

Date: 23 May 2008

REF: SIPU/JMWEN ASS. 07-draft 1

Authors: Nathaniel Copsey and Natalya Shapovalova

An Analysis of Donor Aid to Ukraine in the Energy and Environment Sectors

Ukraine faces major policy challenges in both the energy and environment sectors, and consequently, both sectors have been the target of significant donor aid in the past few years. This paper examines the following: (i) the challenges that Ukraine is facing in the energy and environment sectors, including the scope of work that is needed in these areas in the next 4–5 years; (ii) a brief analysis of the work that other donors are currently carrying out; (iii) an analysis of the gaps in the existing assistance which also asks how Sweden might best make up for these deficiencies.

In the energy sector, the challenges are:

- Achieving a significant energy efficiency savings in terms of both domestic and industrial consumption. Ukraine used 3 times as much energy in 2006 to produce one unit of GDP at PPP than Germany, which puts it on a par with Poland in the early 1990s. The benefits of energy savings are huge: they reduce emissions, boost business competitiveness (and makes it less vulnerable to price increases), increase welfare for Ukrainian consumers and increase Ukraine's energy security. Energy efficiency is improving at a rate of 4-6% per annum, but this figure must increase markedly in the next 4–5 years.¹
- Further adjustment of coal prices towards cost recovery levels in the next 4–5 years, with the additional target for Ukraine to move towards the world price for gas in next 4–5 years;
- The introduction of an emergency oil stocks mechanism in line with Community practice;
- Progressive convergence with the energy acquis;
- Implementation of the roadmap on energy efficiency and renewable energy sources;

Particular problems are posed by the Ukrainian nuclear energy sector, notably in stabilizing the former Chernobyl reactor, but also in terms of upgrading other nuclear reactors, such as the Khmelnitsky-2 and Rivne-4 nuclear reactors, which have been partially upgraded with the assistance of a EURATOM loan.

¹ See IMF Country Report No. 07/47, February 2007.

The challenges facing Ukraine's energy sector clearly have knock-on implications for priorities in the environment sector, however, a great deal of work remains to be done in boosting Ukrainian administrative capacity for policy co-ordination between these two linked policy domains. The 1998–2008 National Strategy for the Environment, which is currently being reviewed does, however, include the clean up of the nuclear industry. The environmental threats that Ukraine currently faces are in the fields of:

- Air quality;
- Water quality. The Dnipro river which supplies 75% of Ukraine's fresh water is heavily polluted. Crimea suffers from water shortages. Access to clean water is particularly poor in rural areas. There is a cross-border dimension to this in the polluted Black Sea and Danube river basin;
- Waste management, including reduction in waste generated as well as the treatment, recovery and disposal of waste. In particular, large quantities of hazardous waste have been generated in mining areas;
- Nature protection, in particular deforestation and illegal logging, which requires the implementation of the National Programme 'Forest of Ukraine' by 2015 to prevent the loss of biodiversity;
- Radiation contamination in the north-east of the country around Chernobyl;
- Climate change, where Ukraine has agreed to formulate a post-2012 emissions reduction programme by 2009, which will allow it to freeze emissions at the 1990 level, in line with the global targets set at Kyoto and Bali.

Donors to Ukraine in the Energy and Environment Sectors

Germany's annual budget for assistance to Ukraine was €48 million in 2005/2006 of which a significant share was spent on energy production and transmission.

The European Investment Bank includes the energy and environment sectors in its priorities for Ukraine in the period 2007–2013.

The EBRD strategy, which was approved in 2005, includes funding for the restructuring of Ukraine's energy and environment infrastructure. In particular, the EBRD has focused on promoting energy efficiency and security, environmental protection and sustainable use of natural resources throughout all sectors of the economy; and, improving efficiency and reliability of key infrastructure, power generation, transmission and distribution of the oil and gas transport systems of Ukraine. It aims to accomplish these goals through direct lending in the corporate, power and infrastructure sectors and through an expansion of intermediated lending within the framework of the industrial energy efficiency credit lines and the structuring of new residential energy efficiency credit lines. Thus the EBRD's primary goal is increased energy efficiency, which it is promoting via an energy efficiency programme (€100 million) to be administered in the form of loans to businesses via local banks.

Energy and the environment are priorities for the UNDP, which is focusing on how these issues are linked to sustainable environmental and community development. Headline goals include: increasing the proportion of people with access to clean drinking water by 12%; stabilizing air pollution from stationary sources by 2015; and, expanding natural and biospheric reserves and national parks up to 10.4% of the overall territory of Ukraine. Energy efficiency is also a top priority; the UNDP has run programmes in the education sector (schools, university and institutes) as well as in municipal district heating (through a pilot project in Rivne, western Ukraine) which have reduced wastage.

Sweden's Role

Whilst the overwhelming policy priority for Ukraine in the sphere of energy and environmental policy is increasing energy efficiency, this is a field in which many other donors (particularly the EBRD) are already active. It is obvious that Sweden cannot and should not seek to replicate the EBRD's system of loans to industrial and business users of energy, however, cheaper educational projects that focus on, for example, increasing public awareness of the need to save energy at home could potentially be an area where Swedish aid could make a difference. An initial pilot study could be conducted at very low cost at a local level (along the lines of the UNDP's Rivne project) before rolling out a larger scale programme.

A second priority for Swedish assistance could be in increasing Ukraine's administrative capacity in the sphere of joint policy planning for energy and environment issues. This is a vital area in which other donors are less engaged and improvements could be achieved at relatively low cost.

A third area in which Sweden could make a difference is in nature protection, in particular in preventing deforestation and a reduction in biodiversity, through providing training and some funding for the Ukrainian forestry service.