)	149170; 282344	Communication services	Sergiy Yu. Dudakov, Director
"Kharkivtelecom" (Kharkiv Oblast state-owned telecommunications enterprise)	310022, Ukraine Kharkiv, Svobody Sq. 5, 3 floor	+38 (0572)	436141; 435101; 470574; 439048	Communication services	Anatoliy V. Ovsy, General Director
Kharkiv regional enterprise of mail communication	310052, Ukraine, Kharkiv, Privokzalna Sq., 2	+38 (0572)	124643; 121361	Postal services	Volodymyr F. Bobnyev, General Director
"Utel", Kharkiv branch (Ukrainian-American-Holland-German joint-stock company)	310125, Ukraine, Kharkiv, Netchenska Emb, 8	+38 (0572)	282210; 282208; 282115	Communication services	Valentyn O. Petryshchev, Branch Director
"Promzvyazok" (open joint-stock company)	310017, Ukraine, Kharkiv, Kotlova Str., 168	+38 (0572)	232153; 128775; 128664	-	Volodymyr P. Pidina, Staff Chief
"Zvyazok", PrJSC	310003, Ukraine, Kharkiv, Solyanykivskiy Lane, 4	+38 (0572)	275430; 272811	-	Olexandr Yu. Krayets, President

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

12. SCIENTIFIC SERVICES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

Scientific enterprises are among the most attractive enterprises for investment in Kharkiv Oblast, in spite of the fact that the sector overall is deeply in debt. The sector's major potential lies in defense industry and machine building applications, owing to the fact that, under the Soviet regime, science was targeted primarily at military technologies.

In recent years, there has been a nearly complete break between the scientific research and manufacturing branches, as evidenced by a significant decline in the number of research design projects commissioned by industrial enterprises. The State has become virtually the only major customer for such research. In addition, few orders are actually fulfilled because of a shortage of funds for salary payment.

Overall, the sector has declined substantially in recent years. The number of construction and design offices, test facilities, and scientific departments at industrial enterprises has decreased. However, this decline is less apparent in terms of the total number of scientific establishments, due to the fact that several former large-scale scientific and technical complexes have been broken up into a number of smaller, independent organizations that somehow still manage to function under existing conditions.

Currently, negative characteristics of the sector include:

- Falling profits and increasing debt
- Monopoly on scientific research by Kharkiv Oblast sector enterprises that are generally not competitive in the overall domestic market
- Decreasing staff levels and graying workforce (average age of scientific enterprise employees is 47)
- Inefficiency of smaller scientific enterprises
- Problems with productivity and efficiency associated with changes in enterprise ownership structure
- Legislative obstacles in the areas of taxation and import/export operations
- Substantial arrears in salary payments
- Rapidly rising production costs and reduced competitiveness, both in Ukraine and in the world market, caused by inefficient state policies

Positive characteristics include:

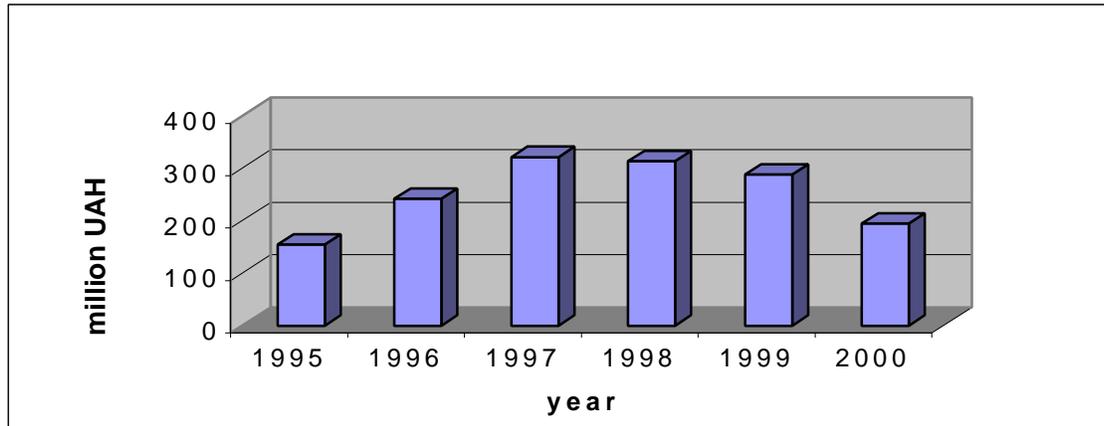
- Kharkiv Oblast ranks second in Ukraine in terms of existing sector infrastructure (several respected educational and research institutions located in the oblast)
- High quality products (20% of projects meet or exceed international requirements)
- 20 unique research and experimental equipment facilities found only in Kharkiv Oblast
- Favorable treatment in profit taxation, VAT assessment, and customs duties available to investment projects under certain conditions

To sum up: the Kharkiv Oblast Science sector still possesses significant potential in terms of scientific/technical resources and personnel. However, a serious negative trend of several years' standing is adversely affecting sector enterprises, and is a significant deterrent to new investment in the region. Current investments in the Kharkiv Oblast Science sector are rather tentative, though there are adequate resources for achieving positive results. One possible solution to current problems could be the creation of an industrial park within the Kharkiv city limits. This park would comprise not only scientific organizations, but also related industrial enterprises. Such a measure would help coordinate research and production efforts and resources along predetermined lines, and could considerably increase the level of investment in this sector of the regional and even national economy.

1. Sector Role in the Kharkiv Oblast Economy

In spite of significant potential in terms of scientific/technical resources and personnel, there has been a general decline in Kharkiv Oblast scientific enterprise output since 1997.

Diagram 1. Kharkiv Oblast Science Sector Products/Services Output: 1995-2000 (million UAH) [2, 3, 4]



Sector share of total Kharkiv Oblast output of goods and services currently equals approximately 2%-2.5%.

As of January 1, 2001, 126,000 people were employed in the sector in Kharkiv Oblast. This equals approximately 9% of the total oblast working population, including 100,000 people employed by educational establishments (79%) and 26,000 at sector research establishments (21%). [4]

2. Strength of Kharkiv Oblast Sector

Kharkiv Oblast Market

In 2000, regional enterprises performed research projects totaling nearly 195 million UAH. [4] This was due primarily to the fact that Kharkiv Oblast sector enterprises, as subordinate to their respective ministries and departments, hold a virtual monopoly of the region's scientific market.

The structure of the Science sector is reflected in the makeup of the overall industry of the region. There are 23 science organizations in the area of machine building, followed by 18 in the defense industry, 13 in electronics, 9 in metallurgy, and 7 in chemistry.

Ukraine Market

Kharkiv Oblast organizations play an important role in the nation's scientific and technical activity. One out of seven research institutions, one out of five design establishments, and one out of eight institutions of higher education are situated in Kharkiv Oblast. In 1999, one sixth of all Ukrainian specialists engaged in scientific and/or technical activities worked at one of the above-mentioned organizations.

Scientific research and design production volumes are another indicator of sector strength in the region. Kharkiv Oblast traditionally ranks second after Kyiv in total Ukraine output, as illustrated in **Table 1**.

Table 1. Technical Standards of Kharkiv Oblast Scientific Output: 1996-1999 [2, 5]

	Total Design Volume				No. of projects that meet or exceed technical world standards			
	1996	1997	1998	1999	1996	1997	1998	1999
Kharkiv Oblast	2,646	2,313	2,050	2,617	1,333	983	842	1,094
City of Kyiv	4,165	3,162	2,671	2,630	2,773	1,694	1,449	1,645
Total Ukraine	14,864	11,464	10,152	10,718	8,267	5,423	5,040	5,466
% of total Ukraine	18%	20%	20%	24%	16%	18%	714%	20%

In 1999, Kharkiv Oblast ranked fifth in Ukraine in total output of new industrial products.

CIS Market

The collapse of the Soviet Union severed a great number of business relationships, which in turn caused a slump in scientific research in the CIS countries. In 1999, there were 230 projects totaling 37.14 million UAH for CIS customers, which equaled 12.8% of the year's total research production volume. Russia is traditionally the largest consumer for research projects amongst the CIS countries, with a 92.1% share of total projects commissioned.

World Market

Due to high costs and complex tax laws, demand for both Kharkiv Oblast and Ukraine national scientific output on the world market is relatively low. In 1999, world orders for domestic research projects came to 17.25 million UAH, only 6.5% of year's total.

3. Economic Condition of Sector Enterprises and Organizations

As shown in **Table 2**, there has been a clear downward trend in sector earnings over the past few years. In 1999, profits fell by 19% in the Science sector, and 41% in the Education sector. This negative trend is underscored by the correlation between trade deficit and sales.

Table 2. Kharkiv Oblast Science Sector Major Financial Indicators: 1997-2000 (million UAH) [6, 7, 8, 9]

Indexes	Science				Education			
	1997	1998	1999	2000	1997	1998	1999	2000
Sale income	206	237	207	194*	49	59	47	n/a
Profit	33	50	40	6*	2	16	9	n/a
Debtor indebtedness	100	139	115	121	5	24	12	8
Creditor indebtedness	223	284	279	230	9	33	14	14

Source: Kharkiv Oblast Transportation and Communications Management Department, in 2001 UAH

The bottom line is that Kharkiv Oblast Science enterprises are in the midst of an economic crisis. While it is true that they produce almost all of the region's scientific output, they have been hard hit by the general economic crisis throughout Ukraine.

4. Sector Development: Raw Materials Base

Due to the specific character of the sector, this issue of raw materials will not be considered here.

5. Sector Development: Technological Base

Seven of Ukraine's 28 national research facilities are located in Kharkiv Oblast. In addition, there are 20 research and test facilities with no counterpart anywhere else in the world; 80 facilities are unique within the CIS countries; and 90 are unique in Ukraine. As of year-end 1999, four testing facilities and nine research/design subdivisions at industrial enterprises in the region were engaged in applied science and/or technology.

Table 3. National Scientific Establishments [1]

Scientific Establishment	Subordination
Genetic Plant Resource Bank of the Yuryev Plant Growing Institute	Ukrainian Academy of Agricultural Sciences
Aerodynamic Complex/Supersonic Wind Tunnel T-6 of the M. Ye. Zhukovsky Kharkiv Aircraft Institute	Ministry of Education
"Lightning" research experimental base and proving ground of Kharkiv State Polytechnic University	Ministry of Education
Atomic establishments of the National Scientific Center, Kharkiv Physical & Engineering Institute	State Committee on Science and Intellectual Property Matters
??-2 Radiotelescope with URAN interferometers system	National Academy of Science
Coherent-optic image processor of the Kharkiv State University Astronomic Observatory	Ministry of Education
National calibration base	Committee on Standardization, Metrology and Certification

Kharkiv Oblast scientists have accomplished significant achievements in a number of fields. These include:

- segregation of a formerly unknown albumen that plays a part in liver cell DNA synthesis (V. N. Karazin Kharkiv National University)
- development and manufacture of 9 new medications, 2 of which are unique in the world (State Scientific Medications Center)
- development and manufacture of a new generation of space apparatus (Kharkiv Research Institute for Radiometry)
- development and manufacture of a customs introscope for car and van control (Institut Monokristaliv and Komunar)

On the whole, Kharkiv Oblast sector organizations possess extensive resources for fundamental scientific and technical research, but they are hampered by the fact that the majority of equipment and infrastructure is outmoded. Replacement/renovation of these resources is crucial to the future growth of the sector.

6. Investment Activities in the Sector

Investment activity in sector scientific/educational enterprises remains rather slack, but as shown in **Table 4**, the foreign investment situation has improved somewhat. This is due primarily to adoption of the law entitled, “Special order on foreign investment activity in Kharkiv,” which offers preferential tax treatment to educational research organizations carrying out natural and technical science projects in excess of 500,000 USD.

In addition to unstable legislation and an ineffective tax system, non-target use of funds is another significant factor contributing to the downturn in investment activity. As of October 1, 2000, the major investors in the Education sector included the United Kingdom and France, while Switzerland and the Russian Federation invested primarily in science and scientific services.

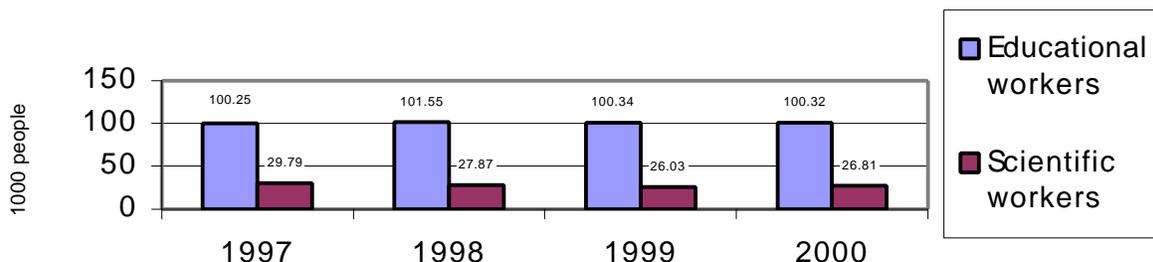
Table 4. Kharkiv Oblast Sector Investment Activity (1000 USD)

Sector	Decrease of Nonresident Capital		Increase of Nonresident Capital		Nonresident Aggregate Capital (12/31/2000)
	1999	9/2000	1999	9/2000	
Science	3,824	-	4,234	5,886	6,551
Education	1,715	15	1,715	-	300
Total	2,944	1,940	11,693	20,966	93,159

7. Employment and Personnel Potential in the Sector

Approximately 34,500 people are employed at Kharkiv Oblast sector enterprises. As shown in **Diagram 2**, a general negative trend in sector employment can be seen since 1997. Total employees in 1999 fell by 6% relative to the previous year.

Diagram 2. Sector Employment: 1997-2000



Distribution of sector employees according to pattern of enterprise ownership in 2000 is shown in **Table 6**.

Table 6. Distribution of Sector Employees by Pattern of Ownership [4]

	Pattern of Ownership		
	Private: Employees (%)	State: Employees (%)	Collective: Employees (%)
Science	- (0%)	19,305 (72%)	7,508 (28%)
Education	173 (0.2%)	97,700 (97%)	2,445 (2.8%)

It is clear that the majority of people in both the Science and Education sectors are employed in state-owned organizations.

One positive trend is the growing number of employees with science degrees at both sectoral science and scientific/pedagogical establishments. The distribution of science personnel with science degrees as of October 1, 1999 shows a concentration in the areas of physics and mathematics (15.8% of doctoral candidates and 23.7% of PhDs), technical areas (34.5% and 28.2%), medicine (14.1% and 17.7%), and economics (7.1% and 3.3%, respectively). Ukraine scientific personnel distribution by region is shown in **Table 7**.

Table 7. Distribution of Doctoral Candidates and PhDs by Region: 1996-1999

Rank in Ukraine	Doctoral Candidates—Science	1996	1997	1998	1999
1	City of Kyiv	15,491	16,024	15,965	15,358
2	Kharkiv Oblast	9,017	9,051	9,050	9,034
% total Ukraine		15.5%	15.3%	15.2%	15.2%
Rank in Ukraine	PhDs	1996	1997	1998	1999
1	City of Kyiv	3,833	3,935	3,951	3,827
2	Kharkiv Oblast	1,451	1,489	1,496	1,466
% total Ukraine		14.6%	14.4%	14.3%	14.3%

The age distribution of Kharkiv Oblast scientific personnel is generally older, with 66% of PhDs and 39% of science doctoral candidates over 55; only 2.6% and 2.8% respectively are under 30.

Table 8. Training candidates and persons working for doctor's degree [2, p. 317].

	1995	1996	1997	1998	1999
Total candidates	2 734	3 016	3 058	3 067	2 989
Candidates graduated	496	590	618	730	820
Including a thesis defended	77	105	106	129	138
PhD candidates	164	182	193	186	160
PhD candidates graduated	34	53	47	53	62
Including a thesis defended	13	17	9	11	17

Scientific personnel have experienced their share of employment problems. In 2000, 4,730 people in the Education sector were laid off (4.7% of the sector total), while 3,378 people in the Science and Scientific Services sector took forced leave (12.6%). In addition, 2,623 people in the Education sector and 6,873 in the Science sector were dropped to part-time status. Thus, it is obvious that the employment situation in the Science sector is much worse than in education; this factor ultimately contributes to the gradual decline of Kharkiv Oblast scientific potential.

Average monthly salaries at collectively-owned enterprises are noticeably higher than at enterprises of other patterns of ownership. Specifically, average monthly salary at collectives is 337.82 UAH, compared with 205.06 UAH at privately-owned enterprises, and 169.70 UAH at state organizations. This seems to indicate overall greater efficiency and a better financial condition on the part of collectives relative to enterprises of other patterns of ownership.

Average monthly salary in Kharkiv Oblast in 2000 was 294.94 UAH, as shown in **Table 9**. Average monthly salary for the Education sector in 2000 was 173.86 UAH (an increase of 7.7% over 1999), while the figure for the Science and Scientific Services sector was 313.47 UAH (an increase of 23.9% over 1999).

Table 9. Kharkiv Oblast Science Sector Average Monthly Salary

	Average Monthly Salary (UAH)			
	1997	1998	1999	2000
Science	190.6	191.3	253.1	313.5
Education	139.0	140.6	161.4	173.9
Total region	161.1	164.7	203.0	294.9

Educational organizations in the region are in last place in terms of average salary, while scientific establishments are somewhere in the middle, which naturally does not stimulate personnel inflow in these sectors of the Kharkiv Oblast economy. Sector salary arrears in 2000 totaled 5,814,000 UAH at Education establishments, and 8,860,000 UAH at Science and Scientific Services enterprises, as shown in **Table 10**.

Table 10. Sector Salary Arrears

Branch	Salary Arrears			% of Arrears (10/1/2001)
	Total, 1000 UAH	(Including Previous Years) 1000 UAH	% of Total	
Science	8,860	4,567	51.5	44.8
Education	5,814	3,211	55.2	25.3

8. Sector Exports

Science and Scientific Services account for the majority of sector exports. In 1999, science exports totaled 38 million USD (12.1% of total Kharkiv Oblast exports), while educational exports came to 0.84 million USD (0.27%). 1000 science organizations and one educational institution were engaged in export operations. Kharkiv Oblast Education sector foreign economic activity is composed primarily of participation by regional scientific personnel in international conferences and scientific research trips. Other, less frequent forms of foreign economic activity include: fieldwork, education, experience upgrading, teaching, lectures, and receipt of international grants.

9. Competitive Environment of Sector Enterprises and Organizations

Given their subordination to various ministries and departments, Kharkiv Oblast sector enterprises hold a virtual monopoly on scientific output within the region, but they are generally not competitive in the overall domestic market. Foreign scientific organizations cannot be considered true competitors of the region's enterprises because domestic consumers of scientific output cannot maintain an adequate level of sustained demand, owing to the general economic crisis throughout Ukraine. Sector imports for 1999 are shown in **Table 11**.

Table 11. Scientific Services Import Volume in Kharkiv Oblast: 1999 [10]

Sector	Import		
	# Enterprises	(1000 USD)	% of Total Volume
Science	80	14,900.3	1.91%
Education	8	482.1	0.06%

10. Ownership in the Sector

There has been relatively little activity in terms of privatization of sector enterprises, due in part to low profitability and decreased demand for sector output. In 2000, 37 privatized scientific organizations in the oblast carried out scientific design and research projects that equaled 18.3% of the region's sector total (compared with 36 privatized organizations and 18.5% in 1999). According to the Kharkiv Oblast Statistics Department, 11 science enterprises and 0 educational organizations reformed their pattern of ownership during the year.

The general volume of research and design financing of these 37 organizations totaled 39.8 million UAH (20.2% of total sector financing for all patterns of ownership). This includes 39.7 million UAH of inpayments funding by enterprise for the current year. Only 3.9% of total financing came from the State budget.

11. SME Growth in the Sector

On the whole, small enterprise share of total sector production volume in both the Education and Science sectors is relatively small. However, key economic indicators show a gradual increase of output volumes by small- and medium-size enterprises, as well as a certain backlog in output development and realization compared with the regional average for small enterprises (**Table 12**). The decrease of realization share is also due to a reduction in the number of projects. One factor that contributes to full output realization is the fact that the majority of scientific research projects in recent years have been performed on commission for specific customers.

Table 12. Kharkiv Oblast Sector SME Production and Realization Volumes: 1998-1999 (1000 UAH)

Branch	Produced		Realized		Realization Level Before Production (%)	
	1998	1999	1998	1999	1998	1999
Science	33,772.6	38,179.1	42,893.7	40,673.6	127.0	106.5
Education	1,742.6	3,709.7	1,923.1	3,740.7	110.4	100.8
Total	35,515.2	41,888.8	44,816.8	44,414.3	126.2	106.0

Table 13. Sector SME Production and Realization Quotas

	SME Quota in Total Enterprises (%)	SME Quota in Total Volume of Production Manufactured (%)	SME Quota in Total Volume of Production Realized (%)
Science	81.6	15.1	17.7
Education	55.0	9.0	7.8

12. Sector Infrastructure

In spite of the current economic crisis, Kharkiv Oblast maintains an extensive network of scientific organizations and rather strong sector potential overall. There are currently 212 scientific establishments and organizations under 15 national ministries and departments located here, (including 21 establishments of the National Academy of Sciences of Ukraine, and another 24 institutions of higher education that offer third- and fourth-level accreditation). [1]

The oblast's overall market infrastructure, like that of the whole economy, is still rather weak. However, not all market assets are employed in research financing. Year after year, the major part of research is financed by way of economic agreements with customers. In 2000, a rather insignificant share was financed through technical/scientific and social development funds (74,000 UAH). Only 235,000 UAH in special non-budget funds were granted for research, and none of the region's enterprises was awarded a grant from the State Innovation Fund.

13. Management Capabilities of Sector Enterprises and Organizations

Kharkiv Oblast sector managerial standards can be characterized as inadequate, due to the fact that almost all executive positions are held by older men of limited education who are reluctant to accept the reality of change in the Ukrainian economy. To cite one cogent example of management ineffectiveness, as of January 1, 2001, not a single executive of any sector organization in the region had applied for investment support from the Investment Council, though the majority complain of lack of funds in their annual business plans.

14. Administrative Impact on the Sector

According to the majority of managers, administrative impact on the sector is negative because it does not contribute to its improvement, with excessive taxation the main obstacle to economic growth. In their opinion, a reduction of the VAT, or even an exemption for science establishments, would do much to improve the situation.

The latest display of unreasonable governmental policy is the recent salary increase granted only to National Academy of Sciences personnel, which has resulted in a personnel outflow from sector enterprises. Turnover of this sort has a negative impact on the development of the sector, in part because it hinders specialization.

The law entitled, "On value added tax" creates a substantial obstacle to effective sector activity by requiring VAT payment on the date a contract is signed—not on the date funding is specified for receipt by the enterprise. Another law that hampers activity is the decree entitled, "Of currency regulation," which prescribes a 90-day term of tax payment for scientific research commissioned by foreign customers, with a fine imposed on the enterprise in the event of any delay in tax payment.

15. Social Issues of Sector Development

Today, the main social problems of the Science sector are the high rates of personnel outflow from scientific organizations of the region, and the overall graying of the remaining workforce. The average age of sector personnel is 47 (53 for science doctoral candidates, and 57 for PhDs). 52.4% of doctors (325) working in the region are over 61, while 36% of science doctoral candidates are between the ages of 36 and 50 (988).

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Investment activity and submittal of proposals for sector enterprises are at a low point. In addition, even those proposals that have been submitted often do not comply with the standards of a normal business plan, lacking as they do sufficient detail on projected future enterprise activity and the level of investment required.

Nevertheless, a number of projects are currently planned. They include:

- Design of national programs for economic development of corresponding sectors
- Project calculations for construction of new enterprises, as well as expansion, reconstruction, and technical modernization of existing enterprises
- Research, adaptation, and introduction of advanced domestic and foreign techniques for the design, construction, and use of enterprise facilities
- Promotion of foreign economic activity, including establishment of direct contacts with overseas partners and resolution of issues in the areas of production and scientific cooperation
- Engineering and informational services supply research

Conclusions

The overall state of affairs of the Science sector can be summarized as follows:

- Kharkiv Oblast still possesses significant potential, in terms of scientific/technical resources and personnel.
- This potential is adversely impacted by a number of negative economic factors, which act as a serious deterrent to investment realization.
- One possible solution to the present economic crisis could be the creation of industrial park within the city of Kharkiv that would comprise not only scientific organizations but also related industrial enterprises. This project would involve coordination of activity and resources along established lines, which in turn could very well help increase investment volume in this key sector of the national economy

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List of Main Sector Enterprises and Organizations

Enterprise Name	Address	Telephone No.	Products	Directors	
"State institute of enterprises projecting of chemical-recovery industry "Diprokoks"	310002 Kharkiv Sumskaya 60	+38 (0572)	431655; 432651; 431655	Development and design of cake and by-product process objects	Rudik Viktor Ivanovich, Director
State Scientific Center of Medicines	310085 Kharkiv Astronomichna Str., 33	+38 (0572)	441033; 441118	Pharmaceutical analysis, standardization	Georgievskiy Viktor Petrovich, Director
Institute of Machinery Problems, National Academy of Sciences of Ukraine	310046 Kharkiv, Pozharskogo Str., 0,2	+38 (0572)	959524; 944635; 945514	Development of technologies, creation of equipment	Macevitiy Yuriy Mihailovich, Director
O.Y.Usikova Institute of Radiophysics and Electronics, National Academy of Sciences of Ukraine	310085 Kharkiv Akademica Proskury, 12	+38 (0572)	441129; 441105; 441129	Research in the field of radio-physics, electronics, solid-state physics, radio waves propagation	Yakovenko Volodimir Mefodiyevich, Director
V.Yuryev Institute of Horticulture, National Academy of Sciences of Ukraine	310060 Kharkiv Moscow avenue, 142 Building 1	+38 (0572)	924343; 920354; 922163	Research on genetics, physiology, biochemistry and plant biotechnology	Bondarenko Leonid Viktorovich, Director
Institute of Therapy, Academy of Medical Sciences of Ukraine	310039 Kharkiv Postisheva Str. 2 ?	+38 (0572)	722024; 726179	Study of etiopathogenetic mechanisms	Malaya Lyubov Trohimivna, Director
Institute of Monocrystals	310001 Kharkiv, Lenina Str. 60	+38 (0572)	320382; 320273; 320382	Research on material authority, creation of new functional materials	Grinyov Boris Victorovich, General Director
Kharkiv Physicotechnical Institute National Scientific Center	310108 Kharkiv, Akademichna Str, 1	+38 (0572)	356552; 351688; 353530	Plasma electronics; physics of heavily-filament beams; technology of materials	Lapshin Volodimir Illich, General Director
Northeastern Scientific Center, National Academy of Sciences of Ukraine	310002 Kharkiv Frunze Str., 8	+38 (0572)	433140; 433140	Scientific and technical products, information and export services	Bubenko Pavel Trofimovich, Director
Ukrainian State Scientific Coal and Chemical Research Institute	310023 Kharkiv, Vesnina 7, Building 1	+38 (0572)	433045; 433058; 433045	Research and design in the field of by-product coke process, coal chemistry	Kovalyov Yevgen Trofimovich, Director
Ukrainian State Scientific Metals Research Institute	310002 Kharkiv, Darvina, 20	+38 (0572)	459349; 432550; 475237	Manufacturing of samples, technological services, of ferrous metallurgy	Nesterov Dmitro Kusmich, Director
B. Vyerkin Physical and Technical Institute of Low Temperature, National Academy of Sciences of Ukraine	310164 Kharkiv, Lenina Avenue 47	+38 (0572)	321223; 322370	Basic and applied research in the field of low temperatures physics and techniques	Yeryomenko Viktor Valentinovich, Director

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

13. HEALTHCARE

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

The analysis of the Healthcare sector of Kharkiv Oblast has shown the following:

- Kharkiv Oblast is one of the leading scientific, educational and practical medical centers in Ukraine today. The oblast boasts a network of medical institutions with substantial scientific and technical capabilities.
- The State-financed sector is historically underfunded in both Kharkiv Oblast and in Ukraine (financing was 54% in 1998 and 93.3% in 2000).
- Internationally, Ukraine ranks 111th of 191 countries in per capita healthcare spending, and is ahead of just seven former Soviet Union republics.
- Over the past ten years, key healthcare indices of medical facilities and patient care have declined.
- The regional share of total State medical facilities, specialists, and patient care has remained constant at about 6% of these indices.
- Medical employment has been steady over the past six years, at about 3.5% to 3.8% of the total number of people employed.
- 83.1% of medical sector employees in the region are women.
- The average per capita expenditure for paid healthcare services over the last six years was less than 1%.
- State-commercial vs. non-commercial indices are 200% less than in other regions, reflecting its low level of commercial development.
- State financing levels for healthcare do not approach the state recommended levels of 5% of GDP.
- Multiple funding approaches are needed to reach 5% of GDP financing, including compulsory medical insurance, regulation of the private pay sector, and increased non-budget funds, such as international program financing.
- In 2000, expenditures on medical equipment made up only 36 kopecks per capita for Ukraine as a whole.
- The lack of financing has led to a steady decline in the overall health of the population, as reflected in major disease indices.

The Healthcare sector of Kharkiv Oblast is divided into two parts: the state-financed, or so-called “free-of-charge” healthcare, and the private payment sector (this “alternative” healthcare functions exclusively on a commercial basis). There are also combinations of healthcare as well. For instance, state-financed medical establishments can also officially provide private payment services.

In Ukraine today there is no such thing as absolutely “free-of-charge” healthcare. In fact, it is former Prime Minister Viktor Yushshenko’s view that healthcare in Ukraine is chargeable de facto. According to Mr. Yushshenko, Ukrainians understand that while free healthcare is not realistic, they feel they should not have to pay twice for healthcare services, as they currently do. The first time Ukrainians pay is in the form of taxes; the second time is at the hospital, where they must provide their own medicines, dressing materials, and so on.

NOTE: The “shadow” economy aspect of this sector is beyond the scope of this report.

1. Sector Role in the Kharkiv Oblast Economy

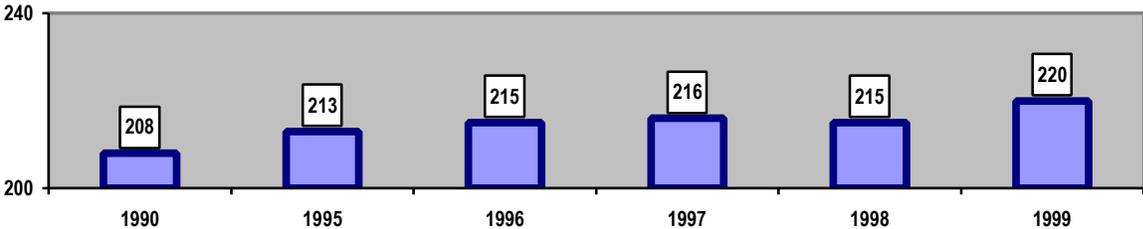
Kharkiv Oblast has a strong healthcare sector characterized by a well-established network of medical establishments with technical proficiency and robust medical supplies. Historically, the oblast has been recognized as a leading scientific, educational, and training center in Ukraine.

Today there are three institutions of higher education and eight medical colleges in the region. Applied and fundamental scientific research efforts are being conducted at many institutions. Over 7,000 scientists work at scientific and educational establishments, among which 1,500 hold masters degrees and over 400 have doctorates; there are also more than 50 academicians from various domestic and foreign academies.

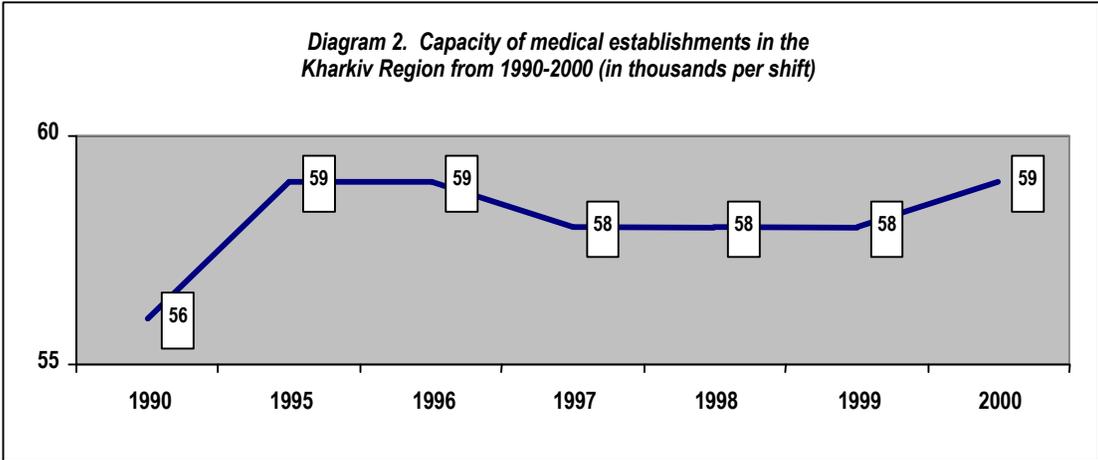
At the beginning of 2000, there were 390 out-patient polyclinic establishments—including hospitals and all other outpatient establishments (polyclinics, ambulance stations, dispensaries, and healthcare stations). As **Diagram 1** indicates, the number of medical establishments has been gradually increasing for the last ten years. [1, p. 331]

It is difficult, however, to assess healthcare facilities using traditional business indicators. More typical measures of healthcare include facility capacities, medical specialists, and patient care indicators, as presented in **Diagrams 1** through **5**.

Diagram 1. Number of medical establishments in the Kharkiv Region, 1990-1999



As **Diagram 2** illustrates, the capacity of the medical establishments in the region (between 56,000-59,000 visits per shift) has remained largely unchanged over the past ten years. [1, p. 330-331; 12]



Over the same period, the number of hospital beds in the Oblast decreased by nearly 40%, as shown in **Diagram 3**. [1, p. 330-331; 12] The number of people who received health care decreased by about 20%, compared with 1990 (**Diagram 4**). [1, p. 330-331; 12] However, this activity has decreased by only 11% per one thousand people (**Diagram 5**), with the number of people who received healthcare virtually the same since 1996.

Diagram 3. Number of hospital beds in the Kharkiv Oblast, 1990-2000, thou. units

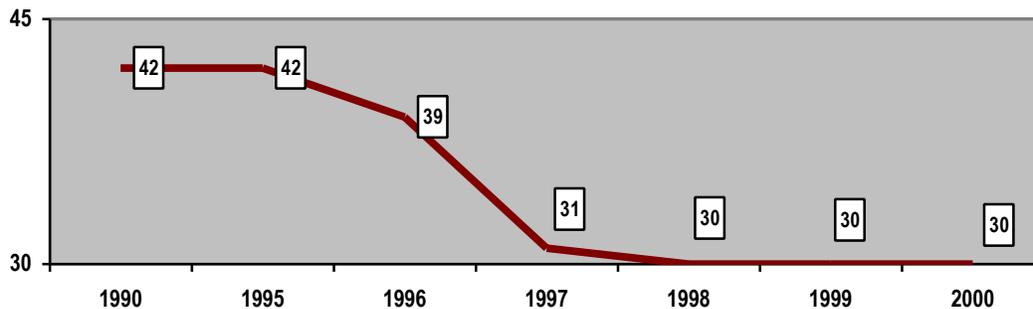


Diagram 4. Number of people who received medical care in the Kharkiv Oblast, 1990-2000, thou. people

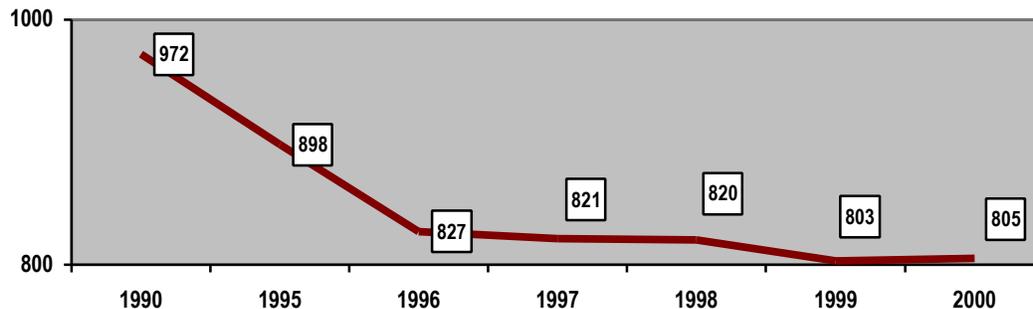
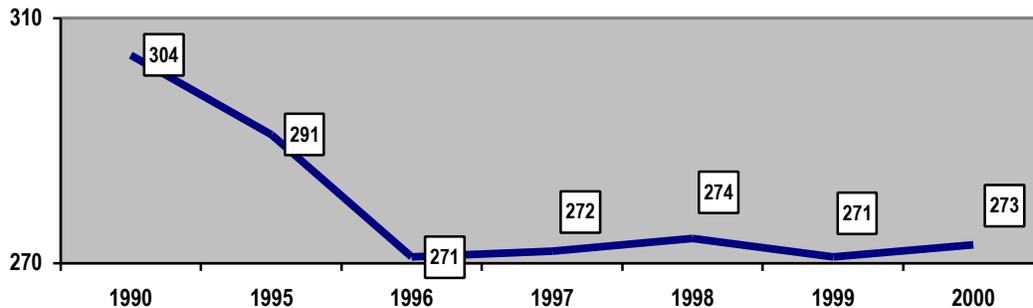


Diagram 5. Number of people who received medical care in the Kharkiv Region per 1000 people, 1990-2000, people

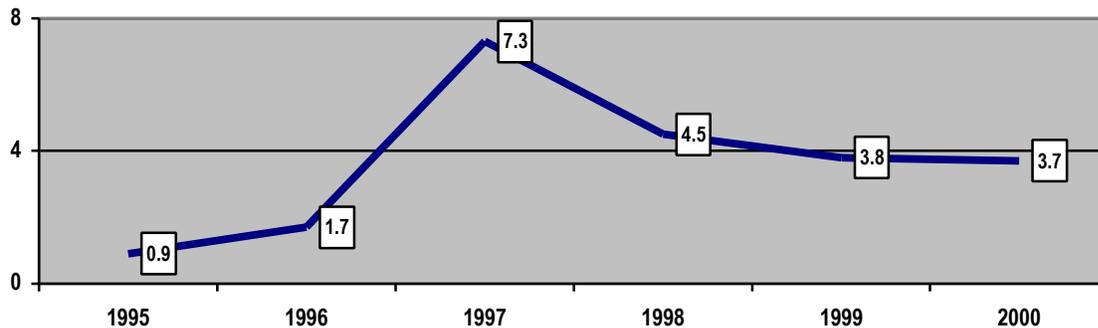


According to the Minister of Health Care, Vitaly Moskalenko, health care in Ukraine is perpetually underfinanced. In 2000, however, the sector was almost financed in full for the first time, with 93.3% of sector funding compared to 54% in 1998. In 1998, health protection assignments made up 3.6 billion UAH, rising to 4.3 billion UAH in 2000. The 2001 budget provides for 5.2 billion UAH in health protection assignments. [2]

In addition to these medical establishments (such as alternative/commercial medicine, including individual privately practicing professionals, and various medical and diagnostic offices), self-supporting branches of traditional hospitals, clinics, centers and even ambulance services have sprung up in Kharkiv Oblast.

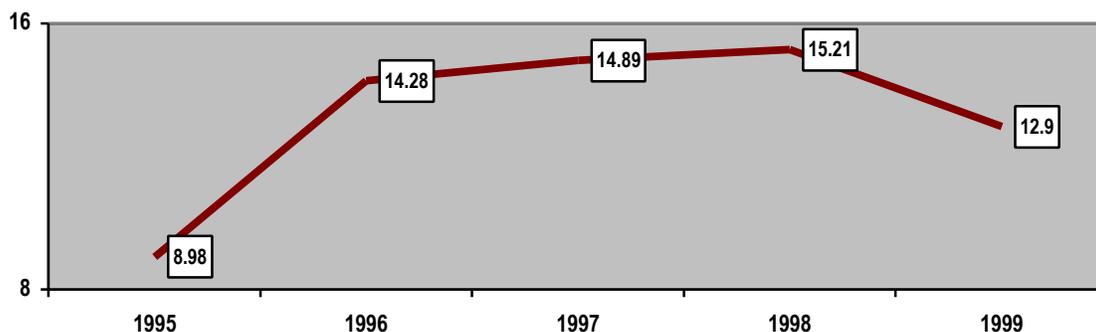
The trend in actual volume of paid health care for the population is shown in **Diagram 6**. As the graph indicates, the actual volume of medical services in current prices have increased 400% 2000 compared with 1995. On the other hand, they have decreased by nearly half relative to 1997. If converted to USD (see **Table 1**), this activity has decreased by more than 450%. [1, p. 188; 13]

Diagram 6. Paid medical services in the Kharkiv Oblast, 1995-2000, current prices, mln. UAH



Apart from paid healthcare services, volumes of resort sanatorium and sanitary services for the population must be considered. As shown in **Diagram 7**, the volumes of these services in 1999 at current prices compared to 1995 increased by almost 45% and decreased by 17.9% compared to 1997 [1, p. 188].

Diagram 7. Paid resort sanatorium services in the Kharkiv Oblast, 1995-2000, current prices, mln. UAH



As Table 1 indicates, Kharkiv Oblast paid health services compared with the total regional paid services is only a fraction of analyzed services. From 1995 to 2000, it varied from 0.46% to 0.51% (except for 1997 when the sector occupied 1.24% of the total volume of the regional services). [1, p. 188; 12]

Table 1. Sector Share in Total Kharkiv Oblast Services: 1995-2000

Activity	1995	1996	1997	1998	1999	2000
Paid health protection services (million UAH)	0.9	1.7	7.3	4.5	3.8	3.7
Paid health protection services (million USD)	0.6	0.9	3.9	1.8	0.9	0.7
Total volume of paid services (million UAH)	199.7	440.7	587.6	693.5	745.3	-
Total volume of paid services (million USD)	135.9	240.8	315.9	283.1	180.5	-
Sector's share of the total paid services (%)	0.45%	0.39%	1.24%	0.65%	0.51%	-

2. Strength of Kharkiv Oblast Healthcare Sector

Historically, Kharkiv Oblast has been considered the leading medical center of Ukraine. However, the percentage of Kharkiv versus Ukraine capacity expressed in visits (**Table 2**) and number of beds (**Table 3**) has remained constant over the last ten years at about 6%.

Table 2. Capacity of Kharkiv Oblast Medical Establishments Compared with Ukraine Overall: 1990-2000 (1000 visits per shift)

	1990	1995	1996	1997	1998	1999	2000
Capacity of Kharkiv Oblast outpatient clinics	56	59	59	58	58	58	59
Capacity of outpatient clinics in Ukraine	895	966	960	964	966	973	992
Percentage share of Kharkiv Oblast medical establishments compared with the capacity of the medical establishments of Ukraine.	6.3%	6.1%	6.1%	6.0%	6.0%	6.0%	5.9%

Table 3. Kharkiv Oblast Share in Hospital Beds Compared with Total Ukraine: 1990-2000 (1000 beds)

	1990	1995	1996	1997	1998	1999	2000
Quantity of hospital beds in Kharkiv Oblast	42	42	39	31	30	30	30
Quantity of hospital beds in Ukraine	700	639	580	583	483	477	476
Percentage share of Kharkiv Oblast hospital beds in Total Ukraine	6.0%	6.6%	6.7%	5.3%	6.2%	6.3%	6.3%

Health care rendered in Kharkiv Oblast during the last ten years makes up approximately 5.6%-5.8% of total health care services rendered in Ukraine, as shown in **Table 4**. [3, p. 511; 1, p.188; 12]

Table 4. Healthcare Patients in Kharkiv Oblast Relative to Total Ukraine Population: 1995-2000 (1000 persons)

	1990	1995	1996	1997	1998	1999	2000
People given healthcare in Kharkiv Oblast	972	898	827	821	820	803	805
People given healthcare in Ukraine	17,800	16,000	14,900	14,200	14,100	14,100	14,110
% of people given healthcare in Kharkiv Oblast vs. Total Ukraine	5.5%	5.6%	5.6%	5.8%	5.8%	5.7%	5.7%

Healthcare patients in Kharkiv Oblast per 1,000 people for the last 10 years is approximately 10%-13% less compared with the corresponding number of people in Ukraine overall, as shown in **Table 5**. [3, p. 511; 1, p.188; 12]

Table 5. Number of People Given Healthcare in Kharkiv Oblast and in Ukraine: 1990-2000 (per 1000 people)

	1990	1995	1996	1997	1998	1999	2000
People given healthcare in Kharkiv Oblast per 1000 people	304	291	271	272	274	271	273
People given healthcare in Ukraine per 1000 people	345	313	292	282	282	284	286

For the first time, the State has spent 217 million UAH for a centralized supply of vaccines, insulin, antituberculin and oncological medications. State budget increases will raise healthcare staff salaries by 25%, or 0.5 billion UAH.

As a percentage of GDP, healthcare will remain stable based on the government's increasing the share from the present 3% to at least 5%. The primary methods to fund this increase include:

- using different channels of funding providing compulsory state medical insurance
- creating a regulated market of chargeable healthcare services
- extra-budget means, including charity donations, financing by various international programs, and similar approaches. [2, p. 5]

Ukraine's Minister of Healthcare, Vitaliy Moskalenko, said that 663 million UAH in extra-budget funds were spent in 2000—an increase of 46% compared with 1999, and twice the extra-budget funds spent in 1998.

Unfortunately, not all funds were used efficiently or legitimately. About 24 million UAH were used to offset deficits or were embezzled in 2000. There are minimal fiscal controls in the various health protection departments, with the majority of such violations uncovered in Kyiv, and the Sumy, Lviv, and Donetsk regions. Investigations have resulted in reprimands for 729 officials, and dismissal of 90 officials.

Ukraine ranks 111th among 191 countries in per capita healthcare expenditures. Seven countries of the former Soviet Union are ahead of Ukraine in per capita healthcare spending—namely the Baltic States, Byelorussia, Russia, Moldova, Armenia. However, it is worth noting that according to the integral criteria of the World Health Organization, Ukraine ranks 60th among other countries of the world. Minister of Health Care Vitaliy Moskalenko believes that this data demonstrates that the intellectual and material resources of this sector are being fully utilized. In 2000, for the first time in the history of Ukraine, the infant death-rate decreased from 12 per 1000 live births to 11.91. The maternal death rate has decreased as well, at 25.6 per 1,000 live births. Owing to the implementation of the national program of immunoprophylaxis, 96% of the children are inoculated. [2]

The medical establishment network has been reorganized by eliminating excess capacity. For example, the total number of beds has been reduced to the optimum of 88.3 beds per 10,000 of the population. However, there are excess beds in some regions of Ukraine, and in some regions the standards of health care still remains low.

A comparison of the commercial activities of Kharkiv Oblast healthcare enterprises with those of Ukraine overall reveals that the region's share in paid services (revenues from realization) for the population has fluctuated during the period 1995-2000, from 2% to 6.4%, as shown in **Table 6**. [3, p. 288; 1, p.188; 12]

Table 6. Kharkiv Oblast Sector Share in Total Ukraine Paid Services: 1995-2000

Sector's size	1995	1996	1997	1998	1999	2000
Kharkiv Oblast Healthcare sector revenues (million UAH)	0.9	1.7	7.3	4.5	3.8	3.7
Kharkiv Oblast Healthcare sector revenues (million USD)	0.6	0.9	3.9	1.8	0.9	0.7
Ukraine Healthcare sector revenues (million UAH)	41.8	84.7	113.0	129.0	132.7	148.8
Ukraine Healthcare sector revenues (million USD)	28	46	61	53	32	27
Kharkiv Oblast sector share in Ukrainian Healthcare sector	2.1%	2.0%	6.4%	3.5%	2.9%	2.5%

3. Economic Condition of Sector Enterprises and Organizations

The main source of funding for health care comes from state and local budgets. The Kharkiv budget is comprised of ten independent budgets—nine regional and one local.

The approved 2000 Kharkiv city budget provided for about 45% of healthcare needs. The 2000 budget was 69.1 million UAH, 20.3% of the local budget (compared to 23.9% in 1996). Salary costs are 76.8% of the combined sector's budget. [12; 13] Imposed budget deficit reduction measures included reductions in spending for medical supplies and foodstuffs, as well as non-paid holidays of up to one month.

The Kharkiv Oblast State Administration developed the following allocation structure:

- 10% of the budget to provide healthcare services
- 10% for the privileged contingent
- 40% to out-patient clinics
- 40% to in-patient clinics [5, p. 30].

Although the Healthcare sector enjoys a higher priority than other sectors in terms of state financing, many officials believe that there are limits. In 2000, payments for healthcare made up approximately 12% of the combined budget, compared with 10.9% in 1999. This increase stemmed healthcare staff salary arrears; and an additional 20 million UAH has been included in the 2001 state budget for healthcare staff payments. Salaries for healthcare staff will make up 53% of the health protection sector budget in 2001, and Healthcare sector staff salaries are expected to increase by 25%. [2]

4-5. Sector Development: Raw Materials/Technological Base

According to the specific character of the sector, it seems appropriate not to detach the material base from the technological base, and to speak instead of the material and technological base of the sector development.

Kharkiv has several historic and architecture monuments to the material and technological base:

- The buildings of the city mental hospital (built in 1796)
- City hospital ? 1 in the Karl Marx Street (the former "Alexandrovska hospital, built in 1869)
- The former "Nikolayevska hospital" on Moskovskiy boulevard (built in 1895)
- City ophthalmological and otolaryngological clinics
- City clinical hospital ? 2, polyclinic for city workers (built in 1927)

The material and technological base of the Kharkiv Oblast Healthcare sector has developed over the last 60-65 years. Up to the 1970s, healthcare institutions were not up to generally accepted standards. The creation of a modern medical technological base was developed over the past 30 years, and included wide-scale construction of standard polyclinics for adults and children, stomatological polyclinics, medical centers, maternity hospitals, isolation hospitals, ambulance substations, etc. A goal of current technological base development was to provide residents of every district with a comprehensive healthcare system of polyclinics for children and adults located as close as possible to apartment blocks and evenly distributed through the territories of the settlements. In addition, inpatient care medical complexes incorporated several kinds of specialty healthcare services.

Stationary care was developed by building medical establishments that combined several forms of special medical care. Thus, from 1980 to 1996, eleven medical buildings with 2,970 beds were put into service. During the same period, ten hospitals with 8,500 visits per shift over all hospitals, seven children's hospitals with 3.255 visits per shift, two stomatological hospitals with 60 chairs, and six ambulance stations were built according to standard designs. [5, p. 35]

Still, with all these advances, the Minister of Health Care believes that the medical technology base in Ukraine on the whole remains unsatisfactory. For example, approximately 45% of X-ray and EKG equipment is old and dilapidated. In 2000, for the first time in the recent past, medical equipment purchases totaling 18 million UAH were made for more than 200 units of high-tech (mainly domestic) medical apparatus. [2] However, this 18 million UAH investment comes to only 36 kopecks per capita in Ukraine overall.

6. Investment Activities in the Sector

Investments carried out in commercial healthcare organizations have not been analyzed within the framework of this report, due to a lack of appropriate data. Since the Healthcare sector is financed predominantly through the state budget, there has been no full value investment process so far (no history of investments yielding profits).

7. Employment and Personnel Potential in the Sector

The percentage of staff (doctors and mid-level personnel, including nurses, doctor assistants, etc.) employed in the Kharkiv Oblast sector has remained constant over the last 6 years at about 3.5-3.8% on average of the total employed in Kharkiv Oblast, as shown in **Table 7**. [1, p. 331; 1, p. 261]

Table 8. Sector Share in Total Kharkiv Oblast Employment: 1995-2000 (1000 employees)

	1995	1996	1997	1998	1999	2000
Kharkiv Oblast Healthcare sector employees	52.3	52	50.5	49.4	48.7	48.7
Total Kharkiv Oblast employees	1468	1400	1422	1412	1387	1390
Percentage employed in the Healthcare sector compared to total employment in Kharkiv Oblast	3.6%	3.7%	3.6%	3.5%	3.5%	3.5%

The number of doctors of all specialties in Kharkiv Oblast has ranged between 15,500 to 16,000 for the last six years, or 6.8-7% of the total of doctors in Ukraine, as shown in **Table 8**. [1, p. 331; 12]

Table 8. Number of doctors in Kharkiv Oblast and in Ukraine: 1995-2000 (1000 doctors)

	1995	1996	1997	1998	1999	2000
Number of doctors of all specialties in Kharkiv Oblast	16.0	15.8	15.6	15.5	15.5	15.6
Number of doctors of all specialties in Ukraine	230	229	222	227	228	229
Percentage of Kharkiv Oblast doctors relative to the total number of doctors in Ukraine	7.0%	6.9%	7.0%	6.8%	6.8%	6.8%

On average, there is 1 doctor per 260 inhabitants, and 1 medical clerk per 130 inhabitants. The majority of doctors (58.9%) work in outpatient clinics and as ambulance rescue workers. Of the total number of doctors in Kharkiv Oblast, there are:

- 882 general practitioners (15% of total)
- 823 dentists (14%)
- 608 pediatricians (10.4%)
- 221 surgeons (3.6%)
- 404 gynecologists (6.9%)
- 117 ophthalmologists (2.0%)
- 114 otolaryngologists (1.9%)
- 191 neuropathologists (3.2%)
- 150 anesthetists and resuscitators (2.6%)
- 588 interns take their internship at medical establishments of the local administration. Kharkiv medical establishments guarantee internships for 16 specialties, including general practitioners, surgeons, pediatricians, dentists, gynecologists and others [2, p. 37]

About 20% of all practicing doctors and 11% of mid-level medical staff take postgraduate courses annually.

The mid-level medical staff in Kharkiv Oblast comprises 5.8%-6% of the total mid-level medical staff of Ukraine, as shown in **Table 8**. [3, p. 511; 12; 1,p. 331]

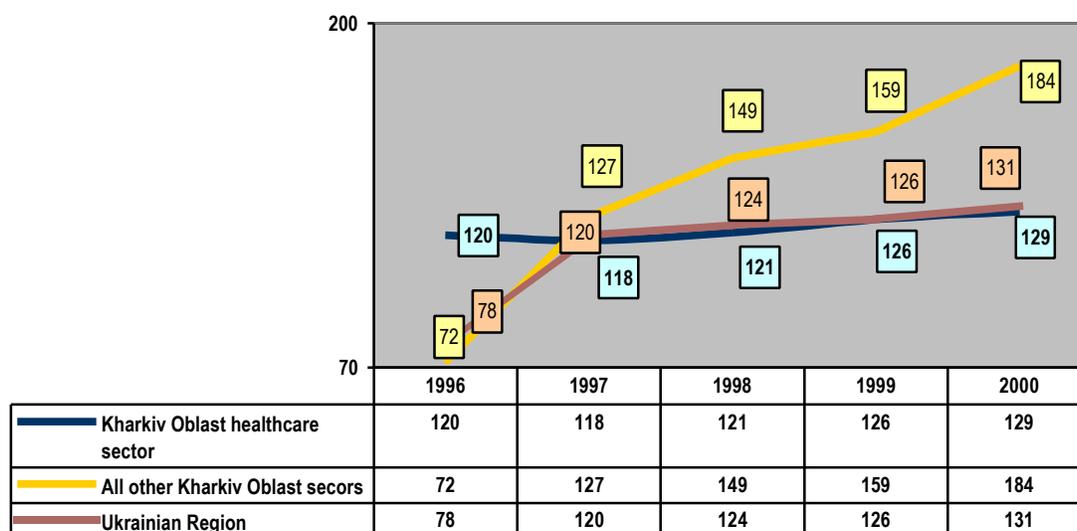
Table 8. Mid-level Medical Staff in Kharkiv Oblast and in Ukraine: 1995-2000 (1000 people)

	1995	1996	1997	1998	1999	2000
Mid-level medical staff in Kharkiv Oblast	36.3	36.2	34.9	33.9	33.2	33.1
Mid-level medical staff in Ukraine	595.1	-	-	582.1	553.4	-
Percentage of Kharkiv Oblast mid-level medical staff relative to total mid-level medical staff in Ukraine	6.1%	-	-	5.8%	6.0%	-

It should also be mentioned that women employees make up 83.1% of the Healthcare sector of Kharkiv Oblast.

The average monthly salary in the sector of the region for the year 2000 was 1.5% less than in the same sector throughout Ukraine—and nearly 40% less than the average salary in Kharkiv Oblast on the whole. Average monthly wages are shown in **Diagram 8**. [3, p. 414; 8,p. 155-156]

Diagram 8. Average monthly wages, 1996-2000, UAH.



Rural areas are lacking the necessary doctors of all specialties as well as mid-level medical staff. In Kharkiv Oblast in 2000, on average there were only 90.3% of the doctors of all specialties needed. Particularly hard hit are the Pervomaysk, Kolomak, Krasnokutsk, Lozova, Dvurichansk districts of the region, as shown in **Table 9**.

Mid-level medical staff manpower is in better shape, however. There is an average of 100.5% of the general demand of the corresponding employees in the region. However, two districts, Zmiiv and Kolomak, suffer from a considerable shortage of these employees, at 87.9% and 76.9%, respectively (**Table 9**). [13; 12]

Table 9. Established Posts for Doctors and Mid-Level Medical Staff in Kharkiv Oblast Districts: 2000

	District	% Posts Filled by Doctors	% Posts Filled by Mid-Level Medical Staff
1	Zachepyliv	100	117
2	Novovodolazsk	100	103.7
3	Sakhnovshinsk	100	100
4	Shevchenko	100	100
5	Barvinkiv	100	90.5
6	Kharkiv	96	95.8
7	Dergachi	94.1	108.6
8	Blyznyuki	91.7	107.7
9	Krasnograd	91.7	106.9
10	Valki	90	95.8
11	Kupyansk	87.1	91.2
12	Zmiiv	86.7	87.5
13	Bogodukhiv	85.7	107.7
14	Zolochiv	84.6	93.3
15	Izyum	82.4	113
16	Chuguiv	81.3	102.7
17	Velyki Burluky	80	117.1
18	Vovchansk	80	109.7
19	Borivske	80	102.3
20	Pechenigy	80	92.3
21	Pervomaisk	78.6	95
22	Kolomak	75	76.9
23	Krasnokutsk	73	105.5
24	Lozova	71.4	121.8
25	Dvorichansk	70	94.2
	REGION	90.3	100.5

As of January 2001, there were no statistics available for outpatient and divisional hospitals in Kharkiv Oblast's Balakliya and Kegychivka districts.

8. Sector Exports

It would be premature to discuss the export potential of the Healthcare sector in Kharkiv Oblast. Moreover, the State Statistics Committee of Ukraine doesn't itemize export and import indexes of the Healthcare sector for Kharkiv Oblast export and import services.

9. Competitive Environment of Sector Enterprises and Organizations

Since healthcare is considered to be free of charge (at least at the legislative level), the essential conditions for sound competition have not yet been created. The economical indices of the healthcare establishments remain rather low: only 1.25 UAH/per capita/year was spent on healthcare services in 2000. However, in 2000, 250 UAH/per capita/year was spent on non-medical services (i.e., every inhabitant spent only 0.5% on healthcare services considering all paid non-medical services expenditures in 2000).

As of January 2000, Kharkiv Oblast had:

- 27 regional medical establishments
- 57 city hospitals
- 27 central district hospitals
- 62 divisional hospitals
- 74 out-patient departments
- 38 dispensaries
- 13 dental polyclinics
- 46 sanitation and epidemiological stations
- 23 autarkic medical establishments
- 5 maternity hospitals
- one republican rejuvenation treatment hospital
- one AIDS prophylaxis and control center
- 12 sanatoria
- three orphanages
- 718 obstetrical stations
- 163 health stations

A considerable portion of the profits earned in the Healthcare sector remain in the shadow economy. It is imperative that Ukraine legalizes the existing shadow economy as soon as possible, so an accurate picture of healthcare expenditures/capita can be made.

10. Ownership in the Sector

As shown in **Table 10**, about 75% of existing medical institutions in the Healthcare sector are state enterprises. The share of the overseas firms is a mere 0.5%.

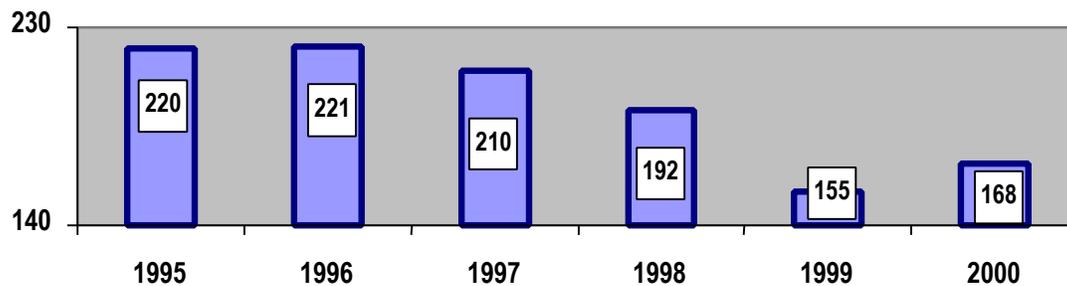
Table 10. Number of Sector Enterprises in Kharkiv Oblast: 1995-2000

	1995	1996	1997	1998	1999	2000
Number of state enterprises	263	260	268	265	276	285
Number of overseas firms	---	1	2	1	2	2
Total sector enterprises	376	383	378	378	378	380

11. SME Growth in the Sector

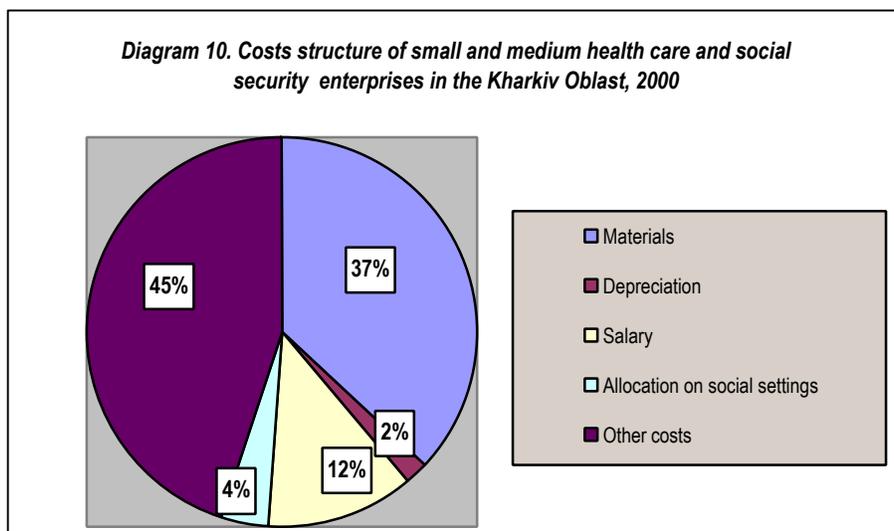
The number of small enterprises in the Healthcare sector has decreased by 30% over the last six years, from 220 in 1995 to 168 in 2000, as shown in **Diagram 9**. [9]

Diagram 9. Small enterprises of the healthcare sector, 1995-2000



The production price structure of small and medium healthcare, physical training, and social security enterprises is presented in **Diagram 10**. [9]

Diagram 10. Costs structure of small and medium health care and social security enterprises in the Kharkiv Oblast, 2000



In 1999, small healthcare enterprises offered 729 jobs for healthcare workers, 612 of which were permanent positions. [9] Healthcare experts forecast an increase in 2001 in the number of small and medium enterprises, their products, and the number of workers employed at these enterprises.

12. Sector Infrastructure

Kharkiv Oblast has a well-respected school for healthcare training and professional development. The school includes three higher educational establishments and eight medical colleges. Applied and fundamental scientific research is being conducted at 13 academic and scientific research institutes (SRI). Over 7,000 scientists work at scientific and educational establishments in the oblast. Of this total, 1,500 hold master degrees, and about 410 have doctorates. There are also 52 academicians of various domestic and foreign academies, and more than 100 people have been honored with national awards.

The state boasts many healthcare/medical and research institutions, including:

- Ukrainian Pharmaceutical Academy
- Kharkiv State Medical University
- Kharkiv Medical Academy of post-degree education
- SSCM
- Ukrainian Institute of pharmacological therapy of endocrine diseases
- Ukrainian R&D Institute of juvenile health protection
- Ukrainian R&D Institute of clinical and experimental neurology and psychiatry
- Ukrainian R&D Institute of dermatology and venerology
- Institute of cryobiology and cryomedicine of NAS of Ukraine
- Institute of therapy of the Academy of medical sciences of Ukraine
- Kharkiv R&D Institute of microbiology and immunobiology
- Kharkiv R&D Institute of orthopaedy and traumatology
- Kharkiv R&D Institute of medical radiology "Grygoryev"
- Kharkiv R&D Institute of general and urgent surgery of the Ministry of healthcare of Ukraine.

13. Management Capabilities of Sector Enterprises and Organizations

Many Healthcare sector managers in Kharkiv Oblast are facing difficult challenges. Although these managers are generally highly educated specialists with many years' of experience in both medical and scientific fields, they are nonetheless at the mercy of budgetary constraints. As a result, it is difficult for these managers to become modern cost-conscious managers in their organizations.

14. Administrative Impact on the Sector

In 2000, the Verhovna Rada passed about 20 laws on various problems of the Healthcare sector, including 7 for immediate budgetary action. The government program, "Reforms for Welfare" approved by the Verhovna Rada is one example of a comprehensive piece of legislation that impacts the Healthcare sector.

Minister of Health Care, Vitaly Moskalenko, has expressed the view that the executive branch of government has contributed considerably to the consolidation of the legislative and normative base of the Healthcare industry. In 2000, the President of Ukraine issued 10 decrees and resolutions; approximately 50 decrees and resolutions were issued by the Cabinet of Ministers, and are currently being implemented. One of the objectives is a stage-by-stage increase in state budgets in the Healthcare sector. For example, the 1998 budget for all levels for the healthcare was 3.6 billion UAH; in 2000, however, 4.3 billion UAH were budgeted for healthcare. In 2001, funds slated for healthcare are expected to exceed 5 billion UAH. [12]

Recently passed laws have outlined ways to improve the state of the Healthcare sector, as have resolutions and other legislative and executive documents. For example, the president-approved decree "On additional measures as to improvement of the medical care for the population of Ukraine" is very important. The decree provides for a complex of inter-sector measures for raising the standards of health care for Ukrainian citizens. And in an effort to raise awareness of the importance of health care in the Ukraine, 2001 has been declared the Year of Health.

The President has also approved the Concept of Healthcare Protection for the population of Ukraine. This Concept outlines a fundamental resolution of the problem of extra-budget sources for sector financing. These sources include compulsory state social health insurance, free-will health insurance, funds of the territorial societies, medical funds earmarked for special purposes, and free-will donations of juridical and natural persons.

With anticipated approval by the Verhovna Rada of the "Law of compulsory state health insurance," multiple sources of financing, legalization, and development of chargeable healthcare services may become a reality. The act will protect a citizen's rights to medical services guaranteed by the state, as well as higher quality medical services provided by the state and private sector. To achieve these objectives, plans have been developed to enlarge and improve the network of private healthcare institutions, and to create a workable market of healthcare services to provide alternative sources of medicine financing.

15. Social Issues of Sector Development

Adverse social and economic conditions in Ukraine have lead to an increase in certain "social" illnesses. For example, the rate of tuberculosis is increasing, drug addiction/drug abuse is on the rise, and the number of AIDS and HIV-positive patients is growing.

The total rate of illness among people in Kharkiv Oblast has increased gradually over last five years, as shown in **Table 11**. For example, the total number of diseases per 100,000 people in Kharkiv Oblast in 1999 increased by 36% relative to 1995. Over the same period, the number of disease-related complications during pregnancy increased by 46%; urino-genital diseases increased by 43%; endocrine system diseases increased by 38%; blood diseases increased by 22%; and dysbolism and immunity failure increased by 20%. [1, p. 333]

Table 11. Kharkiv Oblast Illness Rates by Disease Type: 1995-1999 (100,000 people)

	1995	1996	1997	1998	1999
Disease	42,947	53,533	55,760	57,457	58,600
Infectious and parasitic diseases	2,564	2,537	2,400	2,669	2,579
Neoplasm, indigestion, dysbolism and immunity failure	654	681	706	786	782
Endocrine system diseases	391	376	421	552	539
Blood diseases	176	171	204	251	215
Nervous system diseases	5,431	5,506	5,667	6,191	6,372
Respiratory diseases	29,279	23,664	25,583	24,474	25,806
Blood circulation system diseases	2,438	2,334	2,590	2,890	2,801
Digestive system diseases	1,788	1,810	1,744	1,890	1,968
Urino-genital system diseases	2,221	2,399	2,660	3,005	3,168
Complications during pregnancy	3,839	4,071	4,701	5,500	5,618
Skin diseases	4,520	22,452	4,215	4,380	4,432
Bone and muscle system diseases	2,366	2,329	2,448	2,709	2,503

Similar statistics are characteristic for all of the countries of the former Soviet Union, and in fact some countries face even more dire health conditions. One of the factors that leads to an increase in the Kharkiv Oblast illness rate is a decrease of available medicines, medical equipment, etc.

In spite of these facts, however, there are certain positive healthcare trends in Ukraine. For example, the all-important combined infant and maternity death rate has decreased. It is worth noting that industrial injuries have declined as well.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

At present, there is no data available on investment proposals for sector enterprises and organizations.

Conclusions

The Healthcare sector is an integral part of the Kharkiv Oblast economy. The sector provides healthcare services to more than 800,000 inhabitants throughout the region and employs 3.5%-3.8% of the total workforce in the region.

However, healthcare cannot be considered a typical business sector in the region. Medicine remains non-paid for every citizen of Ukraine, at least according to the law; while health care is financed from state budgets. Commercial health care is still too weak to influence the oblast's economy as a whole.

The most realistic strategy for Healthcare sector development is to increase the level of state and non-state financing, simultaneously increasing effectiveness of the use of available funds. The development of commercial medical establishments in Kharkiv Oblast, as well as in Ukraine, will depend on the economic prosperity of the population.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.	Products	Directors
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There is a list of medical facilities and SRIs (Russian copy). But a quantity of the enterprises is more than 100 and we wouldn't like to pick out only several dozens of them.

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

14. ACCOMMODATION SERVICES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

Today, Accommodation Services can't be regarded as one of the most significant sectors in the general structure of Kharkiv Oblast economy. According to the most recent economic indicators, the sector's total share of Kharkiv Oblast economy is approximately 0.1%.

Traditionally, the consumers of Accommodation sector services are tourists and business travelers. Kharkiv Oblast has never been a large tourist center, either in the Soviet era, or since Ukraine independence; however, the region's huge industrial complex has always attracted a great number of people traveling on business. At present, about 5% of Ukraine's overall hotel sector material resources is concentrated in Kharkiv Oblast, but Kharkiv hotel occupancy is less than the Ukraine annual average. In 1999, Kharkiv Oblast sector share of total Ukraine hotel revenue was only 2.6%. The general decline in real income underscores the shrinking accommodation services market in Kharkiv Oblast.

Another trend worth mentioning is that today, many travelers opt to rent an apartment, as opposed to staying at a hotel, especially if they plan to stay for an extended period. Thus, on the one hand, it is evident that hotel enterprises are no longer necessarily the leaders in the Accommodation Services market, either in Ukraine or in Kharkiv Oblast. On the other hand, this state of affairs implies that hotels have huge potential for development if competent management can be found.

The successful development of hotel enterprises will require adapting to the needs of tourists and business people by providing tasteful accommodations and a decent level of support services—especially in the area of communications—at competitive prices. While the hotel industry saw a period of active growth during the '70s and '80s, intensive use and poor maintenance of buildings and equipment resulted in the advanced deterioration of Kharkiv Oblast sector facilities.

A substantial increase in sector enterprise profits can be expected only if existing facilities are extensively restored and a number of new facilities are constructed. This activity would take into account the different types of sector services required by consumers while introducing up-to-date technologies and service innovations, as well as providing an appropriate level of comfort. Today, Kharkiv Oblast's existing sector infrastructure doesn't satisfy even domestic standards. Since October 1, 1999 all hotel and public catering services providers are subject to obligatory certification; but as of September 1, 2000, there were still no certified hotels in Kharkiv Oblast.

Problems hampering sector investment include large initial outlays of capital and relatively low return on investment. Judging from the experience of a number of enterprises in Ukraine and the CIS countries, virtually all large-scale sector projects are funded—and controlled—by foreign investors.

In the opinion of many experts, the level of foreign investment in the tourist-recreational branch is insufficient for a number of reasons. There are several barriers to foreign investment in Ukraine. Current legislation does not allow preferential tax treatment for the tourism sector. In addition, taxes on imported equipment and furniture can increase project costs by up to 30%. The reluctance of foreign investors is also explained by flaws in the legislation governing long-term land lease.

Kharkiv Oblast's major weakness, in terms of its development as a tourism center, is the relative sameness of the type and quality of accommodations available. In light of the fact that small hotels account for a minimum of 40% of hotel revenues worldwide, the lack of hotel rooms of different price and quality in Kharkiv Oblast hinders development of its tourist industry. Analysis of the sector has also shown that other types of accommodation that are widespread in other countries, such as motels, camping-sites, and youth hostels, are practically nonexistent in Ukraine. Development of these types of enterprises could help further stimulate the sector and provide additional employment.

1. Sector Role in Kharkiv Oblast Economy

The traditional consumers of accommodation services are tourists and business people. While Kharkiv has never been a major tourist center, its large industrial base has historically attracted large numbers of business travelers. The industrial recession, especially in machine building, has severely affected Kharkiv Oblast, compared with other regions less dependent on industry.

In 2000, there were 76 sector enterprises in Kharkiv Oblast, 39 of which were classed as hotels. The remainder includes motels, camping sites, and hostels. Twenty-two hotels are situated in Kharkiv City. [1; 2]

Economically, the hotel sector makes up a small percentage of the overall economy of the region. Its specific share based on employment and gross operating income is about 0.1%. For better or worse, however, hotels help create a region's "postcard image," and can make a lasting impression on travelers. In addition to their direct contribution to the economy, hotels also exert a broad, indirect influence as a channel for ancillary support services, including tourism, transport, retail trade, public catering, insurance, culture and arts, architecture and design, excursion services, and advertising.

2. Strength of Kharkiv Oblast Sector

Kharkiv Oblast Market

The main economic indicators of the hotel industry in Kharkiv Oblast illustrate the sector's current stagnating condition.

Table 1. Main Indicators of the Kharkiv Oblast Hotel Industry: 1995-1999 [4]

	1995	1996	1997	1998	1999
Sector enterprises in Kharkiv Oblast	74	73	72	73	76
Rooms	3,354	3,065	3,048	2,558	2,414
Living space of all rooms (1000 m ²)	59	55	56	52	49
Beds	6,758	6,264	5,822	5,422	5,153
Coefficient of living space usage (%)	29%	28%	23%	14%	18%

According to official statistics, hotel services rendered in Kharkiv Oblast in 1999 comprised 336,500 man-days, for a total of 10.8 million UAH. [5] Operating return (charges for rooms and beds) came to 7.4 million UAH. Hotel profits made up 90% of this sum. The profits structure of sector enterprises is shown in **Diagram 1**.

Diagram 1. Kharkiv Oblast Sector Profits: 1999

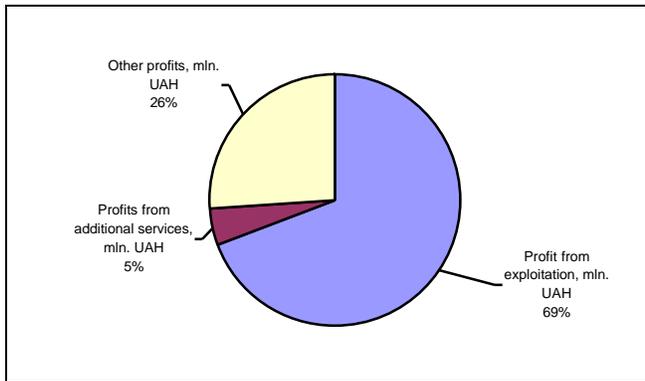


Table 2. Kharkiv Oblast Hotel Enterprise Indicators: 1999 [1; 3]

	Man-Days (1000)	Operating Returns (1000 UAH)	Calculated Price / Man-Day (UAH)
Hotels	224.0	6886.0	30.7
Other sector enterprises	112.5	501.8	4.5
Total	336.5	7387.8	22.0

In 1999, 321,000 foreign travelers stayed at Ukraine hotels, while another 220,800 people stayed at resort establishments. These figures account for only 12.7% of all foreign visitors to Ukraine (4.2 million). The remaining 87.3% did not use hotel services. [2]

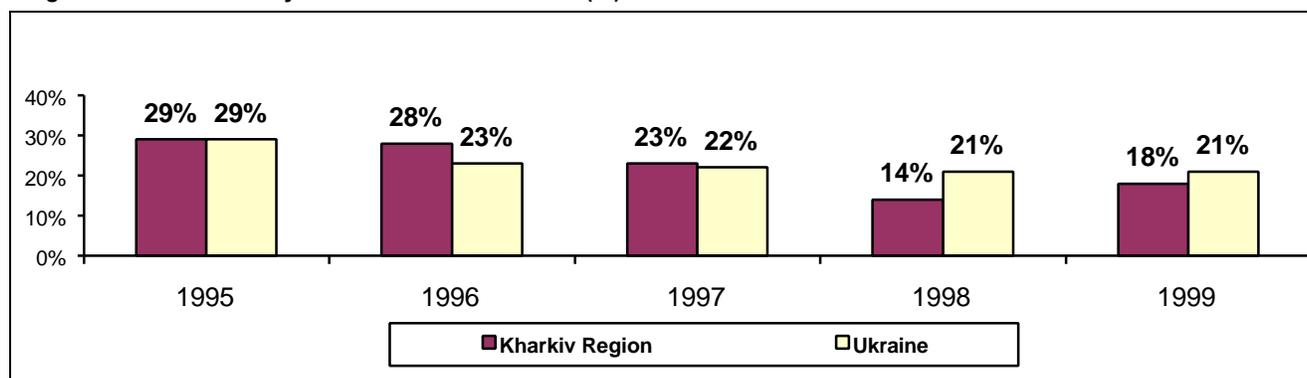
Nowadays, consumers in Ukraine have a choice of staying at a hotel or renting an apartment. The majority of visitors to Ukraine prefer to rent an apartment, especially if they plan to stay for a long time; and today, numerous companies and private persons are engaged in providing apartment accommodations.

Thus, on the one hand, it is evident that hotel enterprises are no longer necessarily the leaders in the Accommodation Services market, either in Ukraine or in Kharkiv Oblast. On the other hand, this state of affairs implies that hotels have huge potential for development if competent management can be found.

Ukraine Market

Accommodation Services efficiency is measured according to the coefficient of utilization. Since 1990, the number of people using hotel services has declined due to a decline in domestic tourism, decreased business activity, falling levels of personal income, and substantial price increases for hotel services. The average annual occupancy rate of Ukrainian hotels has decreased from 80% in 1990 to 21% in 1999, while the correspondent occupancy rates for Kharkiv enterprises are even lower, as shown in **Diagram 2**.

Diagram 2. Hotel Industry Coefficient of Utilization (%)



Hotel enterprise main indicators for 1999 are shown in Table 3. [2; 3; 5]

Table 3. Ukraine Hotel Enterprise Main Economic Indicators: 1999

Region	Hotels	Rooms	Beds	Coefficient of Living Space Usage	Consumers (1000)	Supplied Man-Days	Income (million UAH)
Crimea	83	4,840	9,701	0.20	123.1	695.5	22.6
Vinnitsya	29	1,016	2,042	0.30	96.9	225.9	4.7
Volyn'	31	1,262	2,529	0.18	76.0	167.4	5.2
Dnipropetrovs'k	85	3,180	6,470	0.24	288.9	576.5	19.8
Dochains'k	76	3,658	6,776	0.22	132.8	544.3	10.5
Zhytomyr	37	1,121	2,321	0.12	60.0	100.4	3.5
Zakarpattya	32	1,171	2,363	0.20	86.1	170.8	5.3
Zaporizhzhya	71	2,006	4,003	0.20	123.9	299.5	7.0
Ivano-Frankivs'k	36	1,295	2,457	0.20	67.3	176.5	11.1
Kyiv	46	1,416	2,775	0.24	89.2	247.6	5.2
Kirovograd	26	615	1,269	0.15	32.0	69.6	2.0
Lugans'k	46	1,925	3,606	0.11	52.0	138.7	3.3
L'viv	59	2,620	5,293	0.17	146.1	321.0	16.2
Mykolaiv	47	1,233	2,636	0.10	41.5	97.4	4.0
Odesa	108	3,872	8,688	0.24	213.5	750.5	25.3
Poltava	67	1,724	3,670	0.24	130.8	316.0	6.9
Rivne	22	,992	1,818	0.20	70.3	132.5	3.0
Sumy	39	891	2,103	0.20	51.2	151.0	2.8
Ternopil'	27	1,207	2,933	0.09	41.3	94.5	2.4
Kharkiv	76	2,414	5,153	0.18	132.8	336.5	10.8
Kherson	51	1,535	3,328	0.14	61.0	164.3	2.6
Khmel'nytsky	35	850	1,808	0.17	47.4	114.9	2.2
Cherkasy	35	1,166	2,336	0.21	68.6	180.0	3.6
Chernivtsi	20	968	1,863	0.18	62.7	121.1	2.7

Region	Hotels	Rooms	Beds	Coefficient of Living Space Usage	Consumers (1000)	Supplied Man-Days	Income (million UAH)
Chernygiv	51	878	2,017	0.16	53.8	115.1	2.5
Kyiv City	82	6,948	12,757	0.37	711.0	1,711.0	189.1
Sevastopol' City	9	648	1,507	0.27	34.7	148.5	3.7
Total Ukraine	1,326	51,450	104,224	0.21	3,094.9	8,167.0	378.0

Diagram 3. Share in Total Ukraine Sector Volume by Region

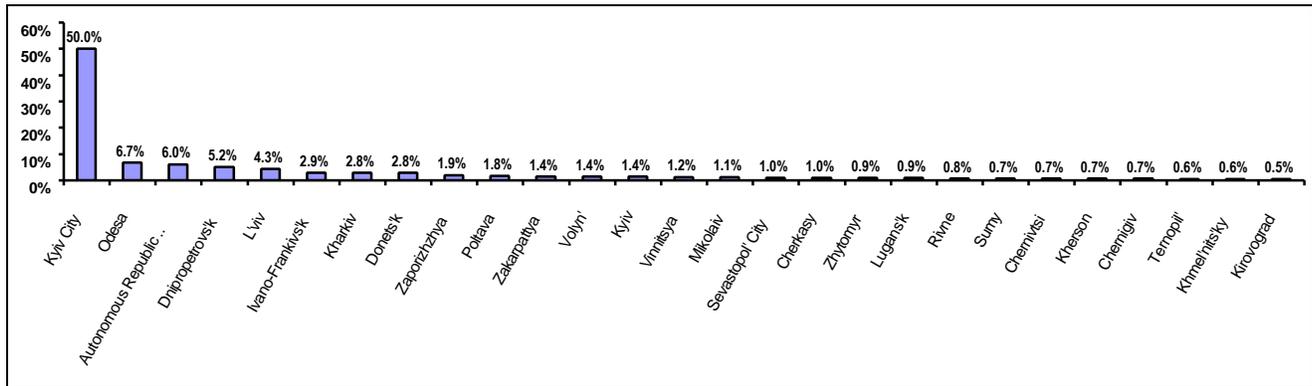
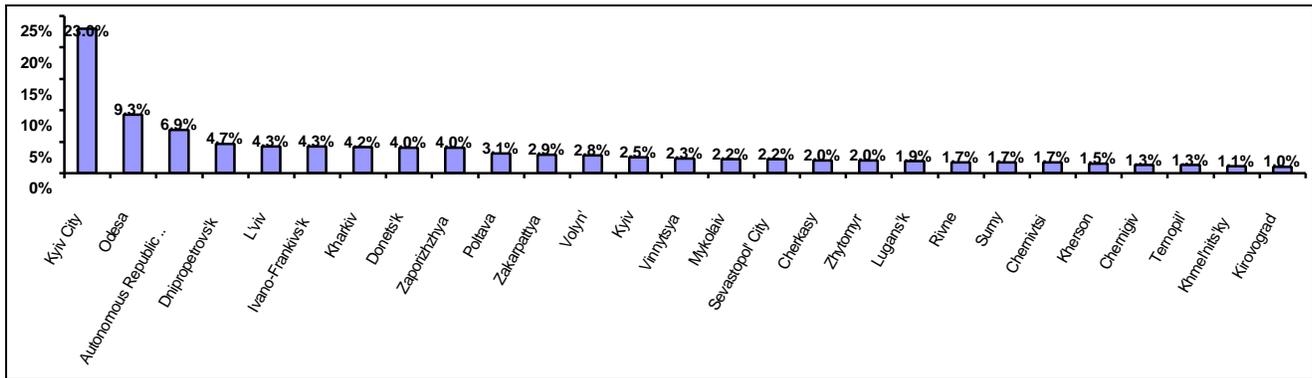
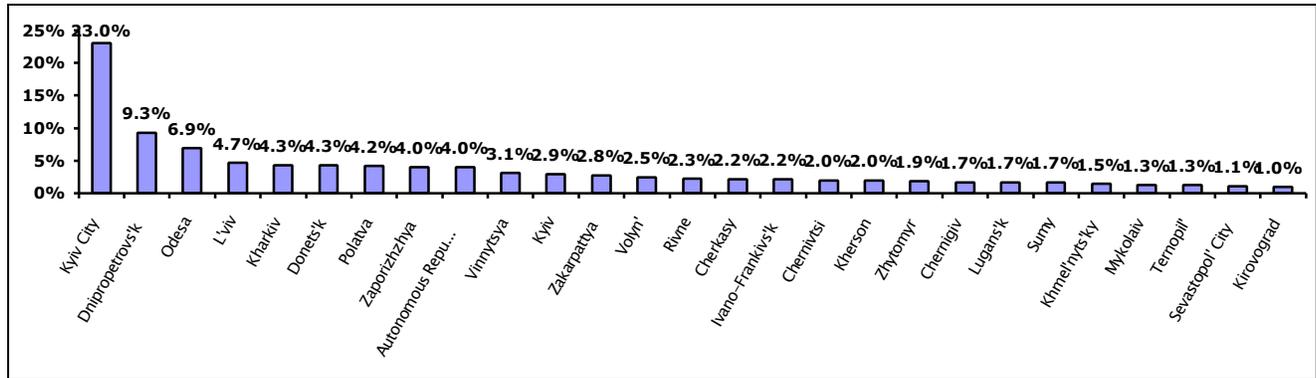


Diagram 4. Share in Total Man-Days Supplied by Region



In terms of total visitors accommodated, Kharkiv Oblast and Donetsk Oblast are tied for fifth place with 4.3%. Kyiv leads with 23%; other leaders include Dnipropetrovsk (9.3%), Odessa (6.9%), and Lviv (4.7 %).

Diagram 5. Share in Total number of Visitors Accommodated by Region



Thus, on the one hand, the main market indicators show that Kharkiv Oblast consistently ranks between 5th and 7th place in the industry overall compared with other regions. However, it may be more correct to say that Kharkiv Oblast is at the top of the middle group of regions in terms of sector market share, as opposed to being at the bottom of the leading group.

3. Economic Condition of Sector Enterprises and Organizations

Kharkiv hotels cater mostly to sportsmen, businessmen, science educators and industry personnel attending seminars, and other foreigners.

The low level of wages has a strong negative impact on the sector. Total hotel enterprise revenue in Kharkiv Oblast in 2000 was 7.4 million UAH, with operating costs approximately 23% higher than income. For this reason, hotel enterprises were forced to seek an additional 3.4 million UAH from ancillary paid services and other activities.

The following information on Kharkiv Hotel, one of the central hotels of the city, helps illustrate how the oblast's hotels survive. [6]. The situation described is typical for the majority of Kharkiv hotels.

Operating costs have risen as follows:

- 1996: 1,108,400 UAH
- 1997: 1,329,400 UAH
- 1998: 1,766,700 UAH

Losses resulted from operating activity made up 102,000 UAH in 1998. The balance of profit was 60,500 UAH, or 3.4%.

In spite of the unprofitability of the hotel's main activity, additional revenue was obtained through other operations, including:

- nonresidential room rental: 145,000 UAH
- office rental: 281,4000 UAH
- function hall rental: 4,600 UAH
- other*: 10,300 UAH

*Breakfasts, texts translations, etc.

This analysis has shown that the volume of additional services in the hotel industry is increasing, even without a substantial increase in the number of beds.

4. Sector Development: Raw Materials Base

Utilities are one of the key raw materials for the hotel industry: electric power, heating, cold and warm water, gas, etc. The two outstanding problems here are: price and quality.

According to the Kharkiv Oblast Statistics Department, prices (tariffs) on housing and communal services in 2000 rose faster than on any other paid services (21%). [7] The rise in prices for hotel services in Kharkiv Oblast in 1999 was even higher (31%). [8] Coupled with the general decline in personal income, higher utility costs contributed to an overall decline in hotel services revenue.

Given the poor quality of regional utility products, a number of hotel enterprises have begun to consider the possibility of installing their own electricity and heat generators. However, it is likely that only those enterprises catering to an elite business clientele could justify the expense of this alternative.

5. Sector Development: Technological Base

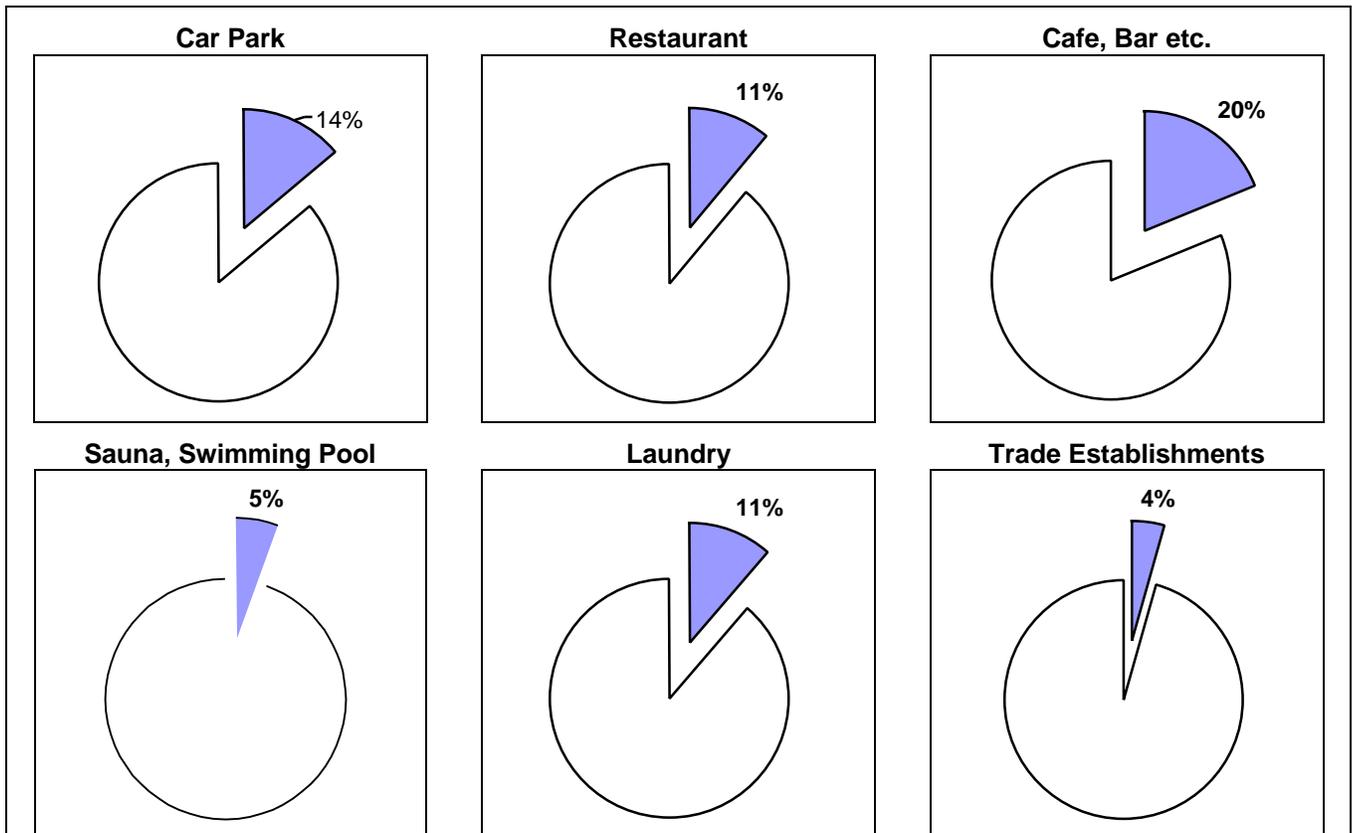
Further development of the hotel industry is impossible without modern equipment and new technologies.

During the late '70s and early '80s, a number of hotel enterprise chains were formed. However, the majority of construction projects (hotels, motels, camping sites, health centers, and recreation centers) did not meet international standards. Intensive use during the period of mass tourism (1960-1980), as well as a lack of timely capital improvements and maintenance, led to substantial deterioration of these facilities.

A substantial increase in profits for hotels catering mainly to domestic and foreign tourism can be expected only if existing facilities are extensively restored and a number of new hotels are constructed. New facilities must cover a range of different types and classes to meet the demand of different categories of citizens. New facilities should also introduce the latest technologies and services, as well as provide an appropriate level of comfort.

As shown in **Diagram 6**, the existing tourism infrastructure does not yet meet international standards. Only 11% of Kharkiv Oblast hotels have restaurants; only 14% have adequate parking facilities; and 5% have saunas or swimming pools. The majority of hotels have no modern means of communication or conference facilities with appropriate audiovisual/translation equipment and technical support services.

Diagram 6. Service Structural Subsections at Kharkiv Oblast Accommodation Services Enterprises [2]



6. Investment Activities in the Sector

Investment aimed at strengthening the sector's material base cannot keep pace with the demands of the sector. Thus, realization of the Tourism Development Program through 2005 still requires more than 900 million USD for building and reconstruction of tourism objects.

Problems hampering sector investment include large initial outlays of capital and relatively low return on investment. Recent hotel construction projects in Ukraine and the CIS countries have shown that building a small hotel (40-60 beds) costs at least 5 million USD; building a larger facility of 150 or more beds would cost USD 15 million or more. All major construction and renovation projects in the former Soviet Union are funded—and controlled—by foreign investors. Most of these projects are in major cities and are aimed at high-level business travelers. The expected payback period is about 15 years.

Another trend consists of modernizing small hotels to bring them to at least the three-stars level. Average cost for this type of project is approximately 1.5 million USD, with payback periods of about 4-5 years, assuming the facility has a good location and a reliable business client base.

There are several barriers to foreign investment in Ukraine. Current legislation does not allow preferential tax treatment for the tourism sector. In addition, taxes on imported equipment and furniture can increase project costs by up to 30%. The reluctance of foreign investors is also explained by flaws in the legislation governing long-term land lease. Those Kharkiv hotels that still “survive” are doing so by gradually renovating rooms. This allows owners to avoid the high financing costs of large loans. However, this piecemeal approach ultimately compromises their ability to carry out a thorough renovation.

7. Employment and Personnel Potential in the Sector

Qualified, competent staff is the main factor that guarantees successful provision of hotel services. The majority of Kharkiv Oblast hotel personnel do not have sufficient customer-oriented training to enable them to serve foreign tourists. This is due in part to the fact that the opportunities to train staff abroad are limited and costly. Training in Ukraine averages about 4,000 USD for 30 persons for a one-month course. This is simply too expensive for most hotels.

Development of Ukraine’s Accommodations sector will require establishing a system for training personnel and raising the level of professional qualification. There are many opportunities for people with higher education in the hotel and restaurant business, and the development of national and international tourism, and the reviving of business activity, will increase demand for new hotels and motels. According to the German Union of Accommodation Services Enterprises, the lack of qualified personnel was the sector’s main problem in 2000.

Analysis of the sector has also shown that other types of accommodation that are widespread in other countries, such as motels, camping-sites, and youth hostels, are practically nonexistent in Ukraine. Development of these types of enterprises could help further stimulate the sector and provide additional employment.

8. Sector Exports

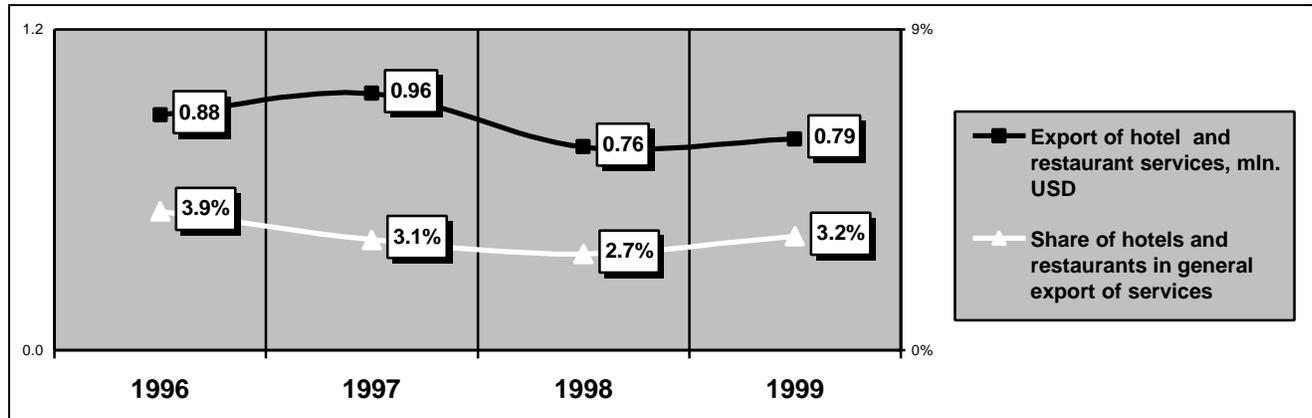
The number of foreign visitors accommodated is an important indicator of hotel activity, since tourists and business travelers are a primary source of foreign exchange earnings. Ukrainian accommodation services provided to foreign guests may thus be considered its “export” activity.

In 1999, 4.2 million foreign tourists visited Ukraine, down from 6.2 million in 1998 and 7.6 million in 1997. This decrease in the number of foreign tourists is due to a number of factors:

- The worsening economic situation in Ukraine, which has led to decreased interest of potential business partners and an attendant decrease in business-related travel.
- Problems with visa processing, including high costs and high consular collections.
- The high cost of travel and recreational services in Ukraine compared with other countries.
- Russia’s new protectionist policy on travel, which led to a 42% reduction in the number of Russian tourists in 1999.
- Lack of national advertising for Ukraine tourism.
- Substandard services for foreign tourists at sanitariums and health resorts.

Kharkiv Oblast sector export activity is shown in **Diagram 7**.

Diagram 7. Kharkiv Oblast Hotel and Restaurant Services Exports (foreigners served): 1996-1999



This analysis has found that two-thirds of Ukraine's tourist activity is limited to five Regions of Ukraine: Kyiv City, Autonomous Republic of the Crimea, and L'viv, Odessa, and Dnipropetrovs'k oblasts. Tourist activity by region is shown in **Tables 4 and 5**.

Table 4. Tourist Activity by Region: Foreigners Accommodated

Foreign Visitors (1000 people)		% of Foreigners in Total Visitors		% of Foreign Visitors Accommodated in Region	
Ukraine	321.4	L'viv	21.1%	Ukraine	100.0%
Kyiv City	123.6	Crimea	18.6%	Kyiv City	38.4%
L'viv	30.8	Kyiv City	17.4%	L'viv	9.6%
Crimea	22.9	Kyiv	12.4%	Crimea	7.1%
Dnipropetrovs'k	19.2	Chernivtsi	10.8%	Dnipropetrovs'k	6.0%
Odesa	17.2	Ukraine	10.4%	Odesa	5.3%
Poltava	11.7	Ivano-Frankivs'k	10.4%	Poltava	3.6%
Kyiv	11.0	Poltava	8.9%	Kyiv	3.4%
Dochains'k	10.6	Odesa	8.0%	Dochains'k	3.3%
Kharkiv	9.3	Dochains'k	8.0%	Kharkiv	2.9%
Ivano-Frankivs'k	7.0	Sumy	7.9%	Ivano-Frankivs'k	2.2%
Chernivtsi	6.8	Sevastopol' City	7.7%	Chernivtsi	2.1%
Zaporizhzhya	6.6	Kharkiv	7.0%	Zaporizhzhya	2.0%
Zakarpattya	6.0	Zakarpattya	6.9%	Zakarpattya	1.9%
Volyn'	4.6	Ternopli'	6.7%	Volyn'	1.4%
Sumy	4.0	Mykolaiv	6.7%	Sumy	1.3%
Rivne	3.4	Dnipropetrovs'k	6.7%	Rivne	1.1%
Vinnytsya	3.0	Khmel'nyts'ky	6.2%	Vinnytsya	0.9%

Foreign Visitors (1000 people)		% of Foreigners in Total Visitors		% of Foreign Visitors Accommodated in Region	
Khmel'nyts'ky	2.9	Volyn'	6.1%	Khmel'nyts'ky	0.9%
Ternopil'	2.8	Zaporizhzhya	5.3%	Ternopil'	0.9%
Mykolaiv	2.8	Rivne	4.8%	Mykolaiv	0.9%
Sevastopol' City	2.7	Chernigiv	4.7%	Sevastopol' City	0.8%
Cherkasy	2.5	Kirovograd	4.4%	Cherkasy	0.8%
Chernigiv	2.5	Lugans'k	4.0%	Chernigiv	0.8%
Kherson	2.2	Cherkasy	3.7%	Kherson	0.7%
Zhytomyr	2.1	Kherson	3.6%	Zhytomyr	0.6%
Lugans'k	2.1	Zhytomyr	3.5%	Lugans'k	0.6%
Kirovograd	1.4	Vinnitsya	3.1%	Kirovograd	0.4%

Table 5. Tourist Activity by Region: Man-Days Expended

Man-Days Expended on Foreigner Accommodation (1000)		% of Man-Days Expended on Foreigner Accommodation		% of Man-Days Expended on Foreigner Accommodation in Region	
Ukraine	863.7	L'viv	18.5%	Ukraine	100.0%
Kyiv City	314.5	Kyiv City	18.4%	Kyiv City	36.4%
Crimea	118.0	Crimea	17.0%	Crimea	13.7%
L'viv	59.5	Chernigiv	14.6%	L'viv	6.9%
Odesa	56.6	Ukraine	10.6%	Odesa	6.5%
Dnipropetrovs'k	33.9	Kyiv	10.4%	Dnipropetrovs'k	3.9%
Kharkiv	31.0	Volun'	9.6%	Kharkiv	3.6%
Dochains'k	30.0	Poltava	9.4%	Dochains'k	3.5%
Poltava	29.6	Kharkiv	9.2%	Poltava	3.4%
Kyiv	25.8	Chernivtsi	8.7%	Kyiv	3.0%
Zaporizhzhya	18.3	Sumy	8.5%	Zaporizhzhya	2.1%
Chernigiv	16.8	Mykholaiv	7.6%	Chernigiv	1.9%
Volun'	16.1	Odesa	7.5%	Volyn'	1.9%
Sumy	12.8	Rivne	6.6%	Sumy	1.5%
Ivano-Framkivs'k	11.0	Ivano-Framkivs'k	6.3%	Ivano-Framkivs'k	1.3%
Chernivtsi	10.6	Zaporizhzhya	6.1%	Chernivtsi	1.2%
Zakarpattya	10.0	Sevastopol'	6.1%	Zakarpattya	1.2%
Sevastopol' City	9.1	Dnipropetrovs'k	5.9%	Sevastopol' City	1.1%
Rivne	8.7	Zakarpattya	5.9%	Rivne	1.0%
Lugans'k	7.8	Ternopil'	5.9%	Lugans'k	0.9%
Mykolaiv	7.4	Zhytomyr	5.7%	Mykolaiv	0.9%

Man-Days Expended on Foreigner Accommodation (1000)		% of Man-Days Expended on Foreigner Accommodation		% of Man-Days Expended on Foreigner Accommodation in Region	
Kherson	6.4	Lugans'k	5.6%	Kherson	0.7%
Zhytomyr	5.7	Dochains'k	5.5%	Zhytomyr	0.7%
Cherkasy	5.6	Khmel'nyts'ky	4.3%	Cherkasy	0.7%
Ternopil'	5.5	Kherson	3.9%	Ternopil'	0.6%
Vinnytsya	5.4	Kirovograd	3.6%	Vinnytsya	0.6%
Khmel'nuts'ky	5.0	Cherkasy	3.1%	Khmel'nyts'ky	0.6%
Kirovograd	2.5	Vinnytsya	2.4%	Kirovograd	0.3%

9. Competitive Environment of Sector Enterprises and Organizations

One of the defining characteristics of the hotel industry is that its goods and services are location-specific. For example, it is not possible to talk about direct competition of Kharkiv hotels with, say, Kyiv and Moscow hotels on the Kharkiv Oblast market. However, some aspects of indirect competition concerning the place of Kharkiv Oblast sector enterprises and organizations are treated in Section 2.

10. Ownership in the Sector

There are 1,326 hotel enterprises with 104,200 beds in Ukraine. Ownership is distributed as follows [2]:

- State/municipality ownership: 40%
- Collective ownership: 57%
- Private ownership: 3%

Many experts believe that changing ownership structure is the best way to complete the incorporation process for hotel, health, and resort enterprises.

Almost all domestic private hotels are reconstructed dwellings, former hostels, or enterprise-owned hotels. Private hotels, most of which are located in Kyiv, typically maintain occupancy rates of 70%-95%.

11. SME Growth in the Sector

In Europe, large hotels make up 15%-25% of the total number of sector accommodations, while 75%-85% are motels and family type hotels. [2] Small hotels account for at least 40% of sector revenues worldwide. Analysis of the sector has also shown that other types of accommodation that are widespread in other countries, such as motels, camping-sites, and youth hostels, are practically nonexistent in Ukraine. Development of these types of enterprises could help further stimulate the sector and provide additional employment.

Tourism in rural areas (“green tourism”) is on the rise in many European countries, and Ukraine is no exception. Green tourism is popular, not only among people with average income, but also among wealthy travelers from developed countries. Green tourism has proved to be a boon for farmers and other small businesses in rural regions, and Ukraine could definitely develop this type of tourist activity. In fact, in 1996 an association of 14 regional centers was formed to promote development of green tourism in Ukraine. The association maintains a record of farms that cater to travelers, and facilitates educational, legal, and informational paperwork for travelers.

12. Sector Infrastructure

The hotel industry depends primarily on tourism. In 1999, tourist activity in Ukraine totaled 3.2 billion USD. Taxes and other compulsory payments to the budget from all sector enterprises involved in tourism came to 6.3 billion UAH. [2]

In Kharkiv Oblast, the hotel industry’s educational infrastructure is represented by the Ukrainian Association of Educational Establishments of Tourist and Hotel Profile, the Kharkiv State Academy of Municipal Services, and the Kharkiv State Academy of Nutrition Technology and Organization.

Cost-effective hotel management requires a thorough analysis of the Accommodation Services market. In addition to improving advertising and marketing, the main task of the Ukrainian Tourist Information System (UTIS) is to form a database on tourist companies and hotels, their locations, services provided, and prices for use in studying and forecasting demand. Ultimately, bringing the level of accommodation services up to world standards will help attract more foreign tourists to Ukraine.

13. Management Capabilities of Sector Enterprises and Organizations

This analysis has found that most of the heads of hotel enterprises do not pay sufficient attention to the development of their material resources. [2] Other shortcomings include insufficient effort in seeking out new investors and failure to develop appropriate business plans for investment projects. As a result, sector enterprise owners often miss the opportunity to participate in international investment trade fairs, meet with representatives of international banks and financial circles, etc.

In spite of recent improvements in service, many experts still believe that most Kharkiv Oblast hotels lag, not only behind world class hotels, but also behind ordinary hotels in Kyiv. This is attributable primarily to the majority of managers’ lack of market experience.

14. Administrative Impact on the Sector

The Ukraine Government has recently announced that tourism is one of the priority trends in national cultural and economic development. Accordingly, the Ukrainian Cabinet of Ministers founded the “Ukrayina Touryistichna” (“Traveling Ukraine”) state JSC, comprising companies of the former “Intourist” tourist complex, for the purpose of developing the tourist industry and strengthening sector material resources. Offices are located in 16 oblasts and in Crimea. The company is responsible for carrying out tourist company economic activity, as well as establishing national hotel chains patterned after foreign models.

The recently adopted program for establishing a national network of international transportation corridors offers assistance in the area of road improvement and other areas favorable to the development of tourism. The national highways network delineated by the program covers practically the whole of Ukraine; approximately 90% of the nation's tourist destinations will be directly connected by the network. The program will also help improve local roads connecting tourist destinations with major highways.

In compliance with the law entitled, "On tourism," obligatory certification of hotels and catering establishments has been enforced since January 1, 1999. As of January 9, 2000, only 152 establishments out of 4,520 in Ukraine have been certified, none of which are in Kharkiv Oblast.

The experience of other countries proves the effectiveness of state support in developing tourism. For example, Great Britain's tourism office allocates 80 million pounds per year for market research and advertising/marketing activities, including participation in international tourist fairs, exhibitions, publishing of advertisements and informational products in different languages, and maintenance of 70 tourist representatives in different countries around the world. The office's market research has shown that 1 pound invested in promotional activity yields 27 pounds profit from foreign tourists—4 pounds of which is returned to the state in the form of taxes.

Sector efficiency and productivity are hampered by a number of problems that can be solved by legislative and executive oversight. The following are suggested measures for legislative action:

- Develop and enact a program to create sufficient infrastructure and reconstruct the sector material base
- Revise the visa approval process to facilitate foreign tourism
- Reform customs control procedures at border crossings
- Establish tourist offices abroad
- Commission a study on the international accommodation services market to analyze business activity and develop concrete business proposals with foreign partners
- Establish a program for training qualified personnel for employment in the sector

Efforts to develop Ukraine's tourist industry should be based on new trends in management thinking, and should allow sector enterprises the economic freedom to bring high quality services to the market. A proactive policy could help ensure the success of Ukraine's tourism industry, which in turn will contribute to the social and economic development of the country.

15. Social Issues of Sector Development

There are no social issues specific to the Accommodation Services sector.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Kharkiv Oblast's best-known investment project in the Accommodation Services sector in recent years is the construction of the three-star Astoria Hotel. Existing investment from Ukraine has brought the project to 30%, with an additional 1.5 million USD needed to complete the work. Additional investors are being invited to invest in its completion, in exchange for corporate ownership and the right to manage the hotel; investment can be in the form of equipment, construction and facing materials, and/or outfitting. The Astoria will have 48 one- and two-bed single rooms, as well as two-room apartments with air conditioning, direct phone lines, TV sets, and Jacuzzis. The project will also feature a top-class restaurant with a seating capacity of 70, a bar with seating for 17, a hair salon, sauna, swimming pool, personal deposit safes, a car rental service, a business center accommodating more than 100, meeting rooms, and a conference hall.

In addition, there are a number of other projects for renovating existing buildings and converting them into small hotels.

Conclusions

Today, Accommodation Services can't be regarded as one of the most significant sectors in the general structure of the Kharkiv Oblast economy. The successful development of hotel enterprises will require adapting to the needs of tourists and business people by providing tasteful accommodations and a decent level of support services—especially in the area of communications—at competitive prices. However, investment activity in the sector is hampered by the large outlays of capital required, and by the relatively low return on investment. Experience has shown that virtually all large-scale sector projects are funded—and controlled—by foreign investors. As a rule, such projects are limited to oblast capital cities, since they are the centers of elite business tourism. Thus, it is unlikely that the Kharkiv Oblast Accommodation Services sector will experience significant economic growth in the near future.

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8. On economic and social situation of Kharkiv Oblast for 1999. – Kharkiv Oblast Statistics Department, 2000.

List of Main Sector Enterprises and Organizations

Enterprise Name	Address	Telephone No.	Directors
Kharkiv	Kharkiv, Svobody Sq 7	45-61-46; 45-63-25; 45-60-58	Maslov Serhij Oleksandrovich
Mir	Kharkiv, Lenin Avenue 27 ?	30-55-32; 30-55-43; 32-23-30	Belchenko Jurij Mihajlovich
National	Kharkiv, Lenin Avenue 21	32-04-69; 32-05-08; 30-02-64	Juravlev Eugen Oleksandrovich
Kievskva	Kharkiv, Culture Str 4	14-31-00; 14-31-03; 14-31-01	Kapustina Ludmila Dmitirevna

Accommodation Services. Sector Profile

Enterprise Name	Address	Telephone No.	Directors
Metalist	Kharkiv, Plehanovskaya Str 92 ?	27-35-46	Maslov Serhij Oleksandrovich
Start	Kharkiv, Plehanovskaya Str 18	21-99-35; 21-57-44	Drach Roman Jurijovich
Slaviya	Kharkiv, Poltava Way Str 52	12-17-01; 12-16-89	Taran Serhij Borisovich
Tourist	Kharkiv, Moskovskijaven 144	92-01-74; 92-11-65; 92-30-10	Pobrizgaeva Tetyana Mikolajivna

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

15. FOOD SERVICES

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

According to official statistics, sales volumes in the Food Services sector have remained constant over the last ten years, but decreased 190% in 2000 on a comparative price basis. Sector share in total Kharkiv Oblast retail sales volume in 2000 decreased 150% in comparison with 1995. However, estimates differ. State statistical data may be inaccurate, due to a lack of monitoring of sector business activity.

The general decline in sector economic activity is mainly due to the failure of a number of businesses that were unable to adapt to changing market conditions. New, fast growing enterprises are generally profitable. In some experts' opinion, the profitability of certain new enterprises is more than 30% in some areas of activity. The profitability of newer food service enterprises is generally attributable to better business practices and up-to-date technology.

The Kharkiv City and Kharkiv Oblast markets should be differentiated. Kharkiv City has 47.8% of the region's total enterprises, provides 58.1% of consumer seating, and accounts for 72.7% of sector sales. The typical Kharkiv Oblast food services enterprise has total sales of about 10,000 USD per year, seats 56, and employs three persons with an average monthly wage of 165 UAH per capita.

From 1996 to 2000, the number of state-owned enterprises decreased by 200% while privately owned enterprises increased 400%. Currently, the competitive environment of the food services market is improving, with new companies offering innovative ideas that distinguish them from their competitors.

The fast food market, offering quality, low-cost meals aimed at the mass consumer, is growing quickly, while elite restaurants are in decline. Foreign companies have also entered the Kharkiv Oblast food services market. The appearance of McDonald's was a significant event for Kharkiv. There are currently 5 McDonald's restaurants in Kharkiv Oblast.

Despite several key legislative reforms, including a measure designed to simplify the requirements for business start up, sector development opportunities are still limited by state controls. However, in the opinion of some experts, the Kharkiv Oblast Food Services sector is currently quite attractive for domestic and foreign investors.

1. Sector Role in the Kharkiv Oblast Economy

The Food Services sector mirrors the overall Kharkiv Oblast economy. While an overall recession in sector activity could be observed over the last 10 years, actual indicators are generally not as bad as it seems at first, due to the so-called shadow economy.

As shown in **Diagram 1**, sector production volumes increased by 190% in current prices over the last six years. However, analysis shows that, on an inflation-adjusted basis, sales actually **declined** 190%, from 37.8 million USD in 1995 to 19.8 million USD in 2000, as shown in **Table 1**. [2; 5; 10]

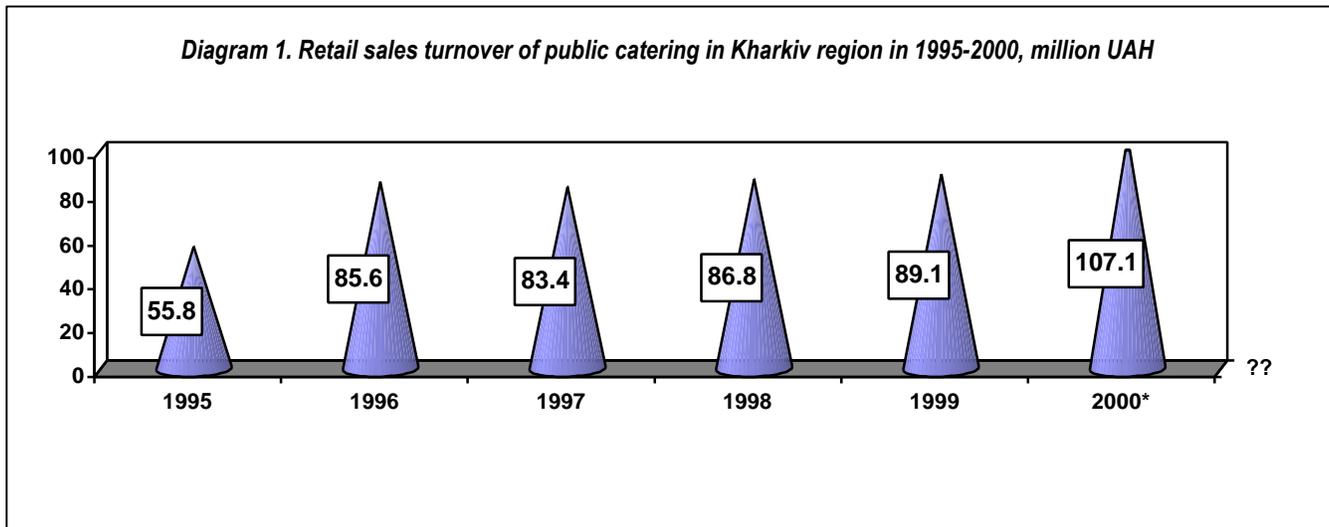


Table 1. Food Services Share in Kharkiv Oblast Total Retail Sales: 1995-2000

	1995	1996	1997	1998	1999	2000
Total retail sales (million UAH)	466.7	531.8	613.7	553.1	377.2	373.6
Food services sales (million USD)	37.8	45.2	44.8	35.4	21.5	19.8
Sector share in Kharkiv total retail sales	8.1%	8.5%	7.3%	6.4%	5.7%	5.3%

The number of people employed in the sector decreased from 0.6% in 1991 to 0.35% in 2000. The sector average monthly wage in 2000 was 110.12 UAH, only 47.8% of the overall average wage in Kharkiv Oblast for the period. [11]

The sector's general economic indicators have remained steady or declined over the last several years. A number of "traditional" enterprises operating before 1990 went out of business due to their inability to adapt to changing conditions. In addition, sales at a number of non-profit and state-owned enterprises (hospitals, schools, kindergartens, health centers) decreased substantially. This decline is attributable in part to changing purchasing patterns of private and corporate consumers, who began shifting away from traditional canteens and cafes to private street vendors, whose sales are not registered (food services enterprises generally understate real profits due to the cash payment nature of the business).

According to the results of International Corporation Research (June 2000), SMEs have a "shadow share" of approximately 50% of total sector sales in Ukraine; and at least 59% of entrepreneurs understate their profits. High taxation rates have led to a decline in SME tax payments. According to the IFC, SME underpayment of profit taxes, payroll taxes, and the VAT is contributing to the perceived recession. [15]

A number of reforms aimed at regulating sector activity have been instituted over the last two years. Presidential Decree No. 746, enacted in 1999, simplified the accounting and taxation procedures for small business. In addition, the previous 14 different tax categories were reduced to two alternatives. Enterprises may choose to pay either a single 10% flat-rate tax on sales, or a 6% sales tax plus a 20% VAT. Private enterprises even have the option of paying a single tax on sales volume that is capped at 200 UAH.

These changes in SME taxation have already shown certain positive results. According to the Ministry of Economy, as of October 1, 2000, more than 55,000 small enterprises had chosen the simplified tax system.

Advantages of the simplified tax options are detailed in **Table 2**. Under the 1999 taxation system, an enterprise with sales of 500,000 UAH and 5 employees, paid 65,310 UAH in various taxes. Under the simplified taxation system (private entrepreneur, Variant 2) the same enterprise would pay only 600 UAH.

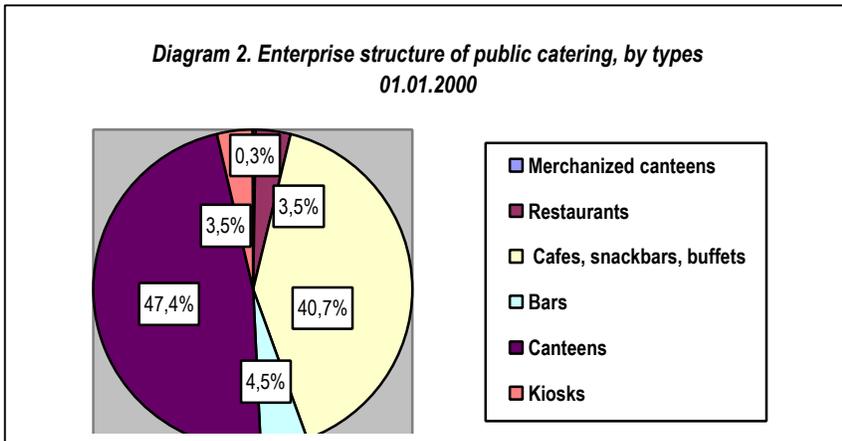
Table 2. Example Annual Taxation According to General and Simplified Systems (1000 UAH)¹

Index	General	Simplified
Total sales, with VAT	500.00	500.00
VAT (tax liability)	83.00	—
Production costs with VAT	350.00	350.00
VAT (tax credit)	58.10	—
VAT for payment	24.90	—
Wages fund (5 employees)	24.00	24.00
Taxes on wages fund	9.00	—
Taxes from wages fund	5.40	—
Base for profit taxation	86.70	—
Profit tax	26.01	—
Single tax (1 entrepreneur and 4 employees)	—	0.60
Total tax sum	65.31	0.60

Simplified taxation and accounting requirements have provided considerable relief for sector enterprises. However, as indicated previously, underreporting of revenue by enterprise owners has resulted in inaccurate economic data. Official estimates indicate that the actual sales, wage, and employment indices in the Kharkiv Oblast Food Services sector are actually 150%-200% higher than reported. This problem is expected to continue, especially given the increase in the number of private enterprises, which will make economic analysis even more problematic.

¹ General and simplified taxes for an example enterprise with sales of 500,000 UAH and 5 employees.

Canteens make up 47.4% of the sector's total enterprises in Kharkiv Oblast, while cafes comprise 40.7%, as shown in **Diagram 2**. [2; 5] These figures do not include new types of businesses such as nightclubs, which currently are a growing part of the sector.



Today, a typical Kharkiv Oblast food services enterprise has annual sales of about 10,000 USD, seats 56 persons, and maintains three employees with an average monthly salary of 165 UAH per capita.

To properly analyze the Kharkiv Oblast Food Services sector, it is necessary to differentiate the various markets, as follows: the Kharkiv City market; other municipal markets, and the rural district markets. As shown in **Table 3**, Kharkiv City has about 47.8% of total sector enterprises in Kharkiv Oblast, provides 58.1% of all seats, and accounts for 72.7% of total sales. By contrast, rural district enterprises make up 45.9% of the total, provide 36.2% of seats, but are responsible for only 21.4% of total sales. [5]

Table 3. Kharkiv Oblast Sector Enterprises and Sales: 1999

	Number of Enterprises		Number of seats (thou)		Sales (million UAH)	
Total	2,231	100.0%	124.6	100.0%	89.1	100.0%
Kharkiv City	1,067	47.8%	72.4	58.1%	64.8	72.7%
Other Municipalities						
Kupyansk	32	1.4%	1.1	0.9%	1.5	1.7%
Chuhuyv	33	1.5%	2.7	2.2%	1.2	1.3%
Lozova	28	1.3%	1.1	0.9%	1.1	1.2%
Pervomayskiy	15	0.7%	0.9	0.7%	0.8	0.9%
Izyum	21	0.9%	0.6	0.5%	0.6	0.7%
Lyubotin	11	0.5%	0.7	0.6%	0.0	0.0%
Rural Districts						
Balakiya	74	3.3%	3.8	3.0%	2.5	2.8%
Krasnohrad	55	2.5%	1.5	1.2%	2.0	2.2%
Kharkiv	73	3.3%	4.9	3.9%	1.8	2.0%
Nov.Vodolaha	45	2.0%	1.9	1.5%	1.1	1.2%
Vovchansk	54	2.4%	3.5	2.8%	1.0	1.1%
Valky	38	1.7%	1.1	0.9%	0.9	1.0%
Velykyi Burluk	46	2.1%	1.7	1.4%	0.9	1.0%
Bohodukhiv	59	2.6%	2.2	1.8%	0.8	0.9%
Derhachi	48	2.2%	2.0	1.6%	0.8	0.9%
Chuhuyv	33	1.5%	1.6	1.3%	0.8	0.9%
Dvorichna	33	1.5%	1.2	1.0%	0.7	0.8%
Kehychivka	34	1.5%	1.5	1.2%	0.7	0.8%
Lozova	27	1.2%	1.2	1.0%	0.7	0.8%
Zachepylivka	31	1.4%	1.1	0.9%	0.6	0.7%
Borova	33	1.5%	1.2	1.0%	0.5	0.6%
Zolochiv	33	1.5%	1.3	1.0%	0.5	0.6%
Krasnokutsk	48	2.2%	1.7	1.4%	0.5	0.6%
Blyznyuky	45	2.0%	1.7	1.4%	0.4	0.4%
Barvinkove	36	1.6%	1.6	1.3%	0.3	0.3%
Kolomak	9	0.4%	0.2	0.2%	0.3	0.3%
Sakhnovshchyna	45	2.0%	2.2	1.8%	0.3	0.3%
Shevchenkove	38	1.7%	1.8	1.4%	0.3	0.3%
Zmiyiv	32	1.4%	1.8	1.4%	0.2	0.2%
Kupyansk	21	0.9%	1.0	0.8%	0.2	0.2%
Izyum	7	0.3%	0.2	0.2%	0.1	0.1%
Pervomayskiy	24	1.1%	1.0	0.8%	0.1	0.1%
Pechenihiy	3	0.1%	0.2	0.2%	0.1	0.1%

2. Strength of Kharkiv Oblast Sector

Sector enterprise activity in Kharkiv Oblast is limited to the regional market, since goods and services are not transported outside the oblast. Enterprise development has declined over the last 10 years, with the number of enterprises in 1999 down by almost 160% in comparison with 1990, as shown in **Diagram 3**. In addition, total seats at sector enterprises decreased 230% (**Diagram 4**) and total jobs fell 220% (**Diagram 5**) in the same period. [2]

Diagram 3. Number of food services enterprises in Kharkiv Oblast

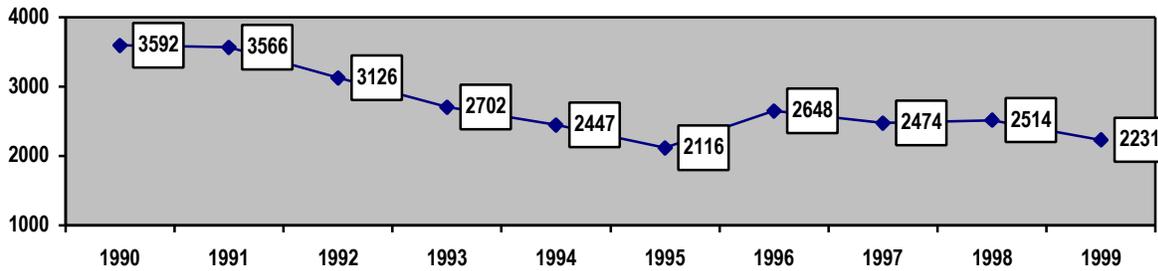


Diagram 4. Number of seats at food services enterprises in Kharkiv Oblast, thou

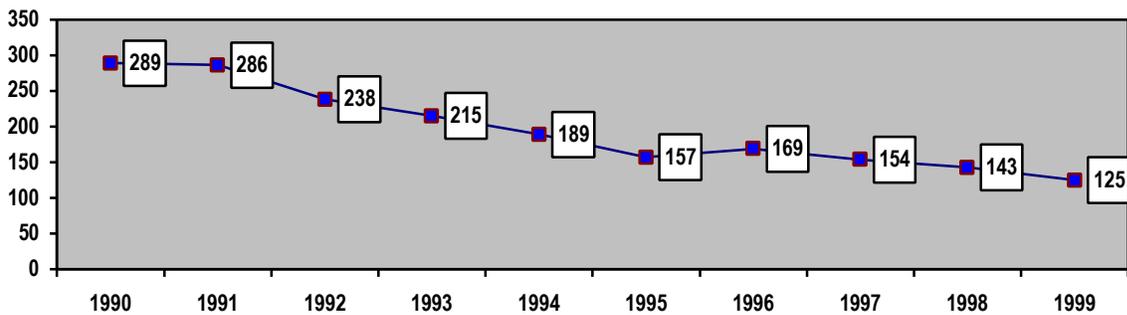
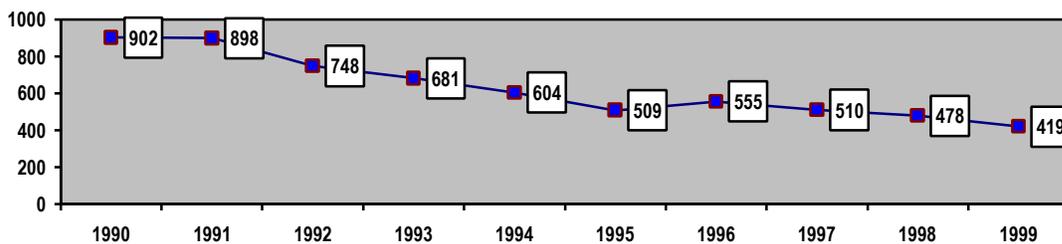


Diagram 5. Number of jobs at food services enterprises of Kharkiv Province per 10000 people



3. Economic Condition of Sector Enterprises and Organizations

According to the Kharkiv Oblast Statistics Department, 55% of sector enterprises were unprofitable in 2000. Losses before taxation totaled -1.1 million UAH; total losses were -1.8 million UAH. Total profit for profitable enterprises came to 0.7 million UAH. Losses according to form of ownership were as follows: [11]

- state-owned enterprises: -0.5 million UAH
- municipal-owned: -0.2 million UAH
- other forms: -0.4 million UAH

The unprofitability of state-owned enterprises is due primarily to the inability of management to adapt to the current market conditions. The majority of so-called new enterprises (those that appeared in 1993-2000) are profitable because their managers are well informed on current business practices in the industry, use new technology, and recognize trends in consumer demand. According to some experts' opinion, the profitability of new enterprises is more than 30% in some areas.

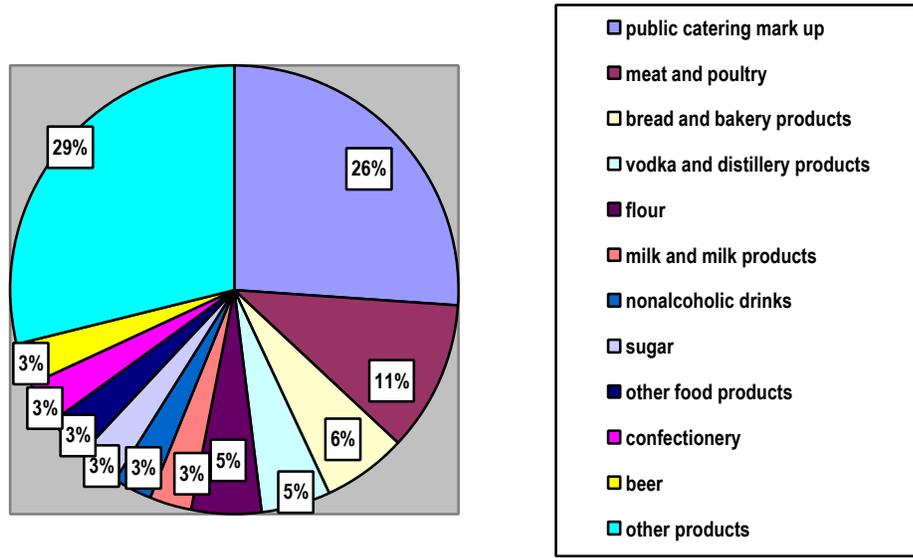
For example, two new enterprises, Italia Pizza and Dallas Burger, both established in 1996, are currently returning profits on the level of 32%-38%, as shown in **Table 4**. [6]

Table 4. New Enterprise Costs and Profitability

	Italia Pizza Cafe	Dallas Burger Café
Fixed costs	38%	39%
Municipal expenses	7%	7%
Wages	18%	8%
Marketing expenses	4%	8%
Other expenses	1%	0%
Total costs and expenses	68%	62%
Profitability	32%	38%

Profitability of Ukrainian fast food enterprises averages 22%-23%, with some enterprises attaining 35% profit. The term of return on investment for such enterprises typically ranges between 4 months to 1.5 years. Sector enterprise costs are illustrated in **Diagram 6**. Raw materials costs in the form of food products make up 74% of sector enterprise expenditures, while other overhead, including wages, taxes, amortization, etc., comprise only 26%. [10]

Diagram 6. Structure of food services enterprises' expenses in Kharkiv Oblast in 2000



4. Sector Development: Raw Materials Base

Sector output by product type for the period 1995-2000 is shown in Table 5. [16]

Table 5. Kharkiv Oblast Food Services Output Volumes by Product: 1996-2000 (1000 UAH)

Commodity group	1995	1996	1997	1998	1999	2000
Meat and poultry	4,614	9,107	10,796	9,199	9,821	11,368
Bread and bakery products	1,165	2,612	5,260	4,430	5,520	6,619
Vodka and distillery products	2,085	4,085	5,471	4,891	3,417	5,303
Flour	1,542	3,467	4,106	3,873	3,695	4,988
Milk and milk products	1,401	2,616	2,696	2,331	2,388	3,539
Non-alcoholic beverages	1,227	2,863	2,556	3,763	2,950	3,370
Sugar	1,529	2,422	2,815	2,515	3,886	3,321
Other food products	8,286	2,777	3,088	2,275	3,407	3,310
Confectionery	1,934	2,813	2,113	2,109	2,529	3,013
Beer	2,010	5,690	2,591	2,911	2,317	2,903
Potato	676	1,630	1,462	1,664	2,137	2,782
Sausages and smoked products	2,454	3,536	4,185	3,837	2,774	2,671
Vegetables	779	1,591	1,723	1,681	1,917	2,299
Butter	1,294	2,135	1,928	1,833	1,985	2,106
Other non-food products	352	897	467	1,019	398	1,787
Wines	406	728	1,257	1,470	1,374	1,743
Eggs and products made with eggs	1,012	1,789	1,420	1,267	3,183	1,596
Cereals and legumes	460	971	964	1,071	1,017	1,465
Vegetable oil	481	975	1,076	1,184	1,229	1,376
Fish	587	1,046	819	1,083	915	1,220
Cognac	251	996	888	864	629	1,144
Cheese and brynza	390	659	544	798	684	1,113
Margarines and mayonnaises	959	1,294	999	1,082	955	1,058
Ice-cream	3,705	1,407	1,182	1,866	941	991
Tobacco products	344	574	551	749	807	912
Canned vegetables	212	553	708	516	553	799
Macaroni	233	510	611	530	795	780
Fruits, berries, vinegar, nuts, water- melons, melons	414	933	605	482	535	762
Champagne	770	1,620	1,118	1,127	629	747
Coffee	135	240	330	687	523	720
Canned fruits and berries	248	481	553	526	510	585
Conserves, jam, fruit butter, honey	180	347	498	454	297	554
Tea	95	182	220	334	313	513
Canned meat	188	265	564	301	547	474
Canned fish	151	293	375	293	315	358
Herrings	697	545	402	334	289	287
Salt	22	76	103	113	93	75
Food and melted adiposes	61	86	134	94	56	70
Matches	26	20	97	19	18	39

In general, more prestigious enterprises, such as restaurants, rely mainly on imported food products. Sector imports by product type for 2000 are shown in **Table 6**. [11]

Table 6. Food Product Imports and Share in Total Kharkiv Oblast Imports: 2000

Products Group	Imports (1000 UAH)	Share in Total Oblast Imports (%)
Fish and fish products	6,268.1	1.39%
Fruits and citrus	2,525.0	0.56%
Coffee, tea, spices	2,411.6	0.54%
Cacao and cacao products	2,028.3	0.45%
Alcoholic drinks	1,208.6	0.27%
Mixed food products	443.0	0.1%
Milk, milk products	439.6	0.1%

Consumption of domestic raw materials grows in proportion to the development of the domestic food services industry. The purchasing policy McDonald's, the largest player in the Ukrainian food services market, proves this. In 1999 only 35% of the raw materials used by McDonald's restaurants were produced in Ukraine. However, this year McDonald's plans to establish a meat processing facility in Kozyatin, Vinnytsa Oblast, and will commission packaging from the Kyiv "Galakton" plant. In addition, a specialized bakery is being constructed in Dnipropetrovsk; this facility will have a production capacity of 15,000 rolls per hour. A potato processing factory is also being built in Chernihiv Oblast, at a cost of 30 million USD.

McDonald's is spending a total of approximately 50 million USD on new food processing facilities in Ukraine, with that figure expected to reach 100 million USD over the next five years. Ultimately, it plans to use 95% domestic raw materials in its Ukraine operations, which will improve the profitability of its activity in the domestic market. [18]

5. Sector Development: Technological Base

To accurately assess the sector's technological base, it is necessary to distinguish between "traditional" and "new" enterprises. The first group uses equipment from the pre-Soviet era, and there are no funds available for its modernization. New enterprises primarily use imported equipment. Most imported equipment used by sector enterprises is manufactured in the USA and Italy. However, a number of domestic manufacturers have entered the food service equipment market, including Ross (Kharkiv), Merks, New Project (Kyiv), etc.

New enterprises entering the market typically pay close attention to their equipment selection, combining elite imported and cheap domestic equipment to optimize expenditures. According to experts, equipment costs for new food services enterprises make up 60% of the capital investment. [16]

6. Investment Activities in the Sector

According to many investors, the elite restaurant segment of the food services market is essentially saturated, thus limiting investment opportunities to medium- and low-priced enterprises. Recent investment projects in Ukraine tend to support this, given the recent growth of the fast food market, which has lower capital costs and shorter periods for return on investment.

Start-up investment for a fast food restaurant typically ranges from 50,000-100,000 USD to 500,000 USD, compared with up to 2 million USD to open an elite restaurant, due to differences in equipment and furniture costs, wages, etc. The term of return on investment for a fast food restaurant is currently 2-3 years, about twice as long as before the 1998 economic crisis, but still 1.5 times faster than the 5-6 year return in western countries. [18]

Several large new enterprises aimed at mass consumers have recently opened in Kharkiv. McDonald's has opened five new stores, and has plans to open three more. Other new enterprises include cafe-restaurants such as Waltsam Donuts, a McDonald's competitor, and Zhili-Bili, which caters to students.

The "Mr. Snack" company is currently engaged in an ambitious plan to become Ukraine's second-largest fast food operation, after McDonald's. Kyiv restaurant veterans Robert Koenig and Falk Nebeiger, co-owners of the Arizona Group, are the driving force behind the chain. The Arizona Group also runs the Arizona BBQ, San Tori, Edelweiss, and Kozak Mamai restaurants. Mr. Snack has recently attracted a number of foreign partners who believe restaurant chains will grow quickly in the near future.

Commercial Capital is a western company that is investing more than 10 million USD in various Ukraine sector ventures. The company plans to invest \$2 million in Mr. Snack, with return on investment expected within 15 months.

7. Employment and Personnel Potential in the Sector

According to the State Statistics Committee, there were 2,878 permanent employees at Kharkiv Oblast sector enterprises in 2000, comprising 0.35% of the total number of people employed in the region. Average monthly salary is 110.12 UAH, or about 47.8% of average salary in the oblast overall. Average hourly salary is 0.87 UAH, about half of the national average of 1.73 UAH. [11] In 1999, the number of people employed in food services made up 2.9% of the total number of people employed in Kharkiv Oblast, and about 2.7% of total sector employees in Ukraine.

Over the last 10 years, the number of sector employees declined faster than the number of enterprises (270% vs. 160%), which is attributable to entrepreneurs' desire to cut salary expenses and increase labor productivity.

According to sector specialists, a food services enterprise needs two key employees: a general manager and a technologist, without whom a cafe or restaurant cannot function efficiently. The technologist selects the products, controls the food preparation process, and oversees customer service. The general manager is responsible for accounting and marketing, hiring and supervising staff, and general operations. A number of skilled technologists and head-cooks are employed at Kharkiv restaurants, including some Chinese, Japanese, and Italian nationals. The salaries of these specialists average a minimum of 2,000-3,000 USD per month. A skilled Ukrainian specialist (technologist or manager) at a new enterprise generally receives a minimum of 500-1000 USD, while waiters earn approximately 150 USD. [16]

There is regular demand for skilled managers and technologists in the sector. A few private schools in Kharkiv Oblast specialize in training waiters, bartenders, and other service employees in the different areas of food service.

8. Sector Exports

There is no export production per se in the Kharkiv Oblast Food Services sector.

9. Competitive Environment of Sector Enterprises and Organizations

As mentioned previously, a proper analysis of the Kharkiv Oblast Food Services sector must differentiate between the Kharkiv City market, other municipal markets, and the rural district markets in the oblast. The rural and other municipal markets are characterized by relatively low sector development, due to the small number of people with disposable income. Relatively few people in these markets can afford to patronize restaurants; and competition among enterprises is fierce. The sector is more developed in Kharkiv City, where demand for fast food enterprises that offer good service and high quality products at reasonable prices is considerable.

Currently, fast food enterprises have the best prospects in the Food Services sector. According to expert opinion, 80% of the Ukraine fast food market is without significant competition. While the number of visitors to traditional enterprises—especially elite restaurants—declined by about 50% during the 1998 economic crisis, fast food purchases remained relatively constant. [16]

At present, however, the number of restaurants aimed at an elite clientele is still several times higher than the number of restaurants oriented toward medium- and low-income clients. Almost 70% of sector enterprises in Kyiv, for example, are elite restaurants that cater to a mere 5% of the population; and a similar situation exists in Kharkiv. [18]

According to one estimate, there are approximately 60 restaurants, 200 cafes, and less than a hundred food services enterprises of other types in Kharkiv City. These figures indicate significant potential for sector development in this city of 1.5 million, especially when considers that there are 1,000 restaurants in Moscow, 7,000 in Mexico City, and more than 50,000 in Paris. [18]

McDonald's is a leading player in the mass consumer market, and their restaurants are the main competitor for all local fast food enterprises. Currently there are five McDonald's restaurants in Kharkiv and 43 in Ukraine; future plans call for as many as eight and 85, respectively. Other fast food projects in Kharkiv Oblast include Cafe Taifun, Baskin Robbins, Waltsam Donuts, Dallas Burger, and Zhili Bili.

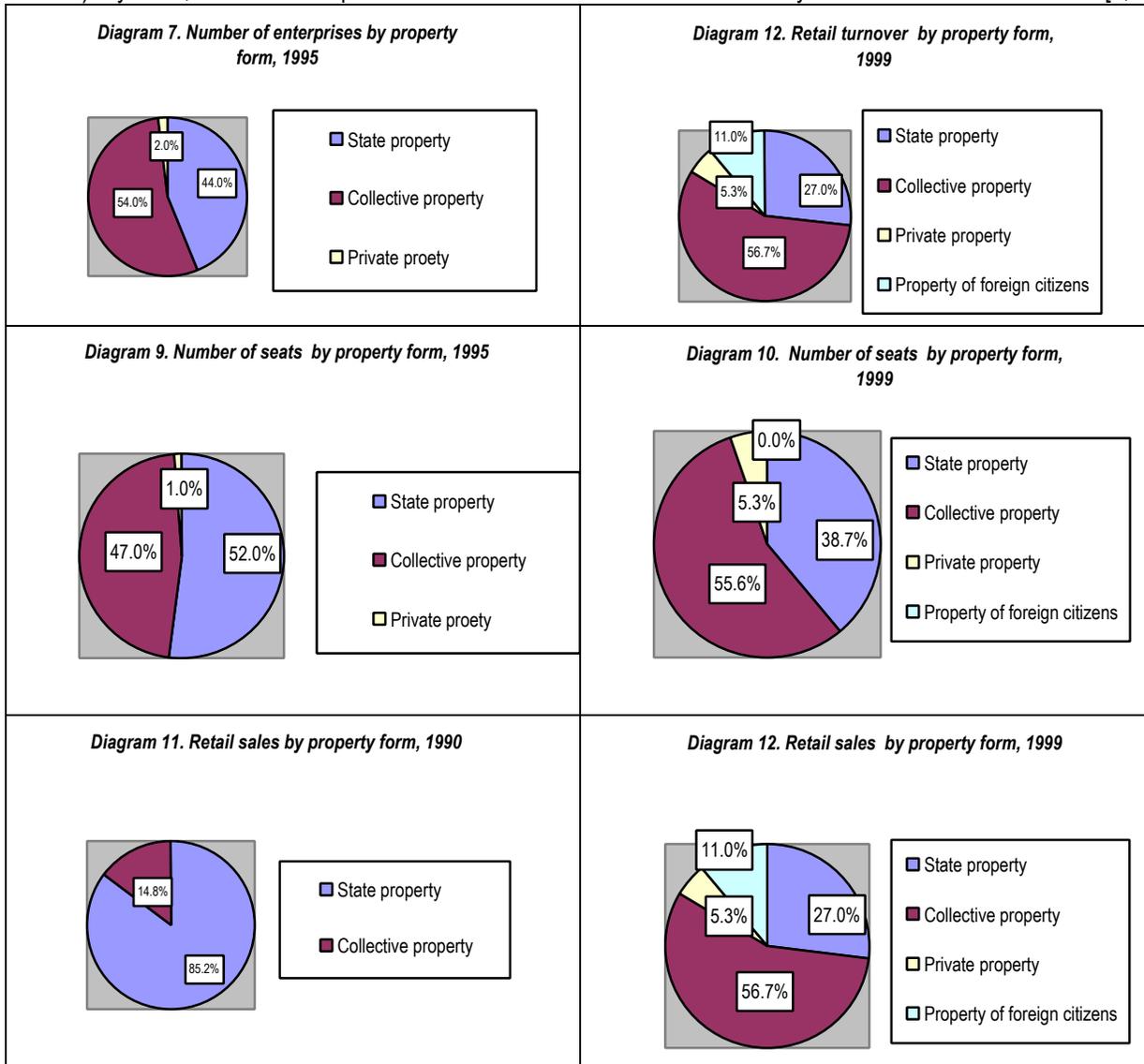
Pizzerias are another growing segment of the market. Enterprises include Italian Pizza and Petri Pizza, with demand among Kharkiv City residents not yet saturated. French style cafes, bakeries, and patisseries are also growing in popularity. The availability of take-out and prepared food products is also increasing.

Nightclubs should be considered separately, since they differ from other sector enterprises by offering not only food and beverages, but recreation, in the form of music, shows, dancing, etc. As a rule, clubs are oriented toward a younger clientele, and each offers its own unique "face" to distinguish it from its competitors. Clubs are the most stylized establishments in the market, with clearly defined profiles, e.g., dance clubs, sports bars, music clubs, etc., and established clienteles.

During the last three years, competition among nightclubs has grown, as evidenced by the fact that more and more enterprises are spending greater sums to enter the market. As a rule, new business projects follow specific themes, e.g., a Hunter's Pub, an Irish pub, etc. Start-up investment has ranged from 50,000 to several million USD.

10. Ownership in the Sector

During the last five years, state ownership of sector enterprises has declined by 200%, while collective- and privately owned enterprises increased proportionately. In 1998, foreign food services enterprises appeared (McDonald's and others). By 1999, the number of private cafes and restaurants had increased by more than 400% since 1995. [2; 5]



During the period 1995-1999, the number of seats in private food services enterprises increased 500%. However, the number of state-owned enterprises is still very high, at 38.7%; and in spite of the growth of private enterprises, state enterprises still have substantial influence. Traditional state-owned buffets and cafes are still characterized by low quality products and services, and are sometimes even guilty of violations of sanitation laws.

The salary index clearly shows the difference between management practices at state and private enterprises, with wages at private enterprises 160% higher than at state enterprises (195.4 UAH vs. 118.4 UAH per month, respectively), and 200% higher than at collectives.

11. SME Growth in the Sector

Given that Ukraine law defines small enterprises having no more than 15 employees, practically every sector enterprise, with the exception of large chains such as McDonald's, can be considered an SME. In light of this fact, separate analysis of small- and medium-size businesses within the framework of the sector overall is not necessary.

12. Sector Infrastructure

The Kharkiv State Academy of Technology and Catering Organization and Kharkiv Business College (formerly a food services technical school) train a large number of people to work in the Food Services sector. The former is one of the largest sector educational institutions in Ukraine, and features research faculties in mechanical and technological engineering, economics, accounting, and commodities.

The Food Services sector financial infrastructure is not as well developed as in other branches of the regional economy. Arranging credit is problematic because of high interest rates and short terms on loan repayment; and leasing schemes are practically nonexistent. However, the Kharkiv branch of the Microfinancial Bank will begin offering SMEs "micro" and "mini" loans of 5,000 to 125,000 USD.

According to some business owners, the simplified taxation system has improved the regulatory climate for sector enterprises by reducing the threat of constant inspections by taxation bodies, thus enabling entrepreneurs to pay more attention to business.

13. Management Capabilities of Sector Enterprises and Organizations

As previously mentioned, the worsening economic condition of food services enterprises (52% of which were unprofitable in 2000) is due primarily to poor management. New enterprises that have opened during the last 3-5 years have clearly distinguished themselves in this regard. As a rule, these new enterprises employ modern management methods, with more attention given to interior decoration, equipment, personnel uniforms and service skills, food quality, and general service delivery. However, formation of a national food services management cadre is still in progress. And while there is a sufficient base of educational establishments for training the workforce and improving the level of services, development of a full-scale sector management methodology is a long-term process. McDonald's, for example, spent more than 40 years perfecting its technology.

14. Administrative Impact on the Sector

In Ukraine, a great number of documents and permits are required to establish a new food services enterprise. This red tape poses a serious obstacle to sector development, and is frequently cited by business owners as a source of abuse by issuing authorities.

For example, the following documents are required to open a new enterprise:

- Statutory documents
- Product range approval from district sanitary epidemiological department
- Trade and storeroom documentation
- Cash machine registration (if applicable)
- Taxpayer registration certificate
- Absence of budget debt certificate
- Sanitary, hygienic, and technological standards compliance certificate
- Fire prevention standards compliance certificate
- Leasing agreement (if applicable)
- Trade patent (if applicable)

Sector enterprises typically spend 50% of start up capital to obtain these certificates and permits; and the approval process can take up to several months. [20] Business owners particularly dislike the approval process for compliance with sanitation and fire prevention standards, since these regulations are out of date and lend themselves to abuse by control bodies during the various inspections. And while regulatory reform solved some problems associated with taxation, sector enterprises still remain under the close control of numerous public authorities, including tax inspectors, sanitation departments, fire departments, etc.

15. Social Issues of Sector Development

The activity of the Food Services sector directly influences the health of the population in the region. Food preparation quality control and adherence to sanitation standards are the top priority of enterprise owners and public authorities alike. Entrepreneurs must understand that only by offering high quality products and services in a sanitary atmosphere can they survive in a competitive environment.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Food services development projects in Kharkiv Oblast are mostly limited to private investment. For this reason, most projects are not offered to a wide circle of potential investors or advertised beforehand.

Conclusions

The Kharkiv Oblast Food Services sector consists almost entirely of small enterprises that play an important social role by providing a rather high proportion of the region's jobs. The Food Services sector is expected to develop substantially, due to new methods and technologies in food services delivery, and increasing consumer demand. Many experts believe that domestic investment will play a key role in development of the sector during the next ten years, with national cafe and restaurant chains seen as one of the key business opportunities in Kharkiv Oblast.

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List of Main Sector Enterprises and Organizations

Enterprise Name	Address	Telephone No.	Directors
"Dionis", restaurant	21, Kosmichna str., Kharkiv,	149188	director Volodymyr A. Khendryk
"Tayfun", LC	P.O.B. 8679, Kharkiv	367461	president Vasyl V. Zaytsev
"National", tourist complex	21, Lenina ave., Kharkiv,	308882	NA
"Akhtamar", firm	38, Krupskoy, str. Kharkiv	264266	General director Sergiy D. Kovalenko
McDonalds Ukraine	6,Rosa Luxemburg str., 9b, Lenina ave., 9, Suzdalskie Ryadi str., Kharkiv	28-23-26, 19-45-09,12-54-78	NA
Zhili-Bili, JH International, LLC	39, Sumska str., Kharkiv	-	NA
DallasBurger, Venus, LLC	3, Danilevskogo str., Kharkiv	14-21-39	NA
Italia Pizza	3, Tobolskaya str., Kharkiv	30-90-20	NA

NA – not available

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

16. FINANCE AND INSURANCE

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

**KHARKIV PARTNERSHIP
Strategic Planning Project**

Under

**MENDEZ ENGLAND & ASSOCIATES
USAID Contract No. 121-C-00-00-00832-00**

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Summary

The Finance and Insurance sector of the Ukraine economy has traditionally functioned as a service provider to other sectors, acting as a stimulus to all types of businesses by directing surplus financial resources to the most attractive and strategically important enterprises and organizations. Furthermore, this sector acts as an instrument of governmental control over the economy itself. Through it, reallocation of all foreign receipts is accomplished; and credit, investment, and insurance issues are resolved efficiently.

At the beginning of 2001, 14 local commercial banks were operating in Kharkiv Oblast. The largest of these are:

- “Ukrsibbank” (joint-stock commercial innovation bank)
- “Grant” (East Ukrainian joint-stock exchange bank)
- “Real-Bank” (joint-stock commercial bank)
- “Region-bank” (joint-stock commercial regional bank)
- “Megabank” (East Ukrainian power bank)

The authorized funds (held by shareholders) of all banks total 144 million UAH.

As of January 1, 2001, there were 21 Kharkiv insurance companies and 22 branches of other oblast insurance companies active in the Kharkiv Oblast insurance market. As of January 1, 2001, 8,454 people were employed in the Finance and Insurance sector, which makes up approximately 1% of the total number of employees in the region. Average monthly salary in 2000 was 558.04 UAH, which, at 2.42 times the regional average, was one of the highest among all sectors. This figure was due in part to a sharp increase in salaries during the last months of 2000. In November 2000, the average salary per employee was 640.3 UAH, and rose to 918.3 UAH in December. Average salary grew 146% in 2000 relative to 1999.

Competition in the Finance and Insurance sector is relatively high, compared with other sectors of the economy. The sector is highly attractive, because of the number of operators on the market and the rapid technical and technological development taking place in the sector. During the early stage of the formation of the banking and insurance system, almost all companies were general-purpose, i.e., offered a comprehensive range of services. Now, however, a trend towards specialization in services provided can be seen.

The presidential decree entitled, “On measures for consolidating the Ukraine banking system and increasing its role in processes of economic transformations,” dated July 14, 2001, will further the policy aimed at fostering favorable conditions for more efficient functioning of the banking system. The decree provides for working out an integrated program of development for the Ukraine banking system by 2001-2003. The decree identifies specific objectives for further development of the Ukraine banking system and provides for the formation of adequate mechanisms and instruments of banking practices to keep pace with the renewed economic growth that began in 2000.

Acting as financial asset holders, banking establishments conduct their own analyses of the investment proposals emerging in the oblast. Business plans of enterprises and organizations of various sectors of the economy go through a thorough examination; and on the basis of this evaluation, funds for implementation are either granted or disapproved. Projects that have been worked out by financial establishments for their own development (e.g., for new services, international partnership, etc.) that require investment are submitted to an immediate prospective partner for consideration; however, these are rare. Investment activity of insurance companies is restricted by law. The use of surplus funds is strictly regulated, and is not allowed for business market positioning or creation of joint projects.

1. Sector Role in the Kharkiv Oblast Economy

The Finance and Insurance sector of the Ukraine economy has traditionally functioned as a service provider to other sectors, acting as a stimulus to all types of businesses by directing surplus financial resources to the most attractive and strategically important enterprises and organizations. Furthermore, this sector acts as an instrument of governmental control over the economy itself. Through it, reallocation of all foreign receipts is accomplished; and credit, investment, and insurance issues are resolved efficiently.

Banking is an elite business. Finance will always be on the cutting edge of all political and technological transformations, and sets an example for other areas of the economy in terms of organizing and conducting business. And while their profits are typically not excessive, banks are the establishments that best characterize the level of development of a nation's economy.

Insurance is one of the most profitable businesses in the world, and is the only branch of the Ukraine economy that has maintained steady growth in its basic revenue index over the past several years. In addition, the fact that insurance returns have exceeded the rate of inflation over the past several years is another positive indicator.

A number of positive changes have begun to take shape in Kharkiv Oblast, including:

- the rate of growth in insurance payments continues to surpass the rate of growth in premium payments (settlement of claims or other outpayments)
- the amount of reserves at the end of the year have considerably increased, compared with payments accumulated during the year
- an increasing trend in the amount paid in authorized funds (held by shareholders) can be observed.

2. Strength of Kharkiv Oblast Sector

Kharkiv Oblast Market

There are currently 14 banks and 21 insurance companies operating in the Kharkiv Oblast market.

Banking

At the beginning of 2001, 14 local commercial banks of legal status were operating in Kharkiv Oblast. The largest of these are:

- "Ukrsibbank" (joint-stock commercial innovation bank)
- "Grant" (joint-stock exchange bank)
- "Real-Bank" (joint-stock commercial bank)
- "Region-bank" (joint-stock commercial regional bank)
- "Megabank" (East Ukrainian power bank)

All of the institutions are general purpose banks. Authorized funds of all banks total 144 million UAH.

There are a total of 119 branches of national joint-stock commercial and local banks in the region, as follows:

- JSC bank "Ukraine": 29 branches
- JSC Industrial Investment Bank of Ukraine: 20 branches
- JSC "Ukrsotsbank": 10 branches
- Savings Bank of Ukraine: 36 branches
- Commercial banks of other oblasts: 11 branches
- Local commercial banks: 12 branches
- Department of the State Ukreksimbank: 1 branch

Since the beginning of reforms, the number of banks and banking establishments has increased by 150% (48 units), with banks accounting for one third of the increment. Formation of the banking system is advancing, albeit with some difficulty; nonetheless, it is becoming more and more established in the region.

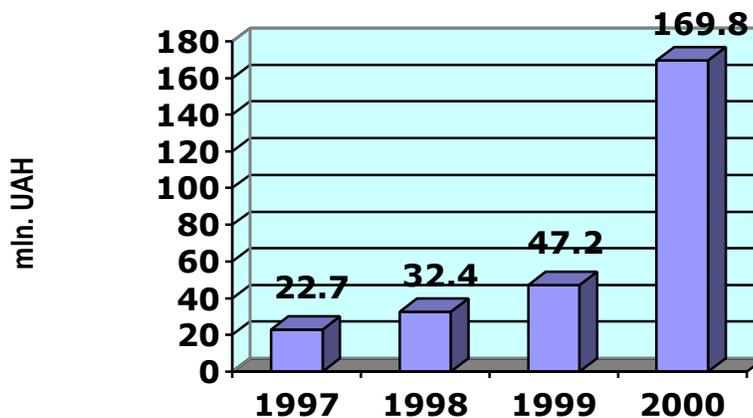
Insurance

As of January 1, 2001, there were 21 Kharkiv insurance companies and 22 branches of insurance companies from other oblasts active in the Kharkiv Oblast insurance market, as shown in **Table 1**. These include 18 from Kiev, 2 from Donetsk, 1 from Dnipropetrovsk, and 1 from Chernyiv. All of these have been entered in the Uniform State Register of Insurers of Ukraine.

Table 1. Development of the Kharkiv Oblast Insurance Market

Indexes	1997	1998	1999	2000
Kharkiv companies	16	20	21	21
Outside companies	11	17	19	22
# of insurance payments	22,698	32,402	47,238	169,756

Diagram 1. Insurance Returns in Kharkiv Oblast



In 2000, insurance inpayments received by insurance companies operating in Kharkiv Oblast totaled 169 million UAH. Inpayments received by Kharkiv-based companies came to 162.4 million UAH (95.6%); payments received by branches of outside companies came to 7.4 million UAH (4.4%). In comparison with 1999, overall insurance returns in 2000 increased by 122.5 million UAH (259.41%). For Kharkiv-based companies, returns increased by 121.2 million UAH (294.7%); returns for branches of outside companies increased by 1.3 million UAH (21.2%). In 2000, premium payments (settlement of claims or other outpayments) and insurance allocations decreased by 205,000 UAH (2.2%), totaling 9.3 million UAH.

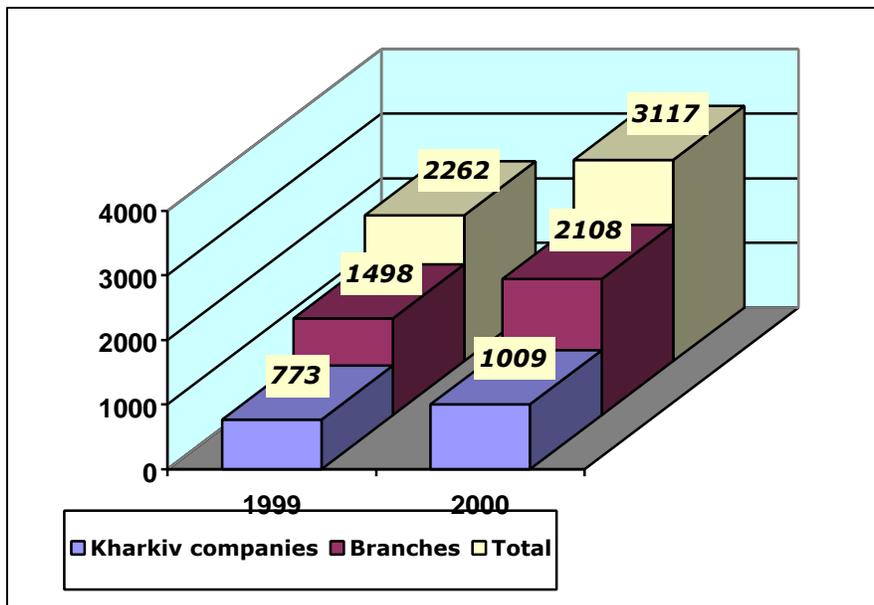
The Ukrainian law provides for 20 different types of voluntary insurance and 26 types of compulsory insurance. However, the Cabinet of Ministers of Ukraine has adopted legislative decrees only for three types of compulsory insurance, in accordance with which insurance services may be provided.

In 2000, the amount of insurance inpayments under **compulsory categories of insurance** totaled 3.1 million UAH (1.8% of total payments for all of categories). For Kharkiv-based companies, compulsory insurance inpayments came to 1.0 million UAH (32.4%), while for branches of outside companies the total was 2.1 million UAH (67.6%), as shown in **Table 2**.

Table 2. Insurance Inpayments Under Compulsory Categories of Insurance (1000 UAH)

Indexes	1999	2000
Kharkiv companies	773	1,009
Outside companies	1,498	2,108
Total	2,262	3,117

Diagram 2. Compulsory Insurance (1000 UAH)



Settlement of claims (outpayments) totaled 73,000 UAH, an increase of 41,000 UAH (0.9%) over 1999.

Vehicular accident or transport insurance accounts for the largest share of payments made for compulsory insurance. In 2000, these totaled 1.6 million UAH (0.97% of total inpayments) in Kharkiv Oblast. Kharkiv companies received 0.4 million UAH (22.1%), while branches of outside companies received 1.2 million UAH (77.9%), as shown in **Table 3**.

Table 3. Insurance Inpayments for Transport Accident Insurance (1000 UAH)

Indexes	1999	2000
Kharkiv companies	320	354
Outside companies	942	1,249
Total	1,262	1,603

In 2000, the amount of insurance inpayments received for **compulsory personal insurance for members of voluntary fire brigades** and **liability insurance** totaled 549,000 UAH (17.6% of total compulsory insurance payments). Kharkiv companies received 434,000 UAH (79.0%), while outside companies received 115,000 UAH (21.0%), as shown in **Table 4**.

Table 4. Insurance for Members of Voluntary Fire Brigades/Liability Insurance: 1999-2000

Indexes	1999	2000
Insurance for Members of VFBs		
Kharkiv companies	420	434
Outside companies	198	115
Total	618	548
Liability Insurance		
Kharkiv companies	88	221
Outside companies	294	744
Total	382	965

In 2000, the amount of insurance inpayments for **automobile owners' civil liability insurance** totaled 965,000 UAH (31.0% of total inpayments for compulsory insurance). Kharkiv companies received 221,000 UAH (22.9%), while outside companies received 744,000 UAH (77.1%). Three Kharkiv-based companies and 10 outside companies are active in this insurance category.

In accordance with Ukrainian law, **voluntary insurance** is based on an agreement between the insurer and the insured, while **compulsory insurance** is based on an agreement between the government and the enterprise/organization.

In 2000, insurance inpayments received for **voluntary categories of insurance** totaled 121.6 million UAH (270.5%), an increase over 1999 levels. Settlement of insurance claims totaled 2.0 million UAH in 2000, an increase of 26% over 1999. Voluntary insurance inpayments in 2000 totaled 166.6 million UAH. Kharkiv insurance companies received 161.4 million UAH (96.8% of total oblast voluntary insurance inpayments), while branches of outside companies received 5.3 million UAH (3.2%). The share of voluntary categories in total outpayments in 2000 was 5.5%, an increase of 15.5% over 1999.

The overall condition of the voluntary insurance market is shown in **Table 5**.

Table 5. Kharkiv Oblast Voluntary Insurance Market: 1999-2000 (1000 UAH)

Categories	1999	2000		Kharkiv Companies	Outside Companies
		Amount	% of Total		
Voluntary insurance:	44,976	166,639	100	161,350	5,289
▪ financial risks	19,779	95,567	57.3	95,540	27
▪ property	10,657	33,576	20.0	-	-
▪ freight	2,687	14,378	8.6	14,293	85
▪ medical	2,884	2,780	1.6	-	-
▪ automobile	1,538	2,016	1.2	947	1,069
▪ accident	542	567	0.3	263	304
▪ other	6,880	17,775	10.7	-	-

Financial risk insurance accounts for the largest share of payments made for voluntary insurance. Payments received in 2000 totaled 95.6 million UAH (57.3%). Kharkiv companies received 95.5 million UAH.

Since 1999, **property insurance** has been the fastest-growing category of voluntary insurance. In 2000, property insurance accounted for 20.1% of all payments made for voluntary insurance, totaling 33.6 million UAH. In 2000, the amount of insurance payments under this category increased by 22.9 million UAH (215.1%), an increase over 1999.

Leasehold insurance accounts for a significant portion of property insurance. In 2000, leasehold insurance inpayments totaled 13.7 million UAH (8.21% of total voluntary insurance inpayments and 27.4% of total property insurance inpayments). Kharkiv insurance companies received 10.8 million UAH (79.1%), while outside companies received 2.9 million UAH (20.9%). 13 Kharkiv-based companies and 6 branches provide services in this insurance category.

In 2000, the total amount of **freight insurance** inpayments was 14.4 million UAH (8.6% of total voluntary insurance inpayments). Kharkiv companies received 14.3 million UAH (99.3%), while outside companies received 0.1 million UAH (0.7%).

Medical insurance in the region is provided by three different Kharkiv Oblast companies that received a total of 2,600,000 UAH in 2000. Medical insurance services in Kharkiv Oblast totaled 2,780,000 UAH in 2000, a decrease of 104,000 UAH (-1.6%) from 1999.

Traveler's insurance is a subcategory of medical insurance. In 2000, inpayments totaled 814,000 UAH (0.5% of the medical insurance total).

Automobile insurance is provided by 10 Kharkiv insurance companies as well as 10 outside companies. In 2000, Kharkiv companies received inpayments totaling 947,000 UAH (47.0%), while outside companies received 1,069,000 UAH (53%).

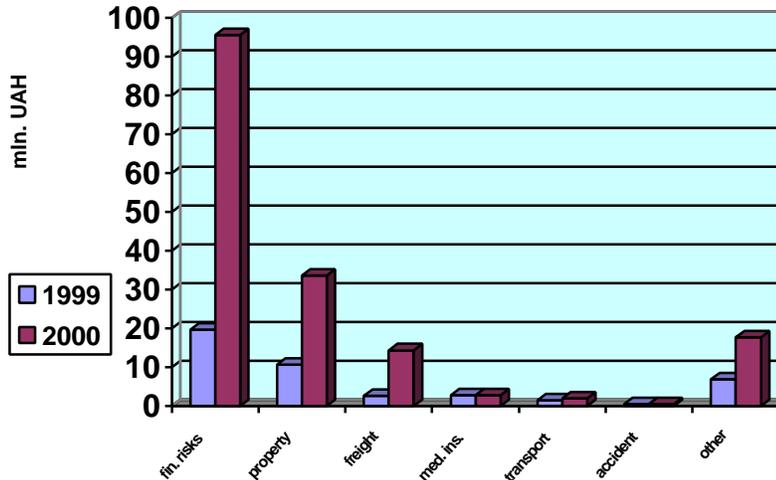
In 2000, total activity for the Kharkiv Oblast insurance market was up 478,000 UAH over 1999, an increase of 31.1%.

Life insurance ranks first among all categories of voluntary insurance. Inpayments in 2000 totaled 3,284,000 UAH (85.3% of all voluntary insurance inpayments). Life insurance outpayments in 2000 totaled 3,591,000 UAH (96.3% of all categories of personal insurance).

Currently, four companies in Kharkiv Oblast provide life insurance. In 2000, these companies received inpayments totaling 3,284,000 UAH. **Personal accident insurance** is provided by 10 Kharkiv insurance companies as well as 10 outside companies. Inpayments in 2000 totaled 567,000 UAH (0.3% of total life insurance inpayments). Kharkiv companies received 263,000 UAH (46.4%), while outside companies received 304,000 UAH (53.6%). Inpayments for all categories of voluntary insurance for the period 1999-2000 are illustrated in **Diagram 3**.

Diagram 3. Voluntary Insurance Inpayments: 1999-2000

Insurance Reserves



As of January 1, 2001, the amount of **formed insurance reserves** totaled 108,914,000 UAH, an increase of 76,102,000 UAH (231.9%) over 1999.

81% of formed insurance reserves, totaling 3,950,000 UAH, are allocated among deposit accounts at Kharkiv city banks. Of this total, 3,580,000 UAH (90.6%) are from Kharkiv insurance companies, and 370,000 UAH (9.4%) are from outside companies.

As of January 1, 2001, two out of the 21 insurance companies had met the requirements for ensuring solvency, had sufficient authorized funds, and had formed insurance reserves allocated in full.

Balance Sheet Profit

In 2000, the total **balance sheet profit** for all insurance companies came to 12,373,000 UAH. Total balance sheet profit for Kharkiv insurance companies came to 12,291,000 UAH, while for outside companies it was 82,000 UAH. Returns on investment of temporary surplus funds came to 941,000 UAH (0.5%).

Expenditures for the Kharkiv Oblast insurance industry in 2000 came to 6,481,000 UAH (3.8% of inpayments received).

Profit tax paid by insurance companies in 2000 totaled 1,251,000 UAH. Kharkiv companies paid 994,000 UAH in profit taxes, while outside companies paid 257,000 UAH.

Ukraine Market

Characteristics of Kharkiv Oblast banks relative to other banks in Ukraine are shown in **Tables 6** and **7**.

Table 6. Ranking of Kharkiv Oblast Banks by Financial Indicators

Rank	Bank	Profit (million UAH)	Share	Profitability of Authorized Capital Stock	Profitability of Net Assets
16	UkrSibBank	7.42	1.9%	8.2%	0.9%
25	MEGABANK	4.59	1.17%	17.3%	2.0%
34	Basis	2.8	0.72%	37.4%	3.3%
50	Region-Bank	1.56	0.4%	15.6%	4.3%
51	Merkuriy	1.54	0.39%	13.4%	1.9%
56	Real-Bank	1.26	0.32%	7.2%	0.9%
59	Grant	1.1	0.28%	12.2%	1.7%
69	Ukrainian Bank of Trade Cooperation	0.884	0.23%	4.9%	1.3%
85	Zemelnyy (Land bank)	0.522	0.13%	3.7%	1.6%
102	Evropeiskiy	0.208	0.05%	1.8%	1.0%
103	Zolotiye Vorota (Golden Gate)	0.184	0.05%	0.9%	0.4%

Note: Three banks have not provided information on their financial results; however, even without that data, one can see that Kharkiv banks are at the “golden mean” among Ukrainian banks, returning modest yet positive results.

Table 7. Credit and Investment Portfolios of Kharkiv Banks as of April 1, 2001 (million UAH)

Bank	Credits and Investments				
	Total	%	Interbank	To Businesses	Into Securities
Kharkiv banks	1,065.0	5.9%	120.4	866.9	77.6
UkrSibBank	606.6	3.4%	48.3	506.9	51.4
MEGABANK	78.6	0.4%	17.3	59.2	2.1
Ukrainian Bank of Trade Cooperation	51.5	0.3%	0	51.4	0.1
Grant	51.3	0.3%	5.0	45.7	0.6
Basis	46.9	0.3%	8.6	37.9	0.3
Real-Bank	46.7	0.3%	17.4	19.1	10.3
Zolotiye Vorota (Golden Gate)	38.3	0.2%	0	38.3	0
Mercuriy	38.0	0.2%	0.6	31.7	5.6
Privat – Excel	34.9	0.2%	5.5	29.4	0
Zemelnyy (Land bank)	32.7	0.2%	8.6	18.6	5.5
Region-Bank	22.9	0.1%	7.9	15.0	0
Evropeiskiy	16.6	0.1%	1.2	13.7	1.7
Total Ukraine	17,906.9	100%	2,875.7	13,804.9	1,226.4

The credit and investment portfolios of Kharkiv banks are distributed as follows:

- entrepreneurial projects: 81%
- interbank credits: 11%
- security investments: 8%

Table 8. Kharkiv Bank Deposits as of April 1, 2001 and Share in Total Volumes in Ukraine (million UAH)

Bank	Deposits of Legal Entities				Deposits of Individuals			
	Sum	%	Demand	Time	Sum	%	Demand	Time
Kharkiv banks	784.2	7.3%	428.6	355.7	216.7	4.6%	23.6	193.1
UkrSibBank	376.7	3.5%	140.2	236.5	143.9	3.1%	7.2	136.7
MEGABANK	179.8	1.7%	151.6	28.2	2.9	-	0.3	2.6
Basis	61.6	0.7%	14.3	47.3	0.9	-	0.1	0.8
Merkiriy	57.6	0.6%	51.2	6.5	3.5	0.1%	0.2	3.3
Grant	25.3	0.3%	17.0	8.3	14.8	0.3%	4.9	9.9
Ukrainian Bank of Trade Cooperation	15.9	0.1%	10.5	5.4	13.2	0.3%	0.8	12.4
Real-Bank	15.2	0.1%	10.4	4.8	15.1	0.3%	5.8	9.3
Zolotiye Vorota (Golden Gate)	14.7	0.1%	10.3	4.4	8.8	0.2%	0.4	8.4
Zemelniy (Land bank)	13.6	0.1%	6.1	7.5	2.2	-	0	2.2
Region-Bank	11.8	0.1%	10.6	1.2	7.8	0.2%	1.4	6.4
Privat-Excel	10.4	0.1%	4.9	5.5	2.3	-	2.0	0.3
Evropeiskiy	1.6	-	1.5	0.1	1.3	-	0.5	0.8
Total Ukraine	10,686.8	100	7,973.4	2,713.4	4,684.3	100	1,036.5	3,647.8

As shown in **Table 8**, deposits of legal entities exceed deposits of individual by 360%. Time deposits predominate among individuals (89%), while demand credits predominate among enterprises and organizations (55%).

In summary, this analysis has found that Kharkiv banks provide account for approximately 5% total banking subsector output in Ukraine, with UkrSibBank performing almost 50% of work content. Credit and deposit activity for the Kharkiv Oblast banking subsector is shown in **Tables 9** and **10**.

Table 9. Credit Activity of the Kharkiv Oblast Banking Subsector: 1998-2000 (million UAH)

Bank	Year		
	1998	1999	2000
UkrSibBank	114.6	209.6	606.6
MEGABANK	13.7	34.9	78.6
Basis	0.5	4.7	51.5
Merkuriy	11.8	16.1	51.3
Grant	29.8	33.6	46.9
Ukrainian Bank of Trade Cooperation	9.8	16.3	46.7
Real-Bank	12.7	14.1	38.3
Zolotiye Vorota (Golden Gate)	15.3	19.3	38.0
Zemelniy (Land bank)	7.8	10.9	34.9
Region-Bank	8.3	6.7	32.7
Privat-Excel	2.2	1.1	22.9
Evropeiskiy	3.8	5.8	16.6
Total	230.3	373.1	1,065.0

Amounts on deposit at Kharkiv Oblast banks have risen dramatically over the past few years, increasing almost 300% in 2000 alone. UkrSibBank is currently the dominant institution in the Kharkiv Oblast banking market, and issues more than half of all credit in the region.

Table 10. Deposits at Kharkiv Banks (million UAH)

Bank	1998		1999		2000		
		Total	Legal Entities	Individuals	Total	Legal Entities	Individuals
Kharkiv banks	281.6	391.7	336.3	55.4	1000.9	784.2	216.7
UkrSibBank	100.6	114.9	95.7	19.2	520.6	376.7	143.9
MEGABANK	50.7	118.6	113.1	5.5	182.7	179.8	2.9
Basis	0.8	6.2	6.2	0	62.5	61.6	0.9
Merkuriy	38.0	53.5	52.1	1.4	61.1	57.6	3.5
Grant	46.7	40.2	37.0	3.2	40.1	25.3	14.8
Real-Bank	12.7	19.0	7.9	11.1	30.3	15.2	15.1
Ukrainian Bank of Trade Coop.	4.9	8.8	7.1	1.7	29.1	15.9	13.2
Zolotye Vorota (Golden Gate)	10.4	9.0	6.2	2.8	23.5	14.7	8.8
Region-Bank	10.9	13.7	6.1	7.6	19.6	11.8	7.8
Zemelniy (Land bank)	3.3	5.0	3.3	1.7	15.8	13.6	2.2
Privat-Excel	0.3	0.4	0.3	0.1	12.7	10.4	2.3
Evropeiskiy	2.3	2.4	1.3	1.1	2.9	1.6	1.3

Characteristics of the eight largest insurance companies in Kharkiv Oblast are shown in **Table 11**.

Table 11. Ranking of Kharkiv Oblast Insurance Companies by Financial Results: 2000 [9, p.27]

Rank	Company	Assets (1000 UAH)	Total	Authorized Funds	Insurance Inpayments (1000 UAH)	Insurance Outpayments (1000 UAH)	Reinsurance Payments (1000 UAH)	Insurance Reserves (1000 UAH)
1	Lemma	149,935.9	78,294.3	10,195.7	150,697.5	812.0	143,885.5	73,010.9
6	Avante	44,773.2	28,745.5	21,000.0	21,182.9	347.4	18,519.6	10,233.1
59	Garant-Veksel	3,761.2	828.0	442.0	11,902.2	1.7	11,552.6	7,316.8
89	Evivva	1,431.6	606.6	522.5	2,128.6	1,450.2	236.4	668.4
98	Nadiya	1,094.1	381.9	600.0	2,649.4	2,742.5	0	0
101	Industrial Ins. Co.	1,027.2	768.0	500.0	566.0	1.0	31.4	245.1
103	Lemma-Vite	991.1	988.8	1,000.0	0.8	0	0	0.6
114	Varta	345.0	323.2	248.8	0.6	0	0	0.2

Other companies refused to publish their financial information. As shown in the table, "Lemma" is the largest insurance company in Kharkiv.

World Market

The presence of any nation's financial establishments in the world market is determined above all by their participation in international projects, creating various systems of customer service that meet international standards and requirements, setting up joint credit associations with other countries, etc. Since Ukraine's banking system is still behind the world banking system, its sector enterprises are faced with the twofold task of introducing international standards in the domestic market, while at the same time trying to create a "good name" among their foreign partners.

In the insurance market, the situation is somewhat worse. In this case, it is the imperfection of the national industry itself, as well as the nation's legal system, that is hindering progress. Current reserves make up only 0.9% of the gross domestic product, while in developed countries reserves average 8%-12%. Thus, considerable funds that could be used as domestic investment for economic development are not being accumulated.

Further development of the Ukraine insurance market will help free the state from expenditures in the case of insured occurrences. In Ukraine today, only 10% of risks are insured, while in developed countries that index is 90%-95%. Ukraine's market share in the European insurance market is only 0.05%, although Ukrainians account for 7% of the population of Europe. Furthermore, the activities of foreign companies in the national insurance market inflict annual losses of \$80-100 million in the sector.

The Program of Development of the Ukraine Insurance Market for 2001-2004 is the government's response to these problems. In addition, its support in setting up an inter-agency coordinating council for insurance issues, presided over by various ministries and departments, testifies to the government's growing attention to the issues facing the sector today.

3. Economic Condition of Sector Enterprises and Organizations

The Finance and Insurance sector experienced rapid growth during 1998-1999. For example, sales proceeds in 1999 were up 200% over 1998, and 2000% over 1997. However, production costs also rose sharply in 1999.

Balance sheet profits, on the other hand, showed a somewhat different pattern. While in 1997 balance sheet profits totaled over two million UAH, 1998 was unprofitable. 1999 saw a return to positive growth with balance sheet profits in excess of 20 million UAH. These and other industry financial indicators are shown in **Table 12**.

Table 12. Finance and Insurance Sector Economic Activity: 1997-1999 (1000 UAH) [2]

Financial Indexes	1997		1998		1999	
	In Region	Finance/Insurance	In Region	Finance/Insurance	In Region	Finance/Insurance
Sales proceeds	10,956,911	7,943	15,604,665	63,010	15,359,561	165,918
VAT	1,136,295	-	1,890,521	1,329	1,909,791	1,208
Other taxes	449,847	-	554,299	0.3	194,763	0.4
Production costs	8,286,584	7,197	10,994,387	58,964	12,378,232	146,844
Commercial expenses	264,254	93	371,132	3,577	512,145	3,610
Balance sheet profit	1,044,468	2,194	1,502,421	-7,428	272,609	20,494
▪ sales	819,932	653	1,794,328	-861	364,628	14,254
▪ other operational earnings and expenses	222,142	568	-296,573	-8,351	123,942	-1,208
▪ earnings from corporate rights ownership	1,037	18	1,646	431	1,873	766
▪ interest until receipt	1,358	954	3,020	1,353	6,311	1,029
▪ other extra-sales earnings and expenses	-	-	-	-	-224,146	5,653

This data illustrates the fact that the financial sector has been developing much faster than the general economy of Kharkiv Oblast as a whole. Additional data comparing sector activity with that of the region overall is shown in **Table 13**.

Table 13. Grouping of Enterprises by Financial Results: 1997-1999 [2]

Financial Indexes	1997		1998		1999	
	All Oblast Enterprises	Finance/ Insurance	All Oblast Enterprises	Finance/ Insurance	All Oblast Enterprises	Finance/ Insurance
Balance sheet profit	1,044,468	2,194	1,502,421	-7,428	272,609	20,494
Profitable Enterprises						
Number of enterprises	2,057	18	1,695	65	1,790	68
% of total number	53.7	64.3	47.4	55.1	49.5	60.7
Profits	1,603,884	2,306	2,395,290	8,940	1,144,231	26,066
Unprofitable Enterprises						
Number of enterprises	1,770	10	1,884	53	1825	44
% of total number	46.3	35.7	52.6	44.9	50.5	39.3
Profits	559,416	111	892,870	16,368	871,623	5,573

While the number of profitable and unprofitable enterprises are fairly close in the region overall, the ratio is better in the Finance and Insurance sector.

4. Sector Development: Raw Materials Base

Specific data on raw materials for this sector is not available.

5. Sector Development: Technological Base

Technological development of the sector is proceeding intensively, thanks to the significant resources of sector enterprises and support from foreign partners.

The National System for Large-Scale Electronic Payments (NSLSEP) program, which is being implemented by the National Bank of Ukraine (NBU), will introduce almost 10 million electronic payment cards to citizens throughout Ukraine. According to the NBU, about 100,000 transaction points will be installed, which will include payment terminals and ATMs. The system will be totally tested by the second quarter of 2001 prior to rollout across the country.

During the pilot phase, member banks will issue up to 100,000 payment cards. The system will use "smart" cards with built-in chip modules. In contrast to cards with magnetic tape stripes, these smart cards will offer a higher level of protection. Smart cards are used in offline systems, which do not require operational communication with a bank account when making a transaction. This technology considerably reduces usage costs, which will allow lower income citizens (e.g., pensioners, students, and schoolchildren) to participate in the NSLSEP program. [6]

Two payment tools will be tested during the pilot phase: "electronic wallet" and "electronic check". The "electronic wallet" will be useful for making small sum payments of a few kopecks or so, while the "electronic check" will be oriented more toward average and large payments of several thousand UAH or more.

Another project planned for implementation is the “Driver’s Card,” which is designed to streamline the payment process for registering automobiles and paying insurance premiums. Nearly 6.5 million Ukrainians are expected to use driver’s cards.

The program stipulates simultaneous introduction at NSLSEP banks and Ukrainian post offices. At present, 10 Ukrainian banks are members of NSLSEP. Introduction of payment card service at the nation’s 15 thousand local post offices will make the system of electronic payments more accessible for the public at large.

6. Investment Activities in the Sector

To accurately assess the level of investment in the sector, it is necessary to examine both the sector’s financial resources and its position relative to other branches of the economy. These are shown in **Table 14**.

Table 14. Kharkiv Oblast Direct Foreign Investment (DFI) by Sector (1000 USD) [1]

Sector	# Enterprises	As of 1.01.1999	%	As of 1.01.2000	%
Industry	55	28,963	56.5%	32,862	43.9%
Trade	80	12,468	24.3%	30,116	40.2%
Finance and Insurance	5	2,834	5.5%	2,834	3.8%
Marketing and Sales	2	259	0.5%	2,467	3.3%
Other	44	6,757	13.2%	6,655	8.8%
Total	186	51,281	100.0%	74,934	100.0%

As one can see from the table, the Finance and Insurance sector is among the most prominent sectors in terms of direct foreign investment (DFI). One negative trend is that DFI in the Finance and Insurance sector remained constant in 1999 while increasing in other sectors, resulting in a relative decrease in the sector’s share of total aggregate capital.

DFI by country is shown in **Table 15**.

Table 15. DFI in the Finance and Insurance Sector by Investing Country (1000 USD) [1]

Country	As of 1.01.1999	%	As of 1.01.2000	%
USA	1,486	52.4%	1,486	52.4%
Czech Republic	1,200	42.3%	1,200	42.3%
Germany	128	4.5%	128	4.5%
Bahamas	20	0.8%	20	0.8%
In total	2,834	100.0%	2,834	100.0%

As shown in the table, more than half of all DFI in the sector comes from the USA, with most of the remaining investment coming from the Czech Republic.

7. Employment and Personnel Potential in the Sector

As of January 1, 2001, there were 8,454 people working in the Finance and Insurance sector, nearly 1% of all employees in the oblast. Average monthly salary in 2000 was 558.04 UAH, which, at 2.42 times the regional average, was one of the highest among all sectors. This figure was due in part to a sharp increase in salaries during the last months of 2000. In November 2000, the average salary per employee was 640.3 UAH, and rose to 918.3 UAH in December. Average salary grew 146% in 2000 relative to 1999.

Sector companies hired 2,900 people in 2000, while 2,831 people left employment in the sector. And although sector turnover somewhat exceeded the oblast average, these figures may be considered positive, since most of the people who left employment did so voluntarily. Involuntary terminations totaled 580. As of January 1, 2001, state employment offices registered 32 vacancies, almost all of which were state official positions.

In summary, growth of the sector in 2000 spurred an increase in the demand for skilled personnel, which in turn drove an increase in turnover and salary levels, as many employees sought more attractive job offers.

8. Sector Exports

Given that the Finance and Insurance sector does not produce tangible goods, all data pertaining to sector exports concerns services (e.g., traveler's checks, credit cards, foreign citizen insurance, etc.). It is important to bear in mind that, because of peculiarities in the Ukraine legal system, this sector does not correspond to world standards. In addition, foreign infrastructure in the sector is much more developed than that of domestic enterprises. Accordingly, it is not surprising that sector imports exceed exports, as shown in **Table 16**.

Table 16. Finance and Insurance Sector Imports/Exports: 1996-1999 (1000 USD)

Years	Exports			Imports		
	# of Enterprises	1000 USD	Share in Total Volume for All Sectors	# of Enterprises	1000 USD	Share in Total Volume for All Sectors
1996	3	693.21	0.2%	18	683.18	0.2%
1997	5	400.69	0.1%	11	5,151.22	0.8%
1998	2	1,502.70	0.4%	10	15,067.21	1.6%
1999	3	124.90	0.04%	13	858.80	0.11%

As shown in the table, the Finance and Insurance sector's share in total Kharkiv Oblast import-export operations is minimal. The fluctuations that occurred during the period 1996-1999 were of an essentially random nature caused by chaotic actions of various contractors, and do not indicate any coherent pattern.

9. Competitive Environment of Sector Enterprises and Organizations

Competition in the Finance and Insurance sector is relatively high, compared with other sectors of the economy. The sector is highly attractive, because of the number of operators on the market and the rapid technical and technological development taking place in the sector.

Of course, every bank or insurance company offers a degree of basic services that are essentially identical across all enterprises. At this level, competition takes place on the level of the fees charged.

Recently, however, more and more sector enterprises are moving toward specialization. For example, the Kharkiv Bank of Trade Cooperation has focused its efforts in serving the Trade sector, while the “Aval” bank is concentrating on lending to agricultural enterprises. In fact, Aval’s affiliates in Kharkiv have won the majority of this market in the region. The “Grant” bank has recently directed its efforts toward providing support for SME development, following the direction of its “Microcreditbank” affiliate.

Among insurance companies, “Lemma” holds 87.3% of the financial risk underwriting market and 88.5% of the freight insurance market, while the “Eviva” and “European” companies currently hold more than 90% of the medical insurance market. Currently, only four companies (“Grantservice”, “Nadiya”, “Mega-Garant-Zhittya”, and “Lemma-Vite”) are active in the Kharkiv Oblast life insurance market.

10. Ownership in the Sector

Today, there are 14 commercial banks with legal entity status in Kharkiv Oblast. All are joint stock companies (mainly of the open type). In addition, branches of two state banks—the National Bank and Savings Bank—are present in the oblast.

There are currently 21 local insurance companies and 22 affiliates of companies from other regions active in the Kharkiv Oblast insurance market. All of them are either open or closed joint stock companies.

Article 2 of the law, “On insurance” states that insurers should be legal entities in the form of either joint stock companies, full partnerships, limited partnerships, or companies with additional liability as determined in accordance with Ukrainian law. In addition, companies from outside the sector may obtain a special license to pursue insurance activities. An insurer should comprise not less than three partners; and only Ukrainian residents may provide insurance. By law, the total share of foreign legal entities and foreign citizens in an insurer’s authorized capital stock may not exceed 49% (although some exceptions have been documented). State-owned organizations may also engage in insurance activity.

11. SME Growth in the Sector

There are no small- or medium-size enterprises in this sphere of the national economy. The reason for this is that national legislation has specific requirements on the size of authorized capital stock for finance and insurance concerns. Accordingly, this section of the analysis deals with financial organizations that assist in developing SMEs.

One such enterprise is “Microcreditbank,” which, together with its Kharkiv affiliate, was established specifically to lend money to SMEs. Another enterprise active in this area is the “Grant” Bank, which has developed a new strategy for SME support.

Creation of the CJSC “Microfinancial Bank” was a milestone in the SME development effort in Ukraine. Microfinancialbank is the first Ukrainian organization with foreign investment oriented toward financing SMEs and private enterprise. The bank’s authorized capital stock is approximately 48 million UAH (10 million EUR). The profile activity of the bank is the issuance of loans to micro-companies and independent entrepreneurs. Aimed at providing its clients with a wide spectrum of top-level banking services, the bank will employ a special loan technology borrowed from the German company “IPC GmbH”. At present, similar credit-financial institutions successfully function in seven other Eastern European countries. The bank will issue loans with differential interest for periods ranging from 9 to 18 months.

For example, loans up to 10,000 USD will be issued at a monthly interest rate of 1.5%, and loans between 10,000-125,000 USD will be issued at 1.25%. Moreover, loans may be issued either in the local currency, USD, or in EUR, as requested by the client.

In addition, Grant Bank has recently shifted its focus from large enterprises to SMEs and private individuals. According to the chairman of the board, the bank's priority this year will be in lending to agricultural sector enterprises, because of a number of promising indicators in that market. As of January 1, 2001, Grant Bank's assets totaled 74.84 million UAH, with individual deposits making up 12.49 million UAH and bank capital 4.76 million EUR. The structure of the bank's credit-investment portfolio also improved.

12. Sector Infrastructure

A number of institutions of higher education serving this sector of the economy may be considered its infrastructure, since they are the ones who provide trained specialists to work in the field. Among the most significant of these institutions are:

- Kharkiv National University
- Kharkiv State Economic University
- Ukrainian Academy of Banking (Kharkiv Oblast branch)

In addition to state establishments, there are a number of private educational institutions that train students exclusively in commercial disciplines:

- Kharkiv Financial-Economic Institute (CJSC)
- Slov'yansk University (LLC)
- Kharkiv Institute of Business and Management (CJSC)
- Institute of Economics, Market Relations and Management (LLC)

The level of training and activity profiling vary among these institutions; therefore, final adaptation of experts to real conditions takes place when these individuals begin working at sector enterprises and organizations.

13. Management Capabilities of Sector Enterprises and Organizations

The condition of management in the sector companies is not homogeneous. For example, each insurance enterprise has to train its managers at its own expense. Banks, on the other hand, are able to hire high quality specialists and adapt them to the specific methods of the firm.

Despite this difference, all branches of the sector have felt the lack of highly skilled staff. This personnel shortage can be explained, first of all, by the under-developed nature of the nation's financial system, which has not yet established a means of training top-level managers. In addition, the various world and local crises of recent years has led to a "brain drain" of experts seeking employment abroad or in other business sectors.

Now, however, the situation is reversed, with well-paid (by Ukrainian standards) positions in banks and insurance companies among the most attractive jobs available in Ukraine. And with the further development of the sector, they will become even more sought after.

14. Administrative Impact on the Sector

As one of the most dynamic and technologically advanced sectors, Finance and Insurance always attracts the attention of state authorities. Regulation of the industry, however, has been rather chaotic, and only in 2000 have some specific steps been taken to manage the sector strategically.

The presidential decree entitled, "On measures for consolidating the Ukraine banking system and increasing its role in processes of economic transformations," dated July 14, 2001, will further the policy aimed at fostering favorable conditions for more efficient functioning of the banking system. The decree provides for working out an integrated program of development for the Ukraine banking system by 2001-2003. The decree identifies specific objectives for further development of the Ukraine banking system and provides for the formation of adequate mechanisms and instruments of banking practices to keep pace with the renewed economic growth that began in 2000.

The program offers a concise view of the entire Ukrainian banking system, as well as of the problems hampering its development. The program outlines major principles and conceptual approaches to aid further development of the banking sector. Implementation of the program will require sufficient organizational, legal, and methodical conditions to meet specified goals. These include:

- strengthening the local currency
- orienting local banks toward meeting the needs of the national economy by increasing credit volumes and investment in the local economy
- strengthening banks' reliability
- developing the ability to emerge from local crisis situations with minimal losses and developing strategies to avert systematic banking crises
- increasing consumer confidence in commercial banks
- clearing banks' credit portfolios of bad debts, and the banking system itself of weak, insolvent banks that are incapable of meeting consumer needs.

In a separate section of the program, there is a concise description of the role and prospects for non-banking financial institutions. The program also details a number of specific measures to ensure reforms and enhance efficiency of banking establishments.

An additional measure, entitled, "On Banks and Banking Performance," was signed by the president on January 11, 2000. This law is intended to further strengthen the banking system and increase its stabilizing influence on the Ukrainian economy. The law further specifies methods for establishing and managing banking enterprises, and describes procedures on their reorganization and liquidation. The Law also stipulates a 2-year period for bringing all banks into compliance with the newly outlined requirements. According to the Ukrainian President, the new measure is better suited to the requirements of the market economy and will further strengthen the nation's banking system.

As for the insurance branch, the Program for Insurance Market Development for 2001-2004 provides an overview of the problems hampering development of insurance services in Ukraine. The program delineates a number of action items for the legislature, including correlation of national law governing insurance with EU legislation. The program outlines special state supported investment programs designed to protect the sector's insurance reserves. A number of specialized programs also provide for insurance of property and underwriting of financial risks, as well as insurance of SME entrepreneurs and export-import operators.

The program outlines a number of measures to increase the financial capabilities and stability of Ukrainian insurers. Other provisions are designed to protect citizens' savings accumulated through long-term life/health insurance and/or pension programs. The latter will provide for the development of voluntary insurance and encouraging citizens to

increase savings to help bolster economic growth. Licensed insurers will be allowed to participate in the non-government pension system. According to expert opinion, implementation of the program will increase insurance revenues by 70%-80% annually.

A pending act of legislation entitled, "On Insurance contracts," provides for the standardization of the various forms of insurance contracts; a draft of this act is now under consideration.

15. Social Issues of Sector Development

There are no particular social issues pertaining to the development of the Finance and Insurance sector.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

Acting as financial asset holders, banking establishments conduct their own analyses of the investment proposals emerging in the oblast. Business plans of enterprises and organizations of various sectors of the economy go through a thorough examination; and on the basis of this evaluation, funds for implementation are either granted or disapproved. Projects that have been worked out by financial establishments for their own development (e.g., for new services, international partnership, etc.) that require investment are submitted to an immediate prospective partner for consideration; however, these are rare. Investment activity of insurance companies is restricted by law. The use of surplus funds is strictly regulated, and is not allowed for business market positioning or creation of joint projects.

Conclusions

Although Finance and Insurance is not the highest performing area of the Kharkiv Oblast economy, a number of positive signs indicate the overall positive state of the sector. Introduction of new technologies, availability of highly skilled personnel, and close cooperation with foreign partners promise stable improvement of sector services and an increased ability to meet client needs. This process will be enhanced through the support of state authorities, who in fact have already begun developing strategies for sector development.

In addition, the Finance and Insurance sector is a powerful generator of financial resources that can be used to develop other sectors of the national economy. Therefore, investment proposals intended for this sector may even be considered joint ventures for the larger good of the national economy in general.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.	Products	Directors
Banks				
UkrSibBank	61005, Kharkiv , Moskovskiy Prospekt, 60	???:351641 219212 224383	Banking services	Oleksandrov Artem Vladymirovich
"Grant" Bank	61001, Kharkiv, Danylevskogo Street, 19	???:351607 474106 303792	Banking services	Martirosov Vladimir Ivanovich
Basis	61078, Kharkiv City, Sumska Street, 88	???:351760 433154 433778	Banking services	Korsunskaya Valentyna Grigoriyevna
Zemelniy (Land bank)	61057, Kharkiv City, Chernyshevskogo Street, 4	???:351652 451162 760065	Banking services	Shchendrik Valentyn Omelyanovich
Zolotiye Vorota (Golden Gate)	61310, Kharkiv City, Lenyna Street, 36	???:351931 322228	Banking services	Meshchaninova Silva Gabrielovna
Ukrainian Bank of Trade Cooperation	61003, Kharkiv City, Klochkovskaya Street, 3	???:351878 122302 401985	Banking services	Stepanov Viktor Yurievich
Region Bank	61002, Kharkiv City, Darvina Street, 4	???:351254 432365 430033	Banking services	Belan Zinaida Romanovna
Real Bank	61001, Kharkiv City, Lenina Street, 60-?	???:351588 332714 333106	Banking services	Schramko Yuriy Merkuriyovich
Evropeyskiy	61125, Kharkiv City, Krasnoschkolnaya Naberezhnaya, 24	???:351845 216263 218568	Banking services	Myachin Eduard Valentynovich
Privat - Excel	61057, Kharkiv City, Rymarskaya Street, 32	???:351715 156640 156650	Banking services	Kurskiy Sergey Vladymirovich
Merkuriy	61064, Kharkiv City, Poltavskiy Schlyach Street, 23	???:351663 728686 728083	Banking services	Solovyov Vasyliy Pilypovich
Megabank	61002, Kharkiv City, Artem Street, 30	???:351629 472079 216613	Banking services	Subbotyn Victor Georgiyevich

Enterprise Name	Address	Telephone No.	Products	Directors
Insurance Companies				
Lemma	61166, Kharkiv City, Kolomenskaya Street 3	409594 142810 141165 409298		
Avante	61166, Kharkiv City, Kolomenskaya Street 3	409594 142810 141165 409298		
Garant - Veksel	61022, Kharkiv City, Gosprom, 2nd Floor, Rooms 115-117	408176 408113 175564 474092		
Nadiya	61037, Kharkiv City, Moskovskiy Avenue 195	283157 283157		
Industrial Insurance Company	61125, Kharkiv City, Netechenskaya 16	212951 215673 217480		
Kharkiv Municipal Insurance Company	61068, Kharkiv City, Plekhanovskaya 77	279425 278904		
Garant - Avto	61035, Kharkiv City, Gagaryna Street 129 Room 109	273596 275882 271778		

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**KHARKIV OBLAST ECONOMY
SECTOR PROFILES**

17. TRADE

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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Summary

Trade has historically been one of the major sources of livelihood for the inhabitants of Kharkiv Oblast. During the rapid industrial development of the Soviet era, the sector established a powerful wholesale and retail network. Under the present market economy, emphasis has shifted to satisfying consumer needs, as opposed to merely selling goods. Today, the trade and food services sectors continue to rank at the top of the Kharkiv Oblast economy.

However, recently there has been a decline in the number of sector enterprises. This negative trend can be looked at in two ways. It may indicate a decline of the sector overall; or it may reflect a transition to a higher level of development, in that increased competition results in the elimination of uncompetitive enterprises and the attendant stimulation of the survivors to intensify their activities and find new markets and clients.

The sector's demographic is also in transition. In 1990, 39% of sector enterprises were located in rural areas, while in 1999 that figure had dropped to 22.1%. In 2000, commodity turnover per person in the region was 645 UAH, an increase of 23.3% over 1999. However, this figure is still very low, since the monthly average is only 54 UAH per person.

The Trade sector is currently in second place in terms of total non-resident capital. Trade accounts for approximately 25% of all investments to the region, and has the greatest number of enterprises receiving investments. The biggest investors in the sector are Liechtenstein, the United Kingdom, the United States, and Vietnam.

Competition in this sector is very low. This is due to the fact that trade infrastructure and the distribution channels for many goods are still in the process of being established. Currently, only certain products (e.g., household appliances, computers, cars, mobile phones) have a well developed wholesale and retail trade system featuring service centers, authorized representative offices, and skilled personnel. The majority of enterprises still rely mainly on price discounting in their competitive activity.

The trade and food services sectors are mostly made up of small businesses. In 1999, 49% (5,741) of enterprises were in one of the two sectors, up slightly from 48.2% (5,385) in 1998. In addition, the total volume of products sold increased from 126 billion UAH in 1998 to 276 billion UAH in 1999, which underscores the fact that SMEs in these sectors are experiencing stable growth.

The administrative impact on the sector is very important, and yet uncertain. On the one hand, new legislation on enterprise deregulation and taxation reform is being passed. On the other hand, fiscal control is still very rigid.

A number of political, social, and geographical factors support an environment favorable to investment in the region. These include: legislative reforms directed toward the support and development of entrepreneurship, and especially small businesses; a dynamic population; and a favorable geographic position.

Kharkiv Oblast, with its strong commercial potential and well developed transport system, is especially well positioned to stimulate the development of its Trade sector, due to the proximity of the large industrial regions of Ukraine, Donetsk and Dnepropetrovs'k, and its main foreign economic partner, the Russian Federation.

1. Sector Role in the Kharkiv Oblast Economy

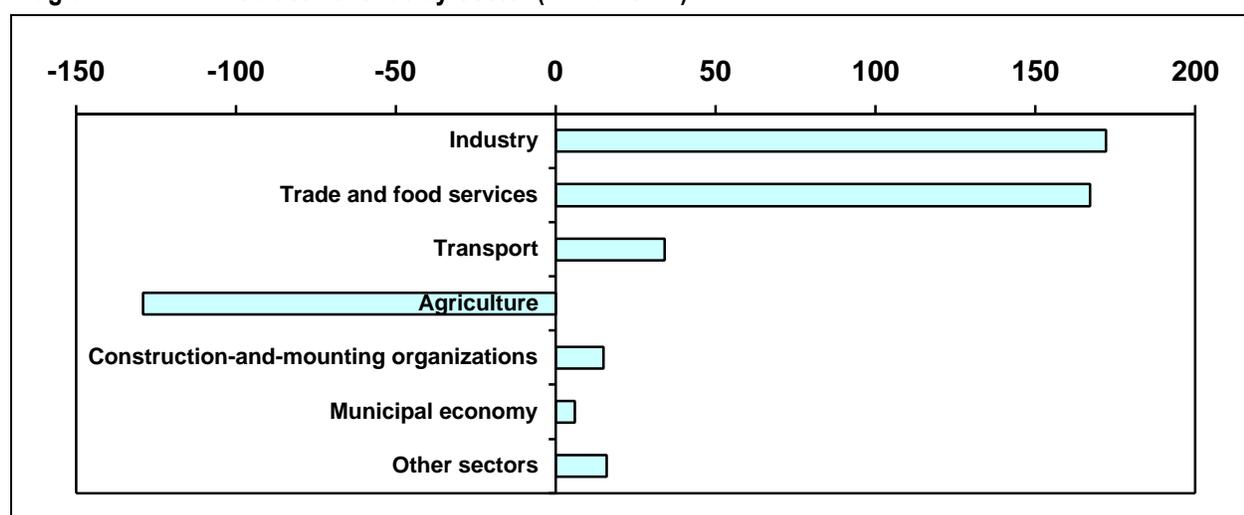
Trade has historically been one of the major sources of livelihood for the inhabitants of Kharkiv Oblast. During the rapid industrial development of the Soviet era, the sector established a powerful wholesale and retail network. Under the present market economy, emphasis has shifted to satisfying consumer needs, as opposed to merely selling goods. Today, the trade and food services sectors continue to rank at the top of the Kharkiv Oblast economy, as illustrated in Table 1.

Table 1. National Sales Outcome by Sector: 1999 (million UAH) [4]

Sector	Sales	VAT	Production Cost	Commercial expenses	Sales Outcome	Profit
Industry	7,126	871	5,790	118	172	3.0%
Trade and food services	4,344	553	3,284	330	167	5.1%
Transport	1,111	124	945	3	34	3.6%
Agriculture	755	107	771	5	-129	-16.7%
Construction organizations	409	66	325	3	15	4.6%
Municipal economy	361	51	303	1	6	1.9%
Other sectors	565	87	426	35	16	3.8%
Total Region	15,360	1,910	12,378	512	365	2.9%

As shown in the table, sales proceeds from trade and food services made up 4.3 billion UAH in 1999, or 28.1% of the total Kharkiv Oblast economy. While trade falls behind the industry sector¹ in terms of total sales, if the profitability index is removed, activity of the Trade sector is actually higher than that of industry (5.1% vs. 3.0%), and even the national economy overall (2.9%). As shown in **Diagram 1**, industry and trade are the leading sectors in Kharkiv Oblast, and together generate more than 90% of the region's revenue.

Diagram 1. Kharkiv Oblast Revenue by Sector (million UAH)



¹ Considering our sector definitions, industry includes two sectors: (1) Mining and (2) Machinery and Metal Manufacturing.

2. Strength of Kharkiv Oblast Sector

The number, profile, and change in the location of retail trade enterprises in Kharkiv Oblast over the past 15 are shown in **Table 2**.

Table 2. Development of Retail Trade Enterprises in Kharkiv Oblast

Years	Shops (# Units)	Floor Space (1000 m ²)	Stalls/Kiosks (# Units)	Total Enterprises	Per 10,000 People	
					Enterprises	Trade Floor Space (m ²)
Total						
1985	6,060	552	1,227	7,287	23	1,747
1990	6,159	595	1,183	7,342	23	1,863
1991	6,110	595	1,053	7,163	22	1,867
1992	6,087	608	1,577	7,664	24	1,909
1993	6,176	647	4,696	10,872	34	2,047
1994	6,013	644	4,205	10,218	33	2,063
1995	5,558	566	3,464	9,022	29	1,832
1996	7,246	662	2,955	10,201	33	2,169
1997	6,478	610	2,422	8,900	29	2,018
1998	6,064	590	2,028	8,092	27	1,973
1999	5,537	498	1,760	7,297	25	1,675
Municipalities						
1985	3,504	411	1,021	4,525	19	1,682
1990	3,545	444	910	4,455	18	1,759
1991	3,528	444	891	4,410	18	1,760
1992	3,494	451	1,429	4,923	20	1,790
1993	3,576	491	3,868	7,444	30	1,966
1994	3,493	490	4,063	7,556	30	1,989
1995	3,524	414	3,339	6,863	28	1,698
1996	5,269	546	2,731	8,000	33	2,272
1997	4,808	503	2,178	6,986	29	2,109
1998	4,451	493	1,870	6,321	27	2,096
1999	4,138	416	1,542	5,680	24	1,773
Rural Areas						
1985	2,556	141	206	2,762	39	1,967
1990	2,614	151	273	2,887	43	2,254
1991	2,582	151	162	2,744	41	2,272
1992	2,593	156	148	2,741	41	2,361
1993	2,600	156	828	3,428	52	2,355
1994	2,520	154	142	2,662	40	2,341
1995	2,034	152	125	2,159	33	2,333
1996	1,977	116	224	2,201	34	1,787
1997	1,670	107	244	1,914	30	1,678
1998	1,613	97	158	1,771	28	1,521
1999	1,399	82	218	1,617	28	1,307

The recent reduction in the number of sector enterprises can be looked at in two ways. It may indicate a decline of the sector overall; or it may reflect a transition to a higher level of development, in that increased competition results in the elimination of uncompetitive enterprises and the attendant stimulation of the survivors to intensify their activities and find new markets and clients.

The reduction in the number of stalls and kiosks, rather than shops, testifies to that fact as well. As a result, per capita retail sales during the period 1995-99 enjoyed stable growth (Table 6), and considerably exceeded the Ukraine national average. The sector's demographic is also in transition. In 1990, 39% of sector enterprises were located in rural areas, while in 1999 that figure had dropped to 22.1%.

The Kharkiv Oblast total retail sales volume in 2000 came to 192 billion UAH, as shown in Table 3. However, while at first glance these figures indicate a pattern of stable growth, the actual volume of trade sales activity in 2000 was only 33.3% of the total volume in 1990. Sales volumes of the food branch continue to exceed the level of non-food trade volume, though this margin has decreased in recent years from 67.9% in 1996 to 51.9% in 2000.

Table 3. Kharkiv Oblast Trade Sector Sales Volume: 1996-2000 [1]

Branch	1995		1996		1997		1998		1999		2000	
	Mln. UAH	%										
Food	428.3	62.1	686.4	67.9	726.4	64.0	780.8	57.7	874.9	56.1	998.3	51.9
Non-food	261.9	37.9	325.0	32.1	408.8	36.0	573.3	42.3	685.2	43.9	925.8	48.1
Total	690.2	100	1,011.4	100	1,135.3	100	1,354.1	100	1,560.1	100	1,924.1	100

Kharkiv Oblast trade sales volume per capita in 2000 came to 645 UAH, an increase of 23.3% over 1999. However, this figure is still very low, since the monthly average is only 54 UAH per person. The dynamics of trade sales volume are shown in Diagrams 2 and 3.

Diagram 2. Kharkiv Oblast Trade Sales Volumes

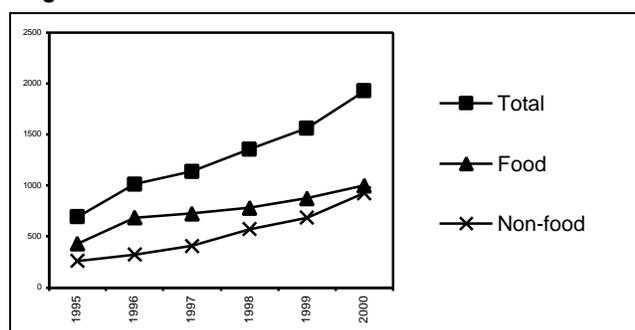
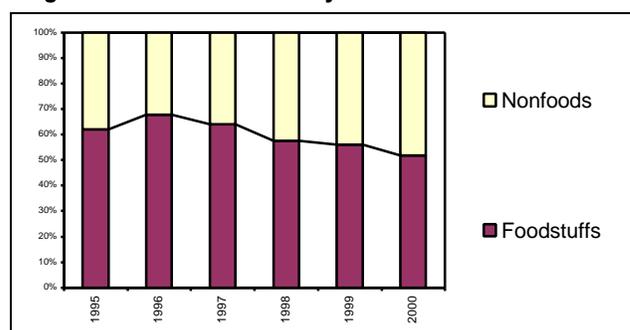


Diagram 3. Sales Volumes by Branch



Kharkiv Oblast is among the five leading regions of Ukraine in terms of total Trade sector sales volume, as shown in Table 4. Another important indicator of sector development is total shop floor space, as detailed in Table 5. In this area, Kharkiv Oblast ranks among the top three leaders.

Table 4. Trade Sector Sales Volume by Region (million UAH) [3]

Region	1995	1996	1997	1998	1999
Ukraine	11,964	17,344	18,933	19,317	22,151
Kyiv City	1,205	2,239	2,856	2,843	3,384
Donets'k	1,286	1,771	1,835	1,916	2,071
Dnipropetrovs'k	842	1,250	1,455	1,554	1,894
Kharkiv	690	1,011	1,133	1,351	1,561
L'viv	611	803	971	1067	1300
Zaporizhzhya	667	886	989	950	1063
Odesa	469	669	660	717	873
Luhans'k	561	787	822	804	853
Kyiv	425	666	689	712	805
Poltava	419	640	617	625	805
Crimea	472	606	625	699	764
Vinnysya	371	543	580	557	610
Chernyiv	340	478	548	509	569
Sumy	344	517	474	492	547
Zakarpattya	232	329	353	395	511
Cherkasy	341	487	494	462	507
Zhytomyr	344	484	515	478	496
Mykolaiv	299	422	436	405	444
Ivano-Frankivs'k	278	451	433	423	436
Khmelnys'ky	317	454	438	382	412
Kherson	242	352	375	377	410
Chernivtsi	213	272	296	298	364
Kirovograd	201	280	278	282	355
Volyn'	198	310	301	291	343
Rivno	241	300	345	302	307
Ternopil'	168	224	251	244	287
Sevastopol'	104	118	152	161	165

Total sales volume per capita is shown in **Table 6**. This analysis has found that Kharkiv Oblast trade sales volume per capita is one of the highest in Ukraine, and has been steadily increasing year by year. These data indicate that the Kharkiv Oblast Trade sector is one of the most developed in Ukraine. And taking into consideration the region's favorable geographical position, the present positive growth trend is expected to continue.

Table 5. Shop Floor Space by Region [3]

Region	Shop Floor Space (1000 m ²)				
	1985	1990	1995	1998	1999
Ukraine	10,195	11,300	10,950	8,767	7,755
Donets'k	1,090	1,171	1,189	962	837
Dnepropetrovs'k	672	742	775	656	575
Kharkiv	552	595	568	590	498
Kyiv City	372	411	446	451	447
L'viv	459	527	518	485	437
Luhans'k	602	641	595	411	358
Odesa	460	499	482	367	356
Crimea	408	459	384	329	311
Zaporizhzhya	394	431	400	336	286
Vinnysya	399	444	458	318	276
Poltava	385	429	393	297	273
Zhytomyr	312	357	334	295	269
Kyiv	389	437	390	305	266
Khmelnys'ty	351	404	424	274	257
Chernigiv	323	350	319	279	253
Cherkasy	347	383	341	267	246
Sumy	329	361	292	266	229
Zakarpattya	252	282	284	235	208
Ivano-Frankivs'k	248	286	295	216	184
Mykolaiv	268	304	311	209	182
Kherson	245	280	288	215	174
Kirovograd	286	310	281	194	167
Volyn'	209	240	227	186	163
Rivno	244	276	283	237	161
Ternopil'	228	264	289	178	151
Chernivtsy	165	180	171	138	124
Sevastopol' City	60	65	70	71	67

Table 6. Retail Per Capita Sales Volume by Region (UAH/person) [3]

Region	1995	1997	1998	1999		
				Total	Food	Nonfood
Ukraine	232	374	384	444	242	202
Kyiv City	456	1 086	1 082	1 287	586	701
Zaporizhzhya	320	478	472	529	283	246
Kharkiv	222	373	450	523	293	230
Dnipropetrovs'k	218	384	413	508	254	25
L'viv	221	355	389	479	273	206
Poltava	240	358	368	476	277	199
Kyiv	224	369	384	440	267	173
Chernigiv	250	409	389	437	274	163
Sevastopol' City	256	381	409	422	222	200
Donets'k	246	360	381	416	256	160
Sumy	245	342	362	407	261	146
Zakarpattya	180	274	307	397	235	162
Chernivtsy	226	315	318	391	177	214
Crimea	213	289	326	360	181	179
Cherkasy	226	333	314	348	184	164
Odesa	181	260	282	346	173	173
Zhytomyr	231	352	330	344	212	132
Mykolaiv	222	328	308	340	197	143
Vinnysya	197	317	303	338	196	142
Kherson	191	300	304	333	173	160
Volyn'	184	281	273	323	176	147
Luhans'k	200	304	299	320	198	122
Kirovograd	163	231	237	302	149	153
Ivano-Frankivs'k	189	296	289	299	149	150
Khmelnys'ty	210	294	259	281	139	142
Rivno	202	289	254	258	150	108
Ternopil'	143	215	210	248	145	103

3. Economic Condition of Sector Enterprises and Organizations

While sales figures show the sector's position within the national economy, they do not necessarily demonstrate its effectiveness. In order to do so, it is necessary to analyze such activities as balance sheet profit and its structural components.

Sector balance sheet profit amounted to 160 million UAH in 1999, or approximately 60% of total oblast revenue. **Table 7** indicates that, on the whole, the sector enjoyed significant growth in 1999. The table shows that trade enterprises transitioned to a new stage of development in 1999, with a 570% increase in balance sheet profit over 1998.

Table 7. Balance Sheet Profit Dynamics of Trade Enterprises: 1997-1999 [4] (1000 UAH)

Year	Profitable Enterprises			Unprofitable Enterprises			
	Profit	Units	% of Total Units	Profit	Units	% of Total Units	Loss
1997	28,193.8	481	54.7	44,012.1	398	45.3	15,818.3
1998	-66,601.7	459	51.8	87,313.2	427	48.2	152,914.9
1999	160,093.6	515	55.7	220,367.0	410	44.3	60,273.4

4. Sector Development: Raw Materials Base

Because of the specific character of this sector, the issue of raw materials is not applicable.

5. Sector Development: Technological Base

Since there are no domestic manufacturers of trade equipment, Ukraine entrepreneurs equip their shops mostly with relatively expensive foreign equipment. This contributes to a longer period for return on investment, and slower profit generation. Development of domestic trade equipment manufacturing would seem to be the preferred solution to this problem.

6. Investment Activities in the Sector

In order to accurately gauge the degree of investment attractiveness of the Kharkiv Oblast Trade sector, it is necessary to analyze data on those countries that have already invested in the Trade sector.

The Trade sector's position with respect to total Kharkiv Oblast investment is shown in **Table 8**. The data indicates that trade, with 25% of total investment in the oblast, occupies second place among the sectors in terms of total non-resident capital, and first place in terms of total enterprises receiving investments.

Table 8. Kharkiv Oblast Sector Investments: 1999-2000

Sector	Number of Enterprises	Total Non-Resident Capital			
		January 1, 1999		January 1, 2000	
		1000 USD	%	1000 USD	%
Industry	55	28,963	56.5	32,638	54.9
Trade and Food Services	80	12,468	24.3	14,868	25.0
Finance and Insurance	5	2,834	5.5	2,834	4.8
Construction	10	1,938	3.8	1,509	2.5
Scientific Services	7	703	1.4	777	1.3
Other sectors	26	4,116	8.0	4,367	7.0
Total	185	51,282	100.0	59,462	100.0

Direct foreign investment in the Kharkiv Oblast Trade sector is shown in **Table 9**. The major investing nations include: Liechtenstein, the United Kingdom, the United States, and Vietnam.

Table 9. Direct Foreign Investment by Nation: 1999-2000

Countries and investment patterns	Total Non-Resident Capital (1000 USD)	
	January 1, 1999	on January 1, 2000
Liechtenstein	5,435	5,435
United Kingdom	99	2,132
United States	1,682	1,435
Vietnam	879	1,310
Turkey	726	699
Australia	604	604
Virginia Islands (UK)	585	586
Israel	547	414
Poland	94	402
Russian Federation	328	328
Germany	366	319
Other countries	1,123	1,204

7. Employment and Personnel Potential in the Sector

Accurate assessment of the Trade sector employment index is difficult because a considerable portion of the employment, discharge, and payment process goes unreported (in the so-called "shadow" economy). This is particularly true of small business enterprises, where employees receive a large part of their wages in cash. Official figures on employment and average salary for the period 1996-2000 in all trade and food services enterprises except SMEs in Kharkiv Oblast are shown in **Table 10**.

Table 10. Kharkiv Oblast Trade Sector Employment and Average Salary: 1996-2000 [7, 8]

Index	1996	1997	1998	1999	2000
Number of employees (1000 persons)	53.4	47.2	45.2	40.6	35.6
Average salary (UAH)	91	113	127	165	213

The data shows that while the number of employees has been steadily decreasing, average salary has actually been increasing.

At SMEs, however, there was an increase in employment during the period 1998-1999, from 24,100 to 26,800 employees, and a more modest increase in average salary, from 73 UAH to 104 UAH. Average monthly salary at sector SMEs in 1999 was 87.3 UAH.

Frequent staff turnover is characteristic of the Trade sector, especially among entry level positions requiring little or no training. For positions requiring higher qualifications, (e.g., manager, commercial representative, etc.), current demand offers job seekers a wide choice of employment opportunities. However, this can also result in staff turnover. According to a recent agreement between the regional state government, trade unions, and the regional branch of the Ukrainian union of manufacturers and businessmen, committees are going to be established in 2001 to control the scale and regularity of wage payment at all small and medium enterprises regardless of ownership type. This measure is expected to stir interest in this sector of the national economy and help enterprise owners recruit additional qualified personnel.

8. Sector Exports

In 2000, the Kharkiv Oblast Trade sector exported products to 95 countries and imported products from 97 countries around the world. Total foreign trade activity was 765.8 million USD in 2000, down 30% from 1999. Exports increased 0.5%, to 315.3 million USD, while imports decreased 42.2%, totaling 450.5 million USD

The foreign trade surplus decreased by 71% in 2000, for a total of 135.1 million USD (466 million USD in 1999). However, Kharkiv Oblast still has a credit balance with 70 different countries, including the USA (31.5 million USD); Germany (18.8 million USD); Austria (11.8 million USD); and the Czech Republic (10.2 million USD).

Kharkiv Oblast's share of foreign trade activity comprised 2.6% of total Ukraine foreign trade in 2000. Kharkiv Oblast ranks ninth in exports and seventh in imports among the regions of Ukraine. Exports to the former USSR countries totaled 236.9 million USD (75.1%), while exports to other countries totaled 78.4 million USD (24.9%). Imports came to 192.3 million USD (42.7%) and 258.2 million USD (57.3%) respectively, as shown in **Diagrams 4 and 5**.

Diagram 4. Exports: 2000

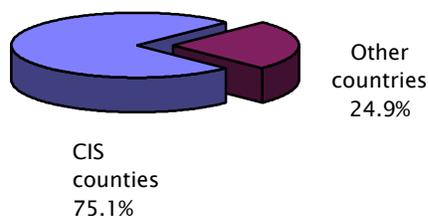
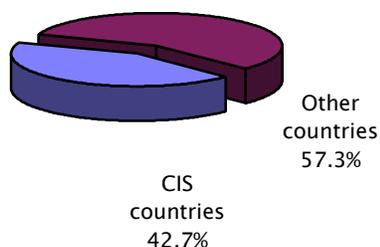


Diagram 5. Imports: 2000



Approximately 44% of exports and 73.8% of imports were paid for in hard currency. Exports traded on barter terms decreased in 2000, totaling 10.3 million USD, or 3.3%, down from 5.7% in 1999. Imports traded on barter terms came to 7.3 million USD, or 1.6%, down from 2.0% in 1999.

9. Competitive Environment of Sector Enterprises and Organizations

The level of competition in this sector is rather low. This is due to the fact that trade infrastructure and the distribution channels for many goods are still in the process of being established. Currently, only certain products (e.g., household appliances, computers, cars, mobile phones) have a well developed wholesale and retail trade system featuring service centers, authorized representative offices, and skilled personnel. The majority of enterprises still rely mainly on price discounting in their competitive activity.

10. Ownership in the Sector

Patterns of enterprise ownership in the Trade sector are driven both by the privatization process as well as by general market tendencies. As shown in **Table 12**, the pattern of ownership in the sector has been changing dramatically, with the number of state-owned and common ownership enterprises decreasing and private enterprises increasing in 1999.

Table 12. Enterprise Ownership by Type: 1995-1999 [8]

Pattern of Ownership	Total of enterprises											
	Units					1999 % Before		% of Total				
	1995	1996	1997	1998	1999	1995	1998	1995	1996	1997	1998	1999
State Ownership	1,158	1,146	840	829	664	57.3	80.1	12.8	11.2	9.4	10.2	9.1
National	320	1,022	381	348	190	59.4	54.6	3.5	10.0	4.3	4.3	2.6
Municipal	838	124	459	481	474	56.6	98.5	9.3	1.2	5.2	5.9	6.5
Common Ownership	5,893	7,322	6,644	6,058	5,335	90.5	88.1	65.4	71.8	74.7	74.9	73.1
collective enterprises	2,428	1,036	820	427	570	23.5	133.5	26.9	10.2	9.2	5.3	7.8
joint ventures	14	42	24	59	54	90.0	91.5	0.2	0.4	0.3	0.7	0.7
Cooperatives	22	43	30	34	17	77.3	50.0	0.2	0.4	0.3	0.4	0.2
consumer co-ops	2,768	2,475	2,224	1,937	1,550	56.0	80.0	30.7	24.3	25.0	23.9	21.2
rental enterprises	627	231	294	190	90	14.4	47.4	6.9	2.3	3.3	2.3	1.2
Private Ownership	1,971	1,733	1,416	1,205	1,298	65.9	107.7	21.8	17.0	15.9	14.9	17.8
Total	9,022	10,201	8,900	8,092	7,297	80.9	90.2	100.0	100.0	100.0	100.0	100.0

11. SME Growth in the Sector

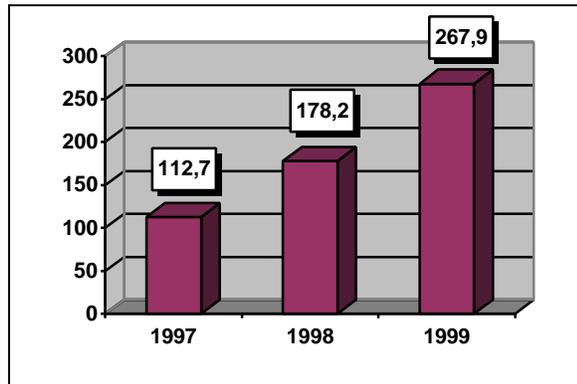
Sector enterprises throughout Ukraine have generally benefited from the simplified taxation system; impediments to the development of small-scale enterprises are now less acute.

At the oblast level, the Program for the Development of Small Enterprises has redefined SMEs as an independent factor contributing to the nation's overall economic growth, employment, development of innovative processes, increased competition, and provision of certain market segments with services and commodities.

As of January 1, 2000, there were 11,686 small and medium enterprises in Kharkiv Oblast, representing approximately 76% of the active self-supporting enterprises in the region. This figure was up 4.6% from 1998, when the number of active SMEs totaled 9,585. [9]

Trade sector enterprises represent 49% of the total number of SMEs. There are currently 5,741 sector SMEs, compared with 5,385 in 1998 (48.2%). In spite of the rather insignificant growth in the number of sector SMEs, the Trade sector did manage to significantly increase its output volume, as shown in **Diagram 6**. As shown in the diagram, Kharkiv Oblast SME output volumes rose during the period 1997-1999, indicating a period of substantial development among sector small businesses in the region.

Diagram 6. Commodity Turnover: 1997-1999, mln. UAH



12. Sector Infrastructure

Enterprises and organizations in Kharkiv Oblast that engage in the following activities can be regarded as the infrastructure that enables the Trade sector to function:

- consulting on foreign-economic activity, assistance in establishing business contacts (search for business partners, preparation and dispatch of commercial offers, directory reference preparation)
- assisting in business negotiations
- contract preparation
- organizing foreign travel for business negotiations
- setting up domestic and international fairs and exhibitions
- customs brokerage services
- language translation
- expert examination of import-export commodity quality; certification of origin
- advertising
- bar code legislation for domestic products

The Kharkiv Chamber of Commerce and Industry (KCCI) plays a key role in facilitating the above services and is a recognized authority in the market. At present, the KCCI has approximately 200 full and corresponding members from a variety of industrial, research, planning, and design organizations. All members of the KCCI also belong to the Chamber of Commerce and Industry of Ukraine.

Another key body that helps ensure the proper function of the Trade sector is the "Slavyansky Bazaar" business forum, which specializes in holding all-purpose and dedicated exhibitions. "Kharkiv Infoexpo" is another firm that offers exhibitions, as well as consulting, legal, and other services that support regional trade.

13. Management Capabilities of Sector Enterprises and Organizations

The lack of qualified management personnel is a pressing concern in the Trade sector. During the transition to a market economy, many unqualified people with no prior experience in trade entered the job market; and while high profits, low competition, and a shortage of personnel considerably reduced the requirements for employment, the sector still needs highly qualified specialists.

Fortunately, there are a number of institutions of higher education in Kharkiv Oblast that offer the requisite training. These include state educational institutions, such as the Kharkiv State University of Economics and the Kharkiv State Academy for Catering Technology and Organization; as well as private schools, including the Kharkiv Management and Business Institute and the Interregional Academy of Personnel Management. A number of other specialized colleges, and technical/vocational schools offer suitable management training. In spite of these resources, however, the shortage of qualified management personnel in the Trade sector is expected to last for some time.

14. Administrative Impact on the Sector

Administrative impact on the development of the Trade sector is substantial. On the one hand, there has been substantial legislation aimed at the development of private business, implementation of which has resulted in reform of the taxation system and improvement in the general business conditions for sector enterprises.

On the other hand, the hidden portion of barter trade is still too large due to loopholes in current tax law. A number of additional legislative bills at all levels of government are currently being developed in an attempt to better regulate barter trade activity; the majority of these are of a fiscal nature, and apply primarily to SMEs.

The state continues to have considerable influence on the Kharkiv Oblast Trade sector as a whole, with relations between state agencies and businessmen generally seen as improving.

15. Social Issues of Sector Development

The development of the Trade sector engenders both positive and negative social impact. In terms of its positive impact, the intense development of the sector, and its attendant integration into every other sector of the national economy, acts as a catalyst in the development of production, delivery, and transport systems, etc. This helps reduce unemployment and improve the standard of living of the people of the region.

On the other hand, poor consumer protection, corruption, and the chaotic nature of trade have a negative impact on society. However, efforts are underway to solve these problems. For example, a council on consumer rights protection made up of representatives from the regional state government, law enforcement agencies, and trade unions has been established in Kharkiv Oblast. One of the major objectives of the council is the control of commercial counterfeiting. Priorities include preventing low-quality meat products from entering the market, introducing state supervision over bakery standards, and regulation of tobacco and alcohol trade.

16. Evaluation of Investment Proposals of Sector Enterprises and Organizations

A number of political, social, and geographical factors support an environment favorable to investment in the region. These include: legislative reforms aimed at supporting and developing entrepreneurship, and especially small businesses; a dynamic population; and a favorable geographic position.

In terms of legislation, the Program for the Development of Small Enterprises, passed in 2001, contains provisions governing enterprise financing, credit, and personnel training. This agreement was enacted at the interregional level through the signing of treaties of cooperation between the Kharkiv city government, the government of Kursk Oblast, and the Moscow city administration.

Kharkiv Oblast may be said to have a relatively dynamic population, because a considerable number of the young people who come to Kharkiv for their education later settle in the city. The resulting demographic tends to be the segment of the population that introduces the most daring and innovative business ideas and projects.

In addition, with its strong commercial potential and well developed transport system, Kharkiv Oblast is especially well positioned to stimulate the development of its Trade sector, due to the proximity of the large industrial regions of Ukraine, Donets'k and Dnepropetrovs'k, and its main foreign economic partner, the Russian Federation.

Significant development projects currently include:

- Creation of a trade and exhibition complex by "AVEK & Co". Total cost is estimated at 5 million USD over 4 years.
- Expansion of the trading center "Barabashevo".
- Construction of a business center for trade exhibitions, an initiative of the central directorate of economic development of the Kharkiv City Executive Committee. Total cost is estimated at 90 million dollars, 25% of which is to be provided by the Kharkiv city administration.

Conclusions

At this time, the Trade sector is one of the most important sectors in the Kharkiv Oblast economy. A number of recent developments have had a significant impact on the sector's business activity. For example, enactment of favorable legislation has improved the overall business climate, especially for small enterprises; and the number of sector SMEs has increased. The investment climate is seen as positive, with the stable growth of various financial indices, the active assistance of state agencies, and increased foreign investments all evidence of the overall positive trend. And given the favorable geographic location of Kharkiv Oblast, its highly developed transportation network, and substantial opportunities for rapid development of staff resources, trade may be considered is one of the most promising sectors in Kharkiv Oblast.

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List of Main Sector Enterprises and Organizations
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Enterprise Name	Address	Telephone No.	Products	Directors
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This information is not applicable to this sector profile

**REGIONAL ECONOMIC DEVELOPMENT PROGRAM
IN EASTERN UKRAINE**

KHARKIV MANAGEMENT CONSULTING INTERNATIONAL

**ANNEX A
STRATEGIC MANAGEMENT
OF REGIONAL ECONOMIC DEVELOPMENT:
A METHODOLOGY
(A COMPILATION OF ENGLISH LANGUAGE SOURCES)**

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

KHARKIV PARTNERSHIP

Strategic Planning Project

Under

MENDEZ ENGLAND & ASSOCIATES

USAID Contract No. 121-C-00-00-00832-00

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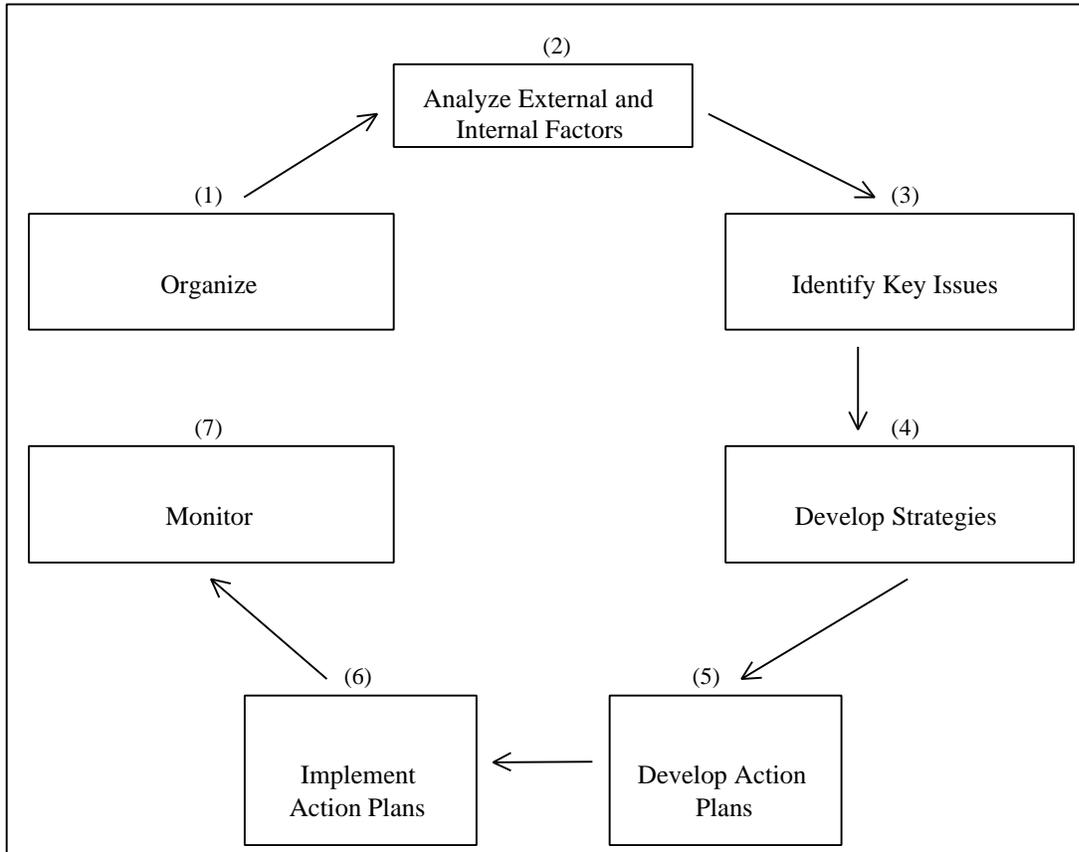


Introduction

The Ukrainian analytical team created under the auspices of Kharkiv Management Consulting International Ltd. has been carrying out a fundamental analysis of the Kharkiv Oblast economy, regarding it as the first stage of the regional economic development strategic planning process. Accordingly, much attention has been paid to the study of other countries' experience in regional strategic planning, and first of all to the study of the corresponding methods and toolkit developed by American specialists and their practical implementation. The methods and the theory of the strategic planning of regional economic development implemented in the USA laid the theoretical and methodological basis for our analysis.

The key theses relating to these aspects were extracted primarily from the fundamental monograph "Managing Economic Development" written by American specialists [25]. That text served as the foundation for this paper except where deviations are indicated. We also referred widely to the textbook "Policies of Regional and Local Governments on Business Support" [1] written by Prof. Y.O. Chernetskiy, President of the "Kharkiv Management Consulting International" Ltd. and compiler of this paper, Doctor of Sociological Sciences, PhD in Economics, Business and Management, together with Y.V.Navruzov, head of the Department of Public Administration and Local Self-Government of the Dnipropetrovsk Branch of the Ukrainian Academy of Public Administration, Office of the President of Ukraine.

Implementation of strategic planning activity was regarded as a mechanism for realizing the regional strategy of social-economic development as stated in the "Kharkivshchina - 2010" Program. However, revision of certain theses of the Program was viewed as not only possible, but was also planned in accordance with the analysis carried out by American and Ukrainian experts. The analytical efforts were focused on implementation of a U.S. algorithm of strategic planning for regional economic development (see the figure on page 4) [25, p. 37].

Economic Development Strategic Planning

1. OECD Expert Recommendations on Management of Regional Development in the Central and Eastern European Countries

Western specialists have tried to draw generalizations from the experience of local governments in the countries that are at the post-communist transformation stage. Being guided by the information given in various sources both concerning separate countries and concerning general trends, according to the specialists of the Organization for Economic Cooperation and Development (OECD), it is possible to suggest several recommendations for the next phase of local and regional development and the functioning of central, regional and local authorities in Central and Eastern European countries [46, p. 163-165].

1) Regarding local initiatives

- Base economic development strategy on an ambitious but realistic vision of the local or regional economy.
- Formulate a strategy that aims for well-skilled, well-paid jobs; a “high-road” rather than a “low-road” development strategy.
- Engage broad-based civic participation and support, and maintain a public, transparent process.
- Ensure full and active participation by the private sector.
- Establish short-term benchmarks to mark progress in long-range plans.

2) Regarding government responses

Promote an entrepreneurial climate at the local level

- Improve the general framework conditions for entrepreneurship (fiscal policy, education and training policy, subsidies for large enterprises, competition policies).
- “Territorialise” direct support measures for entrepreneurship.
- Support regional and local actors in providing high-quality business services at the local level (business advice, training for entrepreneurship and financial services).
- Shift employment policies from passive income support to active job creation measures, as for example the enterprise allowance scheme.

Formulate and support a regional development policy

- Build consensus for a regional development strategy.
- Create a multi-sectoral approach to regional development policy that coordinates policies in areas such as labor market, environment, transportation and education, and that also co-ordinates funding.
- Ensure that policies that have national implications but local impacts—such as transportation, telecommunications, environment and, in particular, labor market policy—are consistent with regional development policy.

- Establish objective criteria or processes by which to designate areas or problems that are to receive development support.
- Follow up a regional development policy with effective management, implementation and funding.
- Establish unambiguous authority at the regional level to co-ordinate and channel resources to localities.

Support and promote local and regional partners

- Trust and co-operate with: local actors, non-governmental organizations and cross-border initiatives.
- Build partnerships with regional and local representatives.
- Support capacity-building at the local level with information, resources and training.
- Enact legislation that facilitates (and regulates) the ability of municipalities and non-governmental organizations to raise funding for economic development; improve the ability of local actors to understand access to private capital.
- Take advantage of foreign assistance for local and regional economic development—but engage local representatives in choosing and designing programs.

3) Receding foreign assistance for local and regional economic development

- Assess local needs and potential in collaboration with local representatives.
- Identify a credible local organisation for implementation
- Decentralise assistance.
- Include substantial training assistance for local leaders who will implement and maintain the project.
- Distinguish support for private enterprise development from support for local or regional economic development planning.

2. Strategic Planning as the Management Tool for Regional Development

Much attention is paid abroad to development of strategies for improving influence by local authorities on economic development [see 1; 25; and also 3; 15; 16; 17; 28; 30; 33; 44]. The experience of the USA in this sphere seems interesting and instructive. Local authorities in the USA can take actions implementing a strategic approach towards economic development using an algorithm created by American scientists who consistently combine theoretical research with management applications.

As the national economy shifts and the world economy exercises more and more influence over state and local business enterprises, communities are, in the words of the operator of a family-run sawmill in Oregon, “tightening their belts, getting a little smarter, and diversifying their economies”. Unfortunately, no blueprint or single policy strategy for successful



economic diversification exists. Similarly, no single factor explains why some states and communities are more successful than others in stimulating the formation, expansion, retention, and attraction of business enterprises. Several factors, however, increase the likelihood of success in state and local economic development planning. These include: identification of local needs and resources; adaptation to external constraints; local leadership that stimulates collaboration among public, private, and nonprofit organizations; and maintaining a sustained effort over many years, sometimes decades.

The process that best integrates these factors is strategic planning. Business organizations use strategic planning to anticipate rapidly changing markets and to adapt organizational resources to external change. In this way, a business remains aware of its competitive position and its investment opportunities. Recently, governmental organizations have begun to use this process to help themselves adapt to technological change, fiscal stress, and the economic shifts.

A variety of different approaches to strategic planning exist, several of which are applicable in state and community settings. Virtually all approaches contain some version of a three-step “diagnosis-vision-action” process. Diagnosis of economic trends seeks an understanding of how major economic forces are reshaping state and local economies; it requires information gathering and exploration of alternatives. Vision involves fundamental change from a narrow, short-term perspective to strategic initiatives that capture the dynamics of a changing economy and require choices among targets of opportunity. Action is realistic implementation of programs targeted to emerging economic opportunities.

Economic development strategic planning is action-oriented, broadly participative, and emphasizes the need to understand a state or community’s strengths, weaknesses, investment opportunities, and competitive threats. It is an effective planning process to facilitate the revitalization of local and state economies. The described approach was originally developed in the 1920s at the Harvard Business School, modified by Public Technology, Inc., for use in the public sector (1984), and further modified by the authors for community economic development. Like their business counterparts, community and state strategic planning teams can use this approach to analyze economic strengths and weaknesses and to devise economic development strategies and action plans. A step-by-step description of this process at the local level is presented by American scientists. A more general version of this approach, adapted for state economic development, is also worked out.

An effective strategic planning process has broad participation by key stakeholders and promotes a shared understanding of strategic issues. Although there are many variations of the strategic planning process described in this chapter, there is usually a three-step cycle of diagnosis, vision, and action. States and communities must adapt this general process to their unique political and administrative circumstances. Some cities, for example, may take longer to complete this cycle than others. As a collaborative process, strategic planning provides a common language and policy framework for making strategic decisions. In addition, it builds commitment by participating leaders to the strategic action plan.

Strategic planning alone will not improve community or state economies. It can, however, greatly enhance the capability of decision makers to formulate and implement effective policies. Participation and support will make the process work, and that means involving those position is important for local communities. As federal and state resources become more difficult to obtain, and as competition increases for scarce public funds, those who are willing to make the effort to organize and target their economic development efforts will have a competitive advantage.

3. Organizational Provisions for Strategic Regional Development

Effective economic development strategies must suit a particular social, cultural, physical, and economic environment, and must emerge from diagnoses of external trends and assessments of internal capabilities. Once the initial strategies have been formulated, states and communities must develop organizations with the responsibility to implement and evaluate these strategies. Some strategies are more easily pursued through informal organizational settings, others through more formal mechanisms. In either case, the choice of organizational form must be guided by the chosen strategies. The issue is how to organize or realign the state's or community's resources to achieve the strategic goals and objectives. There is no single right way to organize for managing economic development strategically. The organizational structure should be designed to fit the stages of development activity, the environment in which development is likely to occur, and the particular needs facing the state and community.

What makes the organizing effort so challenging is the complex set of interdependent relationships in which economic policy exists. State economic development departments, legislative policy committees, and economic task forces all interact with regional and local public and private agencies, development corporations, and even national and international organizations. This creates considerable overlap, duplication, and confusion over development activities. At the state and local levels, these relationships require new types of formal and informal arrangements. No one agency is responsible for the economy, especially as state and local economies increase their participation in national and international economic activity.

In addition, successful development requires collaborative efforts and coordinated responses to economic opportunities. State and local governments cannot effectively pursue economic development unilaterally. Therefore, effective economic development organizations must facilitate planning with the wide variety of departments involved in economic development activities, integrating economic research with strategic action, and learning from experience.

Designing and managing the economic development organization emerges as a major managerial challenge following a successful strategic planning effort. An effective organization can assume a variety of configurations and can build on existing organizations, reorganize existing organizations to fit current strategies, or build new institutions to adjust to changing conditions and activities. The further material will discuss approaches to organizing for economic development and factors to consider in building an effective organizational system to implement economic development activities.

Before rushing into creating a development group, an action team, or a line department, consideration should be given to the purposes of the organization and who should participate. The first step is to ask what the purpose is to be served. Then the focus should shift to who should participate in its realization.

Both states and localities use informal groups to achieve economic development strategies. Such groups are important where diverse interests are represented or where the voluntary nature of the project requires less formal structure. For example, several states and local governments are formulating entrepreneurial networks— networks of people that can



coordinate the needed investments for new business ventures. In fact, governmental investment in these new networks is a critical element in building a successful high-technology development. Other important elements include: an organizational culture that promotes a common civic perspective and a positive attitude about the region's attributes and prospects; an environment that nurtures leaders, both public and private, who combine a track record for innovation with a broad view of their community's resources and promise; and a network of business/civic advocacy organizations that attracts the membership of top officers of major companies and receives from them the commitment of time and effort to work on issues of mutual concern.

Local chambers of commerce and state economic development agencies have created venture capital clubs that informally review prospects for entrepreneurial development and raise capital to provide funding for such efforts. Other informal organizations serve as advisory bodies to another formal body; in five states, governors have created staff task forces to advise on various economic development issues.

Advisory bodies may help defer criticisms about creating another organization or duplicating efforts being made elsewhere. These organizations assist in building support for the strategic goals and objectives of the group when disagreement, dissension, or apathy exists among business or government leaders. Informal organizations also can carry out more traditional planning efforts that help set the stage for actions by the state or community and allow time for public resources to be thoughtfully committed for a longer-term effort.

Informal groups do have some serious shortcomings: they cannot effectively implement actions they propose; they have no legal standing and therefore cannot carry out development activities themselves; they have no way to raise funds directly; and they have no formal standing to ensure that their proposals are seriously considered. Nevertheless, temporary, informal associations may be the most effective vehicle for managing economic development when the issues giving rise to the group are narrowly defined, the effort is largely directed at planning and analysis, or the group is used to generate consensus, support, and interest in specific development activities.

Implementing organizations are structured to carry out strategies developed by policymakers. These organizations can be wholly governmental, wholly private, or a combination; yet they often work closely with other organizations at all levels to implement development goals fully.

Public sector economic development agencies, whether part of the chief executive's staff or a separate line department, add certain strengths to a development effort. First, they can provide public sector funding that otherwise would not be available to local projects or activities. Second, they can provide tax incentives to promote development efforts that otherwise would not be available to private business. Third, they can provide various types of relief from regulation, often considered a major stumbling block by developers. Fourth, public agencies provide assistance in quality-of-life factors, which appear to be increasingly important to business investment decisions. The quality of state and local school systems, access to cultural activities and recreational facilities, the quality and availability of public facilities and infrastructure, and the crime rate can all have an impact. Fifth, they can provide access to political and professional leadership for major development efforts. Without such support, many investment activities might be more difficult to achieve. Finally, public organizations can help orchestrate state and local government resources directed at assisting development efforts. This coordinating function might be difficult to achieve by limiting implementation only to private or quasi-private entities. Further, many federal, state and local resources targeted toward development require the approval



of state or local governments before they can be used to promote specific projects and activities.

In the recent past, most local development efforts were directed by chambers of commerce. This began to change in the 1960s and 1970s as federal dollars were spent in increasing amounts to stimulate local development organizations. The Economic Development Administration funded efforts at the local and regional levels. The Small Business Administration helped support quasi-public and quasi-private organizations.

Localities also have created departments within city hall focused on implementing economic development activities. These departments may be highly specialized or they may incorporate a multitude of development efforts, from enterprise development to housing and community development.

Every state has established an economic development agency, although responsibilities, funding, and staffing patterns vary widely. Traditionally, state economic development efforts are administered by one or more of three agencies or departments. The department of commerce is typically responsible for state banking regulations, small business development, insurance, corporations, and various professional and licensing boards; this is the department with which businesses come into contact most often. The department of economic development is typically the lead agency for industrial attraction, tourism, and state promotion. The department of community development is typically responsible for administering the Community Development Block Grant (CDBG) programs, state loan programs, and housing programs.

There are numerous types of private organizations that have as all or part of their function the planning, development, or implementation of economic development. As with governmental organizations, private associations can focus on planning or on implementation or both. Private organizations are most commonly associated with business groups such as chambers of commerce. Private groups may operate for a profit or act as a nonprofit corporation, and the goals and legal powers of the two types of organizations are very different.

Many different kinds of development corporations may exist within a state or community. Even though they vary in size, objectives, sources of funds, and specific targets, most share common characteristics: (1) they are incorporated; (2) they are locally initiated and controlled; (3) they have public- and private-sector representation; (4) they operate within a geographically defined target area; (5) they are small, flexible, and concerned with implementation; (6) they have more direct access to capital and fewer limitations on investing than strictly public or private organizations; and (7) they utilize their funding for activities that directly stimulate the formulation, expansion, attraction, or retention of business enterprises.

A multitude of different organizational mechanisms exist to assist states and communities in developing and implementing economic development strategies. No other structure is the right one for all communities. Both states and localities have organized in numerous ways in an attempt to stimulate economic activity. Some organizations are informal or are organized to develop plans and strategies. Others are more formal and focus on implementation. Whether these organizations are at the state or local level, they have certain common characteristics. They may be part of the mayor's or governor's office or they may be independent line agencies. They may be narrowly directed at particular economic development functions and activities or they may be more comprehensive and consolidate a number of activities. Coordination is stressed in many states and localities through the use of interagency task forces or committees. Some chief executives assign members of their staffs to oversee development.

Development organizations also operate through quasi-public and private corporations. These entities often serve to implement development activities that are difficult to accomplish within government for legal or political reasons. These corporations come in many forms, but all serve to help stimulate business activity.

No matter what organizational planning or delivery system is developed, it must be structured to operate within the particular economic environment that exists. These organizations are critical to any successful economic development effort and without them, strategies cannot be implemented effectively.

4. Management of Regional Infrastructure Development

It is highly important to form appropriate infrastructure to successfully implement economic development regional strategy [see 1; 25; and also 4; 15; 17; 33; 44]. The state's infrastructure is the physical public-works framework that supports and sustains virtually all economic activity. Definitions of infrastructure typically include transportation facilities (such as interstate highways, roads, and bridges), water resources, and waste treatment systems; increasingly, they also include energy distribution systems (electrical utilities, for example) and telecommunications facilities, both of which are becoming more important for economic growth in an information-based, global economy.

Infrastructure investments affect not only local uses but the overall level of economic activity in a region. For instance, expanded transportation, water supply, and waste systems are needed to accommodate growth; specific infrastructure improvements may be required in order for particular projects to proceed. Inadequate maintenance of existing systems can interrupt economic activity or increase its costs. Underutilized capacity offers opportunities for economic growth at low additional cost but creates high operating costs for present users. The costs of infrastructure expansion, maintenance, and operation constitute an important cost of doing business. The public-works infrastructure can provide a significant inducement to economic development and is essential to a state's quality of life, economic health, and international competitiveness. The supply of paved roads and the number of miles of interstate highway within a region are strongly correlated with employment growth. Infrastructure investments, however, tend merely to move economic activity around, rather than stimulate new productive capacity. Infrastructure expenditures are therefore necessary investments, but alone they are not sufficient to generate new economic development.

Targeting financing toward strategic needs requires creative integration of traditionally separate infrastructure policy areas into statewide economic development strategies. This means that the infrastructure of transportation, water supply and sewage, communications, energy, housing, and waste management are, for the most part, treated by states as policy issues separate from an economic development plan. An exception to this practice is the Mississippi Business Investment Program, which gives low-interest loans to its localities, matched by funds from the private sector, for infrastructural investments to generate business formation. Other strategic combinations for infrastructural investment might include:

- Establishing a program or coordinating council that integrates manpower/human resource training, investment capital policies and regulations, and infrastructure investment policies.
- Creating an infrastructure trust fund that makes loans to local governments in order to repair the existing infrastructure. As in the case of Washington's Public Works Trust Fund, the localities would be required to impose an excise tax for capital improvements and institute a long-range capital financing plan.

- Creating trust funds for specific infrastructural activities (such as sewage) that can be capitalized by state bonds.
- Targeting investments to areas identified as “corridors of statewide significance,” and funding these investments with a state lottery or state trust fund financed through gas taxes and vehicle registration fees.
- Requiring private-sector involvement by requiring investors to reach an agreement prior to construction or improvement of a facility. For example, a 30% matching fund from private firms or local government might be mandatory.
- Improving capital planning and budgeting by analyzing social and economic factors that could increase demand for public facilities. This would include estimating the depreciation rate of infrastructure as well as the effect of new projects on future operating budgets.

5. International Economics and Business Aspects of Regional Development Strategies

The study of international trade and foreign investment potential is an important part of strategic and tactical activity of local authorities in economic development [see 1; 25; and also 9; 15; 16; 17; 23; 26; 30; 31; 44]. Special attention to these aspects is paid in the United States of America. In 1959, Governor Luther H. Hodges of North Carolina traveled to Europe for the purpose of attracting direct foreign investment to the state. At the time, his trip attracted only a modicum of interest.

Today, however, it is regarded as an important turning point for gubernatorial involvement in international economic affairs. Governor Hodges’s travel marked the beginning of a growing realization among state officials that their regional economics do not exist in an economic vacuum. State and local economies have become inexorably intertwined with the world economy, and international trade and business development have become promising strategies for economic growth.

This new reality has, in many respects, expanded the role of the governor, who is now not only the chief executive of the state but a “diplomatic negotiator” abroad in promoting state exports and in attracting direct foreign investments. The National Governors Association (NGA) created an International Trade and Foreign Affairs Committee in 1978. During the second half of the 1980s according to its most recent survey of state involvement in international affairs, 49 states hold export seminars for small and medium-sized businesses; 45 states use publications and computerized systems to assist local exports to find potential markets; 38 states have overseas representatives in 17 countries; 15 states have initiated export finance legislation and ten states already have similar programs in operation; and all 50 states have sister-state relationships with governments around the world.

Similarly, local governments are becoming increasingly active in international economic affairs. In fact, it was local governments, not state governments, that first recognized the importance of foreign relations. In 1956, President Eisenhower initiated the U.S. Sister Cities program, which encouraged exchanges between American and foreign cities. This program has grown more important as American cities have become interested in trade development. For example, in 1981 the U.S. Conference of Mayors organized an “Invest in American Cities” program in Zurich that gave 180 U.S.

cities the opportunity to discuss with foreign cities the possibilities for foreign investment and trade. Presently, 750 American cities have trade development agreements with over 1,200 cities in 86 countries.

City and county government officials have recognized that their local economies are not just local anymore, but global in scope. As a result, the National League of Cities established an international economic development task force in 1982. Their “groundbreaking report”, published in 1984, charted a new international course for local economic development strategies.

This new participation by state and local governments in international economic affairs has been characterized as “global microdiplomacy”, in which new contacts are developed beyond the borders of the United States by state and local officials in order to respond more effectively to the expanding global economy. Nearly all states and communities have been drawn, willingly or not, into the international economic arena, where each must fend for itself with its own unique set of problems and economic structure. Transfer of authority in the sphere of economic development from federal level to the local one played an important role in the 1980s. States and local communities realize that they cannot wait for federal action; rather, their fates now rest, for the most part, in their own hands.

The relationship of domestic economies and international affairs has been called by one scholar “intermestic politics”. Intermestic politics have become particularly important for governors and mayors who find their economies vulnerable to changes in the global economy. Interestingly, the U.S. government has encouraged states to promote foreign trade and reverse investment in the belief that objectives at the domestic and international levels are basically aligned, although nuanced differently. This enthusiasm about state and local involvement in international affairs has not been without its critics.

These issues are real, since state and local involvement in international economic affairs is not a passing phenomenon. The pivotal issue is how to coordinate effectively international activities with a strategic economic plan, and, more important, what should be the scope of state or local involvement in this area.

6. Problems of Attracting Foreign Investments

When speaking about the problems of attracting of foreign investments to Ukraine, the first task is to define several key terms, since one can find considerable terminological discrepancies in various Ukrainian sources. First, we will define “foreign investment” as: capital that is exported from one country and invested in a business or an enterprise on the territory of another country in which occurs, not only the act of profit realization contained in the commodity being exported, but the process of its production itself. Thus export of capital is aimed at getting of a profit from an enterprise using capital or by drawing interest.

Foreign investment (export of capital) is one of the most important forms international economic relationships in the modern global economy. The subjects of the world’s economy are closely connected with one another, not only indirectly (via commodity exchange) but also directly, via capital and production.

Export of commodities is a characteristic form of foreign economic activity in the era of the free market. Modern international economic relations are based on intensifying the function of foreign investments of practically all countries, from the most industrially developed to the developing and post-communist nations, and in fact has become the norm for efficient external economic activity.

The growth rate of capital transfers is generally higher than that of GDP growth and of commodity exports. During a twenty-five year period beginning in the mid 1960s, foreign investments increased by 400%, and in the 1980s approximately 450 billion USD in foreign capital was invested. By 1992, capital transfers reached 2.2 trillion USD, an increase of 400% over the beginning of the century.

When characterizing the specific conditions of external economic activity in Ukraine and investment activity in particular, it is appropriate to make use of foreign experts' observations. For this we chose an interview with Andrew Bihun, the former senior commercial representative of the US embassy in Kiev, concerning business management in Ukraine [see 1]. As is clear from the title, the interview expresses a "outlook from the US embassy". This American expert emphasizes that Ukraine's economic problems are widespread, and are in many ways unique.

Bihun notes that some problems vary by the type of business. For example, smaller businesses within a particular city or a particular region should develop good contacts with city authorities. He also notes that city authorities and regional authorities are not always of the same mind when dealing with small businesses. Therefore, depending on the scope of the business's commercial activities, appropriate contacts will have to be made with either city or regional authorities, or both.

Bihun goes on to observe that while official fees are more or less comparable to those in western European countries, the *number* of fees an entrepreneur must pay is enormous, as is the amount of paperwork required. This is due to over-regulation at the central government and local government levels.

Payment of fees is viewed by many as an opportunity for graft, which is standard in countries with inadequate legislation for business regulation. A. Bihun believes that Ukraine is at least initiating this process, and certainly in various pronouncements of representatives of central government and all the way down to local levels, has begun to normalize its regulations in the granting of certificates.

Bihun recommends that American investors entering the Ukraine market get legal assistance from both an American law firm based in Ukraine as well as a good local attorney. In many cases they can be found at the same firm.

Taking into a close consideration local specifics, we should at the same time base actions on the general principles of international investment activity. Following are highlights from an analysis conducted several years ago that resulted in a breakthrough in generalizing the problems of foreign investment development [1]. Several years ago, the American-Brazilian Business Council (part of the US Chamber of Commerce) was helping the Brazilian government discover what was hindering direct foreign investments to Brazil. The experts involved in the study interrogated representatives from a number of foreign companies (the Council's members) in order to define the factors which, according to them, played an important role in long-term investment decision making. The company representatives surveyed named a number of criteria; the following were the most frequently cited:

- **Domestic market.** The rate and potential growth of the country's domestic market.
- **Free access to the market.** Obstacles to entering the market created by competitors and/or governments (both foreign and domestic).
- **Labor resources and raw materials.** Quality of local labor force and availability of internal raw materials supply.
- **Devaluation protected monetary unit.** Degree of risk that unexpected devaluations will lower dollar value of direct investments.
- **Repatriation of dividends, interest, fees and payments for giving technical aid.** If a company cannot take its money out of the country it is senseless to make investments.
- **Property rights protection.** Degree of risk that intellectual property rights (patents, copyrights, etc.) will be stolen.
- **Export potential.** Extent to which the existing structure effective in one market can be used to serve neighboring markets or maximize company's global efficiency by trading with its various entities in other countries to close up its production cycles.
- **Regulative burden.** Costs of government interference in the business activity (and profit) of entrepreneurs in a given country.
- **Favorable taxation and tax advantages.** Availability of privileges designed to attract primary investments; the way in which taxation in a given country influences normal work conditions.
- **Low political risk.** The degree to which investors can rely on the decency of the government of a given country and its capability to maintain law and order.
- **Predictable macroeconomic management.** Confidence that the economy in which the investment is made will be competently managed, and that the rules of the game will not change during the game.
- **Reliable infrastructure provision.** The ability to carry out operations and supply commodities and services to the market; requires availability of reliable transport, power energy, insurance systems, accounting services, efficient financial system and other basic conditions.

The executive director of the International Private Enterprise Center, John Sullivan, has pointed out that in general, these criteria apply to both potential domestic and foreign investors. That is why, in our opinion, they should serve as the basis of any sound public investment policy analysis.

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**SMALL AND MEDIUM
ENTERPRISES IN KHARKIV
OBLAST:**

**ASSESSMENT AND
RECOMMENDATIONS**

Prepared for



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ABBREVIATIONS

EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIU	Economist Intelligence Unit
EU	European Union
IFC	International Finance Corporation
KMCI	Kharkiv Management Consulting International
KRESF	Kharkiv Regional Entrepreneurship Support Fund
MSI	Management Systems International
NGO	non-governmental organization
SMEs	Small and medium enterprises—throughout the report, the term SME indicates both small and medium enterprises and entrepreneurs
TA	technical assistance
UAH	Ukrainian hryvnia (Ukrainian currency)
UI	Urban Institute
USAID	United States Agency for International Development
VAT	value added tax

DEFINITIONS*

entrepreneur	individual businessperson who operates without establishing a firm
hryvnia	Ukrainian currency, roughly equivalent to US\$0.18
large enterprise	firm with more than 250 employees
medium enterprise	firm with 51 to 250 employees
profit	total revenue minus total costs
small business	Small enterprises, entrepreneurs, and farms (as identified by the Law on State Small Business Support)
small enterprise	firm with 1 to 50 employees
turnover	total revenue
Verkhovna Rada	parliament of Ukraine

*These are the definitions used by the authors. The report indicates when other definitions are used in discussions.

Note on terminology

The term SME is used herein to denote small enterprises, medium enterprises, entrepreneurs, and noncorporate farms. Data sources of varying quality prohibited analyses of SMEs as defined herein. For this reason, Chapters I, V, VI, and VIII and the Policy Matrix discuss SMEs in general, while elsewhere, small enterprises are addressed separately. Every effort has been made to clearly identify the types of enterprises discussed in every chapter.

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EXECUTIVE SUMMARY

Introduction: The Role of Small and Medium Enterprises in Market Economies

Small and medium enterprises (SMEs) are vital to market economies worldwide. For example, SMEs provide more than half of all employment in the European Union and United States. SMEs dominate several sectors, providing more than 80 percent of employment in wholesale trade, retail trade, hotels and restaurants, construction, real estate, financial services, and professional technical and scientific services. SMEs also provide more than half of all employment in Ukraine, and the government increasingly assigns a high priority to them. For these reasons, this assessment sought to do the following:

- estimate the current state and economic contributions of SMEs in Kharkiv;
- examine the business climate and its relationship to the development of SMEs; and
- identify further reform that would have the most positive impact on the development of SMEs in Kharkiv and their contribution to the local economy.

Legal and Regulatory Framework for SMEs in Kharkiv Oblast

In general, the legal system in Ukraine is complicated, uncoordinated, and unnecessarily confusing. It is regularly cited as an obstacle to investment by domestic and foreign firms (EIU 2000; Senchuk and Yacoub 2000; Grey and Whinston 1999). By some indications, however, the legal environment for SMEs in Kharkiv Oblast and throughout Ukraine is rapidly improving. The **Law on State Support of Small Enterprises**, enacted on October 19, 2000, with the stated aim of overcoming economic crisis by defining the legislative basis for state support of small business, outlined a program of support for the Cabinet of Ministers of Ukraine to prepare and implement as well as similar programs for regional and local authorities to prepare and implement.

Methodology and Related Issues

This assessment reviewed previous efforts to assess businesses in Ukraine, employed various local experts and organizations, collected and analyzed official data, and conducted a survey of SMEs in Kharkiv Oblast. Analyzing information from a variety of sources significantly increased the insight provided by the assessment.

Researching SMEs in Kharkiv Oblast presented some challenges for traditional research methodology. During the past 10 years, various government agencies and documents have used different definitions of small enterprises. The assessment discovered no official definition, explicit or implicit, for medium enterprises; the government has not separately researched or reported on these. Varying and absent definitions severely impeded researchers' abilities to compare data from different times and places.

The informal (unofficial or gray) economy of Ukraine is quite large. According to the National Bank of Ukraine, 52 percent of the nation's money supply circulates without the banking system. Informal transactions account for 67 percent of net profit in the financial and banking sector. A report on businesses in Ukraine by Management Systems International (MSI) estimated that less than 25 percent of entrepreneurs and less than 40 percent of enterprises of one to five employees are officially registered. This assessment used the coefficients derived from MSI's research to estimate the sum of registered and unregistered SME activity.

SMEs in Kharkiv Oblast

Attempts simply to identify the number of SMEs in Kharkiv Oblast and the number of their employees highlight the methodological challenges discussed above. Official data sources

contradict each other and even themselves. A combination of the official data with estimates of informal employment leads to the conclusion that SMEs account for at least 45 percent of employment in the Oblast, and that is a very conservative estimate. There are at least 235,500 entrepreneurs and 15,411 small enterprises in the Oblast; no data could be found on medium enterprises (the local and oblast statistics department do not separate medium and large enterprises in their reporting).

To a large extent, Kharkiv SMEs concentrate themselves in the same sectors as SMEs in the European Union and United States, namely wholesale trade, retail trade, and general contracting. Kharkiv SMEs differ from SMEs in market economies, however, in that they are not concentrated in areas such as real estate, financial services, and professional and scientific services. The Oblast government directly provides many of these services—especially in real estate, in which it operates a near monopoly—and so it has effectively crowded out private SMEs.

Employment at large and medium enterprises in Kharkiv Oblast decreased more than 20 percent during 1995 to 1999. During roughly the same period (1996 to 2000), employment by small enterprises and entrepreneurs has more than compensated for this decrease. In addition, the sector distribution of the new employment is quite different from that of the lost employment, indicating structural shifts in the Oblast economy not only in terms of firm size but also in sector distribution.

Survey of SMEs in Kharkiv Oblast

The lack of specific data inspired the conduct of a survey by UI of SMEs in Kharkiv Oblast. The questionnaire for the survey included many of the same questions used in the earlier MSI survey, including the entire section on an "imaginary company" that facilitated surveying responses to questions on tax evasion, extortion, and other forms of corruption.

On many subjects, the results of the UI survey complemented the findings of earlier national surveys by MSI and the International Finance Corporation (IFC) as well as of conventional wisdom on SMEs. For instance, SMEs in Kharkiv Oblast provide many opportunities for women and part-time workers. Most SME transactions are with other companies and individuals, not with the government. The vast majority of SME transactions involve other economic actors within the Oblast. Nearly all their transactions are in cash, not in kind or on credit. Kharkiv SMEs rely on their own earnings for operating and capital funds and use their own equipment or that of their employees.

SMEs pay up to nine taxes and fees, which total more than 40 percent of total revenue for nearly 40 percent of surveyed firms. The central government has instituted an integrated tax system for small enterprises and entrepreneurs, but fewer than half of the surveyed firms participate in the system.

Obstacles to SME Development in Kharkiv Oblast

International donors and international and local press generally agree on the major obstacles to SME development in Ukraine. The UI survey confirmed that Kharkiv SMEs share these same obstacles. The most significant of them are closely related.

The tax system is an obstacle not only because of high tax rates, but also because it is complex, changes frequently, and facilitates corruption. SMEs identified frequently changing, or fishtail, legislation (including tax legislation) as the second most significant obstacle to their development. The next obstacle on the list, lack of working capital, clearly is a function of burdensome taxes and administrative controls. Administrative controls are implemented to a large

extent by the tax authorities. Legislation permits, or fails to prohibit or limit, various administrative controls. These obstacles combine in a regime that is debilitating to SME development. Most of these obstacles similarly affect oblasts of all regions and enterprises of all sizes in Ukraine.

The regime of administrative controls provides an environment conducive to corruption. More than half of surveyed firms report that they frequently or sometimes are asked for payments in addition to those legally established for permits, licensing, inspections, and so on. Another 10 percent report that they always are asked for additional payments. On average, these payments amount to 16 percent of each firm's profit.

After the Tax Administration, the Fire Brigade and the Sanitary and Epidemiological Service are the next most frequent inspectors. These two regulators also issue more permits to SMEs than any other regulators. There appears to be a simple circuit within the administrative system: Giving more permissions provides a fruitful ground for more inspections.

Review and Analysis of Existing Initiatives

Recent efforts by the central and Kharkiv Oblast governments in support of SMEs are encouraging. The current Oblast program is significantly larger than the previous and includes plans for the participation of several interested organizations. It also includes plans for expanded SME contributions to funding various activities. The national program was approved in late 2000 and includes some very significant improvements for SMEs, in particular, the identification of the regulatory environment as an obstacle to SME development. The Oblast program adopted many of the priorities of the national program and now more accurately identifies obstacles for SMEs.

Both the national and Kharkiv Oblast programs suffer from a lack of clarity in their design and implementation plan. For instance, the Oblast program lists many organizations as executors of particular subprograms, but it does not describe the specific tasks for each. In fact, it is not even clear that these organizations were consulted in the preparation of the program. The national law requires a great deal of regulations and procedures for its implementation. It is unclear how and when the government will take action on these.

Both programs indicate that governments of all levels still have not recognized the extent of the significance of small businesses and the size of the informal SME sector.

The regional program demonstrates a remarkable mismatch between the obstacles identified by SMEs and those identified by the program. For example, the existing tax system, which has been steadily ranked by SMEs throughout Ukraine as their most significant problem, has not been mentioned in the current program at all. The program does, however, promote many activities whose demand by small business is not documented and where governmental efficiency in delivering sound results is questionable, at least based on the experience of other countries.

While these programs propose government action in support of SMEs, other government actions and operations contradict the stated program objectives. For instance, at approximately the same time the central government prepared the National Program of State Support for Small Business, the cabinet adopted resolution no. 1755 of November 29, 2000, which established a uniform license fee of UAH 5,100 (Ukrainian hryvnia) for wholesale and retail trade in liquor, regardless of the quantity sold. If the government is serious in its efforts to support SMEs, it will have to work with those efforts in addition to passing legislation.

Suggested Direction of Efforts to Support SME Development

It appears that at the current stage, further progress in SME development depends quite remarkably on the ability of the Kharkiv Oblast government and the central government of Ukraine to make conceptual and policy adjustments that will respond more directly to needs of SMEs as these needs are viewed from inside the SME sector, not as they are viewed from the government.

These changes are best achieved by constructing a proper framework for SME operations. This construction process includes the following steps:

- Reducing the fiscal burden on SMEs
- Restructuring government regulation
- Creating conditions for integrating informal SME activities in the formal sector
- Restructuring government services from provider to enabler

None of the recommendations can be effectively implemented without coordination among all levels and branches of government and cooperation with the public at large. Each recommendation combines various specific tasks and presents opportunities for contributions by the United States Agency for International Development (USAID) and international organizations. The recommendations and specific tasks are summarized in a Policy Matrix at the end of the last chapter.

CHAPTER I
INTRODUCTION: THE ROLE OF SMEs IN THE ECONOMY

SMEs and entrepreneurs (SMEs¹) are vital to market economies worldwide. They play important roles in employment, overall production, provision of quality and diversity in services to the population, and public finance. For example, "Small and medium-sized enterprises have been central to the development of the EU [European Union] economy. According to 1995 Eurostat data, there were 18 million enterprises in non-agricultural sectors within the EU-15 [see Table 1], of which more than 99% were SMEs (Eurostat 1998). A total of 110 million people were employed in all enterprises, of which two-thirds were in firms with less than 250 employees [see Table 1]. SMEs also accounted for over half of the total turnover of enterprises" (EC 2000, 31).

Within the European Union (EU), SMEs account for more than 80 percent of the employment in several major sectors. Many of these are the same sectors in which SMEs dominate in terms of number of establishments in the United States. Wholesale trade, real estate, hotels/restaurants, financial support services, and construction are included in this category (EC 2000, 34; United States Census Bureau 1997, Table 1).

Table 1 Percentage of Employment, by Enterprise Size, in EU Member States, 1994

Country (EU-15)	Size of Enterprise					All SMEs	Large (more than 250 employees)
	Sole Proprietors (0 employees)	Micro (1-9 employees)	Small (10-49 employees)	Medium (50- 249 employees)			
Austria	3.3	20.7	19.2	21.3		64.5	35.5
Belgium	19.7	26.1	15.4	11.4		72.6	27.4
Denmark	6.5	22.5	22.6	17.9		69.5	30.5
Finland	5.3	19.2	16.4	16.4		57.3	42.7
France	10.9	21.3	18.7	14.9		65.8	34.2
Germany	2.7	20.6	20.0	13.8		57.1	42.9
Greece	27.5	29.1	17.2	12.7		86.5	13.5
Ireland	4.1	19.3	22.8	22.4		68.6	31.4
Italy	10.9	36.9	21.4	10.7		79.9	20.1
Luxembourg	5.1	17.7	24.6	24.0		71.4	28.6
Netherlands	6.1	19.9	17.0	17.7		60.7	39.3
Portugal	11.0	27.0	22.8	18.4		79.2	20.8
Spain	20.0	27.5	19.0	12.9		79.4	20.6
Sweden	5.2	21.4	18.2	16.1		60.9	39.1
United Kingdom	12.3	16.6	15.3	12.6		56.8	43.2

Sources: Eurostat (from EC 2000, 32)

Within the United States, firms that have fewer than 500 employees account for more than half of total employment (see Table 2). In many sectors in the United States, nonemployers (or self-

¹ Throughout this report, we include individual entrepreneurs in our references to SMEs.

employed individuals) account for more than 80 percent of total establishments (establishments are firm locations; nationally, the ratio of establishments to firms is 1.06). These are mainly service sectors and include real estate and renting and leasing; professional, scientific, and technical services; educational services; arts, entertainment, and recreation; and other services not including public administration (1997 Economic Census, Nonemployer Statistics).

Table 2 Employment and Percentage of Employment, by Enterprise Size in United States , 1997 and 1998

Employment Size	Employment	Percentage	Cumulative Percentage
Total (employer firms 1998 and nonemployer firms 1997)	123,557,340	100.00	
Nonemployers (unincorporated self-employed), 1997	15,439,609	12.50	12.50
1 to 4 employees	5,584,470	4.52	17.02
5 to 9 employees	6,643,285	5.38	22.39
10 to 19 employees	8,047,650	6.51	28.91
20 to 49 employees	11,317,087	9.16	38.06
50 to 99 employees	8,060,527	6.52	44.59
100 to 499 employees	15,411,390	12.47	57.06
500 to 999 employees	5,547,037	4.49	61.55
1,000 to 1,499 employees	3,304,540	2.67	64.23
1,500 to 2,499 employees	4,211,469	3.41	67.63
2,500 to 4,999 employees	5,717,754	4.63	72.26
5,000 to 9,999 employees	6,086,847	4.93	77.19
10,000 employees or more	28,185,675	22.81	100.00

Source: Adapted from Statistics of U. S. Business, <http://www.census.gov/epcd/www/smallbus.html>, two tables: Employment Size of Employer Firms, 1998, and Employers and Nonemployers, 1997. The total for this table was created from the sum of the two tables from the Statistics of U. S. Business.

Note on "nonemployer" status: Nearly three-quarters of all U. S. business firms have no payroll. Most are self-employed persons operating unincorporated businesses and may or may not be the owner's principal source of income. Self-employed owners of incorporated businesses typically pay themselves wages or salary, so the business is an employer and included in the employer statistics. Because nonemployers account for only about 3 percent of business receipts, they are not included in most business statistics, for example, reports from the Economic Census.

International institutional donors assign a high priority to SMEs and have committed to support their development during reform and restructuring of countries in transition. In March 2001, the European Bank for Reconstruction and Development (EBRD) was preparing to implement a business project competition to assist in increasing the pipeline of SME loan applications to banks participating in the EBRD SME Credit Line to Ukraine. USAID, IFC, and the Ministry of Foreign Affairs of Norway (Norway) all have funded research on SMEs in Ukraine. Both the MSI and IFC surveys² identified SMEs as integral to the transition of Ukraine to a market economy.

² The USAID-funded survey was administered by Management Systems International (MSI), in conjunction with the Kiev International Institute of Sociology (KIIS), and is referred to as the MSI survey.

The MSI survey specifically found SMEs to be the most commercially oriented and dynamic enterprises in Ukraine. The MSI survey estimated that SME employment in Ukraine, as displayed in Table 3, is much greater than might be expected.

Employment Size	Employment	Percentage	Cumulative Percentage
Total	21,220,455	100.00	
Zero	2,654,084	12.51	12.51
1 to 5 employees	503,852	2.37	14.88
6 to 10 employees	853,403	4.02	18.90
11 to 50 employees	3,211,878	15.14	34.04
51 to 250 employees	4,161,270	19.61	53.65
250 or more employees	9,835,968	46.35	100.00

Source: Adapted from MSI Survey 1999 (MSI Table 1)

The central government of Ukraine increasingly recognizes the benefits of SMEs and has made some efforts to improve the SME climate. The most important of these efforts, the new National Program in Support of Small Business Development, is reviewed in Chapters II and VII. Other efforts include such key elements as simplification of taxation (1998); regularization of many regulatory steps, such as registration, licensing, and inspections (1998); and improving the legislation (1999).

In Kharkiv Oblast specifically, SME support efforts have culminated in the Regional Complex Program of Assistance to Small Enterprise Development in Kharkiv Oblast, most recently for 1999–2000 and 2001–2002. The concept of the program is built upon a clear and direct recognition of the importance of SMEs: “Small enterprise is no additional, but an independent factor of economic development that helps to reduce unemployment, activate innovative processes, develop competition, **and** supply various market sectors with goods and services.” The program is discussed in detail in Chapter VII.

Based on the recognition of the importance of SMEs in the Kharkiv Oblast, this assessment sought to do the following:

- estimate the current state and economic contributions of SMEs in Kharkiv;
- examine the business climate and its relationship to the development of SMEs; and
- identify further reform that would have the most positive impact on the development of SMEs in Kharkiv and their contribution to the local economy.

Another major survey was funded by IFC and Norway. It was administered by the Center for Social Expertise and Forecasting of the Institute of Sociology in Kiev and is referred to as the IFC survey.

CHAPTER II LEGAL AND REGULATORY FRAMEWORK OF SMEs IN KHARKIV OBLAST

In general, the legal system in Ukraine is complicated, uncoordinated, and unnecessarily confusing. It is regularly cited as an obstacle to investment by domestic and foreign firms (EIU 2000; Senchuk and Yacoub 2000; Grey and Whinston 1999). By some indications, however, the legal environment for SMEs in Kharkiv Oblast and throughout Ukraine is rapidly improving. The **Law on State Support of Small Enterprises**, enacted on October 19, 2000, with the stated aim of overcoming economic crisis by defining the legislative basis for state support of small business, outlined a program of support for the Cabinet of Ministers of Ukraine to prepare and implement and similar programs for the regional and local authorities to prepare and implement.

This law included the following goals of state support for small business:

- creation of conditions for positive structural changes in the Ukrainian economy;
- assistance to the forming and developing of small businesses;
- support from state producers; and
- formation of conditions for supplying the population of Ukraine with employment and with the creation of new workplaces.

The resulting national program is even more ambitious and innovative. On December 21, 2000, the Verhovna Rada and the President of Ukraine approved the **Law on the National Program in Support of Small Business Development in Ukraine**, No. 2157-III, the first law of Ukraine that acknowledges the significant state interference in, and restriction of, small business in Ukraine. More significant, this law outlines specific measures to reduce the most difficult problems that small businesses currently face. The law calls for improvement of the legal and normative base to regulate the activities of public agencies and their officials in the small business sphere (Article III-1-4) and states that introduction of a "purposeful, consistent and predictable common public regulatory policy in the sphere of entrepreneurship is one of the main tasks of the program" (Article III-2-1).

The law's plan for implementation of a new public regulator policy includes the following:

- public participation and interagency coordination in planning and preparing improvements in regulatory activity;
- evaluation of the effects and social results of regulatory activities;
- legislative improvements to decrease excessive state interference in entrepreneurship;
- coverage of regulatory problems in mass media and participation of the Entrepreneurs Union and citizens in discussing and solving the problems;
- analysis and publication of the results of these efforts; and
- simplification of permit and registration processes.

Again, this is the first time issues such as limiting regulatory control of small business have been included in a law of Ukraine. What the potential effects of the chosen implementation methods are is a separate issue discussed in Chapter VII.

In addition to directing the Cabinet of Ministers to prepare and implement a national program, the **Law on State Support of Small Enterprises** reaffirms the integrated taxation system for small businesses that was established by the **Presidential Decree on Alternation of the [Previous] Presidential Decree on Simplification of the Taxation System, Accountability and Reporting for Small Business Subjects**, No. 746/99 from June 28, 1999. The integrated system permits small businesses and entrepreneurs to pay either a single or a simplified tax. According to the

decree, the *single tax* is available to entrepreneurs who operate without creating a legal entity, have 10 or fewer employees, and have an annual sales revenue of UAH500,000 or less. Local councils determine the single tax rate within the legally defined parameters of UAH20 and UAH200 based on the types of activities to be taxed. Individual entrepreneurs who opt for the single tax are exempted from a variety of taxes and fees provided by the **Law on the System of Taxation**. They pay their single tax to the State Treasury of Ukraine, which then distributes the revenues in the following manner:

- Forty-three percent to the Oblast budget
- Forty-two percent to the Pension Fund of Ukraine
- Fifteen percent to obligatory social insurance

The *simplified tax* is available to legal entities with 50 or fewer employees. Legal entities that opt for the simplified taxation system independently choose one of the following rates:

- Six percent of sales revenue excluding excise duty where value added tax (VAT) is paid separately
- Ten percent of sales revenue, excluding excise duty where VAT is included

The simplified tax is paid to the State Treasury of Ukraine, which then distributes the revenues in the following manner:

- Twenty percent to the State Budget of Ukraine
- Twenty-three percent to the local budget
- Forty-two percent to the Pension Fund of Ukraine
- Fifteen percent to obligatory social insurance

Legal entities that pay the simplified tax are exempt from a variety of taxes and fees provided by the **Law on the System of Taxation**.

According to Articles 5 and 6 of the decree on taxation, sole proprietors who operate in marketplaces and pay marketplace fees may choose to pay a *fixed tax*. The amount of the fixed tax is from 20 to 100 hryvnias a month. The amount increases by 50 percent for each additional employee. Individuals who choose to pay the fixed tax may have no more than five employees and may not have recorded income that is equivalent to more than 7,000 annual salaries at minimum wage.

The State Treasury of Ukraine receives revenues from all business income taxes irrespective of the taxation system used. Local governments determine the rates of only a few taxes and fees that affect businesses. The Cabinet of Ministers **Decree on Local Taxes and Gatherings**, No. 56-93 from May 20, 1993, limits the advertising tax to 0.1 percent for a single advertisement and 0.5 percent if the advertisement is to be displayed for a long period of time. The same decree limits sales tax on imported goods to 3 percent. Changes in other business taxes must be effected at the national level. Table 4 lists laws and decrees that affect enterprises in Kharkiv Oblast.

Table 4 Chronology of Laws and Decrees of Ukraine Affecting Enterprises in Kharkiv*		
Effective Date	Title	Number
December 21, 2000	Law on National Program in Support of Small Business Development	2157-III
October 19, 2000	Law on State Support of Small Enterprises	2063-III
September 30, 2000	Cabinet of Ministers Decree on Realization of the President's Decree on Assistance in Personnel Training for the Sphere of Business (no. 849, July 3, 2000)	1358
September 21, 2000	Head of Oblast Administration Decree on Organizational and Practical Measures on Implementation of Presidential Decree on Measures on Providing Entrepreneurship Support and its Further Development (No. 906, July 15, 2000)	860
July 15, 2000	Decree on Measures on Providing Entrepreneurship Support and its Further Development	906
July 3, 2000	Decree on Assistance in Personnel Training for the Sphere of Business	849
July 1, 2000	Law on Licensing Certain Types of Economic Activities	1775-III
May 11, 2000	Law on Special Investment Conditions in the Territory of Kharkiv	1714-111
June 28, 1999	Decree on Alteration of the Presidential Decree on Simplification of Taxation System, Accountability and Reporting of Small Business Subjects (July 3, 1998, No. 727)	746/99
November 17, 1998	Decree on Licensing Activities of Economic Subjects in the Area of Natural Monopolies	1257/98
July 23, 1998	Decree on Some Measures for Deregulation of Entrepreneurial Business	817/98
July 3, 1998	Decree on Simplification of Taxation System, Accountability and Reporting of Small Business Subjects	727
May 25, 1998	Cabinet of Ministers Decree on State Registration of Subjects of Entrepreneurial Activity	740
May 22, 1997	Law on Taxation of Company's Profits	283/97-BP
April 3, 1997	Law on Value Added Tax	168/97-BP
March 19, 1996	Law on Regime of Foreign Investment	93/96
February 19, 1994	Decree on the Regulation of Investment Funds and Investment Companies	55/94
May 20, 1993	Cabinet of Ministers Decree on Local Taxes and Gatherings	56-93
September 19, 1991	Law on Economic Associations	1576-XII
September 18, 1991	Law on Investment Activity	1560-XII
June 25, 1991	Law on Taxation System	1251-XII
March 27, 1991	Law on Enterprises	887-XII
February 7, 1991	Law on Property	697-XII
February 7, 1991	Law on Entrepreneurship	698-XII
*NOTE: This table is by no means a comprehensive list of all laws and regulations affecting enterprises in Kharkiv. The table contains the most significant laws and decrees that the Assessment team encountered during their research.		

Registration

All businesses, including sole proprietors, are legally required to register with the state as Subjects of Entrepreneurial Activity. Small businesses most commonly register as limited liability companies. The minimum volume of authorized capital for these companies is the equivalent of 100 salaries at minimum wage. Owners of limited liability companies are well protected from financial risk.

Many SMEs, especially individual entrepreneurs, do not register themselves or report their incomes. While it is legal not to register some types of small enterprises, it is, of course, difficult to collect information on such enterprises. The methodological implications for this assessment of this "gray" or unregistered economic activity are discussed in Chapter III.

License

Approximately 60 to 65 percent of SMEs require at least one license. Some activities require five or more licenses. The **Law on Licensing Certain Types of Economic Activities** (No. 1775-III, July 1, 2000) lists 60 types of activities that require licenses. Beginning in at least 1997, the central government attempted to streamline and improve the licensing system. Efforts included amendments to the **Law on Entrepreneurship** and passage of the **Law on Licensing of Certain Types of Economic Activity**, which includes a list of specific operations requiring a license, limited mostly to activities that are potentially harmful to health and environment. The time spent on obtaining licenses has decreased as a result of these efforts. The procedures and administrative arrangements among ministries and their local branches and local governments required by the new law, however, have not yet been implemented (Grey and Whinston 1999, 41; Senchuk and Yacoub 2000, 17).

Permit

Most small businesses require permits in addition to licenses for their operations. Permits are most often required by the Fire Brigade, Sanitary and Epidemiological Service, Labor Protection Committee, Architecture and Construction Inspection, Energy Saving Inspectorate, Environmental Safety Department, and Land Resources Department.

Inspection

Most of the agencies that issue business permits are among the most frequent business inspectors, which also include various tax authorities and the police. Nearly every firm in Ukraine is inspected at least once each year; most are inspected more than seven times each year. The incidence and cost of business inspections is debilitating. While there is some evidence of improvement in this area, inspections still are a major obstacle to the development of small businesses in Ukraine (Grey and Whinston 1999, 44–45). Inspections are discussed in detail in Chapter VI.

CHAPTER III METHODOLOGY AND RELATED ISSUES

This assessment's methodology integrated several approaches and tools. First, the assessment identified, studied, and used results of previous international studies on the status of small business in Ukraine and a range of related reform issues. Within this class, the most important reference sources were *The State of Small Business in Ukraine: An IFC Survey of Ukrainian Small Enterprises* (June 2000)—the IFC survey—and *A Survey of Business in Ukraine* (Management Systems International, October 1999)—the MSI survey.

Second, in addition to employing the Urban Institute's staff, the assessment employed various local experts to assist in research, data collection, and analysis. These included experts in law, SMEs, and survey research. In working with these groups, the assessment accessed much more information than could be gained from working with just expatriate experts or one local group. Sharing research results among the groups enabled each researcher to build on the other research being conducted in parallel. The variety of perspectives contributed to a more holistic analysis of the small business environment in Kharkiv Oblast.

Third, quantitative data was collected from various sources, combined, and analyzed to form an initial sketch of small business in Kharkiv Oblast. The assessment aggressively sought data and secondary indicators on SME characteristics that are difficult to measure, such as informal employment. In particular, the Assessment relied on the Official Oblast Data Book of the Kharkiv Administration Department of Statistics. When appropriate, U.S. and EU statistical sources were referenced to provide comparative data.

Fourth, a special survey of SMEs in Kharkiv Oblast was designed and conducted (its methodology and results are detailed in Chapter V). A focus group for clarifying some positions indicated by the survey results was also designed and conducted. Finally, for presenting recommendations, the format of a “policy matrix,” which often is used by international donor organizations for presenting reform recommendations, was employed.

Two issues that severely impede quantitative assessments of the role of small businesses in Ukraine should be mentioned here.

Varying Definitions and Understandings of SMEs

The **Law on Enterprises in Ukraine** (1991) defined an enterprise as small depending on its number of employees and industry. Several presidential decrees in 1998 defined small enterprises as “registered physical and legal persons of any organizational and juridical form and property category with labor force up to 50 persons and with annual sales proceeds quantity up to 10 million UAH.” The **Law on State Support of Small Enterprises**, enacted on October 19, 2000, identifies entrepreneurs (individuals registered as businesses) and juridical persons with not more than 50 employees and not more than €500,000 gross income as *small business subjects*. The law's final provisions indicate that it should prevail in discrepancies with earlier legislation, leading to the conclusion that this definition of small enterprises is to serve as the standard throughout Ukraine.

The State Statistics Committee, however, has been using its own definition of small enterprise (Committee's Decision # 399 of December 1, 1998), and it remains to be seen if it will adopt the definition from the recent law. Enterprises identified as small by the Statistics Committee range in number of employees from 10 to 50, depending on industry. For example, software, real estate, and fishing enterprises may have no more than 10 employees to be classified as small. In the

printing and communications industries, up to 20 employees are permitted, and in the “municipal economy” or agriculture classes, up to 50 employees would still fit the small enterprise status. Data on individual entrepreneurs is separately reported by the state statistics system.

This assessment found no implicit or explicit definitions of medium enterprises in official documents. This phenomenon is not unique to Kharkiv Oblast or Ukraine. From the tables included in Chapter I, it is apparent that Eurostat and MSI both use 250 employees as a parameter for enterprise size, but the U. S. Census Bureau does not, thereby preventing direct comparisons. The IFC and many other organizations also use 250 employees as a parameter, and medium enterprises generally are defined as those with 51 to 250 employees.

Varying definitions of SMEs within and without Kharkiv prevent standard reporting and monitoring on SME activity. The new **Law on State Support of Small Enterprises** attempts to clarify the definition of small enterprises; it is hoped that the Oblast Statistics Committees will incorporate this definition in its reporting. It and other agencies and organizations also should report information on medium enterprises, as defined by international convention.

Substantial Overlap with the Gray Economy

The informal (unofficial or gray) economy of Ukraine is huge. According to the National Bank of Ukraine, 52 percent of the nation's money supply circulates without the banking system. Informal transactions account for 67 percent of net profit in the financial and banking sector.

The inadequate legal framework, controlled money circulation, and high tax burden all motivate enterprises to conduct their transactions in an unofficial manner. This happens in several ways. Some enterprises operate without registering themselves, and so conduct all of their transactions in the gray economy. Registered companies may fail to report payments to workers (to avoid social taxes) and sales (to avoid profit taxes). Also common is channeling of some portion of the whole production cycle through cash transactions with suppliers and consumers/clients.

These methods are common to enterprises of all sizes, but evidence suggests that they are most commonly used by small enterprises. For example, the MSI survey estimated that only 24.6 percent of entrepreneurs in Ukraine were registered. The amount increases to only 37.6 percent for enterprises of one to five employees. Table 5 indicates that entrepreneurs and enterprises of one to five employees account for the vast majority of employment at unregistered companies. It also is likely that there are unreported employees at registered enterprises, though this assessment found no estimates of such employment.

There are several potential reasons for such a high percentage of SMEs operating in the informal sector, or gray economy. The MSI and IFC surveys both found SMEs to sustain a higher inspection burden than large enterprises. Transactions with smaller numbers of people are easier to conceal than those involving hundreds of people. Also, SMEs tend to complete more transactions in cash (rather than on credit, in-kind, or by barter), which also facilitates concealment from authorities.

Table 5 Estimated Employment at Unregistered Enterprises in Ukraine, 1999

Class Size	Estimated Number of Firms	Estimated Employment	Percent of Firms Registered	Employment at Unregistered Enterprises	Coefficient to Calculate Total Employment Based on Registered Employment
	1	2	3	4	5
Zero	2,651,433	2,651,435	24.6	1,999,180	4.06
1 to 5 employees	148,976	516,947	37.6	322,275	2.66
6 to 10 employees	104,608	850,460	94.1	50,177	1.06
11 to 50 employees	123,757	3,189,226	99.5	15,946	1.01
51 to 250 employees	33,169	4,206,444	99.5	21,032	1.01
250 plus employees	10,851	9,822,542	99.4	58,935	1.01
Total	3,072,794	21,237,054		2,467,545	1.13
<i>Source: MSI 1999 survey and authors' calculations.</i>					

CHAPTER IV SMEs IN KHARKIV OBLAST

Employment

According to the *Regional Program of Small Entrepreneurship Development in Kharkiv Oblast for the Years of 2001-2002*, as of January 1, 2000, 108,500 people were employed by small enterprises,³ 58,400 people were self-employed entrepreneurs, 40,900 people were freelance workers, and 2,100 people worked on small, private farms.⁴ According to Dergcomstat State Statistics, as of January 1, 2000, 69,200 people were employed by small enterprises. Both of these sources rely on information submitted to the Oblast Statistics Committee by registered small enterprises and entrepreneurs. Unfortunately, this assessment found no sources of information on employees of medium enterprises in Kharkiv Oblast.

The number of people actually employed by small enterprises in Kharkiv Oblast probably is much higher for two reasons: first, because many registered enterprises do not report all of their employees; second, because many enterprises, and even more entrepreneurs, simply are not registered at all. The MSI report estimated the extent of unregistered employment among entrepreneurs and enterprises of all sizes (see Table 6).

Table 6 displays the result of applying the coefficients derived for the national level MSI survey to the data from the Kharkiv regional program. Unfortunately, the assessment did not identify data on medium enterprises in Kharkiv Oblast, so we cannot make full use of MSI's coefficients. The analysis indicates that at least 399,008 people in Kharkiv Oblast are employed as entrepreneurs or by small enterprises.

Type of Small Enterprise/ Entrepreneur	Registered Employment	Coefficients	Projected Total Employment
Small Enterprises	108,500	1.09	118,610
Entrepreneurs	58,400	4.06	237,398
Freelance Workers	40,900	NA	NA
Private Farmers	2,100	NA	NA
<i>Total</i>	<i>209,900</i>		<i>at least 399,008</i>
Total Employment	1,403,401	1.13	1,587,900
Percentage of Total Employment	15		at least 25

³ The document references the new law on small enterprises, so it presumably uses the law's definition of 50 or fewer employees.

⁴ As if to underscore the problem with data collection and clarity, the summary table at the beginning of this very same document indicates that in Kharkiv Oblast, 116,000 people are employed by small enterprises and 63,700 people are self-employed.

Source: Regional programs (see KRESF 1999 and 2000) and author calculations using MSI coefficients

The analysis also indicates that small enterprises and entrepreneurs account for at least 25 percent of total employment in the Oblast. Assuming that the percentage of employment provided by medium enterprises is the same in Kharkiv Oblast as for the country leads to the conclusion that SMEs in Kharkiv Oblast account for at least 45 percent of all employment. This is a conservative estimate, especially because, according to the regional program, the average number of small enterprises per person is higher in Kharkiv Oblast (4.5) than in Ukraine (4.0).

Employment at large and medium enterprises (the official data does not separate them) in Kharkiv Oblast decreased by 227,231 from 1995 to 1999 (Vroman 2001). During roughly the same period (1996 to 2000), the number of registered small enterprises increased more than 60 percent to 14,100 and the number of registered entrepreneurs increased nearly 40 percent to 58,000. The findings on unregistered small enterprises and entrepreneurs from the MSI survey suggest that totals in these categories are closer to 15,411 and 235,480. So the loss of employment at large and medium enterprises has been more than compensated for by increased employment among entrepreneurs and small enterprises, although much of this employment is unregistered and so does not benefit the state treasury.

Year	Number of Registered Small Enterprises	Number of Registered Entrepreneurs	Projected Total Number of Small Enterprises	Projected Total Number of Entrepreneurs
1996	8,793	41,485	9,611	168,429
1998	10,139	45,800	11,082	185,948
2000	14,100	58,000	15,411	235,480

Source: Regional programs (see KRESF 1999 and 2000) and author calculations using MSI coefficients

Sector Distribution

Kharkiv SMEs are most active in wholesale trade, retail trade and building, developing, and general contracting. They are also very active in food manufacturing; professional, scientific, and technical services; apparel manufacturing; information services; and repair and maintenance. The same sectors prove attractive to SMEs in the European Union and United States, but the list would include additional sectors, mostly a wide array of other services, such as real estate, financial, and educational. The fact that the public sector in Kharkiv Oblast now provides many of these services is the most likely reason SMEs have not thrived in these sectors. This is especially a concern because the number of employees of the Oblast government increased from 4,151 to 33,389 during 1995 to 1999 (Vroman 2001).

The concentration of Kharkiv SMEs in certain sectors is very significant when examined in light of the employment shifts discussed above. Not only are employees experiencing a general change in the sizes of their employers, but also in the sectors of their employers. Decreased employment at large and medium enterprises in the sectors of industry, transportation, education, and culture and arts represents a decrease not only in the employment at large and medium enterprises in these sectors, but also in total employment in these sectors. Similarly, increased employment at small enterprises in the retail trade and food services sector represents an increase not only in

employment by small enterprises in this sector, but also an increase in total employment within this sector and a structural shift that favors this sector.

Science and scientific services (research and development, in American terminology) deserve a separate note. Given the existence of a broad range of scientific research and education centers in Kharkiv, this field is especially important from both economic and physiological points of view. Available data indicates that the sector is restructuring better than many other areas of economic activity. Within this sector, employment at large and medium enterprises declined by almost 14,000, but employment at registered small enterprises amounted to more than 9,000. Including employment at unregistered small enterprises brings the estimated total to between 22,000 and 24,000.

Contribution in Sales and Public Finance

According to the regional program, the volume of sales by small enterprises is estimated at 5661.8 million UAH, or 36.8 percent of total sales generated in Kharkiv Oblast in 1999, which is a very substantial portion (KRESF 2000).

According Oblast budget data for 2000, small business (see definitions) provided at least 12 percent of the general fund revenues of the Oblast budget. (This account is partial because small enterprise contributions to several budget categories—such as profit tax, payment for land, and municipal rent payments—cannot be separated from total contributions.) The simplified taxes alone (see Chapter II) accounted for approximately 6.5 percent of the general fund revenues. Small businesses also generated UAH 216.3 million of earnings to the budgets of all levels in 2000.

CHAPTER V

SURVEY OF SMEs IN KHARKIV OBLAST

Methodology

The limited availability and reliability of data on employment and business in Kharkiv Oblast and the lack of a previous Kharkiv-specific survey inspired the collection of primary data from SMEs in Kharkiv Oblast. The UI survey sought to test the extent to which SMEs in Kharkiv Oblast resemble those of the rest of Ukraine and the world and to identify a range of other characteristics of SMEs in Kharkiv Oblast. The questionnaire from the 1999 MSI survey provided the main example for the questionnaire used in Kharkiv. It was revised in response to critiques by several researchers in both the United States and Ukraine who were experienced in surveying businesses in transition economies.

The MSI questionnaire included a section that asked participants to respond to questions about an imaginary firm. This technique allows surveyors to ask questions about sensitive issues, such as corruption and tax evasion, without discomforting survey participants. This section and several other questions from the original questionnaire remained, to ensure comparability between the Kharkiv survey and the national survey conducted by MSI.

Because the survey included only SMEs, the results do not provide opportunities to compare large enterprises and SMEs in Kharkiv, but the results do support the findings of other surveys, specifically the finding that SMEs represent the newest, most market-oriented and most sustainable portion of the local economy (for example, Grey and Whinston 1999, xiii-xiv).

A group of potential survey participants was randomly selected to ensure a representative sample of enterprises in Kharkiv Oblast. The proportionality of the sample to the actual industrial distribution of enterprises in Kharkiv Oblast was confirmed by comparison with several databases.

The Urban Institute, the Kharkiv City Donation Fund, and the Kharkiv Regional Entrepreneurship Support Fund developed a survey administration plan that ensured quality and anonymity. The survey was conducted in January 2001 in Kharkiv city and four Oblast district centers: Dergachi, Kupyiansk, Pervomaisk, and Chuguev. Kharkiv City Donation Fund administered the survey, with assistance and technical support from the Kharkiv Regional Entrepreneurship Support Fund and the Main Economic Department of Kharkiv Oblast.

Staff of Razvitie (Development) Fund and staff of Kharkiv Regional Entrepreneurship Support Fund distributed questionnaires to 200 SMEs by mail or carrier and followed up with participants who did not return their completed questionnaires within five days. Each live interview required approximately 30 minutes. Most respondents were enterprise managers or their deputies. In some cases, commercial or financial directors or chief accountants were polled (if they could assess the real enterprise situation and its development of future prospects). The survey resulted in completed questionnaires from 122 SMEs, which proved proportional in size and industry to the entire population of SMEs in Kharkiv Oblast (see annex 3 for details).

General Results

The average age of SMEs in Kharkiv Oblast is approximately five years, with a concentration of new registrations since 1996. Very few SMEs were established prior to 1988. This finding is similar to that of the MSI survey, which found that 75 percent of SMEs were new, compared to less than 17 percent for large enterprises (Grey and Whinston 1999, 15). It should be mentioned, however, that the majority of enterprise managers and entrepreneurs are not beginners, but people

who carried out business activity earlier and have established new companies or have changed the organizational form of their enterprises (requiring re-registration) to take advantage of the simplified system of accounting and reduction of authorized capital expenses.

Kharkiv SMEs are most active in wholesale trade, retail trade and building, developing, and general contracting. They also are very active in food manufacturing, professional, scientific and technical services, apparel manufacturing, information services, and repair and maintenance. Most SMEs do not limit themselves to one activity, but diversify to other activities.⁵ Local and international programs have recognized the concentration of SMEs in the trade sectors of Kharkiv and Ukraine (KRESF 1999-2000, pp. 5-6; Senchuk and Yacoub 2000, 9).

SMEs are most likely to register as limited liability companies (42.9 percent). This can be explained by the low minimum volume of authorized capital required for such an enterprise (it is equal to 100 annual salaries of minimum wage) and, as a result, lower financial risk for owners of limited liability companies.

Contributions to the Local Economy

On average, the full-time staff of SMEs is 46 percent women. More than 40 percent of surveyed firms engage part-time employees in addition to their full-time employees. Most open positions are filled through personal recommendations and networks. Only 16 percent of surveyed firms advertised open positions in newspapers or other media.

The vast majority of Kharkiv SMEs pay no portion of wages in kind. Wages of only 20 percent of the surveyed firms are in arrears, most between one and two months, which is better than the national averages for small (37 percent) and large (70 percent) firms in Ukraine (Grey and Whinston 1999, xiv).

Kharkiv SMEs have large and diverse client bases made up of individuals, corporations, and government entities. Only 12 percent of surveyed firms report that any one of their clients consumes more than 50 percent of their product, with nearly half reporting that any one client consumes less than 20 percent of their product. The market that Kharkiv SMEs face for supplies is a little tighter, but not much. Only 14 percent of surveyed firms report that they purchase more than 50 percent of their inputs from a single supplier, while more than half report that any single supplier provides less than 30 percent of their inputs. Again, this finding is similar to those of national studies (e.g., Grey and Whinston 1999, 108). Table 8 shows the types of clients and suppliers of Kharkiv SMEs.

SMEs are integral to the local economy, not only in terms of employment, but also in terms of production. The chart below illustrates the strong local orientation of the Oblast's SMEs. Recalling the activities on which these firms concentrate (wholesale trade, retail trade, building, developing and general contracting, food manufacturing, professional, scientific and technical services, apparel manufacturing, information services, and repair and maintenance) further stresses their role in distributing goods and services throughout the local economy.

Table 9 shows that the supplier base of SMEs is more geographically diverse than the corresponding client base. This indicates that SMEs are more responsible for importing goods and services to Kharkiv Oblast than for exporting the Oblast's products elsewhere. It is possible that large enterprises in Kharkiv offset this SME trade imbalance.

⁵ This is unusual for countries with developed market economies, but very typical for countries in transition where diversity is needed for survival even at the level of small enterprises.

Table 8 Types of Clients and Suppliers of SMEs in Kharkiv Oblast		
Type	Average Percentage* of Goods and Services	
	Produced for Clients	Obtained from Suppliers
Individuals	49	25
Companies	36	73
Government, government agencies, and budgetary organizations	8	1
<p>*Numbers indicate average percentage, weighted by frequency of responses, of the pool of firms that answered the six relevant questions. Each type (individuals, companies, government) was a separate question for each category (clients and suppliers). Different numbers of firms answered each of the eight questions; the responses to one are independent of the responses to another (which is why the percentages for each category do not total 100). One hundred percent of the surveyed firms answered at least one of the questions on clients and eighty-four percent answered at least one of the questions on suppliers. For more detailed information, see responses to questions 41 to 48 in annex 3.</p>		

Table 9 Locations of Clients and Suppliers of SMEs in Kharkiv Oblast		
Region	Average Percentage* of Goods and Services	
	Produced for Clients	Obtained from Suppliers
Kharkiv city	60	50
Kharkiv Oblast (excluding the city)	24	20
Rest of Ukraine (excluding Kharkiv Oblast)	13	18
Russia and other countries of the former Soviet Union	2	10
Other countries	0	2
<p>*Numbers indicate average percentage, weighted by frequency of responses, from the pool of firms that answered the 10 relevant questions. Each region was a separate question for each category (clients and suppliers). Different numbers of firms answered each of the eight questions; the responses to one are independent of the responses to another (which is why the percentages for each category do not total 100). Ninety-two percent of the surveyed firms answered at least one of the questions on clients and eighty-one percent answered at least one of the questions on suppliers. For more detailed information, see responses to questions 41 to 48 in annex 3.</p>		

More than two-thirds of the surveyed firms expect to increase the amount and type of goods and services they produce, as well as their revenues, in the coming year. In the six months prior to the survey, 36 percent of SMEs increased the number of their employees and half reported unchanging employment levels.

Assets, Investments, and Capital

Almost half of the surveyed firms made capital investments in equipment during the previous year. One-fifth invested in (purchased or improved) buildings. No firms reported investing in land. The average capital investment as percentage of total revenue was 28 percent. Retained income is the main source of operating funds (71.71 percent was the average response in the survey) and capital investments (71.25 percent was the average response in the survey) for Kharkiv SMEs. Foreign and domestic investment played almost no role in firm investments.

Loans provide significant funds for operations and investments: an average of 12 percent of starting capital and 14 percent of capital investment; however, this amount is far below its potential. The lending environment in Kharkiv Oblast is unfavorable, characterized by costly and otherwise burdensome credit provision terms and the lack of a legislative basis for microcrediting. Although a special regime of investment in priority sectors of the Oblast economy began in January 2000, large investment projects in which SMEs are unlikely to participate are favored (see the **Law on Special Investment Conditions in the Territory of Kharkiv**, No. 1714-III, enacted May 11, 2000).

SMEs in Kharkiv Oblast are sustainable because they rely on their own resources. For the most part, these firms use their own equipment or rely on their employees' equipment, indicating significant personal investments. Most firms that do not own their equipment rent it from individuals or other companies. Forty percent of the surveyed firms use buildings or premises that are owned by either the firm or individuals working for it. More than 40 percent of surveyed firms use buildings or premises owned by other companies.

Participation in Industry Organizations

Fewer than 30 percent of Kharkiv SMEs report membership in commerce and other business associations. This finding is similar to that of MSI, which also found evidence that firms are unlikely to join associations because they do not view involvement as worthwhile and suspect they will not receive useful services from these associations. More than 60 percent of SMEs, however, are members of trade unions. This assessment did not identify reasons for membership in trade unions.

This situation provides an opportunity for effective reform and technical assistance. Establishing capacities within associations to deliver services needed by SMEs would encourage enterprises to join associations and further promote business development. See annex 1 for details.

Taxes and Fees

Domestic and international firms regularly cite the tax environment in Ukraine as an obstacle to investment (Senchuk and Yacoub 2000; EIU 2000; Grey and Whinston 1999). Chapters VI and VII discuss details of various aspects of the tax environment and its role in the development of SMEs. Only 21 percent of survey participants answered the question regarding the number of taxes and fees their companies pay, so this does not provide a good basis for analysis. According to official sources, most SMEs in Kharkiv pay up to nine taxes and fees. The government has introduced various tax options to provide relief to small businesses. The integrated tax system was established by a presidential decree of June 28, 1999, and so was effective for more than a year at the time of our survey. Fewer than half of surveyed firms, however, participated in the integrated tax system: 20.87 percent of respondents pay 10 percent of total revenue including VAT; 8 percent pay 6 percent of total revenue including VAT; and 17 percent pay the single tax for individual entrepreneurs or agricultural enterprises.

When asked to estimate tax payments, more than 24 percent of respondents reported that they pay 1 to 10 percent of total revenue, while about 11 percent reported that they pay more than 60 percent of total revenue. Almost 40 percent of respondents paid more than 30 percent of total revenue in taxes and fees, as the pie chart that follows shows. Given this high tax burden, which in reality is even higher because formal payments are supplemented by extortion by government officials (16 percent of profit on average), it is understandable that SMEs prefer not to use true figures in taxation reports and to use “gray business” schemes. In particular, when asked about what portion of required taxes and fees an imaginary SME really pays, the respondent estimated that on average SMEs pay approximately 40 percent of what they are legally required to pay.

An affordable level of total taxes and fees, as viewed by survey participants, is presented in the pie chart below. This chart may perhaps provide some guidance for further efforts to improve the business climate in the Kharkiv Oblast through reducing a fiscal burden of SMEs.

More than 60 percent of surveyed firms report that their overall tax situation did not improve from 1999 to 2000. Only 13 percent of surveyed firms perceived an improvement. Firms identified the value added, payroll, and profit taxes as the most burdensome. As the pie chart illustrates, there was a wide range of responses to the question of the percentage of total revenue actually paid in taxes and fees. The tax administration and inspection system is further discussed in Chapter VI.

Chart 1

Actual Tax and Fee Rate

What percentage of turnover do your company's tax and fee payments represent?

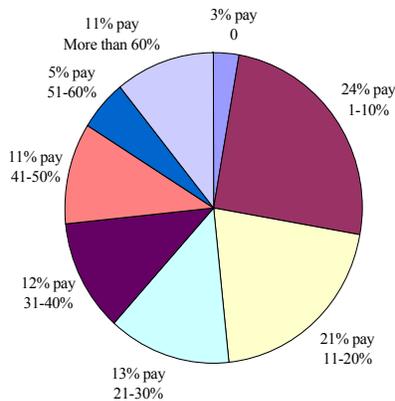
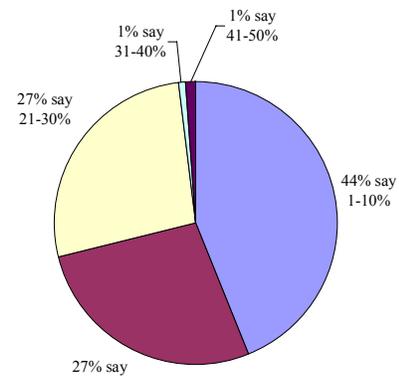


Chart 2

Rational Tax and Fee Rate

What would you consider a rational tax and fee rate for SMEs?



CHAPTER VI OBSTACLES TO SME DEVELOPMENT IN KHARKIV OBLAST

There are at least two perspectives on the problems SMEs in Ukraine face. The first perspective is that of SME managers and owners, as revealed in various studies, such as the MSI, IFC, and UI surveys. The second perspective is that of the government and is reflected in programs to support SMEs. The differences between these two perspectives are quite significant, and the repercussions of those differences are even more so.

Table 10 presents the most significant problems for SMEs in Kharkiv Oblast in 2000 according to their owners and managers. In general, the table indicates that the most pressing problems were not of an economic nature, but were related to the regulatory and administrative environment in which these SMEs have to operate.

Problem	Percentage of Firms
Existing tax system	29
Frequently changing legislation	19
Lack of working capital	15
Administrative controls by public agencies	10
Low market demand for company's goods/services	9
Obtaining credit (availability/interest rates)	7
Pressure from corrupted officials and criminal structures	4
Shortages of raw materials/inputs	2
<i>Source: Kharkiv Survey 2001</i>	
NOTE: The table includes all responses that were indicated by more than 1 percent of the surveyed firms. For exact question and response choices, see annex 2; for exact responses, see annex 3.	

Existing tax system

SMEs identified the existing tax system as the single most significant problem facing their companies in 2000. In general, the Ukrainian taxation system leaves much to be desired. In addition to a burdensome level of taxes, the taxation system is complicated and composite. According to official sources, average SMEs should pay up to nine taxes and fees. A new system of taxation gives some advantages to small enterprises and entrepreneurs; however, not even one-third of surveyed SMEs use this integrated tax system. SMEs identified the value added, payroll, and profit taxes as the most damaging. Two-thirds of respondents indicated that the overall tax situation had not improved from 1999 to 2000.

Fishtail legislation

Frequently changing, or fishtail, legislation is the second most significant problem facing SMEs in Kharkiv. SMEs have been expected to adapt to no less than five major legislative shifts (new laws) since June 1999. SMEs do not have large accounting and legal departments on which they can rely for updates to accounting and taxing standards. Moreover, no associations or other institutions provide such information or assistance to SMEs. Frequent changes in the rules and

laws governing taxation create an environment of confusion in which corrupt tax inspectors can thrive.

Lack of working capital

After the legal and regulatory environment, the most significant obstacle for the surveyed firms is lack of working capital. In some ways, this is a function of the broader economic environment that lacks flexibility because people generally lack confidence (e.g., suppliers do not extend credit, clients refuse to pay up front).

Administrative controls by public agencies

Nearly 10 percent of surveyed firms indicated that administrative controls by public agencies were the most important problem they faced in 2000. Another 10 percent indicated it was their second most significant problem. Among all types of administrative control (see Table 11), SMEs identified inspections as the most destructive. On average, surveyed firms were inspected more than nine times in 2000, resulting in fines and other postinspection expenses amounting to approximately 7 percent of annual turnover. Inspections also required an average of 26 person-days of staff time, which cost roughly another 0.5 to 1.0 percent of annual total revenue.

More than half of surveyed firms report that they frequently or sometimes are asked for payments in addition to those legally established for permits, licensing, inspections, and so on. Another 10 percent report that they always are asked for additional payments. On average, these payments amount to 16 percent of each firm's profit.

Type of Control	Percentage of Respondents
Inspections	52
Sanctions	20
Permits	18
Unanswered/blank	7
Registration	4
Licenses	4
Other	2
<i>Source: UI Survey of Kharkiv SME, 2001</i>	

The Tax Administration conducts the most inspections (see Table 12). Tax inspections are closely linked to other obstacles to SME development, considering that the existing tax system and frequently changing legislation (much of it on taxation issues) are the most important problems for SMEs. In addition, SMEs identified the tax authorities as the public agencies with which it is most important to maintain informal relations in a corrupt environment. The Tax Administration and its regulatory cohorts—namely the Tax Militia, the State Control and Revision Service, and the State Treasury—cumulatively account for more than half of all inspections of SMEs (an average of 4.5 inspections per enterprise per year, out of 8.87 total).

After the Tax Administration, the Fire Brigade and the Sanitary and Epidemiological Service are the next most frequent inspectors. These two regulators also issue more permits to SMEs than any

other regulators. There appears to be a simple circuit within the administrative system: Giving more permissions provides a fruitful ground for more inspections.

Nevertheless, approximately 30 percent of surveyed firms reported that the situation with inspections improved from 1999 to 2000. Recent efforts to curtail inspections and other administrative controls are discussed in the conclusion to this chapter and in Chapter VII.

Inspecting Agency	Average Number of Inspections
Tax Administration	3.43
Fire Department	1.35
Sanitary/Epidemic Station	0.84
Police Department	0.67
Tax Militia	0.62
State Control and Revision Service	0.43
Consumer Protection Committee	0.33
Other	0.29
Ministry of Environment	0.24
Committee on Standardization	0.19
Trade Department	0.16
Department for fight against organized criminals	0.12
Department of Architecture	0.06
Security Service	0.04
Customs	0.05
Anti-monopoly Committee	0.02
State Treasury	0.02
<i>Average Inspections per Enterprise per Year</i>	<i>8.87</i>
<i>Source: Kharkiv Survey 2001</i>	

Low market demand for company's goods/services

SMEs in every market experience fluctuations in demand for their goods and services. The best method for responding to changes in demand is to continuously monitor demand using various types of market research. It is clear that there is a lack of information on regional economic activity, at both the sector and firm levels. Customer and citizen surveys are rare.

Obtaining credit

As already mentioned, the lending environment in Kharkiv suffers from high credit costs, lack of collateral and lack of a legislative basis for microcrediting. Although a special regime of investment in priority sectors of the Oblast economy began in January 2000, Kharkiv Oblast favors large investment projects in which SMEs are unlikely to participate (see the **Law on Special Investment Conditions in the Territory of Kharkiv**, No. 1714-III from May 11, 2000).

Pressure from corrupted officials and criminal structures

The survey indicates rampant corruption throughout the current administrative system, which provides plenty of opportunities for extortion, given frequently changing rules, excessive permit requirements, excessive regulatory inspection powers, low government inspector salaries, and so on. More than half of surveyed firms reported that they frequently or sometimes are asked for payments in addition to those legally established for permits, licensing, inspections, and so on. Another 10 percent reported that they always are asked for additional payments. As already discussed, inspections are, by far, the most destructive form of administrative control of SMEs, and the tax authorities were identified as those with whom it is most important to maintain informal relations within a corrupt environment.

Shortages of raw materials/inputs

Large state enterprises have not fully restructured and continue to clog supply chains throughout Ukraine. In many ways, SMEs are subject to the decisions of government and large private firms in areas of raw material supply. The continued development of supply chains of commercially driven enterprises, however, will help to alleviate this dependence.

Land and Property Markets

Although not identified as a major obstacle by any of the relevant surveys, the undeveloped local land and property markets are a very significant, if indirect, impediment to the growth of enterprises of all sizes in Kharkiv Oblast. The local government operates a near monopoly in the land market. It owns the land used by 70 percent of the firms surveyed. It also is the biggest single owner of buildings and premises used by surveyed enterprises—30 percent of SMEs rent space from local governments. This dominating position of local governments in the land and property rental markets results in multiple distortions to development of fair competition in most sectors of the economy. Selling local government land and buildings and premises to private buyers through competitive procedures would result in significant improvements in the quality and rents of commercial space throughout the Oblast.

Also, it should be noted that governmental control over land and real estate creates a fruitful ground for corruption, as demonstrated by the experiences of many countries. When government controls a substantial part of this important resource, corrupt officials harvest a part of market value of property in exchange for granting the right to use this valuable resource or for allocating it below a true market price.

MSI's summary of this situation, with which this assessment wholly agrees, is worth restating here:

Local authorities also have an inherent conflict of interest in that the local authority sets the rules that affect private landlords. If the authority refuses to let private landlords expand or improve their space, then the local authority will receive higher rents for its space, even if the space is substandard. Municipal and rayon authorities may do the better by selling off commercial space, and allowing landlords and tenants [to] compete to determine the quality and quantity of usable space. The local authorities can maintain control over zoning and can increase property taxes since the value of the rental space will be increased. Questions about use of land and buildings for commercial purposes can be dealt with through public hearings that reflect public interest in the use of the space. (Grey and Whinston 1999, 114)

Conclusions about Obstacles to SME Development in Kharkiv

It is clear from the overlapping evidence and multiple indicators that the system of tax administration in Ukraine seriously impedes or prevents the development of SMEs in Kharkiv Oblast. As detailed in previous sections, the tax system is a significant factor in three of the four most significant problems for SMEs in Kharkiv Oblast: the existing tax system, fishtail legislation, and administrative controls. In a recent effort to stimulate foreign investment, the Ukrainian Tax Administration agreed to limit tax inspections to only those international firms suspected of violations. A similarly stimulated increase in domestic investment would not only improve the local economic situation, but also contribute to improved national accounts.

The fiscal and administrative costs of running an SME in Kharkiv Oblast are unnecessarily high. In addition to formal fiscal charges—taxes and fees, which can be high in themselves—the costs may be loaded by two other components that are unpredictable and often have devastating impacts:

- Formal charges, that is, fines (estimated costs are 7–8% of total revenue), that are often left to discretion of inspectors.
- Informal charges imposed by corrupted officials (estimated costs are about 6 percent of profit) and organized crime (estimated costs are about 2% of total revenue).

This assessment's survey and focus group both confirmed that, to a large extent, SMEs connect the existence of the gray sector with an unfavorable business climate. In this climate, businesses fail to report all of their sales and income and must pay illegal tribute to various governmental officials and organized crime racketeers. Given the important role of SMEs in the Oblast economy, the large size of the “gray sector,” and the fact that the very existence of the “gray sector” is caused to large extent by the existing regulatory and administrative climate, this assessment strongly recommends the government concentrate its efforts on facilitating formalization of existing business activities, rather than on the formation of new businesses or the attraction of businesses from regions or countries abroad. These efforts should include a reduction in the regulatory burden faced by SMEs.

Unfortunately, the overall regulatory and administrative climate has not demonstrated overall improvement during 1999 and 2000. Columns 1 and 2 of Table 13 display SME problems as identified by the UI survey in Kharkiv Oblast in early 2001 and by the MSI survey conducted throughout Ukraine in early 1999. The obstacles in these first two columns are ranked according to level of significance to SMEs. Several important conclusions can be drawn from analysis of Table 13. First, despite the fact that two years passed between the MSI and UI surveys, the existing tax system remained the most significant obstacle in the opinion of SMEs. Also, legislative conditions (or, more specifically, fishtail legislation) and administrative controls by governmental agencies also have remained on the list, even increasing in significance from fourth and sixth in 1999 to second and fourth in Kharkiv Oblast in 2001. This supports views by international business monitors, who recently reported that “the traditional list of complaints of foreign investors remains generally unchanged: redundant economic regulation; unclear and unpredictable legislation; macroeconomic uncertainty; widespread corruption; and a heavy tax burden” (EIU 2000, 31).

There is evidence that the situation with some obstacles has improved. For example, the significance of inflation and low market demand for products has decreased. Lack of working capital still is a significant problem, but it also shows some signs of easing.

Table 13 Most Significant Obstacles to SME Development, According to Various Sources

MSI Survey in Ukraine, 1999	UI Survey in Kharkiv Oblast, 2001	Kharkiv Intergral SME Support Program 1999-2000	Kharkiv Regional Small Enterprise Development Program 2001 - 2002	National Program for Supporting Development of Small Enterprises in Ukraine December 2000
Ranked in Order of Significance as Identified by SMEs	Ranked in Order of Significance as Identified by SMEs	Unranked	Unranked	Unranked
1	2	3	4	5
1. Existing tax system	1. Existing tax system	Insufficiency and imperfection of normative legal basis for small enterprise development (e.g., frequent change, considerable number of taxes, complicated accounting, etc.)	Imperfection of legislative basis, its regulatory burden	Absence of accurate, stated public policy in the sphere of small business development through system of elements of law
2. Lack of working capital	2. Frequently changing legislation	Shortage of circulating capital and complexity of access to financial and credit resources	Insufficient attention to and cooperation between regional and local government agencies and entrepreneurs associations in solving problems of small businesses and protecting their interests, including provision of economic and legislative security and removal of administrative obstacles	Increase in administrative barriers (registration, licensing, certification, control systems and permit process, regulation of rent, etc.)
3. Low market demand for company's products	3. Lack of working capital	Insufficient maintenance, including production facilities, equipment, materials, etc.	Low business culture and low professional skills of entrepreneurs	Absence of real and active mechanisms of financial and credit support
4. Legislative conditions	4. Administrative controls by public agencies	Insufficient level of information supply of small enterprise development	Underdevelopment of personnel training infrastructure, an insufficient number of entities providing informational and other help to small businesses (business-centers, business incubators, etc.)	Tax overpressure and burdensome report system
5. Inflation	5. Low market demand for company's goods/services	Lack of proficiency of entrepreneurs	Difficulties in finding financial resources, lack of working capital	Uncertainty regarding the business climate
6. Administrative controls by public agencies	6. Obtaining credit (availability/interest rates)	Insufficient security of entrepreneurs, difficulty with providing them with economic and legal security, administrative barriers, and obstacles	Insufficient attention to small enterprises participation in state and regional orders, creation of mechanism of their access to technical and material resources, including store and industrial rooms, machinery leasing networks, leasing companies	Excessive interference by public authorities in enterprise management
	7. Pressure from corrupted officials and criminal structures	Low cultural level in industrial sector, negative public attitude	Essential insufficiency of the mechanism of organizational and financial support of attractive	

			investment and innovation projects	
	8. Shortages of raw materials/inputs		Underdevelopment of service framework of small business	Substantial lag in business development in many districts of the Oblast that blocks the fundamental agricultural reform
	9. Complexity of bookkeeping and reporting; inadequate equipment; inflation; absence of a premise; lack of demand for goods and services produced; lack of business experience and knowledge		Underutilization of brainpower in experience of enterprise	
			Insufficient consideration and cooperation of regional and local authorities, unions of entrepreneurs, business structures in solving problems of enterprise and social and economic development of the region	

CHAPTER VII* **REVIEW AND ANALYSIS OF EXISTING INITIATIVES AND INTERNATIONAL EXPERIENCE**

Central Government Initiatives

Central government support for SMEs has focused on small enterprises and entrepreneurs, as culminated in the **Law on the National Program in Support of Small Business Development in Ukraine**, No. 2157-III, enacted in December 2000. Section I of the law refers to small enterprises, entrepreneurs, and farms as small business, at which the program of support is directed. This assessment discovered no central government initiatives directed specifically at supporting medium enterprises.

The introductory section of the law associates small business with an efficient market economy and integration of the Ukrainian economy with the rest of Europe. The law recognizes the following obstacles to small business development (see Table 13):

- Lack of clear policy and law on small business development
- Excessive administrative barriers
- Lack of financial and credit support
- Excessive tax and reporting regime
- General instability and uncertainty
- Excessive interference by public officials in enterprise management

In general, these are the obstacles that small business owners identify as most significant, so the views of business and the central government regarding obstacles to small business development appear to be getting closer, at least on the conceptual level. The new national program recognizes the negative impact of administrative controls such as inspections and excessive taxes on small business development. More important, the law outlines specific measures to reduce the most significant problems that small businesses currently face. The law calls for improvement of the legal and normative base to regulate the activities of public agencies and their officials in the small business sphere (Article III-1-4) and states that introduction of a "purposeful, consistent and predictable common public regulatory policy in the sphere of entrepreneurship is one of the main tasks of the program" (Article III-2-1).

The law's plan for implementation of a new public regulator policy includes the following:

- public participation and interagency coordination in planning and preparing improvements in regulatory activity;
- evaluation of the effects and social results of regulatory activities;
- legislative improvements to decrease excessive state interference in entrepreneurship;
- coverage of regulatory problems in mass media and participation of the Entrepreneurs Union and citizens in discussing and solving the problems;
- analysis and publication of the results of these efforts; and
- simplification of permit and registration processes.

This is the first time an issue such as limiting regulatory control of small business has been included in a law of Ukraine. Successful implementation of these measures could greatly enhance

* NOTE: The Urban Institute is entirely responsible for Chapter VII: *Review and Analysis of Existing Initiatives* and related parts of the Executive Summary and policy suggestions. Ukrainian researchers did not participate in the review of local programs.

the environment for small business development, although it is too early to evaluate the practical results of the national program.

While the new law indicates major improvement in the central government's view of small business, it also indicates that the central government still has not recognized the extent of the significance of small business. For example, the **Law on the National Program to Support Small Business Development** begins by declaring that small business is responsible for 9 percent of total national employment, but in 1999, the internationally funded MSI survey that involved foreign and national experts estimated that SMEs together employed more than 50 percent of the workforce of Ukraine. The MSI survey estimated that firms with 50 or fewer employees, at which the national program is directed, employ 34 percent of the workforce, a great deal more than the 9 percent assumed by the national program

Kharkiv Government Initiatives

Kharkiv Oblast efforts in the area of SME support also have focused on small enterprises, entrepreneurs, and farms. The two most recent efforts are the *Regional Integrated Program in Assistance of Small Enterprise Development in Kharkiv Oblast for the Years of 1999-2000* and *Regional Program of Small Entrepreneurship Development in Kharkiv Oblast for the Years of 2001-2002*. The development of both programs was led by governmental and semigovernmental agencies. In implementing these programs, the government plays a key role, although the implementation and especially finance plans demonstrate increasing reliance on participating enterprises and external (non-governmental) coordinators, executors, and founders. In particular, this is typical for the new components, introduced from 2001. The limited role of government funding and coordination in these components is a positive trend that should be continued where appropriate with all new components.

The planned budget of these programs grew almost 20 times—from approximately 1 million UAH annually for the 1999-2000 program to close to 20 million UAH annually for the 2001-2002 program (see Table 14). The new program fortunately includes plans for quarterly management reports on the progress of implementation. The program document indicates that these reports are for the Ministry of Economy, but it is hoped they also will be used to explain changes in subprogram funding and operational arrangements.

Three major sources of financing are planned for the current program: (1) Regional Enterprise Support Fund, funded from the regional budget; (2) voluntary contributions of enterprises; and (3) other sources that combine various nongovernmental funds (foundations, international donors, etc.) with specialized funds of the central government (for example, from the Social Protection Fund). As Table 14 indicates, the regional program for 2001-2002 expects to obtain only 10 percent of its budget from the regional government. It should be noticed also that the budget included in the formally approved programs and shown below is, to a very large extent, a “potential” budget without certain commitments from intended sponsors. For example, at least 85 percent of funds included in “Other Sources” for 2001 still are at the stage of discussions with potential sponsors.

Year	Regional Enterprise Support Fund	Entrepreneurs' Funds	Other Sources	Total
1999	491	418	125	1,034
2000	381	375	177	934
2001	2,022	3,935	13,982	19,979
2002	1,990	4,735	14,851	21,577
<i>Source: KRESF 1999 and 2000</i>				

Annex 1 presents a summary of the regional programs and also includes some recommendations about specific subprograms. These programs generate several conceptual and functional concerns. First, there is a remarkable mismatch between the obstacles identified by SMEs and those identified by the regional program. Columns 3 and 4 of Table 13 list obstacles to small business development, as identified by the Kharkiv regional programs. For example, the existing tax system, which has been steadily ranked by SMEs throughout Ukraine as their most significant problem, has been only partly mentioned among other issues in the first program and is not mentioned in the second program at all. On the other hand, the programs promote many activities whose demand by small business is not documented and in which governmental efficiency in delivering sound results is questionable, at least based on the experience of other countries. Some examples are discussed in the next section.

This mismatch is especially troubling when the programs offer to governmental agencies the role of direct “providers” of various services and goods (such as brokerage services for obtaining production space or equipment, provision of loans, information, or market studies), while the worldwide evolution of governance over the past 20 years was in the opposite direction: withdrawal from this role and taking instead the role of an “enabler.” This new role of an enabler implies that the government focuses on creation of the favorable regulatory climate and institutional infrastructure for the private sector. This enables multiple private economic actors to function and compete for clients. As a result, services needed by various clients, including small business, are delivered by private for-profit and nonprofit providers faster, better, and cheaper. Some specific issues related to this delineation of functions between the government and the private sector within the programs in question are discussed later in this chapter.

The next concern about the potential effectiveness of the regional programs is related to an unclear level of control that the local governments (oblast, city, rayon) have regarding the regulatory and administrative environment in their territories. In other words, if the regional government (or other local government in Kharkiv Oblast) would have a political will to improve the business climate for small business, would they have enough legal and administrative power? In short, it is not clear what output regarding improvements to the business climate in Kharkiv Oblast can be expected from the regional programs: real changes made at the regional (or lower) level or just recommendations to the central government.

The design of these programs deserves some attention. First, various parties are included among the executors of each subprogram, but the document does not indicate that all of these parties have been consulted and have participated in planning the program. Second, evaluating

achievements to date, the current program credits the previous program for an increase in small enterprises, but presents neither evidence nor indicators to support the accreditation.

Finally, the programs make reference to the formal estimates of the number of small businesses (see Table 15) without any acknowledgment that these data are low estimates. Similar to the new national program, the regional programs do not even mention the need to reduce the informal economic activity.

Table 15 Performance Indicators Used in Kharkiv Regional Small Enterprise Support Programs, 1998 and 2000		
Indicator	as of 01/01/98	as of 01/01/00
Number of small enterprises	10,139	13,328
Number of individual entrepreneurs	45,800	58,400
Small enterprises per 1,000 people	3.7	4.5
Percentage of total employment	9.9	14.7
Percentage of public budget funded by small enterprises	5.4	13.0
<i>Source: Authors' compilation from Oblast program descriptions</i>		

Lessons from Relevant International Experience

Area of Information and Research

The progress in this area needs some initiatives from inside all sectors involved: the government, the private sector, and professional and trade organizations. Also, more clear delineation of areas of information activities among participants is required.

The government may and should make public and easily available all statistics based on information that it gets in its domain because of its unique governmental functions. This includes, first of all, improving governmental statistics related to SMEs. For example, as we demonstrated in Chapter IV, in 1998–1999, the Statistics Department had its own definition of small enterprises, in discord with law, and did not separately report on medium enterprises. Clearly, such glimpses are misleading for all parties involved. Thus, improving the quality and availability of state data associated with SMEs should be a priority for public agencies. Economic analysis, for which governmental agencies are well positioned, usually is related to macroeconomics or demographics, but not to a detailed market analysis for specific industries or products.

It would be an illusion to hope that governmental agencies should and can lead efforts to provide market information, which might be needed for SMEs to operate. First of all, it is proven that enterprises, including SMEs, tend to consider most information related to their operations confidential and do not necessarily disclose true information in response to a government request. Burdening them with such requests, beyond what is required by law, would increase the costs of running businesses but would not produce reliable results. In countries in transition, one of the most common examples of failed attempts of governments to provide market information is related to real estate—when the government or semigovernment agencies try to collect data on market prices. This information is available only at private companies or—when the market reaches a certain maturity—at professional associations.

World experience shows that local and regional market information and market studies on these geographic scales are usually produced either by the private companies (for themselves, as it is typical for big corporations, or for sale to other companies) or by associations and other organizations sponsored by their members.

For the Kharkiv region, the implications of this experience are that initiatives for producing information and market studies would be fruitful when the private sector and associated nongovernmental organizations (NGOs)—such as a trade association—would take the lead to decide what they need and how they are ready to sponsor these initiatives. Governmental—taxpayers-based—support to these initiatives should be limited and in any event may be provided only after the demand is well formulated and expressed by the private sector and its organizations.

Given the transitional nature of the current situation and the highly dynamic and fluid character of SMEs, it might be useful to have some NGOs involved in systematic gathering of information, monitoring and analyzing sector trends, and supplying this information to both governmental agencies and the private sector. One specific experience from St. Petersburg, Russia, might be transferable to Kharkiv: Specialized journalists have played an outstanding role in developing the quality standards for market studies and educating the local government on how to recognize the private sector as an equal partner and be accountable for decisions made.

Box 1. Regional and Local Market Information: Examples of Products, Providers, and Sponsors

Quarterly Report “Major Real Estate Markets in Virginia”; conducted and published by Virginia Real Estate Research Center (at part of Virginia Commonwealth University, USA); sponsored by Virginia Realtors Foundation (an educational and research arm of a professional association of real estate brokers and agent of the State of Virginia)

Market studies regarding specific agriculture products from California; conducted by specialized consultants for California Associations of various specialized agricultural producers (Association of Pear Producers, Association of Dairies, etc.); the studies help producers to position their type of product within regional and bigger markets.

Annual Kosmont Cost of Doing Business Survey; provides information about how much it costs to run businesses in various localities, in terms of property tax, other local taxes and fees (including costs of such utilities as telephone, cellular telephone, electricity, water, and gas), fees associated with land development, and economic incentives provided by local governments to businesses operating in their jurisdictions; covers 250 cities in California and other Western parts of the USA; produced by Kosmont company as a commercial and marketing product.

Periodic reviews and analysis of specific subsectors of the real estate market in St. Petersburg, Russia; (for example, new housing, hotels, industrial/storage, etc.); conducted by specialized journalists and published in weekly "Real Estate and Construction in St. Petersburg"; the weekly newspaper is financed by publishing advertising and direct sales.

Area of Lending to SMEs

Currently, lending to SMEs is in an embryonic stage in Kharkiv Oblast and there is no available data about this sector. There is indirect evidence that bank loans are mostly not available or not affordable to small enterprises.

The current regional program allocates about 2.2 million UAH for direct loans and subsidies to small business, with administration of the whole process (including underwriting and servicing loans) by the Kharkiv Regional Entrepreneurship Support Fund (KRESF), while allocating only 73,000 UAH for developing institutional infrastructure and instruments that would support lending to small enterprises from nongovernmental funds.

International experience in various countries, both developed and transitional, has demonstrated that governments and governmental agencies are usually less efficient lenders than specialized institutions are. Therefore, it would be useful for Kharkiv Oblast to consider direct loans and subsidies issued from public budgets and administrated by a nonspecialized agency as a short-term solution only, and reallocate efforts and more financing on developing more efficient and less costly instruments and programs based on public-private cooperation. The program executors might focus efforts on two main directions. First, it could focus on capacity building at the financial sector, which may include the production of a handbook and training for local banks and credit unions on all components of lending to SMEs (assessing the creditworthiness, underwriting, servicing). Second, it might focus on proactive development and testing of specific lending instruments and mechanisms that would combine the private- and public-sector financial resources and assist existing credit associations and other financial institutions to increase the volume of lending to SMEs.

Area of Real Estate and Related Services

The current program makes the impression that various governmental departments and public agencies intend to get actively involved in improving availability of publicly owned and underused real estate to small business, improving leasing procedures, and otherwise serving as participants or facilitators of the real estate market. The experience of practically all countries in transition over the past 10 years, however, has provided much evidence that local governments and governmental agencies are not efficient property owners and managers. In particular, on the one hand, it has been documented quite well in many countries that municipal lease agreements are always worse than ones used by the private sector in the same country/city, municipal rental prices always deviate from market prices, publicly financed construction projects are always more expensive and less sensitive to location demands of end-users of real estate, and so on. On the other hand, it is known that the private sector can be very efficient in providing infrastructure, including business incubators, to SMEs if and when basic inputs, such as land plots, are available.

Strategic lessons that the Kharkiv Program can take from this experience, and that are directly related to the real estate needs of SMEs, include immediate and long-term corrective action. For the most immediate improvements, such as leasing procedures, provision of underused space to SMEs, and others, there are three main directions:

1. Rely on cooperation with the private real estate industry in Kharkiv, namely, real estate brokers and appraisers, and use their experience and creativity for solving problems associated with inefficiency of use of real estate owned or controlled by government and other public-sector actors.
2. Ease existing regulations that prohibit holders of excessive real estate from immediate release of this space for sale or rent. This liberalization should cover

all holders of excess property regardless of ownership, in particular, state enterprises and such public institutions as educational and research institutions, hospitals, and so on.

3. Simplify and minimize procedures for changing property use, such as conversion of apartments into nonresidential premises.

In the longer term, aggressive privatization of municipal nonresidential property, land privatization, and simplification of land and real estate development procedures is one way to solve the problem of space availability for SMEs. Again, the experience of St. Petersburg in Russia may provide useful insights for Kharkiv.

Business ethics and relations with clients

International experience—again, in both developed and transitional countries—shows that business ethics cannot be planted from outside and should develop from inside the industry. Codes of ethics, along with standards of practice, are common tools of self-regulation within many specialized professional societies throughout the world. They are efficient, however, only when some “critical mass” of economic actors in a particular professional area voluntarily accepts these rules and then maintains and disseminates them through professional organizations. “Growing up” to the stage of acceptance of these tools in emerging markets takes some time; however, *competition* among businesses for gaining confidence of clients proved to be a very powerful and fast-teaching factor that pushed businesses to organize themselves and think about good reputation and credentials. Any attempt to make these tools mandatory for businessmen, in particularly through governmental channels, would have a negative impact on the business climate.

The role of the program in this area can be only educational, and in no case should making a Code of Ethics or any other similar instrument be mandatory by law.

Governmental Contradictions

While several laws and decrees include supportive and encouraging words for businesses and their development, other government actions directly impede them. For example, at approximately the same time the central government prepared the National Program of State Support for Small Business, the cabinet adopted resolution no. 1755 of November 29, 2000, which established a uniform license fee of UAH 5,100 for wholesale and retail trade in liquor, regardless of the quantity sold. Licenses for wholesale and retail trade in tobacco cost UAH 5,100 and UAH 2,550, respectively, again regardless of quantity sold. Enterprises that pay for the initial license pay only UAH 17 for additional retail outlets, a huge benefit for large operations. Similarly, the **Law on Making Amendments to the Law on Using Electronic Cash Registers and Accounting Books in the Spheres of Trade, Public Catering and Services** requires businesses, regardless of size, to acquire cash registers and other expensive symbols of financial responsibility. As final examples, the new **Law on National Program in Support of Small Business Development** prioritizes reducing the regulatory burden on SMEs, and the **Law on the State Budget** proposes funding for the Tax Administration based on the amount of taxes and duties it collects (encouraging rampant inspections and fines).

Recent government initiatives are encouraging, but they need to be holistically supported by the government through tax and budget policies, instead of fading into rhetorical insignificance.

CHAPTER VIII

SUGGESTED DIRECTIONS OF EFFORTS TO SUPPORT SMALL ENTERPRISE DEVELOPMENT

Recent legal provisions at the national level improved a general background for small enterprise development and, in particular, named all major problems that SMEs face. The regional programs also contain many useful initiatives. It appears that further progress of SME development in Kharkiv Oblast will substantially depend on how relevant the regional efforts will be to the needs of the SME sector. Based on the results of this assessment and on international experience, it seems that regional efforts would benefit from three conceptual adjustments, followed by respective adjustments of policies and actions:

1. Regional programs should be further adjusted to respond more directly to needs of SMEs as these needs are viewed from inside the SME sector. In other words, the current mismatch between what the private sector identifies as problems and what the regional programs offer as solutions should be systematically reduced.
2. All levels of government (national, oblast, city, rayon) should transform their roles from “providers” to “enablers.” This would imply focusing efforts, first and foremost, on improving the regulatory and administrative environment for small enterprise operations and removing administrative barriers. Second, local governments may facilitate development of business infrastructure for SME operations, but they should distance themselves from the role of providing this infrastructure to SMEs.
3. The reform agenda should include, and give a high priority to, the idea that legalization and formalization of jobs and activities that already do exist in the “gray sector” is at least not less important than creation of new jobs.

This conceptual refocusing of governmental vision, if accepted, will take time to materialize in specific changes of approaches and programs, so many current activities suggested in the regional program may be useful to continue as transitional ones. It is also important to note that some steps that should be taken for implementing the suggested conceptual shifts cannot be accomplished without additional legislative decisions on the national level and further delineation of the roles between the central and local government, which is discussed below.

The rest of this chapter suggests and discusses some specific issues or aspects that appear important for implementing the suggested readjustment of existing initiatives and that *have not been sufficiently addressed in existing initiatives*. Most suggested policies, programs, and actions that are needed to implement these conceptual shifts are interrelated with one another and, when and if enacted, would produce multiple benefits. Each recommendation presents opportunities for contributions by USAID and international organizations. Recommendations are first discussed and then summarized in a policy matrix.

1. Reduce fiscal burden on SMEs

Taxes routinely are identified as obstacles to SME development in Ukraine. Considering the extent to which SMEs informally operate, a reduction in taxes on SMEs is likely to increase SME investment, a formal part of SME activity (including registration of new SMEs), tax revenues, and economic growth and opportunity in general.

This instrument—tax reduction—should be available to local (at least oblast) governments. Currently, however, the system of taxation is still highly centralized in Ukraine, and local governments may set up rates only for a single tax paid by individual entrepreneurs but not by legal entities. The following are recommended to address this issue:

- ***Introduce elements of fiscal decentralization that would allow local governments effectively to reduce tax burden for small enterprises in their jurisdictions.*** For example, the oblast level might be granted the right to reduce rates below 6 and 10 percent, which are set up by the central government for SMEs' legal entities participating in simplified taxation.
- ***Use already available fiscal latitude at local governments to reduce the fiscal pressure on SMEs.*** For example, local governments may reduce a single tax on individual entrepreneurs or reduce the costs of registration and permits.
- ***Reduce administrative charges imposed on SMEs.*** The national and local government should reconsider the extensive regime of registration, licensing, and permitting and streamline its operations and reduce costs to SMEs where feasible and practical. Specific first measures may include (1) revision of permit requirements at fire and sanitary departments, and (2) making the fees for licenses to provide certain goods and services dependant on the volume of goods and services to be provided. This is not the current situation for licenses to sell alcohol and tobacco, for example.

2. Restructure governmental regulation

While both current programs of SME support—national and regional—acknowledge the problem of overcontrolling SMEs and suggest some activities for improving the situation along this line, a more integrated approach should include several directions:

- ***Limit in number and scope governmental inspections of businesses throughout Ukraine.*** Inspections are particularly burdensome for SMEs because they suffer higher per capita costs (financial and otherwise) than large enterprises. The national and local governments should limit inspecting agencies to inspections related to their respective bailiwicks. For example, the tax police now are authorized to ensure that products have not passed their shelf lives. This role clearly is more appropriate for a food and drug agency, but even more appropriate for NGOs and industry itself.
- ***Codify the permit process.*** Currently, local practice establishes permit requirements, forcing SMEs to check with a number of local authorities before beginning operations. Because the requirements are not spelled out in a widely applicable, formal manner, they provide government officials with leverage to extort funds and favors from SMEs. Central and local governments should reform the system of permits in a manner similar to that of the reform of licensing and with measures to swiftly implement reforms at the local level.
- ***Reduce government employment.*** It is clear that the government employs too many regulators and inspectors, resulting in overregulation of SMEs and providing leverage for extortion. The high level of employment also limits the resources available to pay government employees, further facilitating (even encouraging) corruption.

- ***Make intolerance to corruption an explicit part of governmental support of SME development.*** As the UI survey revealed, much of SME-related corruption in Kharkiv Oblast is related to local governments (oblast, city, rayon). At the same time, this assessment did not clarify to which level of government report all inspecting agencies identified by respondents of the survey—Tax Administration, Fire Department, Sanitary/Epidemic Station, Police Department, and so on—whose permitting, licensing, and inspecting activities also contribute into existence of corruption.⁶ Anticorruption activity would be a big challenge because, as international experience has demonstrated, cleaning government from the inside is always difficult.
- ***Reconcile law and regulation.*** The central and local governments should carefully review their tax laws and procedures and annual budgets to ensure they complement special programs and initiatives such as the National Program of State Support for Small Business. The preparation of such a program is a complete waste of resources if its implementation is to be prevented by the national budget and tax system.

3. Integrate informal SME activities in the formal sector

Implementing this strategy would require a whole set of well-targeted policies and actions that should be specially designed, a project that goes far beyond the scope of this assessment. Here, we outline only some directions. Thus, the survey results indicate that overall improvement and stabilization of the fiscal and administrative environment in which SMEs operate (and, in particular, reduction of a fiscal burden) will motivate some entrepreneurs and businesses to legalize their activity or reduce the informal part of operations. This alone, however, may be not sufficient and should be reinforced by other actions:

- ***Provide incentives (and market existing incentives) for legalization to “gray economy” participants.*** This area should be further elaborated. Clearly, one of several possible lines of incentives should be related to social benefits, which formally working people obtain (such as length-of-service records for pensions).
- ***Study and use international experience of successful reduction of the informal sector in transitional or other industrialized countries.*** There are success stories around the world, but the ones most well documented are associated with fast-growing areas in developing countries, for example, Toledo, Brazil; Inner Kingston, Jamaica; and East Delhi, India.⁷ Therefore, these experiences may be not completely relevant to the situation in Kharkiv Oblast with its high industrialization and urbanization. It would be very useful if USAID or other international donors could sponsor a study of how the issues of the informal sector have been addressed in industrialized and urbanized countries, in particular, in other countries in transition. Meanwhile, there are some policy and regulatory lessons learned in developing countries that appear applicable to the Kharkiv situation (see Box 2).
- ***Use potential political benefits from addressing the issues of the informal sector.*** Adopting a strategy shift toward dealing with legalization of already existing informal

⁶ This reporting hierarchy should be clearly identified and taken into consideration when anticorruption actions are designed.

⁷ G. Peterson, T. Kingsley, and J. Telgarsky, “Urban Economics and National Development,” Office of Housing and Urban Programs, USAID, Washington, D.C., 1991.

jobs, instead of focusing only on creation of new ones, may have an important policy implication. Specifically, this strategy would be new for Ukraine, and political leadership of Kharkiv Oblast may get some credit for pioneering in this important area if implementation of this strategy would be accompanied by a proper public relations campaign.

4. Restructure government services from provider to enabler

As explained in Chapter VII and annex I, the central and local governments are direct providers of many services for which they would better serve as enablers or facilitators. This issue is especially significant for SMEs because the sectors in which government is active are some of the sectors in which SMEs have a high potential to succeed based on international experience. This change of the governmental role calls Kharkiv Oblast to join the worldwide evolution of governance and implies some substantial revision of approaches to solving existing problems. Within the area of supporting SME development, first steps may be based on a “pilot project” approach. Implementation of this approach may begin along two lines—topical and geographical:

- **Identify specific tasks already included in the current regional program, in which switching to the role of “enabler” can be practically done, and conduct pilot projects.** Issues associated with availability of real estate to small enterprises may be one of such pilot tasks.
- **See whether some geographic jurisdiction within Kharkiv Oblast would like to volunteer for the pilot project of an “SME-friendly Area.”**

Box 2: Involving the Informal Sector in Local Economic Development: Lessons From Success Stories*

3. In all successful cases, local governments tolerated and even supported the informal sector instead of punishing or prosecuting it. They also created the climate for its legalization.
4. Specific measures included:
 - Liberalization of the whole range of land and property use regulations. In the Kharkiv context this would imply: allow small production and commercial activity in former residential areas, buildings, and units; for example, allow office and service use in former apartments. Allow street retail kiosks at any location where there is a demand from street retailers to install their kiosks. Allow multiple land use for most vacant land sites, including residential, commercial, and some production use (instead of prescribing a specific land use according to a general plan).
 - Decentralization and democratization of land use policy and infrastructure decisions. In particular, decisions about investment, especially in physical and business infrastructure, should practically depend on priorities expressed by small businesses and entrepreneurs.
 - Simplification of the entire registration/ permission process.

Adapted from G. Peterson, T. Kingsley, and J. Telgarsky “Urban Economics and National Development” – Office of Housing and Urban Programs, USAID, Washington, D.C., 1991

Policy Matrix: Issues of SME Development Support That Are Not Sufficiently Addressed in Existing Governmental Initiatives				
Reform Issue	Priority*	Level of Government	Likelihood of Success	Implications for USAID
Objective 1: Reduce fiscal burden on SME				
1.1 Introduce elements of fiscal decentralization that would allow local governments effectively to reduce tax burden for SMEs in their jurisdictions	B	Central	May succeed faster if it is considered as “experimental” decentralization at Kharkiv Oblast	Support through cooperation with the central government, especially if this reform issue fits in with wider reform agendas supported by international donors (for example, technical assistance (TA) on government decentralization)
1.2 Use already available fiscal latitude at local governments to reduce the fiscal pressure on SMEs	A	Local governments of various levels	May succeed in some localities	Support through the ongoing Kharkiv Oblast project and other projects by incentives, TA, and public relations (PR) assistance to participating local governments
1.3 Reduce administrative charges imposed on SME	B	Local governments of various levels	May succeed in some localities	No specific
Objective 2: Restructure government regulation				
2.1 Limit governmental inspections of businesses throughout Ukraine in number and scope	A	All levels	May succeed in some localities	Support through the ongoing Kharkiv Oblast project and other projects by incentives, TA, and PR assistance to participating local governments
2.2 Codify the permit process.	B	All levels	May succeed in some localities	No specific
2.3 Reduce government employment	B	All levels	May succeed in some localities	Support on the political level Provide assistance on retraining governmental employees within a program of governmental downsizing, if requested
2.4 Make intolerance to corruption an explicit part of governmental support of SME development	B	Local governments of various levels	Not high, in short term	Support on the political level and by providing TA, if requested
Objective 3: Integrate informal SME activities in the formal sector				
3.1 Provide incentives (and market existing incentives) for legalization to “gray	A	Local governments of various	May succeed	Provide strong support through TA for designing various incentives for legalization of informal SMEs

Policy Matrix: Issues of SME Development Support That Are Not Sufficiently Addressed in Existing Governmental Initiatives				
Reform Issue	Priority*	Level of Government	Likelihood of Success	Implications for USAID
economy” participants		levels		
3.2 Study and use international experience of successful reduction of the informal sector in transitional or other industrialized countries	B	N/A	N/A	Conducting a study of experience in other transitional countries and making it available to Kharkiv and other regions
Objective 4: Restructure Government service from provider to enabler				
4.1 Identify specific tasks already included in the current regional program, where switching to the role of “enabler” can be practically done, and conduct pilot projects	B	Local governments of various levels		Provide TA within the ongoing Kharkiv Oblast project, if requested
4.2 Conduct a pilot project of creating “SME-Friendly Area” at some geographic jurisdiction within Kharkiv Oblast	C	City or rayon government	May succeed if properly marketed to local governments	Provide TA to conduct a local pilot project, if requested
*Note: Each proposed action item has been rated by overall importance/priority: A–Critically Important (i.e., an essential next step without which some other important measures will fail); B–Strategically Important (i.e., important for creating long-term progress in SME development); C–Useful as a Component.				

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СТАТИСТИЧНИЙ БЮЛЕТЕНЬ. МАЛЕ ПІДПРИЄМНИЦТВО В ХАРКІВСЬКІЙ ОБЛАСТІ
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ANNEXES

- 1 Review of Kharkiv Oblast Small Enterprise Support Programs
- 2 Kharkiv Survey Questionnaire
- 3 Statistical Presentation of Kharkiv Survey Results

ANNEX 1
REVIEW OF KHARKIV OBLAST SMALL ENTERPRISE SUPPORT PROGRAMS

No. Component	Total Funding (in thousands of UAH)			
	1999	2000	2001	2002
<p>2.1 Normative and Legislative Support</p> <p>The activities of the subprogram have remained constant during the four programmed years. The subprogram's funding has increased considerably.</p>	50	45	115	115
<p>2.2 Regulatory Policy Execution</p> <p>This subprogram is new to the 2001-2002 program. This is the first time this component was included in the regional, or any, business support programs. The goal of the subprogram is "liquidation of legislative, economic and administrative difficulties in the way of entrepreneurial activity development." The head of the Kharkiv branch of the State Committee on Regulatory Policy and Business is the subprogram's coordinator.</p>	NA	NA	40	40
<p>3.1 Financial, Credit, Material, Technical, and Investment Support</p> <p>In the 1999-2000 program, this subprogram was divided in two subprograms: Financial and Credit Support received UAH 75,000 and UAH 30,000; and Material and Technical Support received UAH 50,000 and UAH 40,000 for the respective years.</p> <p>The coordination of this subprogram was transferred from the External Economic Relations Department to KRESF with a complete switch in group members.</p> <p>The regional enterprise support fund, whose formation was a goal of the 1999-2000 program, now is established as the Kharkiv Regional Enterprise Support Fund and has overtaken coordination responsibility for the subprogram, which now includes not only Financial and Credit Support, but also Material, Technical, and Investment Support.</p> <p>This is one of the two most important subprograms in the regional program (the other being Regulatory Policy). Its goals, especially in the area of facilitating leasing of state and private property, which frees unused capacity from large enterprises, have major implications for the regional economy. Especially because the subprogram has grown so quickly, it is very important to ensure that funds in this area are expended most efficiently. The subprogram intends to develop innovative financing and leasing arrangements. The executors should make every effort to involve local banks and credit unions in not only servicing loans to small businesses, but also in making decisions on creditworthiness. For this, the subprogram should include production of a handbook on assessing the creditworthiness of small businesses and entrepreneurs and related training. The recipients of the training should be the bank and credit union loan officers who will evaluate and decide on loan applications. This would instill capacity where it is most needed, in the financial sector, instead of within the government's program.</p>	125	70	1,123	1,263
<p>4.1 Social Partnership Development</p> <p>This subprogram is new to the 2001-2002 program. The subprogram's goal is quite commendable: "... gradual transition from state regulation of business activity to its regulation on the basis of social partnership." The subprogram seeks to increase entrepreneurs' motivation to join associations and to stimulate existing and new institutes of business. The use of business associations in program execution is wise.</p>	NA	NA	40	40
<p>4.2 Enterprise Development Infrastructure</p>	110	110	150	200

No. Component	Total Funding (in thousands of UAH)			
	1999	2000	2001	2002
<p>Again, the subprogram description in the 2000-2001 version does not reference the accomplishments of the previous program. Because the current program includes creation of district centers, a network of business incubators, and business exhibition centers, it would seem that the previous program did not establish these facilities, although their establishment was listed among its activities.</p> <p>In a related matter, the previous program's activities include creation of a regional enterprise reconstruction and development agency and a public chamber for support of small and medium enterprise development, but the current program does not indicate whether these activities were completed or whether these new facilities are functioning.</p>				
<p>4.3 Information Provision</p> <p>Increasing the supply of information certainly is a worthy cause. The role of various government agencies in this subprogram seems too great. In this area, the government would serve best by improving and expanding its existing data collection and dissemination program through the Oblast Department of Statistics.</p> <p>It is encouraging that the mass media is listed among the subprogram executors.</p>	44	37	136	114
<p>4.4 Entrepreneur Rights Protection</p> <p>The 1999-2000 subprogram was called Economic Safety and Entrepreneurs' Safety. Subprogram activity 3, "Introduction of mechanism of control bodies coordination concerning inspections of business activity subjects" is notable. It is encouraging that the district and city executive committees are listed among executors. Subprogram results from the previous two years is not included, so the results of the roundtable meetings are not known, including state law enforcement authorities, tax administrators, and entrepreneur unions, or whether these meetings even occurred.</p>	40	40	70	70
<p>4.5 Personnel Training</p> <p>This is a complete change in subprogram coordination and group members.</p> <p>The current subprogram appears more focused and specific than its predecessor. This is undoubtedly related to the issuance of the Cabinet of Ministers Decree on Realization of the President's Decree on Assistance in Personnel Training for the Sphere of Business (No. 849, July 3, 2000) (No. 1358, September 30, 2000). The subprogram now includes plans for the establishment of an Academy of Enterprise, the creation of retraining programs for the unemployed, the development of continuing education programs to enable entrepreneurs to continue working while learning and to exchange seminars for trainers and the establishment of a curriculum for a new course, "Fundamentals of Business," to be introduced to institutes of vocational, technical, and higher education.</p>	150	165	7,610	9,180
<p>4.6 Creation of Social and Cultural Environment</p> <p>Most of the activities planned for this subprogram would be most effectively managed by an association of small businesses that is accountable to its members. The entrepreneur association is listed among the executors of only one activity, and the Chamber of Commerce is not involved at all. Their roles should be expanded wherever possible. If there are obstacles to involving business associations in program implementation, these should be investigated and solved. The subprogram might seek incentives for small businesses to join representative associations. The same associations would serve as resources to their members, providing training opportunities and representation on policy matters to the regional and national governments.</p>	145	40	190	130

No. Component	Total Funding (in thousands of UAH)			
	1999	2000	2001	2002
<p>4.7 Scientific and Theoretic Provision of Small Business Development</p> <p>The collection and analysis of information on SMEs and their role in the economy definitely should be increased and improved, and the results of the Regional Program should be monitored and evaluated. To increase the likelihood of sustainability, the subprogram might support the building of capacity in collection and analysis of SMEs within the Oblast Department of Statistics.</p>	40	60	45	65
<p>5.1 Innovation Development</p> <p>See comments under subprogram 5.11.</p>	48	70	132	94
<p>5.2 Ecological Entrepreneurship Development</p> <p>This subprogram is new to the 2001-2002 program. This subprogram is unique in its stress on NGOs, both as recipients of support and as executors.</p>	NA	NA	58	58
<p>5.3 Insurance Market Development</p> <p>This subprogram seems misplaced. It is not concerned with SMEs or entrepreneurs in any way. The subprogram addresses major economic issues, such as the regional medical insurance system and use of insurance reserves for regional investment projects.</p> <p>The subprogram in insurance should seek to provide assistance that small and medium enterprises uniquely require. This might include a special program that enabled small businesses to purchase various benefits, including health insurance, through an association of small businesses.</p>	35	60	78	29
<p>5.4 Youth Entrepreneurship Development</p> <p>In the previous Regional Program, this component was coordinated by the Deputy Chief of Family and Youth Matters for the Oblast State Administration. Now, the director of the Ukrainian-American Business Center coordinates. The subprogram is completely funded from other sources, which obviously is a positive characteristic.</p> <p>The formation of a curriculum and establishment of a class on entrepreneurship and small business management within the regional high school system would be an appropriate goal for an expanded subprogram in this area. The curriculum might be developed in conjunction with that of the "Fundamentals of Business" course to be created under the personnel training subprogram.</p>	70	80	123	171
<p>5.5 Gender Entrepreneurship Development</p> <p>This subprogram is new to the 2001-2002 program. Again, it is good that the funds all are from other sources and NGOs are involved (mostly Diya Action organization). The subprogram should seek to establish, or spin-off, from the current government structures an association of women entrepreneurs and small business owners who would be most familiar with the difficulties they face and resources they require to overcome them.</p>	NA	NA	101	101
<p>5.6 Invalids' Entrepreneurship development</p> <p>This subprogram is new to the 2001-2002 program. Again, this new component heavily relies on outside resources. The Kharkiv Civic Invalids' Entrepreneurs Organization coordinates the subprogram and is an executor of every activity. The subprogram is completely funded by outside sources. The number of invalid entrepreneurs in Kharkiv Oblast is not indicated by the program.</p>	NA	NA	159	158

No. Component	Total Funding (in thousands of UAH)			
	1999	2000	2001	2002
<p>5.7 Agricultural Complex Entrepreneurship Development</p> <p>The 1999-2000 subprogram was called Farm Support. This is the only subprogram whose funding decreased from the previous to the current Regional Program. The planned production of a separate program for Small Business Development in Rural Areas probably is an improvement in the approach. The formation of rayon farmers associations is an activity of both the previous and current agricultural/farm support subprogram, but there is no indication of the progress in developing these associations.</p>	67	46	22	24
<p>5.8 Employment Programs Support</p> <p>The subprogram is positive in its goals and external funding, but some of its activities provide opportunities for more market-oriented approaches. For example, the first activity described will provide funds to businesses that take on unemployed workers. Instead, the Oblast government could obtain information about the skills that small enterprises in Kharkiv require, then assess the skills of the unemployed population and provide training to eliminate any gaps in the skill requirements of the enterprises and the skills of the unemployed individuals.</p> <p>Many individuals who are officially registered as unemployed actually work for unregistered enterprises or are unofficially employed by registered enterprises. Research has indicated that SMEs comprise a significant portion of unregistered economic employment. A subprogram whose aim is to increase small enterprise employment and decrease unemployment also should encourage the formalization of illegal employment through incentives.</p> <p>In approaching the issue of increasing employment among small enterprises, the Regional Program has focused on improving the indicator (the unemployment rate) instead of the reality (unemployment).</p>	NA	NA	5,968	6,000
<p>5.9 Foreign Economic Activity Development</p> <p>The subprogram is funded by entrepreneur funds and other sources. Responsibility for subprogram coordination has shifted from a department of the Oblast State Administration to the Enterprises with Foreign Capitals League. The shift away from KRESF funding and government coordination is positive.</p> <p>One of the subprogram's goals is the creation of a favorable investment environment and taxation policy for international cooperation. This is a worthy goal, but the program managers should be careful that they do not create foreign investment incentives that are so great that they create a disadvantage for domestic firms. They also should be careful to ensure that the benefits of foreign investment are distributed as widely as possible among the population of Kharkiv and the surrounding region.</p>	70	70	80	80
<p>5.10 Social Tension Relief</p> <p>This subprogram is new to the 2001-2002 program. The subprogram overlaps a great deal with other components (personnel training, theoretical support, etc.), and its specific focus is unclear. The component is overwhelmingly funded by the Ukrainian Enterprise Support Fund and is coordinated by that Fund's Kharkiv representative. The local officials probably have little control over decisions about use of the state fund's resources.</p>	NA	NA	1,520	1,465
<p>5.11 Innovation Projects Support</p>	NA	NA	2,220	2,220

No. Component	Total Funding (in thousands of UAH)			
	1999	2000	2001	2002
<p>The 1999-2000 program included only one innovation subprogram, Innovative Activities Development. Its funding information is included under the Innovation Development Subprogram.</p> <p>This subprogram is commendable in the identification and attempt at capitalization of Kharkiv Oblast's major competitive advantages. Various recent theories of regional development stress the idea of clustering, which includes the grouping of enterprises of similar or related niches within one geographic area. This permits the sharing of infrastructure that is required by all of the firms in the niche. It is common for such technical and scientific niche clusters to locate near educational institutions that produce employees with specialized knowledge required by the cluster of firms.</p> <p>The existence of a large number of educational institutions, especially technical and scientific centers, within Kharkiv is a great advantage for the regional economy. The innovative projects support subprogram is a correctly oriented component that should be closely monitored and carefully supported.</p>				
6.1 Program Coordination and Monitoring	40	40	--	--
<p>The appearance of removing administrative constraints to small business development within the activities of the program coordination and monitoring component reaffirms the priority assigned to this activity, which is very encouraging. Another improvement in this component is the inclusion of quarterly progress reports among the activities. These reports should be provided to not only the Ministry of Economy and State Enterprise, but also to all program executors and the Kharkiv public in general. Citizens and program participants will be able to provide feedback that is much more useful if they are updated on issues related to the program's implementation.</p> <p>The program management should issue at least a mid-term evaluation at the end of the first year of program implementation to inform business, government, and the public on the program's progress. An annual or biannual summary of program progress, detailed by subprogram and activity, should be included in the next program document.</p>				
Total	1,034	933	19,979	21,617

ANNEX 2
KHARKIV SME SURVEY QUESTIONNAIRE
(Russian version follows English version)

Questionnaire

GENERAL

1. In which year was your business registered?

2. What is the legal/ownership form of your business?

- _____ Private entrepreneur (no legal entity)
_____ Private company
_____ Limited liability company
_____ Open joint stock company without state or municipal shares
_____ Closed joint stock company without state or municipal shares
_____ Open Joint stock company with state or municipal shares
_____ Closed joint stock company with state or municipal shares
_____ Joint venture without state or municipal shares
_____ Joint venture without state or municipal shares
_____ Other (please name) _____

3. What is your company's main activity (product or service that brings most income)?

(Classification of answers will be done after the survey, before computing the results)

4. In how many other activities is the company significantly involved?

_____ 1 other _____ 2 other _____ 3 or more other activities

5. What starting capital is necessary, from your point of view, to open the business in the sphere, where you are engaged? (Please, specify an equivalent in US dollars) US\$ _____

6. During 2000, what were your company's sources of operating funds /оборотных средств/
(please provide estimates for percent contribution of sources listed below):

Retained income from company's operations	_____ %
Foreign investor	_____ %
Domestic investor	_____ %
Loan	_____ %
Other (please, specify)	_____ %

7. During 2000, has your company make any capital investments to purchase or improve:

_____ equipment (machinery, vehicles) _____ buildings _____ land

8. If yes, what were sources for these capital investments:

Retained income from company's operations	_____	%
Foreign investor	_____	%
Domestic investor	_____	%
Loan	_____	%
Other (please, specify)	_____	%

9. Comparing with the annual turnover of your company for 2000, how large were these capital investments (as percent of the turnover)? _____%

10. Who owns equipment, machinery, and vehicles that your company uses (if several answers are applicable because of different arrangements regarding different equipment, indicate all of them):

The company itself _____
Individuals working at the company _____
Another company _____
Other (please, specify who) _____

11. If your company uses equipment, machinery and vehicles that it does not own, what are the arrangements (if several answers are applicable because of different arrangements regarding different equipment, indicate all of them)?

Use free of charge _____
Leasing or rent _____
Other (please, specify what) _____

12. Who owns buildings, premises or structures that your company uses (if several answers are applicable because of different arrangements regarding different real estate, indicate all of them):

The company itself _____
Individuals working at the company _____
Another company _____
Local government _____
Central government _____
Other _____

13. If your company uses buildings, premises or structures that it does not own, what are the arrangements?

Use free of charge _____
Rent _____
Other (please, specify what) _____

14. Who owns land underneath buildings, premises or structures that your company uses or other land that your company uses (if several answers are applicable because different arrangements regarding different land sites, indicate all of them):

The company itself _____
Individuals working at the company _____
Another company _____
Local government _____
Central government _____
Other (please, specify what) _____

15. If your company doesn't own land, which it uses, what are arrangements:

Use free of charge _____

Rent _____

Use for payment _____

Other (specify what) _____

16. Was your company earlier part of a larger company? _____ Yes _____ No

17. Did other companies used to be part of your company? _____ Yes _____ No

18. Please check the organizations of which your company is a member.

_____ Trade association

_____ Chamber of Commerce

_____ Business assistance center

_____ Other (name) _____

PERSONNEL

19. How many people work for your company full time? _____

20. Do other people work for your company part time? _____ Yes _____ No

If yes, how many? _____

21. What percentage of the people who work at your company full time are (estimates acceptable):

_____ Women

_____ More than 60 years old

_____ Less than 23 years old

22. During the past six months, has the number of employees

decreased _____ increased _____ the same _____?

By how many persons? _____

23. If your company hired people during the past six months, please indicate which methods you used for finding new-hires (check all that apply):

- Advertised available job in a newspaper or other media
- Solicited individual references through personal contacts
- Placed info at the employment centers
- Other

24. Are the wages of your company's employees in arrears? Yes No

If yes, to what extent?

- Less than one month
- Between one and two months
- More than two months

25. What percent of your payroll is paid in kind?

- Zero percent
- 1-11%
- 11-40%
- 41-70%
- More than 70%

LICENSES AND INSPECTIONS

26. How many licenses does your company have?

27. How many of your activities required two parallel licenses – one for the company, one for a professional working at the company?

28. Did your activity require obtaining permits, different from licenses? Yes No

29. If yes, from whom (check all that apply)

- Land Resources Department
- Urban Planning and Architecture Department
- Fire Department
- Labor Safety Committee
- Sanitary Epidemiological Supervision Service
- Energy Saving Inspectorate
- Environmental Safety Department
- Other (name)

30. During the year 2000, how many times has your company been inspected?

31. By whom? (Please use the table below to indicate number of visits by various inspectors)

Inspectors	How many times during the year 2000
Tax Administration	
Tax Militia	
Fire Department	
Police Department	
Sanitary/Epidemic Station	
Ministry of Environment	
Committee on Standardization	
Consumer Protection Committee	
Anti-monopoly Committee	
Department of Architecture	
Customs	
State Control and Revision Service	
State Treasury	
Department for fight against organized criminals	
Security service of Ukraine	
Trade department	
Others (name):	

32. How many person-days has your company staff spent during 2000 to deal with inspectors and consequences of inspections (estimates acceptable)? _____ person-days

33. What is the estimated total amount, as a percentage of your annual turnover, of fines imposed on your company and various other payments incurred by your company as a result of these inspections ____ %

34. Has your company been ever asked for any additional payments over established by the legislation at permits, licensing, inspections, etc.?
 _____ Never.
 _____ Sometimes.
 _____ Frequently.
 _____ Always.

35. Has the overall situation with inspections improved for your company in 2000 comparing with 1999?

TAXES and FEES

36. How many taxes and fees does your company pay?

37. Does your company participate in the simplified tax system?

- No
 Yes, it pays 6% of its turnover with VAT paid separately
 Yes, it pays 10% of its turnover, which includes VAT
 Yes, other (name) _____

38. What percentage of turnover does your company's tax and fee payments represent?

- 0%
 1-10%
 11-20%
 21-30%
 31-40%
 41-50%
 51-60%
 more than 60%

39. Are any of the taxes your company pays particularly burdensome (check all that apply)?

- None
 Profit tax
 Payroll taxes
 VAT
 Income tax
 Excise taxes
 State funds
 Others (name) _____

40. Has the overall taxation situation for your company improved in 2000 comparing to 1999?

- Yes
 No
 Not certain about this

CLIENTS/CONSUMERS

41. Please indicate the approximate percentage of your production (goods/services) that is consumed by clients of the following types:

- government and government agencies, budgetary organizations _____ %
companies _____ %
individual consumers _____ %

42. During the past year, how many companies (not individuals) have been your clients?

- 0
 1-5

- _____ 5-10
- _____ 10-15
- _____ More than 15

43. What is the largest percentage of production (goods / services) consumed by a single one of these clients?

- _____ 1-10 %
- _____ 10-20 %
- _____ 20-30 %
- _____ 30-40 %
- _____ 40-50 %
- _____ More than 50%

44. Please indicate the approximate percentage of your production (goods/services) that is consumed by clients in the following regions:

- _____ % to clients in Kharkiv city
- _____ % to clients in the rest of Kharkiv oblast (excluding the city)
- _____ % to clients in the rest of Ukraine (excluding Kharkiv oblast)
- _____ % to clients in Russia and other NIS countries
- _____ % to clients in other countries (please list) _____

SUPPLIERS

45. Please indicate the approximate percentage of your inputs that were provided by suppliers of the following types:

- government, government agencies and budgetary organizations _____ %
- companies _____ %
- individuals _____ %

46. During the past year, how many suppliers has your company had?

- _____ 0
- _____ 1-5
- _____ 5-10
- _____ 10-15
- _____ More than 15

47. What is the largest percentage of inputs supplied by a single one of these suppliers?

- _____ 1-10 %
- _____ 10-20 %
- _____ 20-30 %

- _____ 30-40 %
- _____ 40-50 %
- _____ More than 50%

48. Please indicate the approximate percentage of your company's inputs that is received from suppliers in the following regions:

- _____ % from suppliers in Kharkiv city
- _____ % from suppliers in the rest of Kharkiv oblast (excluding the city)
- _____ % from suppliers in the rest Ukraine (excluding Kharkiv oblast)
- _____ % from suppliers in Russia and other NIS countries
- _____ % from suppliers in other countries (please list)

PERFORMANCE

49. What were the two most significant problems facing your company in 2000?

Problems	Most Significant (select only one)	Second Most Significant (select only one)
Administrative controls by public agencies (registration/ permits / licenses / inspections / sanctions together)		
Existing tax system		
Frequently changing legislation		
Complexity of book-keeping and reporting		
Inadequate equipment		
Inflation		
Labor availability and cost		
Obtaining credit (availability / interest rates)		
Lack of working capital (turnaround means, оборотных средств)		
Shortages of raw materials / inputs		
Absence of a premise		
Lack of demand for goods and services produced		
Low market demand for company's goods/services		
Lack of business information		
Lack of business experience and knowledge		

Pressure from corrupted officials and criminal structures		
Other (name):		

50. Among administrative controls by public agencies, mark the most destructive for your business:

- registration
- permits
- licenses
- inspections
- sanctions
- other (name)

51. Do you think your company will increase production of its current goods and services in the coming year?

Yes No

52. Do you think your company will expand the types of goods and services it produces in the coming year?

Yes No

53. Do you think your company's revenues will increase in the coming year?

Yes No

IMAGINARY COMPANY

And now I ask you to consider (not to name) a small or medium business that you know better than others. This can be owned by a man or a woman, yourself or a neighbor, a friend or relative; it does not matter. It is only important that you have in mind the same business when answering all of the following questions.

54. Do you have such a small or medium business in mind? Yes
 No

55. How many employees are in this business?

- _____ Just one
- _____ 1-5
- _____ 6-10
- _____ 11-50
- _____ 51-250
- _____ more than 250

56. When economic conditions in the country are hard, entrepreneurs are often forced to find a way out by underreporting their activities, establishing informal relations with public officials and use other similar techniques. For development of Kharkiv region and improving its business climate, its important to estimate the scale of such a phenomena in general. Tell me please whether you have ever heard about such techniques of business activities?

_____ yes _____ no _____ refused

57. Is the business, which you have in mind, registered or unregistered?

_____ registered _____ not registered

58. What do you think is percentage of total taxes and fees that this business actually pays?

_____ %

59. Which methods does this business use to evade taxation (check all that apply)?

- _____ Gets part of its revenues in cash
- _____ Employs part of people informally, without paying social taxes for them
- _____ Under-reports production in its financial reports
- _____ Gets part of his revenues to an unregistered account in a foreign bank
- _____ Registers revenues with people who have privileges in taxation
- _____ Deducts expenses for the items that envisage a smaller tax rate
- _____ Registers firm in an off-shore zone abroad or in a free economic zone in Ukraine
- _____ Hard to say/ Don't know (HS/DK)
- _____ Don't want to answer

60. In such conditions that are faced by your imaginary company, is it possible for this business to operate without establishing informal relations with authorities?

_____ yes
_____ no
_____ HS/DK

61. With which agency's officials are informal relations most important?

_____ Ministries, other central state executive agencies

- _____ President's administration
- _____ Verkhovna rada
- _____ State-owned or semi-state-owned banks
- _____ State television
- _____ Oblast authorities
- _____ Municipal authorities
- _____ Rayon authorities, local self-government
- _____ Customs
- _____ Tax inspection
- _____ Prosecutor's office
- _____ Police
- _____ Other (please name) _____
- _____ HS/DK
- _____ Refused to answer

62. Does the business, which you have in mind, have to give part of its profits to representatives of any public agencies? If yes, what percentage of its profit?

_____ % (if the answer is negative, write 0)
_____ HS/DK

63. Does the business have to give part of its turnover to representatives of unofficial force groups (racket, etc.)? If yes, what percentage?

_____ % (if the answer is negative, write 0)
_____ HS/DK

64. What would be a rational tax for this enterprise to pay?

_____ %
_____ HS/DK

QUESTIONS FOR THE SURVEYOR

Survey date and time:

Duration of interview:

Names and positions of interviewees:

Contact phone numbers:

Mailing addresses: postal code, oblast, municipality, street and building number, apartment or office number

Location (if different from mailing address):

To what extent the respondent was sincere when answering questions:

- _____ Absolutely sincere
- _____ Rather sincere
- _____ Sometimes yes, sometimes - no
- _____ Quite insincere

Survey team:

Name of interviewer:

Signature of interviewer:

Name of supervisor:

Signature of supervisor:

Анкета

Обзор экономической активности
малых и средних предприятий
Харьковской области

Общие вопросы

1. В каком году было зарегистрировано ваше предприятие? _____
2. Форма собственности вашего предприятия:
_____ Частный предприниматель (не юридическое лицо)
_____ Частная компания
_____ Общество с ограниченной ответственностью
_____ Открытое акционерное общество без участия государства
_____ Закрытое акционерное общество без участия государства
_____ Открытое акционерное общество с участием государства
_____ Закрытое акционерное общество с участием государства
_____ Совместное предприятие с государственными вложениями
_____ Совместное предприятие без государственных вложений
_____ Другое (пожалуйста, укажите)
3. Основная деятельность вашей компании (продукция или услуги, приносящие основной доход)
4. Сколько других видов деятельности ведёт ваша компания
_____ 1 _____ 2 _____ 3 или более
5. Какой стартовый капитал необходим с вашей точки зрения, для того чтобы открыть бизнес в вашей сфере деятельности (пожалуйста, укажите эквивалент в долларах США) \$ _____
6. Каковы были источники оборотных средств вашей компании в 2000 году (пожалуйста, оцените в процентном соотношении источники указанные ниже)
Доход от деятельности компании _____ %
Иностранные инвестиции _____ %
Отечественные инвестиции _____ %
Заём _____ %
Другое(укажите) _____ %
7. Делала ли ваша компания капитальные вложения в покупку или усовершенствования в 2000
Оборудования (станки, транспортные средства) _____

Здания _____
Земля _____

8. Если да, то каковы были источники этих капиталовложений?

Доход от деятельности компании _____ %
Иностранные инвестиции _____ %
Отечественные инвестиции _____ %
Заём _____ %
Другое(укажите) _____ %

9. Сравните капвложения 2000 года с годовым оборотом вашей компании. Каковы были капиталовложения (% к обороту)?

_____ %

10. Кто является владельцем оборудования, станков, транспортных средств, которые использует ваша компания (если подходят несколько вариантов ответов из-за различных условий для различного оборудования, укажите их все)

_____ Сама компания
_____ Частные лица, работающие в компании
_____ Другая компания
_____ Другое (укажите кто)

11. Если ваша компания использует оборудование, станки, транспортные средства, которые ей не принадлежат, то укажите на каких условиях вы ими пользуетесь (если подходят несколько вариантов ответов из-за различных условий для различного оборудования, укажите их все)

_____ Пользуемся бесплатно
_____ Лизинг или аренда
_____ Другое (укажите что)

12. Кому принадлежат здания, помещения или строения, которые используются вашей компанией (если подходят несколько вариантов ответов из-за различных форм недвижимости, укажите их все)

_____ Компании
_____ Частным лицам, работающим в компании
_____ Другой компании
_____ Местным властям
_____ Центральным властям
_____ Другое

13. Если ваша компания использует недвижимость, которая ей не принадлежит, то каковы условия договора

- Пользуемся бесплатно
- Арендуем
- Другое (укажите что)

14. Кому принадлежит земля, на которой расположены здания, помещения или строения, которые использует ваша компания, или другая земля используемая вашей компанией (если возможны несколько вариантов ответов из-за различных договорённостей относительно различных участков земли, укажите их все)

- Собственно компании
- Частным лицам работающим в компании
- Другой компании
- Местным властям
- Центральным властям
- Другое (укажите что)

15. Если земля, которую использует ваша компания, ей не принадлежит, то на каких условиях она используется?

- Бесплатно
- Аренда
- Используется за плату
- Другое (укажите что)

16. Была ли ваша компания ранее частью какой-либо более крупной компании?

да _____ нет _____

17. Была ли какая-либо другая компания раньше частью вашей компании?

да _____ нет _____

18. Пожалуйста, отметьте организации членом которых является ваша компания

- Ассоциация профсоюзов
- Торговая палата
- Центр помощи бизнесу
- Другое (назовите)

ПЕРСОНАЛ

19. Сколько человек работают полный рабочий день в вашей компании?

20. Есть ли в вашей компании работники с неполным рабочим днём?

_____ да _____ нет

Если да, то сколько? _____

21. Каков процент работников занятых полный рабочий день (оцените если возможно)?

_____ женщины
_____ старше 60 лет
_____ младше 23 лет

22. За последние 6 месяцев количество работников

уменьшилось _____ увеличилось _____ осталось тем же _____?
На сколько человек? _____

23. Если ваша компания нанимала на работу людей за последние 6 месяцев, пожалуйста, укажите какими методами для набора персонала вы пользовались (отметьте все подходящие):

_____ Давали рекламу в газетах или других СМИ
_____ Находили подходящего человека, используя личные контакты
_____ Обращались за помощью в агентства по трудоустройству
_____ Другое

24. Имеет ли ваша компания задолженность по зарплате?

_____ да _____ нет

Если да, то за какой период?

_____ Меньше чем один месяц
_____ Около одного или двух месяцев
_____ Больше двух месяцев

25. Какой % зарплаты выплачивается в натуральной форме?

_____ 0%
_____ 1-11%
_____ 11-40%
_____ 41-70%
_____ больше 70%

лицензии и проверки

26. Сколько лицензий имеет ваша компания? _____
27. Сколько видов деятельности вашей компании требуют параллельных лицензий – одну для компании, другую – для специалиста работающего в компании?

28. Требуется ли деятельность, которой вы занимаетесь, получения каких-либо других разрешений, кроме лицензий? _____ да _____ нет
29. Если да, то от кого?
- _____ Управление земельных ресурсов
 - _____ Управление архитектуры и городского планирования
 - _____ Пожарники
 - _____ Комитет по защите труда
 - _____ Санитарно-эпидемиологическая служба
 - _____ Инспекция по сохранению энергии
 - _____ Управление по защите окружающей среды
 - _____ Другое (назовите)
30. Сколько раз за 2000 год ваша компания подвергалась проверкам?
31. Кто проверял? (пожалуйста, используйте таблицу, чтобы указать количество проверок различными инспекторами)

Проверяющие	Сколько раз за 2000 год
Налоговая администрация	
Налоговая милиция	
Органы противопожарного контроля	
МВД	
Санитарно-эпидемиологическая служба	
Министерство экологии и природных ресурсов Украины	
Комитет по стандартизации	
Управление по защите прав потребителей	
Антимонопольный комитет	
Управление архитектуры	
Таможенная служба	
Государственные контролирующие и проверяющие органы	
Государственное казначейство	
ОБОП	
СБУ	
Управление торговли	
Другое (назовите)	

32. Сколько человеко-дней ваша компания потратила в 2000 году на работу с проверяющими и устранение последствий проверок (оцените то, что возможно)?

_____ человеко-дней

33. Как вы оцениваете сумму, в % от вашего годового оборота, штрафов, наложенных на вашу компанию, а также различных других платежей, выплаченных вами в результате этих проверок?

_____ %

34. Предлагалось ли вашей компании когда-либо платить сверх установленного по законодательству за разрешения, лицензии, проверки и т.д.?

_____ Никогда

_____ Иногда

_____ Часто

_____ Всегда

35. Улучшилась ли ситуация с проверками в целом для вашей компании в 2000 по сравнению с 1999 годом? _____

НАЛОГИ И ПЛАТЕЖИ

36. Сколько налогов и платежей выплачивает ваша компания?

37. Платит ли ваша компания налоги по упрощённой системе?

_____ Нет

_____ Да, 6% от оборота + НДС

_____ Да, 10% от оборота, включая НДС

_____ Да, другое (укажите)

38. Сколько % от оборота вашей компании составляют налоги и платежи?

_____ 0%

_____ 1-10%

_____ 11-20%

_____ 21-30%

_____ 31-40%

_____ 41-50%

_____ 51-60%

_____ больше 60%

39. Являются ли некоторые налоги, которые платит ваша компания особенно тяжелыми для вас?

- Нет
- Налог на прибыль
- Налог на заработную плату
- НДС
- Подоходный налог
- Акцизный сбор
- Государственный сбор
- Другое (укажите)

40. Улучшилась ли налоговая ситуация в целом для вашей компании в 2000 по сравнению с 1999 годом?

- Да
- Нет
- Не уверен

КЛИЕНТЫ/ПОТРЕБИТЕЛИ

41. Укажите, пожалуйста, приблизительный % вашей продукции (товары/услуги) который потребляется следующими категориями клиентов:

- Правительство и правительственные организации, а также бюджетные организации %
- Компании %
- Частные потребители %

42. Сколько компаний в прошлом году были вашими клиентами?

- 0
- 1-5
- 5-10
- 10-15
- больше 15

43. Каков самый большой % продукции (товаров/услуг) был потреблён одним из этих клиентов?

- 1-10%
- 10-20%
- 20-30%
- 30-40%
- 40-50%
- более 50%

44. Пожалуйста, укажите приблизительный % продукции (товаров/услуг) который потребляется клиентами в следующих регионах:

- _____ % Харьков
- _____ % Харьковская область (исключая город)
- _____ % Остальная Украина (исключая Харьковскую область)
- _____ % Россия и другие страны СНГ
- _____ % Другие страны (перечислите, пожалуйста)

поставщики

45. Укажите приблизительно % поставок от поставщиков следующих категорий:

- _____ Правительство, правительственные и бюджетные организации
- _____ Компании
- _____ Частные лица

46. Сколько поставщиков имела ваша компания в прошлом году?

- _____ 0
- _____ 1-5
- _____ 5-10
- _____ 10-15
- _____ более 15

47. Каков наибольший % поставок от одного поставщика?

- _____ 1-10%
- _____ 10-20%
- _____ 20-30%
- _____ 30-40%
- _____ 40-50%
- _____ более 50%

48. Каков процент поставок вашей компании был получен от поставщиков из следующих регионов:

- _____ % Харьков
- _____ % Харьковская область (исключая город)
- _____ % Остальная Украина (исключая Харьковскую область)
- _____ % Россия и другие страны СНГ
- _____ % Другие страны (перечислите, пожалуйста)

показатели ДЕЯТЕЛЬНОСТИ

49. Каковы две самые большие проблемы, с которыми столкнулась ваша компания в 2000?

Проблемы	Наиболее значительная (выберите только одну)	Вторая по значимости (выберите только одну)
Административное регулирование государственными организациями (регистрация/разрешения/проверки/санкции)		
Существующая налоговая система		
Часто меняющееся законодательство		
Сложность бухгалтерии и отчетности		
Неподходящее оборудование		
Инфляция		
Доступность трудовых ресурсов и их цена		
Получение кредита (возможность получения и/или проценты по кредитам)		
Недостаток рабочего капитала (оборотных средств)		
Недостаток сырья/поставок		
Отсутствие помещения		
Недостаток рыночного спроса на производимые товары и услуги		

Недостаточность деловой информации		
Недостаток делового опыта и знаний		
Давление со стороны коррумпированных чиновников и криминальных структур		
Другое (назовите)		

50. Что среди административного регулирования государственными органами является на ваш взгляд наиболее деструктивным:

- Регистрация
- Разрешения
- Лицензии
- Проверки
- Санкции
- Другое (укажите)

51. Как вы думаете, увеличит ли ваша компания объем выпуска продукции (товаров/услуг) в следующем году?

- Да
- Нет

52. Будет ли ваша компания расширять ассортимент товаров и услуг в следующем году?

- Да
- Нет

53. Как вы думаете, увеличатся ли доходы вашей компании в следующем году?

- Да
- Нет

ВООБРАЖАЕМАЯ КОМПАНИЯ

Теперь я попрошу вас рассмотреть (не называя) малое или среднее предприятие, которое вы знаете лучше других. Оно может принадлежать мужчине или женщине, вам лично или вашему соседу, другу или родственнику, это не имеет значения. Важно только лишь отвечать на все вопросы об одном и том же предприятии.

54. Вы имеете на примете такое предприятие?

_____ Да
_____ Нет

55. Сколько работников на этом предприятии?

_____ Всего один
_____ 1-5
_____ 6-10
_____ 11-50
_____ 51-250
_____ больше чем 250

56. Когда экономическая ситуация в стране тяжёлая, предприятия часто вынуждены находить пути сокрытия своей деятельности, установления неформальных отношений с госчиновниками и использования других подобных методов. Для развития Харьковской области и улучшения бизнес климата важно оценить масштаб этих явлений в целом.

Скажите, вы когда либо слышали о подобных методах ведения бизнес деятельности?

Да _____ нет _____ отказываюсь отвечать _____

57. Бизнес, о котором вы говорите, зарегистрирован или нет?

Да _____ нет _____

58. Как вы думаете, каков % от всех причитающихся налогов и платежей, реально выплачиваемый этим предприятием? _____%

59. Какие методы используются на этом предприятии, чтобы избежать налогообложения (отметьте все подходящие)?

_____ Получение части доходов наличными
_____ Неофициальный наём работников, без выплаты налогов на них
_____ Сокрытие части продукции
_____ Получение части доходов на незарегистрированный счёт в заграничном банке
_____ Регистрация доходов на людей имеющих привилегии по налогам

_____ Вычитание расходов на что-то, что предполагает меньший уровень налогов

_____ Регистрация фирмы в оффшорной зоне за рубежом или в СЭЗ на Украине

_____ Трудно сказать/не знаю (ТС/НЗ)

_____ Не хочу отвечать

_____ %

_____ ТС/НЗ

60. Возможно ли в тех условиях, в которых оказалась ваша предполагаемая компания, работать без установления неофициальных отношений с властями?

_____ Да

_____ Нет

_____ ТС/НЗ

61. С какими государственными чиновниками неофициальные взаимоотношения наиболее важны?

_____ Министерства, другие центральные исполнительские организации

_____ Администрация президента

_____ Верховная Рада

_____ Государственные или полугосударственные банки

_____ Государственное телевидение

_____ Областные власти

_____ Городские власти

_____ Районные власти, самоуправление

_____ Таможня

_____ Налоговая инспекция

_____ Прокуратура

_____ Милиция

_____ Другое (назовите)

_____ ТС/НЗ

_____ Отказываюсь отвечать

62. Приходится ли предприятию, которое вы имеете в виду, отдавать часть своей прибыли представителям госструктур? Если да, то какой %?

_____ %

_____ ТС/НЗ

63. Приходится ли предприятию, которое вы имеете в виду, отдавать часть своих доходов представителям неофициальных силовых структур (рэкет, и т.п.)? Если да, то какой %?

_____ % (если ответ отрицательный, напишите 0)

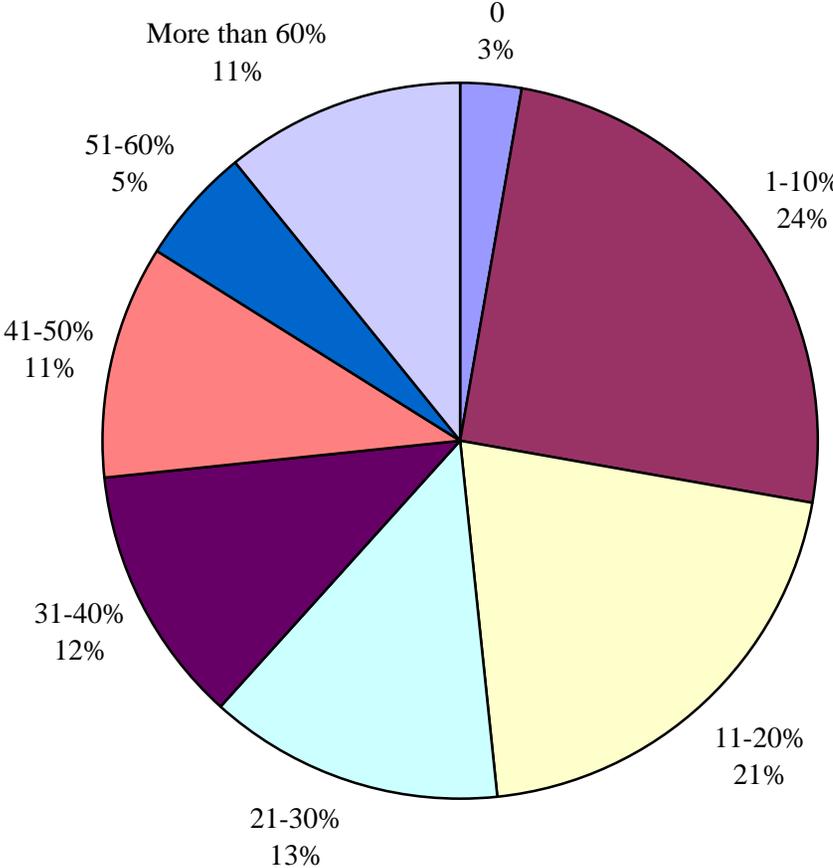
_____ ТС/НЗ

64. Каков должен быть общий уровень налогов (в % от оборота), чтобы предприятие могло платить их полностью?

_____ %

_____ ТС/НЗ

What percentage of turnover do your company's tax and fee payments represent?



ANNEX 3 STATISTICAL PRESENTATION OF KHARKIV SURVEY RESULTS

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
GENERAL				
1 In which year was your business registered?	115	1.00	0.94	1995.76
1997	19	0.17	0.16	329.94
1999	18	0.16	0.15	312.89
1996	18	0.16	0.15	312.42
1998	14	0.12	0.11	243.23
2000	9	0.08	0.07	156.52
1995	9	0.08	0.07	156.13
Unanswered/blank	7	0.06	0.06	
1992	6	0.05	0.05	103.93
1994	5	0.04	0.04	86.70
1993	5	0.04	0.04	86.65
1991	4	0.03	0.03	69.25
1989	3	0.03	0.02	51.89
1990	2	0.02	0.02	34.61
2001	1	0.01	0.01	17.40
1988	1	0.01	0.01	17.29
1945	1	0.01	0.01	16.91
2 What is the legal/ownership form of your company?	121	1.00	0.99	
Limited liability company	52	0.43	0.43	
Private entrepreneur (no legal entity)	29	0.24	0.24	
Private company	14	0.12	0.11	
Closed joint stock company without state or municipal shares	11	0.09	0.09	
Joint venture with state or municipal shares	9	0.07	0.07	
Open joint stock company without state or municipal shares	2	0.02	0.02	
Open joint stock company with state or municipal shares	2	0.02	0.02	
Closed joint stock company with state or municipal shares	1	0.01	0.01	
Joint venture without state or municipal shares	1	0.01	0.01	
Unanswered	1	0.01	0.01	
3 What is your company's main activity?	122	1.00	1.00	
Wholesale trade	27	0.22	0.22	
Retail trade	19	0.16	0.16	
Building, Developing, and General Contracting	11	0.09	0.09	
Food Manufacturing	5	0.04	0.04	
Professional, Scientific, and Technical Services	5	0.04	0.04	
Apparel Manufacturing	4	0.03	0.03	
Information Services and Data Processing Services	4	0.03	0.03	
Repair and Maintenance	4	0.03	0.03	
Animal Production	3	0.02	0.02	
Educational Services	3	0.02	0.02	
Insurance Carriers and Related Activities	3	0.02	0.02	
Management of Companies and Enterprises	3	0.02	0.02	
Chemical Manufacturing	2	0.02	0.02	
Crop Production	2	0.02	0.02	
Fabricated Metal Product Manufacturing	2	0.02	0.02	

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Food Services and Drinking Places	2	0.02	0.02	
Funds, Trusts, and Other Financial Vehicles	2	0.02	0.02	
Miscellaneous Manufacturing	2	0.02	0.02	
Publishing Industries	2	0.02	0.02	
Transportation Equipment Manufacturing	2	0.02	0.02	
Administration of Economic Programs	1	0.01	0.01	
Administrative and Support Services	1	0.01	0.01	
Amusement, Gambling, and Recreation Industries	1	0.01	0.01	
Computer and Electronic Product Manufacturing	1	0.01	0.01	
Electrical Equipment, Appliance, and Component Manufacturing	1	0.01	0.01	
Hospitals	1	0.01	0.01	
Machinery Manufacturing	1	0.01	0.01	
Motion Picture and Sound Recording Industries	1	0.01	0.01	
Personal and Laundry Services	1	0.01	0.01	
Plastics and Rubber Products Manufacturing	1	0.01	0.01	
Securities, Commodity Contracts, and Other Financial Investments and Related Activities	1	0.01	0.01	
Support Activities for Agriculture and Forestry	1	0.01	0.01	
Truck Transportation	1	0.01	0.01	
Utilities	1	0.01	0.01	
Wood Product Manufacturing	1	0.01	0.01	

4 In how many other activities is the company significantly involved?

82 1.00 0.67

One other	39	0.48	0.32
Two other	26	0.32	0.21
Three or more other	17	0.21	0.14
Unanswered	40	0.49	0.33

5 What starting capital is necessary to open a business in your field?

116 1.00 0.95 \$165,876.29

10,000.00	18	0.16	0.15	1551.72
5,000.00	17	0.15	0.14	732.76
20,000.00	12	0.10	0.10	2068.97
100,000.00	9	0.08	0.07	7758.62
50,000.00	8	0.07	0.07	3448.28
<i>Unanswered</i>	6	0.05	0.05	
3,000.00	6	0.05	0.05	155.17
30,000.00	5	0.04	0.04	1293.10
15,000.00	5	0.04	0.04	646.55
200,000.00	4	0.03	0.03	6896.55
1,000.00	4	0.03	0.03	34.48
25,000.00	3	0.03	0.02	646.55
6,000.00	3	0.03	0.02	155.17
2,000.00	3	0.03	0.02	51.72
500,000.00	2	0.02	0.02	8620.69
12,000.00	2	0.02	0.02	206.90
1,500.00	2	0.02	0.02	25.86
10,000,000.00	1	0.01	0.01	86206.90
3,000,000.00	1	0.01	0.01	25862.07
2,000,000.00	1	0.01	0.01	17241.38
150,000.00	1	0.01	0.01	1293.10

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
60,000.00	1	0.01	0.01	517.24
40,000.00	1	0.01	0.01	344.83
7,000.00	1	0.01	0.01	60.34
3,500.00	1	0.01	0.01	30.17
2,500.00	1	0.01	0.01	21.55
500.00	1	0.01	0.01	4.31
60.00	1	0.01	0.01	0.52
50.00	1	0.01	0.01	0.43
40.00	1	0.01	0.01	0.34

6 During 2000, what percentage of your company's operating funds came from the following sources?

111 1.00 0.91

No to all (all blank)	11	0.10	0.09
-----------------------	----	------	------

6a Retained Income

71.71

100	51	0.46	0.42	45.95
Unanswered (blank/zero)	20	0.18	0.16	
80	10	0.09	0.08	7.21
90	7	0.06	0.06	5.68
10	6	0.05	0.05	0.54
70	4	0.04	0.03	2.52
50	4	0.04	0.03	1.80
20	4	0.04	0.03	0.72
40	3	0.03	0.02	1.08
30	3	0.03	0.02	0.81
60	2	0.02	0.02	1.08
5	2	0.02	0.02	0.09
99	1	0.01	0.01	0.89
95	1	0.01	0.01	0.86
93	1	0.01	0.01	0.84
85	1	0.01	0.01	0.77
83	1	0.01	0.01	0.75
15	1	0.01	0.01	0.14

6b Foreign Investment

1.71

Unanswered (blank/zero)	117	1.05	0.96	
40	2	0.02	0.02	0.72
60	1	0.01	0.01	0.54
30	1	0.01	0.01	0.27
20	1	0.01	0.01	0.18

6c Domestic Investment

1.08

Unanswered (blank/zero)	119	1.07	0.98	
70	1	0.01	0.01	0.63
40	1	0.01	0.01	0.36
10	1	0.01	0.01	0.09

6d Loan

12.17

Unanswered (blank/zero)	81	0.73	0.66	
20	11	0.10	0.09	1.98
30	7	0.06	0.06	1.89
50	5	0.05	0.04	2.25
10	5	0.05	0.04	0.45

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses	
	70	3	0.03	0.02	1.89
	40	3	0.03	0.02	1.08
	100	1	0.01	0.01	0.90
	90	1	0.01	0.01	0.81
	80	1	0.01	0.01	0.72
	8	1	0.01	0.01	0.07
	7	1	0.01	0.01	0.06
	5	1	0.01	0.01	0.05
	1	1	0.01	0.01	0.01

6e Other **5.62**

Unanswered (blank/zero)	105	0.95	0.86		
	10	5	0.05	0.04	0.45
	100	2	0.02	0.02	1.80
	50	2	0.02	0.02	0.90
	30	2	0.02	0.02	0.54
	5	2	0.02	0.02	0.09
	95	1	0.01	0.01	0.86
	80	1	0.01	0.01	0.72
	20	1	0.01	0.01	0.18
	9	1	0.01	0.01	0.08

6f Other (specify)

Unanswered (blank/zero)	113	1.02	0.93
personal savings	4	0.04	0.03
founders	2	0.02	0.02
credit 50000 hrs	1	0.01	0.01
credits of bank	1	0.01	0.01
personal	1	0.01	0.01

7 During 2000, has your company made any capital investments to purchase or improve:
68 1.00 0.56

Equipment	55	0.81	0.45
No to all	54	0.79	0.44
Buildings	23	0.34	0.19
Land	7	0.10	0.06

8 If yes, what percentage of the investments came from the following sources?
68 1.00 0.56

No to all (all blank)	54	0.79	0.44
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8a Retained income **71.25**

Unanswered (blank/zero)	63	0.93	0.52		
	100	35	0.51	0.29	51.47
	80	7	0.10	0.06	8.24
	50	6	0.09	0.05	4.41
	90	2	0.03	0.02	2.65
	30	2	0.03	0.02	0.88
	20	2	0.03	0.02	0.59
	93	1	0.01	0.01	1.37
	60	1	0.01	0.01	0.88

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
		40	1	0.01	0.59
		10	1	0.01	0.15
		2	1	0.01	0.03
8b Foreign Investment					0.29
	Unanswered (blank/zero)	121	1.78	0.99	
	20	1	0.01	0.01	0.29
8c Domestic Investment					2.21
	Unanswered (blank/zero)	120	1.76	0.98	
	100	1	0.01	0.01	1.47
	50	1	0.01	0.01	0.74
8d Loan					13.79
	Unanswered (blank/zero)	100	1.47	0.82	
	20	6	0.09	0.05	1.76
	50	4	0.06	0.03	2.94
	100	3	0.04	0.02	4.41
	10	2	0.03	0.02	0.29
	90	1	0.01	0.01	1.32
	70	1	0.01	0.01	1.03
	60	1	0.01	0.01	0.88
	40	1	0.01	0.01	0.59
	30	1	0.01	0.01	0.44
	7	1	0.01	0.01	0.10
	1	1	0.01	0.01	0.01
8e Other					5.44
	Unanswered	115	1.69	0.94	
	100	2	0.03	0.02	2.94
	30	2	0.03	0.02	0.88
	80	1	0.01	0.01	1.18
	20	1	0.01	0.01	0.29
	10	1	0.01	0.01	0.15
8f Other (specify)					
	Unanswered	121	1.78	0.99	
	founders	1	0.01	0.01	
9 What percentage of your company's turnover were these capital investments?		70	1.00	0.57	28.43
	Unanswered (blank/zero)	52	0.74	0.43	
	10	12	0.17	0.10	1.71
	20	9	0.13	0.07	2.57
	30	8	0.11	0.07	3.43
	5	8	0.11	0.07	0.57
	25	4	0.06	0.03	1.43
	1	4	0.06	0.03	0.06
	100	2	0.03	0.02	2.86
	90	2	0.03	0.02	2.57
	80	2	0.03	0.02	2.29
	70	2	0.03	0.02	2.00
	50	2	0.03	0.02	1.43

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	15	2	0.03	0.02
	12	2	0.03	0.02
	8	2	0.03	0.02
	4	2	0.03	0.02
	2	2	0.03	0.02
	200	1	0.01	0.01
	120	1	0.01	0.01
	60	1	0.01	0.01
	57	1	0.01	0.01
	7	1	0.01	0.01
				0.43
				0.34
				0.23
				0.11
				0.06
				2.86
				1.71
				0.86
				0.81
				0.10

10 Who owns the equipment, machinery and vehicles that your company uses?

112 1.00 0.92

The company itself	83	0.74	0.68
Individuals working at the company	37	0.33	0.30
Another company	14	0.13	0.11
No to all	10	0.09	0.08
Other	3	0.03	0.02

Other (specify)

Unanswered	121	1.08	0.99
founders	1	0.01	0.01

11 If your company uses equipment, machinery and vehicles it does not own, what are the arrangements?

72 1.00 0.59

No to all	50	0.69	0.41
Leasing or rent	50	0.69	0.41
Use free of charge	16	0.22	0.13
Other	6	0.08	0.05

Other (specify)

Unanswered/blank	119	1.65	0.98
paid	1	0.01	0.01
gratuitous contract	1	0.01	0.01
No	1	0.01	0.01

12 Who owns the buildings, premises or structures that your company uses?

118 1.00 0.97

Another company	54	0.46	0.44
Local government	35	0.30	0.29
The company itself	33	0.28	0.27
Individuals working at the company	14	0.12	0.11
Central government	6	0.05	0.05
No to all (all blank)	4	0.03	0.03
Other	3	0.03	0.02

Other (specify)

Unanswered/blank	121	1.03	0.99
individual	1	0.01	0.01

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
13 If your company uses buildings, premises or structures that it does not own, what are the arrangements?	98	1.00		0.80
Rent	94	0.96		0.77
No to all (all blank)	24	0.24		0.20
Use free of charge	4	0.04		0.03
Other	3	0.03		0.02
Other (specify)				
Unanswered/blank	120	1.22		0.98
joint cooperation	1	0.01		0.01
lease	1	0.01		0.01
14 Who owns land underneath buildings, premises or structures that your company uses or other land that your company uses?	113	1.00		0.93
Local government	85	0.75		0.70
Another company	20	0.18		0.16
The company itself	9	0.08		0.07
No to all (all blank)	9	0.08		0.07
Central government	7	0.06		0.06
Individuals working at the company	4	0.04		0.03
Other	1	0.01		0.01
Other (specify)				
Unanswered/blank	121	1.07		0.99
individual on Land law	1	0.01		0.01
15 If your company doesn't own land that it uses, what are the arrangements?	99	1.00		0.81
Rent	90	0.91		0.74
Use free of charge	7	0.07		0.06
Other	2	0.02		0.02
Other (specify)				
Unanswered/blank	122	1.23		1.00
16 Was your company earlier part of a larger company?	NA	NA		NA
Yes	6	NA		0.05
17 Did other companies used to be part of your company?	NA	NA		NA
Yes	9	NA		0.07
18 Please check the organizations of which your company is a member.	53	1.00		0.43

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Trade association	32	0.60	0.26	
Other	13	0.25	0.11	
Business assistance center	11	0.21	0.09	
Chamber of commerce	4	0.08	0.03	
Other (specify)				
Audit Council of Ukraine	1	0.02	0.01	
Business Center	1	0.02	0.01	
Entrepreneurs' Club	1	0.02	0.01	
Kharkiv Insurance League	1	0.02	0.01	
Ukrainian Stock Exchange	1	0.02	0.01	

PERSONNEL

19 How many people work for your company full time? 118 1.00 0.97 17.17

2	11	0.09	0.09	0.19
10	10	0.08	0.08	0.85
8	10	0.08	0.08	0.68
5	10	0.08	0.08	0.42
6	9	0.08	0.07	0.46
3	9	0.08	0.07	0.23
12	8	0.07	0.07	0.81
1	7	0.06	0.06	0.06
15	5	0.04	0.04	0.64
Unanswered (blank/zero)	4	0.03	0.03	
7	4	0.03	0.03	0.24
50	3	0.03	0.02	1.27
4	3	0.03	0.02	0.10
40	2	0.02	0.02	0.68
35	2	0.02	0.02	0.59
25	2	0.02	0.02	0.42
22	2	0.02	0.02	0.37
18	2	0.02	0.02	0.31
194	1	0.01	0.01	1.64
141	1	0.01	0.01	1.19
120	1	0.01	0.01	1.02
100	1	0.01	0.01	0.85
72	1	0.01	0.01	0.61
68	1	0.01	0.01	0.58
60	1	0.01	0.01	0.51
45	1	0.01	0.01	0.38
43	1	0.01	0.01	0.36
38	1	0.01	0.01	0.32
30	1	0.01	0.01	0.25
23	1	0.01	0.01	0.19
21	1	0.01	0.01	0.18
20	1	0.01	0.01	0.17
19	1	0.01	0.01	0.16
17	1	0.01	0.01	0.14
14	1	0.01	0.01	0.12
11	1	0.01	0.01	0.09

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses	
	9	1	0.01	0.01	0.08
20 Do other people work for your company part time?	NA	NA	NA		
Yes	54	NA	0.44		
If yes, how many?	51	1.00	0.42		5.18
Unanswered (blank/zero)	71	1.39	0.58		
2	10	0.20	0.08		0.39
1	8	0.16	0.07		0.16
10	6	0.12	0.05		1.18
4	6	0.12	0.05		0.47
3	6	0.12	0.05		0.35
8	4	0.08	0.03		0.63
5	4	0.08	0.03		0.39
6	3	0.06	0.02		0.35
30	1	0.02	0.01		0.59
15	1	0.02	0.01		0.29
12	1	0.02	0.01		0.24
7	1	0.02	0.01		0.14
21 What percentage of the people who work at your company full time are (estimates acceptable):	93	1.01	0.76		
All unanswered (blank/zero for all options)	29	0.32	0.24		
21a Women	92	1.00	0.75		45.78
Unanswered (blank/zero)	30	0.33	0.25		
100	13	0.14	0.11		14.13
50	12	0.13	0.10		6.52
60	6	0.07	0.05		3.91
30	6	0.07	0.05		1.96
80	5	0.05	0.04		4.35
70	4	0.04	0.03		3.04
20	4	0.04	0.03		0.87
5	4	0.04	0.03		0.22
25	3	0.03	0.02		0.82
12	3	0.03	0.02		0.39
10	3	0.03	0.02		0.33
3	3	0.03	0.02		0.10
90	2	0.02	0.02		1.96
15	2	0.02	0.02		0.33
8	2	0.02	0.02		0.17
4	2	0.02	0.02		0.09
2	2	0.02	0.02		0.04
92	1	0.01	0.01		1.00
75	1	0.01	0.01		0.82
65	1	0.01	0.01		0.71
62	1	0.01	0.01		0.67
43	1	0.01	0.01		0.47
42	1	0.01	0.01		0.46

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses	
	40	1	0.01	0.01	0.43
	35	1	0.01	0.01	0.38
	33	1	0.01	0.01	0.36
	32	1	0.01	0.01	0.35
	26	1	0.01	0.01	0.28
	23	1	0.01	0.01	0.25
	18	1	0.01	0.01	0.20
	11	1	0.01	0.01	0.12
	6	1	0.01	0.01	0.07
	1	1	0.01	0.01	0.01

21b More than 60 years old **13** **1.00** **0.11** **12.38**

Unanswered (blank/zero)	109	8.38	0.89	
1	3	0.23	0.02	0.23
10	2	0.15	0.02	1.54
8	2	0.15	0.02	1.23
5	2	0.15	0.02	0.77
100	1	0.08	0.01	7.69
6	1	0.08	0.01	0.46
4	1	0.08	0.01	0.31
2	1	0.08	0.01	0.15

21c Less than 23 years old **29** **1.00** **0.24** **21.14**

Unanswered (blank/zero)	93	3.21	0.76	
10	5	0.17	0.04	1.72
2	5	0.17	0.04	0.34
1	4	0.14	0.03	0.14
20	3	0.10	0.02	2.07
100	2	0.07	0.02	6.90
5	2	0.07	0.02	0.34
95	1	0.03	0.01	3.28
80	1	0.03	0.01	2.76
40	1	0.03	0.01	1.38
25	1	0.03	0.01	0.86
12	1	0.03	0.01	0.41
11	1	0.03	0.01	0.38
9	1	0.03	0.01	0.31
7	1	0.03	0.01	0.24

22 During the past six months, has the number of employees increased, decreased or remained the same? By how many persons? **115** **1.00** **0.94**

Decreased	15	0.13	0.12	1.28
By				
1	4	0.03	0.03	0.03
3	3	0.03	0.02	0.08
50	1	0.01	0.01	0.43
30	1	0.01	0.01	0.26
20	1	0.01	0.01	0.17
12	1	0.01	0.01	0.10
11	1	0.01	0.01	0.10
5	1	0.01	0.01	0.04

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	4	1	0.01	0.03
	2	1	0.01	0.02
Increased By	44	0.38	0.36	1.49
	2	9	0.08	0.16
	1	9	0.08	0.08
	3	8	0.07	0.21
	5	4	0.03	0.17
	4	4	0.03	0.14
	Unanswered/blank	3	0.03	
	10	3	0.03	0.26
	20	2	0.02	0.35
	7	2	0.02	0.12
Remained the same	56	0.49	0.46	0.49
Unanswered	7	0.06	0.06	

23 If your company hired people during the past six months, please indicate which methods you used for finding new hires (check all that apply):

90 0.74

Solicited individual references through personal contacts	76	0.84	0.62
All unanswered (blank/zero for all options)	32	0.36	0.26
Advertised available job in a newspaper or other media	20	0.22	0.16
Placed information at the employment centers	14	0.16	0.11
Other	3	0.03	0.02

Other (specify)

Unanswered/blank	122	1.36	1.00
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24 Are the wages of your company's employees in arrears?

NA NA NA

Yes	24	NA	0.20
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If yes, to what extent?

23 1.00 0.19

Unanswered/blank	99	4.30	0.81
Between one and two months	13	0.57	0.11
More than two months	7	0.30	0.06
Less than one month	3	0.13	0.02

25 What percent of your payroll is paid in kind?

110 1.00 0.90

Zero percent	86	0.78	0.70
Unanswered/blank	12	0.11	0.10
1-10%	11	0.10	0.09
More than 70%	5	0.05	0.04
41-70%	4	0.04	0.03
11-40%	4	0.04	0.03

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
LICENSES AND INSPECTIONS					
26	How many licenses does your company have?	77	1.00	0.63	1.60
	Unanswered (blank/zero)	45	0.58	0.37	
	1	32	0.42	0.26	0.42
	2	22	0.29	0.18	0.57
	0	11	0.14	0.09	0.00
	3	6	0.08	0.05	0.23
	4	3	0.04	0.02	0.16
	6	2	0.03	0.02	0.16
	5	1	0.01	0.01	0.06
27	How many of your activities required two parallel licenses--one for the company, one for a professional working at the company?	35	1.00	0.29	1.31
	Unanswered (blank/zero)	87	2.49	0.71	
	1	16	0.46	0.13	0.46
	2	10	0.29	0.08	0.57
	0	6	0.17	0.05	0.00
	3	2	0.06	0.02	0.17
	4	1	0.03	0.01	0.11
28	Did your activity require obtaining permits, different from licenses?	NA	NA	NA	
	Yes	70	NA	0.57	
29	If yes, from whom (check all that apply)?	70	1.00	0.57	
	Fire Department	56	0.80	0.46	
	No to all	52	0.74	0.43	
	Sanitary Epidemiological Supervision Service	48	0.69	0.39	
	Labor Safety Committee	21	0.30	0.17	
	Urban Planning and Architecture Department	20	0.29	0.16	
	Energy Saving Inspectorate	19	0.27	0.16	
	Other	18	0.26	0.15	
	Environmental Safety Department	18	0.26	0.15	
	Land Resources Department	14	0.20	0.11	
	Other (specify)				
	Unanswered/blank	115		0.94	
	Quality Certificate	1		0.01	
	regional state trade department	1		0.01	
	state stock committee	1		0.01	
	Tax Administration	1		0.01	
	Tax inspection	1		0.01	
	trade department	1		0.01	
	valuable papers commission	1		0.01	
30	During the year 2000, how many times has your company been inspected?				

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
		111	1.00	0.91	9.48
	3	17	0.15	0.14	0.46
	4	13	0.12	0.11	0.47
	2	12	0.11	0.10	0.22
	Unanswered (blank/zero)	11	0.10	0.09	
	7	10	0.09	0.08	0.63
	1	9	0.08	0.07	0.08
	8	6	0.05	0.05	0.43
	10	5	0.05	0.04	0.45
	9	5	0.05	0.04	0.41
	6	5	0.05	0.04	0.27
	5	4	0.04	0.03	0.18
	0	3	0.03	0.02	0.00
	26	2	0.02	0.02	0.47
	22	2	0.02	0.02	0.40
	15	2	0.02	0.02	0.27
	12	2	0.02	0.02	0.22
	11	2	0.02	0.02	0.20
	130	1	0.01	0.01	1.17
	71	1	0.01	0.01	0.64
	50	1	0.01	0.01	0.45
	49	1	0.01	0.01	0.44
	36	1	0.01	0.01	0.32
	32	1	0.01	0.01	0.29
	25	1	0.01	0.01	0.23
	21	1	0.01	0.01	0.19
	20	1	0.01	0.01	0.18
	17	1	0.01	0.01	0.15
	16	1	0.01	0.01	0.14
	14	1	0.01	0.01	0.13
31	By whom?	122	1.00	1.00	8.87
31a	Tax Administration	122			3.43
	1	30	0.25	0.25	0.25
	Unanswered (blank/zero)	29	0.24	0.24	
	2	23	0.19	0.19	0.38
	3	20	0.16	0.16	0.49
	5	5	0.04	0.04	0.20
	4	5	0.04	0.04	0.16
	6	3	0.02	0.02	0.15
	8	2	0.02	0.02	0.13
	120	1	0.01	0.01	0.98
	50	1	0.01	0.01	0.41
	15	1	0.01	0.01	0.12
	12	1	0.01	0.01	0.10
	7	1	0.01	0.01	0.06
31b	Tax Militia				0.62
	Unanswered (blank/zero)	87	0.71	0.71	
	1	17	0.14	0.14	0.14
	2	9	0.07	0.07	0.15

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	3	4	0.03	0.03
	4	2	0.02	0.02
	10	1	0.01	0.01
	6	1	0.01	0.01
	5	1	0.01	0.01

31c Fire Department

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	65	0.53	0.53	1.35
1	20	0.16	0.16	0.16
2	18	0.15	0.15	0.30
4	5	0.04	0.04	0.16
3	5	0.04	0.04	0.12
5	3	0.02	0.02	0.12
12	2	0.02	0.02	0.20
10	2	0.02	0.02	0.16
8	1	0.01	0.01	0.07
7	1	0.01	0.01	0.06

31d Police Department

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	105	0.86	0.86	0.67
1	6	0.05	0.05	0.05
2	4	0.03	0.03	0.07
4	2	0.02	0.02	0.07
24	1	0.01	0.01	0.20
14	1	0.01	0.01	0.11
10	1	0.01	0.01	0.08
7	1	0.01	0.01	0.06
5	1	0.01	0.01	0.04

31e Sanitary/Epidemic Station

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	75	0.61	0.61	0.84
1	23	0.19	0.19	0.19
2	13	0.11	0.11	0.21
4	4	0.03	0.03	0.13
3	4	0.03	0.03	0.10
12	1	0.01	0.01	0.10
9	1	0.01	0.01	0.07
5	1	0.01	0.01	0.04

31f Ministry of Environment

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	110	0.90	0.90	0.24
1	9	0.07	0.07	0.07
14	1	0.01	0.01	0.11
4	1	0.01	0.01	0.03
2	1	0.01	0.01	0.02

31g Committee on Standardization

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	111	0.91	0.91	0.19
1	9	0.07	0.07	0.07
12	1	0.01	0.01	0.10
2	1	0.01	0.01	0.02

31h Consumer Protection Committee

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	95	0.78	0.78	0.33

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
		1	20	0.16	0.16
		3	3	0.02	0.02
		2	3	0.02	0.02
		5	1	0.01	0.01
31i Anti-monopoly Committee					0.02
	Unanswered (blank/zero)	119	0.98	0.98	
		1	3	0.02	0.02
31j Department of Architecture					0.06
	Unanswered (blank/zero)	117	0.96	0.96	
		1	3	0.02	0.02
		2	2	0.02	0.02
31k Customs					0.05
	Unanswered (blank/zero)	117	0.96	0.96	
		1	4	0.03	0.03
		2	1	0.01	0.01
31l State Control and Revision Service					0.43
	Unanswered (blank/zero)	90	0.74	0.74	
		1	17	0.14	0.14
		2	11	0.09	0.09
		3	3	0.02	0.02
		4	1	0.01	0.01
31m State Treasury					0.02
	Unanswered (blank/zero)	119	0.98	0.98	
		1	3	0.02	0.02
31n Department for fight against organized criminals					0.12
	Unanswered (blank/zero)	112	0.92	0.92	
		1	6	0.05	0.05
		2	3	0.02	0.02
		3	1	0.01	0.01
31o Security Service					0.04
	Unanswered (blank/zero)	118	0.97	0.97	
		1	3	0.02	0.02
		2	1	0.01	0.01
31p Trade Department					0.16
	Unanswered (blank/zero)	113	0.93	0.93	
		1	4	0.03	0.03
		2	3	0.02	0.02
		6	1	0.01	0.01
		3	1	0.01	0.01
31q Other					0.29
	Unanswered (blank/zero)	107	0.88	0.88	
		1	6	0.05	0.05
		2	4	0.03	0.03
		3	3	0.02	0.02
		7	1	0.01	0.01

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	5	1	0.01	0.01

31r Other (specify)

Unanswered (blank/zero)	109	0.89	0.89
Pension fund	3	0.02	0.02
bank	2	0.02	0.02
prosecutor's office	1	0.01	0.01
Pension Fund, Statistics Dept.	1	0.01	0.01
Pension Fund, Social Insurance	1	0.01	0.01
Pension Fund, Employment Fud	1	0.01	0.01
Pension Fund, Bank, Employment Fund	1	0.01	0.01
Pension foundation, Public inspection on pharmacy products quality	1	0.01	0.01
Ministry of Finance	1	0.01	0.01
Energy saving Inspectorate	1	0.01	0.01

32 How many person-days has your company staff spent during 2000 to deal with inspectors and consequences of inspections (estimates acceptable)?

101 1.00 0.83 25.71

Unanswered (blank/zero)	21	0.21	0.17	
30	15	0.15	0.12	4.46
20	10	0.10	0.08	1.98
10	9	0.09	0.07	0.89
3	9	0.09	0.07	0.27
2	6	0.06	0.05	0.12
15	4	0.04	0.03	0.59
7	4	0.04	0.03	0.28
0	4	0.04	0.03	0.00
40	3	0.03	0.02	1.19
25	3	0.03	0.02	0.74
12	3	0.03	0.02	0.36
9	3	0.03	0.02	0.27
8	3	0.03	0.02	0.24
1	3	0.03	0.02	0.03
60	2	0.02	0.02	1.19
45	2	0.02	0.02	0.89
27	2	0.02	0.02	0.53
17	2	0.02	0.02	0.34
5	2	0.02	0.02	0.10
300	1	0.01	0.01	2.97
200	1	0.01	0.01	1.98
120	1	0.01	0.01	1.19
105	1	0.01	0.01	1.04
100	1	0.01	0.01	0.99
85	1	0.01	0.01	0.84
70	1	0.01	0.01	0.69
46	1	0.01	0.01	0.46
43	1	0.01	0.01	0.43
28	1	0.01	0.01	0.28
24	1	0.01	0.01	0.24
16	1	0.01	0.01	0.16

33 What is the estimated total amount, as a percentage of your annual turnover, of fines imposed on your company and various other payments incurred by your company as a result of these inspections?

82 1.00 0.67 6.79

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered (blank/zero)	40	0.49	0.33	
0	16	0.20	0.13	0.00
5	14	0.17	0.11	0.85
3	10	0.12	0.08	0.37
1	10	0.12	0.08	0.12
10	7	0.09	0.06	0.85
2	5	0.06	0.04	0.12
6	4	0.05	0.03	0.29
20	3	0.04	0.02	0.73
15	3	0.04	0.02	0.55
12	3	0.04	0.02	0.44
4	3	0.04	0.02	0.15
85	1	0.01	0.01	1.04
50	1	0.01	0.01	0.61
30	1	0.01	0.01	0.37
25	1	0.01	0.01	0.30

34 Has your company ever been asked for any additional payments over those established by legislation for permits, licensing, inspections, etc.? **112** **1.00** **0.92**

Never	39	0.35	0.32
Sometimes	38	0.34	0.31
Frequently	24	0.21	0.20
Always	11	0.10	0.09
Unanswered	10	0.09	0.08

35 Has the overall situation with inspections improved for your company in 2000 comparing with 1999? **NA** **NA** **NA**

Yes	36	NA	0.30
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TAXES AND FEES

36 How many taxes and fees does your company pay? **26** **1.00** **0.21** **7.65**

Unanswered (blank/zero)	96	3.69	0.79	
10	8	0.31	0.07	3.08
1	4	0.15	0.03	0.15
2	3	0.12	0.02	0.23
7	2	0.08	0.02	0.54
4	2	0.08	0.02	0.31
90000	1	0.04	0.01	
30	1	0.04	0.01	1.15
20	1	0.04	0.01	0.77
14	1	0.04	0.01	0.54
9	1	0.04	0.01	0.35
8	1	0.04	0.01	0.31
6	1	0.04	0.01	0.23

37 Does your company participate in the simplified tax system? **115** **1.00** **0.94**

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
No	63	0.55	0.52	
Yes, it pays 10% of its turnover, which includes VAT	24	0.21	0.20	
Yes, other	19	0.17	0.16	
Yes, it pays 6% of its turnover with VAT paid separately	9	0.08	0.07	
Unanswered/blank	7	0.06	0.06	

Other (specify)

Unanswered/blank	109	0.95	0.89
flat-rate tax	5	0.04	0.04
fixed patent	4	0.03	0.03
general tax system	1	0.01	0.01
fixed tax for agricultural manufactures	1	0.01	0.01
fixed patent, marketing tax	1	0.01	0.01
fixed agricultural tax	1	0.01	0.01

38 What percentage of turnover does your company's tax and fee payments represent?

112 1.00 0.92

0	3	0.03	0.02	0.03
1-10%	28	0.25	0.23	0.28
11-20%	23	0.21	0.19	0.48
21-30%	15	0.13	0.12	0.62
31-40%	13	0.12	0.11	0.73
41-50%	12	0.11	0.10	0.84
51-60%	6	0.05	0.05	0.89
More than 60%	12	0.11	0.10	1.00
Unanswered	10	0.09	0.08	1.09

39 Are any of the taxes your company pays particularly burdensome (check all that apply)?

111 1.00 0.91

VAT	58	0.52	0.48
Payroll taxes	47	0.42	0.39
Profit tax	39	0.35	0.32
Income tax	21	0.19	0.17
None	14	0.13	0.11
Others	7	0.06	0.06
State funds	5	0.05	0.04
Excise taxes	3	0.03	0.02

Others (specify)

Unanswered/blank	117	1.05	0.96
Pension Fund, flat-rate tax	1	0.01	0.01
Pension Fund	1	0.01	0.01
pencion fund	1	0.01	0.01
land tax	1	0.01	0.01
10% turnover	1	0.01	0.01

40 Has the overall taxation situation for your company improved in 2000 compared to 1999?

114 1.00 0.93

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Yes	16	0.14	0.13	
No	75	0.66	0.61	
Not certain about this	23	0.20	0.19	
Unanswered	8	0.07	0.07	

CLIENTS/CONSUMERS

41 Please indicate the approximate percentage of your production (goods/services) that is consumed by clients of the following types: **122** **1.00** **1.00**

41a government and government agencies, budgetary organizations

8.08

Unanswered (blank/zero)	80	0.66	0.66	
5	9	0.07	0.07	0.37
10	7	0.06	0.06	0.57
30	6	0.05	0.05	1.48
20	5	0.04	0.04	0.82
70	3	0.02	0.02	1.72
40	2	0.02	0.02	0.66
25	2	0.02	0.02	0.41
2	2	0.02	0.02	0.03
1	2	0.02	0.02	0.02
100	1	0.01	0.01	0.82
80	1	0.01	0.01	0.66
50	1	0.01	0.01	0.41
15	1	0.01	0.01	0.12

41b companies

36.19

Unanswered (blank/zero)	42	0.34	0.34	
100	11	0.09	0.09	9.02
20	9	0.07	0.07	1.48
70	8	0.07	0.07	4.59
30	8	0.07	0.07	1.97
10	7	0.06	0.06	0.57
50	6	0.05	0.05	2.46
60	5	0.04	0.04	2.46
95	4	0.03	0.03	3.11
80	4	0.03	0.03	2.62
90	3	0.02	0.02	2.21
40	2	0.02	0.02	0.66
99	1	0.01	0.01	0.81
94	1	0.01	0.01	0.77
93	1	0.01	0.01	0.76
77	1	0.01	0.01	0.63
75	1	0.01	0.01	0.61
55	1	0.01	0.01	0.45
45	1	0.01	0.01	0.37
39	1	0.01	0.01	0.32
35	1	0.01	0.01	0.29
15	1	0.01	0.01	0.12
5	1	0.01	0.01	0.04
3	1	0.01	0.01	0.02
-20	1	0.01	0.01	-0.16

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
41c individual consumers					48.92
	Unanswered (blank/zero)	26	0.21	0.21	
		100	26	0.21	21.31
		90	8	0.07	5.90
		80	8	0.07	5.25
		50	8	0.07	3.28
		30	6	0.05	1.48
		10	6	0.05	0.49
		70	4	0.03	2.30
		25	4	0.03	0.82
		20	4	0.03	0.66
		60	3	0.02	1.48
		95	2	0.02	1.56
		65	2	0.02	1.07
		40	2	0.02	0.66
		15	2	0.02	0.25
		5	2	0.02	0.08
		1	2	0.02	0.02
		99	1	0.01	0.81
		98	1	0.01	0.80
		45	1	0.01	0.37
		35	1	0.01	0.29
		4	1	0.01	0.03
		3	1	0.01	0.02
		2	1	0.01	0.02
42 During the past year, how many companies (not individuals) have been your clients?		106	1.00	0.87	
	More than 15	40	0.38	0.33	
	5-10	24	0.23	0.20	
	1-5	20	0.19	0.16	
	Unanswered (blank/zero)	16	0.15	0.13	
	10-15	11	0.10	0.09	
	0	11	0.10	0.09	
43 What is the largest percentage of production (goods/services) consumed by a single one of these clients?		98	1.00	0.80	
	1-10%	32	0.33	0.26	
	10-20%	25	0.26	0.20	
	Unanswered (blank/zero)	24	0.24		
	More than 50%	15	0.15	0.12	
	20-30%	14	0.14	0.11	
	40-50%	6	0.06	0.05	
	30-40%	6	0.06	0.05	
44 Please indicate the approximate percentage of your production (goods/services) that is consumed by clients in the following regions:		112	1.00	0.92	
44a to clients in Kharkiv city					59.59
	Unanswered (blank/zero)	27	0.24	0.22	
		100	24	0.21	21.43
		80	14	0.13	10.00

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses	
	90	10	0.09	0.08	8.04
	50	10	0.09	0.08	4.46
	70	6	0.05	0.05	3.75
	40	5	0.04	0.04	1.79
	60	4	0.04	0.03	2.14
	95	3	0.03	0.02	2.54
	10	3	0.03	0.02	0.27
	5	3	0.03	0.02	0.13
	75	2	0.02	0.02	1.34
	25	2	0.02	0.02	0.45
	20	2	0.02	0.02	0.36
	99	1	0.01	0.01	0.88
	86	1	0.01	0.01	0.77
	45	1	0.01	0.01	0.40
	43	1	0.01	0.01	0.38
	30	1	0.01	0.01	0.27
	15	1	0.01	0.01	0.13
	6	1	0.01	0.01	0.05

44b to clients in the rest of Kharkiv oblast (excluding the city)

23.88

Unanswered (blank/zero)	54	0.48	0.44		
	10	14	0.13	0.11	1.25
	100	11	0.10	0.09	9.82
	20	9	0.08	0.07	1.61
	30	7	0.06	0.06	1.88
	80	6	0.05	0.05	4.29
	5	5	0.04	0.04	0.22
	50	4	0.04	0.03	1.79
	15	4	0.04	0.03	0.54
	40	2	0.02	0.02	0.71
	60	1	0.01	0.01	0.54
	57	1	0.01	0.01	0.51
	45	1	0.01	0.01	0.40
	25	1	0.01	0.01	0.22
	8	1	0.01	0.01	0.07
	4	1	0.01	0.01	0.04

44c to clients in the rest of Ukraine (excluding Kharkiv oblast)

13.07

Unanswered (blank/zero)	80	0.71	0.66		
	20	9	0.08	0.07	1.61
	10	7	0.06	0.06	0.63
	50	4	0.04	0.03	1.79
	90	3	0.03	0.02	2.41
	40	3	0.03	0.02	1.07
	5	3	0.03	0.02	0.13
	60	2	0.02	0.02	1.07
	30	2	0.02	0.02	0.54
	25	2	0.02	0.02	0.45
	80	1	0.01	0.01	0.71
	79	1	0.01	0.01	0.71
	75	1	0.01	0.01	0.67
	70	1	0.01	0.01	0.63
	59	1	0.01	0.01	0.53
	15	1	0.01	0.01	0.13

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
		1	1	0.01	0.01
44d	to clients in Russia and other NIS countries				1.88
	Unanswered (blank/zero)	113	1.01	0.93	
		20	3	0.03	0.54
		10	2	0.02	0.18
		70	1	0.01	0.63
		40	1	0.01	0.36
		15	1	0.01	0.13
		6	1	0.01	0.05
44e	to clients in other countries				0.27
	Unanswered (blank/zero)	119	1.06	0.98	
		10	3	0.03	0.27
44f	Other countries (list)				
	Unanswered/blank	121	1.08	0.99	
	India	1	0.01	0.01	

SUPPLIERS

45	Please indicate the approximate percentage of your inputs that were provided by suppliers of the following types:	102	1.00	0.84	
45a	government, government agencies and budgetary organizations				1.32
	Unanswered (blank/zero)	118	1.16	0.97	
		5	1	0.01	0.05
		30	1	0.01	0.29
		100	1	0.01	0.98
		0	1	0.01	0.00
45b	companies				73.29
	Unanswered (blank/zero)	34	0.33	0.28	
		100	52	0.51	50.98
		80	8	0.08	6.27
		50	6	0.06	2.94
		90	5	0.05	4.41
		60	3	0.03	1.76
		97	2	0.02	1.90
		70	2	0.02	1.37
		20	2	0.02	0.39
		10	2	0.02	0.20
		95	1	0.01	0.93
		85	1	0.01	0.83
		55	1	0.01	0.54
		45	1	0.01	0.44
		30	1	0.01	0.29
		2	1	0.01	0.02
45c	individuals				24.65
	Unanswered (blank/zero)	74	0.73	0.61	
		100	11	0.11	10.78
		20	7	0.07	1.37
		50	6	0.06	2.94

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	10	5	0.05	0.04
	90	4	0.04	0.03
	40	3	0.03	0.02
	15	3	0.03	0.02
	80	2	0.02	0.02
	30	2	0.02	0.02
	3	2	0.02	0.02
	98	1	0.01	0.01
	70	1	0.01	0.01
	5	1	0.01	0.01

46 During the past year, how many suppliers has your company had?

120 1.00 0.98

More than 15	34	0.28	0.28
1-5	33	0.28	0.27
Unanswered (blank/zero)	20	0.17	0.16
5-10	17	0.14	0.14
10-15	15	0.13	0.12
0	3	0.03	0.02

47 What is the largest percentage of inputs supplied by a single one of these suppliers?

197 1.00 1.61

10-20%	26	0.13	0.21
Unanswered (blank/zero)	25	0.13	0.20
1-10%	19	0.10	0.16
More than 50%	17	0.09	0.14
20-30%	17	0.09	0.14
30-40%	13	0.07	0.11
40-50%	5	0.03	0.04

48 Please indicate the approximate percentage of your company's inputs that is received from suppliers in the following regions:

99 1.00 0.81

48a from suppliers in Kharkiv city

49.84

Unanswered (blank/zero)	42	0.42	0.34	
100	19	0.19	0.16	19.19
80	13	0.13	0.11	10.51
50	10	0.10	0.08	5.05
10	8	0.08	0.07	0.81
20	5	0.05	0.04	1.01
90	4	0.04	0.03	3.64
70	4	0.04	0.03	2.83
30	4	0.04	0.03	1.21
95	3	0.03	0.02	2.88
60	3	0.03	0.02	1.82
5	3	0.03	0.02	0.15
40	1	0.01	0.01	0.40
17	1	0.01	0.01	0.17
15	1	0.01	0.01	0.15
2	1	0.01	0.01	0.02

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
48b	from suppliers in the rest of Kharkiv oblast (excluding the city)				19.70
	Unanswered (blank/zero)	76	0.77	0.62	
	20	10	0.10	0.08	2.02
	100	8	0.08	0.07	8.08
	10	8	0.08	0.07	0.81
	50	5	0.05	0.04	2.53
	30	4	0.04	0.03	1.21
	90	2	0.02	0.02	1.82
	70	2	0.02	0.02	1.41
	40	2	0.02	0.02	0.81
	60	1	0.01	0.01	0.61
	25	1	0.01	0.01	0.25
	7	1	0.01	0.01	0.07
	5	1	0.01	0.01	0.05
	3	1	0.01	0.01	0.03
48c	from suppliers in the rest of Ukraine (excluding Kharkiv oblast)				17.52
	Unanswered (blank/zero)	82	0.83	0.67	
	20	12	0.12	0.10	2.42
	50	5	0.05	0.04	2.53
	100	3	0.03	0.02	3.03
	10	3	0.03	0.02	0.30
	95	2	0.02	0.02	1.92
	90	2	0.02	0.02	1.82
	80	2	0.02	0.02	1.62
	40	2	0.02	0.02	0.81
	30	2	0.02	0.02	0.61
	15	2	0.02	0.02	0.30
	5	2	0.02	0.02	0.10
	75	1	0.01	0.01	0.76
	70	1	0.01	0.01	0.71
	59	1	0.01	0.01	0.60
48d	from suppliers in Russia and other NIS countries				10.46
	Unanswered (blank/zero)	100	1.01	0.82	
	80	3	0.03	0.02	2.42
	10	3	0.03	0.02	0.30
	90	2	0.02	0.02	1.82
	70	2	0.02	0.02	1.41
	50	2	0.02	0.02	1.01
	30	2	0.02	0.02	0.61
	20	2	0.02	0.02	0.40
	5	2	0.02	0.02	0.10
	100	1	0.01	0.01	1.01
	95	1	0.01	0.01	0.96
	40	1	0.01	0.01	0.40
	1	1	0.01	0.01	0.01
48e	from suppliers in other countries				1.93
	Unanswered (blank/zero)	115	1.16	0.94	
	10	2	0.02	0.02	0.20
	3	2	0.02	0.02	0.06
	75	1	0.01	0.01	0.76
	70	1	0.01	0.01	0.71

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	20	1	0.01	0.01

48f Other countries (list)

Unanswered/blank	120	1.21	0.98
Poland	2	0.02	0.02

PERFORMANCE

49a What was the most significant problem facing your company in 2000?

121 1.00 0.99

2. Existing tax system	35	28.93%	0.29
3. Frequently changing legislation	23	19.01%	0.19
9. Lack of working capital	18	14.88%	0.15
1. Administrative controls by public agencies	12	9.92%	0.10
13. Low market demand for company's goods/services	11	9.09%	0.09
8. Obtaining credit (availability / interest rates)	8	6.61%	0.07
16. Pressure from corrupted officials and criminal structures	5	4.13%	0.04
10. Shortages of raw materials / inputs	2	1.65%	0.02
Unanswered	1	0.01	0.01
6. Inflation	1	0.01	0.01
5. Inadequate equipment	1	0.01	0.01
4. Complexity of book-keeping and reporting	1	0.01	0.01
17. Other (name):	1	0.01	0.01
15. Lack of business experience and knowledge	1	0.01	0.01
12. Lack of demand for goods and services produced	1	0.01	0.01
11. Absence of a premise	1	0.01	0.01
7. Labor availability and cost	0	0.00	0.00
14. Lack of business information	0	0.00	0.00

49b Other (name)

Unanswered/blank	117	0.97	0.96
lack of working capital	2	0.02	0.02
Lack of market demand	1	0.01	0.01
inflation	1	0.01	0.01
Energy Saving Department (regional)	1	0.01	0.01

49c What was the second most significant problem facing your company in 2000?

114 1.00 0.93

3. Frequently changing legislation	21	0.18	0.17
2. Existing tax system	19	0.17	0.16
9. Lack of working capital	15	0.13	0.12
8. Obtaining credit (availability / interest rates)	11	0.10	0.09
1. Administrative controls by public agencies	11	0.10	0.09
Unanswered	8	0.07	0.07
16. Pressure from corrupted officials and criminal structures	8	0.07	0.07
4. Complexity of book-keeping and reporting	7	0.06	0.06
6. Inflation	5	0.04	0.04
5. Inadequate equipment	4	0.04	0.03
12. Lack of demand for goods and services produced	4	0.04	0.03
15. Lack of business experience and knowledge	2	0.02	0.02
11. Absence of a premise	2	0.02	0.02
7. Labor availability and cost	1	0.01	0.01

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
17. Other (name):	1	0.01	0.01	
14. Lack of business information	1	0.01	0.01	
13. Low market demand for company's goods/services	1	0.01	0.01	
10. Shortages of raw materials / inputs	1	0.01	0.01	
49d Other (name)				
Unanswered/blank	119	1.04	0.98	
lack of working capital	1	0.01	0.01	
low buying ability	1	0.01	0.01	
pressure from corrupted officials and criminal structures	1	0.01	0.01	
50 Among administrative controls by public agencies, mark the most destructive for your business:	114	1.00	0.93	
inspections	59	51.75%	0.48	
sanctions	23	20.18%	0.19	
permits	20	17.54%	0.16	
Unanswered/blank	8	7.02%	0.07	
registration	5	4.39%	0.04	
licenses	5	4.39%	0.04	
other	2	1.75%	0.02	
Other (name)				
Unanswered/blank	100	0.88	0.82	
inspections	5	0.04	0.04	
sanctions	4	0.04	0.03	
licenses, inspections	2	0.02	0.02	
licenses	2	0.02	0.02	
inspections, sanctions	2	0.02	0.02	
sanction	1	0.01	0.01	
permits, licenses, inspections	1	0.01	0.01	
permits, inspections	1	0.01	0.01	
permits	1	0.01	0.01	
licenses, sanctions, inspections	1	0.01	0.01	
licenses, inspections	1	0.01	0.01	
all the system	1	0.01	0.01	
51 Do you think your company will increase production of its current goods and services in the coming year?				
	NA	NA	NA	
Yes	82	NA	0.67	
Unanswered (blank/no)	40	NA	0.33	
52 Do you think your company will expand the types of goods and services it produces in the coming year?				
	NA	NA	NA	
Yes	86	NA	0.70	
Unanswered (blank/no)	36	NA	0.30	
53 Do you think your company's revenues will increase in the coming year?				
	NA	NA	NA	

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Yes	80	NA	0.66	
Unanswered (blank/no)	42	NA	0.34	

IMAGINARY COMPANY

54 Do you have such a business in mind? NA NA NA

Yes	97	NA	0.80
Unanswered (blank/no)	25	NA	0.20

55 How many employees are in this business? 94 1.00 0.77

6-10	30	0.32	0.25
1-5	29	0.31	0.24
Unanswered (blank/zero)	28	0.30	0.23
11-50	27	0.29	0.22
51-250	6	0.06	0.05
Just one	2	0.02	0.02
More than 250	0	0.00	0.00

56 ##### 96 1.00 0.79

Yes	90	0.94	0.74
Unanswered (blank/no)	26	0.27	0.21
No	4	0.04	0.03
Refused	2	0.02	0.02

57 Is the business that you have in mind registered? NA NA NA

Yes	87	NA	0.71
Unanswered (blank/no)	35	NA	0.29

58 What do you think is the percentage of total taxes and fees that this business actually pays? 86 1.00 0.70 40.27

Unanswered (blank/zero)	36	0.42	0.30	
50	17	0.20	0.14	9.88
30	15	0.17	0.12	5.23
20	9	0.10	0.07	2.09
10	8	0.09	0.07	0.93
60	6	0.07	0.05	4.19
5	4	0.05	0.03	0.23
80	4	0.05	0.03	3.72
70	4	0.05	0.03	3.26
25	4	0.05	0.03	1.16
90	3	0.03	0.02	3.14
15	3	0.03	0.02	0.52
40	2	0.02	0.02	0.93

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	100	2	0.02	2.33
	13	1	0.01	0.15
	85	1	0.01	0.99
	98	1	0.01	1.14
	0	1	0.01	0.00
	32	1	0.01	0.37

58rev For those companies that provided estimates for question 62, on unofficial payments to public officials, these are the answers for number 58:

46 1.00 0.38 35.76

Unanswered/blank	2	0.04	0.02	
5	3	0.07	0.02	0.33
10	4	0.09	0.03	0.87
13	1	0.02	0.01	0.28
15	3	0.07	0.02	0.98
20	2	0.04	0.02	0.87
25	2	0.04	0.02	1.09
30	8	0.17	0.07	5.22
32	1	0.02	0.01	0.70
40	1	0.02	0.01	0.87
50	9	0.20	0.07	9.78
60	6	0.13	0.05	7.83
70	2	0.04	0.02	3.04
80	1	0.02	0.01	1.74
100	1	0.02	0.01	2.17

59 Which methods does this business use to evade taxation (check all that apply)?

96 1.00 0.79

Gets part of its revenues in cash	54	0.56	0.44
Under-reports production in its financial reports	46	0.48	0.38
Employs part of people informally, without paying social taxes	37	0.39	0.30
No to all (all blank)	26	0.27	0.21
Deducts expenses for the items that envisage a smaller tax rate	20	0.21	0.16
Hard to say/Don't know	13	0.14	0.11
Don't want to answer	10	0.10	0.08
Registers revenues with people who have privileges in taxation	9	0.09	0.07
Registers firm in an off-shore zone abroad or in a free economic zone	3	0.03	0.02
Gets part of its revenues to an unregistered account in a foreign bank	1	0.01	0.01

60 In such conditions that are faced by the imaginary company, is it possible for this business to operate without establishing informal relations with authorities?

96 1.00 0.79

No	69	0.72	0.57
Unanswered (blank/no)	26	0.27	0.21
Yes	21	0.22	0.17
Hard to say/Don't Know	6	0.06	0.05

61 With which agency's officials are informal relations most important?

93 1.00 0.76

10. Tax inspection	31	0.33	0.25
--------------------	----	------	------

	Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
Unanswered	29	0.31	0.24	
6. Oblast authorities	17	0.18	0.14	
7. Municipal authorities	17	0.18	0.14	
8. Rayon authorities, local self-government	10	0.11	0.08	
1. Ministries, other central state executive agencies	6	0.06	0.05	
14. HS/DK	6	0.06	0.05	
15. Refused to answer	2	0.02	0.02	
2. President's administration	1	0.01	0.01	
4. State-owned or semi-state-owned banks	1	0.01	0.01	
9. Customs	1	0.01	0.01	
11. Prosecutor's office	1	0.01	0.01	
3. Verkhovna rada	0	0.00	0.00	
5. State television	0	0.00	0.00	
12. Police	0	0.00	0.00	
13. Other	0	0.00	0.00	

62 Does the business that you have in mind have to give part of its profits to representatives of any public agencies? If yes, what percentage of its profit? 46 1.00 0.38 16.17

Unanswered (blank/no/zero)	76	1.65	0.62	
10	16	0.35	0.13	3.48
20	7	0.15	0.06	3.04
5	6	0.13	0.05	0.65
0	6	0.13	0.05	0.00
30	3	0.07	0.02	1.96
50	2	0.04	0.02	2.17
40	2	0.04	0.02	1.74
2	2	0.04	0.02	0.09
80	1	0.02	0.01	1.74
60	1	0.02	0.01	1.30

62b Hard to say/Don't know 42 1.00 0.34

63 Does this business have to give part of its profits to representatives of unofficial force groups (racket, etc.)? If yes, what percentage? 53 1.00 0.43 4.23

Unanswered (blank/no/zero)	69	1.30	0.57	
0	36	0.68	0.30	0.00
10	7	0.13	0.06	1.32
20	4	0.08	0.03	1.51
30	2	0.04	0.02	1.13
5	2	0.04	0.02	0.19
3	1	0.02	0.01	0.06
1	1	0.02	0.01	0.02

63b Hard to say/Don't know 35 1.00 0.29

64 What would be a rational tax amount for a business like this? 75 1.00 0.61 16.99

Unanswered (blank/zero)	47	0.63	0.39	
10	24	0.32	0.20	3.20

		Number of Active Responses	Proportion of Firms that Actively Responded to this Question	Proportion of Firms in the Survey (x/122)	Weighted average of active responses
	25	12	0.16	0.10	4.00
	20	11	0.15	0.09	2.93
	15	9	0.12	0.07	1.80
	30	8	0.11	0.07	3.20
	5	3	0.04	0.02	0.20
	8	2	0.03	0.02	0.21
	6	2	0.03	0.02	0.16
	3	2	0.03	0.02	0.08
	50	1	0.01	0.01	0.67
	40	1	0.01	0.01	0.53

64b Hard to say/Don't know

19

1.00

0.16

**LEGAL AND REGULATORY
FRAMEWORK OF BUSINESS
IN UKRAINE**

Prepared for



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LEGAL AND REGULATORY FRAMEWORK OF BUSINESS IN UKRAINE

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Table 1 Chronology of Laws and Decrees of Ukraine Affecting Enterprises in Ukraine		
Effective Date	Title	Number
25 January 2001	Decree on the Decision of the National Security and Defense Council of Ukraine of on Measures to Bring the Economy Out of the Shadows	not available
21 December 2000	Law on National Program in Support of Small Business Development	2157-III
29 November 2000	Cabinet Resolution on Licensing the Wine and Tobacco Trade	1755
19 October 2000	Law on State Support of Small Enterprises	2063-III
30 September 2000	Cabinet of Ministers Decree on Realization of the President's Decree on Assistance in Personnel Training for the Sphere of Business (no. 849, 03 July 2000)	1358
15 July 2000	Decree on Measures on Providing Entrepreneurship Support and its Further Development	906
03 July 2000	Decree on Assistance in Personnel Training for the Sphere of Business	849
01 July 2000	Law on Licensing Certain Types of Economic Activities	1775-III
11 May 2000	Law on Special Investment Conditions in the Territory of Kharkiv	1714-111
16 July 1999	Law on Accounting and Financial Reporting in Ukraine	not available
28 June 1999	Decree on Alteration of the Presidential Decree on Simplification of Taxation System, Accountability And Reporting of Small Business Subjects (03.07.1998 ? 727)	746/99
27 June 1999	Decree on Regulation of Certain Issues Concerning the Antimonopoly Committee's Activities	741
22 June 1999	Cabinet of Ministers Resolution on Regulations of the State Sanitation and Epidemiological Inspection Service	1109
17 November 1998	Decree on Licensing Activities of Economic Subjects in the Area of Natural Monopolies	1257/98
23 July 1998	Decree on Some Measures for Deregulation of Entrepreneurial Business	817/98
03 July 1998	Decree on Simplification of Taxation System, Accountability and Reporting of Small Business Subjects	727
25 May 1998	Cabinet of Ministers Decree on State Registration of Subjects of Entrepreneurial Activity	740
22 May 1997	Law on Taxation of Company's Profits	283/97-??
03 April 1997	Law on Value Added Tax	168/97-??
11 December 1996	Cabinet of Ministers Resolution on Some Questions of the Employment in the Tax Police	1486
15 November 1996	Cabinet of Ministers Resolution on Organizing the Activity of the State Tax Administrations of Ukraine	1385
30 October 1996	Decree on Questions of the State Tax Administrations	1013
30 October 1996	Law on State Regulation of Equity Markets	448
28 August 1996	Decree on Creation of the State Tax Administration and Local State Tax Administrations	760

Table 1 Chronology of Laws and Decrees of Ukraine Affecting Enterprises in Ukraine		
Effective Date	Title	Number
28 June 1996	Constitution (Fundamental Law)	
19 March 1996	Law on Regime of Foreign Investment	93/96
29 February 1996	Cabinet of Ministers Decree on Rights and Authorities of Oblast Departments of Town Planning and Architecture	267
11 November 1994	Cabinet of Ministers Resolution on the Implementation of the Procedure of Preventing Commodity Markets Monopolization	not available
26 July 1994	Cabinet of Ministers Resolution on Regulations of the State Fire Brigade	508
19 February 1994	Decree on the Regulation of Investment Funds And Investment Companies	55/94
15 December 1993	Law on Consumer Rights Protection	3682-XII
26 November 1993	Law on Antimonopoly Committee	3659-XII
20 May 1993	Cabinet of Ministers Decree on Local Taxes and Gatherings	56-93
12 May 1993	Cabinet of Ministers Decree on Conditions of Foreign Investment	not available
7 May 1993	Cabinet of Ministers Decree on Regulation on State Control and Revision Service in Ukraine	515
4 May 1993	Cabinet of Ministers Decree on State Labor Protection Committee of Ukraine	328
21 January 1993	Cabinet of Ministers Decree on Collecting Unpaid Taxes and Fees	8-93
18 February 1992	Law on Restriction of Monopolism and Prevention of Unscrupulous Competition in Entrepreneurship	2132-XII
12 December 1991	Customs Code	1970-XII
19 September 1991	Law on Corporations (also translated as the Law on Companies, Law on Business Associations and the Law on Economic Associations)	1576-XII
18 September 1991	Law on Investment Activity	1560-XII
24 August 1991	Declaration of Independence of Ukraine	
25 June 1991	Law on Taxation System	1251-XII
18 June 1991	Law on Equity and Stock Exchange	not available
27 March 1991	Law on Enterprises	887-XII
07 February 1991	Law on Property	697-XII
07 February 1991	Law on Entrepreneurship	698-XII
4 December 1990	Law on State Tax Service	509-XII
16 July 1990	Declaration of the State Sovereignty of Ukraine	not available
1988	Soviet Law on Cooperatives	not available
to be determined	Soviet Law on the Self-employment of USSR Citizens	not available
NOTE: This table is by no means a comprehensive list of all laws and regulations affecting enterprises in Ukraine. The table contains the most significant laws and decrees that UI encountered during its research.		

LEGAL AND REGULATORY FRAMEWORK OF BUSINESS IN UKRAINE

HISTORY

The Soviet Law on Cooperatives of 1988 provoked a massive increase of employees at cooperatives, which benefited from high wages and low taxes. Cooperatives provided a foundation for business development in Ukraine. They were mostly concentrated in industry and construction (Petrovksy 2001).

In February 1991, Ukraine joined Russia, Uzbekistan, Kazakstan, Latvia and Belorussia in complementing the USSR Act on General Principles of Citizen Enterprise of May 1991 by passing the Law on Entrepreneurship. The USSR Act authorizes the formation and operation of collective and private enterprises. This was the first official document since the era of the New Economic Policy in the 1920s that permits, or even mentions, legal private enterprises. The related law of Ukraine boldly states that, "Entrepreneurs shall have the right to make decisions and independently conduct any business activity not contrary to effective law," (Article 3). The law authorizes various freedoms for entrepreneurs, guarantees their safety and that of their workers, defines state support for enterprises and guarantees free competition among entrepreneurs. The Law's provisions are impressive, especially considering that entrepreneurial activity was still defined as criminal in Soviet legislation that was still effective when the Law was approved (Russica 1991).

Ukraine declared its sovereignty in July 1990 and its independence in August 1991. In September 1991, its parliament adopted two laws that affirm the applicability of Soviet and Ukrainian laws passed prior to the country's independence, so long as they do not contradict the Constitution of Ukraine or other laws adopted since independence. As a result, Ukraine is party to the Universal Copyright Convention (Geneva 1952) and other international agreements to which the Soviet Union was party. In 1992, Ukraine joined the Paris Convention for the Protection of Industrial Property of 1883 (amended in 1967 and 1979).

Also in 1992, the Cabinet of Ministers of Ukraine established a working group to develop the Commercial Code of Ukraine. The expert members of the group wrote a draft code that circulated among government officials, academics and domestic and international technical experts before it was presented to the Cabinet of Ministers in December of 1995. A few months later, the draft was submitted to the Verkhovna Rada (Supreme Council).

The Verkhovna Rada finally discussed the draft Code in December 1998, when it decided that a temporary committee should reconcile the draft Commercial Code with the draft Civil Code. The draft Civil Code emphasizes private interests, including individual property ownership, while the draft Commercial Code follows the lead of the Ukrainian Constitution, in particular Article 13 that gives the state responsibility for the social direction of economic development.

LEGAL FRAMEWORK

The legal framework of business and its frequent changes are routinely cited as obstacles to enterprise development in Ukraine (MSI 1999; EIU 2000; IFC 2000; UI 2001; IFC 2001). By some estimates, the legal framework is formed by no less than thirty-three national laws, twenty-two cabinet resolutions and fifteen presidential decrees (Petrovksy 2001).

While businesspeople in Ukraine await the reconciliation and enactment of the proposed Commercial Code, they may create their businesses under either the Law on Enterprises or the Law on Corporations. The Law on Enterprises provides a very basic legal foundation for business in Ukraine, and an even more basic foundation for advanced economic relationships, such as holding companies and joint ventures. The Law on Corporations defines in much more detail the relationships and responsibilities of multiple owners of a business, so most firms are organized according to this law's provisions (Baker & McKenzie 2001). Municipal enterprises are fully addressed by neither of these laws (nor any others), and are discussed in a separate section at the end of this chapter.

ENTERPRISES

The 1991 Law on Enterprises legally defines an enterprise as an independent economic statutory subject that has rights of a legal entity and carries out production, research and development and commercial activities directed at the generation of profit. According to the Law, the financial resources of enterprises consist of: profit; capital allowances; revenues from securities sales; and employee contributions.

Interference by state and public organizations and political parties in the activities, economic and otherwise, of enterprises is prohibited except in cases provided by the state.

The law defines the following types of enterprises:

- private enterprise based on property of a physical person;
- collective enterprise based on property of the work force of the enterprise;
- economic society (corporation);
- enterprise based on property of a civil association;
- municipal enterprise based on property of a certain territorial community;
- state enterprise based on state property.

The Law permits and defines various types of coordination among enterprises. *Associations* are contractual joint ventures created with the aim of permanent coordination of economic activities. *Corporations* are contractual joint ventures created on the basis of a combination of productive, scientific and commercial interests. In a corporation, some responsibilities of individual enterprises are transferred to a central administration. A *Consortium* is a temporary contractual joint venture that includes the combination of production and bank capital in pursuit of a common goal. A *Concern* is a contractual joint venture that is completely, financially dependent on one enterprise or a group of enterprises. Enterprises may merge with, and spin off from, other enterprises.

The Law defines enterprise property as fixed assets and current assets, including:

- money and material contribution of promoters;
- sales revenues;
- income from securities;
- bank and other credits;
- investments and budget subsidies;
- proceeds from privatization of property;
- acquisition of other enterprise property; and
- grants or donations from organizations and citizens.

CORPORATIONS

The Law on Corporations (also translated as the Law on Companies, Law on Business Associations and the Law on Economic Associations) defines and regulates companies, which may be formed by domestic and foreign enterprises, organizations and individuals. State-owned enterprises may not be party to corporations.

General Provisions (Articles 1 - 23)

The law requires corporations to register as legal entities by submitting their constituent documents to the Antimonopoly Committee of Ukraine. The documents must include the type of association, its field of work, its founders and participants and management bodies and procedures. The documents must also include information on the number and division of shares and shareholder voting procedures.

The law guarantees shareholders the right to participate in the management of their corporation and to receive dividends on their investment shares. It also requires corporations to provide to its shareholders minutes of management meetings and annual balance sheets and activity reports. The law requires corporations to maintain accounting records and submit them to state statistics committees. Corporations whose turnover does not exceed 250 tax-free minimum-wage incomes must be audited every three years.

The law clearly identifies corporations as the owners of assets assigned to them by their founders and shareholders. These assets can include monetary, material and intellectual property, as well as rights and concessions.

The law requires corporations to maintain reserve funds of at least twenty-five percent of their equity funds. Annual allocations to the reserve fund must be at least five percent of net income. Corporations may increase their equity funds only after all shares are fully paid. Corporations may reduce their equity funds, but not over the objections of their creditors.

Corporations may be terminated when they achieve their stated goals, by decision of their highest management body, by decision of a court or by other grounds established by the corporation's constituent documents. In cases of liquidation, a special committee receives authority over all aspects of corporation management. Within three days of its appointment, the liquidation committee must publish information on the procedure for creditors to submit claims, and prepare for the settlement of all corporate accounts. Within six months after publication of the liquidation notice, and once the corporation has settled with its staff, banks, bond-holders and other creditors, the corporation's remaining assets are distributed among its shareholders and founders. Assets assigned to a corporation by its founders should be returned as they were received, without compensation.

Joint Stock Companies (Articles 24 - 49; 65)

Shareholders of joint stock companies are liable for corporate commitments within the limit of their investments (shares). Shareholders may choose to accept additional liability up to an amount stipulated by the company's statute, and in proportion to their shares. In this case, the company is a "joint stock company with additional liability" but resembles a joint stock company in every other way (Article 65).

The starting equity fund of a joint stock company must be equivalent to at least 1,250 annual salaries at minimum wage. Joint stock companies may be open or closed. Shares of open joint stock companies may circulate through subscription offers and on stock exchanges. Shares of closed joint stock companies are distributed only among company founders, and may not publicly circulate.

The structure of joint stock companies includes a management board, an observation council and a financial review committee. Members of the observation council may not be members of the management board. The management board is accountable to the company's observation council and its shareholders, is headed by a chairperson and oversees the daily operations of the company. The chairperson may act on behalf of the company without prior authorization. The chairperson must organize the keeping of the minutes of all management board meetings, which should be available to any shareholder at anytime. The financial review committee is elected from among the company's shareholders. The work of the financial review committee may be authorized by the general assembly, observation council, its own initiative or by request from holders of at least ten percent of shares.

Joint stock companies have the right to issue bonds and other securities. The founders of joint stock companies must hold at least twenty-five percent of the company's equity fund for at least two years. Joint stock companies are prohibited from issuing shares to cover losses.

Joint stock companies must publicly announce opportunities to subscribe to share and bond issues. The announcement must include information on the firm, its operations and founders, the types and characteristics of its shares, the company's assets, its accountant and bank, date of shareholder meeting and other information. Share subscriptions may not exceed six months. Purchasers of the shares must deposit with the company at least ten percent of the value of the shares received, and at least thirty percent by the time of the following constituent assembly. In a closed joint stock company, founders must have at least fifty percent of the value of their shares on deposit by the following constituent assembly. If the company sells less than sixty percent of its shares during the subscription, the company is considered not established, and its founders must refund the shares purchased.

A shareholder meeting must be called within two months after termination of a subscription to shares. Shareholder meetings are competent if individuals who own at least sixty percent of the company's shares, or their representatives, are present. If a company fails to gather the necessary representation, then it is considered not established. Competent shareholder meetings may decide on the following issues:

- Adoption of the decision to establish the company;
- Adoption of the company's statute;
- Increase or decrease of the company's equity fund in response to subscriptions;
- Election of the observation council and executive and controlling bodies of the company;
- Affirmation of agreements concluded by the founders prior to establishment;
- Privileges for the founders;
- Approval of in-kind contributions;
- Other issues identified by the company's statute.

Shareholder voting is conducted on the principle of one share, one vote. Most decisions may be concluded on the basis of a simple majority, but the following decisions require support from holders of at least three quarters of all shares:

- Establishment of the company, its subsidiaries, branches and representatives;
- Election of the company's observation council;
- Executive and controlling bodies of the company; and
- Privileges and powers of the founders.

After shareholders fully pay for their shares, a joint stock company may increase its equity fund by issuing new shares, exchanging bonds for shares or increasing the nominal value of shares. Shareholders have priority rights to purchase new shares. An increase of one third or less may be authorized by the company's management board, provided such a procedure is outlined in the company's statute. Similarly, a joint stock company may reduce its equity fund by decreasing the nominal value of its shares or by purchasing and nullifying shares. When changing its equity fund, a joint stock company must issue a public announcement that identifies the following:

- Rationale and procedure for change;
- Draft changes to company statute;
- Details on the shares issued or nullified;
- Related shareholder rights;

The general assembly is the highest authority within a joint stock company. A competent general assembly requires the presence of individuals owning at least sixty percent of outstanding shares, or their representatives. All shareholders may participate in general assemblies, regardless of the number of shares they own. Management officials may participate in general assemblies, but their votes do not count.

Generally assemblies must be announced at least forty-five days in advance. Any shareholder may propose additions to the agenda for the assembly at least forty days in advance. A general assembly has no right to decide on issues not included in its agenda. Companies must hold general assemblies at least once each year. Extraordinary assemblies should be called in case of non-solvency of the company or recommendation by the observation council. An extraordinary assembly also should be held if it is called for by holders of more than twenty percent of outstanding shares. If the company management does not respond to such a call, the shareholders are free to organize an extraordinary assembly themselves.

General assemblies decide on the following issues:

- Main directions, or strategies, for the company;
- Approval of corporate plans and reports on their progress;
- Introduction of changes to the company statute;
- Election and recall of members of the company's observation council;
- Election and recall of members of the company's financial review committee;
- Approval of annual reports on the activity of the company, its subsidiaries and representatives;
- Approval of reports and conclusions of the financial review committee;
- Order of profit division and loss coverage;

- Establishment, reorganization and liquidation of subsidiaries and representatives, and related statutes;
- Responsibilities of the company's officers;
- Corporate rules and internal procedures;
- Repurchase of shares;
- Compensation for company officials and those of its subsidiaries and representatives;
- Approval of agreements on sums of money that exceed the limits identified in the company statute; and
- Approval of decisions to liquidate, appointment of liquidation committee and liquidation balance.

Most decisions may be concluded on the basis of a simple majority, but the following decisions require support from holders of at least three quarters of all shares:

- Change in the company statute;
- Discontinuance of association activity;
- Establishment and discontinuance of subsidiaries, branches and representatives.

Full Partnership (Articles 66 - 74)

Owners of a full partnership are jointly responsible for the company's commitments with all of their personal property. The statute of a full partnership must state the amount of shares to be held by each owner, as well as other investments and contributions, whether in-kind or monetary.

A full partnership is managed by all of its owners, but they may choose to delegate responsibilities to one or more owners by jointly signing an authorization for such delegation. Owners and managers must disclose information on all of their actions that affect the firm. An owner may sell his shares to a third party only by agreement of all the owners. Owners are prohibited from engaging in activities that are in competition with the aims of the firm.

If a partnership was established for an undetermined amount of time, an owner may leave at any point, as long as three months' notice is given to the other owners. If a partnership was established for a determined amount of time, an owner may leave only for valid reasons and with six months' notice. The partnership should pay the leaving owner his or her portion of its income for the year in which the owner leaves. The partnership also should return any assets that were provided by the leaving owner in their original form and without compensation.

The creditors of an indebted partner who has insufficient funds to repay his or her debts may demand liquidation of the partnership, or separation of the debtor partner's share. The other partners may defensively separate a debtor partner's share of the company as well.

When a partnership is liquidated and its assets are insufficient to cover its debts, all of the partners are jointly responsible with all of their personal property. If one partner pays all of the outstanding debts of the partnership, he or she may legally require reimbursement from the other partners.

Limited Partnership (Articles 50 - 64)

Shareholders of a limited partnership are liable for the company's commitments only up to their investments (shares). The statute of the partnership must state the amount of shares to be held by each owner, as well as other investments and contributions, whether in kind or monetary. A limited partnership's equity fund must be equivalent to at least 625 annual salaries at minimum wage. The shareholders must deposit at least thirty percent of the value of their shares with the company prior to registration, and must fully pay for their shares within one year of the company's registration.

Shares of limited partnership are not traded on the open market, but a partner may sell his shares to other partners, third parties and the company itself. Other partners have priority rights to purchase another partner's shares, in proportion to their current ownership shares. Third parties and the company may purchase company shares only after they are fully paid. If the company purchases shares, it must sell them within one year.

A limited partnership may increase or reduce its equity fund, but no sooner than three months after registration, and not without notice of at least three months. When a partner leaves the company, the company must reimburse his or her share of the company after the adoption of the annual report and within twelve months of the partner's leaving. If an individual partner's assets are insufficient to cover debts, his or her creditors may demand the separation of that person's share of the partnership.

The supreme authority in a limited partnership is the assembly of owners, including all partners and/or their representatives. The weight of the partners' votes are proportional to their shares. An assembly is competent if individuals representing at least sixty percent of the company's shares are present, unless the assembly is to decide on issues requiring unanimity (see below). The assembly of a limited partnership has basically the same function and competency as a general assembly of a joint stock company, with the addition of:

- Determination of the amount, form and order of additional contributions;
- Decision to purchase shares from a partner; and
- Exclusion of someone's participation in the company.

Unanimity is required for decisions on the company's plans and reports on their progress, changes in the company statute and exclusion of someone's participation in the company. Other decisions require only a simple majority, unless otherwise stipulated in the company statute. Any partner may demand consideration of an issue at the assembly, provided he or she proposes it at least twenty-five days in advance of the meeting. The head of the assembly is required to keep minutes of all meetings, and to make them available to any partner upon request. Assemblies must be held at least twice each year. In case of insolvency or other urgent matters, an extraordinary assembly should be called. Partners who hold at least twenty percent of the company votes may demand an extraordinary assembly, and may call one themselves if the head of the partnership or assembly has not responded after twenty-five days.

The executive body of a limited partnership is its board of directors headed by a general director, or an individual director. The board of directors has no right to obligate the partners to any actions. The general director or individual director may not be the head of the company's assembly. The financial review committee of a limited partnership is elected from its owners, and must include at least three people.

Mixed Partnership (Articles 75 - 83)

There are two types of owners of a mixed partnership: partners, who are liable for the company's commitments with all of their personal property; and shareholders, who are liable only for their investments (shares). In almost every other aspect, a mixed partnership is the same as a full partnership. A mixed partnership's statute must identify the amounts and types of shares to be held by each partner and shareholder.

In case of liquidation, shareholders have priority over partners in regaining their investments. The shareholders may not own more than fifty percent of the company's assets, or interfere with the activity of the partners. Participants in a mixed partnership must pay at least twenty-five percent of the price of their shares before registration of the company. If all of the company's partners leave the firm, the firm ceases to exist. If only shareholders leave the firm, the company may be transformed into a full partnership.

MUNICIPAL ENTERPRISES

Ukraine's legislation incompletely defines the legal status of municipal enterprises. The Soviet Ukraine Law on the Local Radas of People's Deputies and Local Self-government of 1990 established municipal enterprises by introducing the communal form of property. The Law on Property of 1991 defined communal property as a form of state property, thereby creating state municipal enterprises and incorporating them within the legal framework of state enterprises.

Article 142 of the Constitution of Ukraine, enacted in 1996, states:

Movable and immovable property, incomes of local budgets, other money, land, natural resources owned by territorial communities of villages, settlements, cities, city districts as well as objects of their joint ownership managed by district and regional councils shall be the material and financial basis of local self-government.

This marked the separation of communal and state property and was intended to end state ownership of municipal enterprises. The text is repeated in Paragraph 3, Article 16 of the Law on Local Self-government, which also assigns complete ownership and management rights for municipal enterprises to appropriate oblast and rayon councils. Other articles throughout the law reinforce these municipal rights and authorities. However, the Law on Property still has not been amended, so its Article 20 continues to assign communal property to the jurisdiction of the state (Grynyuk 1999).

REGULATORY FRAMEWORK

REGISTRATION

All businesses, including sole proprietors, are legally required to register as subjects of entrepreneurial activity. The requirements are found in the Law on Enterprises, the Law on Corporations and the Cabinet of Ministers Decree Confirming Regulation of State Registration of Entrepreneurial Subjects. There is no national registration agency; firms register the local administration of the territory in which they are situated by submitting their statutes and other official documents, such as a copy of the lease for their premises. Once it receives the required documents, the local administration should register the company within five days. After registering with the local administration, companies also must register with the tax administration and other agencies (Baker & McKenzie 2001).

According to the Cabinet of Ministers Decree Confirming Regulation of State Registration of Entrepreneurial Subjects, state registration bodies may cancel enterprise registrations under the following circumstances:

- statutory documents are acknowledged to be void or contradictory to the legislation;
- undue notification about changes of name, organizational form, type of ownership, location;
- acknowledgement of bankruptcy; and
- accounting documents are not submitted to tax administration within a year.

LICENSE

In the mid-1990s, the licensing process was a major administrative barrier for enterprises in Ukraine. Beginning in at least 1997, the central government attempted to streamline and improve the licensing system. Efforts included amendments to the Law on Entrepreneurship and passage of the Law on Licensing of Certain Types of Economic Activity, which includes a list of specific operations requiring a license, limited mostly to activities that are potentially harmful to health and environment (the list is included as Annex 2).

The law established a special licensing agency to maintain a single license register. Licenses are issued by a variety of government agencies, depending on the type of license. Most of these agencies delegate their functions to local administrations that directly interact with the businesses requiring licenses. Licensing bodies conduct planned annual audits and unplanned audits, as appropriate. Since establishment of the new licensing regime, the time spent on obtaining licenses has decreased as a result of these efforts (from 1997 to 1998, the average time required to obtain a license fell from 35 to 14 days). However, the procedures and administrative arrangements among ministries and their local branches and local governments required by the new Law have not yet been implemented (MSI 1999, 41; IFC 2000, 17; IFC 2001, 63).

PERMIT

Unlike registration and licenses, permits are unregulated by national legislation, subject only to the rules and procedures of oblast departments and agencies. For this reason, the permit process is one of the most opaque and unpredictable types of business regulation in Ukraine. Enterprises often do not know whether or not they require permits for their activities, so the process often involves obtaining permission from local authorities to engage in certain activities, whether or not

official permits are required. The opaque and unregulated nature of the process provides a moral hazard, and even incentives for extortion, for local officials (IFC 2001, p. 60).

Permits are most often required by the Fire Brigade, Sanitary and Epidemiological Service, and the Health, Safety and Environment Department. These agencies, especially the fire and sanitation departments, also are among the most frequent inspectors of businesses in Ukraine, leading to the conclusion that the permit-inspection linkage creates a fertile ground for corrupt officials (IFC 2001; UI 2001).

INSPECTION

The Presidential Decree on Measures for the Deregulation of Entrepreneurial Business assigns authority for ensuring the financial and economic activities of entrepreneurial subjects to a number of supervisory bodies, including:

- State Fire Inspection;
- Labor Protection Committee;
- Customs;
- Sanitation agencies;
- State Veterinary Control;
- State Committee of Ukraine for Consumers Rights Protection;
- State Control of Prices;
- State Architecture and Construction Inspection;
- Committee of Ukraine for Standardization, Metrology and certification.

Neither these agencies nor any other executive authority may restrict entrepreneurial activities unless such restriction is directly provided by legislation. The decree authorizes several supervisory bodies to conduct field audits of entrepreneurial subjects within their respective spheres of responsibilities. The State Committee for Regulatory Policy and Entrepreneurship oversees audits performed by supervisory bodies. These supervisory bodies, the source of their authority and the activities subject to their supervision are summarized in the Table 2.

Table 2 Supervisory Bodies of Business in Ukraine

Supervisory Body	Source of Authority	Objects of Inspection
Antimonopoly Committee	Law on the Antimonopoly Committee	Noncompetitive practices, mergers and acquisitions, registration of corporations
Consumer Protection Committee	Law on Consumer Rights Protection	Adherence to quality and price regulations
Customs authorities	Customs Code	Payments of entry duties, excise duties and VAT on imported goods
Fire Brigade	Cabinet of Ministers Resolution on Regulations of the Fire Brigade	Adherence to fire safety regulations
Labor Protection Committee	Cabinet of Ministers Decree on the Labor Protection Committee	Adherence to labor law and regulations
Licensing Bodies (various)	Law on Licensing of Certain Types of Economic Activity	Adherence to conditions of licenses
Tax authorities	Law on State Tax Service	Payment of taxes, dues and fees to budget and state target funds
Sanitation and Epidemiological Inspection Service	Cabinet of Ministers Resolution on Regulations of the Sanitation and Epidemiological Inspection Service	Adherence to health and sanitation regulations
State Control and Review Service	Cabinet of Ministers Decree on Regulations of State Control and Review Service	Use of public funds, whether loans, grants or contracts

The Decree authorizes planned and unplanned field inspections. Planned inspections must be included in the work plans of appropriate supervisory bodies. Unplanned inspections are authorized only if one or more of the following applies:

- a cross audit reveals subjects violated laws;
- subjects have not submitted obligatory reporting documents on time;
- subjects have reported invalid data in obligatory documents;
- subjects have complained that supervisory body officials violated laws during planned or unscheduled audit;
- it is necessary to check statements received from the person who had legal relations with the entrepreneurial subject in case the subject does not provide explanations and obligatory written inquiry of the supervisory body during first three days after he has received the inquiry;
- the enterprise is being reorganized (liquidated); and/or
- the Cabinet of Ministers of Ukraine determines an unscheduled audit is required.

Tax Inspections

According to the Law on State Tax Administration, the tax militia, or tax police, have the right to inspect any type of enterprise, regardless of the form of ownership. They have rights of access to any financial documents, premises of production, warehouses and trading facilities so long as they are used in the generation profit. The tax police may require elimination of revealed infringements, suspend bank account operations and repossess documents proving concealment or understatement of taxation objects. Tax police also may apply penalties and administrative fines to enterprises that are found to violate laws or regulations.

According to several surveys of businesses in Ukraine, the tax police conduct by far the most inspections of any regulatory agency in Ukraine. Tax inspections have been, and continue to be, named by businesspeople of Ukraine as major obstacles to business development (MSI 1999; EIU 2000; IFC 2000; UI 2001; IFC 2001).

The breadth of the tax militia's power mainly is a result of its history. Ukraine established its state and local state tax administrations by presidential decree in 1996. Subsequent decrees subordinated to those tax administrations the militia forces within the Ministry of Interior that were used to investigate criminal concealment of taxable incomes. The militia forces were, in fact, transferred as a whole unit to the tax administrations, but their competencies were not redesigned to complement their new administrative positions (Golovan 1998). For this reason, the tax police's functions are not limited to issues of taxation. For example, they are empowered to check products to ensure their shelf lives have not expired, though this task is more appropriately performed by consumer protection groups or industry itself (Petrovsky 2001).

TAXATION

The original legal basis for taxation of enterprises is found in the 1991 Law on Taxation System, which authorizes the government to collect the following taxes: turnover tax, excise tax, a surplus value tax, export-import tax, custom duties, tax on owners of transportation, tax on collective farm workers' wages, payment for use of land, payment for use of natural resources, a forest tax, an ecological tax, and a profit and income tax. On average, companies pay 11 national taxes and fees, totaling approximately twenty-four percent of gross sales. The burdensome and confusing

tax system is routinely cited as a major obstacle to enterprise development in Ukraine, and is one of the main incentives for concealed sales revenues (estimated by the 2001 IFC Survey as 16 percent) and bribes (MSI 1999; IFC 2000; IFC 2001; UI 2001). The most significant and clearly defined corporate taxes are on profit and value added.

Profit Tax

During 1992-1994, the government taxed the dokhod of enterprises, which is similar to profit, but does not deduct the costs of salaries and interest on long-term borrowing. Since 1997, the Law on Taxation of Corporate Profits has governed business taxation. The law established a basic tax rate of 30 percent, a tax rate of 45 percent for intermediary activities and one of 60 percent for gambling activities (Baker & McKenzie 1997). The Law on the State Budget proposes funding for the Tax Administration based on the amount of taxes and duties it collects, thus creating a moral hazard for the inspectors (Petrovsky 2001).

Value Added Tax

The Law on Value Added Tax (VAT) requires additional taxes from legal entities that have sold goods in excess of 3,600 annual salaries at minimum wage or who trade internationally or with a non-resident entity. Sales and imports of goods and services are subject to VAT; the following activities are not subject to VAT:

- Sales of securities;
- Lease payments;
- Property pledges;
- Insurance provision; and
- Purchase of company shares (even if they are not in the form of securities).

The law establishes a rate of twenty percent to be applied to the contractual value of goods and services, including excise taxes, import duties and other related payments. A rate of zero percent is levied on goods and services exported from Ukraine (Baker & McKenzie 2001).

Small Enterprise and Entrepreneur Taxes

The Presidential Decree on Alternation of the [Previous] Presidential Decree on Simplification of the Taxation System, Accountability and Reporting for Small Business Subjects, No. 746/99 from 28 June 1999 established the integrated system that permits small enterprises and entrepreneurs to pay either a single or simplified tax, which exempts them from a variety of taxes and fees established by the Law on Taxation. According to the Decree, the *single tax* is available to individual entrepreneurs who operate without creating a legal entity, have ten or fewer employees and whose annual sales revenue is UAH500,000 or less. Local councils determine the single tax rate, within the legally defined parameters of UAH20 and UAH200, based on the types of activities to be taxed. They pay their single tax to the State Treasury of Ukraine, which then distributes the revenues in the following manner:

- 43% to the Oblast budget;
- 42% to the Pension Fund of Ukraine; and
- 15% to obligatory social insurance.

The *simplified tax* is available to enterprises with fifty or fewer employees, and provides a choice of one of the following rates:

- 6% of sales revenue excluding excise duty where VAT is paid separately; or
- 10% of sales revenue, excluding excise duty where VAT is included.

The simplified tax is paid to the State Treasury of Ukraine, which then distributes the revenues in the following manner:

- 20% to the State Budget of Ukraine;
- 23% to the local budget;
- 42% to the Pension Fund of Ukraine; and
- 15% to obligatory social insurance.

According to Articles 5 and 6 of the Decree on taxation, sole proprietors who operate in marketplaces and pay marketplace fees may choose to pay a *fixed tax*. The amount of the fixed tax is from 20 to 100 hryvnias per month. The amount increases by fifty percent for each additional employee. Individuals that choose to pay the fixed tax may have no more than five employees and may not have recorded income that is equivalent to more than 7,000 annual salaries at minimum wage.

The State Treasury of Ukraine receives revenues from all business income taxes, irrespective of the taxation system used. Local governments determine the rates of only a few taxes and fees that affect businesses. The Cabinet of Ministers Decree on Local Taxes and Gatherings, No. 56-93 from 20 May 1993, limits the advertising tax to 0.1% for a single advertisement, 0.5% if the advertisement is to be displayed for a long period of time. The same Decree limits sales tax on imported goods to 3%. Changes in other business taxes must be effected at the national level.

ACCOUNTING AND FINANCIAL REPORTING

The Law on Accounting and Financial Reporting, passed in July 1999, regulates business accounting and financial reporting in Ukraine. Article 4 of the law outlines the guiding principles of standard accounting in Ukraine. They generally correspond to the International Accounting Standards. The law requires businesses to maintain balance sheets, reports on financial results, cash-flow and private capital and explanatory notes to those reports. The law requires the annual publication, by at least 1 June, of financial reports on joint stock companies and financial institutions. The law also requires holding companies to report the financial performance of their subsidiaries.

The 1999 law is ambiguous and faulty in some respects. For example, it directs businesses to use the principle of historical cost in valuing company assets. However, this is impractical when market prices are in reality quite different from historical costs and when market prices cannot be derived from balance sheets. Investment companies have begun using market prices to assess their portfolios. There is a need to more clearly define accounting procedures such as this.

Another gap in the legal framework of business relates to financial reporting. Since 1998, commercial banks have transferred data on finance and statistics, including data on their clients, to the central bank. However, the central bank has no legal authority or procedure to obtain similar information from other financial institutions, such as credit unions and insurance companies (Synkova 2000).

INFORMAL SECTOR

The informal sector of Ukraine is very large, even by official estimates. According to the National Bank of Ukraine, 52% of the nation's money supply circulates without the banking system. Informal transactions account for 67% of net profit in the financial and banking sector (Kniazhansky 2001).

Several factors contribute to a large informal sector in Ukraine. These include the complex and ever-changing legal environment for business, corruption, lack of a stable currency, trade regulations and a tradition of barter. The government has increasingly recognized and admitted problems that the informal sector presents, and recently changed its approach to encouraging the formalization of economic activity.

In January 2001, the President signed the Decree on the Decision of the National Security and Defense Council of Ukraine on Measures to Bring the Economy out of the Shadows. The Decree directs the Cabinet of Ministers and newly formed Interdepartmental NSDC Commission for Financial Security to implement a program on the Main Principles of Bringing Money Circulation Out of the Shadows (Kazansky 2001).

In an interview with a Kiev-based daily newspaper in April 2001, the Deputy Secretary of NSDC, Trokhym Kovalchuk, indicated that the government has learned that it cannot combat informal economic activity with strict rules and supervision, but that it must work to create conditions that favor formal, or legally conducted, economic activity. For example, the government recently abolished Article 80 of the Soviet Criminal Code that required punishment for individual possession of foreign currency.

Mr. Kovalchuk explains that the legal and regulatory framework of business in Ukraine requires additional improvements to reduce the informal economy. Several tax loopholes exist, and one is the cause of major outflows from Ukraine. For example, the interest paid on a business loan is considered part of production costs, so is exempt from taxation. Some large businesses have established offshore counterparts to lend money to Ukrainian firms at high interest rates, so they can transfer vast sums of money out of Ukraine under the guise of repaying a loan.

Mr. Kovalchuk reports, "For instance, US budget expenditures, worth \$500 billion, include \$9 billion (1.8%) appropriated by Congress as tax privileges. In contrast, Ukraine grants annual privileges of UAH 30 billion, which exceeds total revenues...none of the supervising bodies can show a complete list of the privileged and assess their true incomes because, officially, nobody in Ukraine is authorized to grant privileges." (Kazansky 2001).

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ANNEX 1: KHARKIV INVESTMENT INCENTIVES

The Law on Special Investment Conditions in the Territory of the City of Kharkiv provides various tax exemptions for high-priority investment projects in the City of Kharkiv. Under this Law, entrepreneurial subjects that have been registered for at least thirty years in the City of Kharkiv and whose investment projects meet minimum value requirements (see table below) are exempt from import taxes on goods that are used for their own production needs, including materials and raw materials and equipment and its components. The types and volumes of exempted materials and raw materials are listed by the Council for Special Investment Conditions, the overall regulator of special investments in Kharkiv. Qualified entrepreneurial subjects also are exempt from the land tax on site planning and construction, as well as VATs on qualifying equipment and its components. These special conditions apply for the duration of qualified investment projects, to a limit of five years.

New, restructured and reconstructed enterprises that implement investment projects are completely exempt from profit taxes during the first three years of investment, then are subject to a profit tax rate that is fifty percent of the existing rate during the fourth, fifth and sixth years of investment. This profit tax exemption is applied from the moment when the enterprise generates its first profit.

For the purposes of taxation, the gross income of enterprises excludes investments (tangible and intangible assets, other resources) received for qualified investment projects. These privileges do not apply to activities financed by public sources, including the State Innovation Fund.

Legal Definition of High-priority Investments Eligible for Special Investment Conditions in the City of Kharkiv	
Sectors	Minimum Value of Investment (US\$ millions)
Metallurgy and metal processing Machine-building and equipment Electric, electronic and transportation equipment	3.0
Electric energy Gas and water Coke Other non-metal mineral products Transport Communication Metal waste processing	1.0
Construction Sewage Street refuse collection and waste processing Chemical manufacturing Furniture manufacturing Pulp-and-paper and printing industry	0.7
Food industry and agricultural products processing Textiles and clothes manufacturing Tannery and apparel Education Health care Social support R&D in the area of natural and technical sciences	0.5

ANNEX 2: LIST OF ACTIVITIES REQUIRING A LICENSE, FROM THE LAW ON LICENSING CERTAIN TYPES OF ECONOMIC ACTIVITY

1. Geophysical prospecting
2. Cold steel manufacturing;
3. Explosives manufacturing;
4. Dangerous chemicals manufacturing;
5. Uranium ores mining;
6. Precious metals and stone mining;
7. Precious metals and stone manufacturing;
8. Jewelry manufacturing and sales;
9. Medicines manufacturing and trade;
10. Veterinary medicines manufacturing and trade;
11. Pesticides and agrochemicals manufacturing and trade;
12. Tear gas and other chemical weapons manufacturing;
13. Wire taps and other secret information-gathering devices;
14. Cryptographic equipment manufacturing, trade or use;
15. Holographic protective device manufacturing, trade or use;
16. Projecting, manufacturing, application, maintenance, effectiveness research of systems and devices of technical protection of information, services supply in the field of technical protection of information;
17. Manufacturing of securities and other investment products;
18. Transit of oil, oil products using pipe lines, transit of natural gas and oil gas using pipe lines and their distribution;
19. Natural gas supplies according to the regulated, non-regulated tariff;
20. Natural gas storage in volumes exceeding the level established by the licensing terms;
21. Centralized water supply and drainage system;
22. Projecting, researches, manufacturing, exploitation of launch vehicles, space apparatus and their components, land space infrastructure and its components, equipment that is part of space segment of satellite systems;
23. Projecting, manufacturing, production, storage, buying, acquisition, carriage, import, export, sales, termination of drugs, psychotropics;
24. cultivation, utilization of plants containing drugs in industry;
25. Carrying out of disinfecting, disinsection, deratization works;
26. Medical practice;
27. Donors' blood and its components processing;
28. Veterinary practice;
29. Gambling houses;
30. manufacturing, erection of load-carrying structures, erection of structures in the field of construction;
31. Services supply in air transport of passengers and cargoes;
32. Services supply in river and sea transport of passengers and cargoes;
33. Services supply in auto transport of passengers and cargoes;
34. Services supply in railway transport of passengers and cargoes;
35. Storage, processing, scrap ferrous and non-ferrous metal processing;
36. Picking, preprocessing of outcasts and scrap of precious metals and precious stones, precious organogenic stones, semiprecious stones;
37. Storage, processing of some kinds of resource precious wastes, picking, storage of some kinds of wastes as secondary raw materials (according to the list determined by the Cabinet of Ministers of Ukraine);
38. Operations in the sphere of hazardous waste handling;

39. Education services supply to general, technical, higher educational institutions;
40. Projecting, assembling, maintenance of fire protection devices;
41. Fire risk test of materials, buildings, products and equipment, fire engineering, fire prevention production;
42. Supply of state or other property guard services, bodyguard services supply;
43. Carrying out of topographic, geodesic, cartographic works;
44. Carrying out of aerochemical works;
45. Money transfer;
46. Radio communication services supply (using radio frequencies);
47. Telecommunication services supply (with the exception of department objects);
48. Maintenance of telecasting, radiocasting, cable nets in limits of industrial exploitation;
49. Organizing of foreign, domestic, excursion activity;
50. Sports and health activity;
51. Production of ethyl, cognac, fruit spirit, alcoholic drinks, wholesale trade of ethyl, cognac, fruit spirit, wholesale and retail trade of alcoholic drinks;
52. Tobacco products manufacturing, wholesale and retail trade of tobacco products;
53. Insurance activity;
54. Activity of persons, who are responsible for arbitration (property managers, readjustment managers, liquidators);
55. Mediation on employment abroad;
56. Professional activity on the securities market;
57. Organizing of the use of land, valuation of land;
58. Projecting, construction of new and reconstruction of existing land-improvement systems and separate objects of engineering infrastructure;
59. Activity connected with fishery on the fish industry enterprise ponds (with the exception of inner ponds of enterprises);
60. Mediation activity of the custom broker and custom transporter.

**EMPLOYMENT AND WAGE
DEVELOPMENTS IN
KHARKIV AND EASTERN
UKRAINE**

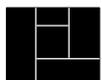
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EMPLOYMENT AND WAGE DEVELOPMENTS IN KHARKIV AND EASTERN UKRAINE

We examined labor market data on employment and average monthly wages by economic sector and industry for Kharkiv and the other four oblasts that cover the eastern region of Ukraine. We traced the developments of the late 1990s in order to pinpoint industries and sectors where positive labor market outcomes can be identified. Two outcomes are of particular interest: employment growth and payment of above-average wages. To the extent these can be found, this may help to target the efforts of USAID to support employment growth, a major objective of the Kharkiv initiative.

Employment decreased substantially in Kharkiv and throughout Eastern Ukraine during the late 1990s. Table 1 helps provide an overview of employment developments in Kharkiv and other four eastern oblasts. The table summarizes employment levels and trends for 23 broad sectors and for 19 detailed industries within the industrial sphere for each oblast. Employment in the five oblasts averaged 5.4 million persons during 1996-1999, accounting for about one third of national employment as recorded in Ukraine's establishment (enterprise) reports.

The employment data summarized in Table 1 are based on the enterprise reporting system that predates Ukrainian independence. Employment and total payroll are reported for the formal sector at large and medium enterprises that traditionally have provided the bulk of employment. These data do not fully capture employment developments in Kharkiv and other areas of Ukraine. Small enterprises, single (own account) entrepreneurs and most individual farmers fall outside the scope of these enterprise reports. Since important employment developments are taking place among the excluded groups, an important part of the dynamics of the labor market is not reflected in these data.

Five sectors (industry, agriculture, transportation, construction and retail-food services) account for about two thirds of all employment covered by this reporting system (percentage shares appear in columns (6) through (10)). In the long run, most enterprises in these sectors would be privately owned and they would be expected to provide a large share if not the majority of new employment opportunities for the labor force.

All five sectors experienced continuous and substantial erosion of employment during the late 1990s. Annual percentage rates of change (columns (11)-(15)) were negative for all five sectors in all five oblasts during 1996-1999. The simple average of these 25 annual percentage changes was -7.6 percent. The smallest (closest to zero) annual change among these 25 was an average decrease of 3.3 percent per year (transportation in Donetsk) whereas the largest (most negative) was a decrease of 12.4 percent (retail-food services in Lugansk).

Total employment across all sectors in Kharkiv decreased from 1.037 million in 1996 to 874,000 in 1999, a reduction of 163,000, or 15.7 percent. For the five sectors identified above, total employment decreased from 670,000 to 530,000, or about 140,000. These sectors accounted for 86 percent of the total decrease in employment in



Kharkiv. Across these sectors, Kharkiv has a relatively smaller reliance on industrial employment but above-average reliance on agriculture (column (6)).

Four other sectors that traditionally provide services to the population (housing and community services, health, education and government) also account for a sizeable share of total employment. Across the five oblasts, their combined share averaged about 25 percent of employment. Note that employment changes in these sectors were generally small in the late 1990s. The simple average of the 20 annualized rates of change was -0.2 percent and the largest annual rate of decrease was 3.2 percent (education in Lugansk). These sectors were comparatively successful at maintaining employment levels, relative to industry or construction, for example.

For the broad sectors summarized in the top lines of Table 1, there was no large sector with robust employment growth in any of the five oblasts. Kharkiv experienced positive employment growth in just five sectors: forestry, communication, computing and information services, geology-geodesy-meteorology and housing and community services. Combined, however, their average employment was only 65,000 or less than 7 percent of the total employment in Table 1. Also, between 1996 and 1999, the increase in employment for the five sectors combined was from 62,000 to 68,000, or 6,000. For large and medium enterprises at the level of the broad economic sectors, no major sectors saw rapid employment growth that could provide a base for absorbing workers losing jobs in industries experiencing employment reductions.

The bottom lines of Table 1 summarize employment levels and shares for detailed industries. The importance of machinery and metalworking in Kharkiv stands out. Its four-year average of 165,000 accounted for 60.2 percent of all industrial employment in Kharkiv during these years. This industry has experienced large employment losses, averaging 6.0 percent per year during 1996-1999.

Machinery and metalworking is an important employment sector in all five eastern oblasts included in Table 1. The industry has experienced large employment losses across all five oblasts. Annual rates of employment losses (columns (11)-(15)) have ranged from 6.0 percent to 7.7 percent. Two industries that are important in the other four oblasts, fuel and black metal production, are not important in Kharkiv. Note the uniformly small employment changes in black metal production across the five oblasts. Absence of this type of employment in Kharkiv may work to the disadvantage of the oblast since employment levels have held up better than for most detailed industries.

Two industries with high employment concentrations in Kharkiv are the electrical industry and food processing, respectively accounting for 8.5 percent and 11.4 percent of industrial employment during 1996-1999. The electrical industry experienced small employment growth during these years. Food processing had employment reductions, but the annual rate of loss was only about half the all-industry average (column (6)). Both industries have experienced below-average rates of employment losses throughout eastern Ukraine (food processing in Dnepropetrovsk is an exception). Based on the twin considerations of size and recent employment trends, these two industries might merit attention as having good potential for future employment growth at large and medium enterprises.

Of all the industries displayed in Table 1, just three exhibited employment growth in Kharkiv during 1996-1999. However, these three industries (electrical, fuel and grain for food and fodder) had average employment of only 30,000 during 1996-1999. Their employment total of 30,800 in 1999 was only 1400 higher than in 1996. Thus, even selecting only the industries in Kharkiv with employment growth, their total addition to employment was less than 2000.

It is very difficult in the data of Table 1 to find sectors and industries where positive developments in total employment have been taking place among large and medium enterprises. It is known that these enterprise data have coverage problems, especially in the emerging sectors and sectors where small and medium enterprises are common. In aggregate national data, the reductions in enterprise employment have averaged about 750,000 per year since 1991 (a cumulative total of more than 6 million through 1999). While unemployment has increased, particularly since 1995, the increases in both unemployment registered at state employment offices and unemployment as reported in the household labor force survey totaled less than 2 million between 1995 (the first year of the labor force survey) and 1999. Thus, there is an increasing gap between total employment reported in the household labor force survey and employment as reported in the establishment survey and summarized in Table 1. A detailed assessment of this problem could not be undertaken with the data from large and medium enterprises examined here. Table 1 shows that all oblasts are experiencing large scale employment reductions in these establishment data.

Table 2 displays data on average monthly wages for the same oblasts, sectors and industries for the same time period as in Table 1. Overall, monthly wages by oblast grew at rates between 10.6 and 15.6 percent annually during 1996-1999. Wage growth during these years was much slower than during 1995-1996 when annual wage inflation in the five oblasts ranged from 65 to 78 percent. A wider dispersion in wage growth during 1996-1999 took place in the industrial sector of these oblasts, from 9.8 percent in Dnepropetrovsk to 19.0 percent in Kharkiv. Both for the aggregate and for the industrial sector, wages grew more rapidly in Kharkiv and Zaporizhka than in the other three oblasts.

Columns (6)-(10) summarize the structure of relative wages across sectors and industries. Five major sectors displayed consistently above-average wages (or wage premiums) across all five oblasts: industry, transportation, construction, finance and government. For each oblast, finance displayed the highest average relative wage, an average premium of 70 percent across the five oblasts and a 100 percent premium in Kharkiv. Unfortunately, relatively few workers realize these high wages since the industry accounted for 0.8-1.1 percent of total employment, 1.0 percent in Kharkiv, (column (6) in Table 1). The industrial sector had the second highest average wage premium across the five oblasts, an average premium of 21.5 percent above the all-sector average. In Kharkiv this premium was only 10.5 percent above the all-sector average. In contrast, the government sector had its highest wage premium in Kharkiv (35.7 percent).



Several sectors are characterized by consistently low average wages. This is observed in agriculture, forestry, fishing, retail-food service and selected consumer services to the population. Additionally, low wages characterize employment in the health, education, culture and arts sectors. Note how the latter sectors also experienced generally low wage growth during 1996-1999. The low rates of wage growth may be linked to the generally modest employment changes (reductions) experienced by these same sectors (columns (11)-(15) in Table 1).

Within the industrial sector, four industries display consistently high wages: electrical, fuel, black metal and process metallurgy. The high wages in these industries observed in Kharkiv (except for black metal) reflect broad patterns across the five oblasts. What is unusual in Kharkiv is the high wages observed in food processing, 27.5 percent above the all-industry average. More typically food processing pays wages in the range from average to roughly ten percent below average.

Several industries pay consistently low wages. This is typical of machinery and metalworking, an industry of particular importance in Kharkiv. Low wages are also observed in woodworking, industry materials, porcelain-pottery and light industry. In most oblasts, these industries pay from half to three fourths of the all-industry average.

From the combined perspective of high wage payments or high wages coupled with favorable employment growth, four sectors seem to provide good job prospects in Kharkiv. These are communication, finance, housing and community service and government. While the first two account for a small number of jobs (recall Table 1) their jobs are high paying on average. The latter two are traditional public sectors where further growth of public sector employment may not be desired as part of economic restructuring. There probably is reason to anticipate growth in private employment in the housing and community service sector. Construction also has high paying employment in Kharkiv, but annual employment losses averaged 10.4 percent during 1996-1999.

Within the industrial sector, the electrical industry pays high wages in Kharkiv and it has experienced modest employment growth. Food processing also pays above-average wages and experienced only modest employment losses during 1996-1999. Creating more jobs in these industries with these levels of pay would seem sensible. Since these two industries rank second and third in industrial sector employment in Kharkiv, employment growth in these specific industries should be encouraged. Positive developments were also present in two other industries (fuel and grain for food and fodder), but the employment base in these industries is quite small.

Table 1

Employment in Kharkiv and Other Oblasts of Eastern Ukraine

# Major Sectors	Average Employment - 1996-1999 (thousands)					Employment Shares - 1996-1999 (Percent)					Annual Employment Change - 1996-1999 (Percent)				
	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zaporizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
1 Total	944.8	1248.8	1680.8	825.1	676.6	100.0	100	100.0	100.0	100.0	-5.2	-4.7	-5.2	-6.0	-4.8
2 Industrial	278.2	446.9	784.5	339.0	220.5	29.4	35.8	46.7	41.1	32.6	-6.2	-3.4	-6.3	-6.1	-4.3
3 Agriculture	147.4	143.6	125.1	85.2	110.1	15.6	11.5	7.4	10.3	16.3	-5.6	-7.7	-7.8	-9.4	-9.0
4 Forestry	3.6	1.1	1.0	2.0	0.7	0.4	0.1	0.1	0.2	0.1	9.1	-1.1	0.0	7.5	4.4
5 Fishing	0.5	1.1	2.5	0.3	2.1	0.1	0.1	0.1	0.0	0.3	-2.3	27.9	-8.9	-1.0	158.5
6 Transportation	66.3	100.6	115.6	56.1	50.4	7.0	8.1	6.9	6.8	7.5	-9.3	-4.5	-3.3	-4.0	-5.2
7 Communication	15.3		21.5			1.6		1.3			3.8		-0.2	0	
8 Construction	55.6	83.4	100.2	49.8	36.7	5.9	6.7	6.0	6.0	5.4	-10.4	-12.7	-9.7	-9.2	-9.5
9 Retail, Food Service	46.3	73.7	82.0	44.0	38.9	4.9	5.9	4.9	5.3	5.8	-7.5	-6.7	-10.6	-12.4	-9.2
10 Computing and Info. Serv.	0.5	0.9	1.0	0.7	0.4	0.1	0.1	0.1	0.1	0.1	16.6	-4.3	6.7	36.1	-2.6
11 Operat. with Immov. Estate		0.2			0.0		0.0			0.0		239.4			-10.3
12 Develop of Market Function	0.4	0.4			0.3	0.0	0.0			0.0	**	36.1			60.6
13 Geology, Geod. & Meterol.	1.7	1.7	2.9	1.6	0.3	0.2	0.1	0.2	0.2	0.0	33.3	-3.0	-11.4	-14.3	-4.7
14 Select. Cons. Serv.	4.0	6.6	7.1	4.8	3.3	0.4	0.5	0.4	0.6	0.5	-9.7	-8.8	-4.6	-8.6	-8.0
15 Other Material Production	9.0	11.8		7.9	5.2	1.0	0.9		1.0	0.8	-13.6	-7.4		-13.7	-10.8
16 Housing and Comm. Services	43.5	70.8	66.6	48.5	39.1	4.6	5.7	4.0	5.9	5.8	2.1	-0.9	8.2	-2.6	2.8
17 Health Care, Social Welfare	81.2	104.8	127.5	67.1	58.1	8.6	8.4	7.6	8.1	8.6	-0.2	-2.4	-1.1	-2.1	-0.8
18 Education	102.3	118.8	130.5	70.9	63.8	10.8	9.5	7.8	8.6	9.4	-2.5	-2.7	-1.1	-3.2	-3.0
19 Culture	11.0	13.5	16.8	10.2	8.1	1.2	1.1	1.0	1.2	1.2	-6.8	-2.9	0.8	-3.6	-1.8
20 Arts	2.4	2.7	2.4	1.1	1.1	0.3	0.2	0.1	0.1	0.2	-4.9	-11.0	-4.9	-12.1	-12.9
21 Research and Development	33.2	15.9	12.8	6.2	8.8	3.5	1.3	0.8	0.8	1.3	-9.7	-7.1	-7.0	-3.7	-6.0
22 Finance, Ins., Sav. Serv.	9.2	12.7	14.5	6.6	7.2	1.0	1.0	0.9	0.8	1.1	-2.4	-2.6	-3.3	-9.9	-4.3
23 Government:Central, Local	33.0	37.7	47.8	23.0	21.6	3.5	3.0	2.8	2.8	3.2	-0.2	-1.5	0.5	4.0	2.1
24 Residual			18.7					1.1					-12.9		

Table 1. (cont'd)

	Average Employment - 1996-1999 (thousands)					Employment Shares - 1996-1999 (%)					Annual Employment Change - 1996-1999 (%)				
	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zaporizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka
# Major Sectors	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
51 All Industries	274.6	446.9	781.5	339.0	220.5	100.0	100.0	100.0	100.0	100.0	-5.7	-3.4	-6.1	-6.1	-4.3
52 Electrical	23.4	12.5	29.6	9.2	19.2	8.5	2.8	3.8	2.7	8.7	1.0	1.0	-1.1	3.3	-0.5
53 Fuel	4.2	30.6	296.7	138.1	1.7	1.5	6.9	38.0	40.7	0.8	2.5	-5.8	-7.6	-7.6	0.5
54 Atomic	0.1	4.9				0.0	1.1				-2.3	7.2			
55 Black Metal – Iron	1.5	185.7	165.9	26.9	38.8	0.5	41.6	21.2	7.9	17.6	-1.9	0.8	-1.6	-0.1	0.3
56 Process Metallurgy	0.5	5.4	5.2	0.9	12.7	0.2	1.2	0.7	0.3	5.8	-6.3	8.7	-14.0	5.4	4.7
57 Chemical-Napthal	8.6	21.6	19.1	31.2	4.3	3.1	4.8	2.4	9.2	2.0	-5.8	-7.7	-12.4	-5.9	-5.8
58 Mach. and Metalworking	165.3	111.1	129.8	81.3	110.5	60.2	24.9	16.6	24.0	50.1	-6.0	-7.0	-7.7	-7.4	-6.8
59 Woodworking and Paper	4.8	4.3	3.8	3.3	1.5	1.8	1.0	0.5	1.0	0.7	-11.5	0.0	-17.0	-8.3	-8.5
60 Industrial Materials	11.2	18.0	27.7	7.0	7.2	4.1	4.0	3.5	2.1	3.3	-8.5	-9.3	-2.2	-11.4	-9.4
61 Porcelain-Pottery	4.5	0.1	8.0	4.8	0.5	1.6	0.0	1.0	1.4	0.2	-15.3	-10.9	-5.4	-4.6	1.3
62 Light Industry	13.9	14.4	18.5	12.9	4.9	5.1	3.2	2.4	3.8	2.2	-11.4	-8.5	-10.5	-6.8	-10.0
63 Food Processing	31.3	26.3	33.6	16.9	15.9	11.4	5.9	4.3	5.0	7.2	-2.8	-6.8	-2.6	-2.0	-3.3
64 Micro					0.2					0.1					-19.6
65 Grain: Food and Fodder	2.0	3.3		2.3	1.9	0.7	0.7		0.7	0.9	6.1	4.5		11.2	-1.9
66 Copper		0.7		0.3	0.0		0.2		0.1	0.0		-1.0		-6.6	14.4
67 Instruments	2.4	1.6		0.8	0.6	0.8	0.4		0.2	0.3	-9.2	1.2		-4.5	-11.6
68 Other Processing Industries	1.0	5.9		2.8	0.5	0.3	1.3		0.8	0.2	-17.1	-6.2		9.2	53.0
69		0.3		0.2	0.2		0.1		0.1	0.1		11.4		0	5.4
71 Residual			43.7					5.6					-7.7		



Table 2.
Average Wages in Kharkiv and Other Oblasts of Eastern Ukraine

# Major Sectors	Average Monthly Wages-1996-1999					Relative Monthly Wages-1996-1999					Average Annual Wage Growth - 1996-1999				
	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
1 Total	154.9	183.8	188.1	157.3	176.9	1.000	1.000	1.000	1.000	1.000	15.0	10.6	12.9	13.1	15.6
2 Industrial	171.2	238.2	227.0	191.2	221.6	1.105	1.296	1.207	1.215	1.253	19.0	9.9	14.3	14.1	18.4
3 Agriculture	109.3	108.8	98.0	98.4	106.2	0.705	0.592	0.521	0.625	0.601	17.8	14.6	25.1	23.0	24.7
4 Forestry	122.9	114.3	96.5	107.1	101.7	0.793	0.622	0.513	0.680	0.575	10.6	4.5	4.0	12.3	1.1
5 Fishing	113.0	101.1	91.7	94.6	100.2	0.730	0.550	0.488	0.601	0.566	9.5	-3.1	28.1	-2.4	4.7
6 Transportation	173.5	193.1	194.2	173.4	197.8	1.120	1.051	1.032	1.102	1.118	12.5	12.9	10.5	14.3	15.6
7 Communication	197.8		224.7			1.277		1.194			17.3		22.0		
8 Construction	191.5	204.4	192.9	180.3	220.1	1.236	1.112	1.025	1.146	1.244	18.2	6.6	7.2	6.2	8.9
9 Retail, Food Service	124.1	136.5	127.3	111.9	154.5	0.801	0.742	0.677	0.711	0.873	27.0	17.6	27.1	19.8	19.2
10 Computing and Info. Serv.	165.1	175.9	189.8	144.6	218.0	1.066	0.957	1.009	0.919	1.232	39.8	28.7	11.9	22.3	28.9
11 Operat. with Immov. Estate		184.9			204.2		1.006			1.154		45.0			14.9
12 Develop of Market Function	164.4	169.0			178.2	1.061	0.919			1.008	33.4	40.5			39.9
13 Geology, Geod.& Meterol.	192.7	142.3	139.2	97.0	134.8	1.244	0.774	0.740	0.616	0.762	1.7	18.0	7.4	14.6	6.9
14 Select. Cons. Serv. to Pop.	61.4	81.1	81.9	61.3	77.6	0.396	0.441	0.435	0.390	0.439	24.6	39.0	15.4	23.0	22.5
15 Other Material Production	163.8	201.7		148.4	206.5	1.057	1.097		0.943	1.167	50.0	38.2		25.1	39.0
16 Housing and Comm. Services	173.7	175.5	177.7	140.1	183.4	1.121	0.955	0.944	0.891	1.037	15.4	10.9	6.2	12.3	14.0
17 Health Care, Social Welfare	121.3	128.3	131.7	114.6	141.8	0.783	0.698	0.700	0.729	0.802	1.5	5.1	3.9	4.6	2.4
18 Education	142.9	133.6	138.3	122.5	137.1	0.922	0.727	0.735	0.779	0.775	6.5	5.4	7.1	7.0	6.2
19 Culture	102.3	108.5	104.2	96.2	104.7	0.660	0.590	0.554	0.611	0.592	1.2	-0.6	3.4	10.1	4.2
20 Arts	131.3	102.3	134.7	89.7	99.9	0.848	0.557	0.716	0.570	0.565	4.1	12.8	14.9	14.2	21.2
21 Research and Dev.	182.1	187.7	167.7	136.8	184.5	1.175	1.021	0.892	0.869	1.043	18.2	16.7	12.0	14.4	24.7
22 Finance, Ins., Sav. Serv.	311.2	276.5	323.4	248.1	299.7	2.009	1.504	1.719	1.577	1.694	15.8	18.3	9.0	11.0	13.0
23 Government: Central, Local	210.2	194.9	195.7	186.4	203.7	1.357	1.060	1.040	1.185	1.151	13.5	10.7	16.4	11.3	12.3
24 Residual			150.1					0.798					43.2		

	Average Monthly Wages-1996-1999					Relative Monthly Wages-1996-1999					Average Annual Wage Growth- 1996-1999				
	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka	Kharkiv	Dneipro-Petrovsk	Donets	Lugansk	Zapo rizhka
Major Sectors	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
51 All Industries	171.4	238.2	227.3	191.2	221.6	1.000	1.000	1.000	1.000	1.000	18.9	9.8	14.2	14.1	18.4
52 Electrical	285.6	334.5	281.9	307.4	376.8	1.666	1.404	1.240	1.608	1.700	11.6	3.8	4.0	12.7	9.7
53 Fuel	464.1	359.3	262.7	245.8	250.2	2.707	1.509	1.156	1.285	1.129	17.1	6.5	14.3	14.7	-1.8
54 Atomic	370.9	209.9				2.163	0.881				72.9	33.0			
55 Black Metal - Iron	164.5	287.5	259.3	222.0	375.2	0.959	1.207	1.141	1.161	1.693	7.2	7.5	12.9	11.6	18.4
56 Process Metallurgy	360.5	302.8	158.9	544.1	311.8	2.103	1.271	0.699	2.845	1.407	51.6	3.4	9.4	51.8	16.9
57 Chemical-Napthal	219.6	223.7	206.0	155.5	180.9	1.281	0.939	0.906	0.813	0.816	19.1	12.9	16.1	15.2	7.2
58 Mach. and Metalworking	144.3	155.6	163.9	118.5	147.2	0.842	0.653	0.721	0.620	0.664	18.8	10.7	18.9	11.1	21.5
59 Woodworking and Paper	121.1	118.3	103.8	153.2	89.1	0.706	0.497	0.457	0.801	0.402	13.0	2.9	14.0	29.3	2.9
60 Industrial Materials	156.2	171.0	152.3	153.2	142.6	0.911	0.718	0.670	0.801	0.644	25.5	13.2	12.6	29.3	9.7
61 Porcelain-Pottery	129.7	76.9	135.8	166.4	264.7	0.756	0.323	0.597	0.870	1.195	32.5	30.0	10.1	14.7	29.9
62 Light Industry	92.0	90.3	59.4	77.5	88.4	0.537	0.379	0.261	0.405	0.399	10.7	17.3	8.3	17.9	28.6
63 Food Processing	218.5	224.4	232.5	170.4	202.6	1.275	0.942	1.023	0.891	0.914	16.4	9.8	12.2	7.6	4.2
64 Micro	209.9				184.1	1.140				0.831					3.3
65 Grain: Food and Fodder	283.6	196.7		164.6	166.4	1.654	0.826		0.861	0.751	-2.1	-5.8		-5.2	-8.8
66 Copper		257.6		323.9	312.8		1.081		1.694	1.412		14.6		8.8	24.9
67 Instruments	175.1	225.5		162.1	191.6	1.021	0.947		0.848	0.865	8.5	3.7		0.5	13.9
68 Other Processing Inds	169.2	207.4		168.1	90.4	0.987	0.871		0.879	0.408	24.8	7.1		5.4	0.7
69		354.9		228.7	310.4		1.490		1.196	1.401		8.0		21.1	29.5
71 Residual			174.1					0.766					13.1		