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SUBJECT: UKRAINE: A CLOSER LOOK AT THE CRIMEAN ECONOMY, PART I

REF: KYIV 2172

Classified By: Economic Counselor Edward Kaska
for Reasons 1.4 (b) and (d)

1. (U) This is the first of two cables on the economy in Crimea. The second cable will focus on Russia's influence on the Crimean economy and will examine the city of Sevastopol.

2. (SBU) Summary: Economic development in Crimea has fallen behind other parts of Ukraine despite great potential, particularly in the tourist sector. A poor business climate, including a burdensome and corrupt government bureaucracy, is a major culprit. Basic infrastructure like drinking water, heating, and roads is old and crumbling. A new highway between Simferopol airport and Yalta, a major project meant to increase tourism, has not gotten off the ground. Dzhankoy, a depressed city in northern Crimea, is slowly getting back on its feet and trying to remodel itself as a transportation hub. End Summary.

3. (U) Following the Ambassador's participation in a local investment conference and meetings with Crimean political leaders (reftel), Econoff stayed on for a more in-depth look at the Crimean economy. Econoff visited the cities of Simferopol, Yalta, Sevastopol, and Dzhankoy October 20-24. Below is Part I of a two-part report summarizing the main topics of discussion during that trip and highlighting two of the peninsula's cities.

Economic Overview

4. (U) Crimea forms the southern-most region of Ukraine, and its location atop the Black Sea gives Crimea strategic and economic advantages sought after since the Greek colonists first began settling along its coast in the 5th century BC. The Crimean economy is divided sharply along geographical lines, with tourism dominating along the



southern and western coast, agriculture supporting much of the rest of the peninsula, and heavy industry surviving in only a handful of cities. Disposable income per capita in 2007 in Crimea was only UAH 8,526 (\$1,688), or 86 percent

of the Ukrainian average, and 47 percent of the figure for the city of Kyiv. Crimean Prime Minister Viktor Plakida told participants at the October 20 investment forum that, while Crimea would always be known as a tourist destination, he hoped the peninsula could become a transport hub, and saw overloaded ports in nearby parts of Russia as an indication of excess demand. The agricultural sector, notably wine and cognac producers, has grown consistently in recent years.

Tourism - Lost Opportunities

5. (U) Crimea is home to some of Ukraine's most picturesque natural surroundings and miles of beachfront that should rival other Black Sea destinations. The region also boasts genuinely interesting tourist sites from ancient Greek ruins to the site of World War II's famous Yalta conference. On the whole, however, Crimea's resorts, including Yalta, have failed to transform themselves into modern, western destinations that can attract serious tourist dollars. There is a lack of modern hotels, the service sector is seriously underdeveloped, and transportation infrastructure is old and hard to navigate.

6. (C) Journalist Larissa Shipico, a stringer for the BBC, noted that Crimea's tax system, which allowed hefty tax breaks for small tourist operations, actually discouraged businesses in the tourist sector from growing. Alexander Basov, Director of Business Support Affairs at the Chamber of Commerce of Crimea, also noted that there were still many state-owned tourist facilities in Crimea, lessening the competition necessary to modernize the industry. Valeriy Prokopenko, deputy head of the Simferopol regional administration, pointed to the undeveloped resort town of Nikolayevka on Crimea's western coast as an area of potential growth, but lamented that no serious investors appeared interested in the Simferopol regional administration's roughly \$200 million project to expand the town's tourist infrastructure.

7. (C) Alexander Balanin, Deputy Minister of Economy of the Crimean government, told Econoff that the tourist season was too short, preventing potential entrepreneurs from

developing sophisticated tourist operations and forcing them instead to live hand-to-mouth for many months of the year. Crimean Prime Minister Plakida told investment forum participants that Yalta should become a major destination for business conferences to help cope with the short tourist season. (Comment: Plakida made his remarks from the Hotel Yalta conference facility, Yalta's largest, a Soviet-era monstrosity not well suited to the needs of modern businesses. End Comment.)

Poor Business Climate Holding Economy Back

8. (SBU) Basov, from the Chamber of Commerce of Crimea, lamented that Crimea's poor business climate tended to choke small and medium-sized enterprises (SMEs), which should be the driving force of the Crimean economy. Bureaucratic obstacles to opening a business and obtaining necessary permits, a burdensome tax system, and government

corruption, particularly in the areas of land purchases and government procurement, all hurt SME development, said Basov.

9. (C) Andriy Ishin, deputy head of the Crimean branch of the National Institute for Strategic Studies, a think tank associated with the President, agreed that Crimea has thus far failed to reach its economic potential due to a lack of market reforms. A general lack of transparency, particularly surrounding land and property issues, had created a hostile investment climate and stifled efforts for sustainable development, said Ishin.

Infrastructure - Crimea's Achilles Heal

10. (SBU) Leaders throughout Crimea usually point to infrastructure as the greatest challenge aching their communities. Basic infrastructure, like clean water, heating systems, and roads, is a mess. Prokopenko noted that Simferopol region, for example, was constantly at odds with the gas company and frequently faced heating cutoffs, even at government buildings.

New Simferopol-Yalta Highway - The Tourist Autobahn

11. (U) Crimean authorities are currently pursuing a major road infrastructure project, a new highway connecting Simferopol and Yalta. The new road would feature tunnels through the mountains to cut the drive time from Simferopol airport to Yalta from 90 to 30 minutes. The project would obviously boost tourist traffic to Yalta, but at an estimated price tag of several billion dollars, and it has as yet failed to get off the ground.

Dzhankoy - The Other Crimea

12. (SBU) Dzhankoy, a depressed, provincial city of 40,000 in northern Crimea, is located well beyond the Crimean coast where tourism is expected to drive economic growth. In Soviet times, Dzhankoy's economy was dominated by a few major factories, including a tractor production plant, that have since vanished, and conditions in the city are only slowly turning around. Yuriy Nosov, deputy Mayor of Dzankoy and longtime businessman and city official, remembers the 1990s as a time of economic catastrophe.

13. (SBU) Dzhankoy has witnessed solid economic growth in recent years, however -- economic output grew tenfold from 1998 to 2008 -- and local leaders credit the city's strategic economic plan, developed in cooperation with a USAID project, with helping to set the ship right. Dzhankoy fashions itself as a transport center, as it falls at the crossroads of Crimea's two major highways. (Note: The city's slogan is: "All roads lead to Dzhankoy." End note.) Mayor Valentin Sinitskiy told Econoff that four substantial investors had come to the city in recent years. Dzhankoy's major project, however, is an industrial park, for which a plot of land, with access to the road and rail networks, has already been allocated. Sinitskiy said that the city is moving forward with plans to develop the industrial park, preparing long-term leases for potential investors, although their work is hindered by the lack of a national Law on Industrial Parks, which would establish a clear set of allowable benefits to be offered investors.

14. (SBU) Sergiy Vybach, local businessman and chairman of

the city Association of Employers, and Maryna Torbunova, director of the Dzhankoy Business Center, which provides consultative services to local companies, identified an unclear tax regime as the greatest obstacle to business in Dzhankoy. Both lamented that the city council, with whom business associations have constructive relations, did not have more control over tax inspectors, who are controlled by the GOU.

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