

Progress through Reforms: How to attract Investments in Ukrainian Extractive Industries

 **Policy Brief**

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This report has been created under the Ukrainian Think Tank Development Initiative, implemented by the International Renaissance Foundation (IRF) in partnership with the Think Tank Fund (TTF) and funded by the Embassy of Sweden in Ukraine (SIDA).

The views and interpretations expressed in this report are the authors' and do not necessarily reflect those of the Government of Sweden.

Abstract

Since the Ukraine–European Union Association Agreement (AA), albeit preliminary, came into effect in January 2016, now the Ukrainian government has to prove if it is capable to meet the expectations of its electorate. Undoubtedly, the transposition of several EU-directives into Ukrainian law as part of the AA needs to be done advisedly and cannot be completed as fast as many wish. But there are definitely priority areas which have to be tackled not later than possible in order to let Ukraine benefit to its full extend from the great opportunity which opens up with the AA. This paper will outline why the present draft law ‘On Data Disclosure in Extractive Industries’ represents nothing less than both, an overriding and indispensable measurement in pushing forward the reform process in such a field of intervention.

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Introduction

Of all priority areas the commodity sector has to be ranked among the most important ones. Within the commodity sector, ÅSLUND (2016) described the Ukrainian energy sector as “[...] key to the success of Ukraine’s economic reform”¹. On the other hand, it is the common opinion of experts from all fields that especially the miss-managed energy sector including rampant corruption remains one of the main obstacles to find this key².

Among others, one apparent evidence for the insufficient circumstances are the different statements on tax payments provided by 38 of in total 120 in Ukraine operating oil- and gas-companies respectively the State Fiscal Service. According to the latest EITI-report for Ukraine, the gap in tax-commitments to the state budget stated by both sides amounts to UAH 1,130.9 million³. A first cornerstone to counter these obvious problems in Ukrainian energy sector was set by the far-reaching adoption of the secondary legislation of the law ‘On the Natural Gas Market’⁴ in October 2015⁵.

However, neither the problem of lacking transparency nor the national relevance only applying to the energy sector alone, but rather to the commodity sector as a whole. Considering that in 2012 mineral exports in the value of \$ 68.8 billion⁶ contributed 39 %⁷ to Ukrainian GDP there should be no doubt at least about the latter statement. In this context the law ‘On Amendments to Certain Legislative Acts of Ukraine on Ensuring the Transparency in the Extractive Industries’⁸ was passed in June 2015.⁹

Nevertheless, both laws should be seen just as a first nonetheless important step towards a raw material sector contributing to the country’s economic reinvigorate in a reasonable

¹ ÅSLUND, ANDERS (2016): *Securing Ukraine’s Energy Sector*. Issue Brief April 2016, Atlantic Council. Global Energy Center and Dinu Patriciu Eurasid Center: p. 1. Retrieved on 29/04/2016: <http://www.atlanticcouncil.org/publications/issue-briefs/securing-ukraine-s-energy-sector>.

² Cf. ÅSLUND (2015); KONOŃCZUK (2015); ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) (2015)

³ Author’s own calculations based on: UAEITI & EY (2013): *Extractive Industries Transparency Initiative. The 1st National Report of Ukraine 2013*: p. 77. Retrieved on 29/04/2016: <https://eiti.org/files/uaeiti-2013-report-en.pdf>.

⁴ Author’s note: Hereafter referred to as Natural Gas Market Law.

⁵ See ENERGY COMMUNITY (EC) (2016): *Energy Community Country Brief Spotlight on Ukraine*. Issue 3, 9th March 2016. Retrieved on 29/04/2016: <https://www.energy-community.org/portal/page/portal/2DA01F3623B07BC3E053C92FA8C0CFDA>

⁶ See UNITED STATES GEOLOGICAL SURVEY ((USGS) (2014): *U.S. Geological Survey 2012 Minerals Yearbook. Ukraine [Advance Release]*: p. 47.2. Retrieved on 29/04/2016: <http://minerals.usgs.gov/minerals/pubs/country/2012/myb3-2012-up.pdf>

⁷ See Ibid.: p. 47.2

⁸ Author’s note: Hereafter referred to as Law Amendment on Transparency in Extractive Industries.

⁹ See UAEITI & EY (2013): p. 13

scope. Much more the chosen pathway of bringing to bring light into Ukraine's extraordinary opaque raw materials sector has to be continued. This applies all the more given the fact that international donors such as the International Monetary Fund (IMF) or the European Union (EU) predicate their constant support for Ukraine on certain progress on governance-reforms, particularly concerning anti-fraud and –corruption measurements in the domestic extractive industry¹⁰. The draft law 'On Data Disclosure in Extractive Industries' is one of the most promising projects on the reform agenda to prove that Ukraine's ambitions to meet this expectations are more than only pipe dreams.

In the following the paper provides a comprehensive overview about each of the components of the Draft Law. Thereby it addresses itself to the question why it provides policy makers with a more appropriate political instrument to meet the current challenges in the Ukrainian extractive sector than the current frameworks do.

1. What has been achieved so far?

During 2015 Ukraine progressed in fulfilling some of the major requirements of EU and the IMF related to its domestic extractive industry in general and the energy sector in special. These legal measurements compromise the adoption of the Natural Gas Market Law in line with the conditions of the 3rd Energy Package. Its purpose is to create an open gas-market via, inter alia, the marketization of domestic gas prices as well as terminating the monopolist status of the highly defective state-owned company Naftogaz in the oil- and gas-sector.¹¹

¹⁰ See EUROPEAN PARLIAMENT: 'Decision (EU) 2015/601 of the European Parliament and of the Council of 15 April 2015 providing macro-financial assistance to Ukraine', in: *Official Journal of the European Union*, 17/04/2015: pp. L 100/1 – L100/7. Retrieved on 29/04/2016:

http://ec.europa.eu/economy_finance/eu_borrower/documents/2015-04-15_decision_of_the_ep_and_the_council_providing_mfa_to_ua_en.pdf;

EU (2015a): *Macro-Financial Assistance for Ukraine Loan Facility from the European Union of up to 1.8 billion. Memorandum of Understanding between the European Union as Lender and Ukraine as Borrower*. Retrieved on 29/04/2016:

http://ec.europa.eu/economy_finance/international/neighbourhood_policy/doc/mou_eu_ukraine_en.pdf ; EU (2015b): *Fact Sheet. EU-Ukraine relations*. Retrieved on 29/04/2016:

eeas.europa.eu/factsheets/docs/eu-ukraine-relations_factsheet_en.pdf; UNIAN: 'МВФ похвалил реформу банковского сектора и раскритиковал борьбу с коррупцией в Украине', in: *Економіка / Фінанси*, 10/03/2016. Retrieved on 29/04/2016: <http://economics.unian.net/finance/1286707-mvf-pohvalil-reformu-bankovskogo-sektora-i-raskritikoval-borbu-s-korruptsiyei-v-ukraine.html>.

¹¹ See KONOŃCZUK, WOJCIECH (2015): *Reform #1. Why Ukraine has to reform its gas sector*. OSW-Commentary No. 181. Retrieved on 29/04/2016: <http://www.osw.waw.pl/en/publikacje/osw-commentary/2015-09-02/reform-1-why-ukraine-has-to-reform-its-gas-sector>.

The Law Amendment on Transparency in Extractive Industries was adopted by the Verkhovna Rada in June 2015. Core intention of the legal amendment is increasing transparency and natural resource government in Ukrainian extractive industries, mainly to boost the investment climate in the sector.

On one hand, the Law Amendment on Transparency in Extractive Industries obliges subsoil users to unveil information on payments to governmental authorities such as taxes and duties as well as on their extractive activities on Ukrainian territory. On the other hand the Ministry of Ecology and Natural Resources of Ukraine has to grant public access to data related to geological surveys and use and protection of natural resources.¹²

The secondary legislation of the Natural Gas Market Law entered into force after it was accepted by the competent authorities in October 2015. However, some of the legal acts are still under review. This is due to non-compliance with the Energy Community's statutory provisions or the need for further legal clarification. Also the proposal to break up Naftogaz, initially envisaged for 15th October 2015, still waits for its mandatory approval by the Energy Community (EC) after it has been postponed by the Ministry of Energy and Coal Industry. Any kind of delays like the stated ones impeding the law's implementation to its full extend.

Both other main legislative issues manifested in the framework of the 3rd Energy Package, the Draft Law on the Electricity Market and the Amended Energy regulatory Authority Law, are waiting for their submission to Verkhovna Rada respectively its review by the Energy Community Secretariat.^{13 14}

However, even if all three main legislative initiatives of the 3rd Energy Package will enter into force and fully implemented in the near future it only will encompass the electric and gas market entirely. Conversely, this means that just these two sectors will profit of the full range of transparency opportunities which are associated with the reforms. The mining sphere of the commodity sector is more or less excluded. In other words such an important sector as the mining and quarrying industries has been simply

¹² See UAEITI & EY (2013)

¹³ See EC (2015): *Energy Community Country Brief Spotlight on Ukraine*. Issue 2, 13th November 2015. Retrieved on 29/04/2016: <https://www.energy-community.org/portal/page/portal/246BA821D1883943E053C92FA8C081A6>.

¹⁴ See EC (2016)

left out of consideration although they accounted for 14.1 %¹⁵ of all industrial production in 2012, which in turn contributed 58 %¹⁶ to Ukraine's GDP.

The same attitude of one-dimensionality is valid for the Law Amendment on Transparency in Extractive Industries which requires to publish payment flows only from the entrepreneurial side and not from public authorities. The obstruction of reforms and their narrow scope hold the risk that corrupt and fraud practices in other areas of the commodity sector will be maintained.

Summed up both laws, the Amendment Transparency in Extractive Industries and the Natural Gas Market Law, have to be considered as a first, even though indispensable step towards more transparent conditions in the Ukrainian commodity sector. Or simply as “[...] the ‘mother[s] of all reforms’ upon which the success of Ukraine’s transformation will depend [...]”, as KONOŃCZUK (2015)¹⁷ stated. That is why, without any doubt, further political tools need to be established to step up to fight against the biggest obstacle in bringing Ukraine’s economy sector forward: The lack of transparency.

2. What to do next?

A convenient way to eliminate all those adversities stated in the chapter above is the present draft law ‘On Data Disclosure in Extractive Industries’. Coherently it adapts the many unquestionable strengths of the Natural Gas Market Law and the Law Amendment on Transparency in Extractive Industries. Furthermore the Draft Law provides Ukraine with a comprehensive political tool for the future offering two crucial advantages:

- Firstly it includes EU-directives which will be mandatory for Ukraine in the course of the AA.
- Secondly it implements other directives in advance which Ukraine anyway has to fulfill if the country wants to continue its way towards becoming a prospering country which finally uses its massive potential by applying to European standards.

¹⁵ See USGS (2014): p. 47.1

¹⁶ See Ibid: p. 47.1

¹⁷ See Ibid: p. 7

2.1 The Draft Law: Advancing the current state of law

Probably the most obvious alteration which differs the draft law 'On Data Disclosure in Extractive Industries'¹⁸ from the Law Amendment on Transparency in Extractive Industries is the inclusion of payments related to pipeline transition of chemical products and hydrocarbons¹⁹. This amendment is totally vital considering that in 2014 gas transmission made up 31 %²⁰ of state-owned Naftogaz' total operating revenues. In other words, profits generated in this branch amount of UAH 24.2million²¹ out of UAH 78.4 million²² in total. To omit a business-segment which exceeds in terms of revenues three times Naftogaz' only other non-regulated operational business, the oil-sector, means that the Law Amendment on Transparency in Extractive Industries becomes nothing more than a paper tiger.

2.2 How the Draft Law contributes to the 3rd Energy Package

The three main legislative initiatives related to the 3rd Energy Package, namely the Natural Gas Market Law, the Draft Law on the Electricity Market and the Amended Energy Regulatory Authority Law, undoubtedly will help to create a competitive environment on energy markets which is less vulnerable to nepotism and fraud. But besides the fact, that despite some setbacks up to here only the Natural Gas Market Law shows significant progress, in opinion of experts it is negligent to disregard other Ukrainian extractive sectors from a comprehensive reform²³.

This concerns very much the mining sector and here foremost the coal extraction. Yet, the Ukrainian coal industry is in a poor economic and technical condition. It suffers from a comparable low and declining productiveness combined with high extraction costs²⁴. Nonetheless, coal is still of utmost significance for Ukraine due in 2013 it contributed round about 36 %²⁵ to the country's gross energy inland consumption.

¹⁸ Author's note: Hereafter referred to as the Draft Law.

¹⁹ See DRAFT LAW OF UKRAINE 'ON DATA DISCLOSURE IN EXTRACTIVE INDUSTRIES' (2016)

²⁰ See NAFTOGAZ OF UKRAINE (2014): *Naftogaz Of Ukraine. Annual Report 2014. Changing for the future.* Retrieved on 29/04/2016:

<http://www.naftogaz.com/www/3/nakweben.nsf/0/386A5C4407B5195BC2257EDD006E9E90?OpenDocument&Expand=2&>

²¹ See Ibid.

²² See Ibid.

²³ See ÅSLUND (2015)

²⁴ See Ibid.

²⁵ Author's own calculations based on: ENERGY COMMUNITY SECRETARIAT (2015): *Annual Implementation Report. 1 September 2015.* Retrieved on 29/04/2016: <https://www.energy-community.org/portal/page/portal/23B450386A075E64E053C92FA8C0F69F>.

Further 46 %²⁶ to the net maximum electrical capacity of power plants stems from coal-fired power plants. In particular the existence of a private monopoly in coal-fired electric generation hampers urgently needed investments in the obsolete technology.²⁷

The Draft Law can play a major role in improving the climate for those investments by guaranteeing foreign investors a non-discriminative treatment based on principles of transparency valid for every business party including state-owned companies. In this way, in interaction with the Draft Law on the Electricity Market it offers the unique opportunity to tackle this issue from both sides simultaneously. Additionally, through the disclosure of payment flows by governmental institutions on one side and business entities on the other side, no matter if state owned or privatized, it will be possible to diminish the most common practice of corruption in the mining sector: The arbitrage of subsidized and non-subsidized prices²⁸.

2.3 How the Draft Law helps Ukraine realizing the Association Agreement

Through the Draft Law three EU-directives will be implemented with a view to strengthen transparency in the Ukrainian extractive industries. The Directive 2007/14/EC provides guidelines to transpose those provisions of the Transparency Directive 2004/109/EC (TD) into national law related to the “[...] harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market [...]”²⁹.

In nexus of the AA the inclusion of Directive 2007/14/EC in the present draft law cannot be considered as an additional bureaucratic condition. According to the AA, anyway it has to be implemented together with the TD within the upcoming four years³⁰. In fact, the realization of Directive 2007/14/EC in the framework of the Draft Law proves that Ukraine is willingly to stand by its pledge it gave to its own citizens sooner than later. This statement of political action is even more credible because it affects an economic sector famous for being extremely characterized by patronage networks.

²⁶ Author’s own calculations based on: Ibid.

²⁷ See Ibid.

²⁸ See ÅSLUND (2015)

²⁹ See EU (2014): ‘Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part’, in: *Official Journal of the European Union*, 29/5/2014: p. L 161/ 1735. Retrieved on 29/04/2016:

http://www.eeas.europa.eu/ukraine/docs/association_agreement_ukraine_2014_en.pdf.

³⁰ See Ibid.

2.3.1 Establishing equal market conditions

The second EU directive covered by the Draft Law is the Transparency Directive Amendment Directive 2013/50/EU (TDAD). The TDAD is an amendment of the originally in the AA embedded TD³¹. It aims on harmonizing the disclosure requirements of the TD with those of the new Accounting Directive 2013/34/EU (AD), the third directive on which the draft Law builds up.

In plain text this means, that oil, gas, mining and logging companies have to report their payments to governments as stated by the AD, no matter if they are registered outside the European Economic Area or not. The decisive factor is if the issuer's securities are admitted to trading on EU regulated markets. Whereas under the application of all three directives subsidiaries are excluded from the obligation to draft a separate financial report on condition that the parent company's consolidated report contains all their payments. Hence the TD corresponds to the universality principle whereupon all exemptions in terms of disclosure requirements potentially appropriable by national legislation should be excluded.³²

As Ukraine is not part of the EU yet, this means no undertaking from a second country engaged in the domestic extractive sector has any advantages towards native market participants. A very important circumstance to ensure that Naftogaz will become a competitive market player. Because one is obvious: Whilst everybody is aware of the need to unbundle the not survivable construct Naftogaz which it is for now, nobody denies its potential for contributing to the country's economic transition.

2.3.2 Giving Ukrainian extractive sector what it needs

It is indisputable that Ukraine extractive sector suffers from underinvestment. Under the current circumstances of financial woes the state-owned companies are not able to stem those alone. But how to attract the urgently needed foreign investors?

³¹ See EUR-LEX (2016A). RETRIEVED ON 29/04/2016: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32013L0050>.

³² See PRICEWATERHOUSECOOPERS (pwc) (2013): *Tax transparency and country-by country reporting. An ever changing landscape. An update October 2013*. Retrieved on 29/04/2016: https://www.pwc.com/gx/en/tax/publications/assets/pwc_tax_transparency_and-country_by_country_reporting.pdf; PUBLISH WHAT YOU PAY (PWYP) (2013): *Fact Sheet: EU rules for disclosure of payments to governments by oil, gas and mining (extractive industry) and logging companies. November 2013*. Retrieved on 29/04/2016: <http://www.publishwhatyoupay.org/wp-content/uploads/2014/09/PWYP-fact-sheet-on-EU-Accounting-and-Transparency-Directives.pdf>.

As matters stand, rampant corruption and fraud is the most dissuasive factor keeping foreign investors away from operating in the Ukrainian extractive sector.³³ The phenomenon is widespread throughout all areas of economic related activities, namely granting business licenses and permits, tax collection or land and other natural resources allocation³⁴.

A survey, conducted by the World Bank³⁵ between January and December 2013, among 1,002 enterprises providing an idea why this assumption is nothing less than true. Thus 73.1 %³⁶ of all polled corporations considered that they believe, other business entities similar in structure to their own “[...] are making informal payments or giving gifts to public officials to “get things done” with regard to customs, taxes, licenses, regulations, services, etc. [...]”³⁷.

Positive signals to potential allies:

The implementation of the AD and TDAD is a strong signal to foreign investors to counter this most problematic grievances in its commodity sector from an inside as well as outside perspective. From the inside, it shows that Ukraine is able to create a welcoming business environment. From the outside it helps investors to assess conscientiously those risks connected to an envisaged commercial participation in the country’s extractive sector.

An assessment report conducted by the renowned audit, accounting and consulting group Mazars³⁸ strengthen this hypothesis. The report examined the impact of the TD on which the TDAD is based up. And the responses were overwhelmingly positive. Whilst none of the companies which were part of the study really questioned the economic sense of the TD, 82 %³⁹ of all participants stated that regularly published information are relevant for decision making related to investments. Similar 79 %⁴⁰ of

³³ Author’s note: Other authors showed that rampant corruption has a negative effect on foreign direct investments, cf. WEI, SHANG-JIN (2000) ‘How Taxing Is Corruption on International Investors?’, in: *Review of Economics and Statistics*, Vol. 82 (1): pp. 1-11. Retrieved on 29/04/2016: <http://users.nber.org/~wei/data/wei2000a/wei2000a.pdf>.

³⁴ See OECD (2015): *Anti-Corruption Reforms in Ukraine. Round 3 Monitoring of the Istanbul Anti-Corruption Action Plan*. Retrieved on 29/04/2016: <https://www.oecd.org/corruption/acn/Ukraine-Round-3-Monitoring-Report-ENG.pdf>.

³⁵ See THE WORLD BANK (2013). Retrieved on 29/04/2016:

<https://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine#corruption>.

³⁶ See Ibid. Author’s note: For Eastern Europe and Central Asia the same questions was affirmed by only 19.5 % of all respondents.

³⁷ See THE WORLD BANK (2013)

³⁸ DEMARGINY, FABRICE & CHRISTOPHE CLERC (2010): *Transparency Directive Assessment Report. Executive summary and possible improvements*. Retrieved on 29/04/2016:

http://ec.europa.eu/finance/securities/docs/transparency/report-application_summary_en.pdf.

³⁹ See Ibid.: p. VIII

⁴⁰ See Ibid.: p. X

financial analysts and institutional investors considered that financial information are of utmost importance for them. All in all no party which got a chance to speak, proclaimed its discontent about a flood of too many information in connection the TD. Also 69 %⁴¹ did not complain about escalating audit costs associated with drafting their reports.⁴²

Why UK serves as a role model for transparency in the Extractive Industry:

Some of the most potent corporations which come into question to become active in the Ukrainian extractive sector are registered in the United Kingdom (UK). The influential role occupied by extractive companies did not prevent the UK to play a pioneering role and to be ranked among the first EU member states which transposed the AD and TDAD into national legislation⁴³.

Rather the Department for Business Innovation & Skills (DBIS)⁴⁴ and the Financial Conduct Authority (FCA)⁴⁵ as UK's responsible agencies clearly expects that both, domestic corporations and investors engaged in resource rich countries will benefit from an improved business environment and risk prediction. This finding is underlined by statements of the affected entrepreneurial side itself. In this connection UK-registered company Tullow Oil confirms: "As long-term investors, we need assurance that the legal, fiscal and regulatory regime will remain stable over the life of the project"⁴⁶. Status as of 2014, in total in UK 177 large enterprises which are no subsidiaries are affected by the AD. This includes such major players as BP, Royal Dutch Shell, Rio Tinto and Anglo American.⁴⁷

⁴¹ See DEMARGINY, FABRICE & CHRISTOPHE CLERC (2010): p. VIII

⁴² See Ibid.

⁴³ See PWYP (2013)

⁴⁴ See DPIS (2014): *UK Implementation Of The EU Accounting Directive. Consultation: Chapter 10 - Extractive industries reporting. Impact Assessment. March 2014*. Retrieved on 29/04/2016:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298603/bis-14-669-impact-assessment-consultation-on-the-uk-implementation-of-the-eu-accounting-directive.pdf.

⁴⁵ See FCA (2015): *Implementation of the Transparency Directive Amending Directive (2013/50/EU) and other Disclosure Rule and Transparency Rule Changes. March 2015*. Retrieved on 29/04/2016:

<https://www.fca.org.uk/static/documents/consultation-papers/cp15-11.pdf>.

⁴⁶ See Ibid.: p 8

⁴⁷ See Ibid.

Looking beyond:

The Draft Law on 'On Data Disclosure in Extractive Industries' also bounds the extractive industry to unveil payments made in any kind. Naturally, this includes non-financial payments. It follows the latest amendment of the AD by Directive 2014/95/EU "about the disclosure of non-financial and diversity information" (NFID)⁴⁸ which introduced those obligations for all corporations registered on an EU-regulated market as well as "[...] for certain large undertakings and groups Text with EEA [European Economic Area] relevance"⁴⁹ as defined by the EU. Unlisted small and medium-sized firms are anyway already excluded from the reporting and auditing requirements via the AD which aims on a further reduction of those.⁵⁰ It has to be adopted by all EU-member states until 6th of December 2016. And Ukraine sooner or later has to do the same if the country wants to keep up with the economic success story taking place in the EEA.⁵¹

The Federation of European Accountants (FEE)⁵² strictly advocates the NFID which aims on establishing equal market conditions for all participating business parties. In opinion of the FEE the NFID is neither an unreasonable burden unnecessarily inflating the existing AD nor forcing business entities to publish irrelevant information. Moreover it emphasizes the fundamental role which non-financial information are playing in undertakings' successful business performance.⁵³ This view is indeed supported by EASLEY AND O'HARA (2004) who are stating that if companies are willingly to publish more information they can account on lower costs per capital.⁵⁴ In this way the FEE argues consistent with the competent state authorities in UK for the implementation of the AD, TDAD and as well the NFID into national law.

⁴⁸ See EUR-LEX (2016b). Retrieved on 29/04/2016: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095>.

⁴⁹ See Ibid.

⁵⁰ See FEE (2014): *The New June 2013 Accounting Directive*. Retrieved on 29/04/2016: http://www.fee.be/images/Factsheet_New_Accounting_Directive_1401.pdf.

⁵¹ See FEE (2016)

⁵² Author's note: The Federation of European Accountants represents 50 professional institutes of accountants and auditors from 37 European countries, see (FEE) (2016): *EU Directive on disclosure of non-financial and diversity information. Achieving good quality and consistent reporting. Position Paper. March 2016*. Retrieved on 29/04/2016:

http://www.fee.be/images/publications/Corporate_Reporting/FEE_position_paper_EU_NFI_Directive_fin al.pdf.

⁵³ See FEE (2016)

⁵⁴ See EASLEY, DAVID & MAUREEN O'HARA (2004) 'Information and the Cost of Capital', in: *The Journal of Finance*, Vol. 59 (4): pp. 1553-1583. Retrieved on 29/04/2016: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2004.00672.x/pdf>.

3. Why the EITI is more than just an additional set of rules

Complementary to the directives, the Draft Law includes the EITI Report as the main framework which shapes the report-design for all business entities obligated to publish their financial- and non-financial information. This concept offers far-reaching benefits due the EITI requirements are congruent with the EU-directives in many points. But above all it prevents companies from the duty of drafting a duplicate report.

Moreover, following the EITI-standards the Draft Law envisages that not only the undertakings engaged in the Ukrainian extractive industries have to publish their payments to governmental authorities, but also the latter ones have to state which monies they received related to extractive activities. Both sides should meet the requirements through publishing the payment flows individually for each single project.⁵⁵ This is not any additional bureaucratic hurdle. Quite the contrary, it will be much easier for the central government to reconsider the details of each of the numerous payment flows on all administrative levels.

3.1 The EITI and decentralization: A promising partnership

Especially in nexus with the proposed reforms decentralization in Ukraine it is important to maintain a certain supervision about practices of regional administrative agencies with more extensive competences⁵⁶. So far the data speak for themselves: According to a survey of the RAZUMKOV CENTRE (2013) 85.7 %⁵⁷ of the individuals surveyed stated that corruption in institutions of local self-government is at least happening. But to meet their controlling obligations in a more credible way governmental bodies have to be caused to act transparent at all levels⁵⁸.

In consequence, the Draft Law enables them to do so with regard to one of the most dominant sectors in Ukrainian economy. Clearly it means a powerful measurement to trace corrupt practices way more efficiently which happen up to now too far away from the competent authorities in Kyiv to get detected.

⁵⁵ See DRAFT LAW OF UKRAINE 'ON DATA DISCLOSURE IN EXTRACTIVE INDUSTRIES' (2016)

⁵⁶ Cf. BICKHAM, EDWARD (2015): *Mining and the Extractive Industries Transparency Initiative A review of international and in-country experiences of the EITI from the perspective of supporting mining companies*. Retrieved on 29/04/2016: https://eiti.org/files/eiti_review_report_v10_-_final.pdf.

⁵⁷ See survey by the Razumkov Centre, September-October 2013. Retrieved on 29/04/2016: www.razumkov.org.ua/ukr/poll.php?poll_id=903

⁵⁸ See SOLOGOUB, ILONA (2014): *Decentralization Reform in Ukraine*. Free Policy Brief Series, October 2014. Retrieved on 29/04/2016: freepolicybriefs.org/wp-content/uploads/2014/10/fpb_oct81.pdf.

Also the Draft Law counters another frequently observed problem of decentralization: The unequal development of regions due to unequal conditions⁵⁹. To avoid such unwished and negative effects potentially coming along with decentralization, the government in Kyiv has to ensure a financial balance between all oblasts, regions and rayons⁶⁰. An in-depth overview about all payments received by all public authorities definitely helps to create a sustainable balance between all territorial entities by ameliorating the distribution of public funds.

As well in this way the most dangerous outcome of decentralization can be antagonized: Envy and dissatisfaction in certain parts of the country which might lead to separatist tendencies can be controlled and minimized⁶¹. Essential for Ukraine in this times when the country has to fight with those movements in its Eastern oblasts Luhansk, Donetsk and on Crimea-peninsula.

3.2 How the EITI helps to attract investors

Two of the most convincing arguments for the implementation of the TDAD and AD into Ukrainian legislation are also valid for the expansion of the Draft Law to the EITI. Firstly the EITI membership enhances the attractiveness of the Ukrainian extractive sector for foreign investors. A recent study⁶² based on a dataset of 81 countries proved that in the course of becoming an EITI candidate country the foreign direct investments (FDI) inflows to GDP in the states concerned raised by 2 %⁶³ on average. This is quite impressive considering that it stands for 50 % of the average share of FDI related to GDP in these 81 countries⁶⁴. Drawing conclusions, the original intention of the Law Amendment on Transparency in Extractive Industries, too boost foreign investments in the domestic industry, is decently an argument for the transposing of the EITI-principles into national law.

Secondly, the serious implementation EITI proves even more Ukraine's capability to undergo a radical change. In consequence, Ukraine will appear in the eyes of EU and

⁵⁹ See Ibid.

⁶⁰ See CAI, HONGBIN & DANIEL TREISMAN (2005): 'Does competition for capital discipline governments? Decentralization, globalization and public policy', in: *The American Economic Review*, Vol. 95 (3), June 2005. Retrieved on 29/04/2016:
<http://www.sscnet.ucla.edu/polisci/faculty/treisman/Papers/compoct06.pdf>.

⁶¹ See SOLOGOUB (2014)

⁶² See SCHMALJOHANN, MAYA (2013): *Enhancing Foreign Direct Investment via Transparency? Evaluating the Effects of the EITI on FDI*. Discussion Paper Series No. 538. Retrieved on 29/04/2016:
https://eiti.org/files/Schmaljohann_2013_dp538.pdf.

⁶³ See Ibid.: p. 1

⁶⁴ See SCHMALJOHANN (2013)

IMF as a trustworthy and reliable partner. However, if the country will back-pedal from its status as EITI candidate country, it will seem as it lost the path of reform and donors will tend to think twice about future aid.⁶⁵

Similar to the principle of publishing payment flows from the payer as well as recipient side, a further core idea of the EITI supported through the extractive industry is implemented in the Draft Law: The beneficial ownership.⁶⁶ Contextual to the beneficial ownership 55 %⁶⁷ of all shareholder being asked, quoted that they wish access to information about lending of voting rights.

Why UK serves as a role model for the principle of beneficial ownership:

In the context of beneficial ownership, again UK can serve as a case of best practice. Together with Germany, France, Italy and Spain the country developed an agreement that will bind all tax and law enforcement agencies registered in these states to share data on company beneficial ownership registers and new registers of trusts. The plans were presented at the spring meetings of the International Monetary Fund in Washington, D.C.⁶⁸

In order to push the ambitious plans forward, as the host country of the *Anti-Corruption Summit: London 2016* UK lately announced that it will become the first state introducing a register of company beneficial ownership freely accessible for every world's citizen from June this year. In the course of the anti-corruption summit the Netherlands, France, Nigeria and Afghanistan will agree to follow the example of UK. At least six other countries will declare to seriously evaluate this option for their own. Further, on the summit numerous participating governments will accede a convention between UK and 33 other nations about exchanging their own enterprise owner lists.⁶⁹

To guarantee equal conditions for every competitor on the domestic markets, UK will oblige foreign investors to join its register of beneficial ownership. This measurement

⁶⁵ Cf. SCHMALJOHANN (2013) & BICKHAM (2015)

⁶⁶ Cf. BICKHAM (2015)

⁶⁷ See DEMARGINY & CLERC (2010): P. X

⁶⁸ See HM TREASURY (2016): *UK leads European calls for G20 action on beneficial ownership. The UK enters ground-breaking deal to tackle tax evasion and corruption with Germany, France, Italy and Spain.* 14th April 2016. Retrieved on 29/04/2016: <https://www.gov.uk/government/news/uk-leads-european-calls-for-g20-action-on-beneficial-ownership>.

⁶⁹ See CAMERON, DAVID (2016): 'The fight against corruption begins with political will', in: *The Guardian*, 11th May 2016. Retrieved on: <http://www.theguardian.com/commentisfree/2016/may/11/fight-against-corruption-begins-with-political-will>.

avoids a climate of envy and distrust by preventing domestic undertakings from feeling underprivileged. An important measurement, also for Ukraine, to take Naftogaz the fear of potential concurrence from beyond the borders. Besides it prevents foreign investors to infiltrate Ukrainian state property or bid for public contracts without the permission of the state itself.⁷⁰

Summarizing it has to be stated that the serious compliance with the EITI-standard shows several from each other mutually dependent positive results: Increased attractiveness for foreign investors respectively reliability towards international donors as well as more control about domestic revenue flows through decreasing corruption.

Conclusions

As the current US-president Barack Obama stated towards his audience at the Millennium Development Goals Summit in New York, “countries are more likely to prosper when governments are accountable to their people”⁷¹. UK’s Prime Minister David Cameron takes the same line when he says “the things we want to see – countries moving out of poverty, people benefiting from their nation’s natural resources, the growth of genuine democracies – will never be possible without an all-out assault on corruption”⁷². The present paper demonstrates that in this context Ukraine constitutes definitely no exception. It becomes clear that fraud, corruption and mismanagement in the extractive industry are disproportionately responsible for the condition of the state.

Since 2014 Ukraine achieved some astonishing success on the reform agenda. But to face the truth, with respect to the sheer scale of necessary reforms, especially in the extractive sector, little has done yet. This is even true if partial success should be extend into a whole success story. That is why Ukraine must assign the highest priority to the draft law ‘On Data Disclosure in Extractive Industries’. It represents the so far most pertinent political

⁷⁰ See Ibid.

⁷¹ See THE WHITE HOUSE (2010): ‘Remarks by the President at the Millennium Development Goals Summit in New York’, 22nd September 2010. Retrieved on 12/05/2016: <http://www.whitehouse.gov/the-press-office/2010/09/22/remarks-president-millennium-development-goals-summit-new-york-new-york>.

⁷² See CAMERON (2016)

tool to combat the most urgent problems in the country's political and economic landscape effectively.

The Draft Law will largely contributing to a reinvigorated Ukraine by:

- guiding decentralization into the right track.
- backing up the implementation of the 3rd Energy Package complementary manner.
- guaranteeing the further disbursement IMF-, World Bank- and EU-loan tranches respectively granting access to future aid programs.
- pursuing the original target of the law 'On Amendments to Certain Legislative Acts of Ukraine on Ensuring the Transparency in the Extractive Industries' to boost investments in the domestic extractive sector through simplifying an opaque legislative framework and establishing equal conditions for all market participants.