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COMMISSION IMPLEMENTING DECISION

of 20.11.2013

on the Annual Action Programme 2013 in favour of Ukraine to be financed from the general budget of the European Union

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EC) No 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down general provisions establishing a European Neighbourhood and Partnership Instrument (ENPI)[1], and in particular Article 12 thereof,

Having regard to Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002[2] (hereinafter referred to as 'the Financial Regulation'), and in particular Article 84(2) thereof,

Whereas:

(1) The Commission has adopted the ENPI Strategy Paper 2007-2013[3] for Ukraine and the Multiannual National Indicative Programme for the period 2011-2013[4], point 4 of which provides for the following priorities: good governance and the rule of law; facilitation of the entry into force of the EU-Ukraine Association Agreement (which includes the Agreement establishing a Deep and Comprehensive Free Trade Area); and sustainable development.

(2) The objectives pursued by the Annual Action Programme are: 1) to support the social, economic and territorial cohesion of Ukraine; 2) to give further support to the implementation of the National Environmental Policy, in line with EU standards, norms and agreed priorities under the EU-Ukraine Association Agreement 3) to promote sustainable and inclusive growth and to contribute to economic reforms and the gradual integration of Ukraine’s economy into the European Union's Internal Market; 4) to effectively raise Ukrainian institutions' capacities in the preparation and implementation of the EU-Ukraine Association Agreement.

(3) This Decision complies with the conditions laid down in Article 94 of Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation No 966/2012 of the European Parliament and of the Council

[1] OJEU L 310, 9.11.2006, p. 1
[2] OJ L 298, 26.10.2012, p. 1.
[3] C(2007)672
[4] C(2010)1144

on the financial rules applicable to the general budget of the Union (hereinafter referred to as 'the Rules of Application').

(4) The Commission may entrust budget-implementation tasks under joint management (indirect management with an international organisation) to the entities identified in this Decision, subject to the conclusion of a contribution agreement. The responsible authorising officer has ensured that these entities comply with the conditions of Article 53d of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities[5] (hereinafter referred to as 'the Financial Regulation 1605/2002') and of Articles 35 and 43 of its Implementing Rules[6].

(5) It is appropriate to acknowledge that grants may be awarded without a call for proposals by the responsible authorising officer who ensures that the conditions for an exception to a call for proposals according to Article 190 of the Rules of Application are fulfilled. Where the reasons for and potential beneficiaries of such award are known at the moment of the adoption of this Decision, they should be identified therein for reasons of transparency.

(6) This Decision should allow for the award of grants in the form of lump sums and/or unit costs and/or flat-rate financing for the reasons and amounts set out in the Annexes 1 and 4 on the basis of Article 124 of the Financial Regulation and Article 182 of the Rules of Application.

(7) The maximum contribution of the European Union set by this Decision should cover any possible claims for interest due for late payment on the basis of Article 92 of the Financial Regulation and Article 111(4) of the Rules of Application.

(8) The Commission is required to define the term "non-substantial change" in the sense of Article 94(4) of the Rules of Application to ensure that any such changes can be adopted by the authorising officer by delegation, or under his or her responsibility, by sub-delegation (hereinafter referred to as the 'responsible authorising officer').

(9) The measures provided for in this Decision are in accordance with the opinion of the ENPI Committee set up under Article 26 of Regulation (EC) No 1638/2006,

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[5] OJ L 248, 16.9.2002, p.1. These provisions remain applicable until 31 December 2013 according to Article 212 of the Financial Regulation.

[6] Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities. OJ L 357, 31.12.2002, p.1. These provisions remain applicable until 31 December 2013 according to Article 212 of the Financial Regulation.

HAS DECIDED AS FOLLOWS:

Article 1

Adoption of the programme

The Annual Action Programme 2013 in favour of Ukraine, constituted by the actions identified in the second paragraph, is approved.

The actions, the description of which is set out in the attached Annexes 1 to 4, respectively, shall be:

– Sector Policy Support Programme - Support to Ukraine's Regional Policy;

– Further support to the implementation of the National Environmental Policy of Ukraine;

– Second phase of the Sector Policy Support Programme -Promoting mutual trade by removing technical barriers to trade between Ukraine and the European Union;

– Framework programme in support of EU-Ukraine agreements.

Article 2

Financial contribution

The maximum contribution of the European Union authorised by this Decision for the implementation of this programme is set at EUR 186 million to be financed from budget line 19 08 01 03 of the general budget of the European Union for 2013.

Article 3

Implementation modalities

The budget-implementation tasks under joint management shall be entrusted to the entities identified in the attached Annexes, subject to the conclusion of the relevant agreements.

Section 4 of the Annexes referred to in the second paragraph of Article 1 sets out the elements required by Article 94(2) of the Rules of Application.

Grants may be awarded without a call for proposals by the responsible authorising officer according to Article 190 of the Rules of Application. Where known at the moment of the adoption of this Decision, the reasons for this as well as the potential beneficiaries shall be identified in the attached Annexes.

The Commission authorises the use of lump sums and/or unit costs and/or flat-rate financing exceeding EUR 60.000 per beneficiary, in accordance with the conditions set out in the Annexes 1 and 4.

The financial contribution referred to in Article 2 shall also cover any possible interests due for late payment.

Article 4

Non-substantial changes

Increases or cumulated changes to the allocations of specific actions not exceeding 20 % of the contribution referred to in the first paragraph of Article 2 shall not be considered substantial, provided that they do not significantly affect the nature and objectives of the actions.
The responsible authorising officer may adopt these non-substantial changes in accordance with the principles of sound financial management and proportionality.

Done at Brussels, 20.11.2013

For the Commission
Štefan FÜLE
Member of the Commission

ANNEX 1

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

Action Fiche for the Sector Policy Support Programme
Support to Ukraine's Regional Policy

1. IDENTIFICATION

<table>
<tr><td>Title/Number</td><td colspan="3">Sector Policy Support Programme - Support to Ukraine's Regional Policy
CRIS number: ENPI/2013/024-517</td></tr>
<tr><td>Total cost</td><td colspan="3">Total amount of EU budget contribution : EUR 55,000,000,
of which:
EUR 50,000,000 for budget support
EUR 5,000,000 for complementary support</td></tr>
<tr><td colspan="4">Budget support</td></tr>
<tr><td>Aid method / Method of implementation</td><td colspan="3">Direct (centralised) management
Sector Reform Contract</td></tr>
<tr><td>Type of aid code</td><td>A02 – Sector Budget Support</td><td>Markers</td><td>BSAR</td></tr>
<tr><td>DAC-code</td><td>43040</td><td>Sector</td><td>Rural/Regional development</td></tr>
<tr><td colspan="4">Complementary support</td></tr>
<tr><td>Aid method / Method of implementation</td><td colspan="3">Direct centralised management – grants – call for proposal procurement of services</td></tr>
<tr><td>DAC-code</td><td>43040</td><td>Sector</td><td>Rural/Regional development</td></tr>
</table>

2. RATIONALE AND COUNTRY CONTEXT

2.1. Summary of the action and its objectives

Regional and local development will be supported with a Sector Budget Support to Ukraine's Regional Policy. The budget support will provide Ukraine with additional financial resources to implement the State Regional Development Strategy 2020 which is currently under elaboration and expected to be finalized and adopted by the Government before the end of 2013. The draft strategy defines three strategic objectives:

1. Improving competitiveness of regions;

2. Territorial social and economic integration;
3. Effective State Governance of Regional Development.

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.

2.3. Eligibility for budget support

2.3.1. Public policy

The current Ukrainian system of regional development can be characterized as rather fragmented and ineffective. A top-down approach with too many inconsistent and uncoordinated policies and strategies elaborated and not always ever implemented still prevails.[7]

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[7] To be noted that the government of Ukraine does not claim to have a well defined sector policy. The updated State Regional Development Strategy as of 16.11.2011 formulates: "low efficiency of state management of regional development which is caused by: underestimation of regional policy as an integral part of socio-economic policy, unsatisfactory regulatory framework of state regional policy (....); unsystematic, fragmented use of certain legislative instruments to promote regional development; lack of a unified system of strategic

In 2005, the *State Regional Development Strategy until 2015* was approved as the main strategic document for regional development[8]. The strategy was slightly updated on 16 November 2011. This strategy links legislation supporting and regulating regional policy, including a law on "*Stimulation of Regional Development*". It establishes as its overall objective the creation of an enabling environment for regions to become more competitive and to realize sustainable growth. However, the strategy lacks a clear operational programme for its implementation and is not directly linked to the budget. All Ukrainian regions have adopted regional strategies, but as is the case at the national level, linkages between budgetary allocations and concrete regional development actions are generally weak.

The Ukrainian Government has expressed a strong interest in approximating its policy to EU Regional Policy. In various political declarations and decisions, President Yanukovych has instructed the Government to develop a programme to reform the "management system for regional development".

One of the mandatory elements of this reform, the State Regional Development Fund, was established on 12 January 2012 with the Law № 4318-VI Amendment of the law to the Budget code of Ukraine and some other legal acts of Ukraine. A draft Law on Fundamentals of State Regional Policy, elaborated with the support of EU technical assistance, is under consideration by the Government of Ukraine. The State Regional Development Strategy until 2015, already approved in 2005, was updated on 16.11.2011. A new State Regional Development Strategy until 2020 is currently under development and will be supplemented with a Plan of Implementation. The initial deadline for approval of the strategy, set on 31 December 2012, was extended to December 2013.[9]

Within the policy dialogue with the EU Delegation, the Ministry of Economic Development and Trade elaborated a roadmap for developing the strategy. A draft State Regional Development Strategy until 2020 was submitted in June 2012. Furthermore, the Minister informed the EU Delegation to Ukraine in an official letter in June 2013 that the Ministry plans to submit the State Regional Development Programme 2020 to the Cabinet of Ministers of Ukraine at the end of August 2013 for approval. The draft strategy defines three strategic objectives, namely: improving competitiveness of regions; territorial social and economic integration; effective state governance of regional development. The Ministry at various occasions expressed its commitment to improve the draft strategy in close cooperation with Ukrainian stakeholders as well as with the EU Delegation and EU technical assistance.

Therefore, it can be concluded that a well-defined sector policy is in the process of being developed. The main conceptual documents currently in place, a concept of State Regional Policy (2001) and the State Regional Development Strategy until 2015 (2006), define objectives to a certain degree but lack implementation mechanisms. However, in 2012 and 2013, clear progress has been made in the overall Regional Development framework, i.e. the

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planning and coordination mechanism of the strategic priorities of States and regions; imperfect administrative-territorial structure (…)". In the 2012 Annual Address to the Parliament, the President criticizes the current Regional Policy system as "critically non effective" as most of the strategic documents of the regions have a "solely declarative character".

[8] The strategy will expire before the sector policy support programme will commence.

[9] The reason for this request was that the Ministry intended to make use of Technical Assistance under the EU financed programme "Support to Ukraine's Regional Development Programme", launched in January 2013. The new deadline is mentioned in the National Annual Action Plan 2013 of the Economic Reform Programme of the President.

launch of the State Regional Development Fund and the drafting of the previously mentioned strategy to 2020.

However, some additional efforts must be implemented to consolidate the policy and meet the eligibility criterion for budget support. The following conditions shall apply:

- New State Regional Development Strategy until 2020 adopted in 2013, including an improved performance assessment mechanism with annual targets;
- Defined Regional Development framework through the adoption of the Law on Fundamentals of State Regional Policy or amendments to regional development legislation;
- Effective coordination mechanism in place, including a structured consultation procedure with regional development stakeholders (national and regional level, including civil society);
- Full transparency and oversight of the budget for regional development, including State Regional Development Fund and subventions.

Sector Budget

There is neither an overall Medium Term Fiscal Framework (MTFF) nor a Medium Term Expenditure Framework (MTEF) for the regional and local development sector. Funds are allocated through the annual state budget. There are two main sources of funding for Regional Development, the *State Regional Development Fund* and *subventions related to Regional Development*.

The *State Regional Development Fund* provides the equivalent of 1% of the revenues of the general annual budget to Regional Development. 70% of the resources of the Fund shall be distributed among regions in proportion to their size of their population. The remaining 30% of resources shall be distributed among regions with a GDP less than 75% of Ukrainian average, also according to their size of population.

A main advantage of the fund is that a clear mechanism for distribution of funds to the regions has been established. Further, regions are in the position to initiate projects and propose them for financing to the central state. However, the Fund is limited in its scope of activities, as only construction (works) projects are eligible actions. In 2012, the fund spent UAH 1.6 Billion, mainly on small social and engineering infrastructure (such as repairing and construction of schools, hospitals and other objects of social infrastructure as well as gasification of rural areas and repairing/constructing of sewage systems).

The amount foreseen in the state budget for the State Regional Development Fund in 2013 is 27.4 % of the amount stipulated in the law on Budget Code. Instead of an equivalent 1% of the revenues of the general part of the budget (approximately UAH 3.6 billion) only UAH 0.987 billion were actually allocated.[10]

The financial control of the funds is implemented at the level of Oblast State Administration (regional government) and at the level of specific projects. As all projects are targeted at construction/repairing of certain infrastructure, the financial and performance control are implemented according to construction works procedures approved in the Ukrainian legislation. The State Regional Development Fund is subject to audit by the Accounting

[10] In 2012 the fund allocated 40% of the amount fixed in the budget code (1.14 billion UAH instead of 2.9 billion UAH).

Chamber of Ukraine that issues audit reports on an annual basis; audits for 2012 are not yet available.

In addition to the fund, the general budget continues to fund regional development activities through subventions. The system is rather complex and opaque, without clear links to the State Strategy. The Ministry of Economic Development and Trade has expressed the intention to integrate all existing budget lines devoted to regional policy into the State Regional Development Fund. Such a decision would allow a better matching between financial resources and strategic documents.

In 2013 the Government introduced a new mechanism of loan guarantees for financing both sectoral (top-down) and local (at the level of urban municipalities) development projects. The President of Ukraine (in June 2013) informed that it will generate projects worth approximately UAH 50 billion (EUR 4.74 billion). The mechanism allows for partial and full reimbursement of interest as well as partial and full reimbursement of loans.

Institutional Capacity

The main beneficiary of this Sector Policy Support Programme (SPSP), the Ministry of Economic Development and Trade, has demonstrated a good commitment to the reforms to be undertaken, a vision of future steps, and good co-operation with the EU Delegation and EU-funded assistance.

However, additional efforts have to be taken to raise institutional capacity of other stakeholders, i.e. on the regional and local level. Regional and, especially, local administrations face an extremely narrow income base and lack powers to expand it. As a result, they have been heavily dependant on transfers from the central level and ended up distributing delegated expenditures in the framework of annual budgets rather than pursuing comprehensive and forward-looking policies in the delegated spheres. The division of responsibilities and the allocation of powers between the different levels of the Ukrainian State Administration do not follow the principle of subsidiarity and are frequently unclear. Legislation is not fully harmonized with the European Charter of Local Self Government signed by Ukraine in 1996, in the framework of the Council of Europe.

Performance Monitoring

The current system of monitoring and evaluation of the State Regional Development Strategy is not sufficient to draw a performance assessment framework. With introduction of new types of development interventions (in addition to construction), further development is necessary. The Government intends to update the monitoring and evaluation framework in the context of elaboration of a new State Regional Development Strategy until 2020.

A list of all projects which received funding out of the State Regional Development Fund from the 2012 budget is publicly accessible; other means of monitoring and evaluation of the financed projects have so far not been published.

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 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 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 1Q2013, 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 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 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 USD 27 billion) 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 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 foreign exchange (F/X) market (due to the fixed exchange rate policy, high public borrowing needs in the F/X, and the ongoing 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

Specific regional and local development projects financed in the past have had, by nature, only a limited capacity to disseminate experiences and best practices to all regions and municipalities of the country. There is, therefore, a need to implement a systematic step-by-step approach related to deepening the capacities in all regions and for all local authorities.

The prevailing regional development planning methodology in Ukraine does not establish a link between limited resources and development needs. Very often Regional Development strategies and regional programs are elaborated based on academic expertise "ex cathedra", without involvement of stakeholders and concrete implementation plans and budgets. A systematic approach is needed which would promote a dialogue between stakeholders in order to elaborate realistic development strategies, link the identification of problems to policies and budgets and involve civil society in all steps of the planning cycle[11]

In spite of the general observation that institutional and absorption capacities in the regions are low, there are at the local level good practices and experiences in understanding main mechanisms for development of specific areas. These lessons have to be taken into account.

2.5. Complementary actions

The European Commission signed in 2009 a Memorandum of Understanding for the Establishment of a Dialogue on Regional Policy and Development of Regional Cooperation with the Ukrainian government. The EU has supported Ukrainian authorities in the past years

[11] The EU Technical Assistance Support to Ukraine's Regional Development Policy is tasked to assist the regions with elaborating of the new Regional Development Strategies and Regional Operational Programs that would correspond with the State Regional Development Strategy until 2020 and be based on EU best practice methodologies of regional development strategic planning and programming.

through different types of projects, using bottom-up as well as top down approaches. The EU has already financed a long term technical assistance project "Support to Sustainable Regional Development" with EUR 6 million in order to develop an EU-compatible approach and a financial instrument for regional development. This project triggered the establishment of State Regional Development Fund in 2012 and also supported the draft law on Fundamentals of State Regional Policy.

A follow-up programme "Support to Ukraine's Regional Development Policy" (Annual Action Programme 2011) was launched in January 2013. The programme will provide support to a large number of local and regional authorities in order to improve their institutional and administrative capacities. This includes a process of learning by doing to link strategic priorities to budgets available and concrete regional development actions. The programme has a budget of EUR 31 million and is a response to the Pilot Regional Development Programme under the Eastern Partnership.

The EU also supports and finances development programmes in the area of local rural development, based on a participatory/community-based approach. There is a large experience in decentralised cooperation; several projects are financed through programmes such, as Cross Border Cooperation programmes, the Non-State Actors and Local Authorities programmes, Cooperation in Urban Development and Dialogue (CIUDAD), etc. Generally speaking, those EU programmes follow bottom-up approaches and promote the concept and principles of self-government or autonomy of local authorities.

The overwhelming majority of donors active in regional development finances projects targeted at municipal development (e.g. USAID, CIDA[12], SIDA[13], the Swiss Agency for Development and Cooperation, GIZ[14] Ukraine Office), mostly reaching out to a maximum of one or two pilot regions. These projects would greatly benefit from a systematic approach to regional development in Ukraine.

2.6. Risk management framework

The risk assessment framework is included as an annex to this action fiche. The specific assumptions and risks relevant to regional policy are highlighted below.

Assumptions:

Ukrainian authorities (at national and local level) will remain committed for delivering improved regional development policies. Promotion of regional and local development and of an administrative-territorial reform will remain a national priority and the Government ensures a stable institutional environment for its implementation.

National/Regional/Local stakeholders are open for full cooperation within the programme. Local and regional authorities will be granted with greater financial autonomy, as well as greater financial visibility and capacity in the mid-term.

Ukrainian authorities are committed to address corruption and conflicts of interest, also at regional and local level.

[12] Canadian International Development Agency
[13] Swedish International Development Cooperation Agency
[14] Deutsche Gesellschaft für Internationale Zusammenarbeit

Risks:

The Government or Parliament will not approve any major reform on the Regional Development. Risk mitigation: constant policy dialogue with involvement of all stakeholders to create a consensus on actions.

Public finance management (PFM) remains weak without a clear reform strategy. There is a risk of corruption linked to the disbursement of the State Regional Development Fund. Risk mitigation: establish sound monitoring and evaluation system. Ensure full transparency of the whole budget-making process.

The authorities will apply unfair selection procedures and/or favour certain regions in a non-objective way. Risk mitigation: involve EU technical assistance and Ukrainian civil society into the developing, improving and assessing of disbursement rules of the fund. Ensure full transparency of the whole budget making process.

The continuation of the economic crisis provokes weaknesses in providing a transparent and comprehensive financial framework for the regions and the municipalities in the short and medium term. Risk mitigation: continuous dialogue with the authorities and strengthening of coordination processes should lead to a better assumption of financial responsibilities within state authorities toward regions and cities.

The State Regional Development Strategy 2020 will not be timely adopted and/or provide the basis for a credible strategy. Risk mitigation: High level commitment to timely approval and close monitoring of strategy building.

3. DETAILED DESCRIPTION OF THE BUDGET SUPPORT CONTRACT

3.1. Objectives

The overall objective of this contract is to support the social, economic and territorial cohesion of Ukraine, wellbeing throughout the country.

The budget support will contribute to the implementation of the State Regional Development Strategy 2020, following its three strategic objectives.

Purpose (specific objective)[15]:

1. Improving competitiveness of regions;
2. Territorial socio-economic integration;
3. Effective State Governance of Regional Development.

Regional Development is per se a crosscutting, multi-sectoral policy. Putting in place policies and framework for Regional Development will help tackle issues of governance, an improved monitoring and evaluation framework the fight against corruption and conflicts of interest across all sectors. The programme will lead to an increased involvement of civil society into the regional and local planning process. Through the provision of financing for regional and

[15] The purpose might need to be adapted in accordance with the objectives defined in the approved version of the State Regional Development strategy until 2020.

local development actions, various crosscutting issues are likely to be tackled, including environmental sustainability, gender equality, and good governance.

3.2. Expected results

Regional and local development will be supported with a budget support to regional policy. The expected results will depend on the State Regional Development Strategy until 2020 which is currently under elaboration and expected to be finalized in July 2013.

According to the Ministry of Economic Development and Trade, for the implementation of the first strategic objective it is planned to develop a set of measures aimed at solving the problems of urban territories; better use the potential of rural territories; increase the possibilities to innovate; supporting the development of a competitive business environment; diversify energy sources and increase energy efficiency; develop cross-border cooperation.

The implementation of the second strategic objective will be aimed at preventing the deepening of disparities that impede the development of regions; support to territories with low access to education, training, health, transport and communication, housing and culture; improvement of environmental protection.

For the implementation of the third strategic objective, measures aimed at improving the system of strategic planning of regional development at national and regional levels; improving the quality of governance of regional development; strengthening inter-sectoral coordination in formulation and implementation of regional policy; institutional support for regional development will be targeted.

Taking into account the objectives defined in the draft State Regional Development Strategy 2020, the SPSP is expected to be linked to the following results[16]:

Component 1: Improving the competitiveness of regions

- Successful realization of projects as defined in the operational programme/action plan for the realization of the State Regional Development strategy.

Component 2: Territorial socio-economic integration

- Stable, pre-defined budget provided for the development of regions;
- Reduction of regional disparities.

Component 3: Effective State Governance in Regional Development

- Operational programmes for the implementation of national and all regional strategies established, linking actions to the budget available with well-prepared project pipeline;
- Improved capacity of central, regional and local authorities to elaborate, implement, monitor and evaluate regional development strategies and operational programmes including a pipeline of projects**;**
- Decentralisation of governance, increased fiscal autonomy of regional and local authorities;
- Procedures of the State Regional Development Fund approximates EU best practices of Financing of Regional Development;

[16] The expected results might need to be adapted in accordance with the results defined in the approved version of the State Regional Development strategy until 2020.

- Improved communication and coordination between stakeholders at all territorial levels;
- An effective monitoring and evaluation system implemented, providing regularly information about the effectiveness of the policy.

3.3. Rationale for the amounts allocated for budget support

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 (or 0.3% of government revenue). Annual disbursements of budget support have varied substantially within this overall ceiling and are expected to reach about 0.05% of GDP in 2013, provided that budget support payments restart."

The total amount allocated to sustainable development under the National Indicative Programme (NIP) is EUR 211,500,000 - 258,527,000 of which 21.27% to 26.00% is to be delivered under the present budget support programme.

This amount is based on:

- The commitment of Ukraine, defined in the budget code, to allocate an equivalent of 1% of the revenues of general part of the budget to the State Regional Development Fund (approximately UAH 3.6 billion) in line with strategic objectives as defined in the State Regional Development strategy 2020.
- The commitment of Ukraine to supplement the strategy with a result oriented monitoring mechanism and an action plan defining annually measurable targets.

3.4. Main activities

Main activities by the EU in the framework of the programme will include:

- transfer of EUR 50 million over the fiscal years 2015-2018;
- continued political and policy dialogue with the Government with a particular focus on regional development policies;
- a continued effort to reinforce Government's capacities in the area of PFM in the context of existing complementary support programmes;
- regular 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 in the context 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.

3.4.1. Budget Support

The proposed sector budget support programme is being prepared jointly with the Ministry for Economic Development and Trade, which is currently developing a new State Regional Development strategy. The Ministry has declared its full support to align the strategy with requirements of this sector budget support.

3.4.2. Complementary support

A technical assistance (TA), complementary to the TA component financed under the Annual Action Programme 2011, will focus on the active monitoring of the implementation of this new policy, formulating recommendations to the Ukrainian authorities, visiting and evaluating on the field the actions undertaken by the authorities. The capacity of the relevant Ukrainian authorities to steer and implement the above-mentioned reform areas targeted by this SPSP will be constantly evaluated. This active technical assistance monitoring will support and facilitate the Ukrainian authorities in ensuring the effective and transparent implementation of this SPSP by ensuring high quality and coherence of the implementation measures and maintaining an efficient programming, management, control, and evaluation system. Further, on request of the Ukrainian government, Twinning programmes may be financed to support the approximation to EU Regional Policy and practices.

3.5. Donor coordination

The Donor co-ordination is formally ensured by the Government. Although the Government had set up the Government-donor co-ordination structure in 2006 and updated it several times since then, the Government-led donor coordination focuses on general coordination in the form of Government-donor meetings once or twice a year.

The Government has not established the mechanism of regular donor coordination in the area of regional and local Development with a structured approach. In the absence of a government led approach to donor coordination, donors have mainly coordinated themselves through informal meetings and working groups.

3.6. Stakeholders

Regional development is a multi-dimensional issue covering a number of policy areas. Stakeholders are:

- *Central Government:* Ministry of Economic Development and Trade (lead ministry), Ministry of Regional Development, Construction, Housing and Municipal Economy, Cabinet of Ministers, Ministry of Finance, Presidential Administration, etc.

- *Local and regional authorities* at Oblast, rayon and municipal level, associations of local and regional authorities

- *Other national & local stakeholders:* Institutes, business and other associations, NGOs, education institutions, etc.

- *Donors and international organisations:* USAID, GIZ, WB, UNDP, CIDA, Swiss cooperation, EU, EBRD, etc.

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

The perspective of budget support in combination with a TA under the "Support to Ukraine's Regional Policy programme" and the ongoing elaboration of the State Regional Development strategy 2020 provides a unique momentum and strong incentives to approximate EU regional policy. It has already encouraged the government to take concrete steps to reform the current regional policy system. In 2012, the government launched the State Regional Development Fund which established a clear and transparent mechanism of distribution of state budget to the regions.

However, as the State Regional Development Strategy 2020 is currently under development and a first consolidated draft is expected only for 1 July 2013, the programme is under high risk. The risk has been mitigated by seeking high level commitment from Ukraine to develop an effective regional policy. The strategy building process is closely monitored.

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

The general conditions for disbursement of all tranches are as follows: Satisfactory progress in the implementation of Regional Policy and continued credibility and relevance thereof; implementation of a credible stability-oriented macroeconomic policy; satisfactory progress in the implementation of the PFM reform programme; and satisfactory progress with regard to the public availability of timely, comprehensive and sound budgetary information.

Specific conditions and broad areas for indicators that may be used for variable tranches will be defined once the new State Regional Development strategy will be approved. The indicators are expected to measure progress in three areas:

- **Competitiveness of regions;**
- **Territorial socio-economic integration;**
- **Effective State Governance in Regional Development.**

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

- Sector policy: satisfactory progress in the alignment of Ukrainian legal and regulatory framework in the area of regional development.
- 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.
- Performance monitoring of specific conditions and disbursement criteria of the variable tranches will be detailed in the Technical and Administrative Provisions to the Financing Agreement.

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 the event of failure to fulfil a condition or achieve a quantitative target of indicator due to forces majeures 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.

Implementation period of 48 months is equal to 4 years: Funds will be disbursed in 2015, 2016, 2017 and 2018.

Country fiscal year	2015				2016				2017				2018				
Tranche Type	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Total
Base tranche		12.5															
Variable tranche						12.5				12.5				12.5			50
Total		12.5				12.5				12.5				12.5			50

4.4. Details on complementary support

4.4.1. Procurement (direct centralised management)

Subject in generic terms, if possible	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
Technical assistance to implement the activities listed in 3.4. (includes communication and visibility).	Services	1	First trimester of 2015
Technical assistance for assessment of performance indicators	Services	1	Third trimester of 2015
Evaluation	Services	1	Third trimester of 2016

4.4.2. Grants: call for proposal /Twinning on Regional Development (direct centralised management)

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

To increase the capacity of governmental and regional authorities to develop and implement effective Regional Development policies

Eligible Actions: Twinning with EU Member states, Grants to public bodies

(b) Eligibility conditions

Potential applicants are public administrations from EU Member States or mandated bodies,

(c) Essential selection and award criteria

The essential selection criteria are financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(d) Maximum rate of co-financing

The maximum possible rate of co-financing for grants under this call is 100% in accordance with Articles 192 of the Financial Regulation if full funding is essential for the action to be carried out. The essentiality of full funding will be justified by the responsible authorising officer in the award decision, in respect of the principles of equal treatment and sound financial management.

(e) Indicative trimester to launch the call

Third trimester 2015

(f) Use of lump sums/flat rates/unit rates

Twinning contracts include a system of unit costs, defined in the Twinning Manual, for the reimbursement of the public sector expertise provided by the selected Member States administrations. This system of unit rates exceeds the amount of EUR 60,000 per beneficiary of a Twinning contract.

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	50,000.00	N.A.
4.4.2. – Call for proposals (Twinning)	1,000.00	N.A.
4.4.3. – Procurement (direct centralised)	3,400.00	N.A.
4.8. – Evaluation	600,000	N.A.
4.9. – Communication and visibility	Included in the Procurement	N.A.
Contingencies	N.A.	N.A.
Totals	55,000.00	N.A.

4.7. Performance monitoring

In general, the concept of performance-based monitoring as a critical component to the implementation of projects, programmes and strategies is broadly understood in Ukraine, although not effectively implemented. With respect to planned SPSP, it is important that at least three levels for monitoring are implemented to ensure effective operation of government programmes, including regional development. With respect to regional development, these levels include:

- Strategic/policy level: At this level, the State Regional Development Strategy and Regional Development Strategies (of regions) should be the subject of monitoring and evaluation. Aggregate information and indicators should be collected and analysed in particular as regards outcomes.
- Implementation/operational level: At this level the implementation instruments for the strategies (thematic programmes, state target programmes, agreements for regional development, etc.) should be the subject of monitoring.
- Working level: At this level the specific measures and projects should be monitored. Progress in the implementation of related activities and actions should be assessed taking into account respective work plans. Specific indicators and interim results (outputs) should be developed to verify progress.

The Ministry of Economic Development and Trade has requested EU support to improve the effectiveness of the current performance monitoring system. The ongoing EU technical assistance project "Support to Ukraine's Regional Development Policy" will support the Ukrainian government to elaborate and implement a more effective system.

Performance monitoring will be exerted by a Joint Monitoring Group to be led by the Ministry of Economic Development and Trade. 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 meeting of the Joint Monitoring Group should take place at least once a year, including in the beginning and at completion of the programme. Additional mid-term meeting at high-level could be convened in case of the need to introduce changes in the policy objectives. The Joint Monitoring Group may include technical subgroups to follow-up specialised issues (e.g. specific industrial sectors, or specific areas of activities, such as the market surveillance, etc). The establishment, composition and schedule of activities of technical sub-groups will be decided by the main Joint Monitoring Group.

4.8. Evaluation

The programme will be subject to regular monitoring by the Joint Monitoring group. A specific mid-term evaluation will be organised to, inter alia, review the validity of the monitoring system.

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

The complementary measures (technical assistance) component may be subject to evaluation/audit following European Commission's standard procedures. Evaluation of the results achieved may be entrusted to independent consultants as well as external audits. Mid-term and final evaluation of the project implementation may be commissioned by the European Commission to assess project performance, achievements and impact.

4.9. Communication and visibility

The programme will follow the orientations of the "Communication and Visibility Manual for EU External Actions" (e.g. press release at the signature of the FA, visibility for reports and studies, etc) available at http://ec.europa.eu/europeaid/work/visibility/index_en.htm.

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 results of technical assistance projects in the areas targeted by the SPSP. The budget foreseen for complementary measures may be used for funding activities aiming at increasing the visibility of the programme.

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

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 coordination[17]).

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

[17] 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 Chornobyl 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.[18]

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

[18] *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 framework[19]

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

[19] 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.[20] 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.

[20] *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*[21] (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.

[21] *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 Programme[22]). 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.

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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.

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[22] *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.

<u>Activity module 1 a</u>: 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.

<u>Activity module 2</u>: 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.

<u>Activity module 3</u>: 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)).

<u>Activity module 4:</u> 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.

<u>Activity module 5</u>: 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.

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

<u>On a crosscutting basis</u>, 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 E5P[23], NIF[24]), but have so far not led to a very significant volume of investment in water and waste water in Ukraine.

Role of the SPSP

[23] Eastern European Energy Efficiency and Environment Partnership
[24] 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 majeures 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.
of which Area 1	*2600*	
of which Area 2	*1400*	
of which Area 3	*2500*	
of which Area 4	*1300*	
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.

ANNEX 3

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

Action Fiche for Second Phase of the Sector Policy Support Programme - Promoting mutual trade by removing technical barriers to trade between Ukraine and the European Union

1. IDENTIFICATION

Title/Number	Second Phase of the Sector Policy Support Programme - Promoting mutual trade by removing technical barriers to trade between Ukraine and the European Union CRIS number: ENPI/2013/024-436		
Total cost	Total amount of EU budget contribution: EUR 55 million, of which: EUR 50 million for budget support EUR 5 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	33110	Sector	Trade Policy and Administrative Management
Complementary support			
Aid method / Method of implementation	Direct centralised management – procurement of services		
DAC-code	33110	Sector	Trade Policy and Administrative Management

2. RATIONALE AND COUNTRY CONTEXT

2.1. Summary of the action and its objectives

The proposed Sector Reform Contract represents a second phase of the currently ongoing, as part of the ENPI Annual Action Programme for Ukraine 2008, programme aiming at the gradual integration of the country's economy into the European Union's Internal Market through the design and implementation of policy measures to remove technical barriers to trade between the EU and Ukraine. In the framework of the ongoing programme, as further explained in more detail in 2.3.1, a comprehensive reform of the technical regulation system has been initiated in Ukraine and has already resulted in the removal of serious conflicts of interests and reduction of opportunities for corruptive practices. Notwithstanding the progress made, Ukraine's path to the modernisation of the legal and institutional frameworks for technical regulation is not over. A follow-up programme will be indispensable to consolidate the situation that has resulted from the above mentioned major reform in the current technical regulation system and of the institutions necessary for its implementation. Furthermore, the approximation agenda as set out in the draft Association Agreement and Deep and Comprehensive Free Trade Area (DCFTA) is far more ambitious than that being currently supported by the ongoing programme. Consequently, Ukraine would need additional resources and assistance to comply with the Association Agreement and DCFTA obligations in the area of technical barriers to trade. Finally, significant economic and trade potential exists in Ukraine in the sectors not listed in the DCFTA agenda on Technical Barriers to Trade and regulated under the EU's "Old Approach". Among them automobiles, agricultural machinery, pharmaceuticals and fertilisers occupy a predominant place. The new SPSP would help Ukraine to enhance the approximation agenda to the "Old Approach" industrial sectors.

This rationale leads to the three-fold specific objective of the proposed sector reform contract:

− To support the national authorities in preparing, concluding and implementing the Association Agreement and DCFTA in the area of Technical Barriers to Trade;

− To extend harmonisation with the EU regulatory framework to the sectors covered by the EU's "Old Approach".

− To improve overall functioning of the technical regulation system and its institutional infrastructure for quality.

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

Presently, the main document serving as the national development strategy is the Economic Reforms Programme 2010-2014 “Prosperous Society, Competitive Economy, Effective State”. It was developed aiming at the economic recovery, establishment of a professional and effective system of public administration, and eventually improvement of the wellbeing of Ukrainian nation. Since the adoption of this Programme, each year ""National Annual Action Plans" are published by President's Decrees, which identify specific planned regulatory and institutional changes, as well as the timeframes and responsible institutions.

The implementation of the National Annual Action Plans by the public authorities is controlled by the Cabinet of Ministers, which in its turn reports to the President's Administration and to the Co-ordination Centre for implementation of Economic Reforms. Furthermore, the Co-ordination Council on Economic reforms, headed by the President, meets on quarterly basis and decides on corrective actions in case the implementation of the annual action plans is found unsatisfactory. The required corrective measures are formalised through the orders by the Presidential Administration to the executive bodies. The Co-ordination Council performs also the annual assessments of the plans' implementation. The public control is executed through the mandatory participation of NGOs and professional associations in the working groups in charge of drafting new legal acts, and through the preliminary publishing of draft legislation for public consultation.

Sector policy and track record of implementation

Since independence in 1991, within the context of improving competitiveness of the economy, Ukraine has established a policy of removal of the technical barriers to trade (TBTs) in line with the general WTO concepts (the WTO TBT agreement) and more specifically the regulatory approximation with the EU through the adoption and implementation of the EU legislation related to the free movement of goods. These principles are embedded within Ukraine’s Economic reforms programme (see 2.1.2) which includes specific policy aims for the reform of technical regulation and the related quality infrastructure.

The current organisation of the system related to TBTs results from successive restructuring measures that continue till today, aiming to remove the conflicts of interest that have been embedded in the old system inherited from the Soviet times. Key milestone events in this effort are outlined below.

In the implementation of the reform plans, in 2010 Ukraine undertook a substantial overhaul of its system of central bodies of executive power, in line with recognised best practice, which resulted in a delineation between those bodies that are responsible for formulating public policy and may issue regulations (ministries) and those that implement various aspects of the approved public policy (services, agencies and inspectorates).

This overhaul also included the reform of the institutional set-up of quality infrastructure. On April 6, 2011 the monopolistic body (State Service for Technical Regulation and Consumer Policy known as DSSU), which encompassed functions of standardisation, conformity assessment, pre-marketing state inspection, and market surveillance, was dissolved. Its functions were transferred to the Ministry for Economic Development and Trade, the State Veterinary and Phytosanitary Service of Ukraine and the newly created State Inspectorate of Ukraine for the Issues of Consumer Rights Protection. This removed a major factor of conflicts of interest, created by the co-existence of incompatible functions within the same organization.

The subsequent enactment of the new Laws on “On State Market Surveillance and Control of Non-Food Products”, "On General Safety of Non-food Products" and "On Liability for Defective Products" eliminated further conflicts of interests between the former DSSU regional branches, which had previously practiced commercial activities (certification) and, at the same time, carried out surveillance of the compliance with mandatory requirements by manufacturers and wholesale suppliers. On June 1, 2011 by Resolution of the Cabinet of Ministers, all market surveillance authorities were appointed, and their areas of responsibilities defined. The surveillance activities according to the new legislation commenced in 2012.

Ukraine has also made progress in adapting its vertical/sectoral technical legislation that define the parameters that products must meet before they can be placed on the market. It has adopted circa 40 Technical Regulations, many of which are based on EU New and Global approach directives. While these are not yet fully compatible with the appropriate EU regulations, work started in 2012 and presently continues to align regulations.

Progress has also been made (although slowed down considerably in 2012-2013) in the revision of national standards and adoption of new ones based on the EU and international standards.

The mandatory pre-market certification of goods, which until recently had been the dominating tool for quality assurance, is being steadily crowded out. The list of products subject for such certification has been reduced considerably (by 65%). The formation of a single national standards body is planned to be accomplished in 2013, removing further conflicts of interest.

Overall, the track record of in implementation of policy/reforms in the area of technical barriers to trade can be assessed as consistent and steady, albeit slower than expected. One of the main reasons for slow pace relates to the difficulties being experienced in the process of concertation of draft legislation with all the concerned Ministries, who raise objections in cases where their powers and budgets might be affected.

The draft Association Agreement, including the Deep and Comprehensive Free Trade Area (DCFTA), initialled by Ukraine in July 2012, while not being, strictly speaking, a national strategy, nevertheless represents a strong evidence of political will and commitment in the area of technical barriers to trade. Once signed, the DCFTA commits Ukraine to a time bound programme of alignment of its technical regulation and quality infrastructure with those of the EU, which requires the completion of institutional reforms, institutional capacity building, and the alignment of horizontal and vertical (sectoral) legislation within the context of the EU legislative framework for the free movement of goods.

To plan further reforms in the concerned sector, the Ministry for Economic Development and Trade, with the involvement of an EU-funded technical assistance project, produced a draft Strategic Plan on the Reform of System for the Technical Regulation of Industrial Products 2013-2017. The document confirms the overall vision of the reforms, provides clear indicators of achievement, timelines for implementation and an inter-departmental allocation of responsibilities. On 18 June 2013, the Minister for Economic Development and Trade, by a letter to the EU Delegation, confirmed that the Ministry would make all possible efforts to have the strategy approved by the Government by the end of 2013.

Besides, a strategy for industry development is under preparation. Although the Concept currently available is not fully mature, key aspects include definition of priority industrial sectors and confirmation of the need for further alignment of the technical regulation system with international standards and practices. The other relevant new policy document is the plan for preparation for and the implementation of the future Association Agreement, including the DCFTA, to be formally adopted by the President's Decree.

Sector Budget

There is neither an overall medium term fiscal framework (MTFF) nor a medium term expenditure framework (MTEF) for the sector. The only data available on the sector financing are administrative allocations to different entities in different fiscal years, which are described below. According to the information provided by the Ministry for Economic Development and Trade, the allocated amounts are not always fully disbursed.

The key actor in the sector is the Ministry for Economic Development and Trade of Ukraine (MEDT), through two of its core Departments on Technical Regulation and Trade Development. Besides, there are other actors, (including the National Accreditation Agency of Ukraine, metrology and conformity assessment institutions) that are state-owned enterprises, operating largely on a self-sustaining basis and often providing unpaid services to the authorities. Several other ministries (e.g. Ministry of Regional Development, Construction and Public Utilities, Ministry of Agricultural Policy and Food) receive budget allocations for the scientific research and development of national standards in their sectors. The wage and non-wage expenditures are not properly balanced. The salaries of staff remain the dominating cost drivers in the budgets related to the technical regulation and market surveillance.

In the fiscal year 2012 the State Budget allocated UAH 318.771 million (EUR 31.2 million) for the maintenance of the MEDT apparatus, of which the two Departments in question are only a minor fraction. Scientific works in the areas of standardisation and conformity assessment, along with other research, professional training and development of scientific infrastructure, also in other areas for which MEDT is responsible, received UAH 42.962 million (EUR 4.21 million) (13.4% of the total budget). For more specific and focused purposes, like maintenance of the national measurement standards, functioning of metrological systems, standards development and alignment of national standards with international and European ones, the State Budget allocated UAH 17.359 million (EUR 1.7 million, or 2.4% of the total budget of the Ministry). UAH 2.194 million (EUR 215,329) was allocated to the state metrological surveillance (still within the competence of MEDT). The State Consumer Protection Inspectorate was allocated UAH 42.525 million (EUR 4.17 million), of which 83,8% was assigned to salaries and other maintenance of the apparatus and only UAH 6.874 million (EUR 674,612) to the exercising supervision.

The relevant allocations foreseen by the Law on State Budget 2013 are as follows: UAH 215,648 million (approximately EUR 20 million) for the maintenance of the MEDT apparatus; scientific works in the areas of standardisation and conformity assessment, along with other research, professional training and development of scientific infrastructure- only UAH 16890 million (EUR 1.56 million, or 0.8% of the total Ministry's budget). For the maintenance of national measurement standards, functioning of metrological systems, standards development and alignment of national standards with international and European ones, the State Budget is going to allocate UAH 4,730.6 million (EUR 0.44 million). The budget for the State Metrological surveillance remains the same UAH 2.194 million (EUR 0.2

million). The Ministries for Agricultural Policy and for the Regional Development and Construction will receive correspondingly UAH 117578.3 million (EUR 10.9 million) and UAH 12123.2 million (EUR 1.1 million) for the scientific and standardization activities in their spheres of competence. The State Consumer Protection Inspectorate is allocated UAH 42060.4 million (EUR 3.95 million), out of which 88% will be spent for the salaries and other maintenance of the apparatus and only 12% on the market surveillance and consumer protection activities.

While there was an increase in the budget allocations in 2012, in 2013 there are apparently cuts in the budget spending in all areas. This should not be considered as a policy-related development, as the reductions concern many areas, not only those of technical regulation. Despite the generally insufficient funding and budgetary cuts, there is still a significant potential for savings, notably in the field of standardisation.

Assessment of institutional capacity

The majority of the principal stakeholders have demonstrated a good commitment to the reforms still to be undertaken, a vision of future steps, and good co-operation with the EU Delegation and EU-funded assistance. However, the institutional capacity varies from one organisation to another (please see 3.6 below). The main stakeholder – the Ministry for Economic Development and Trade – experiences a frequent personnel turnover and still lacks capacity to effectively manage both the internal reforms agenda and the EU assistance. The noted capacity problems have not so far affected the general course of reforms, however resulted in the delays. Furthermore, resistance to reforms is still detected in several entities/units (notably dealing with legal metrology and certification of products), which may lose their current privileged positions. There are also vested interests.

Analytical basis and data quality

The State Statistics Service of Ukraine (SSSU), the main producer of official statistics in Ukraine, now enjoys full independence thanks to the recent Presidential Decree n° 634 dated 19 June 2012. From the recent (June 2012) Adapted Global Assessment conducted jointly by EUROSTAT, UNECE and EFTA, it appears that Ukrainian Statistical System generally complies with international standards, although many recommendations are made for a better respect of confidentiality and improved methods in specific sectors. The current reform plan is being implemented successfully and will be extended for five more years. The reliability of results is already satisfactory and improves continuously, including with the support of the on-going EU-funded Twinning project.

Some specialised statistical data (such as related to the standardisation) are managed by the responsible institutions (e.g. the Ukrainian Scientific, Research and Training Centre for Standardisation, Certification and Quality). For these institutions, further progress is required to collect and process reliable data. The lack of consolidation of the standardization function into a single body, and the differences in data provided from constituent sources represent particular difficulties, which will be taken into account in the definition of performance indicators, through clear specification of the data sources and background figures.

Conclusion on the eligibility

On the basis of analysis of documents, measures and reform process followed by the government in the course of recent 10 years, it can be concluded that sufficiently relevant, consistent and credible policy exists for budget support programme objectives to be largely achieved. The track record of implementation has demonstrated a political will and capacity to initiate substantial regulatory reform for aligning with the EU legislation and practices. The planning and strategic documents for the future period, albeit not yet formally endorsed, demonstrate a clear vision for further regulatory and institutional changes to be accomplished. The most significant evidence is the initialling by the Ukrainian side of the draft DCFTA with the ambitious requirements reflected in the chapter on Technical Barriers to Trade. The policy therefore can be supported by the Commission with the proposed budget support programme, on the condition that a strategy and action plan for the programme's implementation period will be formally endorsed prior to the signature of the Financing Agreement. On 18 June 2013, the Minister for Economic Development and Trade, by a letter to the EU Delegation, confirmed that the Ministry would make all possible efforts to have the strategy approved by the Government by the end of 2013.

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 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 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 first quarter of 2013 economic developments 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 USD 27 billion) 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

The independent review of the ongoing 1st phase SPSP was performed in February-March 2012, and the final version of the report was issued in May 2012. The review covered the policy developments in the technical regulation and quality infrastructure in Ukraine; the fulfilment of performance indicators, and measures for improving the performance of the programme. The review noted existence of high level commitment to the reforms and significant developments in the concerned areas. These conclusions have also been confirmed by the Results Oriented Monitoring (ROM) of the technical assistance component of SPSP in late 2012.

The independent review of 2012 also clearly identified the areas, where progress has been slower than anticipated, possible causes for the insufficient progress, and the actions to be taken. The review also included comments on each of the performance indicators, including the methods of assessment, and clearly brought to light certain deficiencies in formulation, leading to the ambiguities and different ways of interpretation. All those finding are taken into account both in formulation of the scope of for the 2nd phase of SPSP, and in definition of its performance indicators.

2.5. Complementary actions

The EU has continuously, since late 1990s, and through a series of technical assistance and Twinning projects, and a budget support operation, supported the reform of Ukrainian technical regulation system. The presently ongoing complementary actions are the following:

- The 1st phase SPSP "Promoting mutual trade by removing technical barriers to trade between Ukraine and the European Union started on 21 December 2009 and finishes on 21 December 2013, a one year time extension is currently under preparation. It comprises EUR 39 million of untargeted budget support, and EUR 6 million for complementary measures. Its performance indicators refer to the reform of the Ukrainian quality infrastructure, development and adoption of relevant horizontal and sectoral/technical legislation, harmonisation of Ukrainian standards with international and EU ones, establishment of the system of market surveillance and gradual; abolition of practice of pre-market control and certification of products.

- The Twinning operation for the National Accreditation Agency of Ukraine started on 6 October 2011, the duration is 27 months, and the budget is EUR 1.5 million. The project aims at aligning the NAAU's accreditation function with relevant international standards, strengthening its internal procedures and personnel's competence, achieving international recognition of NAAU's activities in several areas, increasing NAAU's visibility.

The activities by other donors in this sector have been few and of much smaller scale than those of the EU. The most recent examples include the SIDA-funded study on market surveillance, and some activities within the IFC project on enabling business climate.

2.6. Risk management framework

The risk assessment framework is included as an annex to this action fiche. The specific risks and assumptions relevant to the sector are highlighted below.

The existing up to date track record of the implementation of reforms in the sphere of technical regulation in Ukraine is the good indication that continuation of efforts in this sphere is potentially sustainable. Nevertheless, the budget support operation is a 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;
- Consolidated efforts on the strategy front towards the development of a new sector strategy, along with an action plan for its implementation;

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

- Short-term economic considerations can possibly divert Ukraine's commitment from deepening relations with the EU and towards another direction of integration. Consequently, the Association Agreement the Deep and Comprehensive Free Trade Area may lose momentum.

  Mitigation: High-level political and policy dialogue; disbursement modalities (no fixed tranche, payment only on the basis of actual achievements).

- Continued pressures from lobbies and vested interests may obstruct the course of reforms.

  Mitigation: High-level political and policy dialogue; disbursement modalities (no fixed tranche, payment only on the basis of actual achievements). This risk will diminish in case the Association Agreement is signed.

- A new unified sector strategy on removing the technical barriers to trade and related action plan become postponed.

  Mitigation: This risk will be rather low in case the commitment to sign DCFTA is maintained. The DCFTA itself, if signed, could serve as a strategic planning document. There will be continued dialogue with and assistance to the Government and other stakeholders in the course of development, review and discussions on the strategy. Before the signature of the Financing Agreement, the sector strategy will be duly re-assessed. Disbursement modalities (no fixed tranche) will prevent payments in case the planning documents foreseen by the performance indicators are not delivered.

- The legislation needed for further reforms continues to be blocked by other Ministries, fearing losing parts of their powers and budgets.

  Mitigation: High-level political and policy dialogue; disbursement modalities (no fixed tranche, payment only on the basis of actual achievements). This risk will diminish in case the Association Agreement is signed. Besides, the EU technical assistance has proved instrumental in helping the Ministry for Economic Development and Trade to solve disputes with other Ministries in the area of technical regulation. Continuity of technical assistance will be of utmost importance to support sustainability of the reform process and effective approximation with the EU.

- The Government fails to achieve the expected improvements in the quality of public financial management.

  Mitigation: Policy dialogue with involvement of all relevant stakeholders, on-going technical assistance. Before the signature of the Financing Agreement , the PFM reform strategy/ action plan will be duly re-assessed.

- One or several of the ministries and agencies involved in the programme might either be reluctant or not have the capacity to cooperate in an expected manner.

  Mitigation: Policy dialogue with involvement of all relevant stakeholders, on-going technical assistance. A strong overall and continuous coordination function of the Ministry of Economic Development will be essential to ensure effectiveness and coherence of the reform process.

- The economic situation in Ukraine deteriorates to a point that it affects the financial and operating capacities of the main Programme's stakeholders.

  Mitigation: Consultations with the Government, follow up of the IMF dialogue with Ukraine. Continued dialogue with and technical assistance to the stakeholders. Before the signature of the Financing Agreement, the macroeconomic stability will be duly re-assessed.

- Insufficient co-ordination among the beneficiaries and stakeholders.

  Mitigation: Policy dialogue with involvement of all relevant stakeholders. The Joint Monitoring Group in the framework of the ongoing SPSP has proved instrumental to increase understanding and co-ordination among different stakeholders.

3. DETAILED DESCRIPTION OF THE BUDGET SUPPORT CONTRACT

3.1. Objectives

The overall objective of the proposed SPSP is to promote sustainable and inclusive growth and to contribute to economic reforms and the gradual integration of Ukraine's economy into the European Union's Internal Market.

The Specific Objective is three-fold:

− To support the national authorities in preparing, concluding and implementing the Association Agreement and DCFTA in the area of technical barriers to trade;

− To extend harmonisation with the EU regulatory framework to the sectors covered by the EU's "Old Approach".

− To improve overall functioning of the technical regulation system and its institutional infrastructure for quality.

3.2. Expected results

The following Results, taken directly from the Government's approved documents, will be supported:

- Rendering all standards voluntary, with the exception of those standards referred to as an evidence base in the mandatory vertical/sectoral legislation – "technical regulations";
- Continuation of adoption of technical regulations on the basis of the EU legislation of the New and the Global Approach, as well as other EU legislation;
- Continuation of excluding the products subject to conformity assessment in accordance with technical regulations and low-risk products (services) from the list the products subject to compulsory certification in Ukraine.
- Elimination of remaining excessive and duplicative pre-market control requirements and further streamlining and optimisation of the institutional and regulatory aspects of the surveillance activities;
- Establishing methodologies for risk assessment for market surveillance activities.
- Ensuring the development of national standardization system in accordance with provisions of the Agreement on technical barriers to trade and the harmonization of EU standardization system;
- Continuation of harmonization of national standards with international and European standards, and elimination of conflicting standards;
- Improvement of national legislation, the legal and regulatory framework in the field of metrology in accordance with the EU standards and rules;
- Development and improvement of primary and secondary standards of units of measurement, national reference standards and reference samples in accordance with international rules;
- Preparation of and signature of Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAA) in priority sectors.

The above listed Government's planned results, the requirements set out in the initialled Association Agreement and DCFTA, and the objectives reflected in the draft Ukrainian strategic plans, lead to the formulation of the following planned Results for this Sector Reform Contract:

- To complete the on-going regulatory approximation, to implement and maintain it in the context of Association Agreement and DCFTA.
- To extend the regulatory approximation to the new sectors of the EU's "Old Approach".
- The regulatory authorities, implementing agencies and quality infrastructure are capable to work adequately and in a coordinated way under the new legislation and rules and to provide good quality services to their clients.
- The business community has received sufficient information to operate under the new technical regulations.
- Increased awareness of and support to the new system of technical regulation among relevant stakeholders.

3.3. Rationale for the amounts allocated for budget support

The total amount allocated to the Priority Area 2: "Facilitation of the entry into force of the EU-Ukraine Association Agreement (including DCFTA) under the National Indicative Programme (NIP) 2011-2013 is EUR 128.05 million of which 39% is to be delivered under the present budget support programme. The allocated amount is based on:

– Financing needs of the partner country in the relevant sector. As explained above, the salaries of staff represent the dominating cost drivers in the budgets related to the technical regulation and market surveillance. Consequently, there is persistent lack of funding for development and scientific activities, which are indispensable to reach the policy objectives in the area of technical barriers to trade, as well as the international relations activities (e.g. development and maintenance of primary reference standards in fundamental metrology; establishment of information systems; upgrade of testing and conformity assessment facilities; information campaigns for market operators; development of risk assessment methodologies for market surveillance; participation in activities of relevant international and European organisations, etc.).

– Track record of past disbursements and their correspondence with the achievement of agreed objectives and performance indicators. For the ongoing programme with a comparable volume of budget support (EUR 39 million), the calculations performed by the Ukrainian Authorities have demonstrated that the addition of budget support to the national sector budget would allow performing the activities necessary to reach the performance indicators. Up to date, for the ongoing programme the achievement of performance indicators slightly surpasses the disbursement rate. For the proposed 2nd phase of the programme, the objectives and expected results are even more ambitious than those planned for the ongoing 1st phase.

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 (or 0.3% of government revenue). Annual disbursements of budget support have varied substantially within this overall ceiling and are expected to reach about 0.05% of GDP in 2013, provided that budget support payments restart. That notwithstanding, the budget support of this sector reform contract would bring the significant value added in achieving the sector policy objectives.

3.4. Main activities

Main activities by the EU in the framework of the programme will include:

- transfer of EUR 50million over the fiscal years 2016-2018;
- continued political and policy dialogue with the Government with a particular focus on removal of technical barriers to trade between EU and Ukraine;
- a continued effort to reinforce Government's capacities in the area of PFM in the context of existing complementary support programmes;
- regular 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 in the context 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.

3.4.1. Budget Support

The proposed budget support programme is being prepared jointly with the Ministry for Economic Development and Trade, which has declared its full support to the planned policy objectives and the scope of results and activities of this sector reform contract. For preparation of the Financing Agreement, the Ministry has established a working group involving all the principal sector stakeholders presented in 3.6 below. The specific conditions described in 4.3 have been discussed and agreed preliminarily between the EU Delegation's and the Ministry's working group. The main issue to be clarified in the course of preparation of the Financing Agreement remains the selection of priority "Old Approach" industrial sectors with the involvement of relevant responsible authorities (e.g. Ministry of Agriculture, Ministry of Health, others).

The substantive activities to be implemented under this sector reform contract were defined basing on the objectives set both in the national policy for the sector, and in the initialled Association Agreement and DCFTA. They will be organised around five priority Components:

Component 1 – Further Regulatory Approximation in the context of Association Agreement and DCFTA.

This Component aims to complete the existing gaps in the legislation, and to bring the legislative and regulatory frameworks in line with the respective frameworks of the EU. It comprises three categories of interventions, for each a set of specific Activities will be planned:

- Horizontal Legislation - Complete the current framework legislation with the adoption of a number of pending Laws and implementing regulations in the areas of Standardisation, Metrology, Conformity Assessment and Consumer Protection, and remove any inconsistencies with other pieces of legislation, that may be created as a result of the adoption
- Harmonisation of vertical (sectoral) legislation - Harmonise Ukrainian Technical Regulations with the respective EU Directives and regulatory instruments (predominantly falling under the "New Approach" category) listed in the DCFTA chapter on technical barriers to trade. This activity will include achieving compatibility between bringing the already adopted or drafted Technical Regulation and into actual conformity with appropriate the EU Directives (including those being revised as part of the EU New Legislative Framework). The programme will also include, and the adoption of those required by DCFTA but not currently incorporated into the Ukrainian legislation (e.g. on building materials, high speed railways, telecommunication equipment, others). Evidence of actual implementation will be required, starting from adoption of an implementation plan for each of the Regulation.
- Development of standards – Adoption of international and EU standards along with the review and replacement of old standards.
- Evaluation of the results of approximation, to facilitate the conclusion of ACAA.

Component 2 – Extension of harmonisation to the new (not included in the DCFTA) sectors of the EU's Old Approach.

The Old Approach sectors include, inter alia, Chemicals, Detergents, Drug Precursors, Fertilisers, Cosmetics, Glass Products, Motor Vehicles, Agricultural and Forestry Tractors, Biocides, Pressure Vessels, Textiles and Footwear. It would be overly ambitious to expect Ukraine to fully adopt and implement all the legislation listed in the EU's "Pink Book" in the course of the proposed SPSP. It would be reasonable to expect selection and of up to five priority sectors. The main Activities will include:

- Selection of Priority Sectors;
- Transposition of the respective EU legislation into Ukrainian legislation;
- Establishment of an implementation plan for each of the respective Technical Regulation, covering as appropriate adoption of harmonised standards, market surveillance capacity, conformity assessment capability (where necessary, unless it is more practical to use the conformity assessment services by another country; Information provision to enterprises);
- Execution of the implementation plans.

Component 3 – Strengthening of the Quality Infrastructure

Actions under this component should address the strengthening of the human resources and working methods for the core elements of quality infrastructure. In certain cases, in particular for the new sectors, implementing infrastructure may need to be reorganised or even established from scratch. In particular this relates to the “Old Approach” Directives, for which the implementation is not, in general, based on the same methodologies of conformity assessment/market surveillance as the New Approach Directives. Activities under this Component will be both horizontal (aiming at improving the quality services in general for all sectors) and vertical (through execution of implementation plans for each of the relevant specific sectoral regulation) and will include:

- Standardisation: (i) abolition of remaining mandatory and outdated standards still in force; (ii) improvement of standardisation procedure and coordination of the activities of Technical Committees; (iii) integration of the National Standards Body in international and European organisations.
- Conformity Assessment: (i) strengthening of institutional and technical capacities of Conformity Assessment Bodies (CABs) including training of how to apply for designation, and training of designated CABs on ways of subcontracting activities to EU CABs; (ii) implementation of Inter-Laboratory Comparisons (ILC) and Proficiency Testing (PT) schemes; (iii) improvement of the working methods of testing, verification and calibration laboratories; (iv) enhance the knowledge of CABs' personnel on accreditation standards;
- Accreditation: Furthering collaboration with the European Co-operation for Accreditation (EA) through the signing of more Multi-Lateral Agreements (MLA) (Bilateral Agreements) with the European Cooperation for Accreditation as well as with the International Laboratory Accreditation Co-operation (ILAC). Moreover, auditors of the National Accreditation Agency of Ukraine (NAAU) should be further trained to acquire sectoral know-how to selected Directives.
- Metrology: Capacity building and technical modernisation of the National Metrology Centres, involving among other upgrade of the national base of measurement and reference standards and samples, development of testing methodologies and evidence base of standards for new Technical Regulations.

- Market Surveillance: (i) Institutional / organisational / technical capacity development for market surveillance authorities; (ii) full development and operation of the national market surveillance information system and of the system for rapid exchange of information on the products posing a serious risk; (iii) establishment of information services for market operators; (iv) establishment of a national market surveillance training force which would lead in the design and implementation of specialised and targeted training.
- Evaluation of the results of institution building, to facilitate the conclusion of ACAA.

Component 4 – Institutional strengthening of the Regulatory Authorities and Implementing Agencies.

The purpose of the component is to complete and strengthen the institution building started under the present programme and to extend it to new sectors.

- Enhance capacity of Ministry for Economic Development and Trade's Departments. This concerns primarily staff of the Departments of Regulatory Policy and Trade Development, in mastering the administrative duties associated with their functions, and especially the procedures and requirements for the appointment of Conformity Assessment Bodies (to become equivalent to the EU "notified bodies").
- Enhance capacities of Line Ministries and other competent Authorities in charge of technical aspects of implementation of New and Old Approach Directives under their competency.

Component 5 – Information campaign for market operators and other stakeholders

The purpose is to ensure that the reforms are embedded across key actors and stakeholders through actions of improving capacity and knowledge, including the market operators, civil society, professional associations, local authorities and general public. The information campaign will include the horizontal one as well as the information activities under each of the vertical/sectoral implementation plans. Under the sectoral implementation plans, detailed guidelines will be developed for market operators on how to work under the new technical regulations and on the requirements of market surveillance system. A regular structured dialogue between the government and the national and international business community on the reform process will be established. The effectiveness of information and awareness activities will be verified by surveys.

It is expected that the results and activities specified above will be implemented by the Government of Ukraine, supported, where needed, by the technical assistance within the complementary measure part of the programme.

3.4.2. Complementary support

The complementary support part will cover the technical co-operation to implement the activities listed in 3.4, independent reviews (regular assessment of general and specific conditions), communication and visibility and evaluation.

Following the Backbone Strategy's principles, the technical co-operation will be demand-driven and will support the partner country's programme rather than have its own separate objectives and scope. Therefore, the results of 3.2 and activities of 3.4 will be joint for the budget support and complementary components of the sector reform contract, and will be realised under the ownership and leadership of the Ukrainian authorities. The degree of technical assistance involvement may vary between activities. It can be expected that such involvement will be particularly intensive in the activities related to assessments of level of approximation of the Ukrainian and EU legislation, needs assessments, regulatory impact assessments, studies related to specific industrial sectors, capacity building and information campaign.

3.5. Donor coordination

The Donor co-ordination is formally ensured by the Government. Although the Government had set up the Government-donor co-ordination structure in 2006 and updated it several times since then, the Government-led donor coordination focuses on general coordination in the form of Government-donor meetings once or twice a year. An informal regular co-ordination exists among the donors in the form of a group of major development partners.

At the same time, the Government has not established the mechanism of regular donor coordination at sector level in a concerted and formalised manner. There has been only an ad-hoc co-ordination effort between the projects.

In 2011-2012, donors were continuously reaching the Ministry of Economic Development and Trade to resume the functioning of thematic sub-groups. At the moment, donors are keeping the dialogue on the way to set up regular and practical sector coordination mechanisms.

In the sector of technical regulation the EU is a lead donor, whilst the activities of others being of far smaller scale and of much more narrow scope. There is a co-ordination between the EU's and other donors' projects. For example, the International Finance Corporation (IFC) project on business enabling environment co-operated well with the EU-funded technical assistance, through joint public awareness events and joint support to relevant legal initiatives.

3.6. Stakeholders

The relevant stakeholders include:

The principal stakeholder is the *Ministry for Economic Development and Trade*, which is responsible for all major technical regulation functions, carried through two of its core Departments, namely the Department of Technical Regulation (responsible for the issues of standardisation, conformity assessment, metrology, legal drafting, technical regulations and international cooperation in the respective areas) and the Department of Trade Development (responsible, among other things, for consumer protection policy and market surveillance coordination and analysis). Both Departments were established following the above mentioned institutional reform of 2011. They both have demonstrated a good commitment to the reforms still to be undertaken, a vision of future steps, good co-operation with the EU Delegation and EU-funded assistance. Both Departments participate in the dialogue with the EU through the Sub-Committees. However, there is a lack of capacity to effectively manage both the internal reforms agenda and the EU budget support, resulting in the delays (e.g., in drafting of legislation, utilization of EU budget support funds, etc.). There are also frequent changes of the top management of Technical Regulation department.

Line Ministries and other authorities responsible for regulation of specific industrial sectors. The exhaustive list of such authorities can be established only after the choice of specific sectors is made. It is likely that the Ministry for Industrial Policy (liquidated in 2011 and recently re-established), the Ministry for Agricultural policy (for fertilizers, agricultural machinery) and the Ministry for Health would be involved.

Quality Infrastructure institutions:

Ukrainian Scientific, Research and Training Centre for Standardisation, Certification and Quality (known as UkrNDNC) – the planned future independent National Standardisation Body. It is currently characterised by certain weaknesses particularly regarding the co-ordination of the work of relevant Technical Committees. The major weakness in the standardization process is evidenced by much exaggerated cost of “harmonising” standards through a complicated, lengthy and costly procedures (rather than "adopting" the EU standards as they are).

With the exception of the National Standardization Body, for which arrangements have yet to be formalized, all the appropriate institutions have been established and appear to be largely mature. Further development is needed in specific areas:

Metrology institutions, including the National Scientific Centre "Institute of Metrology" in Kharkiv; State Enterprise "All-Ukrainian State Research and Industrial Center for Standardisation, Metrology, Certification and Consumers' rights protection (known as “UkrMetrTestStandard” - UMTS); the State Enterprise "Scientific and Research Institute for Metrology, Measurement and Control systems" (known as DPI "Systema") in Lviv; State Enterprise on Standards and Metrology in Ivano-Frankivsk. In the metrology sector, there is a need for transition from a system of verification of measures to the one based on calibration. The system for legal metrology needs to be enhanced.

The National Accreditation Agency of Ukraine (NAAU) has developed to a point where it has successfully passed a peer assessment process with European Co-operation for Accreditation (EA), resulting in bi-lateral agreements in a number of areas of accreditation, and in the status of an associate member. There is likely to be an ongoing need to develop capacities to assess the competency of Conformity Assessment Bodies against EU New Approach Directives, and for accredited calibration.

In the *Conformity Assessment* area, a network of conformity assessment bodies (CABs) has been developed for the majority of the adopted technical regulations. The key issue in this area is the changing geography, characterised by the expected emergence of a private sector in an area dominated by publicly owned enterprises. While the requirements set out in the Ukrainian legislation for designation of CABs have some similarities with the relevant EU reference provisions (Article R17 of decision 765/2008/EC) they are not fully compatible. Alignment of the requirements, as well as enhancement of their CABs' operating systems and practices will be needed.

Market Surveillance Authorities, including State Inspection for Consumer Protection, State Inspection for Marine and River Transport, National Commission for Radio and Telecommunication, State Veterinary and Phyto-sanitary service, State Inspection for supervision of mining industry; State Inspection for Architecture and Construction, State Inspection for Medicines and others. The recent (Autumn 2012) start of market surveillance activities according to the new legislation revealed substantial needs for further organizational and human resources development, as well as for risk assessment methodologies.

Civil Society (consumers' associations, business and professional associations), market operators, general public). Despite the past and ongoing awareness activities, a substantial effort is still required for these stakeholders to understand and accept the reform in the sphere of technical regulation. Nowadays, the support for reforms is very limited. Many market operators are not satisfied with the transition, as they fear increased competition from abroad and regard the technical barriers as an effective tool to protect their businesses. The consumer associations and the general public still believe that the State should guarantee not only the safety of products, but their quality, and regard the mandatory standards as a way to ensure such quality. As these attitudes have not changed, attempts to involve the civil society and business in the dialogue on technical regulation issues have often been counter-productive, and reforms in line with the EU practices were opposed.

Upon signature of the Financing Agreement, through the complementary measures/technical assistance component, a needs assessment for capacity building will be carried out both for the regulatory authorities and the quality infrastructure institutions. The needs assessment for further capacity building will consider both "Vertical" and "Horizontal" capacity, both of which are necessary for the successful implementation of the EU technical regulation. While the "Horizontal" capacity building will focus on the organization of Institutions and improvement of their interactions with clients, ensuring that they are objective, impartial and accountable, "Vertical" capacity building will focus on verifying to what extent the institutions are equipped with the technical skills and knowledge to ensure that products comply with regulations. Such capacity building will relate to specific Directives, and will be cross cutting between institutions.

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

Ultimately, the proposed SPSP will achieve its results and address its goals only if actions foreseen for risks mitigations measures will be carried out as well as 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*: satisfactory progress in the alignment of Ukrainian legal and regulatory framework in the area of technical barriers to trade, and of the related institutional infrastructure with those of the EU.
- *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

Formal adoption of an overall Strategy for Reforming the system of Technical Regulation in Ukraine (presently available in a draft version under the internal consideration by the Ministry for Economic Development and Trade), along with an Action Plan, to be updated annually, represents a pre-condition for all disbursements of variable tranches.

The performance criteria and indicators, to be used for decisions on disbursement of further 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, and sometimes directly taken from, the Government's already adopted and draft documents on the reform of Ukrainian system for technical regulation. They cover the following areas:

- Adoption and implementation of the horizontal (framework) and vertical (sectoral) legislation necessary to achieve the Specific Objectives stated above;

- Development of quality infrastructure institutions in four key directions:
    - standardisation,
    - accreditation,
    - conformity assessment,
    - metrology,
    - development of the market surveillance system.

For each of the listed directions, key measures and indicators of effectiveness are chosen to demonstrate the strengthening of capacities and quality of work.

- Increase in the enterprises' awareness and capability to operate under the new regulatory requirements.

Hence, the specific conditions for disbursement represent seven complex areas of assessment. As the programme targets the regulatory approximation, 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 actions taken (e.g. adoption of a new technical regulation) and output indicators measuring the immediate and concrete consequences of the measures taken (e.g. identification of non-conforming goods at the market).

The legislative area of assessment is particularly complex, given the vast volume of legislative and implementation effort necessary to fulfil the DCFTA requirements and to cover the industrial sectors beyond the DCFTA. As it would be impossible to plan precisely all the regulatory measures needed for all industrial sectors, the main assessment criteria to be applied will be the adoption and execution of an implementation plan for each of the sector. The table of indicators specifies the minimum requirements for such implementation plans.

Some of the areas, notably the standardisation, market surveillance, conformity assessment and awareness raising will be assessed in horizontal and vertical dimensions. For example, the overall pace of adoption of EU and international standards in Ukraine will be an indicator of effectiveness of the national standardisation system, whereas the availability of adopted EU standards as evidence base for conformity assessment for each of the concerned industrial sector will signal the stage of sector's approximation to the EU regulatory framework.

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 the event of failure to fulfil a condition or achieve a quantitative target of indicator due to forces majeures 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	2016				2017				2018				
Type of tranche	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Total
Variable tranche		17				17				16			50
Total		17				17				16			50

4.4. Details on complementary support

4.4.1. Procurement (direct centralised management)

Subject in generic terms, if possible	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
Technical assistance to implement the activities listed in 3.4. Includes communication and visibility.	Services	1	First trimester of 2015
Technical assistance for assessment of performance indicators	Services	1	Third trimester of 2015
Evaluation	Services	2	Third trimester of 2016

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	50,000.00	N.A.
4.4.3. – Procurement (direct centralised)	4,700.00	N.A.
4.8. – Evaluation	300.00	N.A.
4.9. – Communication and visibility	Included in the Procurement	N.A.
Contingencies	N.A.	N.A.
Totals	55,000.00	N.A.

4.7. Performance monitoring

Performance monitoring will be exerted by a Joint Monitoring Group to be led by the Ministry of Economic Development and Trade. 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 meeting of the Joint Monitoring Group should take place at least once a year, including in the beginning and at completion of the programme. Additional mid-term meeting at high-level could be convened in case of the need to introduce changes in the policy objectives. The Joint Monitoring Group may include technical subgroups to follow-up specialised issues (e.g. specific industrial sectors, or specific areas of activities, such as the market surveillance, etc). The establishment, composition and schedule of activities of technical sub-groups will be decided by the main Joint Monitoring Group. The meetings of the Joint Monitoring Group will be documented by minutes. The minutes will be drafted and distributed to the participants for comments in three weeks after each meeting. In the absence of comments in three weeks after the distribution, the minutes will be deemed tacitly approved.

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 may use external support for this purpose.

The Government of Ukraine is expected to submit to the European Commission the annual reports on the achievement of general and specific conditions in the first quarters of the years 2015, 2016, 2017 and 2018. The reports are to be submitted regardless of the degree of achievement of conditions, and of the intention of the Government to request disbursement of budget support. The European Commission may hire independent experts to implement reviews of the programme in the second quarters of the mentioned years. The scope of the reviews will cover the implementation of agreed policy objectives in the area of technical barriers to trade, the status of performance indicators, recommendations on disbursement and suggested measures to improve performance. The review reports will be submitted for comments to the Government of Ukraine. Any feedback communicated by the Government will be either taken into account in the final version of the review report, or (in case of disagreement) commented upon in a separate note.

4.8. Evaluation and audit

Assessment of the results achieved will be reviewed and decided by the European Commission. In carrying out such reviews, the European Commission will, as appropriate, use the technical advice of external consultants to verify technical reports and data transmitted by the Government of Ukraine. Programme reviews and evaluations, whenever necessary, will also be decided by the European Commission and funded from the complementary measures part of the Programme.

The timing of evaluations – 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.

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.

ANNEX 4

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

Action Fiche for the Framework Programme in support of EU-Ukraine Agreements

1. IDENTIFICATION

<table>
<tr><td>Title/Number</td><td colspan="3">Framework programme in support of EU-Ukraine agreements
CRIS number: ENPI/2013/024-446</td></tr>
<tr><td>Total cost</td><td colspan="3">Total estimated cost: EUR 21 million
Total amount of EU budget contribution: EUR 21 million</td></tr>
<tr><td>Aid method / Method of implementation</td><td colspan="3">Project Approach
Direct centralised management:
- grants – call for proposal;
- grants – direct award;
- procurement of services
- supplies

Joint Management with the NATO Support Agency – NSPA</td></tr>
<tr><td>DAC-code</td><td>15110</td><td>Sector</td><td>Public Sector Policy and Administrative Management</td></tr>
</table>

2. RATIONALE AND CONTEXT

2.1. Summary of the action and its objectives

The action aims at supporting the implementation of the key EU-Ukraine agreements, namely, the future EU-Ukraine Association Agreement (AA), including a Deep and Comprehensive Free Trade Area (DCFTA), the EU-Ukraine Association Agenda, the Framework Agreement on the general principles for the participation of Ukraine in Union programmes and the Cooperation Agreement on a Civil Global Navigation Satellite System. This action will also provide support to Ukraine with regard to destruction of stockpiles of PFM-1 anti-personnel mines under the Ottawa Treaty.

The action will therefore focus on the following areas:
- capacity building in the area of state aid control and, where appropriate, in the area of steering and implementation process for the future AA and DCFTA;
- capacity building in priority areas of the EU-Ukraine Association Agenda; a special attention will be paid to governance issues, private sector development, transport and energy;
- support for Ukraine's inclusion in the European Geostationary Navigation Overlay Service (EGNOS) coverage area in line with Cooperation Agreement on a Civil Global Navigation Satellite System (GNSS);

- support for Ukraine's participation in Union programmes in line with the above-mentioned Framework Agreement between the EU and Ukraine;
- support for destruction of Ukrainian stockpiles of PFM-1 anti-personnel landmines.

2.2. Context

2.2.1. Country context

2.2.1.1. Economic and social situation and poverty analysis

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 limited amount of external investments. 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.

2.2.1.2. National development policy

The EU-Ukraine Association Agreement (AA), which will include a Deep and Comprehensive Free Trade Agreement (DCFTA), was initialled in 2012. Its signature is expected after the EU conditions related to justice and elections law reform and progress in key reform areas are met by Ukraine.

The EU-Ukraine Association Agenda that entered into force on 24 November 2009 defines key reforms and cooperation areas with a view to prepare for and facilitate the entry into force of the above-mentioned AA, including a DCFTA.

The Association Agenda specifically foresees cooperation in addressing common security threats, including destruction of anti personnel land mines. Ukraine signed the Anti-Personnel Mine Ban Convention in 1999. Its declared stockpile of PFM-1 anti personnel mines is 6,000,000 units. In 2013, destruction of 300,000 PFM-1 mines has been carried out by the NATO Support Agency – NSPA (NSPA) at the Pavlograd Chemical Plant.

This Action will provide further assistance for destruction of the remaining stockpile of PFM-1 anti personnel mines. Based on the above mentioned successful experience, a joint management with the NSPA is envisaged.

The Comprehensive Institution Building (CIB) programme under the Eastern Partnership aims at improving capacity of the institutions that play a central role in preparing ground for and implementing the future AA and DCFTA. In Ukraine, the CIB programme addresses four reform challenges: a) steering and implementation process for the AA and DCFTA; b) sanitary and phyto-sanitary capacity; c) capacity in state aid control; d) capacity in the field of migration.

In line with the CIB concept, the Government adopted the Institutional Reform Plans (IRP) in the above-mentioned reform areas. This Action is aimed to support selected measures of the IPR in the area of state aid control

In November 2010 a Framework Agreement on the general principles for the participation of Ukraine in Union programmes was agreed between the EU and Ukraine[25]. This action will support Ukraine's participation in selected EU programmes and agencies.

In December 2005, a Cooperation Agreement on a Civil Global Navigation Satellite System (GNSS) between the EU and Ukraine was signed, which is expected to enter into force soon. The agreement aims at extending the EGNOS coverage to Ukraine. This extension would significantly improve Ukrainian access to GNSS applications and would also improve EGNOS coverage in eastern EU territories.

The national development policy is defined by the Economic Reform Programme for 2010-2014[26] (ERP), adopted in June 2010. The ERP covers important policy goals related to sustainable economic development, improving social services, improving the business climate, modernising the infrastructure, improving efficiency of public administration.

The ERP also aims at preparing the ground for implementation of Ukraine's obligations under the future AA and DCFTA, including those sectors covered by the CIB programme.

The National Action Plan for the ERP implementation in 2013 was adopted by the President on 12 March 2013 by decree No. 128. It covers key reform priorities targeted by the ERP, including the CIB areas, namely, steering and implementation process for the AA/DCFTA (sections 113-117 of the NAP) and state aid control and monitoring (section 3 of the NAP).

2.2.2. Sector context: policies and challenges

Specific sector context related to the CIB areas is provided in the sub-sections below.

Steering and implementation process for AA and DCFTA

The National Action Plan for ERP implementation in 2013 includes a number of measures aimed at preparing ground for the AA implementation:

- development and setting up of a national coordination system for AA implementation;
- development and approval of an Implementation programme for the AA and DCFTA.

The IRP in the area of implementation of the future AA was adopted by the Government on 10 October 2012 (decision ref. 767). The Ministry of Foreign Affairs is in charge of the overall coordination of this IRP. The IRP envisages the following three reform areas:

- establishment and a national coordination mechanism for AA implementation;
- development of a draft AA implementation programme, as well as an information and communication strategy;
- improvement of human resources management in the field of European integration, as well as improvement of Ukraine's system of EU assistance management and implementation.

[25] Available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:018:0003:0006:EN:PDF

[26] Unofficial translation into English: http://www.usubc.org/site/files/Ukraine_Program_of_Economic_Reforms_2010-2014.pdf

These above-mentioned measures reflect Ukraine's clear will to improve institutional set-up and policy making framework in the area of European integration.

State aid control

Reform of Ukraine's state aid system is directly linked to the fulfilment of Ukraine's future obligations under the DCFTA. State aid reform will also increase transparency of state aid system, minimize negative impact on competition and increase efficiency of the public finance management.

In line with the National Action Plan for ERP implementation in 2013, the Government has to submit to the Parliament a draft law "On state aid to economic entities" by August 2013. The adoption of this law is a key pre-condition for a comprehensive reform in the area of state aid.

On 4 March 2013, the Government adopted an IRP in the area of state aid control and monitoring. It includes a number of measures aimed at creating a state aid monitoring system, establishing a national state aid inventory and building capacity of concerned institutions.

2.3. Lessons learnt

The past EU assistance to Ukraine was often characterised by limited capacity of the beneficiary institutions in terms of strategic management, instability of senior and middle level civil servant, and strong dependence of the projects' outputs on the approval of new legislation/regulations by the Government or the Parliament. Consequently, political support at a high level is a crucial factor for the successful implementation of assistance projects.

For technically and politically complex actions such as mine destruction experience has shown that specific expertise and capabilities are needed, and that a successful track record is of importance. In this regard, the NATO Logistics Agency NSPA is a preferred organisation to manage the destruction of Ukrainian stockpile of mines, particularly, through joint management.

Concerning some CIB areas experience shows that the lack of coordination, unclear division of tasks and insufficient budget allocations to the sector may affect greatly the progress of reforms.

It will therefore be crucial for the success of this Action to ensure that each assistance project is directly linked to clearly identified reform needs which are translated in an IRP or in other relevant policy documents.

2.4. Complementary actions

This programme will complement actions that will be launched under similar framework programmes funded out of 2011 and 2012 Annual Action Programmes for Ukraine. The involvement of other donors in the areas covers by the CIB programme is still limited to narrow short-term missions.

The Sigma Programme will be engaged in institutional assessment and targeted support related to policy making, administrative legal framework and civil service reform.

2.5. Donor coordination

The existing Government-Donor coordination mechanism will be used for the overall coordination of this programme. This mechanism is led by the Ministry of Economic Development and Trade (for technical assistance) and the National Agency on Civil Service (for Twinning).

In the framework of the CIB programme donor coordination will be ensured through specific steering committees (one per IRP), led by the principal beneficiary institution and involving the European Commission, the EU Member States and other donors.

3. DETAILED DESCRIPTION

3.1. Objectives

Overall objective:

To effectively raise Ukrainian institutions' capacities in the preparation and implementation of the EU-Ukraine Association Agreement, including the DCFTA and visa dialogue/VLAP, as well as in meeting the objectives of the EU-Ukraine Association Agenda, the Framework Agreement on the general principles for the participation of Ukraine in Union programmes and the Cooperation Agreement on a Civil Global Navigation Satellite System (GNSS).

Specific objectives:

- To improve policy making system and institutional framework with a view of preparing the ground for and implementing the future AA, including the DCFTA;
- To support the establishment and implementation of s state aid control system in Ukraine in line with EU standards;
- To enhance capacities of relevant Ukrainian institutions with an aim to allow them to comply effectively with the commitments set forth in the EU-Ukraine Association Agenda;
- To extend the EGNOS coverage area to Ukraine in line with Cooperation Agreement on a Civil Global Navigation Satellite System (GNSS);
- To support participation of Ukrainian administrations in selected EU programmes in line with the relevant framework Agreement between the EU and Ukraine;
- To ensure preparatory, monitoring, evaluation and audit work necessary for timely and efficient launch and implementation of actions in priority sectors in line with EU-Ukraine Association Agenda;
- To support Ukraine's efforts with regard to destruction of stockpiles of PFM-1 anti personnel landmines in line with the Ottawa Treaty and the EU standards in this area.

3.2. Expected results and main activities

The expected results are the following:

- further progress on the EU-Ukraine Association Agenda commitments and overall reform process is achieved by closer EU-Ukraine cooperation;

- improved capacity of the Ukrainian administration for strategic planning and policy making in line with national reform agenda and priorities of the regulatory approximation process with the EU;
- selected institutions have the capacity to implement the undertaken commitments under the EU-Ukraine agreements;
- the state aid system in Ukraine is fully operational and the control over public funds is improved;
- further progress in GNSS cooperation through implementing EGNOS extension in Ukraine;
- selected institutions are able to effectively participate in the Union programmes;
- assistance to Ukraine under ENPI annual programming in the priority sectors is relevant and timely, and project implementation is monitored and evaluated.
- Ukrainian stockpile of PFM-1 anti personnel landmines destroyed in line with the Ottawa treaty and the EU standards in this area.

To meet its objectives and results above, the Action will have the following components:

1. Component I - Support to the implementation of selected measures of Institutional Reform Plans (CIB programme)

Steering and implementation process for the AA and DCFTA

Main activities:
- establishment of an effective institutional and policy-making framework for the AA and DCFTA coordination and implementation;
- capacity building of the institutions involved in the steering and implementation process for AA and DCFTA (strategic management, procedures, human and technical capacity);
- monitoring and evaluation of the AA and DCFTA implementation, including impact assessment, awareness raising and information provision.

State aid control and monitoring

Main activities:
- improvement of the legal and institutional framework;
- review of the policy making system, including budgetary, industrial and competition components in line with the requirements of the state aid control legislation;
- establishment of the state aid inventory, including an IT system;
- development of methodological and technical support to state aid system;
- capacity building of state officials in the institutions concerned;
- creation of mechanisms for ensuring accountability, transparency and stakeholder involvement in state aid monitoring and control.

2. Component II - Support to implementation of the EU-Ukraine Association Agenda, including Cooperation Agreement on a Civil Global Navigation Satellite System concerning EGNOS extension and destruction of PFM-1 anti personnel land mines

Main activities:
- *building capacity of the Ukrainian administration in implementing EU standards, and in adapting Ukrainian legal and institutional framework to the requirements stemming from bilateral agreements;*
- *providing systemic approach towards legal approximation to achieve in due time the critical mass of approximated legislation required by the bilateral agreements;*

- *carrying out measures necessary for implementing EGNOS extension in Ukraine in line with Cooperation Agreement on a Civil Global Navigation Satellite System (GNSS);*
- carrying out measures related to implementation, monitoring and evaluation of actions in the areas and sectors recognised as priorities with the Ukrainian authorities.
- carrying out measures necessary for ensuring destruction Ukrainian stockpiles of PFM-1 anti personnel landmines.

3. Component III - Support to implementation of the Framework Agreement on the general principles for the participation of Ukraine in Union programmes

Main activities:
- capacity building of Ukrainian administration with a view to facilitate their participation in Union programmes, including awareness raising about the EU agencies and programmes concerned and, if necessary, bringing the relevant Ukrainian legislation and approaches in line with the best European practices;
- provision of financial support for Ukraine in terms of its contribution for Union programmes.

3.3. Risks and assumptions

Ukraine's political commitment to the AA/DCFTA progress will strongly depend on Ukraine's capacity to address the EU pre-conditions for the signature of the agreement, adopted in December 2012. Moreover, the AA implementation may not be adequately followed-up without an appropriate coordination mechanism and detailed sectoral strategies and policies.

Therefore, the main risks are linked to the policy follow-up, the political fragility and the instability of administrative structures potentially benefiting from assistance under this Framework Programme. Political support from the Government will be needed for approval of the IRP in the area of state aid. The biggest risk at the moment, the IRP on state aid will not be approved, which would imply a cancellation of this component.

Lack of improvement of the general economic situation in Ukraine could lead to shortage of public funds to implement the foreseen reforms, and to co-finance the CIB programme.

These risks will be mitigated through continuous monitoring of the relevant sectors as well as through regular policy dialogue with Ukrainian stakeholders and involved implementing agencies.

This programme shall be based on the following assumptions: a) Ukraine pursues its objective of improved relations and economic integration with the EU, maintains its trend of increased co-financing of EU-funded assistance projects, and pursue its efforts to improve its public administration based on European principles; b) the Government enhances its donor coordination effort and supports improvement of decision-making processes in line with European principles; c) twinning and technical assistance projects are designed taking into account its prioritisation and further proper sequencing.

3.4. Cross-cutting issues

Good governance, human rights and the rule of law are essential elements of the future Association Agreement between the EU and Ukraine and will therefore constitute an additional horizontal priority for the CIB programme in Ukraine. The following two main outcomes are expected in this regard: increased knowledge of EU standards and practices will raise democratic standards, involvement of civil society organisations will be a guarantee for an efficient and stable surveillance of the reform progress in main area covered by this Framework Programme.

Integrity of public administration: actions envisaged under this Programme shall include measures aimed at improving transparency of the administration and at eliminating or minimising opportunities for corruption and the misuse of public funds

Other issues: in implementation of this Action attention will be paid to ensure equal opportunities, sustainable environment as appropriate.

3.5. Stakeholders

The key stakeholders will be the concerned ministries and implementing agencies, relevant civil society groups and also, though indirectly, the donor community. This Framework Programme will primarily impact on the policy-setting and implementing agencies, particularly, in the areas covered by the future AA and the DCFTA, including those involved in the CIB programme.

On the Ukrainian side, this programme will be coordinated by the Ministry of Economic Development and Trade acting as National Coordinating Unit for the EU assistance, as well by the National Agency on Civil Service acting as the Coordinator for Twinning/TAIEX/Sigma programme and the CIB coordinator.

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 3.2. and 4.3. will be carried out, is 60 months, subject to modifications to be agreed by the responsible authorising officer in the relevant agreements.

4.3. Implementation components and modules

4.3.1. Grants: call for proposal under the Twinning programme (direct centralised management)

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

Grants will be provided in the framework of the Twinning programme with a view to support the implementation of the EU-Ukraine Association Agenda (component II of the Action).

(b) Eligibility conditions

Essential eligibility criteria for applicants will be established in line with the Twinning manual applicable at the date of the call for proposal.

(c) Essential selection and award criteria

The essential selection criteria are financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(d) Maximum rate of co-financing

In line with the Twinning manual the maximum possible rate of co-financing for grants under this call is 100 % of the eligible costs of the action.

(e) Indicative trimester to launch the call

The calls for proposals for twinning projects are launched in line with the quarterly programming.

(f) Use of lump sums/flat rates/unit rates

Twinning contracts include a system of unit costs, defined in the Twinning Manual, for the reimbursement of the public sector expertise provided by the selected Member States administrations. This system of unit rates exceeds the amount of EUR 60,000 per beneficiary of a Twinning contract.

4.3.2. Grant: direct award (direct centralised management)

(a) Objectives of the grant, fields of intervention, priorities of the year and expected results

This type of grants will be provided with a view to support participation of Ukrainian administration in selected Union programmes (Component III of the Action)

(b) Justification of a direct grant

Under the responsibility of the authorising officer by delegation, the grant may be awarded without a call for proposals to Ukrainian public bodies participating in Union programmes in line with the Framework Agreement on the general principles for the participation of Ukraine in Union programmes.

In particular, the financial support to the contribution of Ukraine for participating in Union programmes and agencies will take the form of a reimbursement of up to 50% of the corresponding accession fee(s). The reimbursement will take the form of an ad hoc grant contract to be signed with the institution that will pay the fees and will be made after receiving evidence of the payment of the total fee.

(c) Eligibility conditions

Grant through direct award may be received by the Ukrainian state bodies participating in the Union programmes on the basis of evidence of the payment of the relevant accession fee(s).

(d) Essential selection and award criteria

The essential selection criteria are financial and operational capacity of the applicant, including provision of evidence of the payment of the total fee(s) for participation in Union programmes.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(e) Maximum rate of co-financing

The maximum possible rate of co-financing for this grant is 50 % of the eligible costs of the action (accession fee(s) for the relevant Union programme.

(f) Indicative trimester to contact the potential direct grant beneficiary

Third trimester of 2015

(g) Exception to the non-retroactivity of costs

n/a

4.3.3. Procurement (direct centralised management)

Subject in generic terms, if possible	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
Component I Support to the implementation of selected measures of Institutional Reform Plans (CIB programme)	Services Supplies	2 2	First quarter of 2015
Component II Support to implementation of the EU-Ukraine Association Agenda, including Cooperation Agreement on a Civil Global Navigation Satellite	Services Supplies	5 3	Second and third quarter of 2015

System concerning EGNOS extension and destruction of PFM-1 anti personnel land mines			

4.3.4. Joint management with the NATO Support Agency – NSPA

Measures related to destruction Ukrainian stockpiles of PFM-1 anti personnel landmines under the Component II of this Action will be implemented in joint management with the NATO Support Agency – NSPA.

This implementation is justified because of technical character of this process and successful experience of the NSPA in destruction of mines and other conventional weapons. Joint management with this international organisation in accordance with Article 53d of Financial Regulation 1605/2002 is possible because the project is elaborated jointly between the NSPA and the Commission. Furthermore, following the four-pillar assessment of the NSPA, which was undertaken between December 2012 and April 2013, the NSPA is able to comply with the requirements detailed in 53d of the Financial Regulation No 1605/2002.

The NSPA will manage the process of destruction of Ukrainian stockpiles of PFM-1 anti personnel landmines in cooperation with relevant Ukrainian stakeholders. The project is expected to destroy 3,000,000 landmines. The maximum amount of EU contribution is estimated at €1.8 million. This project is co-financed by the German Government.

4.4. Scope of geographical eligibility for procurement in direct centralised and decentralised management

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 ENPI 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.

4.5. Indicative budget

Component	**Amount in EUR thousands**	**Third party contribution**
Component I Support to the implementation of selected measures of Institutional Reform Plans (CIB programme) composed of		
- Call for proposals under the Twinning programme (direct centralised)	3 000	0
- Procurement (direct centralised)	6 200	0
Total Component I	**9 200**	

Component II		0

Support to implementation of the EU-Ukraine Association Agenda, including Cooperation Agreement on a Civil Global Navigation Satellite System concerning EGNOS extension and destruction of PFM-1 anti personnel land mines		
- Call for proposals under the Twinning programme (direct centralised)	4 500	0
- Procurement (direct centralised)	5 000	0
- Joint Management with the NAPA Support Agency – NSPA	1 800	300[27]
Total Component II	**11 300**	
Component III Support to implementation of the Framework Agreement on the general principles for the participation of Ukraine in Union programmes		0
- Grant: direct award (direct centralised management)	500	0
Total Component III	**500**	
Totals	**21 000**	

Under the Component I (CIB programme), in case supply of EU norms driven equipment is agreed, Ukraine is expected to co-finance (in kind) and/or cover 20% of total cost of such equipment.

4.6. Performance monitoring

The monitoring of this Action will follow standard procedures, based on benchmarks to be agreed during the preparation of each of the sub-projects to be defined under the Programme, in co-operation with the Ukrainian government and other stakeholders and, in the case of twinning, based on the mandatory results agreed during the project preparation phase.

The sub-projects under this Action will be monitored throughout their implementation by Results-Oriented Monitoring System of Projects and Programmes of External Co-operation. For overall monitoring of the CIB programme, it is envisaged to set up Steering Committees at the level of each IRP, to involve all national stakeholders and donors, as well as all relevant project representatives and civil society. For Twinning and TA contracts, separate Steering Committees will be set up.

4.7. Evaluation and audit

Each of the actions to be defined under this Action will undergo expenditure verifications, as foreseen by the standard procedures, which foresee that such audit be properly budgeted under each of such actions. Audits of specific actions will be carried out based on risk assessment.

A mid-term and final evaluation of the CIB programme implementation is envisaged.

[27] The project related to destruction of PFM-1 anti personnel landmines is co-financed by Germany

4.8. Communication and visibility

Proper communication and visibility of the measure will be achieved via widespread dissemination of project achievements and results, as well as international visibility of twinning and technical assistance projects, for which a specific budget will be allocated (section 4.3).

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