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and annual monitoring reports,
thematic reports, analytical
briefs

Supports Human Security
Council under the ARC
Verkhovna Rada Speaker



CRIMEA ANALYTICAL BRIEF

April-May 2009

Issue focus: Small Business Sector in Crimea

Facts at a Glance*

CRIMEAN INDICATORS AND TRENDS	
ECONOMY	
Gross Regional Product	Increased by 9% in the first half of 2008, compared to the same period of 2007. No data for the first half of 2009.
Inflation	For April 2009 – 1.1%, January-April 2009 – 7.7% (in January-April 2008 - 16.0%); Annual inflation in 2008 – 23.3%.
Industrial production (growth in percent)	-29.4% for the period January-April 2009, compared to January-April 2008. (13% in January-April 2008, compared to January-April 2007).
Agricultural production (growth in percent)	1.9% for the period January-April 2009, compared to January-April 2008.
Export of goods and services	USD 130,376 for January-March 2009. Growth: - 8% compared to January-March 2008.
Foreign investments	USD 652,888 for January-March 2009. Growth: - 11.9% compared to January-March 2008.
SOCIETY	
Population	1,965,907 in April 2009; 1,968,209 in April 2008. Decrease of 0.1%.
Demographic net balance (deaths-births)	-2.4 per 1000 people for the period January-March 2009, compared to -4.8 per 1000 people for the same period in 2008.
Life expectancy (annual indicators)	67.96 years in 2007, compared to 67.91 years in 2006. No data for 2008.
Employment	60.2% of able-bodied population in 2008, compared to 59.6% in 2007.
Average nominal wages	UAH 1,623 in April 2009 (c.a. \$ 213) compared to UAH 1,521 in April 2008; Growth rate: 6.7%.
Unemployment (ILO methodology, annual)	4.7% of economically active population at end 2008. Increase of 0.1 % against 2007.
New housing	63,500 m ² in January-March 2009. Growth by 47.9% compared to the same period of 2008.
Tuberculosis (new diagnosis)	85.4 (per 100,000 people) in 2007, compared to 85.1 in 2006. No data for 2008.
HIV/AIDS (new diagnosis)	51.1 (per 100,000 people) in 2008, compared to 49.1 in 2007.
Alcoholism (new diagnosis)	114 (per 100,000 people) in 2007, compared to 109 in 2006. No data for 2008.
Drug abuse (newly registered)	7.1 (per 100,000 people) in 2007, compared to 11 in 2006. No data for 2008.

* based on the latest statistics available as at May 2009

Current Issue

The present issue focuses on the small business sector: What is the current role of this sector in Crimea, how does it compare to the Ukrainian average, what are the key obstacles to its development? Does the small business sector represent a real economic chance, for Crimea, to mitigate the impact of the economic crisis?

In developed market economies, the small business sector plays a significant social and economic role. In Europe, this sector represents nearly 99% of all non-financial enterprises and employs half of the workforce, generating 40% of value added. In the medium or long term, should Crimea aim for such a large and strong small business sector?

Between October 2008 and January 2009, UNDP CIDP undertook, at the request of the Crimea Human Security Council (a multi-stakeholder body under the Speaker of the Crimean Parliament, created in 2007 and supported by UNDP CIDP since then) a review of this sector and its role in Crimea's economy. The key findings of this report are presented in our article "Small business – the economic chance of Crimea?"

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Small business – the economic chance of Crimea?

By Kurtmolla Abdulganiyev, UNDP CIDP Analyst

The Ukrainian legislation defines a small business as employing less than 50 persons and having a yearly turnover up to UAH 70 m (ca. €7 m). Small enterprises have two basic legal forms in Ukraine: legal entity and physical entity (entrepreneur). The analysis of small business sector, presented in this article, is based on official statistics¹, on the results of a special research that we conducted among entrepreneurs (17 in-depth interviews and a poll) and employees of offices issuing licenses and permits (“one-stop-shops”), and a review of Crimean and Ukrainian periodicals.

A role for small businesses in Crimea?

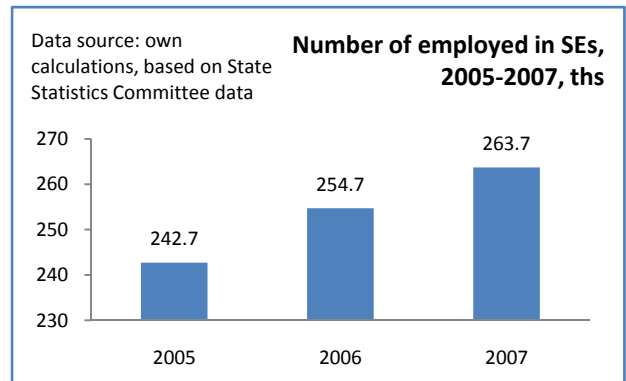
According to official statistics, the number of small businesses in Crimea has been constantly increasing over the last 10 years. At the end of 2008, there were 87 legal (and 927 physical entities) registered per 10,000 people. This indicator places the region in the second position, after Ukraine’s capital – Kiev, whilst the Ukrainian average barely reaches 71.

Many indicators equally show that the social and economic role of small enterprises in Crimea is higher than the average in Ukraine. Small enterprises – both legal and physical entities – make up 78% of Crimean private sector. Over 60% of Crimean small enterprises operate in retails, real estate or construction. The number of people employed in small business has similarly been increasing over the years, reaching 270,000 in late 2008, i.e. 53% of the total workforce in the private sector.

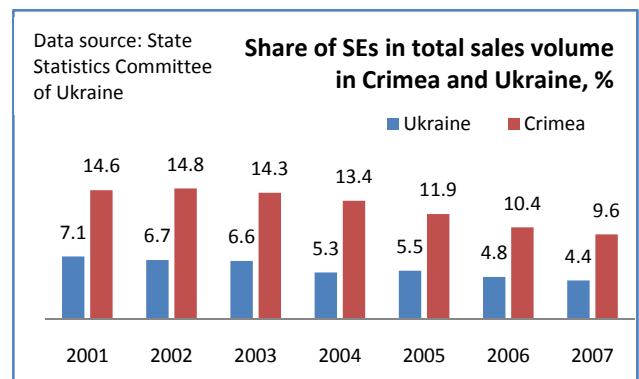
However, the small business sector largely owes its job-creating role to a proliferation of physical entities, whereas the number of people employed in legal entities is

register as entrepreneurs, or they conceal the real number of staff employed from tax authorities.

The economic significance of Crimean small business is twice higher than the Ukrainian average, but in absolute



terms its share in total sales volume is rather modest. In 2007, it fell to 9.6% of total sales (4.4% in Ukraine). In addition, half of the registered Crimean small businesses are not operating at all: in 2007 statistics showed they had no trading activities, and the share of such inactive businesses is further increasing. According to official statistics, the small business sector also incurs significant losses: in 2007, for instance, the sector displayed a negative total financial balance of UAH 232 million.

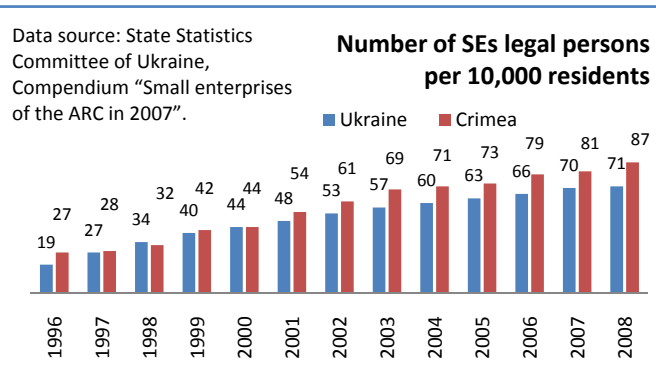


Small businesses in the “shadow”

UNDP CIDP research, as well as other data (e.g. inspections of state institutions), indicate that, indeed, official statistics do not reflect the real role of small enterprises in the Crimean economy. A large share of their activities is left unaccounted for.

For instance, Crimean restaurants and hotels are all registered as small businesses. Their number has been increasing significantly over the last few years. Yet, paradoxically, the profitability of restaurants and hotels located in in-land rural districts is officially much higher than of those in touristic cities, such as Yalta, Alushta, and Evpatoria. To any Crimean resident or guest, the reality appears much different. Why are the statistics lying?

In CIDP-conducted interviews, many entrepreneurs openly acknowledged that they hide their real profits from tax offices and use a variety of methods to avoid full official payment to their employees, such as whole salaries “in envelopes”, or remuneration declared in part.



continuously decreasing. The reality behind this trend is rather prosaic: employers wish to reduce tax payments. Therefore, either legal entity owners oblige employees to

¹ Statistics in Ukraine have several shortcomings: published with significant delays they often present inconsistencies with administrative data. Data relating to the small business sector are difficult to obtain, and they do not reflect the reality as a large number of small businesses operate in the shadow economy.

According to UNDP CIDP estimates, at least 60,000 people employed in small businesses are not registered, and therefore not included into the social insurance system. Budget losses from unrecorded employees are estimated as high as UAH 500 million per year.

The weight of the shadow economy, assessed by the experts as representing about 45% of the total economy, makes it difficult to estimate the real role of small businesses in Crimea. We can only state that it largely exceeds the level recorded by official statistics. Moreover, the lack of official information on enterprises' "deaths" gives no opportunity to measure the net growth of the sector nor the real or possible impact of the economic crisis on it.

The cost of doing business in Crimea

UNDP CIDP analysis of the costs of doing business in Crimea indicates that the small business sector is affected by a number of key constraints – legal, regulatory or institutional – which increase the overall financial burden and make entrepreneurial activity results unpredictable.

Many small businesses feel powerless against widespread corruption in regulatory organs as they need adequate financial, social (networks of acquaintances), administrative resources to overcome the red tape or bend unreasonable rules. As a result, many unprotected businessmen feel insecure and cannot calculate all the risks associated with running their activities. This feeling of insecurity is strengthened by regular harassment from the tax officers, sanitary services, fire service, road police and other controlling and permit-issuing bodies.

Among the problems identified by the UNDP CIDP research, one seems particularly important - that of registration. How long does it take to register a small business in Crimea? The answer is 21 days for a physical entity, and 255 for a legal entity. This is 7 times longer and 7.5 times more expensive than the legislation suggests.

	Financial inputs, in UAH		Time inputs, in days	
	Declared	Real	Declared	Real
Physical entity	34	255	3	21
Legal entity	204	1594	34	255

Data source: legal regulations on registration, and opinion poll among entrepreneurs, conducted in March 2009.

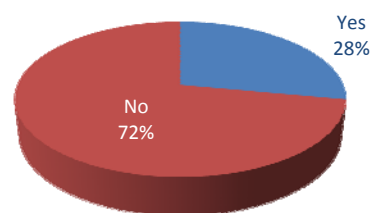
To obtain permits constitutes another important problem for businessmen. The permit acquisition procedure is open to corruption opportunities, and significantly increases the costs of doing business. Not only does the legislative framework give significant discretionary powers to officials, but businessmen are not informed effectively about requirements and standards which have to be met when getting a permit.

A system of offices in "one-stop shop" format was introduced by a Ukrainian law in 2005, aimed at simplifying and speeding up the procedures necessary to obtain licenses and permits. The one-stop shops set up in Crimean are, however, proving to be inefficient. This is mainly due

to the failure of state structures to cooperate and coordinate their actions.

Data source:
March 2009,
CIDP opinion
poll among
entrepreneurs

Have you used services of one-stop-shops permit offices?



According to officials, only 40% of entrepreneurs receive permits through one-stop shops. The UNDP CIDP research shows that only 50% of businessmen are aware of the existence of these offices, whereas merely 28% have resorted to their services. Among those who used one-stop shops' services, a large part had, still, to visit various authorities individually. The average time of getting a permit amounted to 24.4 days, though certain issues – especially concerning land regulations – required over two years. Businessmen clearly indicated, in CIDP-conducted interviews, that the permit-issuing system enduringly plays an obstructive role to business development.

Another problem, identified by many experts and researchers, are the inspections. In Ukraine, inspections are not based on risk assessment, and they remain ubiquitous – over 90% of all enterprises are inspected at least once a year. Over 30 institutions have control powers, and principles of inspections set by the legislation are often violated by the authorities themselves.

The evidence gathered in Crimea confirms a significant number of abusive acts taking place during inspections. Here again, entrepreneurs are not informed about the standards which must be met to fulfill the control requirement. The UNDP CIDP research also confirmed the existence of widespread state bodies' practices to issue fines in order to fill in the state budget deficit. Several interviewed businessmen reported tax officers saying "You must pay at least a minimal fine. If not, others will come to inspect you, and you will pay more".

One of the cross-cutting issues which influence the general abilities of businessmen is the access to information. Entrepreneurs are unable to deal with the legal intricacies relating to the management of their business, and opportunities to get timely and quality information are limited. The interviews showed that, in order to get information, businessmen have to address state officials personally; no leaflets are available for consultation, the written information provided in state regulatory offices is often illegible and not user-friendly. An analysis of the calls that we did to the Crimean "Business Hotline" shows that businessmen are mainly interested in such issues as employment, reporting and taxation regulations.

The efficiency of business support institutions (at present, in Crimea there are 21 business development centres and

5 company incubators) has not been measured or assessed. Those businessmen who are located outside the Crimean capital experience more difficulties to access business support. Some have purely nowhere to go to solve their professional problems.

The provision of business support poses significant challenges to authorities which declare their support to the small business. Since 1999, the Crimean government, amongst only a few Ukrainian regional governments, implements the Republican Small Entrepreneurship Support Programme. It allotted UAH 1.15 million in 2008 (1.5 million in 2007) for various activities and direct financial support to small businesses. The mechanism used to allocate financial support to small businesses is, however, non-transparent and favors, over the years, a specific group of companies.

What can be done?

All problems described above are not unique to Crimea. They exist all around Ukraine, and lead to unfair competition and uncertainty for small business managers or entrepreneurs in the whole country. Together with unstable rules of the game which depend on authorities' changing decisions, these problems and constraints discourage many people from setting up their business

activity, or can even lead businessmen to close their business.

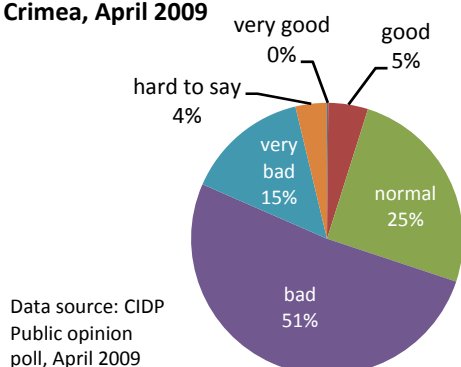
Yet, the small business sector is important for Crimean economy, and is constantly developing despite the problems identified. To better help it out, certain decisions should be made. A recent round table on small businesses, organised by UNDP CIDP on 24 April in Simferopol, confirmed this requirement. The key resolutions/recommendations of the round table were as follows:

- to establish effective business information mechanisms, in order to build transparent rules of business regulation in Crimean districts;
- to introduce free and obligatory legal training for newly established business entities;
- to improve the functioning of the joint permit offices (one-stop shops), and to consider delegating certain permit-issuing powers to non-governmental organizations;
- to modify the principles of governmental support to small business to make it more targeted and tailored to priority segments of the small business sector in Crimea.

For information on the dissemination of the CIDP report on Small Businesses in Crimea (April 2009), please send an e-mail to: [Kurtmolla Abdulganiyev \(kurtmolla@undp.crimea.ua\)](mailto:kurtmolla@undp.crimea.ua)

VOX POPULI

How do you evaluate relationships between representatives of different nationalities in Crimea, April 2009



Crimea is a region of Ukraine where numerous nationalities live next to each other. 58% of the population is ethnically Russian, 24% - Ukrainian, 12% - Crimean Tatar, and 6% belong to other ethnic groups including Bulgarians, Greeks, Armenians, Germans, Karaims, etc. This ethnic composition makes Crimea a unique and culturally rich region, but also presents higher conflict risks. UNDP CIDP is monitoring those risks and carries out, on monthly basis, a public opinion poll on the quality of inter-ethnic relations. The data below indicate that, in April 2009, 30% of interviewees thought that the relations between different nationalities (ethnic groups) are good or normal, while 66% assessed them as bad or very bad. These results show a slight improvement of perceptions compared to February 2009, when the respective indicators amounted to 29% and 68%.

ABOUT CIDP

The UNDP Crimea Integration and Development Programme (CIDP) is a long-term international technical assistance programme financed by the United Nations Development Programme and donor countries.

The main goal of the current fifth phase (period up to 2011) of the Programme is to lead multi-ethnic rural Crimea towards socio-economic development, taking into account region's ethnic and cultural diversity, by ensuring that Crimean institutions, processes and partnerships are strong and sustainable, and operate on the basis of sound democratic practices.

This goal is achieved through a bottom-up delivery approach comprising four stages: (1) community mobilisation, (2) promotion of socio-economic development models for multi-ethnic rural communities, (3) strengthening district level institutions, partnerships and processes for effective democratic governance, and (4) strengthening republican level institutions and processes for effective policy making and monitoring of Crimea's sustainable socio-economic development.