

ANNEX 2

of the Commission Implementing Decision on the Annual Action Programme 2013 in favour
of Ukraine

Action Fiche for Further support to the implementation of the National Environmental Policy of Ukraine

1. IDENTIFICATION

Title/Number	Further support to the implementation of the National Environmental Policy of Ukraine CRIS number: ENPI/2013/024-642		
Total cost	Total amount of EU contribution: EUR 55 million, of which: EUR 47 million for budget support EUR 8 million for complementary support		
Budget support			
Aid method / Method of implementation	Direct (centralised) management Sector Reform Contract		
Type of aid code	A02 – Sector Budget Support	Markers	BSAR
DAC-code	41010	Sector	Environmental policy and administrative management
Complementary support			
Aid method / Method of implementation	Direct centralised management –procurement of services		
DAC-code	41010 14010 14015 14040	Sector	Environmental policy and administrative management Water resources policy and administrative management Water resources

			protection River development
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2. RATIONALE AND COUNTRY CONTEXT

2.1. Summary of the action and its objectives

The proposed Action is focused on the further support to the implementation of the National Environmental Policy (NEP) of Ukraine, in line with EU standards, norms and agreed priorities under the EU-Ukraine Association Agreement.

The specific objectives for this programme are two-fold:

- To facilitate and promote the EU environmental *acquis* approximation process based on the Basic Approximation Plan (BAP) of Ukraine, other framework documents to be developed concerning convergence of environmental legislation and fixed by the Association Agreement (Art. 360 - 366 and Annex XXIX).
- To support Ukraine's Water Policy implementation and to strengthen the international cooperation on trans-boundary water basins.

2.2. Country context

2.2.1. *Main challenges towards poverty reduction/inclusive and sustainable growth*

From 2000 to 2007, Ukraine's economic performance was strong and poverty decreased substantially, but the economic crisis hit Ukraine hard in late 2008. After experiencing one of the sharpest downturns in the region in 2009, real GDP growth reached 4.2% in 2010 and 5.2% in 2011, helped by export-oriented industries, particularly steel, but increasingly also by domestic demand. In 2012, however, Ukraine's economy was affected by a negative global environment as well as by a weak investment climate, and real GDP growth slowed to only 0.2% year on year (y/y). In the absence of a strong global economic recovery leading to higher external demand, real growth in 2013 is expected to remain sluggish between – 1 and - 2.5%.

Ukraine scored 76th out of 187 in the 2011 Human Development Index (HDI), in the group of High Human Development. Inequality remains a major problem in Ukraine. Ukraine's per-capita income is about USD 3,600, or 10% of the EU level.

2.2.2. *Fundamental values*

Ukraine presents a mixed picture of developments on deep and sustainable democracy. Recent positive developments in the areas of legal reform and freedom of association have been overshadowed by selective justice, slow progress in critical reforms, a high level of corruption and the conduct of the parliamentary elections showing deterioration from previously set standards.

However, despite backsliding in several areas, Ukraine remains broadly committed to the protection and promotion of common fundamental values of democracy, human rights and the rule of law. The citizens of Ukraine have continuously shown their attachment to a democratic

and pluralistic society, and the Ukrainian authorities should step up their efforts to strengthen democracy and pluralism.

The overall country's adherence to fundamental values is further reviewed as part of the enclosed risk assessment framework. The issues relevant to the sector are highlighted below.

The technical nature of regulation in the sector is neutral in terms of discriminatory practices, while the development of a quality infrastructure based on EU principles ensures transparency and inclusivity in decision making processes. The policy aims to create technical infrastructure environment based on competence and accountability. This inherently includes adoption of principles of good governance within the respective institutions. Furthermore, an upgraded quality infrastructure in Ukraine should lead to upgraded production methods, which would respond to the higher demand for quality that enhanced standards and technical regulations generate. This can lead to improved working conditions in factories, higher demand for skilled labour, better education and ultimately an increase of wages.

Similarly, the quality infrastructure services, such as standardization, accreditation and metrology have significant cross-cutting roles in respect to policy areas which have a technical impact. The most significant of these is perhaps the environmental sector, which makes use of standardization to codify good practices related to energy use, and requires accurate measurement and assurance of integrity and competence of laboratories to measure the implementation of policy goals.

An upgraded quality infrastructure in Ukraine along the lines of the EU regulatory system contributes to the promotion of the rule of law in Ukraine. The separation of regulatory and enforcement powers enhance transparency of administrative practices and inevitably reduces opportunities for illegal habits and arbitrary behaviour. It creates instead a demand for clarity, non-discrimination and motivation of administrative decisions, which are all core fundamental EU values. An enhanced quality infrastructure, which is based on market demand, also places all economic operators on equal footing, irrespective of ownership, size and sector.

Finally, the technical regulation is the sector where political objectives are balanced against the need to serve and protect the population, as the application of EU technical legislation and international standards will ensure safer and better quality products for the population. Access to redress by consumers will be ensured by the implementation of legislation related to liability for defective products and by the development of market surveillance capacities.

2.3. Eligibility for budget support

2.3.1. Public policy

Main features of the public policy

The overall environmental situation in Ukraine is alarming and risks deteriorating in future. Several explanations can be put forward: increasing pressure on the environment of a fast-growing consumption society with very little care for nature protection; outdated industries releasing in the air and waters large quantities of pollutants with very limited effective controls; huge quantities of chemicals inherited from the Soviet times still posing major problems in dozens of hot spots; poor general governance at all levels; corruption and lack of

funding to implement adequate remediation and mitigation measures are among the main ones.

The alarming environmental situation of the country is of increasing concern to Ukrainians. On the international scene, Ukraine is regularly exposed to sanctions for non-compliance with its commitments vis-à-vis, for example, the Espoo and Aarhus conventions.

The Ukrainian Ministry of Ecology and Natural Resources (MENR) is quite lucid on this dire environmental situation. The **2010 National Environmental Strategy** ("Fundamental Principles (Strategy) of Ukraine's Environmental Policy for the period until 2020" in short: the "**NEP**") prepared with EU assistance fully acknowledges this situation and highlights possible ways out. The "**National Action Plan** of Environmental Protection of Ukraine for the period 2011-2015" (in short: the "**NAP**") adopted in May 2011 proposes clear and concrete actions.

The strategic purpose of the National Environmental Policy is to stabilize and improve the environment in Ukraine by means of integration of the environmental policy into the socio-economic development of the country in order to have a safe environment for life and health of the population, as well as to provide a balanced approach between use and preservation of the natural resources.

The main objectives of the NEP are the following: (i) Raising public environmental awareness; (ii) Improving the environmental situation and level of environmental safety; (iii) Achieving the state of environment safe for people's life and health; (iv) Integrating the environmental policy; (v) Prevention of the losses of biological and landscape diversity and establishing the ecological network; (vi) Ensuring sustainable use of natural resources; (vii) Improving regional environmental policy.

The European Union has welcomed the adoption of the NEP and NAP which are largely inspired by the EU *acquis*. The NEP and NAP were consulted very closely with the EU before adoption. They constitute a sound framework to improve the environmental situation in Ukraine, in line with the environmental priorities of the EU-Ukraine Association Agenda. Their implementation is definitely a priority for Ukraine and for the EU.

In December 2010, the EU has launched an Environmental Sector Policy Support Programme (SPSP) of 35 M€ to support the implementation of the NEP combined with a 3.2M€ complementary Technical Assistance (TA) launched in January 2012. Besides general conditions related to PFM and macroeconomic stability, this SPSP sets objectives covering environmental legislation, institutional development and awareness raising on environmental issues - in line with the NEP. Regular performance assessment has taken place in that context and has generally supported progress in this difficult area.

The NEP contains a monitoring and performance assessment framework. Monitoring is a regular exercise and based on a system of performance indicators, oriented towards sustainable development and a balanced environmental policy. Monitoring results are presented in the National Report on the implementation of the NEP submitted by the Cabinet of Ministers to the Verkhovna Rada of Ukraine every five years (the reporting period of implementation of the National Action Plans 2011 – 2015 and 2016 – 2020). The regional and sectoral environmental reports are to be submitted on an annual basis by central and regional authorities to the Ministry of Ecology and Natural Resources.

However, there is, today, no systematic, comprehensive and formal environmental monitoring in Ukraine. The latest National Report on the Environmental situation in Ukraine (foreseen by

the Law on Environmental Protection) was published in 2011. According to the requirements of the on-going SPSP, the MENR should publish on an annual basis (starting from 2011) a Report on the implementation of the NEP as well as provide support to the civil society to publish a Report on citizens' opinion on implementation of the environmental policy. While the MENR's report is still awaited, the Civil Society Assessment report for 2011 was already completed and published and the one for 2012 is planned to be published in April 2013 (on track), which would constitute an important achievement.

Thus, while the goals of environmental monitoring are spelt out clearly in the adequate policy framework, implementation leaves much to be desired. This needs to be taken into account for all environmental support action in Ukraine including the SPSP proposed by this Action Fiche. It does not, however, fatally undermine the fulfilment of the eligibility criterion (Strengthening of capacity of, and of incentives for, the MENR to carry out environmental monitoring is put as a priority in the on-going SPSP and should be kept as an area of specific attention for the future SPSP.)

With specific regard to **approximation**, the following additional information is of relevance for the sector context:

- In March 2012, the Association Agreement/Deep and Comprehensive Free Trade Agreement was initialled. The Foreign Affairs Council in December 2012 gave a perspective of signing this agreement subject to Ukraine's performance on a number of critical issues (appropriate follow up to the shortcomings of the October 2012 elections; addressing the issue of selective justice; implementing the reforms defined in the jointly agreed Association Agenda);

and Ukraine has repeatedly emphasized its wish to sign this agreement.

- The Parliament has adopted the Statement on Euro-integration aspirations of Ukraine and support to the EU-UA Association Agreement on 22 February 2013. The EU - Ukraine Summit on 25 February 2013 reinforced this perspective if conditions are met.
- The on-going SPSP contains a Basic Approximation Plan (BAP) as a performance indicator. It is thus subject to the review and performance assessment process in the current SPSP. In 2011, the MENR, supported by SIDA/SEPA experts, developed a Baseline Plan for Harmonisation (BPH) with an overview of the national legislation and tables of concordance. Additionally, the BAP has been drafted and approved by the Minister in December 2012.
- In the framework of the current SPSP, and the accompanying EU assistance project, further support to the MENR is envisaged in BAP implementation as well as in other framework documents to be developed concerning convergence of environmental legislation which will be based on the BPH and the BAP.
- All 31 Directives in Environment fixed by AA/DCFTA are included in the BAP and relevant to the scope of the current approximation module in SPSP.

The conception of the **Ukrainian Water Policy (WP)** constitutes a specific sub-segment of the overall sector strategy:

- Complementing the NEP and the NAP, the Parliament has amended the Law "On State programme 'Drinking water' for 2006 – 2020" in October 2011 and in May 2012 the Law "On the National Targeted Programme for Water Management, Development

and the Environmental Rehabilitation of the Dnieper river basin for the period till 2021" was adopted.

- The WP is focused, *inter alia*, on integrated river basin management according to the river basin approach and the use of river basin management plans as an operational tool. It requires to establish river basin councils and to increase the role of existing and the establishment of the new basin authorities. It corresponds to the requirements of by the *EU Water Framework Directive*.
- Among other flood protection activities, the WP also aims at the following activities: construction and reconstruction of hydro-technical installations reducing erosion, flood protection dams, riverbed cleaning, reforestation of river banks, drainage network establishment in rural area, measures against erosion etc., which corresponds to *Directive 2007/60/EC of the European Parliament and of the Council of 23 October 2007 on the assessment and management of flood risks*.
- Other measures can be considered as contributions to the implementation of the *Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources*.
- The WP also aims at stimulating the construction and reconstruction of water supply and wastewater systems in the Dnipro river basin. Comprehensive implementation of the tasks will support implementation of the Council Directive 91/271/EEC (concerning urban waste-water treatment) and Council Directive 98/83/EC (on quality of water intended for human consumption).

The **main stakeholders** for the new SPSP are the *Ministry of Ecology and Natural Resources (MENR)*, which is responsible for the National Environment Policy (NEP) and the National Action Plan (NAP) implementation. Despite the subordinated status to the MENR the *State Agency of Water Resources (SAWR)* is considered as the second stakeholder in the planned SPSP responsible for implementation of the Water Policy.

The *Ministry of Regional Development, Construction, Housing and Municipal Economy* is a key stakeholder for action taken by municipalities and regional bodies and for municipal utilities. The *Ministry of Justice* is the leading ministry in the legislative approximation process in Ukraine and will accompany the MENR as a stakeholder in the approximation component. (For detailed information about all stakeholders, which include civil society organisations, see section 3.6 below).

Policy relevance

Given the dire state of the environment in Ukraine, the Ukrainian national environmental policy framework is highly relevant. It reflects the Millennium Development Goals (goal 7: Ensure Environmental Sustainability) and is aligned with the objectives of sustainable and inclusive growth, and – through, albeit hesitant, involvement of civil society - democratic governance. It can be noted that various environmental subsectors, including in particular the water sector, are of significant direct impact to the European Union due to shared river basins and the shared Black Sea. From an EU perspective this obviously heightens the relevance of Ukraine's environmental policy, in this field and more generally in the area of legislative approximation.

Policy credibility

Capacity of the governmental structures and capacity of the institutions and staff is a general source of concern in Ukraine. This staff shortage, combined with some organisational deficiencies, is not limited to the MENR and affects also other ministries. It is however of particular acuity for the MENR. The MENR has clear difficulties to mainstream environmental issues in the Ukrainian national policies. The question of effective interagency coordination stands out sharply and is aggravated by capacity issues including those of other Ministries supposed to coordinate their policies with MENR.

In the course of administrative reform, a new Regulation of the MENR was adopted by Presidential Decree №452/2011 on 13 April 2011 that has taken the reform process in the wrong direction. It started a process which led to a reduction of staff and excluding regional departments of the Ministry from the environmental governance system and to their transfer to *oblast* administrations.

However, despite the unhelpful administrative changes, the structure of the central apparatus of the MENR has not actually weakened significantly. In addition, the SAWR has a staff of about 200 persons (excluding regional affiliation and river basins management units).

The Ministry of Ecology and Natural Resources of Ukraine (MENR) demonstrated commitment and ownership in achieving of the goals of the NEP and the NAP. The NEP/NAP was implemented in 2011 – 2012 effectively despite the lack of financing, permanent reorganisation and putting on hold of the EU Sector Budget Support disbursement (two tranches).

This is only seemingly in contradiction to Presidential Administration's assessment that in 2012, in general, the NAP's implementation was insufficient with deficiencies of ownership of the central and regional authorities. While it is true that the performance level in 2012 may be somewhat below the performance level in 2011 this was due to objective reasons and a generally optimistic assessment of the NAP as to achievable targets rather than a lack of commitment to these goals. It therefore does not distract from the fact that, overall, the achievement level, reveals a satisfactory track record.

A similar picture emerges when analysing the available data on budgetary financing. To start with, it can be noted that Ukraine's budgetary allocations for environmental purposes are vulnerable to external economic shocks (e.g. due to the financial and economic crisis, at the end of 2008, the MENR budget had been cut by more than 30% compared to the budget commitment at the beginning of that year).

For the implementation of the NAP 2011 – 2015 an indicative multiannual budget of UAH 4.3 billion (EUR 420 million) is foreseen. The total multiannual state budgetary resources envisaged for the implementation of the WP are UAH 46478.5 million (EUR 4.53 billion). The period of implementation is up to 2021 (10 years). State financing of the programme ensures payment for staff and incidental expenditures of the SAWR as guarantee of the programme's sustainability. In addition to the State Budget, local budgets should envisage supplementary funds for implementation of the programme additional to the state budget.

Comparison of financing budgetary programmes in years 2008-2011 shows a positive trend. However, while the decision of the Government in 2011 to reduce the number of environmental state target programmes that are financed from the state budget from 10 to 4 may have reduced the total amount of funds directed at environmental protection and

restoration, energy efficiency and pollution prevention, the overall system of their funding is, however, not sufficiently clear to give reliable figures.

The state budget supports MENR (including State Agencies under its coordination¹¹).

In financial year (FY) 2011, the total for the ministry was UAH 3025 million (or approximately EUR 280 million). In the budget for FY 2012, the total for the ministry was UAH 4040.5 million (or about EUR 396 million). The state budget for FY 2013 fixed the amount of UAH 4240 million (or about EUR 415.7 million) as a budget allocation for the MENR and the environmental agencies.

A substantial increase in funding in FY 2013 is foreseen for the implementation of the WP. Additional financial resources are included in the local and regional budgets, which will enhance financial sustainability for the WP implementation. Due to legal status of the Water Policy (as a Law of Ukraine, with a 10-year budgetary framework) the funding of the activities planned will be included in the annual budgeting process, and provide for a certain likelihood of financial continuity/sustainability.

Irrespective of the exact overall figures (including the environmental agencies) it is evident that these funds are hardly sufficient to account for the total needs of the sector. This is acknowledged by the NEP itself as the key principle to the one of instruments for the NEP implementation is a proper use of the economic and financial mechanisms. Given the scarcity of budget funds, special importance is attached to searching for new financial sources for environmental activities aimed at elimination of pollution, promotion of environmental safety, and activities related to the restoration and maintaining natural resources in proper condition. Favourable tax, credit and investment conditions to attract international donors' funds and private capital to environmental investments, establishing environmental management systems by economic entities, introducing cleaner production techniques, resource and energy saving technologies are needed.

It can therefore be concluded that the eligibility criterion of public policy is met, albeit with certain reservations which need to be addressed in the programme itself (e.g. through an investment mobilization indicator) and through its accompanying technical assistance component (e.g. with regard to capacity building).

2.3.2. Macroeconomic policy

Ukraine's economy was affected by a negative global environment in 2012 as well as by a weak investment climate. Following growth at 4.2% of GDP in 2010 and 5.2% of GDP in 2011, real GDP growth slowed to only 0.2% y/y in 2012. Ukraine's GDP real growth was negative at -1.3% y/y in the first quarter of 2013, implying that economic contraction continued without any major improvement in key economic sectors.

Ukrainian industry, which is heavily dependent on exports, suffered from restrained private investment, very weak foreign demand in the metals and machinery markets, from Russia's introduction of a car utilization fee and from disruptions in domestic railcar production. As a result, industrial output declined by 1.8% y/y in real terms in 2012, causing a slowdown in the

¹¹ The Minister of Ecology and Natural Resources of Ukraine directs and coordinates the activities of the State Service of Geology and Mineral Resources (SSGMR) of Ukraine, the State Agency of Water Resources (SAWR) of Ukraine, the State Environmental Investment Agency (SEIA) of Ukraine and the State Environmental Inspection (SEI) of Ukraine. The state budget (including special fund) supports MENR, SSGMR, SAWR, SEIA and SEI. Since December 2012, a fifth agency, namely the State Agency for the Chernobyl exclusion zone was subordinated to the MENR. For reasons of better comparability of data the budget of this agency is not included in the below figures.

construction (-14% y/y) and cargo transportation (-7.6% y/y) sectors. Agricultural output fell below the 2011 record-high levels (-4.5% y/y). Among the key sectors, only retail trade turnover showed positive growth of 14% y/y last year (in line with 2011), manifesting still strong domestic consumption demand supported by government social spending ahead of the October 2012 elections. In the first quarter of 2013 industrial output dropped by 5% y/y in real terms, showing no signs of recovery across the board (except in the food processing sector), and the reported growth in the retail trade sector (+13% y/y) hid a one-off surge in sales of imported cars ahead of the introduction of higher import duties which took effect in mid-April.

The economic developments in the first quarter of 2013 confirm that Ukraine's prospects continue to be affected negatively by external headwinds and uneven policy implementation. Private consumption is expected to weaken in 2013 on tighter spending policy of the government, and investment activity will remain low. In April 2013, the IMF downgraded its GDP growth forecast for Ukraine to 0% y/y for 2013 and 2.8% y/y for 2014 from its previous projection of 3.5% for both years. World Bank worsened its forecast of Ukraine's GDP real growth to 1% y/y (from 3.5%) for 2013 and to 3% (from 4%) for 2014. EBRD for the second time this year downgraded the forecast for the development of the Ukrainian economy, expecting it to decline by 0.5% y/y in 2013 and grow by 2.4% y/y in 2014. Meanwhile, the Ukrainian government continues to underpin its planning by extremely optimistic economic projections, including for GDP growth, which is officially forecast to accelerate by 3.4% y/y in real terms in 2013 and by 3% y/y in 2014.

Low food prices (53% of the official consumer basket) brought inflation to its lowest level in a decade. Headline inflation reached -0.2% at year end, after 9.1% and 4.6% in December 2010 and 2011 respectively. In the first quarter of 2013, consumer prices continued declining as the Consumer Price Index (CPI index) was reported at -0.5% y/y. The key reason for this was strong domestic production of key food staples. Besides, the government further delayed increases in administratively regulated utilities tariffs (11.4% of the official consumption basket). The central bank was pursuing very tight monetary policies, which suppressed investment and economic growth. In 2013, the CPI dynamics will be largely dependent on the volumes of the agricultural harvest, any decision to implement utility tariff hikes, and foreign exchange policies (which might lead to the depreciation of the hryvnia). The official government forecast for the end-of-year CPI is 5% end-of-period. The low inflation rates observed for the past year have both positive and negative aspects. On the one hand, they support household real income and purchasing power. However, a prolonged period of zero inflation may discourage growth in domestically oriented sectors.

Ukraine's fiscal deficit (including the Naftogaz state oil and gas company) exceeded the IMF projection of 5.3% GDP and increased to an estimated 6% GDP (of which Naftogaz' deficit was 1.7% GDP) in 2012, up from 4.2% GDP in 2011 (of which Naftogaz' deficit was 1.5% GDP), mainly as a result of the authorities' refusal to increase gas tariffs for households and utilities to cost-recovery levels, but also because of increased government spending before the October 2012 elections. Neither the 2013 central budget deficit target of 3.2% GDP, nor the 2014 central budget deficit target of 3% GDP appear realistic, as both are based on optimistic real GDP growth estimates (see above). For 2013, the highest risks lie in the estimated collections of VAT on local products, due to expected slowdowns in domestic consumer demand and corporate income tax, stemming from weak corporate profits, sizable advances already paid and a reduction in the corporate income tax rate already in 2013. IMF experts insist on cutting tax benefits and privileges as an immediate remedy to help the government avoid a massive shortfall in revenue collection. Also, should the government continue to delay

adjustments to gas and utility tariffs, Naftogaz Ukrainy's "structural deficit" will likely exceed the 0.8-1% GDP both in 2013 and 2014.

Ukraine's current account deficit increased to USD 14.4 billion in 2012, or 8.3% GDP, compared to 5.5% of GDP in 2011. Weak external demand combined with strong consumer and investment imports were the key factors behind the increase in last year's C/A deficit, while the energy import bill (the key reason for C/A deterioration in 2010-2011) declined by 8% y/y in 2012 (to 27bn USD) as Ukraine cut gas import volumes to 33 bcm from 40 bcm in 2011, fully offsetting a 36% increase in the average gas price. A social spending hike ahead of the October 2012 parliamentary elections and state infrastructure projects related to the Euro2012 football championship caused non-energy imports to increase by 12% y/y, keeping overall merchandise import growth positive at +5.3% y/y. At the same time, exports increased by a mere 0.5% y/y in 2012 as strong grain and vegetable oil sales only partially offset weaknesses in metallurgy and machine building. The share of food & agriculture exports increased to 26% in 2012, from 18% in 2011. The first quarter of 2013 C/A dynamics suggests that the full-year C/A deficit will remain high, with a slight improvement over the 2012 record (around 7.6% GDP in 2013 versus 8.4% of GDP in 2012) as the prospects for a global economic recovery remain slim.

The international reserves of the National Bank of Ukraine (NBU) stood at USD 24.5 billion as of end 2012, down 23% y/y or USD 7.3 billion compared to end 2011. This represented the equivalent of 2.8 months of imports, below the 3.0 month safety threshold and the lowest level since 2002. Since the start of 2013, the National Bank has continued to support the hryvnia via foreign exchange (F/X) market sale interventions which signals that pressures on the currency remain high.

The public debt volumes in 2011-2012 have remained constant: after a marked rise following the 2008-09 crisis, public debt has been at around 36-40% GDP in 2011-2012. In the first quarter of 2013, Ukraine's public debt increased by 3.9% (+ USD 2.9 billion) to USD 67.4 billion and reached 38% of the 2012 GDP. In 2013, Ukraine has taken advantage of the favourable conditions in external capital markets and placed more bonds than previously expected (USD 1.25 billion 10-year Eurobond at 7.5% yield in April and a USD 1 billion Eurobond placement at 7.625% in February), most likely letting the debt-to-GDP ratio rise above 40% GDP in 2013, despite the very high public F/X debt repayments (peaking at USD 10.5 billion in 2013). Overall, the Ukrainian government appears sufficiently financed to cover its F/X debt service, allowing Ukraine to "muddle through" without IMF financing.

In November 2008, the IMF board approved a USD 16.5 billion or Special Drawing Rights (SDR) 11 billion Stand-By Arrangement (SBA). However this SBA was interrupted in November 2009 due to slow progress in a number of agreed structural reform priorities. By that time, Ukraine had drawn some USD 10.6 billion under the programme. A new 29-month USD 15.2 billion SBA was approved in July 2010. Following the successful conclusion of the first review under the current SBA, Ukraine received the first tranche of USD 1.89 billion. The second review – originally scheduled for conclusion at end-March 2011– is yet to be completed. Ukraine received no disbursements under the IMF standby arrangement in 2012 (which lapsed in December 2012) and no new cooperation programme has been agreed up until the present moment, as authorities have not reached agreement with the Fund on gas prices, the budget parameters and the issue of exchange rate flexibility. No progress is likely until the yearend on the IMF front.

To summarise, Ukraine's macroeconomic performance worsened in 2012 and economic decline continued in the first quarter of 2013. Further ahead, the internal (related to the

increasing fiscal deficit) and external vulnerabilities are significant, especially the growing fragility of the local FX market (due to the fixed exchange rate policy, high public borrowing needs in the F/X, and the on-going re-pricing of the emerging market assets on the back of growing expectations on reversal of the US monetary policies). As a result, they may endanger the ‘muddling-through’ approach of the Ukrainian authorities in the short-term and therefore need to be monitored closely.

2.3.3. Public financial management

The Public Expenditure and Financial Accountability (PEFA) Assessment 2011 for Ukraine (update of the 2006 PEFA Assessment) was published in July 2012. Ukraine scored 2.67 out of 4, above the worldwide average of 2.53. This indicates that the country has established fundamental Public Finance Management (PFM) systems but there is still considerable scope for improvement. Ukraine performs well on execution control as well as on accounting and reporting, however is lagging behind on credibility of the budget, policy based budgeting, external scrutiny and audit. Public procurement has been a difficult area with setbacks since 2011 further reducing competition and oversight of state purchases.

Overall, progress in PFM has been fragmented and not based on a comprehensive reform strategy. A Concept Note to develop PFM, formally approved by the Cabinet of Ministers in September 2012 was considered a "good start" by the EU, but the need for a real and consistent Strategy was also underlined. A draft Action Plan on PFM presented in October 2012, which responded only in a limited way to requirements, was withdrawn by the Cabinet of Ministers in January 2013. An Inter-Ministerial Working Group started working on a "Global Strategy for the Reform/Improvement of Public Finance Management" which is expected to take into account comments from the EU Delegation and SIGMA received at various stages in the process, and to be approved by September 2013.

The latest report by the Accounting Chamber of Ukraine was published in December 2012 for 2011. It concluded that the major part of budget law infringements, cases of mismanagement and inefficient spending of budget funds were of a systemic nature. In particular, there was no decrease in the rate of offences in the public procurement sphere.

Corruption continues to be an important problem in Ukraine. According to Transparency International's Corruption Perceptions Index (CPI), corruption in Ukraine was perceived to be higher in 2012 than it was in 2011. The CPI index published for Ukraine in December 2012 was 26 while it was 27 in December 2011 (fewer points mean higher corruption perception).

In summary, whereas fundamental PFM systems are in place, there is still considerable scope for improvement in several areas. Actions taken with regard to PFM in 2012 were more of a political than of a practical nature and corresponded in a limited way to what is needed. There is an urgent need to adopt a comprehensive PFM strategy document and action plan in 2013.

2.3.4 Budget transparency and oversight of the budget

The six indicators measuring Comprehensiveness and Transparency in the PEFA exercise have basically remained the same from 2006 to 2011 (2xA; 1xB+; 1xB and 2xD+). Public access to key fiscal information scores a B in the 2011 PEFA report (as in 2006). Ukraine's OBI score for 2011 is 54 out of 100, which is a little higher than the average score of 43 for all the 100 countries surveyed. Ukraine's score indicates that the government provides the public with only some information on the national government's budget and financial activities during the course of the budget year. This makes it challenging for citizens to hold the government accountable for its management of public money.

The most recent World Bank – EU report from 2011 on the effectiveness of state budget management confirmed that Ukraine provides the public with a significant amount of information. However, this information is not well-structured and transparent. For example, the comprehensiveness of end-year reports could be increased by an analytical explanation of key budget indicators. For the moment budgetary information is more of statistical nature.

An important negative development in 2012 was that, contrary to the requirements of the Budget Code, the budget proposal for 2013 was not published in September for consultation prior to adoption at the end of the year. It is expected that in 2013 the draft budget will be published in line with the law.

2.4. Lessons learnt

Although it is too early to draw final conclusions on the overall performance of Ukraine in implementing the first SPSP some important tendencies can already be noted following the Mid Term Review which was concluded in 2013:

- In spite of difficult circumstances, Ukraine performs relatively well in complying with the agreed sectoral conditionalities, with an elevated percentage of indicators met in 2011, although the achievement rate may be reduced in 2012;

- There appears to be a link of causality between this – albeit still fragile - progress and the EU SPSP (that progress, however being put at risk by negative repercussions of the fact that to date no disbursement has as yet been made):

- The SPSP has had a motivating effect on staff of the Ministry of Ecology and Natural Resources;
- It has succeeded in crystallizing a degree of attention by other governmental stakeholders, who otherwise would have been less interested, to the goals (indicators) agreed at Ukrainian governmental level;
- The SPSP has had a beneficial effect on involvement of civil society and has encouraged governmental stakeholders to confront and engage with civil society.

- In addition to civil society involvement, involvement of industrial stakeholders needs to be ensured. Dialogue with the private sector and in particular with industrial stakeholders must be sought to increase effectiveness of environmental action and minimize the risk of fatal obstruction by these stakeholders. Special attention should be paid to enhancement of environmental policy integration. The implementation of the NEP and NAP requires a participative approach of all the stakeholders having an impact on the environment, and therefore a horizontal approach that the MENR has difficulties to impose.

- In spite of some successes on awareness raising activities (e.g. environmental forums), communication should be further improved. Better communication of benefits would raise the chances of mobilising finance for environmental improvements and of environmental mainstreaming into other policies. (Communication on the current SPSP was not helped by the fact that no disbursement was made since the beginning of the programme.)

- Not only ratification, but also implementation of multilateral environmental agreements (in particular the Espoo and Aarhus Conventions) should be prioritized by the Ukrainian government.

- Continued attention needs to be given to capacity building measures.
- The Commission and other donors should discuss with the Government how it can be assisted in strengthening its role as leaders of donor coordination at the national level (in line with the Paris Declaration on Aid Effectiveness).

Overall, these lessons are in line with those gathered from other assistance projects, from dialogue with key stakeholders and during the current SPSP programming exercise.

Therefore, the progress which *was* achieved is still fragile. The NEP and NAP are difficult to fund and implement in the current economic context of Ukraine. Attention to environmental problems is generally low in the central State apparatus and without further incentive and supportive action, further implementation of the NEP in a participatory manner would be jeopardized. While paying some inter-ministerial attention to environmental issues when environmental action is made the centre of attention (e.g. through an SPSP), the actual mainstreaming of environmental concerns has not yet taken sufficient root to be self-sustainable without outside reinforcement.¹²

2.5. Complementary actions

To strengthen effectiveness of the EU assistance channelled through the SPSP coordination will be ensured with other on-going initiatives in order to lift synergies:

- The EU technical assistance project "Complementary support to the MENR for the Sector Budget Support implementation" was launched in January 2012 (duration 35 months; budget EUR 3.2 million). The project assists the ministry and other stakeholders and the civil society actors in implementation, coordination and management of the on-going EU SPSP. One of the key project tasks is to assist the MENR in developing the Ecological Convergence Strategy for approximation of the Ukrainian legislation towards EU requirements. The strategy will address the approximation process at the central and sectoral levels, drafting the action plans for implementation of EU directives taking into account economic, institutional financing resources aspects.
- The regional EU project on Environmental Protection of International River Basins was launched for seven Commonwealth of Independent States (CIS) countries including Ukraine in 2012 (duration 48 months, budget EUR 7,5 million). It aims at: (i) improving availability and quality of data on the ecological, chemical and hydro-morphological status of trans-boundary river basins including groundwater; and (ii) developing River Basin Management Plans for selected river basins/sub-river basins according to the requirements of the Water Framework Directive (WFD).
- The second phase of the co-funded by EU, OECD and UNECE project "Support to the EU Water Initiative in Eastern Europe, the Caucasus and Central Asia" was launched in 2012 (duration 48 months, budget EUR 4 million). The overall objective of the project is to contribute, through the development and implementation of water policy reform, to the achievement of the water related Millennium Development Goals as well as the water management objectives that are part of the Neighbourhood Policy, the Eastern Partnership and the EU-Central Asia Strategy country programmes. More specifically, the project will support the implementation of a number of policy packages to be elaborated in the framework of National Policy Dialogue (NPD) on integrated water resources management and water supply

¹² For example, when preparing its draft revised energy policy till 2030, the Ministry of Energy made no reference at all to the NEP and many environmental provisions of this strategy were actually ignored.

and sanitation. In Ukraine, the Ministry of Regional Development, Construction and Municipal Economy has confirmed its interest to continue the dialogue on water supply and sanitation sector reform. The Ministry of Ecology and Natural Resources will continue the NPD activities.

- The EU and the United Nations Development Programme (UNDP) has launched in January 2013 a project "Improving Environmental Monitoring in the Black Sea" (duration 24 months; budget EUR 600,000). The overall objective of the project is to set up initiatives that will help improve the protection of the Black Sea environment. More specifically, the project aims at improving (i) availability and quality of data on the chemical and biological status of the Black Sea, in the line with expected Marine Strategy Framework Directive (MSFD) and Black Sea strategic Action Plan needs; (ii) partner countries' ability to perform marine environmental monitoring along the MSFD principles. Partner countries are Georgia, Moldova and Ukraine.

- The regional EU project "Towards a Shared Environmental Information System (SEIS) in the European Neighbourhood countries" has been launched in 2009 (duration 48 months; budget EUR 5.75 million). Ukraine is one of the Partner countries for this project. The implementing institution is the European Environment Agency (EEA). The overall goal of the project is to promote the protection of the environment in the countries of the ENPI area. In order to achieve this, the project aims towards a set of measurable and specific objectives: (i) to identify or further develop environmental indicators and scorecards suitable for the design and review of environmental policies, supporting the monitoring and compliance with various national, regional and international obligations and targets; (ii) to improve capacities in the field of monitoring, collection, storage, assessment, and reporting of environmental data in the relevant environmental authorities including the national statistical systems, in compliance with reporting obligations to international agreements and in coordination with relevant regional initiatives; (iii) to set up national and regional environmental information systems in the countries of the ENP area that are in line with the EU Shared Environmental Information System (SEIS), and (iv) to track progress of the regional environmental initiatives (ENP, Eastern Partnership, Horizon 2020).

The regional EU project "Air quality governance in the ENPI East countries" runs since January 2011 (duration 42 months; budget EUR 7 million). Ukraine is one of the project beneficiaries. The overall objective is the improved and sustainable management of natural resources including nature protection, reduced effects of climate change, and increased environmental cooperation and awareness. Specific objectives are: (i) to improve the convergence to European legislation and regulations contributing to the improved air quality and strengthen implementation and compliance (ii) to improve the implementation of Multilateral Environmental Agreements; (iii) to raise environmental awareness through cooperation at regional and sub-regional levels among decision makers, industry and civil-society.

Complementary action in wider areas but including environmental activities is also taken under the Danube Strategy and as part of Cross Border Programmes with Ukraine.

Ensuring complementarity and lifting of synergies with these projects will require due attention. This will be done through the appropriate design of performance indicators as well as through the Technical Assistance project included to the SPSP "complementary support" envelope. Its Steering Committee of as well as the Joint Monitoring Group to be established

during implantation of the new SPSP will be required to pay specific attention to synergies with these other projects.

2.6. Risk management framework¹³

The existing up to date track record of the implementation of the NEP and the NAP in Ukraine is a good indication that continuation of efforts in this sphere is potentially sustainable. Nevertheless, the budget support operation is subject to assumptions and risks as follows:

Principal assumptions for effective and successful implementation include:

- The Government of Ukraine remains committed to developing and deepening relations with the EU, including among other adopting the necessary reforms towards the completion of the Association Agreement and the Deep and Comprehensive Free Trade Area;
- Continued government commitment to stability-oriented macroeconomic policy, and satisfactory progress on implementation of the programme to improve and reform public finance management, including public procurement; adequate budget transparency;
- Continued commitment by all stakeholders to fulfil respective obligations for the effective implementation of the programme;
- Ukraine updates the NAP (required by 2015);
- Ukraine does not weaken the NEP;
- IMF conditionalities are met and vulnerability to external economic and financial shocks is suitably addressed;

Possible risks involved that could have an impact on programme implementation include:

- A further deepening of the global economic crisis adversely affects the Government's willingness to introduce reforms, particularly with respect to the introduction of commercially-based tariff regimes; short-term economic considerations divert Ukraine's commitment from deepening relations with the EU and the Deep and Comprehensive Free Trade Area loses momentum;
[risk mitigation: High-level political and policy dialogue; disbursement modalities (no fixed tranche, payment only on the basis of actual achievements)];
- The government is unable or unwilling to implement reforms in the field of public finance management. The PFM reform process stalls, undermining the transparent allocation of resources according to strategic priorities and disbursement issues affect the motivation of sectoral stakeholders negatively;
[risk mitigation: follow up to political and working level initiatives set to address the problem];
- One or several of the Ukrainian ministries, agencies or companies involved in the

¹³ Provide the Risk Management Framework as supplementary document for internal DEVCO approval processes, see annex 7 of New Budget Support Guidelines

programme as stakeholders lack(s) ownership in the Government's programme and obstructs or undermines cooperation or proves disinterested to cooperate in an ordered manner; deficiencies in inter-ministerial coordination in Ukraine lead to poorly coordinated strategies and reforms

[risk mitigation: ensure during financing agreement negotiations that all governmental stakeholders are involved and committed];

- The MENR, who is already the direct beneficiary of many international projects and faces shortages of manpower, could become hesitant to embark on a new Budget Support if it is perceived as a heavy and time-consuming bureaucratic exercise

[risk mitigation: capacity building; donor coordination; advocacy; overall prioritisation of approximation agenda by Ukrainian government; intensified sector policy dialogue];

- There are frequent changes in key personnel and political leadership in the partner agencies, and in particular in the MENR

[risk mitigation: consider incentive programmes for staff retention, as in the transport SPSP];

- The number of sub-targets (31 Directives to be approximated according to the AA/DCFTA) may prove to be too wide dispersing focus

[risk mitigation: focus on prioritization; BAP and other framework documents concerning convergence of environmental legislation to be priorities adequately; not all directives/regulations have same implementation date in AA/DCFTA];

- Sub-targets on water policy: weaknesses in monitoring and reporting impede measurement of achievement

[risk mitigation: technical assistance; donor coordination and civil society involvement to support process];

- Insufficient co-ordination among the beneficiaries and stakeholders

[risk mitigation: policy dialogue with involvement of all relevant stakeholders. The Joint Monitoring Group in the framework of the SPSP has to be an effective instrument to increase understanding and co-ordination among different stakeholders].

3. DETAILED DESCRIPTION OF THE BUDGET SUPPORT CONTRACT

3.1. Objectives

The objective of the National Environmental Policy (NEP) is to stabilize and improve the environment in Ukraine by means of integration of the environmental policy into the socio-economic development of the country in order to have a safe environment for life and health of the population, as well as to provide a balanced approach between use and preservation of the natural resources. The general objective of the proposed SPSP is to give further support to the implementation of the NEP, in line with EU standards, norms and agreed priorities under the EU-Ukraine Association Agreement.

However, the specific objectives for this programme are more focussed. They are two-fold:

- To facilitate and promote the EU environmental *acquis* approximation process based on the Basic Approximation Plan (BAP) of Ukraine, other framework documents to be developed concerning convergence of environmental legislation and fixed by the Association Agreement (Art. 360- 366 and Annex XXIX).

- To support Ukraine's Water Policy (WP) implementation and to strengthen the international cooperation on trans-boundary water basins.

Through these two focal areas the SPSP directly targets the cross-cutting issue of environmental sustainability.

Institution building and support to better legislation, as well as the implementation of international conventions, will contribute to the development of good governance, respect of human rights and gender equality. It is noted that access to sanitation water is of particular importance for vulnerable population groups. Moreover, the measures will support democratisation and enhance the role of civil society and NGOs through participatory processes, and (assuming the countries' willingness) of fulfilling the commitments made through the Aarhus Convention, which incorporate access to environmental information and public participation in environmental decision making.

3.2. Expected results

The **SPSP** is expected to contribute to the following specific results:

- environmental legislative and regulatory frameworks developed and implemented in line with the respective frameworks of the EU (see initialled Association Agreement Art. 360 - 366 and Annex XXIX); In particular:

- the laws and relevant regulations in the areas of Access to Information, Environmental Impact Assessment (EIA) and public participation in EIA, Strategic Environmental Assessment (SEA), and on removing any inconsistencies with other pieces of legislation are developed, adopted and implemented;
- the laws and relevant regulations in the area of industrial emissions, reducing air pollution and improving air quality, are developed and adopted; due attention to the preparation of laws on waste issues linked to extractive industries (mining activities) will be paid;
- the laws and relevant regulations in the water sector (including flood protection, water pollution, waste-water treatment) developed, adopted and implemented;

- Ukrainian water policy implemented more effectively; in particular:

- the capacity of the responsible institutions for water management and monitoring is improved and the river basin councils are established;
- the action plan for the implementation of the Bucharest Convention and the Marine Strategy Framework Directive (MSFD) are developed, approved and implemented;
- government supported mechanisms for environmental investments in particular in municipal water and waste water and industrial waste water are enhanced leading to increased, sustained and targeted environmental investments and reduction of pollution and contamination levels;

- the dialogue between the Government and Civil Society is improved, environmental awareness in the country is increased and an efficient system to inform the population on environmental protection established.

The results are linked to expected progress in terms of the eligibility criteria (satisfactory progress in the implementation of the NEP and the NAP; consolidation of macroeconomic stabilization; reforms in the PFM; and, satisfactory progress in budget transparency – see details in section 4.3).

The **complementary support** is expected to contribute to the following specific results:- The capacity of the MENR and SAWR is enhanced in key areas and pre-conditions of planning, implementation and monitoring of the sector budget support (SBS) programme (specifically for legal approximation and water sector);

- The SPSP is implemented and monitored according to the requirements of the EU-Ukraine Financing Agreement;
- Harmonisation of the Ukrainian legislation with the EU *acquis* is effectively supported and implemented subject to the time-frame foreseen by the Association Agreement (art. 360 - 366, Annex XXIX), assuming timely entry into force;
- More effective cooperation between the Government, municipalities and investors/lenders is achieved through technical assistance targeting specific bottlenecks, in particular in the pre-feasibility study stage of the water and waste water sector;
- More effective cooperation between the MENR, SAWR and other governmental stakeholders is established, facilitating mainstreaming of environmental policies;
- Private sector is more strongly involved in financing and implementation of environmental strategies;
- Communication on environmental issues is intensified and leads to greater public awareness on environmental risks and benefits of environmental action;
- Civil society's ability to contribute to environmental monitoring is strengthened.

3.3. Rationale for the amounts allocated for budget support

The total amount allocated to the environment under the National Indicative Programme (NIP) 2011 – 2013 is EUR 55 million of which 85,5% is to be delivered under the present budget support programme and 14,5 % is to be delivered under the complementary support. This amount is based on the following considerations.

Financing needs

The World Bank calculated that Ukraine's investment needs in environmental protection over a period of ten years (2006-2015) may amount to some USD 1.5-3 billion annually (excluding investments in energy and water supply and sanitation projects), which may thus translate into almost 2% of the GDP.¹⁴ Considering the budgetary figures specified above (EUR 415 million in 2013; see section 2.3.1), it is evident that Ukraine faces difficulties to finance the implementation of its NEP and that the NEP's financing need can only be covered to a minor (although not altogether insignificant) degree by state budgetary resources.

¹⁴ Information as quoted in a Draft official document on greening the economy: mainstreaming the environment into economic development, ECE, March 2011.

It is therefore of essential importance for the sustainability of funding of environmental protection that blending of sources with donor funds is sought and, even more importantly, that private, regional and municipal resources are enlisted, e.g. by more rigidly enforcing the polluter pays principle.

This SPSP will, on the one hand, directly pursue this goal of improved financing mechanisms. On the other hand, approximation to EU standards and norms, which is targeted with the proposed SPSP, will certainly be a major driving force for such a 'paradigm shift' and can thus be expected to have a mid-term positive impact on the sustainability of environmental funding in Ukraine.

Commitment to allocate budgetary resources

As shown above (section 2.3.1) the Ukrainian Government is committed to certain elements of multiannual financing (on the NAP and on the WP) and provides regular annual budgetary financing for environmental purposes.

A substantial increase in funding in FY 2013 is foreseen for the implementation of the WP. Additional financial resources are included in the local and regional budgets, which will enhance financial sustainability for the WP implantation. Due to the legal status of the Water Policy (as a Law of Ukraine, with a 10-year budgetary framework) the funding of the activities planned will be included in the annual budgeting process, and provide for a certain likelihood of financial continuity/sustainability. The total state budgetary resources envisaged for the implementation of the WP are UAH 46478.5 million. The period of implementation is up to 2021 (10 years). State financing of the programme ensures payment for staff and incidental expenditures of the SAWR as guarantee of the programme's sustainability. In addition to the State Budget, local budgets should envisage supplementary funds for implementation of the Programme additional to the state budget. All regional (local) programmes of water management development should be amended and adapted to the programme accordingly. By January 2013, 10 Oblasts had amended their local programs already. A further source of financing is the Environmental Fund which can be used for the Programme implementation for urgent matters.

Effectiveness, value for money

The EU funds provided under the first Environment SPSP (EUR 35 million, equivalent to UAH 353.5 million); and the proposed funding for this follow-up SPSP AAP 2013 including complementary support (EUR 55 million, equivalent to UAH 563 million) cannot, in themselves, close the gap between financing needs and budgetary allocations. Nevertheless they are not altogether insignificant in comparison to the environmental budget allocations and thus can provide a fair degree of incentive and policy leverage.

If the results pursued are achieved this is certainly good value for money, firstly, with regard to supporting Ukraine in achieving its policy objectives. Secondly, considering that the environmental situation in Ukraine has a very direct impact on the environmental situation in the EU (inter alia through shared river basins and the shared Black Sea), this is also very good value for money for improving and safeguarding the EU's environmental safety.

In the long run, the alignment of the legal and regulatory framework with EU requirements as well as improved institutional capacity of the MENR and the relevant stakeholders will increase their ownership as well as the human, financial and technological resources in order to implement the NEP effectively,

Track record

No disbursements have as yet been made during the on-going SPSP. In spite of difficult circumstances, Ukraine performed relatively well in complying with the agreed sectoral conditionalities and objectives, with an elevated percentage of indicators met in 2011.

The track record of achievements, or partial achievements, includes:

- 25 out of 27 regions and 17 out of 22 sectors of the economy have developed and adopted their specific environmental programmes. This is a ‘mainstreaming’ success even though the quality of the programmes is uneven and implementation remains a challenge.
- The MENR has been quite pro-active in raising awareness on environmental issues through, for example, the organization of large forums “Environment for Ukraine” in 2011 and 2012 that gathered thousands of participants (NGOs, private sector, officials).
- In general, dialogue with civil society (NB: there are numerous environmental NGOs in Ukraine) and with the regions is run adequately and actively supported *via*, for instance, international round-tables like “the Assessment of environmental policy in the countries of the Eastern Partnership” and "Environment, Energy Security and Climate Change – Ukrainian National Platform of the Eastern Partnership Civil Society Forum" held in Kyiv in March 2012 and February 2013 accordingly.

Ukraine makes as well efforts to honour its international commitment on nature protection. In 2011, the country had the presidency of the International Commission for the Protection of the Danube River (ICPDR). This led to the signature of the Integrated Tisza River Basin Management Plan in Ukraine by all the Ministers of Environment of the Tisza countries. The country added as well 10 sites to the Ramsar (wetlands) convention in 2011-2012. By contrast, progress remains still very limited – and overall unsatisfactory - for what concerns compliance with the Aarhus and Espoo conventions.

Result orientation

The NEP foresees two phases of implementation. The Government of Ukraine has approved in May 2011 the NAP 2011 – 2015. It covers the first period of implementation and presents a road map with 277 activities, specifying responsible public institutions and the deadlines for implementation. The performance monitoring of the NAP is to be provided by the MENR to the Cabinet of Ministers of Ukraine on an annual basis. Within that framework, also the WP is result oriented. The proposed SPSP will translate this to strict result orientation in its two focal areas.

Given the relatively large size of the Ukrainian economy the macroeconomic impact of budget support is limited. The EU national aid programme in the current financial perspective is equivalent to about EUR 150 million per year or 0.1% of GDP (0.3% of budget revenues). This SPSP constitutes approximately a mere 0.1% of an annual UA budget. However, as mentioned above, when compared to the annual budgetary allocation for the environment, this amount nevertheless leads to a certain degree of leverage.

3.4. Main activities

The main activities to implement the budget support package are policy dialogue, financial transfer, performance assessment, reporting and capacity development.

3.4.1. Budget Support

Performance monitoring and assessment will include regular performance and monitoring of budget support eligibility criteria:

- monitoring of achievement of the sector's priority objectives will be undertaken on the basis of annual progress reports and other EU or development partners' reviews, supported by regular briefings for and discussions in the relevant sector working group;
- monitoring of macro-economic developments will be performed taking into account of the results of the IMF missions and other relevant assessments;
- monitoring of PFM eligibility will be done on the basis of the reviews of the government's PFM reform strategy and associated assessments or ad-hoc analysis;
- monitoring of budget transparency will be undertaken through verifying public availability of appropriate documentation.

The SPSP will engage in dialogue around conditions and government reform priorities, the verification of conditions and the payment of budget support.

The proposed SPSP (Budget Support modality) will be focused on two particular components.

Component 1 – EU environmental *acquis* approximation

This Component aims at completing the existing gaps in the legislation, and to bring the legislative and regulatory frameworks in line with the respective frameworks of the EU. It is based on the Basic Approximation Plan (BAP) of Ukraine, other framework documents to be developed concerning convergence of environmental legislation and fixed by the Association Agreement (Art. 360 - 366 and Annex XXIX).

This component comprises two categories of approximation interventions:

- *Horizontal Legislation*¹⁵ (Environmental governance and integration of environment into other policy areas – 4 Directives): the focus is on support for completing the current framework legislation with the adoption of a number of pending Laws and implementing regulations in the areas of Access to Information, Environmental Impact Assessment (EIA) and public participation in EIA, Strategic Environmental Assessment (SEA), and on removing any inconsistencies with other pieces of legislation, that may be created as a result of the adoption;
- *Harmonisation of vertical (sectoral) legislation* (selected priority areas: air, industrial pollution and water): the focus is on harmonising Ukrainian environmental legislation with the respective EU Directives. Due attention will be given to priorities.

¹⁵ Horizontal EU legislation on the environment (fixed by AA Annex XXIX) comprises:

Access to Information Directive: Directive 2003/4/EC of the European Parliament and of the Council of 28 January 2003 on public access to environmental information and repealing Council Directive 90/313/EEC;

Environmental Impact Assessment Directive: Council Directive 85/337/EEC of 27 June 1985 on the assessment of the effects of certain public and private projects on the environment as amended by the Council Directive 97/11/EC of 3 March 1997;

Strategic Environmental Assessment Directive: Directive 2001/42/EC of the European Parliament and of the Council of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment;

Directive providing for public participation in EIA: Directive 2003/35/EC of the European Parliament and of the Council of 26 May 2003 providing for public participation with respect to the drawing up of certain plans and programmes relating to the environment and amending with regard to public participation and access to justice Council Directives 85/337/EEC and 96/61/EC.

Component 2 – Ukraine's Water Policy implementation including cooperation on trans-boundary water basins

This Component aims at support of the Government in implementation of activities in the water sector foreseen in the National Action Plan (NAP) and the Water Policy (State Water Management Programme¹⁶). The main activities, in addition to legislative ones, will include:

- *Enhanced river basin and trans-boundary water bodies' management including improved monitoring: (1) Development of the River Basin Management Plans; (2) Establishment of the river basin councils and increasing the role of existing basin authorities, including Bug, Danube (Tisza, Prut and Delta) river basins'. (This corresponds to the requirements of the EU Water Framework Directive); (3) Improvement of the international cooperation in the field of rational use and protection of trans-boundary water bodies; (4) Improved monitoring and (measurable) improvement of water resources using modern technologies(;*
- *Promotion of access to finance for sanitation water and waste water improvements - Stimulating the construction and reconstruction of water supply and wastewater systems in the Dnipro river basin. This will include promotion of access of municipalities to sources of finance such as NIF, E5P, IFI programmes); Comprehensive implementation of the tasks will support implementation of the Council Directive 91/271/EEC (concerning urban waste-water treatment) and Council Directive 98/83/EC (on quality of water intended for human consumption);*
- *Development of an action plan for implementation of the Bucharest Convention and the Marine Strategy Framework Directive.*

3.4.2. Complementary support

Activity module 1: Technical assistance is necessary to support the MENR and the SAWR in implementing the NEP, NAP and WP.

Technical assistance to enhance capacity of the MENR is currently provided under the ENPI AAP 2009 project "Complementary support to the MENR for the sector budget support implementation". Under current circumstances it would be overly optimistic to assume that without further technical assistance MENR staff alone could sustain implementation of the priorities included in the NEP and the NAP. This concern is aggravated by the fact that legal approximation requires further resources. In the short term, MENR capacity can be supported through a strong component of technical assistance accompanying the SPSP.

Under a new SPSP, technical assistance is therefore necessary to support the MENR and the SAWR in order to achieve the goals of the NEP and NAP and the specific objectives with regard to the proposed focal areas. The technical assistance project(s) will assist the Beneficiary to implement policy measures relevant to the water sector as well as Environmental governance and integration of environment into other policy areas. They will be instrumental in providing policy advice, information and capacity building services to the Beneficiary and other relevant stakeholders.

¹⁶ Law of Ukraine "On the National Targeted Programme for Water Management, Development and the Environmental Rehabilitation of the Dnieper river basin for the period till 2021"

Sustainability in the mid-term will require a process in which environmental concerns move from the periphery to the centre of public attention, creating more awareness of the need for, and value of, adequate staffing. Judging from the growing number of environmental NGOs such a process may well be on its way. The proposed new SPSP, if successful in ensuring the participation of all governmental and non-governmental stakeholders will have a positive effect on this process and thus outweigh the risk that technical assistance is considered a mid-term substitute for own human resources.

Activity module 1 a: Due to the specific requirements of technical assistance on approximating legislation it is considered that this constitutes a distinct sub-module for which separate implementation modalities should be foreseen.

Activity module 2: TA will provide assistance in *monitoring* the implementation of the SPSP according to the requirements of the EU-Ukraine Financing Agreement. In this capacity, it will provide support to the functioning of the Joint Monitoring Group.

Activity module 3: The technical assistance will support more effective cooperation between the Government and municipalities on one side and investors/lenders on the other side. This will be done through technical assistance targeting specific bottlenecks, in particular at the stages of identification (pre-feasibility studies) and formulation (feasibility studies) of projects in the water and waste water sector.

On the one hand, IFIs become increasingly interested in the water/water water sector in Ukraine. A number of, partly large, loan projects and programmes are being prepared by EIB, WB, EBRD, KfW. On the other hand, these projects and programmes currently obviously still face a number of obstacles and difficulties. In depth discussions during the formulation stage of this SPSP with IFIs have revealed that there is a clear need for grant support and/or direct TA for such projects at an early stage, most importantly at pre-feasibility study stage, but also - at least to the extent that instruments such as NIF cannot be used – at the stage of feasibility studies. The need appears to be highest with small and medium-sized municipalities. A fair number of pilot actions with EU support in this area could have a very good multiplying factor, leveraging investment grants (through E5P or NIF) and loans by IFIs. (Complementary support for these purposes is included in the indicative procurement list in section 4.4.1 (Institution capacity building)).

Activity module 4: Technical assistance should promote more effective cooperation between the MENR, SAWR and other governmental stakeholders in order to facilitate mainstreaming of environmental policies and strengthen ownership of all governmental stakeholders involved.

Activity module 5: Technical assistance should be provided to key governmental stakeholders in order to more strongly involve the private sector in the financing and implementation of environmental strategies.

Activity module 6: TA will undertake support action to strengthen Civil Society's ability to contribute to environmental monitoring.

On a crosscutting basis, TA should ensure intensified support for MENR, the SAWR, the Ministry of Regional Development, Construction, Housing and Municipal Economy, the Ministry of Economy and the Ministry of Justice (the key stakeholders for the two focal areas) with regard to access to information and communication on environmental issues in their respective competences, and including on fulfilment of the requirements of the respective international conventions (Aarhus, Espoo). Likewise TA activity should support

communication on the benefits of environmental mainstreaming across all modules but with specific emphasis on activity modules 1, 3 and 6.

See section 4.4 for implementing details.

3.5. Donor coordination

Governmental coordination with Donors

There are a number of Donors and IFIs involved in the environment sector in Ukraine. Besides the EU, they include the World Bank, EBRD, EIB, SIDA, UNDP, the USA, Canada, and Switzerland, and some EU countries like Germany, Sweden, the United Kingdom, Denmark, Poland and the Slovak Republic.

Donor co-ordination is formally to be ensured by the Government. Although the Government set up the Government-donor co-ordination structure in 2006 and updated it several times since then, the Government-led donor coordination focuses on very general coordination in the form of Government-donor meetings once or twice a year. Although Ukraine has formally established a Donors Government Working Group (DGWG) for each sector in 2010, including for environment, the Government has not established the mechanism of regular donor coordination at sector level in a concerted manner. Specific sector consultations have been carried out in the Thematic Working Sub Group D1 "Environment Protection", led by the MENR. Such meetings were supposed to take place every three months; however, only a few have taken place so far and concrete results have remained meagre. Coordination therefore essentially takes place *between* Donors.

Coordination between Donors

European integration dominates the development agenda in Ukraine, and the European Commission is the principal actor in this.

In addition, the Swedish International Development Agency (SIDA) plays a leading role in the EU Member States environmental coordination in Ukraine. Furthermore, regular meetings with Member States (and Switzerland) are organised by the EU Delegation to Ukraine allowing timely exchange of information on programmes and activities such as the establishment of a joint sectoral project matrix. In both contexts, the European Commission's intentions have been presented and no risk of overlapping action on this level was identified. SIDA also participates in the Joint Monitoring Group (JMG) of the on-going SPSP on environment which was established in June 2011.

Likewise, coordination with IFIs (and Donors other than EU MSs) plays an important part of the EU Delegation's coordination activities in the environmental sector. E.g. coordination meetings with IFIs have allowed the EU Delegation to discuss its plans for a new SPSP with IFIs during identification and formulation phase. These discussions have revealed a significant potential for synergies in the area of municipal water and waste water facilities in which various IFIs have clear intentions to provide loans. Blending instruments exist already which can be applied to this segment (notably E5P¹⁷, NIF¹⁸), but have so far not led to a very significant volume of investment in water and waste water in Ukraine.

Role of the SPSP

¹⁷ Eastern European Energy Efficiency and Environment Partnership

¹⁸ Neighbourhood Investment Facility

Building upon the on-going SPSP, the proposed SPSP is expected to strengthen Donor coordination by focussing on some elements of strong interest to EU Member States and other donors, not least IFIs. Appropriate formats of coordination need to be developed to lift synergies. These can consist in ad hoc or regular participation (as observers) in the Joint Monitoring Group, similar participation in the Steering Group for the technical assistance project(s) and generally support for strengthening of coordination instruments including those (to be) led by the Government.

3.6. Stakeholders

The principal stakeholder is the *Ministry of Ecology and Natural Resources (MENR)*, which is responsible for the National Environment Policy (NEP) and the National Action Plan (NAP) implementation. The MENR directs and coordinates the activities of the State Service of Geology and Mineral Resources (SSGMR) of Ukraine, the State Agency of Water Resources (SAWR) of Ukraine, the State Environmental Investment Agency (SEIA) of Ukraine and the State Environmental Inspection (SEI) of Ukraine.

Despite the subordinated status to the MENR the *State Agency of Water Resources (SAWR)* is considered as the second stakeholder in the planned SPSP responsible for implementation of the Water Policy. The SAWR has a staff of about 200 persons (excluding regional affiliation and river basins management units) and is in charge of: (i) drafting and adopting of the water sector regulation and developing technical standards; (ii) policy making and planning; (iii) registration, licensing and permitting; (iv) monitoring of surface water resources; and, (v) flood management.

The *Ministry of Finance* will provide information on progress in the implementation of the PFM reform Strategy and Action Plan and has a key role in defining accessibility of municipalities to funds.

The *Ministry of Economic Development and Trade* is donors' coordinator (including the European Commission funding in Ukraine) and needs to be closely associated to the management of the programme.

For specific issues (e.g. river transport, hydropower), the *Ministry of Infrastructure* and the *Ministry of Energy and Coal Industry* can be relevant stakeholders and can be invited to participate.

The *Ministry of Foreign Affairs* has particular competences in the sphere of international agreements.

The *Ministry of Regional Development, Construction, Housing and Municipal Economy* is the key stakeholder for action taken by municipalities and regional bodies and for municipal utilities, in particular with regard to municipal water and waste water.

The *Ministry of Justice* is the leading ministry in approximation process in Ukraine.

Selected *regional and local administrations* and *agencies* involved in implementation of the proposed measures in the Component 2 will be involved as well as *civil society*, the *private sector and other Donors and IFIs*. The final target group is the population of the country which will benefit from protected environmental resources and reduced risk of pollution.

A consultation process with the Government regarding the new SPSP was launched in September 2012. The Ministry of Economy was informed and consulted. The EU Delegation had meetings with the First Deputy Minister of the Ministry of Ecology and Natural Resources (MENR) and the Deputy Chairman of the State Agency for Water Resources (SAWR) of Ukraine. The relevant follow-up actions were also discussed during the Joint Monitoring Group (JMG) meetings of the on-going SPSP in October 2012, December 2012 and March 2013 (in which a whole range of governmental stakeholders are represented). Both sides expressed mutual interest for further development of the policy dialogue and cooperation in the environment, specifically in the following areas: (i) the approximation of the Ukrainian environmental legislation to the EU Acquis, and (ii) the Water Policy (WP) implementation. This was confirmed through positive feedback received from the MENR on the selected priorities on 12 April 2013.

3.7. Conclusion on the balance between risks (2.6.) and expected benefits/results (3.2.)

Overall the expected benefits/results clearly outweigh the risks. The cost of non-intervention is high. Ultimately, however, the proposed SPSP will achieve its results and address its goals only if actions foreseen for risks mitigations measures will be carried out and the Ukrainian Government remains committed to developing and deepening relations with the EU.

4. IMPLEMENTATION ISSUES

4.1. Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 184(2)(b) of the Financial Regulation.

4.2. Indicative operational implementation period

The indicative operational implementation period of this action, during which the activities described in sections 3.4. and 4.4. will be carried out, is 48 months, subject to modifications to be agreed by the responsible authorising officer in the relevant agreements.

4.3. Criteria and indicative schedule of disbursement of budget support

Disbursements of all tranches will depend on meeting *general conditions* related to:

- *Sector policy*: (i) satisfactory progress in the implementation of the NEP and the NAP (existing NAP only relevant to the disbursement of the first variable tranche); (ii) follow up National Action Plan for the period 2016 – 2020 developed and approved by the Government by the end of 2015 (relevant to the disbursement of the first variable tranche); (iii) satisfactory progress in the implementation of the Basic Approximation Plan (BAP); (iv) satisfactory progress in the implementation of the Water Policy specified by the Law "On State Water Management Programme till 2021" and on implementation of commitments of the government under the international conventions on trans-boundary water basins (Helsinki, Danube) and the Black Sea (Bucharest).
- *Macroeconomic*: maintenance of a credible and relevant stability-oriented macroeconomic policy or progress made towards restoring key balances.

- *PFM*: satisfactory progress in the implementation of its programme to improve public financial management.
- *Budget Transparency*: satisfactory progress with regard to the public availability of accessible, timely, comprehensive, and sound budgetary information.

Specific conditions

The performance criteria and indicators, to be used for decisions on disbursement of three variable tranches, follow the intervention logic of the programme (described in the sections 3.2 and 3.4 above). The criteria and indicators are fully coherent with the NEP and the WP.

They cover the following areas:

- Adoption and implementation of:
 - the horizontal legislation (Environmental governance and integration of environment into other policy areas);
 - the vertical (sectoral) legislation;
- Institutional capacity building to implement the NEP and the Water Policy;
- Improvement of drinking water facilities, waste water treatment and sanitation.

For each area key measures and indicators of effectiveness are chosen to demonstrate the strengthening of capacities and quality of work. In order to assess the achievement of the environmental approximation goals the process and output indicators would be the most appropriate to measure the effectiveness. Consequently, each of the areas will be assessed using a mix of process indicators, describing the regulatory (administrative) actions taken (e.g. adoption of the Action Plans, River Basin Management Plans, establishment of the river basin councils, etc.) and output indicators measuring the immediate and concrete consequences of the measures taken (e.g. volume of pollutants, capacity of sewage water network, etc.).

The disbursements will therefore depend on the degree of compliance with the general and specific conditions stipulated in the Financing Agreement. Amount of the variable tranches will be decreased in case of partial compliance or non-compliance, in proportion of the weight specified in the Financing Agreement for each condition. Assessment on the degree of compliance with the general and specific conditions will be performed by the EU Delegation (with possible external support, if there is a need). In case where part of one variable tranche would not be disbursed, the corresponding funds may be transferred to the next variable tranche, being still subject to the fulfilment of the corresponding general and specific conditions. In the event of failure to fulfil a condition or achieve a quantitative target of indicator due to forces majeure it will be possible for the given condition or indicator to be neutralised as a determinant of the variable instalment.

The indicative schedule of disbursements is summarised in the table below (all figures in EUR millions) based on fiscal year of the partner country.

Country fiscal year	Year 1 (2016)	Year 2 (2017)	Year 3 (2018)	

Type of tranche	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Total
Variable tranche			17				15				15		
Total			17				15				15		47

4.4. Details on complementary support

4.4.1. Procurement (direct centralised management)

Subject in generic terms, if possible (activity modules : see 3.4.1.)	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
Area 1. Complementary support for SPSP implementation (includes all general aspects of NEP/NAP implementation and monitoring and specific WP implementation and monitoring, except for legal approximation) – Activity modules 1 and 2	Services	1	First quarter 2015
Area 2. Specialised legal support to approximation process Activity module 1a	Services	1	Second quarter 2015
Area 3. Institutional capacity building part A (covering cooperation of government and municipal authorities with investors/lenders; including conduct of pilot project pre-feasibility and feasibility studies) – Activity module 3	Services	1	Third quarter 2016
Area 4. Institutional capacity building part B, Private sector and Civil society (covering promotion of effective intra governmental coordination; promotion of private sector involvement; Support to participation in SPSP and environmental monitoring by civil society) Activity modules 4,5,6	Services	1	Fourth quarter 2015

4.5. Scope of geographical eligibility for procurement

Subject to the following, the geographical eligibility in terms of place of establishment for participating in procurement procedures and in terms of origin of supplies and materials purchased as established in the basic act shall apply.

The responsible authorising officer may extend the geographical eligibility in accordance with Article 21(7) of the basic act on the basis of the unavailability of products and services in the markets of the countries concerned, for reasons of extreme urgency, or if the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

4.6. Indicative budget

Module	Amount in EUR thousands	Third party contribution (indicative, where known)
3.3. – Budget support Sector Reform Contract	47000	N.A.
4.4.3. – Procurement (direct centralised)	7800	N.A.
<i>of which Area 1</i>	<i>2600</i>	
<i>of which Area 2</i>	<i>1400</i>	
<i>of which Area 3</i>	<i>2500</i>	
<i>of which Area 4</i>	<i>1300</i>	
4.8. – Evaluation	200	N.A.
4.9. – Communication and visibility	Included in Procurement	N.A.
Contingencies	N.A.	N.A.
Totals	55000	N.A.

4.7. Performance monitoring

Performance monitoring will be exerted by a Joint Monitoring Group, composed of two principal sides (EU and Ukrainian government), and to be chaired by the Ministry of Ecology and Natural Resources (MENR). It is foreseen that on the Ukrainian side at least the following organisations will be represented in the Joint Monitoring Group (the list is not exhaustive):

- Ministry of Ecology and Natural Resources;
- State Agency for Water Resources;
- Ministry for Economic Development and Trade;
- Ministry of Finance;
- Ministry of Justice;
- Ministry of Infrastructure;
- Ministry of Energy and Coal Industry;
- Ministry of Foreign Affairs;
- Ministry of Regional Development, Construction, Housing and Municipal Economy

The representatives of the Civil Society (NGOs) should be invited as observers. Ad hoc participation of IFIs, key complementary donors and to the extent possible of the private sector (industrial stakeholders/business associations) should be proposed to promote synergies and overall coherence. For the same reason, team leaders of complementary assistance projects can be invited.

The Joint Monitoring Group will rely on official information provided by Ukraine and verify as appropriate. The Joint Monitoring Group will meet at least twice a year at technical level. High level meetings of the Joint Monitoring Group should take place at least once a year, including in the beginning and at completion of the programme. They shall be chaired by a representative of the MENR at the level of Deputy Minister. Meetings of the Joint Monitoring Group can be complemented by a high level sector policy dialogue (at the level of Minister and Head of Delegation) to provide specific high level impetus to the sector policy dialogue. The Joint Monitoring Group may set up technical subgroups to follow-up specialised issues (e.g., specific areas of activities, such as surface water monitoring, regulation and technical standards in water sector, etc). The establishment, composition and schedule of activities of technical sub-groups will be decided by the Joint Monitoring Group.

The Joint Monitoring Group will serve as a forum to follow the policy development, verify the achievement of performance indicators, identify problems and suggest solutions. It will present its opinion (or different opinions in case of major divergences between the members) to the European Commission. The responsibility for the final decision on the achievement of disbursement conditions will rest with the European Commission, which can use external support for this purpose. In case where part of one variable tranche would not be disbursed, the corresponding funds may be transferred to the next variable tranche, being still subject to the fulfilment of the corresponding general and specific conditions. In the event of failure to fulfil a condition or achieve a quantitative target of indicator due to force majeure it will be possible for the given condition or indicator to be neutralised as a determinant of the variable instalment.

Performance monitoring of specific conditions and disbursement criteria of the variable tranches will focus on the areas listed in article 3.4 of this Action Fiche.

4.8. Evaluation

Assessment of the results achieved will be reviewed and decided by the European Commission. In carrying out such review, the European Commission will, as appropriate, use the technical advice of external consultants recruited by the European Commission to verify technical reports and data transmitted by the government of Ukraine. Programme reviews, evaluations, whenever necessary, will also be decided and funded from the complementary measures part of the Programme. Part of the technical assistance may be used to enhance the local capacities for auditing the programme.

The European Commission may mandate consultants to carry out an independent evaluation of the programme. The timing of evaluation – either mid-term, final or ex-post – will be decided in the course of implementation. Evaluation will be concerned with the extent and under what circumstances the programme, including the budget support component, was relevant, efficient, and effective in contributing to achieving sustainable impacts in the areas which are the focus of the objectives of the programme. In case of mid-term evaluation, validity of the monitoring system and performance indicators will be verified. The evaluation

will be expected to identify evidence, best practice, lessons, and recommendations regarding to what extent, how, why, and when the programme has either contributed to reaching and/or could contribute to reaching intended objectives.

4.9. Communication and visibility

The programme will follow the orientations of the Communication and Visibility Manual for the EU External Actions. Proper communication and visibility of the action will be achieved via regular joint communication events on the occasion of the achievement of the disbursement criteria, as well as in connection with the important events related to the sector policy, and with the results/milestones of the technical assistance. A reasonable communication budget will be set aside for this purpose in the complementary measures.

Each project under this Programme will have its own communication and visibility component and budget, according to the EU Manual on Visibility of External Actions.