

**ANNEX 2: ACTION FICHE (SUPPORT FOR THE IMPLEMENTATION OF THE ENVIRONMENTAL STRATEGY IN UKRAINE)**

**Action Fiche Ukraine**

**THIS TEXT EXISTS ONLY IN ENGLISH**

**1. Identification**

Title/Number	Support for the implementation of the Environmental Strategy in Ukraine (CRIS: ENPI/2009/20399)		
Total cost	<i>EC contribution: EUR 35 million</i> <i>Other contribution: SIDA EUR 10 million (parallel co-financing)</i>		
Aid method / Method of implementation	Sector Policy Support Programme: - Sector budget support (centralised management): EUR 35 million		
DAC-code	41010	Sector	Environmental policy and administrative management

**2. Rationale and country context**

**2.1 Country context and rationale for SPSP**

***2.1.1. Economic and social situation and poverty analysis***

Ukraine is a lower middle-income country with a gross national income per capita of USD 2,550 in 2007 (GNI per capita, Atlas method), which after a period of deep economic recession (1992-1999) has been growing at an average rate of 7.5% per year. During that same period, thanks to efforts on social spending rather than to the direct effect of economic growth, poverty in the country has dramatically shrunk from more than 30% of the total population (estimated at 52 million in 1999) to about 5% of the total population (now estimated at 47 million). Ukraine has been excluded from the list of aid-recipient countries by a number of donors since 2000.

During the past seven years Ukraine's economy has grown very rapidly, with real GDP annual growth averaging 7%. Production-side factors such as utilization of large excess capacities and favourable conditions in the external markets were coupled with solid domestic demand growth (averaging 15% in annual terms over the period), stimulated by generous governmental incomes policies and credit boom driven by strong capital inflows.

By the middle of 2008, the economy was overheating. Credit growth exceeded 70%, inflation surged to 30%, wage growth settled in the 30–40% range, imports surged at an annual rate of 50–60%, driving the current account deficit to as high as 7% of GDP by Q2 2008. However, economic growth started to slow down in the third quarter of 2008 as Ukraine was subjected to a sharp reversal of external capital flows in the context of the deepening global financial crisis and worsening conditions in Ukraine's main exports

markets. At present, the credit crunch has already suppressed domestic demand while external demand remains weak for Ukraine's main exports of steel and chemicals. The very good harvest could not overshadow the rapid contracting of the manufacturing sector. The IMF now projects a deepening recession in 2009. In this context, the IMF approved on 5 November 2008 a two-year stand-by arrangement for USD 16.5 billion to help Ukraine restore financial and economic stability. USD 4.5 billion was disbursed immediately to replenish the international reserves of the National Bank of Ukraine (NBU) which had intervened in the foreign exchange markets to limit the depreciation pressures on the Ukrainian currency (*hryvnia*).

Though Ukraine has extensive human capital, natural resources and industrial potential it still faces significant medium-term barriers for sustainable growth. The main challenges are: (i) improvement of competitiveness and the investment climate, (ii) modernisation of public infrastructure, (iii) strengthening of economic and public governance, and (iv) improvement of the quality of public services.

### ***2.1.2. National development policy***

Ukraine's national strategy is the programme of the current Government, "The Ukrainian Breakthrough". This programme was approved shortly after the Government was appointed on 18 December 2007.

The Government programme embraces a very large number of economic and social priorities, with emphasis on the latter (pensions, healthcare, emergency responses, compensation for the devaluation of roubles deposited with the Savings Bank of the USSR). The environment has been singled out in the Government programme as a sector of importance for the first time since the inception of Ukraine's independence. The Cabinet of Minister has adopted in September 2007 the Concept of the National Environmental Strategy 2007-2020 and requested the Ministry of Environmental Protection (MEP) to identify priorities and develop accordingly the national environmental strategy, thus ensuring clear ownership of policies and future activities in this sector.

## **2.2. Sector context: policies and challenges**

### ***i. Environment sector context***

The environmental challenges in Ukraine remain significant and present one of the most complex areas for the country in order to preserve its achievements and safeguard against the risk of further environmental degradation under the pressures of rapid economic growth and social transition. Despite a considerable progress achieved in addressing the heavy environmental legacy of the past, Ukraine's environment still remains in a critical state. There is an urgent need for integration of environmental considerations and improvement of energy efficiency in industrial, energy and agricultural sectors as well as to raise environmental awareness among consumers. The key environmental issues in Ukraine mostly relate to the air quality, water quality, waste management, nature protection and radiation contamination in the north-eastern part of the country.

Ukraine is a party to 20 major environmental conventions including the Millennium Development Goals (MDG) stated by the World Summit on Sustainable Development in Johannesburg (2002). The country shares terrestrial or maritime borders with 10 other countries therefore treats trans-boundary cooperation as a key priority. Ukraine has made pledges following the adoption of the MDGs (access to clean water, etc.), but still failed in its compliance with and enforcement of international agreements mainly due to the lack of financial means clearly dedicated to implementing their provisions.

Based on the Concept of the National Environmental Strategy 2007-2020, a National Environmental Strategy and an Action Plan for its implementation are currently being drafted by the Ministry of Environmental Protection. At this stage, both draft documents are being finalised with the support of the Joint European Commission-SIDA-Ukraine Working group and of experts from the Ukrainian-European Policy and Legal Advice Centre (UEPLAC) support project. Substantial inputs have been provided by the

Commission services in commenting on the draft Strategy. The Strategy is to be finalised and approved by the Parliament by summer 2009.

In 2007, the Government had formulated its main priority areas in the field of environmental protection as being:

- Development of the legislative base for implementation of the UNFCCC requirements and the Kyoto Protocol mechanism.
- Improvement of the environmental situation of the Black and Azov Seas and prevention of their pollution.
- Preservation of biodiversity and landscape.
- Waste management improvement based on the international standards and norms.
- Improved management of nature reserves and protected territories.

It is envisaged that these priorities will be incorporated in the new environmental strategy and action plan documents.

Overall, the Government has made significant progress over the past years in developing a coherent policy on the environment and in its efforts to mainstream environmental issues. The country has also shown strong commitment to respect its international agreements in this sector and to advance on the agreed actions in the EU-Ukraine- ENP Action Plan.

#### ii. Sector budget and its medium term financial perspectives

The sector budget financial control procedures are in compliance with international requirements, but remain based on an annual budget process, planning and approval of which remains a complex political processes.

#### iii. Coordination process with the beneficiary country and other donor

The coordination structures with the Ukrainian Ministry of Environment as well as SIDA have been recently put in place. For donor activities and coordination process description see section 2.5 and 2.6. The coordination of activities under various working groups (for example European Commission-Ukraine Climate Change working group) has been effective.

#### iv. Institutional capacity

The Ministry of Environmental Protection has the leading role in development and coordination of the environmental policies implementation in Ukraine. There are also other institutions involved in environmental protection, among them the Parliamentary Committee on Environmental Policy, Use of Natural Resources and Mitigation of the Consequences of the Chernobyl Accident, Ministries of Economy and Finance, some sectoral ministries and state committees.

The MEP performs its duties directly and through authorised executive bodies. The Ministry has a stable number of staff (approx. 250 people). It supervises the activities of state inspectorates, oversees the work of the state services, research institutes and state enterprises. In addition, it works with the regional departments for environmental protection which are formally subordinated to the Ministry; but also have to coordinate their activities with the regional administrations. The structure and responsibilities within the institutional framework of the MEP have been undergoing continuous changes over the last decade, which have undermined the administrative and technical capacity and hindered the development of sound policies and attraction of investments in the environmental sector.

#### v. Overall framework for performance monitoring

There is not much evidence of availability of performance monitoring in Ukraine's environment sector. However, the United Nations Country Team (UNCT) in close cooperation with the Government of Ukraine

has prepared the United Nations Development Assistance Framework (UNDAF) 2006 to 2010, under which a unified system of monitoring and evaluation is being realised. It encompasses: (a) establishment of mechanism guided by human rights standards and principles and key environment priorities thereby enabling stakeholders to assess the strengths and weaknesses of their programmes and projects; (b) provision of informed decision making in terms of operations management, policies, institutions strengthening and the capacity building of counterparts responsible for national monitoring and evaluation.

#### *vi. Macroeconomic framework*

The information is provided under point 2.1.1.

#### *vii. Public Financial Management*

Public financial management is generally assessed as acceptable (World Bank PEFA Report, 2006). In October 2007 the Ukrainian Government has approved the Strategy for the Modernization of Public Finance Management System and a revised version of the Concept of Development of Public Internal Financial Control for the period up to 2015 (including the relevant Action Plan).

Control is carried out at all levels of the budgetary process and clearly stated in Article 26 of the Budget. It ensures: (a) continuous evaluation of adequacy and consistency of a budget-funded entity with the requirements of internal financial control; (b) evaluation of consistency of results with the chosen tasks and plans; (c) information to the senior management of the budget-funded entity on the results of each check-up (evaluation, investigation, study or audit) conducted by the internal financial control units.

It is envisaged in particular that public internal financial control will be improved, in line with the recommendations of the on-going EC twinning project with the Control and Audit Department (KRU) at the Ministry of Finance. A Central Harmonisation Unit for internal audit was established in KRU and a decision was made to transform KRU into a public audit body already in 2008.

In the course of 2008 a significant step forward was made by the Ukrainian authorities in improving the situation in the public procurement (PP) area. On 21 March 2008 the Law was adopted abolishing the PP legislation in force since 2006 which was not in line with EU practices and which undermined fair competition in the PP area. Immediately after, the Cabinet of Ministers of Ukraine approved the Interim provisions governing PP actions in Ukraine until the adoption of the new law. The new PP Law (prepared by the Ministry of Economy of Ukraine) passed the first reading in the Parliament on 20 May 2008. While drafting the Law, a series of consultations with the IFIs were held and the EU experts working in UEPLAC project have been invited to join the group and provide their comments<sup>2</sup>. Due to the situation of political instability affecting Parliament, the draft law is currently still pending.

### **2.3. Eligibility for budget support**

The Cabinet of Minister's adoption in 2007 of the "Concept of the National Environmental Strategy 2007-2020" provides an adequate policy framework for the sector. The National Environmental Strategy and Action Plan currently being drafted will provide a more detailed assessment framework for the sector budget support and basis for the dialog with the Government on environmental priorities. Although adoption of the National Environmental Strategy by the Parliament of Ukraine (Verhovna Rada) is legally required, the prior approval of the document by the Government (possibly through a Cabinet of Ministers' resolution) is deemed sufficient for starting the implementation of this Programme, particularly to take into account the fragile political situation and the planned elections in 2009/10. The macroeconomic stability

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<sup>2</sup> The draft PP law is still pending approval. While the World Bank considers its revised content in line with their requirements, SIGMA experts funded by the Commission consider that the draft law is not in line with European standards. In the frame of the SIGMA programme, Ukraine has retained PP as one of the priorities to tackle. A revision of the draft law by the SIGMA experts was proposed and in principle accepted by the Ukrainian authorities. The proposal was reiterated at the Cooperation Council held in November 2008.

criterion is met in general, but due to recent negative trend in country's economic growth, the macroeconomic situation needs to be carefully monitored. The economic program that has now been approved in line with IMF recommendations should provide an appropriate framework to improve the macroeconomic situation through prudent fiscal and monetary policies.

The PFM eligibility criterion is met and a PFM Reform strategy is in place (see § 2.2).

#### **2.4. Lessons learnt**

Ukraine has benefited from numerous environmental projects under the Tacis programme. These projects have mainly focused on sub-sectoral policies, such as the management of water basins or the development of waste management policies at the regional level. No overall lesson can be validly derived from this fragmentary experience, but it has helped identify the main challenges for the sector. Further, a sector evaluation commissioned in preparation of this action has reviewed previous lessons learned.

A recurrent lesson is the difficulty for the central administration to translate decisions into concrete actions at the local level, due to the lack of institutional reform. The need for institutional reform has been therefore identified as a priority objective for the programme and preparatory studies will be launched to support capacity-building during the action.

Under ENPI, the first budget support programme in the field of energy is now on-going in Ukraine. This support amounts to €87 million (including up to €82 million of budgetary support) and is used to support the implementation of Ukraine's energy strategy. The disbursement of the first fixed tranche has been approved in December 2008 and hence it is too early to draw comprehensive lessons from the experience so far. It has taken time for policy makers in the Ministry of Economy, Ministry of Finance and the relevant sector ministries to understand and appreciate this new implementing modality. However, interest in budget support has grown gradually throughout 2008 as the modality has become better known among key stakeholders and there is now firm commitment to it, not least in view of the more constrained budget situation. Nonetheless, low administrative capacity among implementing ministries and agencies remains a key concern and more attention must be given to improve monitoring and evaluation of sector policies and to strengthen related statistics. Emphasis should also be placed on improving the overall budget system and medium-term expenditure frameworks, both at central level as well as with line ministries.

At the same time, with an increasing number of Sector Budget Support operations in place by 2010, it will be critical that there is a tight follow up of commitments and conditionalities among the various programmes by the Cabinet of Ministers, including synergies to be achieved with related conditionalities among IFI programme in order to improve coordination and performance on key reforms.

#### **2.5. Complementary actions**

During the preparation of the SBS measure, complementary activities provided by the Commission services (including the European Commission Delegation), SIDA and the UEPLAC project have focused on the following:

- Support to the Ministry in the finalisation of the National Environmental Strategy towards 2020;
- Support to the Ministry in the preparation of the National Environmental Action Plan for 2009-2013

The country strategy signed between Sweden and Ukraine for development cooperation 2009 – 2013 identifies environment as one of two priorities. For this area, SIDA will allocate resources equivalent of approximately EUR 10 million in particular for capacity building and institutional strengthening of the MEP and related government agencies. In addition to capacity building linked to the National Environment Strategy, expertise will be provided to Ukraine related to legal approximation in the waste management, including hazardous waste, chemicals, radiation safety, climate change and energy savings. This support will be complemented through co-financing of investments through its support with IFIs. Further, SIDA will continue its cooperation with Ukraine on PFM management issues.

Besides SIDA, the World Bank is engaged in the PFM Reform plan. It has been recognised that pilot PFM reforms should also be conducted in pilot ministries, such as the MEP.

Other complementary actions will be provided to Ukraine under on-going and planned Tacis/ENPI East Regional Programme projects to support: Kyoto Protocol Implementation; Water and Waste Governance strategies; and improvement for the Management of Environmental Data. A Twinning Project is being planned to support the MEP in the implementation of the Law on Ecological Audit as well as a TA project to support the implementation of key international conventions in the environment field.

## **2.6. Donor coordination**

The program has been designed in accordance with the assessment and review of the principles of effective aid delivery, currently being undertaken by EuropeAid (i.e. the Backbone Strategy).

Programming of the measure was jointly carried out between SIDA and the EC during 2008 and several joint missions were carried out during identifications of the programme. As a result, a Joint Working Group European Commission – SIDA – Ukraine has been set-up to support the preparation of the Sector Budget Support. The Joint Working Group also supports Ukraine in the finalisation of the draft National Environmental Strategy and Action Plan.

Besides SIDA/SE and the European Commission, there are a good number of donors involved in the environment sector in Ukraine, including the World Bank, EBRD, UNDP, the USA and Canada, and several other EU member states (in this sector, mainly Germany, the United Kingdom, Denmark, Poland and the Slovak Republic). The EIB has also earmarked the environment as one of the three priority sectors for its activities in Ukraine.

Ukraine has established a Donor Government Working Group (DGWG) for each sector, including the environmental sector as well, with a view to implement its coordination commitment under the Paris Declaration, which it signed in April 2006. The aim is to maintain close links between Ukraine and donors in order to coordinate the involvement of international technical assistance with more alignment towards the Paris Declaration principles and the country's priorities for social and economic development.

Specific sector consultations have been carried out in the Thematic Working Sub Group D1 'Environment Protection', led by the MEP.

## **3. Description**

### **3.1. Objectives**

The objectives of the government strategy are to preserve natural systems, support their integrity and life-supporting functions for sustainable development of the society, higher quality of life and better health of the population and better demographic situation, and to ensure environmental security of the country.

The general objective of this measure is to support the implementation of Ukraine's sustainable environmental strategy, in line with EC norms and agreed priorities under the EU-Ukraine ENP Action Plan. The specific objective of this budget support operation is to help the Government of Ukraine improving environmental policy performance.

### **3.2. Expected results and main activities**

Results anticipated from the Government environmental sector programme being encouraged by the measure comprise:

- National environment legislation approximation to EC standards and the regional environmental policy improved.

- Implementation of the multilateral environmental agreements improved;
- Level of public environmental awareness significantly increased;
- Environment standards raised to meet human health safety standards;
- Losses of bio- and landscape diversity are limited;
- Application of sustainable use of natural resources mainstreamed;

The proposed actions will be specifically targeted:

- Increased Government ownership of the environment sector reform process and development of sustainable environment sector policy and strategy;
- Increased coherence between environment, energy, transport and other related sectors, including improvements in energy efficiency as well as mitigation of and adaptation to climate change
- Greater harmonisation and alignment of procedures and policies in environmental sector in Ukraine with EU norms and practices.
- Improved institutional/administrative capacity, accountability and transparency in the environment sector;
- Contribution to achieving the Millennium Development Goals (MDGs) on ensuring environment sustainability;
- Improved budgeting and financial management in the environment sector; including water ;
- Improved dialogue between the Government and all relevant civil society stake-holders and international partners.

### **3.3. Risks and assumptions**

In addition to the general political risk in Ukraine relating to the (in-)stability of government and/or of major changes in the overall orientation of government policies, a number of specific risks and assumptions with regard to the sector programme have been identified as follows:

Risks

- In the light of the current financial crisis, the Government might not demonstrate sufficient commitment to the implementation of stability oriented macroeconomic policies and/or no progress is made in the implementation of reforms in the field of public finance management, particularly with regard to public procurement. Mitigation of this risk can be ensured through ongoing technical assistance activities in these areas and by adequate donor coordination, in particular with the IFIs, on these issues and in the context of the IMF stand-by facility in particular.
- One or several of the ministries, agencies or companies involved in the project will be reluctant or not have the capacity to cooperate in an orderly manner in the context of this programme. This risk can be mitigated through the use of dialogue mechanisms and the provision of adequate technical assistance.
- The Ministry of Environmental Protection of Ukraine will follow the process-driven rather than results-driven approach in the implementation of its policies. The lack of qualitative and quantitative data available reduces the measurability and effectiveness of the environmental policies.

Assumptions

- The Government will adopt a National Environmental Strategy, send it to Parliament for approval and draft a related Action Plan before the start of the SBS operation, in line with the Concept of the National Environmental Strategy 2007-2020 already adopted for the sector.
- Ukraine will keep to its commitments under the Environmental chapters of the EU-Ukraine ENP Action Plan and will continue demonstrating strong interest in implementing related measures. Ukraine and EC will negotiate and conclude the New Practical Instrument which will further confirm the mutual commitments and policy objectives for the Environment sector for the coming years.

### **3.4. Stakeholders**

The main national institutions involved in the implementation of the environment component of the programme are the Ministry of Environmental Protection, the National Environmental Investment Agency, the State Committee for Water Management, the State Forestry Committee and the State Committee on Land Resources.

The Ministry of Finance will provide information on progress in the implementation of the PFM reform plan.

The Ministry of Economy, coordinator of the European Commission in Ukraine will be closely associated to the management of the programme. The Ministry of Housing and Communal Services and the Ministry of Justice will also be involved.

Selected regional and local administrations and agencies involved in implementation of the proposed measures will be involved as well as NGOs and the private sector. The final target group is the population of the country which will benefit from protected environmental resources and reduced risk associated from pollution.

### **3.5. Crosscutting Issues**

Achieving environmental sustainability is the main objective of the programme. The measures will support improvements in environmental governance and environmental mainstreaming also in other sectoral policies such as energy, transport and industry.

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. 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.

## **4. Implementation issues**

### **4.1. Method of implementation**

The programme will consist of untargeted budget support under centralised management with fixed and variable tranches. Funds will be disbursed directly to the account of the treasury of the Government of Ukraine. In line with its budget procedures, the Government of Ukraine will establish a decision for the receipt and use of budget support funds received.

No specific TA component is foreseen under this proposed measure. Provision for technical support accompanying this SBS programme through technical assistance and twinning operations will be made available under the AAP 2008 and the AAP 2009 measure for *Twinning and ENP Support Technical Assistance* (see relevant Action Fiche), as well as under future AAP 2010. The twinning would mainly aim at the capacity strengthening. The technical assistance shall ensure sufficient implementation, providing

support in monitoring, reporting, visibility, and other relevant activities, including evaluation and audit as necessary. It will focus on the support to the MEP in adopting EU legal acquis, strengthening enforcement of key legislation, improving M&E of its policies and strengthening statistical accuracy and capacity.

#### **4.2. Procurement and grant award procedures**

No procurement or grant award procedure is foreseen separate to the disbursement of budget support tranches. It is foreseen that complementary Technical Assistance in support of the sector budget support programme will be procured under existing TA/Twinning facilities.

#### **4.3. Budget and calendar**

The total budget of the SBS operation is EUR 35 million. The implementation period of the SBS operation extends in principle over 36 months. The provisional start of the programme is January 2010 provided the Financing Agreement is signed.

It is expected that the programme be disbursed in three tranches (one per year): a first up-front fixed tranche of EUR 15 million, indicatively by the end of Q2 2010, and two variable tranches of EUR 10 million each, indicatively by the end of Q3 2011 and 2012, respectively.

#### **4.4. Performance monitoring and criteria for disbursement**

Performance of the sector budget support programme will be monitored by a Joint EC-GoU Monitoring Group (JMG) established for this purpose. The Joint Monitoring Group will include beside the Ministry of Environment, all key Government Ministries and authorities responsible for the attainment of the sector objectives, including the Ministry of Finance, the Ministry of Economy, the Ministry of Housing and Communal Services and the Ministry of Justice. Other donors, in particular SIDA, will be invited to take part in the JMG.

The standard general eligibility conditions will apply for the disbursement of all tranches. In addition, specific disbursement conditions will be agreed upon in the Financing Agreement for the disbursement of tranches. This may include the adoption of the national strategy, the establishment of the Joint Monitoring Group as well as decisions for the receipt and use of budget support relating to this programme.

Performance indicators for the variable tranche will be determined for the key areas of the environment policy and the results identified above, using a mix of output and process indicators, and reflecting the policy priorities as established in the EU-Ukraine ENP Action Plan among others. In line with good practice, performance measurement will be made through a limited number of performance indicators per variable tranches in order to facilitate the assessment of progress in the sector and avoid over-burdening the reform process.

#### **4.5. Evaluation and audit**

No specific evaluations or audits are foreseen for this sector budget support programme. Should during the implementation of the programme a need for independent evaluation/audit arise, these will be financed from other sources as necessary (GTAF, etc.).

The beneficiary government will make available the audit report of the country's Independent Audit Institution on an annual basis.

#### **4.6. Communication and visibility**

The Government of Ukraine and the Delegation of the European Commission to Ukraine will ensure adequate visibility of the assistance provided through the budget support programme. Complementary TA and Twinning projects will also make reference to the sector budget support programme in their visibility tools and communications, as appropriate. The Government of Ukraine will acknowledge and mention the

receipt of budget support funds received from the EC in press releases, including those dealing with budgetary assistance provided by other international donors.