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## **Implications of Structural Changes for Assistance Programmes**

**Author: Kevin Prigmore**

### **Executive Summary**

There are four factors affecting the technical cooperation programmes to Ukraine:

- The current general economic environment, which will have adverse effects in the short-term although the reform it necessitates will, in the medium term, allow Ukraine to develop, and the continuing political instability with resulting risk.
- The restructuring and development of certain sectors (particularly energy) and the Public Administration to support the long-term development of Ukraine and the move towards European Integration.
- The development of the aid and budgetary institutions and capacity to meet the Paris Declaration commitments so they provide an efficient and effective aid coordination and management function, which is so essential to aid programme delivery.
- The new format and structure of aid, using budgetary support and the Government of Ukraine's strategic framework established for attracting foreign assistance.

Happily, the SIPU technical reports, SIDA cooperation strategy and the Government of Ukraine plan for attracting foreign aid are in broad agreement on the future requirements for developing the institutional structures and capacity in Ukraine.

Clearly any assistance to Ukraine in the future will be extremely valuable, given the shortage of budget funds, but there are obligations in terms of co-financing and management resources which will add to the internal strain in Government.

Governance is crucial to the future development of Ukraine, for its integration with the European Union, and its general credibility, in particular the ability of the government to manage and enforce the Association Agreement and New Practical Instrument effectively.

Aid coordination and budgetary capacity development are essential elements of the Paris Declaration. Donors will need to support the development of an Aid Coordination body and the budgetary support mechanism both technically and by

utilizing the 'official' Government channels. Increasingly, budget support will be used in line with the Paris Declaration requirements.

SIDA is in a strong position to provide technical assistance to complement larger donors' programmes, such as budget support, given its extensive experience in providing assistance for energy efficiency and financial management and control.

Sector Support could assist in the general economic areas in which foreign (and SIDA) assistance would be of value:

- In determining what supervisory changes are necessary to ensure that the specifically Ukrainian elements in the crisis do not reoccur;
- In helping to solve the medium-term structural problems, some of which are outlined in this paper.

A further area in which Ukraine has proved to be extremely weak is that of external communication with key countries and institutions abroad.

Foreign Assistance and SIDA programmes have a vast array of potential areas of support in the environment and energy saving sector, particularly targeted at addressing the three strategic weaknesses of Ukrainian environmental policy:

- i) The modernization of the existing legislation on a national system of environmental management.
- ii) Allocating resources to ensure that environmental protection legislation can actually be implemented.
- iii) Establishing monitoring and compliance organisations and effective means of tackling non-compliance with environmental protection.

There is a need to strengthen the private sector and civil society institutional capacity in managing their links with government, which are essential for the development of Ukraine's European Integration economic and social sectors.

## **1. Current Issues and Future Structural Changes in Sectors**

The SIPU papers on Ukraine's Economy (Special paper), Environment (13a) and Energy (13b) identified a number of structural issues and reforms which will be necessary if Ukraine is to achieve substantial growth and develop energy and environmental standards in the medium term. This list includes:

- the business environment
- governance: competition, state aid, public procurement, corruption
- environment
- energy
- agriculture

A review of the sectors provides further details on the requirements for the future.

*Governance: state aids, public procurement and corruption*

Vested interest has slowed the development of effective arrangements for state aids, public procurement and anti-corruption, for all of which Ukraine is ranked poorly in international comparisons. This is despite a major effort by the international community to help Ukraine introduce modern transparent legislation in these areas.

The use of the EC budgetary support mechanism and technical assistance may stimulate the Government to implement the required changes. The initial budgetary support package for energy reform has a benchmark for the establishment of a suitable procurement law, failure to do so will lead to cancellation of substantial funds.

The EU–Ukraine negotiation process for the Association Agreement has stimulated the government to start restructuring its EU integration coordination mechanism. The Coordination Bureau for European and Euro-Atlantic Integration (CBEEAI) is based in the Secretariat of the Cabinet of Ministers. A centralized Government EI coordination function is an essential requirement for the future development of Ukraine's move to closer European cooperation and the Bureau will act as a catalyst for public administration reform and enforcement of EU standards. The Bureau has had an expanded role since January 2009 and the Section for Strategic Planning has the responsibility for the development of the strategic framework for European Integration.

### *Environment*

The Ministry for Environmental Protection, Ministry of Economy and Ministry of Labour and Social Policy of Ukraine each have their share of responsibility for the introduction of principles of sustainable development and harmonization with EU standards. However, governmental instability has resulted in an absence of reforms.

For Ukraine to have an effective environmental policy, measures are needed to:

- modernize the existing legislation on a national system of environmental management.
- improve institutional capacity, coordination between ministries, and cross-border cooperation
- allocate more resources to ensure that environmental protection legislation can actually be implemented and enforced.
- establish appropriate monitoring and compliance systems to check on the effectiveness of environmental protection legislation, and compliance.

Restructuring of the government framework and the establishment of an Agency for monitoring and enforcement of environmental standards, will be essential to the proper management of the sector. It is believed that this sector will also receive budgetary support to stimulate development.

### *Energy*

In March 2008, the EU–Ukraine working group signed the roadmap on energy efficiency, renewable energies and measures to tackle climate change. The roadmap envisages that Ukraine will improve the normative and legal framework in the given field and will approximate its legislation to that of the EU. The scope for increased energy production in Ukraine and especially for energy saving is considerable. Budgetary support is being provided to the sector, but it is having difficulties with implementation of the required actions to meet the benchmarks set for the project.

Many of the main priorities of Ukraine's energy policy concern energy efficiency, areas for future development are:

- improving the legal framework, approximation of the EU law, elaboration of standards and technical requirements and monitoring for enforcement;
- sectoral priorities: building; housing and communal services; the public sector; energy transportation; and metering in the housing sector;
- the development of an of energy production and consumption registration and balance system and a monitoring and audit system;
- energy labelling and financing (prices and tariffs, access to loans, fulfilling the commitments made by Ukraine in the Kyoto agreement).

#### *Agriculture*

Agriculture is an extremely promising sector of the Ukrainian economy in the future, providing progress is made in the creation of a real land market, which would allow efficient farmers to expand their holdings and suitable EU regulatory framework has been established. There is scope for improved government systems and procedures to support this development.

#### *Economic Outlook*

Ukraine's financial and economic problems are partly homemade and partly a result of the world crisis. There is obviously little that the Government can do to solve the latter problem. However, the homemade problems need to be tackled systematically by a stable government.

But undoubtedly the most promising development will be Ukraine's integration with the European Union, realised through the negotiation of the Association Agreement. The Association Agreement will introduce new market economy regulation into Ukraine. If properly implemented, this will help to make Ukraine an attractive home for FDI, with a much improved business environment and less scope for corruption. Above all it will help to re-establish Ukraine's reputation as a reliable partner and reduce country risk, leading to lower borrowing costs for companies and the State.

## **2. Technical Cooperation Future Priorities and Structures**

The recent cooperation strategy for Swedish Development with Ukraine from 2009 to 2013 has identified specific areas for reforms that promote European integration and democratic governance in the country. The key goals or factors are:

- more efficient and transparent public administration that is closer to European standards and norms.
- environment sector and energy efficiency: greater capacity by Ukrainian authorities to formulate and implement legislation and regulatory frameworks adapted to those of the EU in the field of environment, climate and greater energy efficiency.
- Most of the cooperation shall take place through reform aid to the Ukrainian Administration and contributions that focus on investment in the environment field. Cooperation shall include support to civil society.

The Government of Ukraine has recently prepared a document outlining the Strategic Priorities and Objectives of Attracting Foreign Aid to Ukraine for 2009 to 2012. A review of the detailed aspects of the strategy paper shows Governance and European Integration as a horizontal or over-arching theme, with all sectors requiring support in meeting EU standards. The key areas are broad and currently un-prioritized, and include:

- promoting market conditions conducive to the enhancement of the competitive performance of the national economy;
- improving the social conditions and health of citizens of Ukraine; humanitarian development; **civil society development**;
- contributing to a **technological breakthrough in industry** and implementing an innovation system;
- eliminating infrastructure restraints;
- achieving **European and Euro-Atlantic integration**;
- raising the level of **environmental**, nuclear and radioactive safety; protection of the State and citizens.

There is interest within Government and the donor community in strengthening technical cooperation (aid) coordination so there is a more efficient and effective use of external assistance and Ukraine has committed itself to the Paris Declaration (2005) on aid effectiveness in 2007. The commitment creates obligations on behalf of the Government of Ukraine (GoU) as well as the donor community.

This is leading to a change in the structure and the management of donor programmes, which will be increasingly focused towards meeting the Paris Declaration commitments. A major player and leader in this field, the European Commission, is providing a large portion of its ENPI inputs through broadly targeted budgetary support. This will be a driving force within the technical cooperation programmes in future.

The EU–Ukraine negotiations for the Association Agreement and the changing technical cooperation environment geared towards meeting the Paris Declaration commitments has stimulated the government to start restructuring its EU integration coordination mechanism and external technical cooperation coordination and budgetary functions.

The OECD Paris Declaration survey 2008 for aid efficiency and effectiveness indicates a low current level of performance by the responsible Ukrainian authorities for aid coordination and management, and public financial management (PFM). The establishment of an effective aid management and budgeting process will require the government to develop structures and institutional capacity to undertake the strategy, programming, monitoring, coordination, public financial management, and procurement of aid, and for it to be championed at the political level.

The decline in aid coordination services in Government is being tackled and it is likely that there will be a consolidation of the current fragmented structures and an improvement in aid coordination and management efficiency. The Ministry of Economy has initiated development of a new strategic framework for donor assistance and has made the first steps towards meeting the Paris Declaration obligations.

Despite significant improvements in Public Financial Management (PFM), large capacity-building needs remain in both the Ministry of Finance (MoF) and other bodies in the public expenditure cycle. The Ministry of Finance and Line Ministries will need to gear up for managing technical cooperation fund flows, including restructuring and strengthening departments, and establishing modified or new systems for multi-annual and timing budgeting, co-financing and monitoring.

### **3.The Implications for Foreign Assistance and SIDA**

There are four factors affecting the technical cooperation programmes to Ukraine:

- The current general economic environment, which will have adverse effects in the short-term but is likely in the medium term to allow Ukraine to develop; and the continuing political instability with resulting risk.
- The restructuring and development of sectors (particularly energy) and the public administration to support the long term development of Ukraine and a move towards European Integration.
- The development of the aid and budgetary institutions and capacity to meet the Paris Declaration commitments so they provide an efficient and effective aid coordination and management function, which is so essential to aid programme delivery.
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Happily, the SIPU reports, SIDA cooperation strategy and the Government of Ukraine plan for attracting foreign aid are in broad agreement on the future requirements for developing the institutional structures and capacity in Ukraine.

Clearly any assistance to Ukraine in the future will be extremely valuable, given the shortage of budget funds which is bound to arise as income falls and

expenditure increases, but on the other hand obligations in terms of co-financing and management resources will add to the internal strain in Government.

## Governance

In terms of aid programming for Ukrainian assistance, it is obvious that the area of governance is crucial to the future development of Ukraine, for its integration with the European Union, and its general credibility with foreign investors. An essential feature will be the development of the public administration to manage and enforce the Association Agreement and New Practical Instrument effectively.

The Paris Declaration commitments in the medium term and the new instruments for EC technical cooperation, budgetary support and twinning/TAIEX are changing the institutional capacity of the Government of Ukraine, and the goals and methodology for aid donors.

Aid coordination and budgetary capacity development are essential factors of the Paris Declaration and Donors will need to support the development of an Aid Coordination body and budgetary support mechanism both technically and by utilizing the 'official' Government channels. This means supporting an aid coordination mechanism that meets the criteria of a consolidated, coordinated approach with suitable political backing, and also putting pressure on the Government of Ukraine to meet its commitments under the Paris Declaration. In a similar way donors will need to support the Ministry of Finance, in its development of the budgeting and public expenditure process.

The Ministry of Finance is a powerful body and will have an increasing role as the EC budgetary support mechanism and donor funds are decentralised and national co-financing is more of an issue; similarly audit bodies will become more important as they ensure verification of systems and procedures and transactional compliance. The aid coordinator can be a significant catalyst for change as it introduces modern technical planning and results-based management concepts to the government. These two bodies, with the EI central coordinator can be a significant tool for change.

SIDA is in a strong position to provide technical assistance to complement larger donor's programmes, such as budget support, given its extensive experience in providing assistance for energy efficiency and financial management and control. This could be an important factor in the success of these projects as the timing of the technical assistance inputs in areas such as development of the monitoring system are mismatched with the budget support and government budget inputs. There is also the possibility of funding smaller projects that would strengthen the capacity of the Ukrainian state to design policy and manage projects to EU standards in this field.

## Sector Support

There are general economic areas in which foreign (and SIDA) assistance would be of value:

- In determining what supervisory changes are necessary to ensure that the specifically Ukrainian elements in the crisis do not reoccur;
- In helping to solve the medium-term structural problems, some of which have been outlined in this paper.

A further area in which Ukraine has proved to be extremely weak is that of external communication with key countries and institutions abroad.

Foreign Assistance and SIDA programmes have a vast array of potential areas of support in the environment and energy saving sector. These vary from major projects such as the environmental protection programmes such as the Dnipro Basin Environment to smaller programmes, more suitable to SIDA assistance, targeted at addressing the three strategic weaknesses of Ukrainian environmental policy:

- The modernization of the existing legislation on a national system of environmental management.
- Allocating resources to ensure that environmental protection legislation can actually be implemented.
- Establishing monitoring and compliance organisations and systems so that the state has both reliable information to draw upon in assessing the efficacy of environmental protection legislation, and effective means of tackling non-compliance with environmental protection.

There is a need to strengthen the private sector and civil society institutional capacity in relation to their links with government, which are essential for the development of Ukraine's European Integration economic and social sectors.

In a similar vein, a unique programme could support a public-private partnership. Large financial concerns in Ukraine, in the current business climate will be looking for new markets in Europe, and see themselves as future multinational enterprises at the European level. They will be promoting Ukraine's integration with the Union, which will provide the political imperative which is lacking at present and they could provide the financial resources that are lacking in Government.

In effect, this exciting venture would be a public-private partnership (PPP) to support the development of Ukraine's integration with Europe. In this proposal foreign assistance (particularly a forward-looking independent donor, like SIDA) could be an innovator, acting as a partner to this PPP project. Donors have considered it politically difficult to work with the oligarchs, but then PPP was *persona non grata* in aid portfolios 20 years ago.