



The Business & Law Readers Digest

**Economic relations
between Ukraine and Russia**

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The characteristics and history of trade and economic relations between the two countries

The economic history of the world testifies that productivity develops successfully only when the state, as the organiser of a society, creates favourable conditions for it. Therefore the economic role of the state has been, is, and will continue to be objectively relevant when discussing trade relations.

When creating business plans for an entry to the international markets, it is necessary to consider one of the most important factors - the state, and in particular its internal and foreign policy. Excessive intervention by the state in the economy is an extreme and counterproductive interpretation of its economic role, though today this occurs frequently. The state role should be restricted to promoting the creation of a new market environment, the market infrastructure, new economic legislation, uniform rules on the economic behaviour of citizens and their economic culture.

Despite recognition at the international level that external economic policy based on principles of free trade are the most comprehensible, several countries - including both Ukraine and Russia - adhere to a protectionism in their regulation of foreign economic relations.

Commercial policy is realised by certain tools: tariffs or customs duties; an

import quota; non-tariff barriers; voluntary export restrictions; export grants and countervailing duties, and dumping. The raising of duties and establishment of quotas by one country will lead to reciprocal actions by its partners; therefore international trade conditions worsen as a whole, its volume will be reduced, and the level of incomes and employment in all countries will decrease. Foreign trade policy is inseparably linked with the internal economic policy of the state.

Analysis of the prospects and problems in the development of Russo-Ukrainian economic relations shows that the deep and long recession which has been observed in the economic systems of Ukraine and Russia has been caused by the disintegration of the uniform economic complex of the USSR, and the rupture of the majority of economic communications between the countries. Foreign trade became one of the first spheres of foreign economic activities to broaden in both nations.

In the trade relations between Russia and Ukraine, essentially, the standard international principles of customs regulation are applied. Among the CIS countries Russia is potentially the most important but also one of the most difficult for Ukraine to form a partnership for



economic cooperation with. Since the moment that the two most influential of the former Soviet republics started to build communication as sovereign states, the economic component in the system of their mutual relations acts as the focus of a disputed collision of

national interests. Nevertheless, it is unwise to deny the presence of an objective interest by Ukraine in the development of trade, industrial technology and investment cooperation with Russia.

The legal base of Russo-Ukrainian relations

Domestic subjects in the Russian and Ukrainian provinces (especially at a modest, small business level) have an acute shortage of information, such as a lack of details on the constantly varying base of legal norms which regulate foreign trade activities in both countries, a selection of reliable business partners, their offers, legal support for transactions, and details about possibilities to participate in privatisation of domestic objects in Ukraine and Russia.

This lack of information essentially constrains the processes of formation and development of steady business ties and, as a consequence, harms their ability to barter at this level.

The legal basis for trade and economic cooperation between Russia and Ukraine are: the intergovernmental Agreement on free trade, the Friendship treaty, cooperation and partnership between Ukraine and the Russian Federation ("the big contract") and the Programme for Ukraine's economic

cooperation with the Russian Federation for 1998-2007, according to which the most important directions for cooperation on a bilateral basis are aircraft engineering, metallurgy, fuel and energy complexes, the space travel and chemical industries and agriculture. These documents provide for the carrying out of actions, by an agreed strategy, of realisation of economic reforms, the deepening of economic integration on the basis of the harmonisation of economic legislation, the coordination of a financial, investment and customs policy, preservation and development on a mutually advantageous basis of industrial, scientific and technical cooperation by the design and manufacturing of modern, high technology products.

According to the Friendship treaty on cooperation and partnership between Ukraine and Russia, and also the Programme for economic cooperation until 2007, the model of economic relations should be constructed on the basis of an equal rights partnership, and mutu-



ally advantageous market integration by the individual economic systems of the sovereign states. The plans laid forth in these documents provide a chance to adapt cooperation in various areas of the economy, to increase deliveries of equipment, to oversee the building of

cars and domestic industry goods; to realise projects by the creation of joint ventures, to carry out joint scientific and technical projects and to introduce the newest technologies, and to realise interstate economic programmes.

The legal base of Russo-Ukrainian relations

As far as resources and technologies are concerned the two states are substantially interdependent, but they have developed a network of multilateral economic relations, and both aspire to civilised integration into the international economic community. In order to develop globally and nationally, Russia and Ukraine must form economically-based relations using their combined potential as much as possible, to create inter-regional cooperation and an interconnection with international economic organisations.

On certain occasions the Russian and Ukrainian commodity producers have become real competitors in those segments of the market which had earlier absorbed all (or a considerable part) of their production. There are certain divergences of interests in the sphere of power supply. There are also certain other factors which constrain expansion and the deepening of economic interests.

The Russian Federation is the largest commodity market for traditional Ukrainian export goods, namely, agriculture, mechanical engineering, the metallurgical and chemical industries.

In turn Ukraine imports raw materials, gas, oil, mineral oil, nuclear fuel and mechanical engineering production from the Russian Federation. The real mutual goods turnover of Ukraine with Russia between January and February 2008 totalled USD 5,520 million, a gain of 34%.

Russia's export has grown by 47.9%, to USD 3,514.8 million. Import from Ukraine between January and February 2008 increased by 15%, to USD 2,005.2 million. Ukraine's share in Russia's general goods turnover in 2007 was 5.5%, and its share in Ukraine's goods turnover with all countries was 29%. Since 2002 there has been a steady growth in the volume of Russo-Ukrainian trade and in Russia's share of Ukraine's goods turnover. As of today Ukraine is the fifth



largest of Russia's trading partners, after Germany (USD 52.9 billion), the Netherlands (USD 46.6 billion), China (USD 40.3 billion) and Italy (USD 36.1 billion), and the most significant in the CIS, eclipsing Belarus (USD 26.1 billion).

The volume of goods turnover between Ukraine and Russia is stable. In 2007 among exports of Russian goods to Ukraine the leading place was occupied by mineral products (47%, although their share is gradually declining). In 2007 mineral goods with the value of USD 7,697.7 million were exported. The volume of deliveries of Russian oil to be treated by NPZ Ukraine - the country's national oil processing company - was 9.6 million tons.

The rates of export of cars, equipment and transport vehicles is growing, having increased their share in the structure in comparison with 2006 from 16.7% to 20% from total exports (USD 3,216 million). Deliveries of metals and metal products (USD 2,069.3 million) stably maintain their import share at a level of 13%.

There have been considerable rates of increase of production in the chemical industry (136.5%).

Since 2006, mechanic and technical production (for which 36% of all Russian imports from Ukraine are necessary) and also metals and metal products (31%) have increased by 158% in the import structure of goods from Ukraine in

terms of the volume of deliveries (USD 4,719 million).

Deliveries of food and agricultural raw materials have increased by more than 62.7% and stably make up about 11% of import. The share of chemical production in Russia's import is 10% from Ukraine, and mineral products - 4%.

Frequently, intergovernmental agreements and arrangements lead to an increase in supply. Thus, at the end of the first quarter of 2008 the supply of the produce of sixteen meat industry enterprises and twelve dairy industry enterprises of Ukraine to the Russian Federation were permitted upon joint certification (a ban was imposed in January 2006).

The sanitary and veterinary services of both countries work towards expanding the list of Ukrainian enterprises which deliver such products to Russia. In the alcohol production market two tendencies have emerged during this year: along with the relocation of certain Ukrainian alcoholic drinks manufacturers to Russia (spirit is being withdrawn from the free trade regime) their import has grown (by 18.8% for the first 10 months of 2007). Import from Ukraine of alcoholic production makes up 50.3% of all Russian import of alcoholic beverages from CIS countries.

The structure of Russian import from Ukraine - unlike export - is characterised by the big share of production which has



a high added cost, and Russia is the most attractive partner to, and importer of, Ukrainian production. In turn, stable maintenance by Russia of the Ukrainian economy and power resources is an important factor for trouble-free development of Ukrainian industry and agriculture enterprises.

Thus, for example, aluminium, ferrochrome, large diameter pipes and mechanical technical equipment, delivered from Ukraine, play an important role in the Russian economy, while deliveries of many types of Ukrainian food rigidly compete with their Russian counterparts.

A special place in interstate relations is allotted to investment cooperation. The given sphere is a priority for the majority of the states as it allows for additional capital to be attracted and to provide timely contributions to the state budget.

According to the official Ukrainian Committee for statistics, as of 1 January 2008, the Russian Federation invested into the Ukrainian economy USD 1,462.2 million, or 5% of the total amount of direct foreign investments, and occupies sixth place by volume of investments after Germany (USD 5,941.8 million), Cyprus (USD 4,957.6 million), the Netherlands (USD 2,511.2 million), Austria (USD 2,075.2 million) and Great Britain (USD 1,968.8 million).

Russian companies prefer investments and object privatisation in key economic

branches of the Ukrainian economy - fuel and energy complexes, the chemical industry, metallurgy, mechanical engineering and metal working, and also the banking and financial sector. Large perspective investment projects include the building of a gas pipeline between Bogorodchany and Uzhgorod which is part of the main gas pipeline of Novopskov-Uzhgorod. The cost of the project is approximately USD 560 million.

A Russian-British company of the multinational corporation VR intends to invest approximately USD 150 million into the development of the Lisichansky oil refining factory between now and 2010. The holding company "Group Alliance" intends to invest in the modernisation of the Kherson oil refining factory USD 450-500 million until 2010. The investment programme "Lukoil-Neftekhim", permitted to commence the manufacture of chlorine and caustic soda at "Karpatneftekhime" will be active for 2 years. The total cost of the project is USD 113.5 million. "Lukoil" plans to invest USD 500 million until the end of 2014 in the modernisation of the Odessa Oil Refining Factory (NPZ), and USD 200 million on development of its own gas stations.

The Russian trading retail company "Vester" in 2008 intends to invest about USD 41 million in opening in Ukraine not less than 13 trading objects with a total area of more than 45 thousand in sq.m. in Kharkov, Mariupol, Sevastopol,



Khmelnitskiy, and also in the Lvov and Dnepropetrovsk regions.

Until 2011 the company plans to open 50 hypermarkets and 24 supermarkets in 35 Ukrainian cities, with a total floor space of 307 thousand in sq.m.

The Russian investor "Volga-Dnepr" is contemplating a project to revive the manufacture of AN-124 (Ruslan) airplanes with the factory "Antonova". The cost of the project is approximately USD 200 million. The company "Metalloinvest" has suggested creating a joint enterprise with a Ukrainian party for completion of the Krivorozhsky oxidized ore mining and concentrating industrial complex (Kirovograd region).

In order to complete the building and commissioning of the first stage of the industrial complex, approximately USD 200 million are required. The building company "Joint Stock Company Inteko" is participating in the building of residential and trading complexes in Kyiv. The cost of the project approximately USD 350 million. The financial corporation "Social Initiative" is considering building residential complexes in Donetsk. The cost of the project is approximately USD 226 million. Completion of a Russian-Ukrainian joint venture (hereafter - the joint venture) is planned in Ukraine for the repair, service and modernisation of Ukrainian anti-aircraft defence systems, and installations in third countries is planned. The co-founders of the joint ventures are the Russian state enterprise "Defensive Systems" and the Ukrainian

state company "Ukroboronservis".

It is supposed that the creation of this joint venture will essentially simplify the procedure for purchasing arms and Russian-made military technology for Ukraine and other countries. During 2007 investments from the Russian Federation in financial activity, construction, the hotel and restaurant business and wholesale trade considerably increased. The Russian Federation causes as much interest among Ukrainian investors - as of 1 January 2008, Ukrainian investments accounted for USD 148.6 million (2.4% of the total amount of direct Ukrainian investments into the economy of other countries).

More than half of the investments go towards real estate transactions. Other areas which are heavily invested in include the government, banking and finance, mechanical engineering, building and ferrous metallurgy.

Some Ukrainian companies have already been operating in Russia for several years, the company "Konti" (formerly "Kiev-Konti") being one of the largest. The production of confectionery in Russia at the Kursk confectionery factory is growing: it plans to increase the production volumes of its confectionery products by 200% by the end of this year.

Ukrainian vodka companies have become more active in the Russian market. Following the lead of the well-known



company "Nemiroff", the group of companies "Soyuz-Viktan" (Kyiv), one of the largest Ukrainian manufacturers of strong spirits, opened a factory in Ruze (Moscow region) in March 2005. Investments into it have totaled USD 5 million, which has allowed them to increase factory output from 5.5 million units to 8 million units per year.

The acquisition by "UkrSibbank" of 60% of the Russian bank "National Financial Traditions" for USD 5.4 million serves as acknowledgement of the change of priorities by Ukrainian investors. Thus, the bank became the first bank to enter the market of the Russian Federation.

"UkrSibbank" has entered into the group of the ten largest Ukrainian banks with a capital of USD 157 million. Its net wealth is estimated at USD 1.12 million. The bank has changed its name to "UkrSibbank-Rossiya". By the end of 2009 there will be almost one hundred banks in this network of branches in Russia.

Ukrainian investors carry out considerable investments in Russia's pulp and paper complexes, ferrous metallurgy, mechanical engineering and metal working. The group "Privat" supervises the Alapaevsk metal works, and also the share holdings of Nitrogen and Altay by-product coke factory. The group "Energo" supervises in Russia the mines "Kostroma" and "Zarechnuyu", and also masters a deposit of coked coal. "Ukrprominvest" owns 78% of the

shares of the Lipetsk confectionery factory. The Ukrainian company "Bogdan" and the Zaporozhye car manufacturing factory (operated by the "Ukravto" corporation) have started building a car manufacturing factory in the Nizhniy Novgorod region. More than USD 700 million is planned to be invested into the factory; this is the largest Ukrainian capital investment in the Russian economy. Now, Ukrainian capital is arriving in Russia on a wave of considerable growth of mutual goods turnover, increase in the number of projects in various branches of the economy, and growth in the consumer markets.

Despite the small volume of Ukrainian capital which is present in the Russian economy, it is necessary to note the positive dynamics of its development, which, it is supposed, shall continue for the next few years. It is possible to ascertain that in the presence of considerable divergences between Ukraine and Russia, both states aspire to construct strong and long-term economic relations, and for these purposes develop new programmes and create organisations whose work will be directed at attracting investments. Two such organisations are the Russian Federation's representative office for trade in Ukraine in Kyiv and the Russian-Ukrainian investment-commercial centre, whose primary goals are the attraction of Russian investments, and also active development of the Russian-Ukrainian trade and economic relations at inter-regional level.

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