

## Ukraine

**The Development Challenge:** After prolonged economic stagnation during the 1990s, Ukraine has made some strides in developing and implementing sound macroeconomic policies and in strengthening its financial institutions. Ukraine has also started to lay the foundation of a legal environment conducive to private sector growth. However, despite recent, strong economic growth rates, delays in structural reforms still stymie more profound longer-term progress. The Government of Ukraine (GOU) has made considerably less progress in establishing the spread of sound democratic institutions and practices. While there are promising signs of political reform for elected local government, weak political accountability, particularly at the national level, unequal enforcement of law, and tightly controlled media hinder democratic development. In the education, basic services, and health sectors, weak government policies, corruption, and outdated management practices continue to hinder the state's ability to provide adequate services and protect the most vulnerable population groups.

Cautious macroeconomic policies, increased consumer spending, and external demand were major factors behind strong economic growth in 2003. In January-September 2003, the GOU maintained a budget surplus and a stable foreign exchange rate. Real GDP growth exceeded 6% while inflation was only 4%. The Government also made improvements to state procurement processes, state auditing procedures, and the administration of social transfers. Significant problems still remain, however, such as the accumulation of tax arrears (now equal to 29% of the national budget) and the use of non-cash transactions to settle public sector liabilities.

The GOU pursued the development of a sounder financial system by making progress in accounting reform and through the establishment of an independent regulator for non-bank financial institutions. These institutional developments, together with strong economic growth, have stimulated the financial sector not only to grow, but also to develop new and more sophisticated products. Important legal reforms included the passage of a Civil Code, a Personal Income Tax Law and a Legal Entity Registration Law. However, poor structural policies (particularly, in the energy and foreign trade sectors), high transaction costs and the extensive network of direct government subsidies and implicit taxes, continue to distort the efficient allocation of resources. Overall, businesses still face extensive barriers, such as long delays in registration procedures, a myriad of non-tax penalties, and high real interest rates. Because of these distortions, the informal economy remained sizeable by most estimates.

Due to conflicting legislation, a weak judiciary, and an ambivalent attitude towards international corporate governance practices, foreign direct investors continue to be wary of Ukraine. As a result, Ukraine still has one of the lowest per capita levels of direct investment in the region (about \$130 per capita). Furthermore, the GOU's reticence to take further hard steps on the reform path has put a damper on cooperation with the International Monetary Fund (IMF) which decided to defer approval of a precautionary stand-by arrangement until the GOU made more tangible advances in reducing value added tax exemptions and refund arrears. However, at the end of the year the Government appeared to be closer to reaching agreement with the IMF.

Limited progress was made during FY 2003 towards developing an increasingly transparent, democratic government. Although political parties and other civil society organizations have become more visible, so far these groups have not been able to mobilize their constituencies and offer easily distinguishable services to the public. Moreover, increased media censorship and extensive pressure on the opposition to support the current Government has tempered progress in the democracy arena. With the approaching presidential elections, the situation is unlikely to improve. Therefore, a growing majority of Ukrainians feel that democratic change is not occurring.

Frequent changes of key personnel within the coalition Government over the past year did not fundamentally alter the political landscape. However, the shuffling of positions has impaired the GOU's institutional capacity to develop and implement sustainable national development policies, as well as serious policy debate and efforts to increase transparency within the government. In the absence of effective political opposition, strong civil society organizations and an institutionalized system of checks and balances, these factors have particularly hindered advances in the social sector.

The Government has made little progress towards advancing modern social practices in health, education and social security. The official data show that about 30% of the Ukrainian population still live in poverty. The growth of HIV/AIDS and other infectious diseases has been increasing at an alarming rate. The level of domestic violence, alcoholism, prostitution, and abandoned children are also of concern. Perhaps the only important positive legislative development in this area was the adoption of pension legislation, which opens tremendous possibilities for private sector expansion. Otherwise, social systems continue to be characterized by low staff morale, obsolete equipment, and ineffective practices.

**The USAID Program:** The overall strategic goal of the USAID Mission, increased social and economic well-being of all Ukrainians within a framework of democratic governance, has several facets. First, to improve the investment climate and accelerate the growth of small and medium enterprises (SMEs) and agriculture, USAID supported Ukraine's aspired accession to World Trade Organization and continued partnering more with local governments, private sector, and non-governmental organizations. For example, USAID reprogrammed its assistance in the fiscal area to local governments, expanded support to SMEs, and started new programs to improve agricultural marketing and access to bank finance in the rural areas. USAID, however, also had to withdraw its support to the energy sector because of the GOU's inability to pursue key sectoral policy reforms.

Second, to improve democratic governance by strengthening government institutions and civil society, USAID started a new project that consolidates and institutionalizes democratic practices in the Parliament. Also, given the increasing pressure on the media, USAID continued providing support to independent media, focusing on financial viability and improving the legal and regulatory framework, and developed a program aimed at increasing citizens' participation and transparency during elections.

Finally, in response to Ukraine's emerging HIV/AIDS epidemic, USAID has designed a new HIV/AIDS strategy that will focus on reducing the HIV/AIDS transmission rate and the disease's associated stigma and discrimination. USAID also began a new project to develop modern prenatal services and will begin a new five year program to reduce trafficking of women and children.

**Other Program Elements:** USAID/Ukraine receives support for mother-to-child transmission of HIV/AIDS and will receive Washington matching funds for the new HIV/AIDS strategic objective. USAID is also providing support to Ukraine's \$92 million Global HIV/AIDS Fund to develop a national surveillance and evaluation system, support procurement of anti-retroviral drugs, and provide key technical assistance to principal HIV/AIDS-stricken regions. Other health program-related support is provided through a World Health Organization grant for tuberculosis control and a policy project for reproductive health. With USAID funding, the Eurasia Foundation manages an economics education program and small research grants.

**Other Donors:** The largest donor is the European Bank for Reconstruction and Development (EBRD) with a portfolio in food production, financial sector development, energy, and transport development. The World Bank (WB) supports programs in public utilities, agriculture, health, social protection, and public finance. The U.S. is Ukraine's largest bilateral donor, followed by the European Union (EU) which funds programs for institutional, legal, and administrative reform, private sector support, and economic development. The United Kingdom (UK) provides assistance in social protection, governance, civil society, and private sector development. Canada and Germany assist in public policy development and capacity building, private sector development, and education. USAID cooperates with the EBRD for SME development, the WB and the EU for policy reform, agriculture, and social transformation, with the UK for social protection and governance, and with Canada and Germany for private sector development and agriculture.







WTO Accession (\$150,000 FSA carryover). In August 2003, USAID began a one-year project to assist the Government of Ukraine (GOU) in meeting the requirements for accession to the WTO. The major task is to improve Ukraine's sanitary and phyto-sanitary (SPS) regulations, which guarantee food safety and quality. The project assists the Ministry of Economy to prepare for the WTO Working Party meetings in 2003-2004. To meet its objective of joining the WTO by 2005, Ukraine will need to increase the pace of its legal reform. USAID is adding carry-over funds to broaden the scope of work of the WTO project to assist in other non-SPS legal and regulatory areas.

Financial Sector (\$1,115,282 FSA, \$108,740 FSA carryover). USAID programs support: 1) the adoption of legislation that promotes transparent corporate governance practices and supervision; 2) training, examination and certification of accountants that will enable listed Ukrainian companies to use International Financial Reporting Standards, starting in 2005; and 3) legal, regulatory and institutional reforms to develop long-term financial markets in Ukraine. Also, the banking supervision activity is establishing stronger risk-based supervision at the National Bank (NBU) and risk-based management within commercial banks. Principal contractors: Financial Markets International (FMI), Chemonics and Bearing Point (prime).

Budget reform (\$2,398,627 FSA). In FY 2004, local government budget reform continues. USAID will provide assistance to 26 local governments in three oblasts: Khmelnytsky, Lviv and Poltava. USAID is strengthening local budgets, budget decentralization and program budgeting in key regions and cities. USAID plans to work with the Parliament's Budget Committee on aspects of national and local budget policy issues and will provide increased assistance on tax policy issues to the Rada's Sub-Committee on Tax Policy. Principal contractor: Development Alternatives, Inc.

**FY 2005 Program:**

The FY 2005 program will allocate \$2,075,000 FSA to improve the investment environment in the following ways: 1) to assist the GOU to meet its commitment after joining the WTO; 2) to develop a more vibrant, transparent financial sector; 3) to strengthen the ability of cities and towns to develop and manage their own budgets.

USAID will also allocate \$2,000,000 to the Local Budget Reform Project to expand technical assistance to 75 cities in 10 oblasts.

**Performance and Results:** USAID accomplishments created important conditions for improving Ukraine's investment environment in 2003. USAID assisted in the adoption of a progressive Civil Code, which will become the framework for Ukraine's body of commercial law. USAID's promotion and co-sponsorship of the new mortgage law, signed in July, has also stimulated a large demand for mortgage loans, currently estimated at \$300 million in Kyiv alone. Following recommendations by USAID's Banking Supervision project, the NBU formally adopted "risk-based supervision," which is improving the asset management capabilities and anticipated performance of Ukraine's commercial banks. The Cabinet of Ministers issued a decree to give greater protection to shareholders of joint stock companies. The Securities and Exchange Commission and the NBU have endorsed and are promoting the USAID-sponsored Certified International Professional Accountant (CIPA) program. CIPA certified accountants are bringing transparency into Ukraine's private sector and moving private enterprise towards compliance with global business practice. Municipalities are taking greater control of their budgeting process. The Ministry of Economy is implementing the USAID's legislative road map for accession to the WTO.











private pension insurance and to develop its regulation. Prime contractors/grantees: Planning and Development Collaborative International Inc. (PADCO), and the Centre for Ukrainian Reform Education (CURE, a Ukrainian NGO).

Community Humanitarian Assistance Program (\$710,000 FSA carryover). In addition to providing humanitarian assistance, USAID will support indigenous social services NGOs to strengthen their organizational and management capacity. Prime contractor/grantee: Counterpart International.

**FY 2005 Program:**

Prevent the spread of HIV/AIDS (\$1,750,000 CSH, \$2,000,000 FSA). Because Ukraine is an Intensive Focus country in USAID's war on AIDS, USAID will support the provision of information and services in high prevalence regions to at least 60% of high-risk groups to prevent the spread of HIV and to extend care to those affected. Efforts will also focus on reducing stigma and discrimination, preventing mother to child transmission, and assisting children affected by HIV/AIDS.

Anti-trafficking (\$1,050,000 FSA). Trafficking in persons from, through, and in Ukraine will be reduced, primarily among women and children 12-25 years of age. A new five-year project aims to: 1) increase awareness, understanding and preventative actions taken among 'at-risk' groups, 2) provide victims assistance and rehabilitation, and 3) strengthen the coordination and execution of national and regional programs. Principal contractor/grantee to be determined.

Improve health status (\$5,425,000 FSA). USAID will extend the implementation of the WHO-recommended anti-tuberculosis DOTS strategies and expand efforts to address multi-drug resistant tuberculosis in the pilot Donetsk region. USAID also plans to establish a high level TB Policy Group and improve nationwide TB surveillance for furthering the program's expansion. USAID will continue its pilot interventions for improving maternal and neonatal health services in four regions to reduce morbidity and mortality. USAID also plans to develop and introduce a new child health program for particularly vulnerable groups. By developing evidence-based protocols and supporting advocacy efforts, USAID and its partners will improve reproductive health at the national level. Principal contractors/grantee: same as above.

Pension reform (\$1,000,000 FSA). USAID plans to continue providing legal and regulatory support to policy makers to implement the new three-tier transparent, reliable, fiscally sound, and sustainable pension system. USAID will help the GOU reduce the administrative burden on employers through the introduction of unified social insurance contributions for all public social insurance programs and the development of institutional capacity for a private pension industry. Principal contractor/grantee: same as above.

**Performance and Results:** USAID's support enabled the HIV/AIDS Information Clearinghouse to provide information and educational materials to policy makers, health providers, and vulnerable groups. Each quarter, 26 indigenous NGOs provided the needed information and services to 33,000 clients with high risk behaviors for HIV infection in 20 oblasts. USAID's health partners opened twelve demonstration family medicine clinics which served as a catalyst for the establishment of 483 family medicine clinics by local health administrations, in pilot areas by the end of FY 2003. As a result of policy reforms in the provision of services through the Women's Wellness Centers and family planning clinics, the abortion rate among these clinics' clients declined nearly 50% in the last few years. USAID's WHO-recommended pilot tuberculosis program in Donetsk had expanded its reach from 61.5% of the population to 80% by the end of July 2003. A USAID funded birth defects surveillance system is now active in five pilot regions. USAID has helped the GOU stabilize the current public pension system and lay the foundation for a voluntary private pension industry. The new three-tier pension system will take effect on January 1, 2004. Humanitarian assistance was provided through 251 local NGOs, directly meeting the immediate needs of some 462,000 vulnerable citizens.



The USAID-supported ULRMC applied remote sensing and GIS technologies to assist Ukraine in managing such problems as flooding and fires near the Chernobyl exclusion zone, flooding in the Tysa River basin, forests in the Carpathian Mountains, biodiversity in the Azov Sea - Black Sea corridor, and protected areas in Crimea and Transcarpathia.

Other Developments: USAID continued to help Ukraine meet its commitments under the United Nations Framework Convention on Climate Change (UNFCCC), stimulated investment in projects for the mitigation of green house gas (GHG) emissions, improved Ukraine's GHG emissions inventory by completion of the inventory for the power sector, and raised public awareness about the problem of global climate change. USAID's EcoLinks program, completed in July 2003, resulted in improved environmental management and efficiency at public and private enterprises.



