

# Ukraine Country Strategy

2018-2023 As approved by the Board of Directors on 3 October 2018



**European Bank**  
for Reconstruction and Development

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## Glossary of Key Terms

<b>ABI</b>	Annual Business Investment	<b>SME</b>	Small and Medium Enterprise
<b>ATC</b>	Advanced Transition Country	<b>SOB</b>	State Owned Bank
<b>ATQ</b>	Assessment of Transition Qualities	<b>SOE</b>	State Owned Enterprise
<b>BEEPS</b>	Business Environment and Enterprise Performance Survey	<b>TC</b>	Technical Cooperation
<b>COOs</b>	Countries of Operation	<b>TFP</b>	Trade Facilitation Programme
<b>DFTA</b>	Deep and Comprehensive Free Trade Agreement		
<b>DGF</b>	Deposit Guarantee Fund		
<b>EBRD</b>	European Bank for Reconstruction and Development		
<b>EIB</b>	European Investment Bank		
<b>ETI</b>	Expected Transition Impact		
<b>EC</b>	European Commission		
<b>EU</b>	European Union		
<b>FDI</b>	Foreign Direct Investment		
<b>FI</b>	Financial Institution		
<b>GEFF</b>	Green Economy Financing Facility		
<b>GET</b>	Green Economy Transition		
<b>GHG</b>	Greenhouse Gas		
<b>IFI</b>	International Financial Institution		
<b>IMF</b>	International Monetary Fund		
<b>IPO</b>	Initial Public Offering		
<b>MSME</b>	Micro, Small and Medium Enterprise		
<b>NPL</b>	Non Performing Loan		
<b>ODA</b>	Official Development Assistance		
<b>PPP</b>	Private-Public Partnership		
<b>PTI</b>	Portfolio Transition Impact		
<b>R&amp;D</b>	Research and Development		

# Executive Summary

Ukraine is committed to and applying the principles of multiparty democracy and pluralism as enshrined in Article 1 of the Agreement establishing the Bank. Following Revolution of Dignity, wide-ranging efforts have been made to accelerate passing and implementation of democratic reforms. While many challenges remain, in particular in the area of the rule of law, and in tackling corruption, significant accomplishments have been made.

Since the Revolution of Dignity, Ukraine has also embarked on a path of economic reforms, underpinned by the aspiration of European integration, as codified in its 2014 Association Agreement and DCFTA with the EU, which entered into force in 2017. Despite difficult political and security circumstances, including the heavy toll that the illegal Russian annexation of Crimea and the continuing armed conflict in the industrial Donbas region have exerted on the economy, the country is on a gradual recovery path after two years of recession caused by external disruption, as growth has returned, inflation moderated, and the banking system stabilised.

To turn the fledgling recovery into sustainable growth, Ukraine must target the gaps in the qualities identified by the EBRD as essential for a sustainable market economy (competitive, well-governed, green, inclusive, resilient and integrated), and tackle the corrupt “old” economic system and the vested interests it represents. Building on its attainments to-date under its Ukraine Crisis Response Package, the Bank will support Ukraine in these endeavours in close co-operation with other IFIs and development partners.

The EBRD will prioritise strengthening competitiveness and good governance through reforming the currently underperforming and inefficient public sector, while supporting adoption of best operational and management practices by private corporates (including re-emphasising support for SMEs); enhancing resilience of the economy through improved energy security and a well-functioning financial sector; and advancing Ukraine’s integration with the EU region. The Bank will also promote green transition at a project level, as an integral component of a competitive and resilient economy, and will aim to support inclusive, gender-equal growth, with an emphasis on skills matching as an important element of competitiveness, in line with its Board-approved Gender Strategy and Economic Inclusion Strategy. The Bank will prioritise developing projects that seamlessly integrate investment and policy engagement, which proved highly effective in the implementation of the Ukraine Crisis Response Package. Continuing with the main themes of the Package, which remain largely relevant, the EBRD will expand and deepen its engagement in pursuit of the following strategic priorities in 2018-2023:

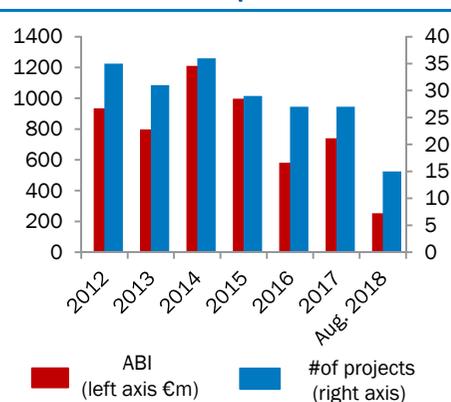
- Promote privatisation and commercialisation in the public sector to increase competitiveness and foster good governance.
- Promote rule of law, competition and level playing field in the private sector by supporting best practice companies.
- Strengthen energy security through effective regulation, market liberalisation, diversified and increased production, and energy efficiency.
- Enhance resilience of the financial system by strengthening the banking sector, and in parallel developing capital markets and other non-bank finance.
- Improve integration by facilitating trade and investment, expanding infrastructure links, and supporting convergence with EU standards.

# Ukraine – EBRD Snapshot

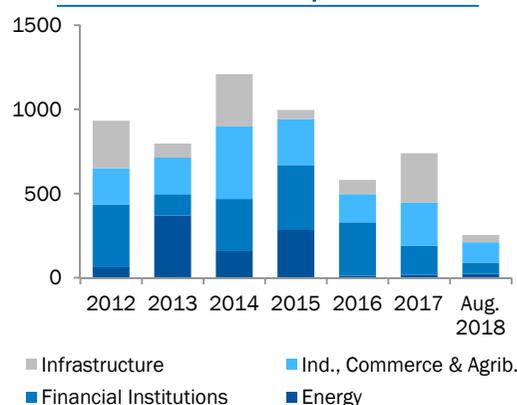
## EBRD Investment Activities in Ukraine

Portfolio	€3.6 bln	# of active projects	169
Equity share	10%	Operating assets	€2.0 bln
Private share <sup>1</sup>	72.6%	Net cum. investment	€12.6 bln

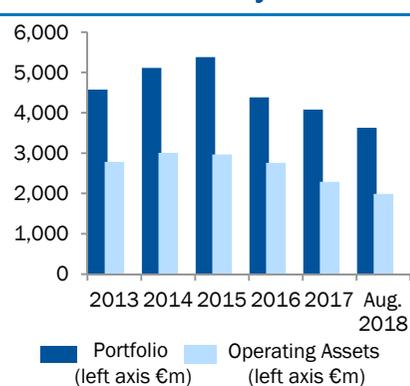
### ABI and Operations



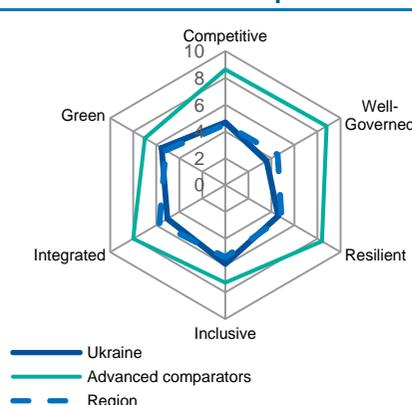
### ABI Sectoral Composition



### Portfolio Dynamics



### Transition Gaps<sup>2</sup>



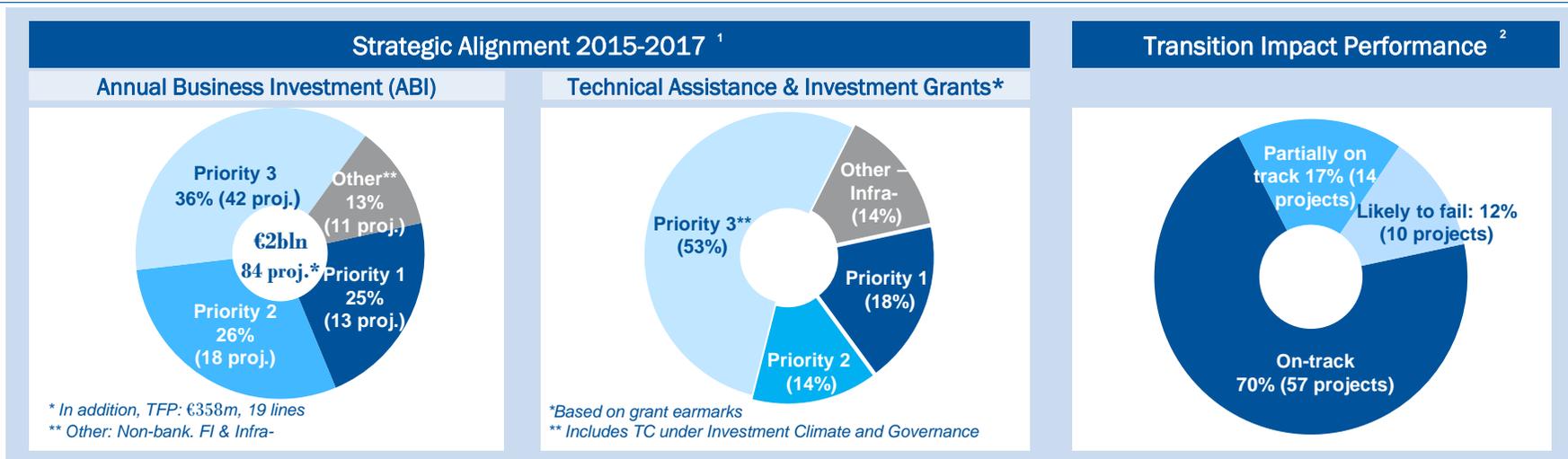
## Ukraine Context Figures

Population (m) <sup>3</sup>	45	2017
GDP per capita (PPP, const. int. 2011 USD) <sup>3</sup>	7,894	2017
Global Competitiveness Index (WEF)	81 <sup>st</sup> <i>Out of 137</i>	2017-2018
Corruption Perception Index (Transparency International)	130 <sup>th</sup> <i>Out of 180</i>	2017
Youth unemployment (% ILO est.) <sup>3</sup>	21.6%	2017
Female labour participation (% ILO est.) <sup>3</sup>	46.9%	2017
Energy intensity toe/thousand 2005 USD (TPES/GDP) <sup>4</sup>	0.7	2015
<i>For comparison: Azerbaijan – 0.2, Armenia &amp; Georgia – 0.3, Belarus – 0.4, Moldova – 0.5</i>		
Emission intensity/GDP (kgCO <sub>2</sub> /05'\$) <sup>4</sup>	1.6	2015

<sup>1</sup> 5-year rolling portfolio ratio. <sup>2</sup> For methodological details refer to the 2017-18 Transition Report. <sup>3</sup> World Bank's WDI <sup>4</sup> IEA's Energy Atlas

# 1. Implementation of the Crisis Response Package

## 1.1. Key Transition Results Achieved in 2015-2017



### Priority 1: Banking sector stabilisation and restructuring

Intermediated Financing	Key Transition Results		
	2015	2016	2017
<b>Outstanding volume of SBI finance (€)</b>	400K	335K	283K (H1)
<b>Volume of sub-loans signed under EE facilities (€)</b>	4m	42m	161m
<b>Volume of TFP lines committed (€)</b>	101m	121m	136m

Played a major role in supporting the banking sector and capital markets as major channels of lending to the real economy at times of sharp devaluation and macroeconomic fragility.

- Made a decisive contribution to the banking sector clean-up and restructuring:** coupled equity participation and recapitalisation of viable banks (Raiffeisen Bank Aval and Ukrsibbank BNP Paribas) with extensive capacity building and policy engagement, including introduction of the Kyiv Approach for out of court NPL settlement and development of the Strategy for the Financial Sector Reform until 2020.
- Facilitated modernisation and reform of state-owned banks:** supported nationalisation of Privatbank; provided commercialisation and pre-privatisation support to OschadBank.
- Conducted cornerstone policy engagement as a basis for financial sector reform:** holistic capacity building of the National Bank of Ukraine (banks' oversight, NPL resolution and good governance) and the Deposit Guarantee Fund (workout and recovery of "failed bank" assets).
- Supported financial intermediation & expanded product portfolio of partner banks:** focused on agribusiness, women-led and green energy projects; introduced local currency agri- machinery leasing facility for OTP Bank.

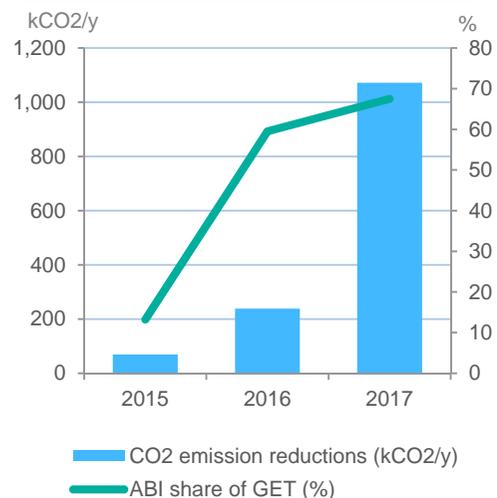
1. Strategic priorities 2015-2017: 1) Banking sector stabilisation and restructuring; 2) Energy security and energy sector reforms; 3) Financing key private corporate players.  
 2. Transition impact performance reflects how likely projects are to achieve the transition impact that was expected of them at signing. Calculated based on active mature portfolio (older than two years).

# 1. Implementation of the Crisis Response Package

## 1.1. Key Transition Results Achieved in 2015-2017

### Priority 2: Energy security and energy sector reforms

#### Green Economy Transition



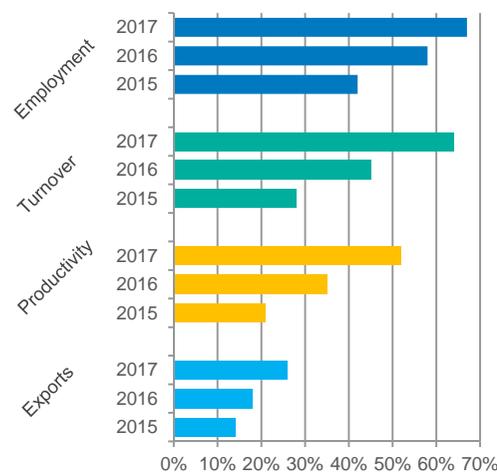
#### Key Transition Results

Completed the project to construct the unique Chernobyl New Safe Confinement (installation and commissioning to be finalised). A breakthrough engagement with Naftogaz and an integrated energy sector reform support in line with the 3d Energy Package in a joint effort with the EU, IFIs and other international partners, boosting investments and advancing towards an effective market structure.

- **Flagship Naftogaz reform/investment:** provided two loans amounting to nearly US\$ 500 million to support gas purchases and upgrade pipelines in conjunction with extensive policy engagement (unbundling, corporate governance upgrades in Naftofaz and future TSO, unbundling of storage and transmission activities and gas sector reform), which resulted in increased profitability, end-user gas prices at par with imports in 2016, largely independent board in place, diversification of gas resources).
- **Established as a key investor in renewable energy** and strengthened the regulatory framework for renewable energy and electricity : new auction system discussion launched, corporate governance reform of UkrEnergy; Electricity and new ESCO Law adopted.
- **Municipal sector reform with tangible energy efficiency benefits:** progress on district heating payments resolution; setting energy efficiency performance standards in industrial and buildings sectors; financed metro in Kharkiv, which will result in 3.5km extension to relieve transport congestion and rejuvenate a residential area with 160,000 inhabitants and launch municipal transport framework.

### Priority 3: Financing key private corporate players/investment climate & governance

#### % of ASB clients increased their...



#### Key Transition Results

Financed companies - standard setters, including SMEs and with a focus on agribusiness, preparing a basis for future private sector growth. Beyond investments, EBRD made a direct and visible contribution to cross-cutting and sector-specific investment climate reforms.

- **Established effective reform delivery support platforms:** created Business Ombudsman, the first operating post-Maidan anti-corruption institution (2, 656 closed cases to date with 75% of complainants satisfied); supported National Investment Council; launched the EU-sponsored Ukraine Reforms Architecture, an innovative tool increasing capacity across the public administration.
- **Promoted SOE restructuring, privatisation & public sector capacities:** contributed to the Privatisation law adoption with pre-privatisation of Oschadbank on track; continued Naftogaz engagement and participation in Supervisory Boards of other SOEs; structured concession legal and institutional framework; launched ProZorro - an electronic platform for transparent public procurement; continued advisory on financial markets and renewable energy reforms.
- **Supported competitive SMEs through integrated financing and advice:** launched the Blue Ribbon programme, providing longer-term growth support to leading SMEs with potential to create high value & demonstration effects across the economy, creating 15 Business Support Centres.

# 1. Implementation of the Crisis Response Package

## 1.2. Challenges to Implementation and Key Lessons

**Context for implementation:** Responding to the political upheaval and the violation of Ukraine’s sovereignty and territorial integrity since 2014, the EBRD re-focused its Ukraine country strategy to emphasise crisis mitigation. The Bank also switched to a more nimble delivery mode, to which end it adopted a package of rapid-response measures. By carefully blending policy engagement with investment, the EBRD reinforced crisis-resistance in key sectors of Ukraine’s economy, including energy and banking, and was instrumental in delivering a number of urgent reforms. Strong alliance with reformers in the government and the enduring commitment to its corporate clients proved key to the Bank’s success, as did close co-operation on policy matters with other IFIs. The reform momentum in the country was further bolstered by the 2014 Association Agreement with EU, including DCFTA, which provided an external anchor for adopting European standards, and was conducive to the Bank’s efforts. Along with successes and attainments, however, the Bank encountered headwinds from the “old” economy, beset with vested interests and corruption. Inconsistency in the reform momentum and challenging business environment are expected to continue into the next strategy period, prompting the EBRD to remain steadfast and ambitious in its efforts, yet realistic in expectations.

### Implementation Challenges

- Simmering **political pressures and externally-imposed conflict** inhibit economic development and **deter investment**; crisis conditions have weakened demand from private companies and SMEs
- External pressures aside, endogenous **impediments to reform** remain significant; implementation of DCFTA has been tenuous
- Lack of **implementation capacities and accountability** for public sector projects, inconsistent procurement support and bureaucratisation of the investment cycle
- **Weak banking sector and under-developed capital markets** impede the Bank’s work with smaller viable businesses

### Key Lessons & Way Forward

- Continue and **ramp-up policy engagement and advice to high-growth companies, integrated with investments**. The country strategy will incorporate directions of the Crisis Response for continuity and consistent advancement towards the long-term goals.
- Promote cross-sectoral reform in close **alignment with domestic reformers and international development partners** (including IFIs), while **linking investment and policy engagement**
- Provide a dedicated **project implementation support** and advisory on key sectoral reforms and legal bottlenecks via the Ukraine Reform Architecture platform and transaction/cross-cutting TC
- Leverage successful engagement in banking to systematically support partner banks and **expand the range of banking products**; reach SMEs through **on-lending frameworks**; continue policy advice on **capital market development** and capacity building on the DGF

## 2. Economic Context

### 2.1 . Macroeconomic Context and Outlook for Strategy Ukraine

Ukraine's economic growth is deterred by lack of productivity-enhancing investment and by the absence of the critical mass of reforms, despite meaningful progress in some policy areas.

Ukraine - Main macroeconomic indicators				
	2015	2016	2017	2018 proj.
GDP growth (% y-o-y)	-9.8%	2.4%	2.5%	3.0%
CPI inflation (% avg.)	48.7%	13.9%	14.4%	10.7%
Government balance (% of GDP)	-1.2%	-2.3%	-1.3%	n.a.
Current account balance (% of GDP)	1.8%	-1.4%	-1.9%	n.a.
Net FDI (% of GDP)	-3.3%	-3.5%	-1.9%	n.a.
External debt (% of GDP)	130.4%	121.7%	103.5%	n.a.
Total investment (% of GDP)	13.5%	15.5%	16.0%	n.a.
General government gross debt (% of GDP)	79.1%	81.0%	71.8%	n.a.
Private sector credit (% of GDP)	49.2%	41.8%	34.0%	n.a.
Unemployment (%)	9.1%	9.3%	9.5%	n.a.
Nominal GDP (€bn)	82.1	84.3	99.4	106.4

Sources: National statistical authorities, National bank of Ukraine, Inflation report June 2018 (NBU), EBRD REP May 2018

- **Ukraine has embarked on a strategic path of comprehensive political and economic reforms, underpinned by the aspiration of European integration.** Since the Revolution of Dignity, Ukraine has made significant reform progress, after more than two decades of uneven and stagnating transition. However, important challenges related to the rule of law, weak public governance standards and slow implementation of sectoral reforms remain.
- **Lack of efficiency-enhancing structural reforms and investment has resulted in low and stagnant labour productivity.** Low value-added commodities continue to dominate the production and export base. Major increase in foreign investment and acceleration of reforms are required to modernize industries and diversify Ukraine's economic structure away from excessive dependence on commodities.
- **The economy is on a slow recovery path after two years of recession.** Real output grew by 2.4% in 2016 and 2.5% in 2017, following a cumulative 16% decline in 2014-15. Inflation moderated from the peak of 48.7% in 2015 but remains elevated at 11.7% year-on-year as of the first eight months of 2018. Hryvnia stabilised after approximately 70% devaluation in the previous three years. Official reserve assets recovered from a critically low level of US\$ 5.6 billion (approximately one month of imports) to US\$ 17.2 billion (approximately 3 months of imports) as of August 2018.
- **Banking system stabilized following three years of transformation, although systemic challenges remain.** Non-performing loans reached 56% of total gross loans in Q2 2018. Market share of state-owned banks (SOBs) is exorbitant as they account for approximately half of the system-wide assets. They suffer from weak corporate governance, highly concentrated loan exposures, low quality of assets and suboptimal business models.

## 2. Economic Context

### 2.2 . Key Transition Challenges<sup>1</sup>

#### Well-governed (3.6 out of 10)

- Civil service is poorly motivated, overstaffed and lacks insulation from political pressures.
- Rule of law and protection of property rights are weak, and administration of justice is often inconsistent.
- Capacity of the newly-created anti-corruption institutions needs to be strengthened
- Tax administration needs to be reformed further
- SOEs are poorly governed and no meaningful progress has been achieved with respect to the overarching State Ownership Policy.
- Corporate governance of companies suffers from shortcomings in the structure and functioning of boards, transparency and disclosure, and internal controls.

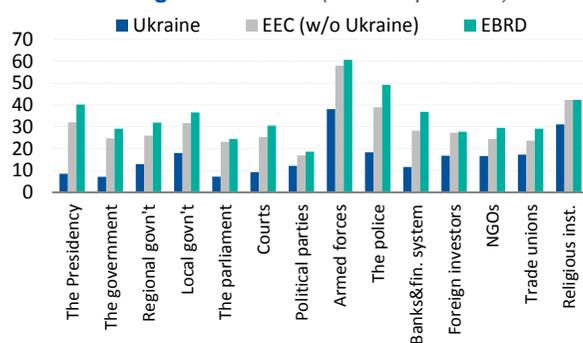
#### Competitive (4.7 out of 10)

- Challenging business environment is exacerbated by unstable politics, prevalence of SOEs and resistance to reforms by entrenched vested interests.
- Privatization is progressing slowly due to vested interests, wavering political commitment, weak capacity at the State Property Fund and lack of investor interest.
- Enforcement of the competition regime is weak despite EU-aligned competition laws.
- Export is dominated by low value added products (primary agriculture, metals and minerals), and lacks diversification, complexity and competitiveness.
- Labour productivity is below the EBRD and the OECD average.
- Innovation is constrained by limited access to ICT infrastructure, low R&D spending by firms, poor institutional framework.

#### Resilient (4.6 out of 10)

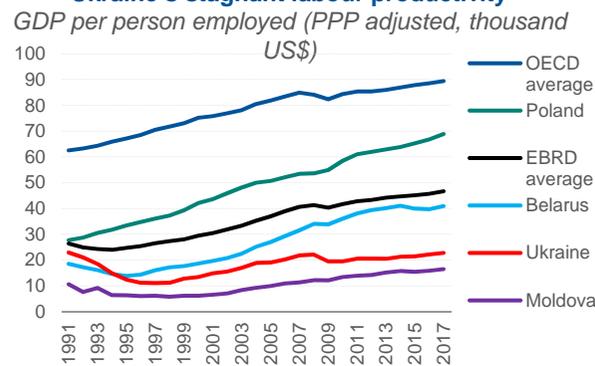
- Systemic challenges stem from high share of state ownership in the banking sector.
- Lending activity is impeded by risk aversion, deleveraging, lack of progress in creditor rights protection, high and volatile interest rates.
- Very high level of NPL's with significant concentration of problem assets in state-owned banks.
- High degree of balance sheets dollarization exposes banks to foreign exchange risks.
- Undeveloped capital markets and limited alternatives to bank financing.
- Slow implementation of the adopted EU's Third Energy Package legislation.
- Electricity market liberalization needs to be implemented
- Reforms in the gas market are unfinished, impeding foreign investments.
- Gas tariffs are not maintained at the import parity level.

Trust in the institutions is one of the lowest among EBRD CoOs (% of respondent)



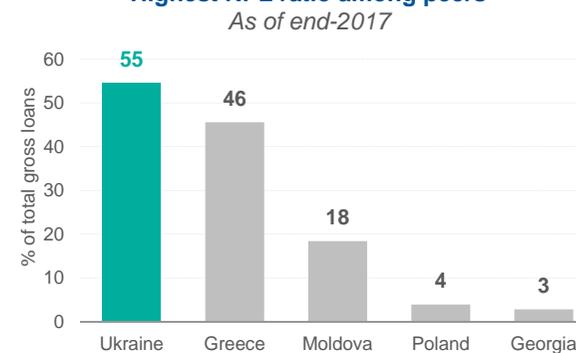
Source: EBRD LITS III

Ukraine's stagnant labour productivity



Source: The Conference Board Total Economy Database

Highest NPL ratio among peers



Source: IMF FSI

## 2. Economic Context

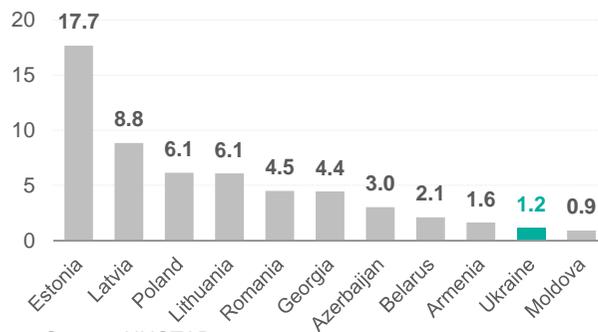
### 2.2 . Key Transition Challenges

#### Integrated (5.0 out of 10)

- FDI, deterred by high risk perception, capital controls, challenging business climate and weak rule of law, is at low levels.
- Poor and deteriorating state of physical infrastructure, particularly roads. Quality of ICT infrastructure falls behind peers.
- Quality of logistics in terms of cost and time of border and documentary compliance, lags behind.
- Cumbersome and inefficient customs procedures with inconsistent and arbitrary customs clearance procedures complicate trade and makes it more expensive.
- Excessive port costs.
- Extensive gas transit system with multiple connections to EU, but subject to uncertainties regarding gas flows as the current Russian-Ukrainian gas contract expires in 2019.

#### FDI stock per capita

Thousand USD per capita, 2017



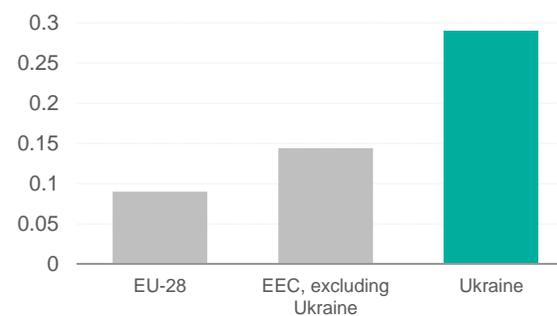
Source: UNCTAD

#### Green (5.5 out of 10)

- Energy intensity is among the highest in the world and over 3 times higher than EU average.
- Poor energy efficiency in housing and industrial sectors.
- Despite improvements, existing subsidy schemes fall short of incentivising efficient consumption of energy, particularly with regard to gas and heating.
- Inefficient district heating systems due to inadequate maintenance, pipeline leakages, poor insulation and old equipment.
- Obsolete energy infrastructure requiring significant investments.
- Outdated waste disposal practices as very low level of municipal waste gets recycled; legislative framework needs improvements.
- Very low share of renewables' in the energy mix. Renewable energy is highly subsidized and in need of a new competitive pricing system.

#### Energy intensity

Total primary energy supply per GDP PPP, in 2015



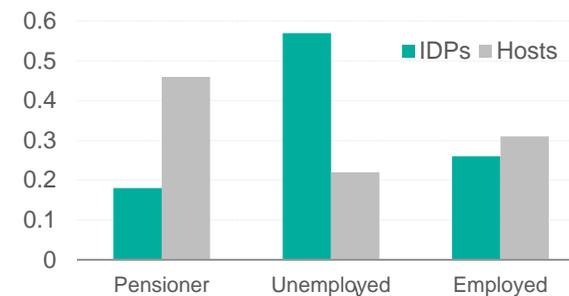
Source: IEA

#### Inclusive (5.9 out of 10)

- Labour participation and access to finance for women is lower than in regional comparators.
- Gender segregation in the labour market and gender pay gap are high.
- Youth and regional inclusion is affected by outdated education and vocational training systems, as well as limited training opportunities outside of the formal education system.
- On the back of intensifying emigration, employers report skills gap, especially in food processing and IT sectors.
- Loss of jobs due to hostilities in the East; large number of internally displaced persons (IDP) who lack marketable skills.

#### Employment status of IDPs and host communities

Bottom household income quintile



Source: WB (May 2017), Socio-economic Impacts of internal displacement and veteran return

# 3. Government Priorities and Stakeholder Engagement



## 3.1. Government Reform Priorities

The Government's priorities are reflected in a wide range of cross-cutting and sector-specific strategic documents, also anchored in the EU-Ukraine Association Agreement and the Memorandum of Economic and Financial Policies with the IMF. The **Government's Priority Action Plan until 2020** translates the over-arching goal of increasing the living standards and improving the quality of life into objectives along the following pillars:

- **Inclusive economic growth:** favourable business environment, promotion of entrepreneurship and innovation, adoption of EU standards, investment attraction, international trade and investment, privatisations, reforms in the energy, transport, utilities and agribusiness sectors.
- **Effective governance:** public administration & finance management reform, decentralisation, quality public services (including e-government solutions) and public control over government's expenditures.
- **Human capital development:** healthcare and education reforms (including vocational training and effective science management), improvement of the social safety net, development of culture and sport, opportunities for the youth.
- **Rule of law and fight against corruption:** anti-corruption institutions, equal access to justice and protection of property rights, fairness and equality.
- **Security and defence:** public safety, state sovereignty and territorial integrity, informational security.
- **Green economy transition,** a cross-cutting topic, which includes climate change resilience, energy efficiency, development of renewable energy projects, as well as sustainable resource management.

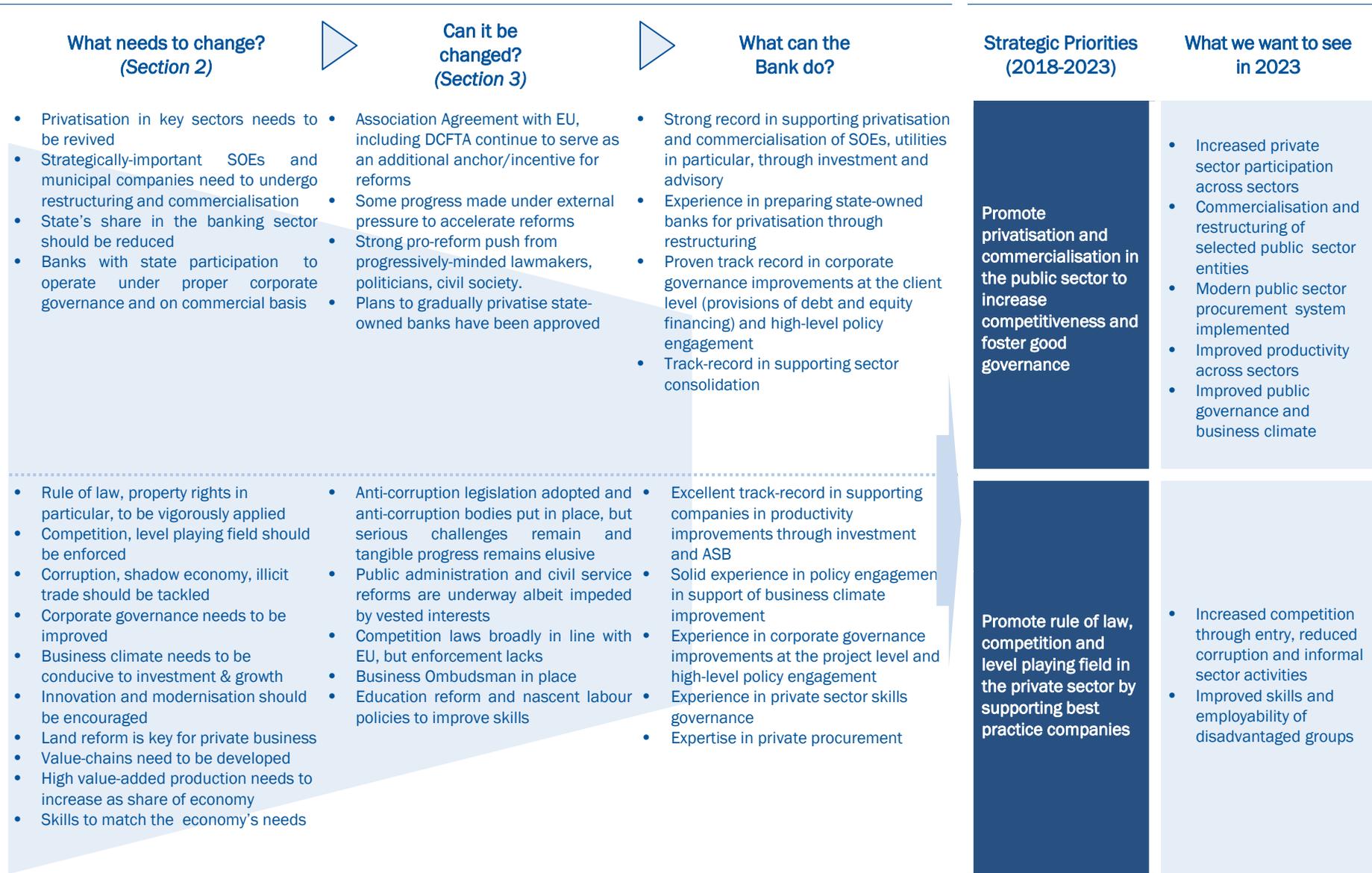
## 3.2. EBRD Reform Areas Broadly Agreed with Authorities

- **Privatization and SOE commercialisation :** policy, legal and institutional support, corporate governance action plans for major SOEs, pre-privatisation and privatisation assistance.
- **Financial sector reforms:** restructuring of SOBs with supporting policy engagements, including reform of corporate governance and commercialisation of SOBs, capacity building of DGF, strengthening of financial sector regulation and supervision.
- **Energy security and gas sector reforms:** market liberalization and transparency (EU's 3d Energy Package), Naftogaz restructuring, support in establishment of a credible independent regulator; implementation of the new Renewable Energy framework.
- **Public administration reform, anticorruption and rule of law:** investment climate reforms, Business Ombudsman, institutional capacity building (incl. through Reform Support Teams under the Ukraine Reforms Architecture platform).

## 3.3. Key Messages from Civil Society to EBRD

- The EBRD should **ally with the Civil Society** in advancing reforms, incl. convergence with EU standards, in particular environmental
- Significant steps by the government toward curbing **corruption**, but challenges remain in **governance of law enforcement agencies**.
- **Lack of high level convictions for corruption** undermines public trust.
- **Grey economy, illicit trade** need to be tackled much more vigorously.
- **Waste management** is a problem, grant support required
- **Rural SMEs suffer from underinvestment**, while large agri companies receive support from the government.
- **Challenges in renewable energy sector** with respect to conversion of land to energy use, transparent tariffs. connection to grid; EBRD support needed.

# 4. Defining EBRD Ukraine Country Strategy Priorities



# 4. Defining EBRD Ukraine Country Strategy Priorities – Continued

What needs to change? (Section 2)	Can it be changed? (Section 3)	What can the Bank do?	Strategic Priorities (2018-2023)	What we want to see in 2023
<ul style="list-style-type: none"> <li>Energy markets need to develop</li> <li>Production needs to increase to underpin extensive connectivity by surety of supply</li> <li>Diversification of energy sources to be augmented by increase in renewable energy</li> <li>Energy efficiency across sectors needs to improve</li> <li>Sustainability of municipal services should be enhanced</li> </ul>	<ul style="list-style-type: none"> <li>Secondary legislation to implement EU's Third Energy Package passed</li> <li>Independent regulator operational</li> <li>New Waste Strategy in place</li> <li>National Energy Efficiency Strategy adopted</li> </ul>	<ul style="list-style-type: none"> <li>Expertise in energy market reform</li> <li>Proven ability to support best practice production</li> <li>Proven ability to support best practice energy generation</li> <li>GET instruments available</li> <li>Solid experience in cross-sectoral energy efficiency (direct and intermediated financing) and sustainable municipal services</li> <li>Sustainable scheme to support renewable energy</li> </ul>	<p><b>Strengthen energy security through effective regulation, market liberalisation, diversified and increased production, and energy efficiency</b></p>	<ul style="list-style-type: none"> <li>Sustainable energy market structure &amp; improved energy connectivity</li> <li>Increased resource efficiency &amp; use of renewable energy</li> </ul>
<ul style="list-style-type: none"> <li>Commercial banks need to be induced into lending</li> <li>NPLs need to be settled, their share in the portfolios needs to decline to acceptable industry norms</li> <li>Local currency transactions should become prevalent</li> <li>Capital markets need to be consolidated to develop beyond the current nascent state</li> <li>Insurance and leasing need to be developed</li> </ul>	<ul style="list-style-type: none"> <li>Clean-up and consolidation of underperforming banks underway</li> <li>Out-of-court NPL restructuring mechanism in place, although with limited effect to-date</li> <li>Banks adopt tougher credit practices</li> <li>Hryvna stabilisation measures have stemmed from further dollarization</li> <li>Some progress in reducing the number of exchanges</li> <li>Microeconomic and geopolitical situation deter private equity</li> </ul>	<ul style="list-style-type: none"> <li>Experience in NPL resolution</li> <li>Existing mechanisms for supporting private banks</li> <li>Ability to support non-bank financial institutions of sufficient size and bankability as opportunities arise</li> <li>Strong experience in local currency finance via capital market instruments</li> <li>Proven expertise in capital markets institutional consolidation</li> </ul>	<p><b>Enhance resilience of the financial system by strengthening the banking sector, and in parallel developing capital markets and other non-bank finance</b></p>	<ul style="list-style-type: none"> <li>Stable and efficient banking sector</li> <li>Increased variety of non-banking financial channels and the use thereof</li> </ul>
<ul style="list-style-type: none"> <li>Domestic infrastructure gaps needs to be narrowed; cross-border corridors developed</li> <li>"Soft infrastructure", including logistics, need to improve</li> <li>Quality inbound FDI needs to be encouraged, overcoming risk perception</li> <li>Complexity of exports needs to increase</li> </ul>	<ul style="list-style-type: none"> <li>Openness to FDI flows comparable to regional averages</li> <li>Work on methodology for various transportation dues underway</li> <li>Concession legislation to be approved by the Parliament</li> <li>Highly developed gas transit connectivity infrastructure</li> <li>DCFTA as an inducement to improve quality and operational practices to comply with EU standards</li> <li>Adoption of Transport and Export strategies (the latter in progress)</li> </ul>	<ul style="list-style-type: none"> <li>Solid track-record in transport infrastructure finance on both sovereign and commercial bases</li> <li>Experience in supporting private operators in PPPs, logistics, freight</li> <li>Experience in assisting exporters, DCFTA-minded companies</li> <li>Well-positioned to support FDI through brand-recognition, preferred lender status</li> <li>Availability of TFP for PFIs and their export-oriented clients</li> </ul>	<p><b>Improve integration by facilitating trade and investment, expanding infrastructure links, and supporting convergence with EU standards</b></p>	<ul style="list-style-type: none"> <li>Improved connectivity through enhanced infrastructure</li> <li>Increased trade and investment flows</li> </ul>

# 5. Activities and Results Framework

***Priority 1: Promote privatisation and commercialisation in the public sector to increase competitiveness and foster good governance***

Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Increased private sector participation across sectors	<ul style="list-style-type: none"> <li>• Subject to political will, advance privatisation and pre-privatisation support activities through policy engagement and investment, with a focus on energy and banking, including through equity investments</li> <li>• Support structures that increase private sector participation in infrastructure (i.e. PPP, concession, PSC, management contracts, etc.) through policy engagement and investment</li> <li>• Work on creating opportunities for the private sector engagements by supporting the State Property Fund, including improving its governance</li> </ul>	<ul style="list-style-type: none"> <li>• Number of projects outsourcing activities to private sector</li> </ul>
Commercialisation and restructuring of public entities	<ul style="list-style-type: none"> <li>• By integrating policy engagement and investment, promote commercialisation and restructuring of SOEs, SOBs (see also Priority 4) and municipal companies (the latter through “Green” underlying projects), including improvement of corporate governance, capacity building, transparent procurement, introduction of commercially sound practices and diversification of funding sources</li> <li>• Solidify an effective and efficient reform support architecture as a basis of the public administration reform across ministries, agencies and municipalities</li> </ul>	<ul style="list-style-type: none"> <li>• Number of clients implementing commercialisation/restructuring</li> </ul>
Conducive environment for market efficiency	<ul style="list-style-type: none"> <li>• Support reform-oriented legislative progress, with a focus on legislative framework for privatisations and other forms of private sector participation</li> <li>• Improve regulations for energy (3d Energy Package) and infrastructure, promoting deregulation, robust and efficient PSOs and tariff reforms</li> <li>• Support land reform, as it develops.</li> </ul>	<ul style="list-style-type: none"> <li>• Change in tariffs to cost-reflecting level through Bank-supported projects</li> </ul>



# 5. Activities and Results Framework

**Priority 2: Promote rule of law, competition and level playing field in the private sector by supporting best practice companies**

Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
<ul style="list-style-type: none"> <li>Improved productivity of SMEs and private corporates in the economy</li> <li>Enhanced skills matching</li> </ul>	<ul style="list-style-type: none"> <li>Directly finance best practice corporates with high integrity standards, including providing working capital support</li> <li>Invest in direct equity, and through institutional quality PE funds and Bank’s own Venture Capital frameworks</li> <li>Provide SME credit lines and risk-sharing facilities to partner financial institutions under stand-alone facilities and targeted frameworks (e.g., DCFTA, energy efficiency and renewable energy) including in local currency with donor grant support</li> <li>Provide ASB support to SMEs, specifically on adoption of best management and operational practices, domestic value chain development and help export-oriented companies enhance “trade readiness” to tap into existing EBRD financing frameworks (e.g., DCFTA, TFP).</li> <li>Promote and support quality FDI, as well as domestic export-oriented companies</li> <li>Support enhancement of the skills base, as well as employability with a focus on core target groups (i.e. women, youth and populations living in remote areas), but also IDPs, veterans, individuals with disabilities , as well as state sector employees made redundant in conjunction with SOE privatisation and restructuring</li> </ul>	<ul style="list-style-type: none"> <li>Number of ASB clients reporting increased productivity, turnover</li> <li>Number of people receiving new/improved skills as a result of training by target group</li> </ul>
<p>Improved business environment and strengthened rule of law</p>	<ul style="list-style-type: none"> <li>Continue supporting Business Ombudsman and National Investment Council Secretariat to promote investment climate reforms</li> <li>Support industry self-regulating organisations in their efforts to monitor and enforce business ethics, improve business standards and rule of law</li> <li>Support reform of public procurement to further eliminate corruption opportunities</li> <li>Support strengthening of governance and business climate, including through the EBRD/EU Ukraine Reforms Architecture, and help enhance the administrative capacity to implement reforms.</li> </ul>	<ul style="list-style-type: none"> <li>Legal, institutional or regulatory improvements in target areas related to good governance</li> </ul>

# 5. Activities and Results Framework

*Priority 3: Strengthen energy security through effective regulation, market liberalisation, diversified and increased production, and energy efficiency*

Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Increased production and diversified energy supply	<ul style="list-style-type: none"> <li>• Finance on-site co-generation and renewable energy projects, including waste-to-energy, while promoting reforms of regulatory framework, including transparent rules for connection to grid, conducive to sustainable markets</li> <li>• Support rehabilitation and optimisation of existing energy networks</li> <li>• Support best practices in trading, production, transportation and storage in compliance with the EBRD Energy Sector Strategy</li> <li>• Facilitate local and foreign private sector investment in the energy sector, including through management contracts, concessions, PSAs and privatisation</li> <li>• Support de-monopolisation and liberalisation of the sector through policy engagement (3d Energy Package), as well as financing ensuing investment projects</li> <li>• Support to implementation and revision of Ukraine’s Nationally Determined Contributions (NDCs) under the Paris Agreement.</li> </ul>	<ul style="list-style-type: none"> <li>• Total Renewable electricity produced (MWh/y)</li> <li>• ENTSO-E, ENTSO-G integration advanced</li> </ul>
Improved energy efficiency	<ul style="list-style-type: none"> <li>• Promote energy efficiency improvements and implementation of resources efficiency measures across industries and in the built environment, including through green economy financing facilities (GEFFs) and, as appropriate, under the Green Cities initiative for municipal projects</li> <li>• Increase involvement of the private sector in providing energy savings services, including through performance-based contracts</li> </ul>	<ul style="list-style-type: none"> <li>• Total energy saved (GJ/y)</li> </ul>



# 5. Activities and Results Framework

*Priority 4: Enhance resilience of the financial system by strengthening the banking sector, and in parallel developing capital markets and other non-bank finance*

Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
<p>Well-capitalized banks with sound risk management practices and sustainable funding structures</p>	<ul style="list-style-type: none"> <li>• Support SOB reform strategy (see also Priority One) through investment and TA, with the focus on governance, capacity building, commercialisation, pre-privatisation investment</li> <li>• Support partner banks (private and state-owned) in provision of longer-term funding through stand-alone facilities and dedicated credit lines, risk-sharing facilities with the help of grants when needed (see also Priority Two), as well as equity</li> <li>• Prioritise development of LCY instruments, including unfunded structures</li> </ul>	<ul style="list-style-type: none"> <li>• Improvement in financial performance ratio of partner financial institutions</li> </ul>
<p>Functioning capital markets and alternative channels of finance</p>	<ul style="list-style-type: none"> <li>• Provide technical assistance to strengthen institutional and regulatory frameworks for capital markets consolidation and further development</li> <li>• Support corporate issuances (debt and equity, including Venture Capital), including through anchor investing</li> <li>• Develop an LC finance framework to emphasise capital and commodities markets solutions</li> <li>• Seek bankable opportunities in leasing and insurance</li> </ul>	<ul style="list-style-type: none"> <li>• Total number/volume of outstanding non-bank lending of partner financial institutions in target segment</li> </ul>



# 5. Activities and Results Framework

*Priority 5: Improve integration by facilitating trade and investment, expanding infrastructure links, and supporting convergence with EU standards*

Objectives (Outcomes)	Activities (Outputs)	Tracking Indicators
Improved quality and connectivity of infrastructure	<ul style="list-style-type: none"> <li>Pursue investments in domestic core transport network (rail, air, maritime, road, waterways), as well as in projects to expand cross-border links and trans-European corridors (ten-t), including domestic and cross-border river waterways, in line with the government’s Transport Strategy</li> <li>Invest in development of modern logistics centres and support private transport and logistics operators with a view to support the government’s Export Strategy</li> <li>Invest in modernisation and expansion of urban transportation capacity, as well in quality of service improvements</li> <li>Support further energy connectivity by promoting convergence with ENTSO-E and ENTSO-G and financing cross-border interconnectors (linking with Priority 3)</li> <li>Support development of “soft” connectivity and digitalisation</li> <li>Enhance project absorption and implementation capacity of the public sector</li> </ul>	<ul style="list-style-type: none"> <li>Improved/increased infrastructure capacity (incl. total net increase in capacity) through Bank-assisted projects</li> </ul>
Enhanced cross-border trade and investment	<ul style="list-style-type: none"> <li>Support adoption of best international practices and convergence with EU standards, as well as companies’ integration in cross-border value chains (linking with Priority 2)</li> <li>Expand and scale-up Trade Facilitation Program</li> </ul>	<ul style="list-style-type: none"> <li>Total number/volume of TFP transactions supported by the Bank</li> </ul>

Impact Indicator: FDI stock per capita (Baseline 2017: 1,200 USD per capita; UNCTAD)

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# 6. Mapping of International Partners' Complementarity in EBRD Business Areas



European Bank  
for Reconstruction and Development

EBRD BUSINESS AREAS		Sectors														Other							
Indicative annual investment/grants (2015-2017 average unless otherwise specified, excluding budget support)		Corporate				Energy		Infrastructure				Financial				Green Transition			Inclusion	Governance			
		Agribusiness	General industry	Real estate	ICT	Natural resources	Electric power	Water / wastewater / solid waste	Urban transport	Roads	Railways	Banking	Insurance	MSME finance	Private equity	Capital markets	Water efficiency	Materials efficiency	Sustainable energy		Gender	Youth	Region
EIB	€92m	€				€		€	€	€	€				€						€		
World Bank	€59m					€P		€P			€P			€P									€P
EU	€293m**	€P				€P	€P			€P	€P							€P		€P	€P	€P	
KfW	€144m					€P	€P											€R	€R				€P
GIZ	€37m							€P	€P									€P		€P	€P	€P	
IFC	€53m	€R	€									P			€								€R
BSTD	€36m	€		€		€P			€					€									
EBRD [forward looking]	€773m	€	€			€R	€R	€R	€R	€R	€R	€R	€R	€R	€	€	€R	€R	€R	€R	€R	€R	€R

## Areas for Potential Cooperation



### Competitive:

Partner with the EIB & IFC to co-finance bankable private corporates; work with the EU on product standards



### Well-Governed:

Advance investment climate reforms (including land reform) with the EU & World Bank



### Resilient:

Coordinate MSME on-lending frameworks with the EIB; joint advocacy on the EU 3d Energy package



### Green:

Co-finance with the EIB & World Bank "green" MEI and urban transport projects



### Integrated:

Co-invest in large transportation projects with the World Bank & EIB, while working on logistics with the IFC



### Inclusive:

Leverage EIB investments in higher education and improve complementarity with EIB's investments, especially in the private sector

- € Area of significant investments
- €P Area of significant policy engagement
- Focus mostly on private sector
- Focus mostly on public sector

\*\* Based on total EU funding since 1991.

Note: IFI activity mapping based on publicly available information.

Significant IFI investment defined as projects exceeding 5% of annual investment and signed from 2015. The exchange rate used is of 20 April 2018.

# 7. Implementation Risks, Environmental and Social Implications

Risks to the Strategy Implementation	Probability	Effect	Environmental and Social Implications
<ul style="list-style-type: none"> <li>▪ <b>Vulnerability to external shocks &amp; implications of the IMF programme: geopolitical fluidity, fluctuating commodity prices</b>, exposure to global emerging market factors – all could increase Ukraine country risk, deterring domestic and foreign investment and affect the Bank’s engagement; while a faltering IMF programme could inter alia jeopardise pursuit of infrastructure projects</li> </ul>			<ul style="list-style-type: none"> <li>▪ Environmental Policy, Management of Environmental &amp; Social Impacts, Stakeholder Engagement: Assist through PD and capacity building in the implementation of EU directives as part of the Association Agreement. Ensure that EU EIA Directive is transposed and implemented, with project impacts assessed and mitigated; help clients develop adequate implementation capacity; work to improve knowledge and practice of CSR and stakeholder engagement.</li> </ul>
<ul style="list-style-type: none"> <li>▪ <b>Vulnerability to domestic politics, incl. in privatisation:</b> weakening or reversal of the reform momentum, would impede operations with the public sector and create additional headwinds for the private sector development activities, including stalled privatisations</li> </ul>			<ul style="list-style-type: none"> <li>▪ Labour and Working Conditions: ensure that clients’ HR policies and labour practices comply with EBRD PR2, with a focus on workers organisations, potential discrimination towards minority groups and women, employment terms and conditions of migrant workers. Retrenchment planning may be required as part of SOE privatisation.</li> </ul>
<ul style="list-style-type: none"> <li>▪ <b>Dependence on external reform anchors:</b> disruption or deceleration of the EU approximation process by either side would weaken the reform drive</li> </ul>			<ul style="list-style-type: none"> <li>▪ Health and Safety: aim to improve occupational and community H&amp;S culture and practice, including in construction practices, and road safety in connection with transport projects.</li> </ul>
<ul style="list-style-type: none"> <li>▪ <b>Vulnerability to commodity prices swings:</b> a drop in the price of Ukraine’s major export items (metals, chemicals, primary agriculture) could trigger a recession, which would weaken demand from the private sector. Conversely, a spike in prices would create a disincentive for reforms.</li> </ul>			<ul style="list-style-type: none"> <li>▪ Land Acquisition, Involuntary Resettlement and Economic Displacement: encourage clients to improve consultation and information provision with affected people. Where occupiers have no legal titles, clients will need to ensure compensation and livelihood restoration are provided in accordance with the Bank’s requirements.</li> </ul>
<ul style="list-style-type: none"> <li>▪ <b>Impediments to energy sector reform:</b> low political consensus, vested interests and political instability could derail the all-important energy reform, thus affecting the Bank’s strategic focus on enhancing Ukraine’s energy security</li> </ul>			<ul style="list-style-type: none"> <li>▪ Biodiversity Conservation and Sustainable Management of Living Natural Resources: The Bank will support development and implementation of the sustainable management and biodiversity conservation practices in agriculture, forestry and irrigation projects.</li> <li>▪ Cultural Heritage: Work with clients to identify and consult with key stakeholders and protect sensitive cultural heritage.</li> <li>▪ Financial Intermediaries: Ensure that FI partners have adequate E&amp;S capacity and risk management procedures in place.</li> <li>▪ Monitoring and supervision: Work with existing clients to monitor environmental and social performance and address legacy issues associated with the Bank’s portfolio. TC support is needed to improve ambient environment and industrial pollution monitoring standards and practices.</li> </ul>

# 8. Donor Co-Financing Assessment

## 8.1. Grant Needs Assessment

Donor funding will be required to achieve the strategic objectives for 2023, including support for:

- Strengthening **energy security** through energy efficiency financing facilities and regulatory reforms
- Improvement of **municipal and environment infrastructure** under Green City Action Plans, including public transport, district heating and solid waste
- **Local currency and capital market** development
- Promotion of **financial sector reform** through supporting relevant institutions and regulatory bodies
- Better **governance of state-owned enterprises** and state-owned banks
- Supporting **SME and Energy Efficiency lines**, including in local currency, with grant-funding mechanisms
- Promoting **private sector and SME development** more broadly
- Policy engagement and legal reforms including for improving **investment climate**
- TC support will be required to ensure robust **biodiversity impact assessments** of projects. TC support will be also needed to improve Road Safety and health and safety standards.

## 8.2. Potential Sources for Grant Funds

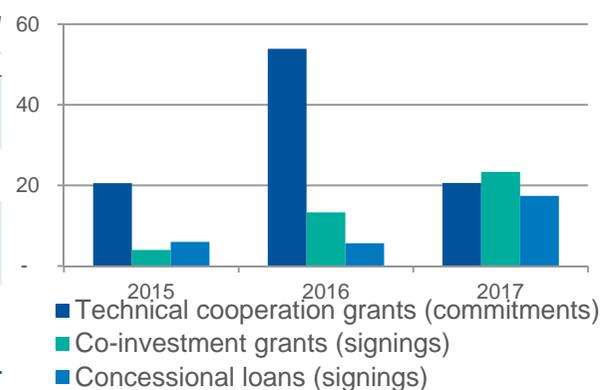
- Donor support will be channelled through the EBRD multi-donor funds: **EBRD Ukraine Stabilisation and Sustainable Growth Multi-Donor Account**, **EBRD Small Business Impact Fund** and **SME Local Currency Special Fund**.
- The EBRD will continue to explore partnership with existing and potential **bilateral donors**.
- The **EU** will remain a very important source of grant funding for policy reforms and connectivity support, municipal infrastructure and energy efficiency projects. The main facility is the Neighbourhood Investment Facility East.
- EBRD will further explore opportunities to access the funding from the **Clean Technology Fund** and the **Global Environment Facility** for residential and corporate energy efficiency, and sustainable agribusiness
- The grant funding can be also allocated under “Other ODA” window of the **EBRD Shareholder Special Fund**.
- The **E5P** (Eastern Europe Energy Efficiency and Environment Partnership) is another source of grant funding for Ukraine.

### Selected Affordability Indicators

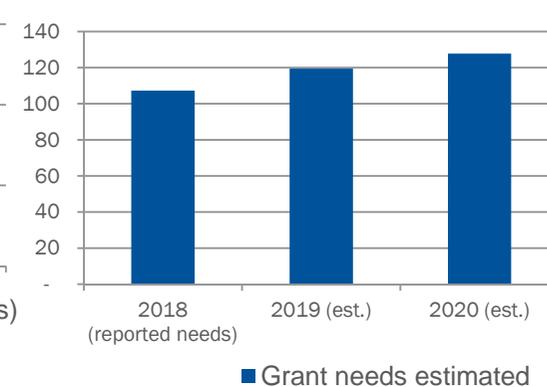
		EBRD regional percentile rank <sup>1</sup>
GDP per capita (PPP, current int. \$) <sup>2</sup>	8,305	11 <sup>th</sup> (CoOs)
ODA Country	YES	N/A
ODA as share of Gross National Income (%) <sup>3</sup>	1.65	40 <sup>th</sup>
ODA disb. per capita (\$ - current prices) <sup>3</sup>	33.8	24 <sup>th</sup>

Sources: <sup>2</sup>- IMF (2016), <sup>3</sup> - OECD (2016)

### Donor finance during last strategy (€m)<sup>4</sup>



### Grant Needs Projection (€m)



1. Simple percentile rank reported as the share of EBRD countries (ODA CoOs in case of ODA indicators) that are represented below Ukraine.

4. The 2015 TC data is based on Commitments as at the end of March 2016 (the latest available date before data migration in a new Donor Funds System). 2016-2017 TC data is based on earmarks at the project level.

*ANNEX*

# Annex 1 – Political Assessment in the Context of Article 1

Ukraine is committed to and applying the principles of multiparty democracy and pluralism as enshrined in Article 1 of the Agreement establishing the Bank. Despite difficult political, security and economic circumstances, significant accomplishments have been achieved following the Revolution of Dignity. Nevertheless, many challenges remain, in particular in the area of the rule of law and combating corruption.

The Revolution of Dignity (the Euro-Maidan revolution) in November 2013-February 2014 was a watershed that put Ukraine on a strategic path of comprehensive democratic reforms, underpinned by the aspiration of European integration, leading to a stronger emphasis on the protection and promotion of fundamental values of democracy, human rights and the rule of law.

In June 2014, Ukraine and the European Union (EU) concluded a landmark Association Agreement, including DCFTA, which has provided an important legally-binding framework for political and economic reforms and committed Ukraine to converge its legislation and regulation with those of the EU. After almost three years of provisional application of different parts of the Agreement, it finally entered into force on 1 September 2017. In June 2017, a visa free-regime for short-term stays in the Schengen area for Ukrainian citizens also came into force, following the fulfillment by Ukraine of the required benchmarks, including related to citizens' rights, in particular protection of minorities and anti-discrimination.

Since the Revolution of Dignity, Ukraine has been pursuing a reform agenda aimed at transforming itself into a modern European democratic state. Intense reforms have been implemented, and democratic institutions revitalized. Despite challenging political, economic and security circumstances, elections were held at all levels and were generally assessed as "free and fair." Ukraine's democratic political system has stabilised, although remains unconsolidated. The country's particularly vibrant civil society, together with reformers in the government and in the *Verkhovna Rada* (parliament), has energetically pushed for reforms, strongly supported by Ukraine's international partners. But although democratic achievements have been real, still a lot of ground needs to be covered on the road of reforms. The rule of law and access to justice, including independence of the judiciary and the effective enforcement of laws, need to be strengthened in particular. While significant progress has been made in laying the legislative, policy and institutional foundations for reducing corruption levels, corruption continues to be a main issue of concern.

The illegal annexation of Crimea and Sevastopol by the Russian Federation and the conflict in parts of Donetsk and Luhansk regions (Donbas) in the east of Ukraine, which both have entered their fifth year, have caused significant human suffering and the dramatic rise of violence and insecurity. According to official data, more than 10,000 people have been killed and around 24,000 injured. Ukraine has also faced a humanitarian crisis, which resulted in over 1.6 million Internally Displaced Persons (IDPs). The gravely deteriorated security environment has posed serious challenges to Ukraine's democratic reform process as well as to implementation of international human rights conventions, especially in the areas not under the Ukrainian government control.

## ***Free Elections and Representative Government***

### *Free, fair and competitive elections*

The Constitution of Ukraine guarantees free elections held on the basis of universal, equal and direct suffrage, by secret ballot.

The last presidential election was held in one round on 25 May 2014. It was an early election, called by the *Verkhovna Rada* following the Revolution of Dignity. The OSCE/ODIHR-led International Election Observation Mission (IEOM) assessed the election as "characterised by high voter turnout and the clear resolve of the authorities to hold what was a genuine election largely in line with international commitments and with a respect for fundamental freedoms in the vast majority of the country."

# Annex 1 – Political Assessment in the Context of Article 1

International observers stressed in particular that “this was despite the hostile security environment in two eastern regions” and that the election did not take place on the Crimean peninsula as “it is not under the control of the Ukrainian authorities, and citizens residing there faced serious difficulties to participate in the election.”(1)

The last parliamentary elections took place on 26 October 2014, under a mixed proportional-majoritarian system, which, according to the OSCE/ODIHR, “has long been the subject of controversy in Ukraine and is viewed by many shareholders as being particularly vulnerable to fraud.” These were also early elections. The OSCE/ODIHR-led IEOM concluded that the elections “marked an important step in Ukraine’s aspirations to consolidate democratic elections in line with its international commitments. There were many positive points to the process, such as an impartial and efficient Central Election Commission, an amply contested election that offered voters real choice, and a general respect for fundamental freedoms.” While voting, and to a lesser extent the vote count, were assessed positively by IEOM observers, “significant problems were noted during the tabulation process in some election districts.” Observers also highlighted that the elections were conducted under particularly difficult political, economic and security circumstances.(2) Due to challenges to Ukraine’s territorial integrity, only 423 of 450 seats in the *Rada* were filled.

The above mentioned conclusions were reaffirmed by the OSCE/ODIHR-led international assessment of local elections in October and November 2015. International observers assessed the elections as “competitive, well organised overall” and the campaign as “generally showed respect for the democratic process.” Some criticism was nevertheless expressed in relation to the complexity of the legal framework, the dominance of the powerful economic groups, and the fact that virtually all campaign coverage in the media was paid for.(3)

The next presidential and parliamentary elections are due in spring and autumn 2019 respectively. The OSCE/ODIHR, the EU, and the Venice Commission and Parliamentary Assembly of the Council of Europe (PACE), have called on Ukraine to undertake a comprehensive electoral reform with the aim to harmonise its election legislation regulating all types of elections.(4)

## *Separation of powers and effective checks and balances*

Ukraine has a parliamentary-presidential system of government. The December 2004 constitutional amendments diminished the powers of the president and strengthened the position of the Prime Minister (PM). The amendments were overturned in October 2010 when, under the previous administration, the Constitutional Court controversially considered the 2004 amendments unconstitutional. In February 2014, the *Verkhovna Rada* overwhelmingly passed a law reinstating the 2004 constitutional amendments.

The executive power is shared between the PM and the president. The president is the head of state elected for a five-year term on the basis of the direct suffrage. The PM heads the Cabinet of Ministers which is the highest authority in the system of bodies of executive power. Relationship between the PM and the president has not been free from competition. Legislative power is vested in the *Verkhovna Rada*, elected for five years. The *Rada* appoints the PM upon the submission by the president who acts on the proposal of a parliamentary coalition. The *Rada* also appoints – upon the submission of the president – the ministers of defence and foreign affairs, and all other ministers upon the submission of the PM.

(1) OSCE/ODIHR Election Observation Mission (EOM): Ukraine, Early Presidential Election, 25 May 2014, Final Report, Warsaw, 30 June 2014, pp. 1-4.

(2) OSCE/ODIHR EOM: Ukraine, Early Parliamentary Elections, 26 October 2014, Final Report, Warsaw, 19 December 2014, pp. 1-6.

(3) OSCE/ODIHR EOM: Ukraine, Local Elections, 25 October and 15 November 2015, Final Report, Warsaw, 19 February 2016, p. 1.

(4) OSCE/ODIHR EOM: Ukraine, Local Elections, Final Report, p. 32; European Commission (EC) and High Representative of the Union for Foreign Affairs and Security Policy (HR): Joint Staff Working Document, Association Implementation Report on Ukraine, Brussels, 4 November 2017, p. 4; PACE: Resolution 2145 (2017) on “The functioning of democratic institutions in Ukraine”, 25 January 2017, p. 3.

# Annex 1 – Political Assessment in the Context of Article 1

Ukraine's constitution ensures for the principles of separation of legislative, executive and judicial powers. Some international bodies, e.g. the PACE, take the view that the ongoing constitutional reform in Ukraine is also needed in the area of the division of powers, with a view to addressing the remaining deficiencies.<sup>(5)</sup>

## *Effective power to govern of elected officials*

Elected officials have effective power to govern. Civilian authorities have generally maintained effective control over military and security forces. There has been, however, a close relationship between political and business elites, and oligarchic interests have had significant influence over the country's political life.

## **Civil society, Media and Participation**

### *Scale and independence of civil society*

Ukraine's civil society is large, diverse, independent, vibrant and active. Since the EuroMaidan revolution, it has become one of the strongest actors in Ukraine's democratic transition, playing a crucial role in promoting, designing and overseeing reforms. Civil Society Organisations (CSOs) have been particularly proactive in setting and promoting anti-corruption agenda.

According to official data, there were over 90,000 public associations, charity organisations, creative unions and other professional associations registered in Ukraine at the end of 2016. Public perception of CSOs, especially of volunteer organisations, is very positive, and the level of trust in them is one of the highest (together with churches and the army).

At the same time, due to economic situation in recent years, CSOs have been faced with limited public and private funding. International donors have continued to support Ukrainian CSOs, but this support is mainly project-driven: only few international donors cover the administrative or indirect costs of CSOs.

### *Independence and pluralism of media operating without censorship*

The media environment in Ukraine is lively, vivid and diverse, with a wide range of media outlets, both public and private. Television is the main source of political information, followed by on-line media and periodicals. The legislation generally provides a sound framework for freedom of the media. The media autonomy is, however, affected by political or corporate interests of media owners, leading to politicization of the media sector at both national and regional levels. <sup>(6)</sup> An important safeguard against undue concentration of media ownership and a prerequisite of media pluralism was the adoption in September 2015 of a law on transparency of media ownership.

The war in the east and the overall deterioration of the security situation in the country have, however, jeopardised journalists' safety. There have been instances of physical attacks against journalists, along with impunity for those who committed such crimes, although the authorities were strongly condemning all such cases. The investigation into the high-profile killing of prominent journalist Pavel Sheremet in July 2016 has not yet brought results.<sup>(7)</sup> Citing national security, the Ukrainian government took several steps to restrict the use of Russian media in Ukraine. The EU and Ukraine agree on the importance of a pluralistic media environment, taking due care as to the proportionality of measures to protect national security.<sup>(8)</sup>

Media freedom and safety of journalists have deteriorated in particular in the annexed Crimea and in the conflict-affected parts of Ukraine, as condemned regularly by the OSCE Representative on Freedom of the Media.<sup>(9)</sup>

<sup>(5)</sup> PACE: Ibid, p. 2.

<sup>(6)</sup> OSCE/ODIHR EOM: Ukraine, Early Parliamentary Elections, Final Report, p. 19, and Early Presidential Elections, Final Report, pp. 18-19.

<sup>(7)</sup> OSCE Representative on Freedom of the Media (RFoM): Statements on 25 October, 20 October and 20 July 2017, 11 May and 26 February 2016, and 16 April 2015; EC/HR report, 2017, p. 4; PACE: Resolution 2145 (2017), p. 1 and the report accompanying, pp. 8-9.

<sup>(8)</sup> EU-Ukraine Association Council: Joint Statement, 8 December 2017, p. 1.

<sup>(9)</sup> OSCE RFoM: Statements on 3 February and 24 January 2017, 19 April 2016, and 1 April and 13 March 2015.

# Annex 1 – Political Assessment in the Context of Article 1

## *Multiple channels of civic and political participation*

Ukrainian citizens enjoy multiple channels of civic and political participation. The Revolution of Dignity produced a mass mobilisation and has had a lasting impact on the culture of civic engagement in Ukraine. Ukrainian CSOs are very active in their advocacy efforts and have become effective at influencing public authorities at all levels. In recent years, leading CSOs have contributed in a major way to the development of reform legislation and its implementation. The government often relies on CSO expertise. Work to improve mechanisms for civic participation in policy making at national and local levels continues: a draft law on Public Consultations has been prepared. At the same time, some civil society actors have recently denounced increased pressure on their activity.(10)

## *Freedom to form political parties and existence of organised opposition*

The freedom of political activity is guaranteed by the Constitution and implemented in practice. Ukraine has a multi-party system. Around 350 political parties are officially registered. 29 political parties and blocs contested in the last (2014) parliamentary elections. Six overcame the 5% electoral threshold and entered the parliament. Opposition parties are able to campaign freely and oppose government initiatives.

Nevertheless, the majority of parties in Ukraine have small membership and unclear ideological platforms. Political parties are often influenced by business interests, and popular trust in parties is low overall. A major achievement in recent years has been the establishment of public funding to political parties. Ukraine has also put in place a new legislative framework improving the transparency of party funding, although much remains to be done in respect of the implementation of the new laws.(11)

## **Rule of Law and Access to Justice**

### *Supremacy of the law*

The principle of the rule of law is enshrined in Ukraine's Constitution, and necessary legislative and institutional safeguards for the supremacy of the law are in place. The right to a fair trial is also envisaged in the legislation, although the remaining need to enhance the independence of the judiciary and the functioning of prosecution undermines this right.

### *Independence of the judiciary*

While the Constitution provides for the independence of the judiciary, interference in the work of the judiciary had been common. After the Revolution of Dignity, Ukraine has embarked on a comprehensive reform of the judiciary. Constitutional amendments, adopted in June 2016, aimed at strengthening the independence of the judiciary and at ensuring an effective justice system, in line with European norms and international recommendations. The steps taken since have included the adoption of a new law on the Constitutional Court, the launch of the new Supreme Court, and the start of reorganisation of the system of lower courts. Following the introduction of the stringent anti-corruption legislation and public procedure on the evaluation of judges, almost 1,700 judges have voluntarily left their positions. The selection of judges to the new Supreme Court was assessed as transparent overall – nevertheless, the Public Integrity Council, which includes civil society representatives, has questioned the integrity, independence and professional record of some of the proposed candidates. As a result of the ongoing reform, the perceived level of judicial independence is increasing, although much remains to be done. (12) The last meeting of the EU-Ukraine Association Council (December 2017) agreed on the need to continue the implementation of the judicial reform.(13)

(10) EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 4.

(11) GRECO: Third Evaluation Round, Second Compliance Report on Ukraine, "Transparency of Party Funding", Strasbourg, 4 December 2015, p. 16.

(12) EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 6; PACE: Resolution 2145 (2017), p. 2 and the report accompanying it, pp. 12-14.

(13) EU-Ukraine Association Council: Joint Statement, 8 December 2017, p.1.

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## *Government and citizens equally subject to the law*

The Constitution guarantees the equality of all citizens before the law. To ensure this fully in practice, the effective administration of justice, in particular the independence, effectiveness, transparency and accountability of the judiciary and the functioning of prosecution, need to be enhanced. In a welcome development, the recent constitutional amendments and a new law on the Prosecutor's Office adopted in 2014 have abolished the general oversight function of the Prosecutor General, which was contrary to European standards and norms.<sup>(14)</sup> Nevertheless, the prosecution service, along with courts, continues to be one of the least-trusted public administration institutions. Their reforms need to continue, and the effective enforcement of laws has yet to be achieved.<sup>(15)</sup>

## *Effective policies and institutions to prevent corruption*

Widespread corruption was one of the catalysts for the Revolution of Dignity. Since then, fighting corruption has become a key demand of the Ukrainian society. Ukraine has achieved remarkable progress in laying the legislative, policy and institutional foundations for reducing corruption levels. Comprehensive anti-corruption legislation has been put in place, and a new institutional framework comprising specialised anti-corruption bodies, such as the National Anti-Corruption Bureau (NABU), the Specialised Anti-Corruption Prosecutor's Office (SAPO), the National Agency for Prevention of Corruption (NAPC) and the Asset Recovery and Management Agency (ARMA), has been set up. Ukraine has also achieved significantly increased level of transparency, *inter alia*, by establishing the electronic asset declaration system (with around one million public officials having filed their e-declarations), introducing the innovative ProZorro public procurement system, opening up the public registries, including of beneficiary owners, implementing fiscal decentralisation, and enforcing a new civil service law establishing rules on ethics and conflict of interest. All this has significantly diminished the space for corruption.

Despite the achievements, corruption continues to be a main issue of concern, and the public perception of the level of corruption, especially in the judiciary, remains high. Transparency International ranked Ukraine 130<sup>th</sup> out of 180 countries on its 2017 Corruption Perceptions Index – only a one point improvement compared to 2016. Furthermore, relevant international organisations and international financial institutions (IFIs) have in recent months raised concerns about a serious risk of backsliding on anti-corruption reforms, including pressure on new anti-corruption institutions and anti-corruption civil society activists.<sup>(16)</sup>

Sustainable and tangible changes in the governance system to eliminate corruption opportunities and ensure proper prosecution and punishment for corruption-related crimes remain therefore one of the key challenges. The EU-Ukraine Association Council and relevant international organisations and IFIs have all stressed the remaining need to ensure the necessary independence, operational capacity and full effectiveness of the specialised anti-corruption institutions, and the particular importance of establishing a specialised anti-corruption court, in full compliance with the Venice Commission opinion, and ensuring its full independence, as well as guaranteeing an effective mechanism for the verification of electronic asset declarations and subsequent asset recovery. <sup>(17)</sup> Ukraine has also been called to repeal the extension of e-declaration obligation on civil society activists.<sup>(18)</sup>

<sup>(14)</sup> PACE: Resolution 2145 (2017), p. 2 and the report accompanying it, pp. 12-13; OECD: Anti-corruption reforms in Ukraine, 4<sup>th</sup> round of monitoring of the Istanbul Anti-Corruption Action Plan, 2017, pp. 9-10.

<sup>(15)</sup> EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 7.

<sup>(16)</sup> OECD: Ibid, p.6; European Commission: Statement by Commissioner Hahn on the extension of e-declaration obligations to civil society in Ukraine, 28 March 2018; European External Action Service: Statement of the spokesperson on recent developments in the fight against corruption in Ukraine, Brussels, 5 December 2017; IMF: Statement on the efforts to fight corruption in Ukraine, Washington, D.C., 6 December 2017. See also, European Commission for Democracy through Law (Venice Commission) and the OSCE/ODIHR: Joint Opinion on Draft Laws No. 6674 and 6675 on introducing changes to some legislative acts to ensure public transparency on the financing of public associations and of the use of international technical assistance, Venice, 16-17 March 2018.

<sup>(17)</sup> Venice Commission: Opinion on the draft law on anti-corruption courts in Ukraine, Venice, 6-7 October 2017; EU-Ukraine Association Council: Joint Statement, 8 December 2017, p. 1; EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 2; PACE: Resolution 2145 (2017), pp. 2-3 and the report accompanying it, pp. 14-16; OECD: Ibid, pp. 6-10; GRECO: Evaluation report on Ukraine – Fourth evaluation round, Corruption prevention in respect of members of parliament, judges and prosecutors, Strasbourg, 23 June 2017, pp. 4-5.

<sup>(18)</sup> European Commission: Statement by Commissioner Hahn, 28 March 2018; Venice Commission and OSCE/ODIHR: Joint Opinion on Draft Laws No. 6674 and 6675, Venice, 16-17 March 2018.

# Annex 1 – Political Assessment in the Context of Article 1

## *Civil and Political Rights*

### *Freedom of speech, information, religion, conscience, movement, association, assembly and private property*

Ukraine is committed to the respect for human rights and fundamental freedoms. As member of the UN, the Council of Europe and the OSCE and being in Association Agreement with the EU, Ukraine is party to almost all core international human rights treaties, and cooperates well on them. The assessment of the human rights track record of Ukraine in the framework of the third cycle of the UN Universal Periodic Review was completed in February 2018, with Ukraine having accepted the vast majority of the recommendations received.(19)

The country has also developed a strong national legal basis for the protection of civil and political rights that has been improved further after the EuroMaidan revolution. In 2015, Ukraine adopted its first ever, ambitious National Human Rights Strategy and Action Plan for 2015-2020, containing clear timelines and definition of responsibilities, although some of the deadlines set have been missed. The EU and Ukraine hold annual Human Rights Dialogue in the framework of the Association Agreement.

The overall human rights and humanitarian situation in Ukraine has been influenced dramatically by the war in the east and the annexation of Crimea and Sevastopol, which have resulted in a series of serious violations of human rights and of international humanitarian law, and restrictions on freedom of movement, which are difficult for the Ukrainian government to address.(20) In December 2016 and December 2017, the UN General Assembly adopted resolutions on the situation of human rights in the Autonomous Republic of Crimea and the city of Sevastopol (Ukraine), which pointed to the sharp deterioration in the overall human rights situation on the peninsula, echoed in a decision by the Committee of Ministers of the Council of Europe and the joint Report by the OSCE ODIHR and High Commissioner on National Minorities.(21)

The rights of the Crimean Tatars have in particular been gravely violated, including the banning of the activities of the Mejlis, their self-governing body, the persecution of its leaders, and the shutting down of Crimean Tatar media outlets.(22)

(19) UN Human Rights Council: Compilation on Ukraine – Report of the Office of the United Nations High Commissioner for Human Rights (OHCHR), 4 September 2017, p. 5.

(20) EU: Annual Report on Human Rights and Democracy in the World in 2016, p. 60; Council of Europe Commissioner for Human Rights: Report following his visit to Ukraine from 29 June to 3 July 2015, Strasbourg, 3 November 2015, and Report following his visit to Ukraine from 21 to 25 March 2016, Strasbourg, 11 July 2016.

(21) UN General Assembly (UN GA): Resolution 71/190 on the Situation of human rights in the Autonomous Republic of Crimea and the city of Sevastopol, Ukraine, adopted on 19 December 2017, and Resolution 71/205, 19 December 2016; See also: UN GA: Resolution 68/262 on Territorial Integrity of Ukraine, adopted on 27 March 2014; UN Human Rights Council: Situation of human rights in the temporarily occupied Autonomous Republic of Crimea and the city of Sevastopol (Ukraine), 25 September 2017; Council of Europe Committee of Ministers: Decision on the Situation in the Autonomous Republic of Crimea and the city of Sevastopol (Ukraine), CM/Del/Dec(2017)1285, 3 May 2017; OSCE/ODIHR and High Commissioner on National Minorities: Report of the Human Rights Assessment Mission on Crimea (6-18 July 2015), 17 September 2015; see also PACE: Resolution 2132 (2016) of 12 October 2016 on Political consequences of the Russian aggression in Ukraine.

(22) European Parliament: Resolution on Human rights situation in Crimea, in particular of the Crimean Tatars (P8\_TA(2016)0043), 4 February 2016.

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Subjected to unaccountable rule and excluded from the legal system applying to the rest of Ukraine, the population living in the non-government controlled territories of eastern Ukraine has been “effectively denied protection and deprived of basic human rights and freedoms,” as reported by the Office of the UN High Commissioner on Human Rights (OHCHR).(23)

Referring to the impact of the ongoing conflict, Ukraine has given notice of derogations from certain provisions of the International Covenant on Civil and Political Rights and of the European Convention on Human Rights.

The OHCHR also noted the widespread impunity for perpetrators of human rights violations, often justified by the challenges posed by the ongoing conflict. The EU and other international bodies continue to call on Ukraine for further progress to be made in the investigations into the crimes committed during the EuroMaidan protests and the violent events in Odesa on 2 May 2014.

### *Political inclusiveness for women, ethnic and other minorities*

Ukraine’s Constitution prohibits any privileges or restrictions based on race, political, religious and other beliefs, sex, ethnic and social origin, linguistic or other characteristics.

Legislative and other changes in recent years, including the amended law on Principles of Prevention and Combating Discrimination, the new Labour Code, and the national Programme on the Equality of Rights and Opportunities between Men and Women (2017-2021), have further strengthened a ban on all forms of discrimination. According to the European Commission’s sixth and final progress report on Ukraine’s implementation of the action plan on visa liberalisation, the Ukrainian government has achieved the benchmark related to citizens’ rights, including protection of minorities and anti-discrimination.(26)

Profile international bodies have welcomed Ukraine’s efforts to increase the participation of women in political and public life. Nevertheless, women remain significantly underrepresented at the decision-making levels. In the parliament women comprise only 11.3% of all MPs (the European average is 25.6%), and in senior and junior ministerial positions there are only 6.3% of women (compared to the European average of 22.4%), making Ukraine one of the lowest scoring countries – members of the Council of Europe.(27) Gender-based discrimination remains a challenge. Although Ukraine has signed the Council of Europe Convention on preventing and combating violence against women and domestic violence (Istanbul Convention), the parliament has not yet ratified it.(28) Ukraine, however, adopted the national law on Preventing and Combating Domestic Violence, and in 2017 the government established the Office of the Commissioner for Gender Equality.

Ukraine is a multicultural, multi-ethnic society. The participation of a large number of native Russian speakers and of Crimean Tatars in the recent elections was, however, diminished severely by the crisis in the east and the illegal annexation of the Crimean peninsula.

(23) UN Human Rights Council: Compilation on Ukraine – Report of the Office of the United Nations High Commissioner for Human Rights (OHCHR), 4 September 2017, p. 5.

(24) Ibid, p.5.

(25) EU-Ukraine Human Rights Dialogue, Joint Press Release, Kyiv, 13 June 2017

(26) EC: Sixth Progress Report on the Implementation by Ukraine of the Action Plan on Visa Liberalisation, Brussels, 18 December 2015, pp. 10-11.

(27) UN Committee on the Elimination of Discrimination against Women (CEDAW): Concluding observations on the eighth periodic report of Ukraine, 9 March 2017, p. 11; Council of Europe Gender Equality Commission: Balanced participation of women and men in decision-making, Analytical Report – 2016 data, September 2017, pp. 23-25, 42-43.

(28) EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 3; PACE: Resolution 2145 (2017), p. 3.

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The OSCE/ODIHR recommended to the Ukrainian authorities to *inter alia* amend the electoral legislation with a view to enhance national minority representation at the local level.<sup>(29)</sup> The language provisions of the new education law, adopted in September 2017, have sparked controversy both domestically and internationally – they are now expected to be implemented in line with ensuing recommendations by the Venice Commission of the Council of Europe.<sup>(30)</sup>

As a result of the war and difficult humanitarian situation in the east, Ukraine has got more than 1.6 million IDPs whose integration remains a challenge.<sup>(31)</sup>

In its recent Compilation on Ukraine, the OHCHR was concerned at reports of increased hate crimes and incidents. While noting some positive efforts by the authorities, the OHCHR indicated that “hate crimes remained underreported and that there was no government system in place for monitoring such crimes.”<sup>(32)</sup>

### *Freedom from harassment, intimidation and torture*

Ukraine’s Constitution prohibits torture and cruel, inhuman or degrading treatment or punishment. The National Preventive Mechanism to prevent torture and ill-treatment was established in 2012, under the auspices of the Human Rights Ombudsman. However, the armed conflict in the east of the country and the illegal annexation of Crimea, which have raised dramatically the level of violence and insecurity, pose a significant challenge to the exercise of this constitutional right.

Although relevant international bodies have acknowledged major reforms in the field of law enforcement, they have criticised the Ukrainian government for cases of forced disappearances, arbitrary detention and ill-treatment.<sup>(33)</sup> The most severe cases of torture, ill-treatment and/or inhuman conditions of detention have been recorded in the areas not under the Ukrainian government control, where the rule of law and public order has collapsed.<sup>(34)</sup>

(29) OSCE/ODIHR EOM: Ukraine, Local Elections, 25 October and 15 November 2015, Final Report, pp. 22-23

(30) Venice Commission: Opinion on the provisions of the law on education of 5 September 2017, Strasbourg, 11 December 2017; Committee of Ministers of the Council of Europe: Decision on Situation in Ukraine (CM/Del/Dec(2017)1299/2.1bis), 8 November 2017.

(31) EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 3; PACE: Resolution 2198 (2018) on “Humanitarian consequences of the war in Ukraine”, 23 January 2018.

(32) UN Human Rights Council: Compilation on Ukraine – OHCHR Report, 4 September 2017, p. 3.

(33) The European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT): Report to the Ukrainian Government on the visit to Ukraine from 21 to 30 November 2016, Strasbourg, 19 June 2017.

(34) UN Human Rights Council: Compilation on Ukraine – OHCHR Report, 4 September 2017, p. 3; EU: Annual Report on Human Rights and Democracy in the World in 2016, p. 60; EC/HR: Association Implementation Report on Ukraine, 14 November 2017, p. 3.