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## **Evolution of Competition Policy of Ukraine due to its Integration to the European Union**

### **1. The main points of the institutional dialogue between Ukraine and the European Union on questions of economic competition**

1 May 2004 became for Europe not only “Enlargement Day”, when the European Union enlarged with ten new Member States, but also “Competition Day” – the day of revolution in the way competition rules are enforced within the European Union<sup>1</sup>.

The enlargement had been prepared for over five years and, finally, ten European countries – Cyprus, the Czech Republic, Hungary, Malta, Poland, Slovenia, the Slovak Republic, and 3 former Soviet Union countries – Estonia, Latvia and Lithuania – became members of the European Union. During the enlargement negotiations all these countries proved that they really fulfill the “Copenhagen criteria”, according to which they have a functioning market economy; a stable democracy, respect for human rights, the rule of law, the protection of minorities; and they have also adopted the common European rules, standards and policies, among them – competition policy.

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<sup>1</sup> Interview with Mario Monti, Commissioner responsible for competition, Competition Policy Newsletter, 26 April 2004.

Ukraine is one of the post-Soviet countries that, because of a discrepancy of some parameters compared to the European level, has not yet reached the status of member. However, an orientation for integration into the European Union is considered as a basic strategy of economic and social development of Ukraine.

The European choice of Ukraine imposes on our state the complex task of an implementation of economic reforms, a creation of a truly functioning market economy and a stable democracy. The achievement of this task directly depends on the introduction of an effective competition policy, aimed at a creation of a competitive environment, a protection of enterprises' and consumers' interests and an increase of competitiveness of commodity producers in internal and external markets. That is why the sphere of competition policy and competitive relations takes an essential place in the process of economic integration between Ukraine and the European Union. The collaboration requires a number of bilateral agreements and projects, the main goal of which is an increase of the efficiency of competition policy and its adaptation to the European level.

The European Union – Ukraine relations are mainly based on the “Partnership and Cooperation Agreement” (the PCA<sup>2</sup>). This agreement outlines a respect for fundamental values as the main element of the relationship, creating a framework for a political dialogue, setting principal common goals in terms of harmonious economic relations development, cooperation in a number of areas and support for Ukrainian efforts towards democracy, as well as creating

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<sup>2</sup> The PCA was signed in Luxembourg on 16 June 1994 and came into force on 1 March 1998.

an institutional framework for pursuing these goals. The PCA is an important instrument in bringing Ukraine in line with the legal framework of the Single European Market and the WTO system.

Under the umbrella of the PCA two bilateral institutions started their work: the Cooperation Council at ministerial level (with the participation of the EU Presidency, the European Commission, EU High Representative, and the Government of Ukraine) and the Cooperation Committee on the senior civil service level, chaired alternately by the European Commission and Ukrainian side. Within the framework of the latter a Subcommittee on Trade and Investments has been created, under the direction of which the Interdepartmental Working Group on questions of competition policy and antitrust regulation works.

With the purpose of realizing the above mentioned Agreement the President's Strategy for European Integration was adopted. The Strategy outlines the main directions of Euro-integration activity, in particular in sphere of competition policy, up to 2007. According to this document the strategic directions of the integration process in this field are:

1. Adaptation of the national competition law of Ukraine to EC competition law;
2. Development of institutions that provide for the introduction and improvement of competition policy;
3. Implementation of economic freedom and policy of fair competition protection;

4. Abandonment of restrictions on competition and maintenance of equal conditions for competition between enterprises;
5. Prevention and termination of some exclusive activities and unfair competition between enterprises;
6. Coordination of competition policy and the policy of domestic commodity producers' protection, restriction of protectionist measures;
7. Improvement of interaction between institutions of different levels during the introduction of fair competition.

With the purpose of implementing the Strategy, the Program of Integration of Ukraine into to the EU was accepted<sup>3</sup>. One of the subitems of this Program is "Competition". The main points of the Program are: an increase of efficiency of competition protection institutions; distribution and promotion of information concerning legislation on questions of competition, competition policy and rules of fair competition among enterprises.

Cooperating with the EU also created a push for the development and further introduction in 2002-2004 of the TACIS project "Legislative and institutional bases of competition protection" the main tasks of which are:

1. Grants to help maintain the conformity of Ukrainian competitive legislation to the EU requirements and world standards, by improving the working of competitive legislation, by creating capable mechanisms for its introduction,

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<sup>3</sup> Authorized by the President's Decree of 14 September 2000.

and by ensuring the preference for competitive markets within the development of legislation on state aid;

2. Ensuring the availability of information and analytical capability for Antitrust Authority activity, on the basis of modern technologies, software and technical means;
3. Increasing the professional level of human resources in the government bodies which are responsible for the process of competition policy;
4. Distribution and popularization of information concerning competition legislation, competition policy and rules of fair competition among government bodies, enterprises and consumers.

These are the main points of the institutional dialogue between Ukraine and the European Union on questions of economic competition.

## **2. Development of competitive environment in Ukraine**

Let us examine the current situation in the economy of Ukraine: what has been done and what is going to be done in the field of improving competition rules; and what problems have to be resolved for successful integration with the EU in the sphere of competition policy?

More than 10 years have passed since economic competition came to Ukraine. A lot has been done in these years in the field of improving competition rules and implementing economic competition within still existing state monopolies. After carrying out privatization and demonopolization processes, the structure of major

sectors of the economy has dramatically changed. The share of the monopolistic sectors in the Gross National Product of Ukraine today makes up about 40 %, instead of total monopolization in Soviet times, when the State controlled the whole output of production. The fastest rates of development have been noticed in the sectors where the level of competition is especially high: light manufacturing, food, the woodworking industry, and also metallurgy, most production in these sectors is comparable with highly competitive foreign markets<sup>4</sup>.

In recent years a number of scientific research, devoted to the analysis of a competitive environment conditions in Ukraine, has been published<sup>5</sup>. In order to estimate the important changes a share of sectors with different structural preconditions of a competition in 2000-2003 was defined. For this purpose on the basis of the depersonalized data of the statistical reports shares of 1.3 and 5 largest enterprises in approximately 300 nation-wide and 2000 regional markets have been calculated. Using the given methodology, offered by O. Kostusev, four groups of the markets have been recognized<sup>6</sup>:

1. Pure monopolies (a share of the largest enterprise is equal or exceeds 90 %);

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<sup>4</sup> A. Kinahk, *The priorities of power*, Competition. Bulletin of Antitrust Committee of Ukraine No 2/2003.

<sup>5</sup> *Internal markets development in Ukraine: welfare because of competition*, Kiev 2004, p. 91; O. Kostusev, *Competition policy in Ukraine*, Kiev 2004, p. 310; *Macro structural policy and structural transformation: experience of Poland and Ukraine*, Kiev 2004, p. 357; M. Pugacheva, A. Shcherbak, *Competitive environment in Ukraine: trends of last years*, Competition. Bulletin of Antitrust Committee of Ukraine No 2/2005, p. 19-24.

<sup>6</sup> O. Kostusev, *Competition policy in Ukraine*, op. cit., p. 123-125.

2. Markets with a domination of one company (a share of the largest enterprise exceeds 35 %, but less than 90 %);
3. Markets with attributes of rigid oligopoly (a share of three largest enterprises exceeds 50 %);
4. Markets with competitive structure (all other markets).

**Table 1: Structural preconditions of competition development in Ukrainian economy**

Market types	Number of markets			%		
	2000	2002	2003	2000	2002	2003
Pure monopoly	361	278	310	15.2	11	12.6
Markets with one firm domination	923	914	856	38.9	36	34.7
Rigid oligopoly	343	402	414	14.4	15.8	16.8
Markets with competitive structure	748	943	884	31.5	37.2	35.9
Total	2375	2537	2464	100	100	100

The general results of calculations are presented in Table 1 and 2. They confirm that more than half of goods and services are produced in the nation-wide and regional markets where structural restrictions of competition are absent. A decrease of a share of production in conditions of pure monopoly from 11.8 % in 2000 up to 10.5 % in 2003 and also in the markets with domination of one firm

from 22.7 % in 2000 up to 19.9 % in 2003, gives evidence to positive changes in the economy,

The increase in a share of the markets with attributes of rigid monopoly from 11.6 % up to 15.3 % speaks about the level of fast growth in manufacturing in a number of such branches, as petrol processing, and also transition in the given group of some important markets in the food, chemical industry, also in mechanical engineering and transport. It is necessary to note that on the majority of oligopolistic markets in Ukraine the competition is strong enough. At the same time research show that participants of such markets sometimes resort to tacit collusions<sup>7</sup>.

**Table 2: Structural preconditions of competition development in Ukrainian economy**

Market types	Volumes of production, works, services			%		
	2000	2002	2003	2000	2002	2003
Pure monopoly	32627775,80	39763541,70	46145429,40	11.8	11.4	10.5
Markets with one firm domination	62500818,40	74361645,70	87173697,50	22.7	21.3	19.9
Rigid oligopoly	31819511,50	76890626,50	67030867,20	11.6	22	15.3
Markets with competitive structure	148274891,40	157826395,00	238379256,70	53.9	45.3	54.3
Total	275222997,10	348842208,80	438729250,80	100	100	100

<sup>7</sup> M. Pugacheva, A. Shcherbak, op. cit., p. 19-24.

It is necessary to note that in different branches of national economy condition of a competition essentially differ. The general characteristic of the competitive environment condition in the basic branches of economy enables to observe a following picture<sup>8</sup>.

In agriculture more than 20,000 enterprises, more than 40,000 farms operate. Moreover, several millions of households are engaged in manufacturing the agricultural products. Although the structure of many agricultural markets is close to a model of perfect competition, the competition in the given branch can be characterized as moderate. It is limited by the state regulation, the state support, an insufficient level of market knowledge of participants, and also various actions of local authorities.

In a mining industry the national markets of iron, manganese, mercury, titanite ore, salt and sulfur are characterized by a high level of concentration. Rather low level of concentration in the coal industry has not led to development of a competition because of rigid state regulation and domination of state ownership in the branch.

The markets of sand, gravel, limestone because of high transport costs are regional. They are characterized by oligopolistic structure, however in some regions they are monopolized.

The manufacturing industry represents especially complex picture. Food, light, woodworking industry, the industry of building materials in general are characterized by rather low production concentration ratio. Some markets are oligopolistic or monopolistic. For example in the food-processing industry exclusive associations act in

the separate national markets of food concentrates (a dairy, acetic acid, baking soda), and also in a number of the regional markets of bread, bakeries and flour.

Mechanical engineering, chemical and petrochemical industry, especially nonferrous metallurgy and manufacture of coke are characterized by the high level of concentration. The significant capital intensity has led to a creation of high entrance barriers. At the same time restraints of demand and orientation of many enterprises of key economic branches to foreign markets supports a development of competition.

### **3. The legal and organizational aspects of competition policy of Ukraine**

The positive results in competition building have been achieved largely as a result of the creation of legal and organizational framework of competition policy. Permanent mechanisms for the development, support and protection of economic competition, the basic items of which are fixed in Article 42 of the Constitution of Ukraine through the principle of state protection of competition in enterprise activity, have now been created. Today the basic laws regulating the sphere of competitive relations in Ukraine are: “On protection of economic competition”<sup>9</sup>, “On Antitrust Authority of Ukraine” and “On changes to the Law about Antitrust Authority of Ukraine”<sup>10</sup>, “On natural monopolies”<sup>11</sup>, “On protection against unfair

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<sup>8</sup> O. Kostusev, *Competition policy in Ukraine*, op. cit., p. 310.

<sup>9</sup> The law of 11 January 2001, № 2210-III.

<sup>10</sup> The law of 13 July 2000.

<sup>11</sup> The law of 20 April 2000, № 1682-III.

competition”<sup>12</sup>. All these documents were adopted with a view to integration with the European Union.

For example, the law “On natural monopolies” takes into account the experience of the European Union countries, and became the first legislative act of national value in the scope of regulation of natural monopoly markets. The law establishes precise but flexible legal framework concerning the prevention of consumer discrimination by natural monopolies; it establishes norms and rules of pricing, as well as quality standards and service parameters for such enterprises.

The new basic law “On protection of economic competition” makes the competition policy of Ukraine more transparent and predictable. This Law develops the competition legislation of our country by establishing rights corresponding to the requirements of the European Union, and so creates the necessary preconditions for a investment-friendly environment. Changes brought in by the Law cover coordinated action in Ukraine for the control of economic concentration, and observance of antitrust requirements as a whole, and correspond to the world principles and standards.

The program of competition policy in Ukraine for the next few years is determined by the Presidential Decree “About the main directions of competition policy on 2005-2009”. The purpose of the Decree is: the improvement of competition rules; protection and support of competition; competition institutions development. The Decree also outlines the importance of collaboration between Ukra-

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<sup>12</sup> The law of 7 June 1996, № 236/96-BP.

ine and the European Union's Member States in the competition policy, through signing bilateral agreements regarding collaboration in that area.

The governmental Antitrust Authority of Ukraine, established in November 1993, according to the law "On Antitrust Authority of Ukraine" is responsible for a protection of competition. According to its competence, the Antitrust Authority applies the measures directed at observance of obligations under Article 49 of the PCA (section VI "Competition. Protection of the intellectual, industrial and commercial property and cooperation in the field of the legislation"). The specified article provides for the action to correct or eliminate competition restrictions that arise in enterprises' activity or because of state intervention; improve control over granting state aid; to improve regulation of the activity of natural monopolies.

The basic tasks of Antitrust Authority of Ukraine are:

- Implementation of state control over the observance of the Antitrust Law;
- Prevention, revelation and termination of infringements of the Antitrust Law;
- Control of economic concentration;
- Assistance in developing fair competition.

#### **4. Main steps of competitive environment improvement and creation of effective competitive relations between different groups of market participants**

Today, the primary goal of the Antitrust Authority of Ukraine is not simply achieving a formally competitive structure for mar-

kets, but also creating an effective competitive environment which is capable of providing stable economic growth and increasing the quality of life.

In outline, the main measures for creating an effective competitive environment are:

1. Increasing the transparency of commodity markets by narrowing the use of non-monetary elements, including barter;
2. Stimulating the entrance to markets of new types of economic activities;
3. Reducing entrance barriers to markets:
  - Enlarging possibilities for financial support of promising economically and socially effective business-plans;
  - Establishment of local taxes rates that stimulate economic development;
  - Simplification the procedure for new economic entities to be created and registered.
4. Optimizing state aid to economic activities and sectors of the economy;
5. Achieving a new level of privatization processes development, transition to large-scale privatization in strategic sectors and a focus on development of commodity markets as well as markets for services, capital and labor, and the structural reorganization of the economy;
6. Developing small and medium sized business development and forming a middle class;

7. Introducing effective mechanisms of management in state enterprises and joint-stock companies in which the state share is more than 50 %;
8. Establishing control over state owned entities' management;
9. Decreasing tax pressure with a simultaneous expansion of a tax base;
10. Canceling privileges for some economic entities;
11. Alignment of competition conditions at the regional and local level;
12. Improving legal mechanisms of protecting fair competition.

## **5. The primary factors barring the creation of an effective competitive environment in Ukraine**

Presently, the primary factors barring the creation of an effective competitive environment in Ukraine are:

- Inadequate tax policy which provides unjustified privileges to some businesses and sectors of the economy;
- Inequality of competition conditions; different “rules of the game” in a market for different participants, even if at first sight there are no restrictions. One can see that different enterprises have different opportunities of an access to infrastructure, and to financial and material resources;
- Discrimination against some businesses by government bodies, including ones at local levels, and where there

is an element of direct economic activity by the body itself;

- Opportunities for natural monopolies to establish unnecessarily high tariffs;
- Creation by natural monopolies of obstacles to market entrance of new businesses.

Given the present situation, current priorities for the Anti-trust Authority of Ukraine are:

- Formation of an effective competition environment in commodity markets;
- Creation of equal conditions for enterprise activity;
- Elimination of negative factors in areas subject to natural monopolies;
- Reduction of the proportion of economic activities in monopoly sectors;
- Legislative improvements controlling the granting of the state aid to enterprises.

## **6. State aid influence on the creation of a competitive environment in Ukraine**

Currently, a task of primary importance (also from the perspective of the Copenhagen Criteria) is the coordination of Ukrainian and European competition legislation, in particular in the sphere of state aid.

The state aid negatively influences not only domestic market, but also trade between different countries, in particular between Ukraine and the European Union. For these two reasons the effective

control above the state aid is one of the major elements of competition policy.

Article 15 of the Law “On protecting an economic competition” establishes the total interdiction on decisions of authorities concerning individual subjects or their groups when such decisions lead to restriction of the market competition. However, the analysis delivered by the Antitrust Authority of Ukraine proves that such kind of infringements is very common. For example, 139 infringements (23.2 % of all anticompetitive actions) by the state bodies have been revealed and stopped in 2003. In 2004 the wrongful state aid increased up to 269 infringements and made 31.1 % of all anticompetitive actions of the state bodies. Thus infringements were carried out both local, and the central authorities and had a wide spectrum of actions in the different commodity markets.

To such infringements it is possible to carry an establishment of privileges for the local enterprises in comparison with another's in the markets of external advertising, privileges in definition of a rent for the ground areas, privileges in use of premises of the municipal property. In a number of cases the local authorities unfairly differentiated local taxes and tax collections.

Apart from a negative influence on a competition on micro level, the wrongful state aid has a negative impact on market relations on macro level. As various researchers estimate in 2001 the state aid made about 30 % of Gross National Product while in the EU countries it changed from 0.66 up to 1.58 %. Thus in Ukraine indirect grants accounted for 84 %, and in the EU less than 40 % of the total volume of the state aid.

In such conditions the Antitrust Authority of Ukraine has developed a law “On the state aid”. The overall objective of the law is improving mechanisms of the control over a granting and use of the state aid to economic entities.

The law provides for a creation of the consequent conceptual device, fastening of positions, principles, criteria and procedures of granting, use and control over the state aid. It establishes an interdiction on allocation of the anticompetitive aid, creates a basis of the account and the report of the state aid, and provides the responsibility for infringements of granting procedures and use of such aid by economic entities and authorities.

However, it is not a question of the termination of the state support to business, but rather a question of order, creation of transparent mechanisms, inadmissibility or minimization of anticompetitive consequences of its granting.

We hope that more dynamic activity on development and of law “On the state aid” will promote strengthening the collaboration between Ukraine and the EU and will facilitate the further cooperation.

## **7. New directions in competition policy improving**

Two years ago in the process of competition development Ukraine faced another problem: which body of competition legislation of the EU should be a target for Ukraine, the current one or a future one? While developments take place in Ukraine, the European Union continues to develop its own policy. It is a question of time if Ukraine can continue to keep catching up with European deve-

lopments. Two conferences were carried out recently that were devoted to this problem. Both were organized within TACIS project “Legislative and institutional bases of competition protection”.

Firstly, “The Round Table” titled “Competition policy in Ukraine. Quo vadis?” was devoted to the adaptation of Ukrainian competition legislation to the requirements of the European Community. The main subjects of the round table were the changes in competition legislation by the EU, and the prospects for developing the Ukrainian framework in a corresponding manner. The Head of the Antitrust Authority of Ukraine. A. Kostusev noted: “The European choice of Ukraine makes harmonization of national legislation and the legislation of the European Union a priority. Though that is not to say there can be an automatic copying of this or that structure, regardless of context. A creative approach is necessary taking in view current conditions in our country”<sup>13</sup>.

On May 18, 2004 the Antitrust Authority of Ukraine, within the framework of the 13th anniversary of independence celebrations, organized an international conference devoted to the problems and tasks of modern competition policy. This conference was also devoted to the problems of globalization. That is why on opening of the conference, the Head of Antitrust Authority of Ukraine A. Kostusev noted: “Today we come to the moment when the competition policy of different countries needs to be carried out in coordination... I am very glad, that in Kiev the world elite of experts on questions of

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<sup>13</sup> Speech of A. Kostusev at the opening of the “Round table”, on March 24, 2004.

competition has gathered. It will help us to improve our legislation and to work towards keeping up with the standards of the EU”<sup>14</sup>.

Summing up, it is necessary to note that there are two types of problems Ukraine has to decide in the path of integration with the European Union. They can be described as internal and external. The internal one is a creation of an effective competitive environment inside the country; the external one is further coordination of Ukrainian and European competition legislation.

Assessing the results of the formation and introduction of competition policy in Ukraine, it is important to try to focus on obvious positive changes. Today in Ukraine modern legislation on questions of competition, which is harmonized to some extent with the European model, is working, but nevertheless further harmonization is needed.

In recent years a new understanding of the place and value of competition itself, and of the competition policy, has been realized. In a period of economic transformation in Ukraine competition policy has real weight and potential. Today in Ukraine there are no influential political or public forces which would deny the necessity and utility of economic competition. The basic task is not simply achieving a formally competitive system of markets, but creating an effective competitive environment, capable of providing stable development, in a socially responsible market economy. We hope that, following the Baltic countries, one day Ukraine will be on the list of

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<sup>14</sup> Speech of A. Kostusev at the opening of the Conference, on May 18, 2004.

countries to join the EU. Competition policy will play a crucial role in that process.