



## The EU-Ukraine FTA Social Impact Analysis

Prepared in the framework of [Trade Sustainability Impact Assessment](#) (TSIA) study carried out by an international consortium of ECORYS Netherlands BV and CASE Ukraine.

September 2007

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## 1 Existing social situation and trends in Ukraine

Ukraine has been rather explicit in expressing its desire to eventually become part of the EU. Whether this is feasible or realistic is not an issue for this report, but it has meant that the country has made improvements to the overall quality of life to meet EU standards, in addition to meeting political and economic requirements.

The EU/Ukraine Action Plan includes a section on social situation, employment, and poverty reduction, which envisages (1) strengthening cooperation on social matters, ensuring a closer approximation of Ukraine to the EU standards and practices in the area of employment and social policy; (2) introducing effective employment creation and poverty reduction measures, aimed at a significant reduction in the number of people with income below the poverty line and improved social cohesion, including sustainable systems for education, health and other social services with access for all. In addition one of the priorities for action is to “encourage dialogue on employment issues and best endeavours, in accordance with the Partnership and Cooperation Agreement (PCA), to ensure that treatment of migrant workers does not discriminate on grounds of nationality.”

The main social indicators described in this section include: (1) Labour issues, and particularly decent work as defined by the ILO; (2) Poverty, including the number of people living under poverty line, GINI index, regional effects, etc.; (3) Equality, relating to gender, race, religion, in areas such as education, employment, geographic location, etc.; (4) Education, including primary, secondary and tertiary enrolment rates, literacy rates, access and quality issues, etc. and (5) Health, including life expectancy, mortality rates, access to and quality of health services, sanitation, nutrition, etc.

### 1.1 Labour issues

The ILO concept of Decent Work provides a converging focus for the strategic objectives of the ILO – to which the EU subscribes – namely rights to work, employment, social protection and social dialogue. As such it touches on issues of unemployment and underemployment, poor quality and unproductive jobs, unsafe work and insecure income, rights which are denied, gender inequality, exploitation of migrant workers, lack of representation and voice, and inadequate protection and solidarity in the face of diseases, disability and old age. Present Ukraine labour legislation seems to address the main elements of the decent work concept.

#### *1.1.1 Labour legislation*

The main body of laws covering Ukrainian labour regulations is the Labour Code of Ukraine. Ukrainian labour legislation is inherited from Soviet times; therefore, the emphasis is on protecting the rights of employees. An illustration is article nine of the Labour Code, which states that the provisions of the individual employment agreements which worsen the working conditions of the employees compared to those stipulated by the Ukrainian labour legislation are considered ineffective. In fact, employment protection legislation in Ukraine is significantly stricter than in other CEE countries and even stricter than in most OECD countries.

Ukrainian labour legislation provides certain guarantees to employees, including the following:

- Wages for time spent away from work for performing functions of trade union officer, appearing in court, voting and fulfilling other state or social responsibilities;
- Right to keep one's job while on a training programme;

- Wages while hospitalised;
- Severance pay in certain situations;
- Social benefits, such as: maternity leave, paid vacation and holidays;
- Minimum wage guidelines.

In addition, the following is provided by the labour legislation:

- Working week is not to exceed 40 hours;
- Overtime is generally prohibited, except for certain cases, in these exceptional cases time limitations are such that overtime may not exceed four hours during two consecutive days or 120 hours per year;
- Annual leave of 24 calendar days;
- Paid maternity leave for women 70 days prior and 56 days after the childbirth; women are also entitled to partially paid leave until the child reaches the age of three.

In terms of labour legislation, but also in terms of major indicators such as unemployment, labour participation and labour conditions, Ukraine seems to perform quite well relative to some of the other transition economies and even relative to the EU average. However, Ukraine's performance 'on paper' is better than in practice, as several recent studies confirm.<sup>1</sup>

Since Ukraine's independence the following developments with regards to labour issues can be considered positive:

- Labour force participation and unemployment rates are not that bad and approximate the EU average;
- The proportion of women in the labour force is fairly high (48.9 per cent) and is similar to the situation in the EU;
- Between 2000 and 2004, the share of people who identified themselves with "middle class" increased from 9.2 per cent to 16 per cent;
- The share of wage and salaried employees covered by occupational injury insurance is quite high (84 per cent);
- With a collective bargaining coverage rate of 74.1 per cent, Ukraine is at the level of the EU average.

Negative developments and trends can be outlined as follows:

- Monetary increase in wages and salaries has not been able to compensate for the loss in purchasing power caused by inflationary processes;
- Over 16 per cent of low pay workers earned less than 2 USD a day, which means that in 2004 the salary of low pay workers in Ukraine was less than the established minimum wage;
- In spite of a relatively low unemployment, the number of long-term unemployed grew almost tenfold. Ukraine's falling unemployment rate is largely a function of the negative population growth pattern than of the creation of new jobs;
- In comparison with the EU, Ukraine has the lowest incidence of employer sponsored/ organized training;

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<sup>1</sup> Chernyshev, I. (2005) "Socio-economic security and decent work in Ukraine: A comparative view and statistical findings." Working Paper No. 76, Policy Integration Department, Statistical Development and Analysis Group, ILO, Geneva./ United Nations Development Programme (2006) "Ukraine. Poverty Alleviation." Millennium Development Goals Project. Ministry of Economy of Ukraine (<http://www.undp.org.ua/>).

- Job-related training especially for women is a major concern. Moreover, the majority of the Ukrainian employees had received no promotion in the past five years;
- In spite of the decline in strike activity, the last decade witnessed continued erosion of the social security system and a deterioration of working condition in such accident prone industries as construction and mining.

### *1.1.2 Employment opportunities and labour market security*

Ukrainian economy grows at a high rate and, as mentioned above, unemployment is relatively low. At the same time productive job opportunities are scarce, especially in the formal sector. Many workers have a hard time finding a job, and many become discouraged and withdraw from the labour force.

As in many transition economies, the employment elasticity of growth in the Ukraine is rather low, thus despite strong GDP growth, employment growth has been disappointing. To an extent this can probably be attributed to productivity increases and the fact that in many sectors the number of people employed is already higher than needed. Another reason appears to be the limited role of SMEs in the economy. In transition economies jobs are created mainly by the private, usually small, firms. However, the size of this job-generating sector in Ukraine is significantly smaller (less than 30 percent of total employment) than in the most successful transition economies. The high costs of doing business in Ukraine deter entry of new firms. According to the World Bank Doing Business in 2006 report, Ukraine ranks among the last (with most complications for starting a business) countries in the region. For example, Ukraine and Belarus rank the last in the number of procedures to start a business (this number equals 15). Hence, there is a scarcity of jobs because there are few firms creating them.

### *1.1.3 Labour migration*

There is emerging evidence on migratory flows from Ukraine to the EU countries such as Poland, Italy, Portugal, Spain, Greece and the Czech Republic. Given that a significant number of migrants engage in irregular forms of employment, it is difficult to estimate the actual numbers of male and female labour migrants from Ukraine working abroad. Official estimates of registered migrant workers in countries of origin and destination usually tend to underestimate the effect and at times differ from one another.

Out of a population of over 46 million people, Ukrainian authorities estimate that over two million Ukrainian women and men work abroad, with one million working in Russia, and the other million spread out mostly among EU countries (Poland – 300,000; Italy – 200,000; Czech Republic – 150,000; Portugal – 150,000; Spain – 100,000). The majority of these migrant workers come from rural areas of Ukraine's Western regions.

### *1.1.4 Unemployment and employment security*

The labour market in Ukraine is at a relatively early stage of transition. Most labour is still employed in the public sector, which implies that the major wave of job and labour reallocation lies in the future. At the same time, despite low open unemployment, the labour market is depressed and productive job opportunities are few.

The unemployment rate, at about 7 percent, is relatively low by the standards of transition economies.<sup>2</sup> But the unemployment rate does not tell the whole story. The scarcity of job opportunities in Ukraine

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<sup>2</sup> Calculated using International Labor Organization methodology, year 2006.

manifests itself largely in the relatively low labour force participation rate. Many workers have become discouraged by the futility of their job search and have withdrawn from the labour force. About 60 percent of the working age population are either employed or looking for a job. As a result the employment-to- population ratio, which is the most comprehensive indicator of the degree of utilisation of labour resources, is relatively low in Ukraine (around 60 per cent compared to the OECD average of 70 per cent).

Moreover, the official unemployment figure fails to completely account for hidden unemployment. For example, more than a third of rural residents of working age are technically unemployed, as the majority of the population working on their own small farms, do not consider themselves employed. Large numbers of working age rural residents are forced to move away from their places of residence in search of employment, including moving abroad. The number of officially registered unemployed citizens is unreliable, also for another reason: instead of registering with the state unemployment agency, many unemployed choose to leave the official labour market and move to the shadow economy.

#### *1.1.5 Rights at work and social protection*

Social dialogue and workplace relations also deserve a few comments. It is the case that the last decade has witnessed a positive historical change in the right of Ukrainian workers associate themselves. Today, instead of one All-Ukrainian Federation of Trade Unions with a reported 100 per cent membership, the country has a dozen of independent trade union organisations with their own federations and representation at both national and international levels. The reality of today is that in order to safeguard their level of representation and position in the process of social dialogue, the Ukrainian trade unions have to strengthen their positions. They need to demonstrate their ability to defend workers' rights in an environment characterised by growing competition coupled with the population's declining interest in their activities.

One measure of the failure of social dialogue is the recourse to strike. However, the absence of strike action could also indicate the absence of the right to strike. In a ten-year time span, the annual number of strikes diminished dramatically from 247 in 1995 to only 4 in 2004. However, this decrease in recourse to industrial action does not necessarily mean that social dialogue and workplace relations have improved proportionally in the reverse direction. For example, working conditions in Ukraine's mining industry are among the most dangerous in the world with a very high number of miners killed each year.

## **1.2 Poverty**

With respect to social policy the EU/Ukraine Action Plan emphasises effective poverty reduction measures with an aim to significantly reduce the number of people with income levels below the poverty line.

Until 1999 poverty as a national problem was not recognised in Ukraine. There was no commonly accepted definition of poverty or a single methodology or strategy for poverty reduction. In 1999, after a careful selection and analysis of international experience in poverty monitoring, a relative poverty measure – 75% of median expenditures per equivalent adult – was chosen to be an official poverty line definition in Ukraine. In the Presidential Decree issued on August 15, 2001 the Ukrainian Government explicitly recognised the problem of poverty as the inability of the household to provide for its basic needs and instated a relative poverty line definition as the basis of the first State Poverty Reduction Strategy. A methodology for measuring poverty comparable to international standards was established and poverty monitoring finally began in Ukraine.

Thus, in 2001, the proportion of the Ukrainian population defined as poor according to the international cost of living criteria for Central and Eastern European countries and the CIS (daily consumption below 4.3 USD, based on PPP) equaled 11%. Noteworthy, in the same year, the national relative poverty line in monetary units constituted 175 UAH per month, which is equivalent to about 5.4 USD of daily consumption, based on PPP rate (PPP rates source of data: IMF). According to this national poverty line definition, in 2001, the proportion of population below this line constituted 27.2%. Given this high level of poverty for the economy, the Ukrainian Government has made poverty reduction one of its primary goals. Poverty reduction indeed was the first of the eight UN Millennium Development Goals to be achieved by 2015 according to the document signed by Ukraine at the UN Millennium Summit in September 2000. The first target - reduce by 50% the proportion of people with a daily consumption below 4.3 USD measured at average purchasing power parity by 2015 – has already been met; the ‘poor’ portion has decreased significantly, to 1.3% in 2005, down from 11% in 2001. The second target was to reduce by one third the proportion of the population living below the nationally defined level of poverty. This second target has proven much harder to achieve: According to the Ministry of Economic Affairs of Ukraine, in 2005 the ‘poor’ population constituted 27.1%<sup>3</sup>, which was practically the same level as in 2001. According to a more recent study of the World Bank on poverty in Ukraine<sup>4</sup> (using 2005 statistics) the poverty rate has declined from 32% in 2001 to below 8% in 2005. Such substantial difference from the official figures can be explained by the choice of poverty line: the World Bank takes 151 UAH per month as poverty line, which is much lower than the national poverty measure.

In 2005, the Ukrainian Government took concrete actions aimed at poverty reduction. These were concentrated on ensuring that the state minimum wage and level of social support for vulnerable groups of society continue to increase. More specifically, the Government significantly raised social aid for many vulnerable groups: newborn children and children under the age of three, children in low-income families, unemployed, retired, disabled, victims of work-place accidents. In addition Government set the minimum wage with a view to gradual convergence with the minimum living standard, indexed to the changes in consumer prices.

As there are no recent data on poverty incidence in the Ukraine, it is hard to indicate the exact impact of these policy measures. Reports of the World Bank (2006) and the 2007 review of the European Neighbourhood Policy by the Directorate-General for Economic and Financial Affairs (DG ECFIN) both refer to the decline in poverty rates and the positive contributions of social transfers to this decline, however, poverty statistics used in these studies are all from 2005 or earlier. The DG ECFIN report indicates that considering the average rate of economic growth of 7.2% and the increase in pensions, it is likely that poverty has further declined. However, the observations made above regarding the limited employment effects of GDP growth requires some caution in directly equating GDP growth to poverty reduction. Moreover, it must be noted that regional disparities and more general income inequality seem to have increased<sup>5</sup>, implying that poverty reduction may be unevenly spread as well.

### 1.3 Equality

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<sup>3</sup> In this same period the national relative poverty line in monetary equivalent increased twofold from 175 UAH to 365 UAH (9.3 USD of daily consumption, based on PPP).

<sup>4</sup> Ukraine: Poverty Update, June 20, 2007, the World Bank.

<sup>5</sup> GINI coefficient for Ukraine increased from 0.274 in 2003 to 0.276 in 2005, which indicates a slight increase in inequality



The Constitution of Ukraine states that all citizens have equal constitutional rights and freedoms and prohibits discrimination based on race, gender, political, religious and other beliefs, ethnic and social origin, property status, linguistic or other characteristics.

### *1.3.1 Income distribution*

A distinctly uneven income distribution is continuing to form in Ukraine, with the majority of the population concentrated in the low-income category. The gap between the rich and poor is widening.

Also regional income disparity is increasing in Ukraine. Substantial gaps between wage levels in different geographical regions of Ukraine remain pronounced. For instance, average wage level in 2006 in Donetsk oblast equals 1,204 UAH, while in Ternopil oblast it is only 731 UAH. The highest paying location remains Kyiv, averaging 1,737 UAH per month. The wage gaps are largest between the capital and provinces, especially those in the predominantly agrarian west of the country.

Sectoral income disparity is an issue in Ukraine as well. There is a significant differentiation in population income and consumption levels between different industries. Especially alarming is the fact that such professional groups as doctors, engineers, teachers, social sphere workers fall into the poorest categories. The fact that the specialists from the above-mentioned spheres belong to the low-income group can have a negative impact on the society's development potential. But the most critical situation remains in the agricultural sector, where the average wage in 2006 was UAH 553, reaching only 50 percent of the national average. However, it should be kept in mind that in the agricultural sector a significant share of labour compensation is delivered in-kind, creating a gap between accrued wage and actual labour compensation amounts and increasing the error in income level calculations for rural areas.

### *1.3.2 Gender Equality*

In the process of Ukraine's development as a member of the world community and on its way towards integration with its European neighbours, gender equality is becoming an increasingly important issue in public dialogue at all levels. By now all national legislation regarding rights of men and women has been brought into accord with the international conventions ratified by Ukraine. Non-discrimination in employment and equal opportunities for men and women are guaranteed by the Ukrainian Constitution. Most international experts confirm that Ukraine has managed to adopt a gender-friendly national legislative environment, which guarantees that no one is discriminated against on the base of one's sex. Yet, constitutional norms can be implemented only under the condition that legally approved international standards of gender equality are implemented in the relevant institutions. The Millennium Development Goals targets and indicators are seen as milestones for providing gender equality and raising the profile of women in Ukrainian society. The first target was to achieve a gender ratio of at least 30:70 for either gender in legislative and executive office.

2004 gender equality data gives the following numbers: gender ratio among deputies of the Verkhovna Rada (women/men) - 5/95; gender ratio in oblast governments - 10/90; in municipal governments - 22/78; in village governments - 47/53, etc. Noteworthy is, that in 2005, for the first time in the history of independent Ukraine a woman was appointed Prime Minister.

The second target was to halve the gap in income levels between men and women. In 2002, the ratio of average wages of women as a percentage of average wages of men was 69.3% of that of men, and in 2003 - 68.6%. In 2004, this ratio decreased further to the level of 68.56%.

Summarising the performance on gender equality indicators, it is worth noting that progress in achieving most targets remains insufficient. It should be emphasised that Ukraine, which has traditionally high standards in women's education and significant achievements in developing legislation based on the principle of equal rights, has deliberately committed itself to a larger challenge than many other post-soviet countries.

## 1.4 Education

From the Soviet Union, Ukraine inherited quite an effective education system. Afterwards, it underwent fundamental changes, both positive and negative.

A sharp reduction of funding for education led to a rapid deterioration of its quality, a lowering of the general educational level of the population, and a devaluation of the social status of teachers, due to low salaries in the sector.

In recent years, Ukraine has made significant efforts to develop reform strategies and to undertake reform policies in the human development sector. The country continues to face challenges, however, and in the education sector these translate into unequal access, eroding quality and low efficiency in the use of resources.

## 1.5 Health

Health of the population is now viewed as an indicator of social and cultural progress and the overall quality of life. The 2002 report on the state of the European health care system by the World Health Organization (WHO) Regional Office for Europe says that investments in the health care system should be considered as a contribution to the development of the national economy and to the reduction of the poverty rate.

The medico-demographic crisis peaked in Ukraine in 1995-1996, caused by an abrupt drop in living standards during the period of socio-economic changes, unfavorable environmental conditions, socio-psychological stress, and reduced health care accessibility. Although the situation has improved since then, Ukraine falls behind economically developed nations in health and life expectancy indicators.

### 1.5.1 Major Health Problems

The major problems faced by Ukrainians today and which have been getting most attention lately are maternal health and child mortality; the spread of HIV/AIDS and tuberculosis.

The Ukrainian government is very supportive of maternal and child health and ranks it high among state priorities. Although it looks like Ukraine has almost fulfilled its obligations under the Millennium Development Goals 2005 both for maternal (to reach an indicator of 19.8 deaths per 100,000 live births in 2015), and child mortality rates (9.3 per 1,000 children less than one year old and 12.3 for under fives), these indicators appear rather high compared with the European ones. In particular, in 2004 in Ukraine, the infant mortality was 9.5 per 1,000 infants and maternal mortality – 13.7 per 100,000 live births.

The HIV/AIDS epidemic in Ukraine poses a serious threat to national security. According to official statistics, as of December 1st, 2006 there were over 70,000 officially registered HIV-positive people in Ukraine, while experts estimate the real number to be approximately 377,000. At the end of 2006, the International HIV/AIDS Alliance in Ukraine reports on the implementation of the two largest HIV/AIDS programmes in Ukraine: 'Overcoming HIV/AIDS Epidemics in Ukraine' financed by the Global Fund to

Fight AIDS, Tuberculosis and Malaria, and the USAID-supported project 'Scaling up the National Response to HIV/AIDS through Information and Services'. Some results have been already achieved, among which are the following: i) over 3,500 people are receiving life-saving AIDS treatment; ii) the groups most vulnerable to HIV have access to prevention and information services, including 31% of the injecting drug user population (over 102,000 individuals covered), 13% of women involved in commercial sex (over 14,000 women), and 23% of prisoners (about 26,000 people); iii) 406 medical institutions in all regions of Ukraine received medicines and other medical supplies.

Tuberculosis is no less important an issue than HIV/AIDS epidemic. Currently Ukraine is experiencing a tuberculosis epidemic. According to the official statistics the epidemic threshold has been significantly exceeded and as of beginning of 2007 there were 85 sick people with tuberculosis per 100 thousand. According to WHO representatives in Ukraine, the situation is getting more threatening: just 10 or 15 years ago tuberculosis was a disease of marginal level to people (people suffering from alcoholism, prisoners, etc.), and now everyone is at threat. Socially successful people and even children can become infected with tuberculosis. The WHO has outlined the target for each country – to detect 70% of "contagious" tuberculosis cases and have 85% of the detected patients cured. Ukraine has still a long way to go to get to these standard levels. According to WHO statistics, approximately 50-60% of all sick people are detected in Ukraine and about 65-70% of patients get cured. Another problem for Ukraine is that there are no modern laboratories and necessary methods for diagnosis especially for diagnosing multidrug resistant TB (MDR TB), from which about 10% of patients in Ukraine suffer. In 2006, the Foundation for Development of Ukraine of SCM Company decided to fully finance a pilot project on struggle against MDR TB in Donetskaya Oblast. Two million euros were allocated for purchasing the necessary diagnose equipment and staff training.

In spite of some progress achieved by Ukraine in the most problematic areas, the general condition of the nation's health may be characterised as unsatisfactory. In Ukraine, compared to economically developed nations, the mortality rate of the population remains too high, including early death rates (child, maternal, able-bodied).

#### *1.5.2 Healthcare System Financing*

The general approach to financing the health care system in Ukraine has not changed since the Soviet times when it was mandatory, based on joint taxation and provided virtually free to the public. The Constitution of Ukraine, adopted in 1996, declares that "state and community health institutions provide medical services free of charge; the existent network of such institutions may not be reduced." The citizens' right to health insurance is also guaranteed in the same Article of the Constitution. Since most health facilities in Ukraine are state and community run, despite the existence of the private health care sector, the state budget and the budgets of local and regional self-governing bodies remain the major official source of health care financing.

The proportion of the budget allocated for health care in Ukraine cannot meet the needs of the public. The shortage of public funds results in the replacement of free-of-charge health care by medical services for a fee. Personal spending on health care is rapidly becoming more common. According to official statistics, in eight years (1996–2003) the proportion of private payments rose from 18.8% to 38.5% and, including informal payments, the estimate becomes 52%. A network of private health care providers and private health facilities has emerged in Ukraine since its independence. It is hard to estimate the population's spending on the services delivered by the private healthcare sector due to a lack of relevant statistics.

#### *1.5.3 Birth and death rates*

The birth rate in Ukraine has been declining — from 12.6 per 1,000 in 1990 to 7.7 per 1,000 in 2001. This is due to the ageing of the population and self-regulation of the number of children by families. This, in turn, is due to socio-economic conditions. However, starting from 2002 the birth rate has been stabilising: from 8.1 in 2002 to 9.8 in 2006. Death rates in Ukraine remain high – State Statistics Committee reports a figure of 16.2 (in the total population per 1000 individuals). Death rates among the rural population are higher than among the urban population.

## 2 Social sustainability impacts of the FTA

The screening of social impacts of the FTA is done using the sustainability impact indicators in line with the TSIA Handbook. The social sustainability impact indicators include: poverty, health, education, labour issues, and equality.

Overall, the EU-Ukraine FTA is expected to increase employment, raise real incomes and wages and hence decrease poverty in the long run. However, the short term effects are often very different from the long term effects and due to restructuring of industries these social effects can turn negative in the short run.

The FTA is expected to encourage an overall improvement of working conditions, health & safety standards (via regulatory approximation) and quality of work along the lines of the decent work indicators as identified by the EU and ILO. This effect will be both direct, due to the need to adjust to and comply with EU standards and more indirect, through the fact that the FTA will further encourage and speed up ongoing restructuring and modernisation in certain sectors which still use out-dated (and often more hazardous) technologies and production methods.

Finally, growth potential in some sectors, may spur investments, entrepreneurial activities and self-employment, which all have positive potential impacts on income and poverty levels.

### 2.1 Poverty

Most poverty in Ukraine is concentrated in the rural agricultural areas, which is stipulated by the lack of income earning opportunities and low average wages. The EU-Ukraine FTA might cause even higher unemployment levels in rural areas, since many of the sub-sectors faced with the competition of EU producers will need major modernization and improvement of production technology, which especially in the short run (when the investments are not there yet) might lead to employment reductions. Moreover, the situation with migration flows of low-skill workers will most likely only worsen. Some part of the newly unemployed in the agricultural sector might be reallocated to other sectors of economy. At the same time, many of the unemployed will not have an opportunity to leave their places of residence, thus aggravating the poverty problem in rural areas.

Moreover, especially in the short run, large scale restructuring of the coal industry – a possible FTA outcome – would have a negative impact on poverty levels in areas where this industry is concentrated, because it raises unemployment in a sector with workers that are not easily re-allocated to other industries or sectors.

However, increasing employment opportunities in metallurgy, machinery & electronics, the electricity and distribution services sectors will lead to higher employment and increased incomes, thus offsetting negative poverty effects described above.

#### 2.1.1 *Regional effects*

Through various mechanisms, the FTA is expected to have regional effects in Ukraine. Regional effects are important in the country because of political sensitivities and because of regional development and poverty reduction programmes.

If FDI leads to improved productivity in wine production the wine producing areas in the south of Ukraine benefit. If the FTA leads to increased importance of metallurgy and machinery, that are predominantly located in the east of Ukraine, this should lead to employment and income growth in these regions. Possible closure of the coal mines for environmental reasons and because of a change in the energy mix resulting from an FTA will have large negative social and economic impacts in Eastern Ukraine where most miners live and work. The development of distribution services has a regional effect in that it will benefit the industrial areas in Ukraine more than the agricultural countryside.

## 2.2 Health

### 2.2.1 *Life expectancy*

Life expectancy increases when living conditions in general improve. One effect of the regulatory approximation of SPS standards to comply with EU food safety regulations and harmonisation of technical standards for industrial products to EU levels is that food quality goes up and that product safety and health aspects improve. Both these effects lead to an increase in life expectancy. Also envisaged improvements in working conditions, worker safety, and quality of work in manufacturing and agriculture will lead to higher life expectancy. On the other hand, negative environmental impacts like increased CO<sub>2</sub> and SO<sub>2</sub> emissions, more chemicals in the air, and increased water and waste pollution lead to a less healthy environment and reductions in life expectancy. In general, if poverty decreases and disposable incomes increase, people have more money and will live healthier lives, leading to higher life expectancies. For coal miners, an FTA that improves working conditions and worker safety can have a significantly positive impact on their life expectancies. Government procurement improvements resulting from the FTA can have a positive effect on life expectancy in the long run through increase procurement quality of facilities like roads, infrastructure, hospitals, better advice and policies, etc.

### 2.2.2 *Maternal and child health*

Maternal and child health is likely to improve due to increasing income levels and more transparent government procurement for maternity and child hospitals. Although labour migration of health professionals (especially obstetricians and paediatricians) may have a negative effect, it must be noted that such migration is still limited as long as Ukrainian diplomas and certificates are not yet recognised in the EU.

### 2.2.3 *Ageing of population*

Although the ongoing process of an ageing population due to low birth rates and high mortality rates represents an autonomous demographic process, an FTA with the EU may indirectly affect this process. The extent of these effects should not be overestimated though. On the positive side, improved public health (systems) may decrease the mortality rate, while on the negative side labour migration may reduce further the share of the working population and the availability of health professionals.

### 2.2.4 *Nutritional levels*

Through improved Ukrainian SPS standards as a consequence of the FTA effects on approximation of the EU food safety standards, meat, fruits, cereals enjoy higher quality and increased nutritional levels. Technical agri-food standards improvements have the same effect.

## 2.3 Education

Reductions in poverty, and increases in income will likely have a positive effect on education, as less children will be required to supplement household income at a young age. This is a medium to long run effect.

However, in the short run, trade liberalisation leads to increased levels of competition in most sectors of the Ukrainian economy which will lead to both intra- and inter-sector restructuring. Thus this implies that skills and skill levels required in specific sectors may change, while labour will have to transfer from losing to gaining sectors. Both of these effects place an adjustment burden on the education system, not just in terms of the quality of existing basic and higher education systems, but also in terms of the need for adult education, vocational training, on the job training and retraining, etc.

## 2.4 Labour issues

### 2.4.1 *Employment and unemployment*

Unemployment overall is expected to go down. However, this is not the case for all sectors. Employment gains may be more than moderate, particularly in the short run. Production, sales and export growth may not immediately translate into new jobs, but rather lead to increased productivity of the existing workforce.

In addition, in certain sectors the FTA will not substantially change the direction of ongoing transition and modernisation processes. Thus, for instance, in the long run the number of jobs in the agricultural sector is expected to decrease, as the sector is modernised and becomes more efficient and as employment shifts from agriculture to manufacturing and services.

### 2.4.2 *Employment opportunities*

The effect of the FTA on employment opportunities would be on the one hand more of the same type of jobs and on the other hand new and/or different jobs. Examples of the first effect would be the metallurgy sector, and machinery & electronics sector, where more similar jobs are expected to be created due to increased outputs of those sectors. Examples of the second type of effect include agriculture, financial and transport services. The nature of employment in agriculture will change due to mechanisation. This will have implications for the skills required for these jobs, for instance the use of new tractors and machines, IT skills for administrative and management purposes, etc. Government procurement and competition policy is expected to generate further employment opportunities in the long run.

### 2.4.3 *Wage effects*

In financial services and transport services wages are expected to decrease and so are wages in the coal industry. The effects on agricultural wages are expected to be mixed, with positive effects for the meat and animal fats sub-sector, if SPS standards are harmonised. Competition policy will lead to less protection and a downward pressure on wages initially. In the longer run, competition policy will make Ukrainian firms more competitive internationally and with rises in productivity allow for rises in wages.

### 2.4.4 *Self-employment*

In service and manufacturing sectors such as metallurgy, chemicals and machinery, the possibilities for self-employment are low due to minimum investment levels needed to start up a successful business. However in agriculture, and various services sectors (communication, financial) these possibilities exist. The FTA will have a positive impact on self-employment in these sectors if at the same time, red tape and bureaucracy around setting up new businesses is significantly reduced. Since cutting these costs is part of the border and standard costs reductions in the FTA, this is an expected impact.

#### *2.4.5 Productivity*

Overall, productivity is expected to increase for various reasons. First, improved competition because of the FTA will force firms and industries to become more efficient in order to survive. Second, increases in investments in (new) production technologies and updated and cleaner machinery, R&D as a consequence of the FTA, would lead to higher levels of productivity. Finally, improved government procurement procedures will lead to more competition and pressure to perform on the part of the tenderers. These effects would be particularly noticeable in certain (sub) sectors. With respect to agriculture (livestock), gross inefficiencies of many pig-breeding and cattle-breeding enterprises and outdated production methods exist according to sector experts. These inefficiencies will alter potentially because of the FTA. Metallurgy and machinery are expected to increase productivity over time as investments come in. In turn, higher productivity also allows for payment of higher wages in various sectors of the Ukrainian economy. The FTA envisages the energy sector to become more productive by improving energy efficiency in the production of electricity.

#### *2.4.6 Quality of work*

The FTA clearly puts sustainable development as a top priority in the negotiations. This should be achieved through adoption of EU technical standards, which often already include environmental, health and safety aspects with regard to the work place and methods. Indirectly, restructuring and modernisation should lead to the adoption of safer and cleaner technologies and working conditions in sectors such as metallurgy, machinery & electronics, transport and the coal industry. In the energy sector, improving safety standards and their monitoring and implementation related to nuclear energy is envisaged. Likewise, inflows of FDI would lead to upgrading of machine parks, introduction of cleaner production methods, increased worker safety, and increased health standards at the workplace, e.g. through corporate social responsibility (CSR) schemes on the part of the foreign investors.

#### *2.4.7 Rights at work and social protection*

The FTA impact on rights at work and social protection would take place both through the adoption of standards and FDI inflows. However, most of the effects will likely be indirect and require specific policy measures to take place. The EU approach to the FTA is to grant Ukrainian workers similar rights that EU workers currently enjoy.

### **2.5 Equality**

As simulated in the CGE analysis, the main FTA effect on gender equality would occur due to the expected substantial employment increases in the textiles and wearing apparel sectors (if technical standard procedures are cleared). Given the fact many women work in these sectors this would have a positive impact on gender equality in terms of labour participation rates.



### 3 Social impacts by sector

#### 3.1 Agriculture

The major social concerns in the agricultural sector in Ukraine relate to the lack of income earning opportunities and low average wages in rural areas of Ukraine.

Large numbers of rural residents of most active working age are currently forced to move away from their places of residence in search of employment. The major reasons are low-paid agricultural jobs or simply the lack of those. According to 2006 data, the average wage in the agricultural sector hardly reached 53 percent of the national average. Moreover, the owners of new restructured agricultural enterprises often pay even less than minimum wages to agricultural workers, thus violating labour laws.

EU-Ukraine FTA might cause even higher unemployment levels in rural areas, since many of the sub-sectors, i.e. dairies, cattle-breeding and pig-breeding and, faced with the competition of EU producers will need major modernization and improvement of production technology, which especially in the short run might lead to employment reductions. Thus, An FTA between the EU and Ukraine will initially lead to higher levels of unemployment in rural areas, moreover, these negative effects may last for an unpredicted period.

Increasing competition will lead to strong pressure on the Ukrainian agricultural industry to modernise and improve production technologies. In the short run – when the investments are not yet in effect – this will lead to substantial reductions in employment. In the long run, increased efficiency will also likely lead to a reduction in the number of employees doing today's jobs, but increase employment in 'new' jobs in the agricultural industry – with the overall effect likely to be negative, since modernized agriculture will need less labour force. The Ukrainian agricultural industry will then be able to produce much more for lower prices with less inputs.

Modernising Ukrainian agriculture also has the positive social impact of improving the quality of work, working conditions and possibilities for self-employment through entrepreneurial activities in Ukraine's rural areas.

Wage increases and – in the long run – modernisation of the agricultural sector will increase the disposable incomes of workers in rural areas and thus have a negative impact on the GINI coefficient (i.e. a positive effect on income equality). Whether the overall FTA impact will lead to converging incomes depends also on the FTA effects in the industrial and service oriented sectors.

An increased variety of food products, possible increases in fruits and vegetables production and better quality of food (because of higher SPS standards) are likely (in the longer run) to affect positively public health. The increase in income is correlating as well with better eating habits and a rise in the consumption of fruits and vegetables. Better health and safety standards are also likely to enhance the public health. Similarly the FTA is expected to include provisions aimed at improving the working conditions of the employees together with better equipment and new technologies. It will take time to adopt the new SPS and safety standards, so these effects would be long term effects. Improvements in the education level of the agriculture workers and producers are also expected with the implementation of new standards. The strength of these social impacts depends, of course, on the courage and decisiveness with which the FTA is implemented.

Another important social issue is labour migration. Labour migration out of the rural areas is a phenomenon that is currently happening. The FTA is likely to have negative effects on labour migration especially in the short run, with possible offsetting effects of rising earnings in the longer run. In the short run, transitional unemployment in agriculture will lead to the unemployed reallocating themselves to other sectors of the economy, i.e. construction or transport. This may also lead to geographical migration from rural areas to the cities. At the same time, many of the unemployed will not have an opportunity to leave their places of residence, which may – in the short run – aggravate the poverty problem in rural areas. These trends should be of concern to the government and FTA in developing a strategy and negotiate policy provisions to alleviate poverty and generate employment in rural areas.

In the longer run the EU-Ukraine FTA will most likely have a positive effect on the level of earnings in the sector. This might keep the agricultural workers from migrating to other regions or sectors. As a result of FTA, working conditions of those employed will also improve which is another reason for not migrating.

The restructuring of Ukraine's agriculture – that has already been initiated and will be further encouraged by an FTA – can be seen as a necessary phase in Ukraine's transition and development that involves – often painful – adjustments for industries, regions and/or groups of people. Mitigating measures and development plans have to address these issues to bridge the gap between the short run pains and long run benefits.

### 3.2 Metallurgy

Social impacts for metallurgy focus on poverty reduction, and mostly labour issues like productivity and upgrading production facilities with respect to labour circumstances and worker safety.

Currently the use of outdated technologies and furnaces with expired life spans endanger worker safety in the sector. Upgrading of production facilities has been initiated, especially after the gas price increases, but still has limited coverage. Nevertheless, technological changes to modernize metal production aimed at increasing energy efficiency and productivity – i.e. motivated for economic reasons – will inter alia lead to higher levels of worker safety and positive (secondary) health effects. No longer do workers have to operate polluting machines in factory halls but instead they can enjoy machines with identical technologies to the EU.

The FTA will lead to more inflow of foreign investments from the EU into the sector and facilitate upgrading of the machinery and production methodologies which is expected to lead to higher productivity and thus to higher worker salaries as well, since wages reflect labour productivity. Increased productivity also leads to lower prices – not for consumers but as an intermediate input – and as such has a significant impact on the cost of living in Ukraine.

Growing demand for metal and metal products from the side of other expanding industries, such as machinery and construction, will most likely have a positive impact on employment in the metallurgy sector. Furthermore, lower unemployment leads to lower levels of poverty. Since the metallurgy sector employs by and large low-skilled workers the positive effect on poverty alleviation is expected to be substantial.

### 3.3 Machinery & Electronics

Employment increases are expected for the entire sector machinery & electronics including the transport equipment and motor vehicles sub-sectors. Also wages are expected to go up in the sectors because of productivity increases.

We expect employment increases in the motor vehicles sub-sector to be strong due to the expected FDI inflows because of resource reallocation and production fragmentation of large multinational car producers. The EU-Ukraine FTA will strengthen the Ukrainian comparative advantages of cheap labour and the prospect of a domestic market for European car producers, who will likely expand their presence in Ukraine. The more Ukraine is able to reduce red tape and other border and standard costs, the stronger this effect will be.

Opening new European automobile plants and upgrading Ukraine's machinery production will have an additional social effect. Working conditions are likely to improve with foreign firms entering the market and conducting greenfield investments (or upgrading existing machine parks) making use of the latest insights in worker safety, health conditions on the work place and clean production technologies.

Because of the concentrated location of the machinery & electronics industry we expect limited regional effects to occur, i.e. some regions will benefit substantially more than others.

Overall, since through FTA provisions the EU and Ukraine will agree on standards for quality of work, this will lead to the improvement of working conditions, especially in the manufacturing industries, including the machinery and electronic equipment sector. Moreover, the effect of an FTA including machinery & electronics is that a larger share of Ukrainians will decide to enter the labour market again, with higher wages offered and more job opportunities to choose from.

### 3.4 Energy

The outputs of the CGE modelling exercise show negative impacts on employment for coal, oil, and gas production, but positive effects for the electricity sector.

Since about 80 percent of total labour in coal, oil, and gas sector is employed in coal production, this sector will be affected the most by the negative employment trends. The FTA is expected to speed up the adoption of the government programme for the coal sector restructuring. The programme foresees privatisation of the majority of Ukrainian mines. Private owners will introduce new technologies and equipment, aimed at raising productivity and output, but with possible negative employment effects.

However, in the long-run negative employment effects are less pronounced than in the short-run. This suggests that in the long-run (where according to the model capital stock is allowed to adjust) private investments are likely to reach such levels that increased production will cause increases in employment again, driven by gradual production recovery.

One of the major social problems of the coal sector is the very low worker safety standards in Ukrainian mines. Statistics show a threatening picture: 168 miners were killed in accidents already in 2007, and according to these numbers Ukraine is ranked in the world second from the bottom after China. Though the number of miners killed in accidents has been showing a declining trend since late 1990s<sup>6</sup>, the

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<sup>6</sup> Source: Korrespondent, August 4, 2007, based on Ministry of Extraordinary Situations data.

situation is still alarming. Successful implementation of the EU-Ukraine FTA, and inside it the accession to the Energy Community, will lead to higher worker safety standards.

Membership of the Energy Community is also expected to generate significant positive health effects through lower nuclear risks and increased attention to health and safety standards in energy production. Regulatory approximation to EU standards will further strengthen the quality of work, social protection of employees and emphasise the core aspects of decent work.

Impacts on employment in the electricity sector are expected to be positive, with most employment created under the long run scenario.

The FTA facilitates the privatisation process encouraging foreign capital participation thus boosting investments in new machinery and equipment and the adoption of new and improved production methods. The FTA is expected to generate similar positive changes in working conditions standards as in raw materials production.

Finally, since the overwhelming majority of labour employed in the energy sector (97%) is low-skilled, this part of the labour force will be most affected by the changes. While, the coal, oil, and gas sectors will suffer especially in the short-run from employment reductions, the electricity sector is expected to create additional employment. Thus, it is important to take regional employment effects and re-education into account (Eastern regions of the Ukraine - where coal mining is mostly concentrated).

### 3.5 Trade in services

#### 3.5.1 *Distribution services*

The Ukraine FTA will have a major positive impact on employment in the distribution services sector. Derived from strong employment growth and employment opportunities is the fact that we expect poverty to decrease – the more because the distribution sector is an enabling sector that has an impact economy-wide – and health impacts to be positive, with increasing life expectancy and lower mortality rates. This latter effect can be enhanced even further, if – in parallel to employment growth – enough emphasis is placed on decent work and improvements of the quality of work and employment circumstances and surroundings. The FTA provides the perfect vehicle to emphasise these effects.

During this transition process, for this sector, the strong skewness towards low-skilled employment in the sector needs to be kept in mind. Care should be taken that the incentives for higher education among young Ukrainians do not diminish, especially given that the EU-Ukraine FTA will most likely lead to a closing income gap.

Another important social impact is the fact that development in distribution services (especially retail trade) is geographically uneven, benefiting the industrial areas in Ukraine more than the agricultural countryside.

#### 3.5.2 *Transport services*

The extended FTA envisages full elimination of barriers to FDI, which stipulates a stiffer competition from foreign service providers than in the case of a limited FTA. Increased competition creates pressures to reduce costs and raise labour productivity, thus, leading to employment reductions. Moreover, domestic providers will most likely lose their market shares to more competitive foreign operators. Worth

mentioning is also the fact that the extended EU-Ukraine FTA envisages liberalising the service sectors including the free movement of those providing these services. Therefore, the extended FTA may also cause employment reductions as a result of labour migration to the EU. However, in the longer run, it should be noticed, that the foreign operators can employ (cheaper) Ukrainian transport sector workers, hence mitigating the negative effect to employment in the sector.

In light of Ukraine's integration into the European Common Aviation Area, the aviation sub-sector might appear the most vulnerable in terms of employment effects due to significant increases in competition. Experts acknowledge that already today Ukrainian carriers are faced with increasing competition from the foreign airlines. This competition is likely to become much more stringent, since the Ukrainian market, where passenger turnover increases by 30 percent every year, tends to be very attractive for European operators, which enjoy up to 5 percent passenger turnover annual growth rates. Thus, local carriers might be faced with a risk of loss of market share to foreign airlines, accompanied by employment reductions. However, there is a positive side to it as well: Ukraine will have to abide by the European safety standards, including working conditions of the pilots and flight attendants, which will undoubtedly improve passenger safety and contribute to the goals of decent work.

Passenger safety issue is an important issue for rail and road transportation, where the accident rates have been considerably increasing. Among the main reasons experts name poor infrastructure maintenance. If the FTA has the effect of improving the infrastructure, this leads to a positive indirect effect on passenger safety through the promotion of EU investment in rail and road infrastructure and improvements in infrastructure management.

### *3.5.3 Communication services*

The CGE model predicts negative employment impacts in the short run and positive effects in the long run. The difference in the short-run and long-run effects can be explained by the model assumptions on capital stock, which is kept constant in the short run but allowed to adjust in the long-run. Thus, in the long run investments are likely to reach sizeable enough levels to evoke output increases, and as a result - increases in employment. In-depth analysis of this sector, confirms these model outcomes.

Employment issues in the telecommunications sector are related to the privatisation of Ukrtelecom, the state monopolist in fixed telephony. Experts consider Ukrtelecom an inefficient and hugely overstaffed company with substantial social burdens. Thus, Ukrtelecom's privatisation is expected to be accompanied by employment reductions needed to reduce costs and raise productivity. Further liberalisations of the communications markets like telecommunications are also expected to lead to the introduction – through FDI and international competition – of decent work standards through multinational (telecommunication) companies and more gender equality over time (in the longer-run).

With respect to communication services, the positive social impacts of the FTA may accrue mainly to the services provided in major cities like Kyiv, Kharkiv, Dnipropetrovsk and Donetsk while leaving the rural population further behind.

Ukraine's integration into European networks necessitates infrastructure modernisation and introduction of new technologies that will most likely entail rising labour productivity in the sector. Consequently, in the long-run increases in real wages are possible, fuelled by rising labour productivity.

#### 3.5.4 *Financial services*

The modelling results show negative effects for the financial sector in Ukraine, especially in the short run, regarding employment.

Unlike the other service sectors financial services are represented by a substantial share of high-skilled labour in Ukraine – comprising about 20 percent of total labour.

Since the extended FTA envisages liberalisation of services sector including free movement of service providers, next to stronger competition, labour migration to the EU can be a consequence, while capital will flow from the EU to Ukraine. Especially high-skilled workers, who are in great demand in the EU, may migrate. This gets even more probable, if the EU will introduce ‘blue card’ (EU-wide work permit) for non-European highly-qualified workers.

On the other hand, even if the domestic providers of financial services could find the competition too strong, the negative effects to the employees are not likely to be as strong. Foreign financial service providers entering the Ukrainian market will need also Ukrainian employees to serve the local market. This will naturally alleviate the negative effects for the employment and workers could only change from a domestic employer to a foreign one.

Among the possible positive social impacts should be mentioned the effects of increased competition in the sectors which puts a downward pressure on prices for financial services, which will have an overall positive effect on many facets of the Ukrainian economy. Not only the financial service sector, but all sectors in Ukraine will benefit. This decrease in cost levels can positively affect the well-being of households, increasing household’s disposable incomes.

## 4 Horizontal issues social impacts

### 4.1 Competition policy

The EU-Ukraine FTA through its competition policy leverage is expected to have rather ambiguous social impacts. The key issues to be negotiated within future FTA - state aid, anti-trust, and state monopolies policies – should increase competition in the most monopolised sectors and in general improve the overall competitiveness of Ukrainian enterprises. These major effects will further lead to an upward pressure on wages and a downward pressure on goods and service prices. On the other hand, increased competition also creates pressures to reduce costs and raise labour productivity, thus, leading to potential employment reductions.

The most affected sectors are expected to be those with highly monopolistic structure and state ownership dominance, such as transport and telecommunications, energy and coal industries. However, since the harmonization of the FTA competition provisions is rather a long process, the competition policy effects will be of long-term action.

Ukraine – since 1990 – has gone through a tough transition period from a centrally planned economy to a market economy. Even though formally Ukraine is a fully functioning market economy, several aspects of market forces still need to be implemented and enforced – especially in the utilities markets of Ukraine – which will lead to a further reallocation of resources in the Ukrainian economy.

Competition policy, through its lowering effect on prices, will generate more income and thus lead to less poverty, especially when price reductions involve basic commodities or services.

### 4.2 Government procurement

First of all, the difference between a well-functioning government procurement system and a non-functioning system (e.g. because of corruption) is the difference between employing public money to conduct works and services that generate work, earn wages and reduces poverty versus the absence of these effects.

Secondly, the non-transparent and highly corrupted system of government procurement in Ukraine indirectly influences the health status of the Ukrainian population. Population and specifically the health sector are affected through the channels of government procurement of medicines and medical equipment and through government procurement of food for children (including catering for kindergartens, schools, orphanages, etc.)

The most frequent violations of the law are linked to: incomplete information provided in the tender documentation and procurement of goods from intermediaries at prices considerably exceeding the wholesale market price. The first leads to sub-optimal allocation of public funds and the production of good of questionable quality. The latter is especially alarming when it concerns medicines for public hospitals and polyclinics, where still the majority of population receives medical care. The second ultimately leads to insufficient resources and as a consequence – shortages of medicine and food supplies, with obvious negative health impacts.

These violations occur because of high levels of corruption in the government procurement system. The EU-Ukraine FTA through ensuring effective implementation of transparency, non-discrimination, and competition should gradually rule out the schemes used in government procurement corruption. This will

positively affect the health of population uppermost through the changes in the government procurement of medicines, food for children, and medical equipment.

A better managed government procurement system can also increase the number of social projects (e.g. improvements in health care, and the creation of food safety laboratories) in the country and hence generate positive social impacts.

Improvements in the government procurement procedures in Ukraine can lead also indirectly to improvements in the education system and level of education. With a better organised public procurement system, which is more cost-efficient, schools can be improved at lower costs and better equipment.

#### 4.3 Technical standards

The process of approximation of Ukraine's technical standards and regulations with those of the EU will undoubtedly facilitate trade and improve the investment climate by ensuring transparency, predictability and simplification of regulation. The most affected sectors in this respect are expected to be those for which harmonisation of norms will significantly reduce their current costs of compliance with the EU. These include agri-food, manufacture of textiles and wearing apparel, wood and paper products, motor vehicles, machinery and apparatus<sup>7</sup>. Increased exports of these sectors should serve as a driving force for the production expansion and hence for potential job creation.

In the agri-food sector the improved quality of products will have an additional positive impact – in the long run it is likely to positively affect the health levels of the Ukrainian population (e.g. higher nutritional levels). While a significant expansion of textiles and wearing apparel production will improve the situation with gender equality, since predominantly women are employed in these sectors. Overall, harmonisation of technical norms should reduce health and safety hazards, thus positively affecting public health, also because regulatory approximation goes hand in hand with machinery upgrades.

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Based on paper "Non-tariff barriers in Ukrainian exports to the EU" by Jakubiak M. et al, CASE Report # 66, 2006.