

USAID/Ukraine

Annual Report

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Ukraine

Performance:

Background: In 2004, the Ukrainian economy continued to recuperate and attract new investments. By the end of September, GDP growth rate exceeded 13 percent; foreign direct investments (FDI) increased by 15 percent and positive trade balance reached 15 percent. Still, private sector development continued to be characterized by onerous business barriers, including: heavy dependence on several basic industries (transport, utilities, coal production), and an agricultural sector still heavily dependent on government subsidies; sizeable arrears (up to 25 percent of accounts payable); and disproportional investments in real estate combined with huge capital outflows and accumulation of the most valuable industrial, commercial and financial assets in the hands of several politically powerful Ukrainian and Russian clans.

The GOU economic policies in a pre-election environment became increasingly nontransparent and focused on short term fixes, which contributed to the growing budget deficit (about 4 percent of GDP), inflation (up to 12 percent), and price instability in the food, gasoline, and financial markets. Benefiting from accelerated economic growth, resumed large privatization, and an improved international credit rating, the GOU continued to provide huge subsidies to loss-making enterprises, invest in nuclear stations and transport infrastructure, and increase pensions and public sector salaries. At the same time, it made little progress in removing impediments to sustainable economic growth, such as eliminating tax privileges, strengthening budget discipline, improving intergovernmental transfers, reducing value added tax arrears, etc. Not surprisingly, the International Monetary Fund (IMF) and the World Bank (WB) have not resumed cooperation with Ukraine as planned.

Democratic reform in Ukraine had gotten off to a relatively quick start in the mid to late 1990's; however, but over the past three to four years reforms were sidetracked, as the government increasingly exercised unwarranted pressure over political and public life. Ukraine's media operated in a steadily worsening climate dominated by an accelerating presidential election campaign characterized by government and oligarchic control of information and abuse of administrative resources. Promising signs of political reform and empowerment among the elected local governments have recently become evident, but weak political accountability, unequal enforcement of law and tightly controlled media have continued to restrain Ukraine's democratic development.

In education, basic services and health, weak government policies, corruption, and outdated management practices continue to hinder the state's ability to provide adequate services and protect the vulnerable population.

Donor Relations: The largest donor in Ukraine is the European Bank for Reconstruction and Development with a portfolio in agribusiness, financial sector, energy sector, transport and telecommunications. The World Bank supports programs in public finance, energy and utilities, rural development, health and social protection. United Nations Development Program provides assistance in governance, poverty reduction, health and environment protection, education and human security. The European Union TACIS program supports legal and administrative reform, civil society development, SME development, housing and municipal services, energy sector reform, health and social security. The United Kingdom (UK) provides assistance in governance, economic integration, social protection, and democracy building. Canada provides assistance to strengthen governance and civil society. Sweden focuses on natural resource management, public administration, infrastructure and urban development, and democracy building. Germany finances predominantly economic and social research.

U.S. Interests and Goals: Ukraine's strategic location on the eastern border of NATO and the European Union (EU), and its large and educated population make it a key player in the stability of Eastern Europe.

Ukraine can best contribute to regional stability by pursuing a democratic political transition in 2004 through a free and fair presidential election. U.S. Government assistance programs are designed facilitate Ukraine's transformation to a democratic society with a market-based economy, a pre-condition for achieving Ukraine's stated objective of integration into NATO and the EU. A member of the Partnership for Peace, Ukraine opened its airspace in support of Operation Enduring Freedom and contributed the fourth largest contingent of troops to Operation Iraqi Freedom. Ukraine inherited an extensive weapons-of-mass-destruction (WMD) infrastructure from the Soviet Union, and it is in the U.S. interest to ensure that Ukraine's technological capabilities are directed to civilian purposes and safeguarded with appropriate controls.

Challenges: In the recent past, Ukraine has made important strides in macroeconomic reforms, price liberalization, and small-scale privatization but competing national visions and policy intransigence have held back Ukraine's aspired transition to democratic governance, broader economic development, and Western-oriented political and economic institutions. Although the economy has been expanding dynamically since 2001, delays in structural reforms still stymie more profound, developmental progress and reduction of poverty.

Ukraine has made little progress in its second-stage economic reforms, which focus on developing sustainable market instruments. This is particularly true, for example, in the case of building a financial sector critical to the long-term sustainability and growth of a free-market economy. Despite major progress associated with the introduction of risk-based bank supervision, the financial sector regulatory bodies remain inexperienced and weak with an inadequate legal and regulatory framework. As a consequence, the financial sector and its institutions are still woefully inadequate to support economic growth. For example, the advent of a new pension system in Ukraine is expected to generate contributions in excess of \$1 billion by 2007. Available financial and investment instruments can absorb only a fraction of this amount.

The creation of a stable and secure financial sector is the most critical missing component in Ukraine's transition to a free market economy. Ukraine has made little progress in its second-stage economic reforms, which focus on developing market instruments. Despite major progress associated with the introduction of risk-based bank supervision, establishing a secure and stable financial sector, modernizing international accounting practices, increasing corporate governance transparency and introducing program-based budgeting for local government are still Ukraine's key economic challenges.

The social care systems continue to be characterized by low staff morale, obsolete equipment, and ineffective practices. Rates of abortion, suicides, domestic violence, alcoholism, and prostitution remain high. Up to 10 percent of Ukrainians need serious medical treatment. HIV/AIDS, tuberculosis (TB), and other infectious diseases have been increasing at an alarming rate. Low school enrollment rates and the numbers of abandoned children raise a particular concern. About a quarter of the population still lives in poverty, and about a third has a daily diet containing less than 2100 kilo-calories.

Key Achievements:

Improved Investment Climate: USAID's economic growth projects offered key 2004 results that are importantly contributing to an improved investment environment in Ukraine. Among them: USAID assistance is enabling the GOU to bring its legislative and regulatory framework into compliance with WTO requirements and eventually help Ukraine achieve "market economy" status. Specifically, the GOU brought sanitary and phytosanitary regimes into compliance with WTO requirements, meeting USAID estimates 65 percent of the requirements for membership in 2004 and greatly increasing the likelihood of Ukraine's WTO accession in 2005. The American Institute of Certified Professional Accountants and the International Accounting Standards Committee Foundation partnered with USAID in the CIPA Global Development Alliance to give the CIPA certification greater international credibility and added value to Ukraine's enterprise accountants. Since May 2002, CIPA-EN has administered nearly 10,000 exams in Ukraine, with a record 2,000 exams administered in November 2004 alone. Nearly 1,000 accountants have earned first level certification as Certified Accounting Practitioners (CAP). More than 80 percent of these CAPs are women currently working in Ukraine's small and medium enterprises, insurance companies, commercial banks, and audit firms. USAID's Commercial Law Resource Center provided assistance to draft and support the recent enactment of Ukraine's national mortgage and national leasing

laws the new mortgage law, which came into effect in January, 2004, leading to \$450 million in new mortgage loans. Mortgage and leasing laws already had a profound impact on Ukraine's 2004 economy: USAID estimates that the current mortgage market for residential real estate is valued at \$500 million and could increase 30 - 40 percent over the 2005-2007 period to \$700 million, generating no less than five million secure loans totaling \$5 billion over the next two years. The National Bank of Ukraine adopted "risk-based" supervision as recommended by the BASEL accords, thereby improving the overall soundness of the banking system and increasing investors' confidence (As a result, personal bank deposits have increased by 40 percent through October 2004). The Overseas Private Investment Corporation (OPIC) made two loans valued at \$40 million to the International Mortgage Bank and the ProCredit Bank as a result of a USAID evaluation of the commercial banking sector and USAID's technical assistance in mortgage lending.

USAID's current program to accelerate SME and agriculture growth is making an impressive contribution to Ukraine's agricultural and small business economy, providing on average ten dollars of economic benefits for every dollar spent and contributing nationally to Ukraine's 25 percent increase in processed fruits and vegetables (F&V). The programs with the greatest benefit-cost ratios are the agricultural policy project, which has a benefit-cost ratio of \$867 and the Grain Warehouse Receipts program which has a ratio of \$267. USAID's support led to an increase in the volume of fruits and vegetables (F&V) traded by 41,330 MT of processed, value-added F&V with an estimated value of \$7.1 million. USAID's agricultural programs also created 3,000 new seasonal and full-time jobs in 2004 with a net gross wage value of \$1.5 million. USAID's Grain Warehouse Receipts program improves credit access for the entire grain and oilseeds market. The overall impact of the program has been to broaden the range of available processed foods, improve food quality, and lower the cost of staples such as bread.

USAID has directly and indirectly assisted more than 130 cities across Ukraine to apply improved procedures for business registration: 70,000 enterprises have used USAID-supported hotlines to receive critical information on regulatory issues, taxes, registration, and other issues. Entrepreneurship training enabled 30 percent of graduates to launch businesses and 20 percent to find employment. The average cost of business registration decreased by 55 percent. The average time required to register and obtain business licenses and permits decreased by about 50 percent. On average, corruption related to business registration decreased by 84 percent.

In 2004, USAID projects increased access to credit in Ukraine with 97,507 loans valued at \$298 million. In total, more than 215 thousand loans with a cumulative value of \$1 billion and with no more than 5 percent defaults have been made with USAID assistance. Generally, these loans went to micro enterprises, SMEs and agriculture. Due to the enactment of the mortgage and leasing laws achieved with USAID legal assistance, mortgage and financial leasing loans increased rapidly in the third quarter of 2004. In 2004, \$97 million of direct investments, loans and leases occurred through USAID's support to the West/NIS Enterprise Fund.

USAID utilized a Development Credit Authority (DCA) grant - a partial loan guarantee mechanism for medium- and long- term loans - to extend loans to small farmers and agricultural input suppliers through a private Ukrainian bank (Nadra). In 2004, Nadra Bank made 115 loans valued at \$1.5 million. The average loan disbursed is \$13,000. Nadra Bank and UkrSibBank also signed Municipal Credit DCA guarantee agreements to help local governments improve the delivery of municipal services to local citizens and local industries through increased access to credit for infrastructure improvements.

USAID assistance in business management education enabled 50 Ukrainian educational institutions offering business and management education to establish and staff MBA and undergraduate programs that are gradually evolving toward international standards of quality.

USAID's activities aimed to advance the growth of democracy and good governance achieved the following results in FY04: 1) an increase in public awareness of reform issues among Ukrainian citizens from 46.13 percent in 2003 to 48.65 percent in 2004; 2) an increase in civil society capacity and sustainability as measured by a lower score on the 2004 NGO Sustainability Index (from 3.9 to 3.8 in 2004); 3) improved coalition-building among various political factions; 4) an improved electoral framework

through passage of legislation governing local, parliamentary and presidential elections; 5) the establishment of a network of nationwide organizations and coalitions that launched a massive voter education campaign; and 6) the launching of a nationwide voter education campaign to provide citizens with balanced and accurate information through literally thousands of Public Service Announcements.

The Mission's health portfolio addressed critical health and social needs as well as global USAID and USG priorities. By linking its maternal and infant health project with its reproductive health policy project, USAID assisted the Ministry of Health (MOH) in developing and adopting a new order on inpatient care of mothers and newborns, founded on international, evidence-based principles. To ensure the sustainability of results, USAID also initiated the integration of pilot practices into training curricula for medical students, midwives, and pediatric nurses. Coverage of Directly Observed Treatment Short Course (DOTS) in the pilot region increased from 80 to 100 percent, with regional TB case-detection rates improved from 40 to 52 percent. Evidence-based training of medical personnel in Donetsk resulted in a drop in caesarean sections from 18 to 11 percent of deliveries, an average daily weight increase among newborns of seven grams, and the virtual elimination of hypothermia among newborns. This contributed to significant declines in the infant (IMR) and maternal mortality rates (MMR). The IMR decreased from 10.3 per 1,000 live births in 2003 to 9.6 in 2004; and the MMR from 17.4 per 100,000 live births to 14.2.

USAID assistance was crucial in correcting mismanagement issues with the Global Fund Against AIDS, Tuberculosis and Malaria's \$92 million grant to Ukraine. By alerting the Global Fund about significant delays in implementation, possible financial irregularities, and conflict-of-interest issues, USAID was instrumental in redirecting the GFATM grant to partners better able to manage it. With GFATM and USAID support, Ukraine has gone from being a non-performer in the critical area of HIV prevention, treatment, care and support, to the top 10 percent of high performing grants worldwide. Today, USAID is providing significant resources for HIV/AIDS prevention efforts in Ukraine - second only to the Global Fund grant - which supplement and complement Global Fund activities.

The new HIV/AIDS Special Objective aims to reduce transmission of HIV through the adoption, promotion, and facilitation of protective behaviors, and mitigate the impact of HIV/AIDS on those affected. USAID developed the capacity of 33 Ukrainian NGOs to work with high risk groups and actively involve them in HIV prevention and care programs. Building on the NGO Secretariat supported under the previous program, local NGOs established a coalition of HIV-service NGOs to advocate for non-governmental sector involvement in planning and implementing policies and projects throughout Ukraine. USAID provided technical assistance to this newly formed coalition of HIV-service NGOs (HIV NGO Coalition) to develop their three-year strategic plan.

Advancing the USG anti-trafficking policy, USAID assisted seven NGOs to operate Women for Women Centers (WWC) to train and support 44,000 women to seek employment, address domestic and workplace violence, and disseminate information on TIP. More than 5,000 (11 percent) found new jobs and more than 4,700 women and girls (10 percent) entered re-qualification or continuing education programs. USAID helped the GOU to launch a new three-tier pension system in January 2004 for some 14 million pensioners, comprising 30 percent of the population on the country. The new State Commission for the Regulation of Financial Services Markets issued the first licenses for 26 private pension funds.

In FY04, USAID supported conducting the following evaluations and assessments: financial sector assessment; BIZPRO project mid-term evaluation; countering trafficking in persons evaluation; assessment of the status of reproductive health in Ukraine; and assessment of the family planning and contraceptive availability in Ukraine.

In FY05, USAID is scheduling the following evaluations and assessments: assessment of the willingness and ability of persons to pay for modern contraceptives in Ukraine; assessment of contraceptive availability as related to products, services, procurement, management, distribution, and logistics through the private sector; assessment to estimate the need for HIV commodities and to estimate their availability through the public and private sectors in urban and rural areas; abbreviated survey of knowledge, attitudes, and practices of men who have sex with men in Ukraine to assist in the planning of activities

aimed at reducing HIV transmission among high-risk groups; strategic assessment of SO 121-0213 and SO 121-0224 as part of an overall democracy and governance assessment with one or more sub-sector assessments likely to follow; and evaluation of the effectiveness of USAID's land titling project and its impact on future agricultural land sales.

Results Framework

121-0120 Increased Soundness of Fiscal Policies and Fiscal Management Practices

121-0130 Accelerated Growth and Development of Private Enterprises

121-0131 Privatized Enterprises are More Competitive and Efficient

121-0132 Growth of SMEs and Agriculture

SO Level Indicator(s):

Private SMEs (including agribusinesses) value added as a share of total GDP

Share of registered private SMEs (including agribusinesses) employment in total employment

2.1 Legal and regulatory environment supports growth

2.2 Increased access to land and credit

2.3 Organized markets stimulate growth

121-0133 Expanded Role of Small and Medium Enterprises in National Economy

121-0140 A More Competitive and Market-Responsive Private Financial Sector

121-0141 Improved Investment Climate

SO Level Indicator(s):

Economic Intelligence Unit (EIU) Business Environment Rating

1.1 Business legal environment improved

1.2 Financial sector mobilization increased

121-0150 A More Economically Sustainable and Environmentally Sound Energy Sector

121-0160 Increased Environmental Management Capacity to Promote Sustainable Development

121-0210 Increased Better-Informed Citizens' Participation in Political and Economic Decision-Making

121-0213 Citizenry Increasingly Engaged in Promoting Their Interests and Rights

SO Level Indicator(s):

Citizens who are involved in civic action

Freedom House Nations in Transit Democratization Rating

3.1 Availability of quality information produced by targeted outlets increased

3.2 Effectiveness of civil society organizations increased

3.3 Political parties better represent citizens' concerns

3.4 More credible and competitive electoral process

121-0220 Legal Systems that Better Support Democratic Processes and Market Reforms

121-0224 Effective, Transparent and Accountable Government Institutions

SO Level Indicator(s):

Freedom House Nations in Transit Governance Rating

Local Good Government Index

4.1 Autonomy and responsiveness of local self-governance increased

4.2 More effective, independent and representative legislature

121-0230 More Effective, Responsive and Accountable Local Government

121-0320 Increased Promotion of Good Health and Access to Quality Health Care

121-0325 Improved Social Conditions and Health Status

SO Level Indicator(s):

Abortion Rate

Maternal mortality rate

Monthly old-age benefit in relation to poverty level for the elderly

5.1 Changed behaviors and systems to improve health

5.2 Conditions for targeted vulnerable groups are improved

121-0328 HIV Transmission among High Risk Groups Reduced and Impact on Those Affected Lessened

- 121-0340 Mitigation of Adverse Social Impacts of the Transition to Market-Based Democracies**
- 121-0410 Special Initiatives**
- 121-0416 Increased Environmental Protection**
- 121-0420 Cross-Cutting Programs**
- 121-0427 Program Support Initiatives**