Partnering Climate and Priority Sectors for Cooperation

As participants in the inaugural meeting of the Canada-Ukraine Intergovernmental Economic Commission, Monitor Editors Orest Dubas and Nina Romas joined some 50 companies already active in Ukraine or examining the opportunity to join in. We share with our readers the following IEC overview on the partnering climate and opportunities in the priority sectors: Oil and Gas, Construction, and Agriculture and Agri-Foods.

Partnering Climate

Following a period of macroeconomic stability, the Ukrainian government introduced its long delayed new currency, the Hryvnia, in September 1996. This move has extremely high symbolic value, signalling the end of hyperinflation and economic depression, and offering hope for the economic future. This move has also shown a commitment on the part of the government to control the value of the currency. The IMF has approved an additional $900 million for Ukraine in 1996, but it is contingent on the continuation of the strict currency controls adapted in the fall of 1995 and reduction of the monthly inflation rate to 1-2%.

Currency points are strictly controlled, but Canadian citizens can easily exchange Canadian and American dollars. Traveller's checks are not readily accepted as currency at restaurants and shops, but many banks and exchange points now have the ability to exchange them without significant hassle. Some major hotels and restaurants accept credit cards.

Although few foreign banks have completed the registration process yet, a wide variety of domestic banks exist to service businesses. Ten or so of the largest and more secure banks are used by businesses for their cash accounts. Any Ukrainian legal or non-legal entity may open a hard currency account and freely transfer funds from their home country without penalty. The process for returning funds to a country, however, includes a repatriation tax. The cost of borrowing money in Ukraine is among the highest in the world, and rarely attractive for local or foreign investors.

Canada and Ukraine have a number of bilateral agreements in effect: a Convention on Avoidance of Double Taxation (1996); a Foreign Investment Protection Agreement (1995); the Economic Cooperation and Trade Agreements (1995).

Business Overview

Ukraine, a country the size of France with 52 million people is ripe with opportunities for investors willing to withstand the intricacies of its market. Practically void of foreign investment, Ukraine offers a large domestic market, a well-educated population, skilled labour with low wages and a good geographic location.

Visa requirements: the best way to obtain a visa is to apply to the Ukrainian Consular office in Toronto or the Ottawa Embassy before coming to Ukraine. Visas can be obtained at Boryspil International Airport in Kyiv or at any border check-point. The applicant must provide a valid passport, two photos, an invitation and pay a fee (approx. US$150).

Languages requirement: Ukrainian is the official state language of Ukraine. However, due to decades of russification, Russian is still a language of business and education. Major Ukrainian companies operating in the international market use either English or German. Interpretation services are available for US$10-20 per hour.

A key to success in the Ukrainian market is to control the economic and political risks on doing business. Market research, legal, auditing and other business support services are available in Ukraine. However, local authorities are demanding a share of the business and asserting their decision-making, taxation and territorial ownership rights. Businessmen also must deal with regulators, tax officials and import/export bureaucracies. There is considerable delay in implementing new laws, as well as a lack of transparency.

Foreign Investment Methods

Unlike many of the former Soviet republics, Ukraine is seeking large investments and supplying numerous, albeit difficult, investment mechanisms, including:

1. Joint participation in Ukrainian enterprises either by forming third company joint ventures or by direct acquisition of shares in Ukrainian enterprises;
2. Creation of wholly-owned subsidiaries, representative offices, branch affiliates, etc.;
3. Direct acquisition by non-residents of personal or real property or securities thereto, including land plots, buildings, apartments, other premises, equipment, transport, etc.;
4. Acquisition of intellectual property rights;
5. Entering into various contractual agreements (including import-export contracts, cooperation or joint production agreements);
6. Acquisition of land use or concession rights to use Ukrainian natural resources (either direct foreign investment or with assistance of Ukrainian residents);
7. Purchase of shares of existing private companies on an open exchange or through financial intermediaries.

Market Entry Strategies

The optimum method for involvement of a Canadian company in the Ukrainian market will differ for each company. The decision will naturally depend to a large extent on the Canadian company's product and/or service, its size and financial capabilities, and its short and long term objectives. In general, some form of presence in Ukraine is required; at the minimum, an agent or a non-resident representative office. Small companies will need an agent, either through a local firm by way of a sale/purchase agreement, or by way of a wholly owned foreign subsidiary. Larger companies, although beginning with an agent's or a reference project, should at the minimum have a company which is a legal entity in Ukraine through which to conduct their business.

Foreign companies typically select the non-resident representative office as the preferred business form, particularly in the case of import-export activities. Non-resident representative offices typically service existing contracts between the non-resident company and a local (Ukrainian) customer. This arrangement legally allows a non-resident company to earn foreign currency abroad. As an extra advantage, the favourable (i.e., foreign) currency regime applied to representative offices in the past allowed the Ukrainian employees to earn foreign currency (and additional instructions reduced half of the income tax on dollar salaries).

Recent legislation has placed Ukrainian non-residents into two categories: those which effectuate profit-generating activities in Ukraine through a permanent representative office (active), or without a permanent office (passive). Different tax rates and payment procedures are attached to each category. This significant distinction is aimed at closing the loophole by which non-resident representative offices circumvented currency regulations and paid lower (if any) taxes in Ukraine on activities typically performed by resident companies.