

**REPORT TO USAID/KYIV
REGIONAL CONTRACTING OFFICE**

**REGIONAL ECONOMIC
DEVELOPMENT PROGRAM IN
EASTERN UKRAINE**

USAID CONTRACT NO.: 121-C-00-00-00832-00

FINAL REPORT

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ME&A

FINAL REPORT**Regional Economic Development Program in Eastern Ukraine****Contract No: 121-C-00-00-00832-00****October, 2000 – November, 2002**

Note: This report is supplemented by copies of materials developed during the project recorded on a CDROM that accompanies the report. The CDROM materials are referenced in the report and illustrate in depth, the activities which took place to implement the contract, training guides, results obtained, observations and conclusions drawn from the project.

Overview and history of the project

The contract was implemented in three phases. Phase I from October 2000 - March 2001; Phase II from April 2001 – March 2002, and Phase III from April 2002 – November 2002. During Phase I, effort was made to implement the original project as called for by the terms of the contract signed by ME&A. This implementation involved two major subcontractors, The Urban Institute (Washington DC) and Kharkiv Management Consulting International (KMCI), located in Kharkiv.

The goal of the original project, Phase I, was to draft a regional strategic plan to develop promising sectors of the Kharkiv regional economy. The work plan envisioned assessing the regional economy and identifying those sectors that could be the major drivers of regional economic development over the next 3-10 years. However, several months into Phase I it was recognized that this goal was not achievable. In January 2001, both the Oblast administration and the local USAID office called for a major redirection of the project.

Working with the Oblast administration, the project was redefined and a new work plan written. Phase II, under the name “Strategic Planning Activity” (SPA), had two major components, small city economic development strategic planning, and market and industry assessments of three sub sectors or industries of the Kharkiv economy. Both components were implemented. Two oblast subordinated cities and two raion subordinated towns were selected and assisted to perform economic development (ED) strategic planning and to established ED offices (EDOs). Sectors chosen for assessment included information technology, meat production and power machinery. Teams were established to evaluate markets for products and services of these industries, and to assess the status of Kharkiv firms producing these products and services. A third major activity during Phase II was organizing a trip to Ohio by Kharkiv businessmen which took place at the end of January 2002. This trip also included Governor Kushnaryov and other public officials. The public officials and businessmen participated together on some parts of the visit to Ohio, but also had separate activities. The SPA was responsible for the business portion of the trip. The Center for Economic Initiatives (CEI), Cincinnati OH, was contracted by the SPA to

arrange business forums and training for business participants in Ohio. The Kharkiv office of the International Executive Service Corps (IESC) helped prepare business participants prior to departure. The trip resulted in a business oriented sister region-state relationship between Ohio and Kharkiv and establishment of an Ohio-Kharkiv business NGO.

As the original contract was drawing to a close in March 2002, a contract extension (Phase III) was awarded to continue and expand smaller city ED strategic planning. In Phase III, the four initial communities were assisted in implementation of their strategic plans. Five new communities were added which included rural raion administrations, a city district of Kharkiv City, and in Kupyansk, a joint raion/city combination. The selection of these types of communities permitted testing the strategic planning approach in all types of Ukraine local administration. During Phase III, the nine participating communities formed a NGO, "Association for Economic Development of Kharkiv Oblast Communities" (Association) to support continued cooperation among these communities and others in local economic development.

During Phase II, the small city component of the SPA became a pilot for the design of a nationwide local economic development project. This report summarizes Phase I and briefly describes Phase II results. The sector assessment component of Phase II is also noted and the reports resulting from this work are included on the CDROM. However the Final Report focuses on lessons learned and insights gained from implementation of economic development planning and formation of economic development offices in the nine Kharkiv communities.

The CDROM contains documents in English, Ukrainian and Russian such as the complete strategic plans written by the initial four communities, training materials used, brochures generated by the communities for marketing themselves to businesses, surveys and other methods used to obtain public input, and samples of press coverage of the project and of SP activities carried out in participating communities. Annex B contains a table of contents of the CDROM.

Phase I. Assessment of the Kharkiv regional economy

The clients envisioned in the original project design were the Kharkiv City and Oblast administrations as well as major regional businesses and business associations. There was to be a rapid economic assessment of the region leading to identification of the most promising sectors for planning and assistance. The proposed strategy was based on foreign sector experts rapidly analyzing economic data and making short on-site visits for interviews with business leaders and local experts during which they would verify conclusions based on economic analysis. The Urban Institute (UI) and Kharkiv Management Consulting International (KMCI) gathered economic data and organized local and foreign expert teams. However, difficulties in implementing the proposed strategy soon became evident.

Economic assessment requires reliable economic data. Assessing the prospects of economic sectors depends on performance data for enterprises in the sector as well as local, regional, national and international market assessments. Also needed, is assessment of the competitiveness of Kharkiv enterprises and their products. In Ukraine, the system for collecting and reporting economic statistics remains largely unchanged from the Soviet period and fails to capture much of the data needed for the analysis envisioned in the project. Most of the data required to perform the sector assessment called for in the project work plan, was not available.

Furthermore, available official data is considered suspect and real business activity and performance information is closely guarded.

The resources of the project and aggressive project schedule did not permit the depth of research needed for serious sector analysis. Foreign experts were not well enough prepared to yield productive interactions with local officials, business leaders and local experts. Ukraine culture requires establishment of trust relationships before frank and serious discussion of sensitive topics is possible. Brief visits by foreign experts were not conducive to establishing the relationships required to obtain full and frank input from local experts and businessmen. In addition, the Kharkiv political environment was far from neutral in terms of accepting an unbiased evaluation of the regional economy that might challenge existing and future support for favored sectors.

There was also a clash of expectations. From the local perspective, the success of the project was to be judged in attraction of foreign, specifically American investment to Kharkiv industries and businesses. The economic assessment was to identify these prospective beneficiaries and the strategic planning was to indicate how to attract investment resources to the selected sectors and industries. However, foreign direct investment in specific Kharkiv enterprises was never within the mandate, time frame or capability of the project.

Between the time when the project was conceived and when the contract was awarded, there was a change in Oblast and Kharkiv City administrations. The new Governor and his staff did not feel adequately consulted and involved in the project and did not fully accept the assumptions on which the original project and work plan were based.

For all these reasons, the rapid assessment of the regional economy by foreign experts and identification of promising sectors, failed. In February 2001, it was agreed by the Oblast administration, USAID and the contractor to refocus the project and to draft a new work plan. However, the effort to assess the regional economy did lead to useful results in terms of a detailed description of the Kharkiv economy broken into 17 sectors. Official data was combined with that from other sources. An economic profile was written for each sector. In addition, several studies were completed: a survey and analysis of small and medium enterprises in Kharkiv; an analysis of the legal and regulatory framework for business, and a study of Eastern Ukraine regional employment and wages. These results have been published as a CDROM in both English and Ukrainian, "The Kharkiv Regional Economy, Summary and analysis of the Kharkiv Economy by Sectors ". This information is also available on several web sites. The Table of Contents of this CDROM appears in Annex A. Over 300 copies of the CDROM have been distributed in and outside Ukraine. Requests for this data and analysis continue to be received from researchers, foreign assistance projects, and government. The Phase I results are a step in the direction to the analysis required to understand and evaluate a regional economy in Ukraine, but also illustrate the limitations imposed by lack of reliable economic and business performance data.

Phase I. Lessons learned and recommendations

- 1) Accurate, reliable, and up-to-date economic and business data essential to managing and understanding a modern market economy are not available in Ukraine. A significant portion of the growing private sector is "informal" and unreported. The historic almost exclusive reporting of production outputs continues, while sales,

revenues, profits, margins, return on investment and other data essential to analyzing economic performance of enterprises and sectors are not reported, or are suspect. Projects dependent on tools using such data are likely to falter.

Recommendation: Assistance and training to upgrade collection and analysis of economic data to developed world standards would benefit business and economic development efforts. Independent, non government based data gathering and processing organizations might be the recipients of such assistance.

- 2) Regional level economic development planning is difficult to implement under present political conditions. Following the redirection of the SPA away from Oblast level planning, the LARGIS (British Know-How Fund) project attempted to support regional economic development strategic planning in Kharkiv in 2001. However, support was ended after the Oblast administration failed to fully participate. Greater independence of regional government may be necessary for meaningful regional level planning to occur.

Recommendation: Focus on local (raion, town, city) economic development and strategic planning. Support growth of regional ED associations and ED agencies as a mechanism for ED coordination and planning at the regional level.

Phase II. Small city economic development and sector assessment

In 2001, the Kharkiv Initiative was renamed the Kharkiv Partnership, in part to explicitly recognize that USAID and the Kharkiv Oblast administration share responsibility for Partnership activities. The redesign of the ME&A project during February and March of 2001 was fully in partnership with the Oblast. A project committee was formed including two Vice Governors, the Acting Head of the Department of Economy and the COP and his deputy. Considering the project resources remaining and the needs of smaller towns and cities in the Oblast, it was decided to focus on economic development assistance to smaller Kharkiv communities as one component of Phase II. The second component was to assess three sectors of the Kharkiv economy in terms of the market for products and services of the sector, and in terms of the status of Kharkiv enterprises in that sector.

Sector Assessment

The Oblast Department of Economy (DOE) has broad responsibility for implementing Oblast actions in the economic sphere. However, the role of this department in the transition to a market economy is in flux. On the whole it continues activities assigned during the Soviet period and has not yet successfully redefined its mission to meet the needs and opportunities presented by the evolving market economy. Among the functions a similar department in a US state performs is analysis of the state (regional) economy including sector assessment. For example, the Ohio Department of Development, reports regularly on the status of the Ohio economy: which sectors are growing, which are declining, shifts in employment, investment, market changes, and so on. It undertakes economic research with its own staff, and subcontracts for economic research and analysis to other institutions. It helps guide the state executive and legislature on economic policy issues. The SPA sector analysis component was an effort to involve the Oblast DOE in performing

a credible analysis of three sub sectors considered by the Oblast to offer significant potential for growth.

The three sectors selected were:

- Meat production – a declining activity since 1990, but thought to have potential in terms of a growing domestic market and export to Russia.
- Information technology – a sector utilizing the intellectual resources embodied in the high technology history of Kharkiv universities, institutes and industries.
- Electric machinery building – a traditional large State industry in Kharkiv and still important in the regional economy.

These sectors were selected by the SPA project committee. It was also agreed that the sector assessment work would be carried out under the leadership of the DOE and that teams including DOE staff and local outside experts would undertake the work. Foreign expertise would be sought on an as-needed basis. The DOE assigned staff to the teams; the SPA provided a budget to pay for research assistants, for a local non government coordinator, and for foreign technical assistance. Each team developed a work plan and schedule. The assessments were to address the following:

- What markets could be identified for the products/services of the sub sectors, both domestic and export? What are the size of these markets and expected trends over the near and mid-term? What are the key factors in entering and succeeding in these markets?
- What is the capacity of the Kharkiv enterprises in these sub sectors to enter or expand into the markets identified? What is the status of sub sector enterprises in terms of facilities, technology, workforce, management, product quality, cost, and so on?

Stated briefly, the idea was to identify and quantify the opportunities for these sub sectors and the present capacity to take advantage of them. In addition, the analysis should identify what was needed for Kharkiv enterprises to enter and succeed in the identified markets. This work is similar to that envisioned in the original project, but on a more limited scale and using the Oblast DOE rather than foreign experts.

The sector teams worked over a six month period and the Meat and IT teams produced substantial reports. The Electric Machinery team did not complete its work and report. The IT team went beyond reporting and fostered implementation of its major recommendation which was formation of a local consortium of software development enterprises to contract with a US software development firm and seek outsource software development work. The Meat and IT reports are on the CDROM accompanying this report.

The sector assessment teams faced the same difficulty mentioned under discussion of Phase I, the lack of reliable economic data to support market analysis and to perform assessment of the performance of Kharkiv enterprises in the sub sectors. Nevertheless, the Meat and IT teams demonstrated that useful insights are possible even with limited data and resources. The failure of

the Electric Machinery effort is, perhaps, an indication that this Kharkiv sacred cow remains too sensitive a topic for critical analysis.

Sector assessment. Lessons learned and recommendations

1. The analysis called for and attempted by the sector assessment teams is important and needed to guide economic development interventions. It should be incorporated into the regular activities of the Oblast DOE either directly by allocating department resources and training staff, or by subcontracting to outside expert organizations.

Recommendation: A pilot project be developed to support economic analysis within and/or outside the Oblast administration which can guide regional and local economic development. Long-term, perhaps dependent on greater independence of regional government, it is worth considering assisting redefinition of Oblast Departments of Economy more along the lines of US state level departments of economic development.

2. The success of the IT team in implementing its primary recommendation was clearly due to including on the team one of the major players in the proposed consortium. Assessment teams should include representatives of the firms in the sub sector.

Recommendation: A pilot sector assessment be supported where the enterprises agree to contribute resources to the assessment and to fully participate. This could be tried in the Kievsky district of Kharkiv City where the EDO could agree to manage the process, or, in another SPA community such as Izyum where optical and instrument building enterprises might prove interested and willing to partially underwrite the assessment.

Note: The January 4, 2003 **Denver Post** reported on a decision by the Colorado State Government to promote biotechnology as a major regional industry. The story noted the research done that led to this decision: an analysis of current and future markets for biotechnology research and products, identification of the resources (research facilities, workforce training, biotech firms, venture capital resources) presently available in Colorado to support entering these markets and the expected results in terms of investment, jobs, and income. Promotion by state government will include tax incentives, support for increased workforce training, and creation of a biotechnology park. The USAID LED project might consider how the capacity to perform economic analysis required to guide regional and local ED interventions can be fostered in Ukraine.

Small city economic development:

The decision to work with smaller cities in Kharkiv Oblast was made for several reasons. Achieving visible results was highly desired on the part of both the Oblast and USAID. Given the resources available and the time frame of the project, Kharkiv Oblast and Kharkiv City are too large and complex for an economic development effort to have much visible impact. Furthermore, with both national parliamentary and local elections scheduled for March 2002, the Governor wanted to demonstrate development work throughout the region. Technical assistance tends to gravitate to the large population centers. In Kharkiv Oblast, over half the population lives in settlements outside Kharkiv City. The Oblast administration fully supported the focus on smaller communities and their enthusiastic support was crucial to successful project implementation.

The concept of “local economic development” is a shift from a focus on macro economic issues in transition economies. Of course, the health of the national macro economic environment is a major factor in the status of local economies. Interest rates, currency stability, the legal framework, import and export regulations and the availability of credit obviously impact on business success but are not under local control. The domestic regulatory framework and major tax laws are also generally outside the control of local administrations in Ukraine. Although many unresolved problems remain at the national level in terms of completing a successful transition to a market economy, sufficient progress has been made to create conditions for local economic development.

It is important to remember that businesses operate locally. Their employees come from the locality. They depend on local infrastructure and in many cases, their markets are primarily local. Under Soviet central planning, enterprises were located by decisions made centrally. As a market economy develops in Ukraine, localities must compete for businesses, jobs, and the infrastructure required to support development of their local economy. This change is enormous and local governments, businesses, and business associations are poorly prepared to succeed in a competitive market environment. Even the best macro economic conditions will not result in well distributed economic development without full participation on the local level.

Mid size and smaller Ukraine communities are particularly vulnerable. They often depend on one or a few very large state enterprises for employment, enterprises that are now bankrupt or operating at only a fraction of their previous employment. Many of the community’s most educated and capable workers have left, seeking employment in larger cities or abroad. In the absence of a very proactive approach to attracting new businesses and promoting entrepreneurship by local citizens, many smaller communities will cease to be viable. On the other hand, smaller communities have several potential strengths and natural advantages. Citizens and their local government tend to be in closer interaction than in large cities. A united community effort can be organized which brings together government, businesses and citizens around a shared vision for development of the community. Such community mobilization is a key factor in economic development success.

The most dynamic and rapidly growing sector of the Kharkiv economy is small and medium enterprises (SME). For SMEs the local business environment is a critical element. Meeting permitting and regulatory requirements, surviving inspections, finding affordable premises, obtaining business support services, and accessing critical infrastructure such as telecommunications can determine success or failure. Local government can assist and actively support SMEs, or can be an additional obstacle to their success. Even where local government does not have authority, it can intercede with local offices of the national government in favor of its local businesses.

The local economic development approach taken in the SPA had two major elements, *economic development strategic planning* (SP), and establishment of *economic development offices* (EDOs) within the local government structure. The hierarchy of local self government in Ukraine includes large cities divided into city raions or districts, single district midsize and smaller cities that are oblast subordinated, towns which are raion subordinated and settlements and villages which are raion subordinated. It was decided that the first four communities selected would include two oblast subordinated cities and two raion subordinated towns. Criteria for selection

were drafted and candidate communities suggested by the Oblast administration. All candidates were visited by a team including a Vice Governor and the COP. The selection process and results are described in a report "Small City Visits, May 4-May7, 2001" included on the CD ROM. The four communities selected were Merefa, Bogaduchiev, Izyum and Chuhuiv. Each community agreed as their contribution, to provide two staff, an office, telephone line, furniture and electric power suited to computers and office equipment. The SPA project agreed to equip the offices (EDOs) with two computers, printers, fax, small copier, software and supplies. In addition, the project agreed to fund the cost of installing the best Internet connection available in the locality.

The equipment was tendered and purchased locally in Kharkiv. A sample of the tender used including the equipment list is included on the CDROM. The average cost of equipping the offices of the initial four cities was under \$4000/office. An additional average of \$1000/site was required to install and pay the first year cost of Internet access. Internet communication is a crucial information access and communication tool. Chuhuiv and Izyum local administrations had very slow telephone modem access adequate for e-mail, but impossibly slow for utilization of Internet based information. Bohoduchiv and Merefa had no Internet connection. As a result of SPA support, relatively high speed Internet access has been established in all four communities using radio Ethernet in two and dedicated lines in two others. A side benefit is that the infrastructure installed by the ISPs and telephone company at these locations to provide high speed access, is also available to individuals and businesses in the communities.

The original ME&A contract included a line item for duplicating equipment that had been requested by the Oblast administration. However, the new administration agreed to modify that request to obtain information technology which would help complete a local area network at the Oblast secretariate and a system for electronic communication with raions throughout the Oblast. The tender used to obtain equipment and software for the Oblast administration is included on the CDROM.

Strategic planning methodology is well developed and has been applied in communities world wide. In the SPA, participating communities were asked to perform the following strategic planning tasks:

- 1) Form a working group or task force which included representatives from the business community, NGOs, citizens, and local government. This group met regularly to guide the strategic planning process.
- 2) Perform an assessment of the local economy that showed trends since independence and identified performance of major sectors.
- 3) Involve citizens in creating an "economic vision" for the community. Invite participation in a manner that resulted in mobilizing and uniting the community around improving its economic welfare.
- 4) Assess the strengths and weakness of the local economy (SWOT analysis), and identify specific competitive advantages that could contribute to development.
- 5) Draft a strategic plan for the near and mid-term that identified *actions that can be taken locally* to achieve the vision. Assign priority to these actions and estimate the resources required to implement the actions.

- 6) Present the plan to citizens via public hearings and other methods for comment and input. Work with the local council to adopt the plan as a guide for economic development over the near and mid-term.

Examples of local economic development plans and descriptions of the planning process were provided from a wide range of communities, Ukrainian, Polish, American, West European and others. Copies of these documents are included on the CD ROM. However, the communities were challenged to undertake the tasks above *using their own approach*. Regular meetings of participating communities were held where communities reported on their approach and progress. A surprisingly diversity emerged in terms of how different communities tackled each task. The CD ROM accompanying this report contains examples of the approaches taken by different communities.

Technical assistance and training were provided to the communities in terms of utilizing the equipment, software and the Internet. Staff assigned to the SPA had little experience making public presentations such as marketing their strategic plans or presenting the business advantages of their communities to various audiences. Training was provided on presentation skills. Progress was monitored through on-site visits (mentoring), and through regular one-day workshops where communities reported on progress and shared experience. Three Peace Corps volunteers worked with the SPA in addition to their primary assignments. Their activities included mentoring visits and participation in presentation workshops and Internet training. The SPA provided transportation and interpreters to support work with the SPA communities by the volunteers..

The four communities completed all tasks and drafted strategic plans by December 2001. By March 2002, councils in the four communities had adopted the strategic plans. Following elections in March 2002, new administrations in three of the communities elected to continue economic development activities and implement the approved plans. In the fourth community, the mayor was reelected. The newly elected Mayor of Izyum asked for a review of the strategic plan and consideration of changes he felt would strengthen it, but continued support for the EDO and its staff.

Economic development offices were established in the four communities. These offices provide a “home” for equipment and staff allocated to strategic planning and economic development. They are also becoming the place where local business people come to obtain services, use the Internet connection and talk about problems. Izyum and Chuhuiv are moving to create “one-stop” offices where most business transactions with local government, such as registration and permitting, can take place. These offices will also include economic development activities and staff. Most local government-business transactions in raion subordinated towns are handled by the raion administration, not the town. The EDOs in Merefa and Boghaduciev remain focused on development and do not include other local government-business functions. This raises the question if economic development offices should be supported for raion subordinated towns, or only at the raion administration level for settlements below the level of oblast subordinated cities? (See conclusions.)

Results of the small city program of Phase II will be discussed following a brief summary of Phase III.

Phase III Extension and expansion of the small city component of Phase II.

Phase III provided continuing support to the EDOs in the four initial SPA cities as they began implementing aspects of their strategic plans and expanded services to the local business community. Five new localities were added and assisted to undertake strategic planning and opening of EDOs.

Agricultural reform is seen as a significant aspect of the transition to a market economy in Ukraine. In comparison with western agriculture, Ukraine agriculture is labor intensive. Reform and modernization is already making much of the farm workforce redundant. Without creating alternative employment opportunities, rural communities will see large migration of the working age population. However, rural economic development has not received much attention. In Phase III, three rural raion administrations were selected to participate in economic development strategic planning: Kravnokutsk, Pechinihy, and Valki.

To complete testing of economic development work with the full range of local administrations, Kupyansk Raion and City were invited to participate as a combined unit, and Kievsky District of Kharkiv City was selected as a large city raion. As in Phase II, the Oblast administration made a candidate list, visits were made to each candidate by a selection team which included the COP and Oblast representatives, and final selection was based primarily on interest and commitment expressed by raion heads and staff. Selection of the Phase III communities was completed in June 2002.

In small towns, villages and rural settlements, raions administer most business related functions such as registration and permitting. Raion heads are appointed by the governor and raion administrations do not have the same independence as city executives and councils. Nevertheless, raions are "local" government for rural areas. Large city districts are also raions in administrative structure and perform many local government administrative functions for residents and businesses located in the district. Kharkiv City's municipal organization is most similar to that of New York, a federation of somewhat independent districts (boroughs). The expansion of communities involved in the SPA in Phase III focused on the raion.

A major portion of the strategic planning training for the new communities participating in Phase III was performed by the EDO staffs of the original four cities. These staff attended all training sessions and meetings of the new communities where experience was exchanged and progress reports made. Additional training was provided by the "Agency for Municipal Development", a Chuhuiv NGO led by a former Deputy Mayor of Chuhuiv who had participated in both SPA and LARGIS sponsored strategic planning training and implementation. The Agency developed a three day workshop for the work groups established by communities as a first step in the SP process. EDO staff also

participated in workshops on strategic planning offered by the US/Ukraine sponsored Regional Training Center.

By November 2002, the final month of the ME&A contract, the new communities were well along in completing the strategic planning process, but had not completed their plans. All had received the equipment for their EDOs and had established offices and Internet connections. The five communities are continuing work on their SPs and expect to present them to their respective councils for approval by February 2003. Annex C. is a contact list for EDOs in all SPA communities.

The original four cities are implementing components of their plans. Chuhuiv and Izyum have implemented formal monitoring programs to track implementation progress. Izyum is completing a well designed city economic development web site in Russian, English and Ukrainian that will serve as a model for other communities. Izyum is also evaluating the impact of offering local tax incentives to SMEs meeting certain criteria. Merefa's SP had finding firms to occupy unused facilities as a high priority action. They have succeeded in attracting a gas equipment manufacturer to one facility. Chuhuiv's support for SMEs is paying off in rapid expansion of this sector in the local economy. Bohoduciev used a city celebration to showcase its economic development activities and is supporting renovation of a facility for entrepreneurs and small businesses.

In October 2002 all nine communities prepared and made a marketing trip to Kyiv where they presented their communities as desirable places for business. The audience included members of the American Chamber of Commerce, other business chambers and representatives of foreign assistance organizations. Extensive preparation was involved. A brochure featuring the competitive advantages of each community was prepared and translated to English.. Each community created a Power Point slide show focused on the business advantages of the community and practiced making the presentation. These slide shows and the brochure are included on the CDROM.

In August 2002, the nine communities organized an association, "Association for Economic Development of Kharkiv Oblast Communities", which is now registered and operational. The city of Chuhuiv offered premises for the Association, a Director has been appointed and a Board elected. The Association will be financed by member community assessments based on population. The details and mechanism for funding are being worked out. However, already, other towns are making inquiries about how to join. Associate membership for business associations and other NGOs is being discussed. The Association Charter and business plan are included on the CDROM.

USAID is continuing assistance to the SPA communities into 2003 through a contract with Mr. Paul Hoover, COP of the ME&A and his assistant. It is expected that the new communities will complete their strategic plans during this period and that the Association will work out issues of membership, fees and sustainability.

Discussion, conclusions and recommendations

In developed market economies the practice of economic development is well defined, but how to apply these practices to a transition economy is less obvious. The SPA sought to adapt economic development practices to Ukraine and to the circumstances characteristic of Kharkiv region for small cities and towns.

Economic development is a long-term process. A rule of thumb among economic developers in the US is that major payoffs require a decade of effort. Of course, signs of progress and successes need to be evident sooner in order to maintain commitment to the process. But, it is unrealistic to imagine that strategic planning and opening of economic development offices can radically restructure and improve local economies in a short time. The SPA in Kharkiv has operated for less than two years and most of the work initiated is still in process. More time is required to assess the results of this effort. The following comments should be seen as tentative conclusions for which solid evidence can only be gathered in the future.

Economic development strategic planning approach --- Economic planning was a major feature of the socialist state and for many Ukrainians recalls the centralized authority of the State in every aspect of local affairs. The concept of “planning” does not automatically carry a positive image among citizens and business people in Ukraine. Soviet planning was top-down, done by experts and offered little opportunity for local input. An important step in the SPA was redefining the meaning of economic planning. Strategic planning means setting goals and working out how to achieve them. The idea that ordinary citizens have a role and that experts *advise* but do not dictate, is a very foreign concept. Centralized planning also relieved localities from responsibility for their economic status and future. The State had all the authority and all the responsibility for economic decision making and actions. Many citizens and most local officials continue today to look to the State for solutions to their economic problems. However, in a market economy much responsibility is shifted to the local level. Localities succeed or fail based on their own actions. This is a very different reality and hard to understand and accept, the more so because Ukraine is a transitional economy where the Soviet legacy remains in attitudes and values as well as in the political, legal and financial frameworks of the country.

Local economic development is hindered by the “mentality” engendered by this legacy. The SPA challenged this mentality by placing the responsibility for strategic planning on local authorities and by supporting the local staff assigned to the task through informal training and mentoring. The project provided an outline of the steps required and examples of successful local planning from a diverse variety of localities, but challenged each locality to define its own approach to completing each step. A primary technique used was to hold frequent meetings of participating communities where each reported on their progress, problems and successes. Learning from each other was a key technique in the planning methodology used in the project. When the project was extended from the original four communities to five new localities, the staff involved in the original communities became the primary source of training and support for the new communities. Several important results stem from this approach to local ED strategic planning:

- Increased confidence on the part of the community representatives, that is, staff assigned to the SPA, public officials involved, and community representatives of important constituencies, in their own ability to plan and lead local economic development.
- Increased acceptance of the idea that the health of local economies depends on local initiative and local action. The paramount role of the State which controls most levers of economic power has not changed, but communities participating in the SPA are finding room for positive actions within this framework.
- Recognition that exchanging experience and finding ways to cooperate strengthens each community's ED efforts despite the fact that in a market environment each community competes with others for resources, businesses and employment opportunities. The SPA communities formed the Association to continue their cooperation post SPA.

Recommendations: A formulaic, one-size-fits-all, methodology for economic development planning should be avoided in LED assistance. An approach which challenges localities and the staff assigned to planning tasks to develop their own methods and solutions will more effectively mobilize local government staff and officials, the public and important stakeholder groups. In Ukraine, habits, attitudes and values present as serious barriers to economic improvement as do more evident problems in legal, regulatory and financial frameworks. Future LED projects should directly or indirectly address the "mentality" issues that inhibit development.

Establishment of Economic Development Offices (EDOs) --- World wide, local economic development activities are carried out by two forms of organization: departments or offices *within* the local government unit (city, county or region), or a NGO *independent* of local government including representatives of business, business associations, local government and other local stakeholders. Both forms are common and very successful examples of each can be found. The SPA project decided that creating offices within local government units was desirable in Ukraine for the following two main reasons.

1. The EDO can become a publicly visible focal point for local government actions to create a good environment for business. It will also help establish the role and responsibility of local government in economic development planning and in promoting the local economy. Government in Ukraine at all levels has not widely established itself as a supporter of business and business development. Government actions ranging from taxation through regulation, inspections, business registration, property rights, and customs are frequently perceived as hostile to business. Communication between local government and the local business community is often reported as poor in surveys of businesses in Ukraine. An office within the local government structure oriented to economic development and business support cannot solve many of these problems, but can help place local government behind business development.
2. Economic development requires a long-term focus and continuity. Local NGOs in Ukraine, especially those involving diverse constituencies, have not proven viable when they have to be self-supporting. Participation in the SPA required communities (municipalities and

raions) to provide an office, furniture, telephone line, and two staff. They were also asked to pass an ordinance establishing the EDO as a permanent part of the municipal structure. Although continuity of these offices and staff cannot be guaranteed post project, the new administrations elected in three of the four municipalities in March 2000, have continued the staff and offices. Raions do not have the authority to establish new formal "offices" but those in the SPA have had their Raion Councils approve an ED function within the existing structure.

The limited SPA experience is that EDOs *within* local government structure appear to be working well. They have survived changes in leadership of local administrations. However, staffing these offices is problematical especially for raion administrations. Raions do not have the flexibility of municipalities in terms of staff assignments. Staffing is dictated by the Oblast administration as are budgets. It is unclear if economic development functions and staff will be sustainable within raion administrations.

Recommendation: Although the SPA chose for reasons given above, to establish EDOs within local governments, future LED projects should also be willing to support a NGO EDO if that form appears attractive in a particular locality.

Funding economic development. --- Finding funds to support economic development activities is very difficult for the smaller towns and rural raions. National and oblast budgetary support for local economic development is needed. This issue has been discussed with Oblast representatives but remains unresolved. Examples of national and regional support for local economic development exist in Poland, Hungary and Bulgaria. Legislation in Ukraine exists to support regional ED planning and to reward regions through a "contract" mechanism for funding regional improvement projects. However, implementation of this concept is still in the future. The SPA did not directly address questions about funding local economic development. What funding is required to achieve significant results? What level of resources in terms of staff and budget are allocated by typical Western local governments to economic development? What is appropriate for Ukraine? Because the SPA worked with small local government units where at most two to three staff were active in the SPA, defining staff roles in a larger ED department or office was not addressed.

Recommendation: Future LED projects be tasked with evaluating economic development funding issues in the Ukraine local government environment. What amount should a mid-size city expect to allocate to economic development functions and activities? Associated with the funding question is defining an economic development department or office. What are its functions, what staff are required, what qualifications should they have, where should such a department be located in the city organizational structure? For non governmental EDOs, what sustainable sources of funding can be tapped ?

Economic development level --- The optimal level at which to undertake local economic development remains an open question, both in and outside Ukraine. In many US jurisdictions there are both non governmental and government offices at regional, county, city, and even neighborhood levels, e.g., "the downtown," involved in economic development planning and actions. In Ukraine there are also government offices and NGOs at various levels making some claim to economic development activities. SPA experience is too limited to make a clear case for

what the most effective jurisdictional level may be for strategic planning and EDOs. Cities and towns participating in the SPA were asked to identify and include the economic region surrounding city territory in its economic assessment and planning, but the SPs primarily focus on the territory of the city or town.

Although Kupyansk raion and city initially agreed to create a shared EDO and develop a common SP, they have ended up working separately even though their offices are in the same physical building. Jurisdictional conflicts and competition are difficult to overcome. This may suggest that when jurisdictional boundaries have to be crossed in order to include the economic region, a non governmental development agency rather than a government department/office will have greater success.

Kyivsky district of Kharkiv city has almost 200,000 residents, twice the number of the next largest city in Kharkiv Oblast. Its inclusion in Phase III of the SPA was based on the supposition that the district administration would be in better touch with its residents and business community, especially the SMEs, than would the central Kharkiv administration. Should economic development planning and support be centralized at the central administration, or decentralized to the districts? There is too little experience at this point to resolve this question. Economic development activities at both levels may be the most effective approach.

Recommendations: Although the sample is small, it appears that below the Oblast subordinated municipal level, the raion is the appropriate local government unit for economic development work. Raion subordinated towns such as Bohaduchiev and Merefa do not have the authority to provide most local government business related services such as business registration, permits and licenses. These are delegated to the raion administration. Also, at the raion subordinated town level, the communities have little control of budgets and staff which makes sustaining ED work very difficult. The limited experience with Kievsky Raion of Kharkiv City suggests that without active participation of the central administration, city districts will not be able to sustain sufficient commitment to significantly influence the development of their territory. It is recommended that the appropriate local government targets for economic development are municipalities and their district offices, towns and cities of oblast subordination and raions. It is recommended that regional development be approached from the bottom-up through associations and agencies of local entities.

Public participation --- One step called for in the planning process was defining a vision of a desirable economic future for the community. Each SPA community was asked to define the important “publics” to include in discussing this vision, work out how to involve them and how to come up with a vision statement. They were asked to communicate with the general public about the planning process, to obtain citizen input, and to keep the publics informed as the process led to a strategic plan. Among best practices in economic development is periodic mobilization of the community around ED planning and ED actions. The deterioration of public services and of life in general for many Ukrainians since independence, has resulted in both cynicism and despair. However, there is also optimism and a great loyalty to local communities. Very different approaches were taken by communities to involve stakeholders and the public in general. Some organized working groups that were very broadly inclusive and met regularly as a whole and as subgroups. Two set up task groups along different sectors of the economy. Several held formal

public hearings. Several involved schoolteachers and students. All used the local press, radio and TV when those were available. When not, public posted notices and even a flyer delivered door to door were methods used for public communication. Raions discussed the planning process at village council meetings. Business surveys were used in all communities as part of the economic assessment and in some for public input.

As important as the ideas generated and input received, was participation itself. World wide, the great economic development success stories include mobilization of community stakeholders around a common vision and shared goals as a major factor in their success. Sustained leadership and articulate spokespersons are other key elements. Successful ED interventions in Ukraine will have these same features and LED projects need to consider how to find leaders in local communities, how to support them and how to provide the tools they need. It is important to emphasize that economic development success everywhere is **never** attributed to the application of some tool or technique, or to strategic planning methodology, or to strategic planning at all. Strategic planning may be used and other tools and methods applied, but success is **always** attributed to *vision, leadership, persistence, marketing, and what would be called customer care in the private sector*, where the customers are businesses retained and helped to expand, businesses attracted to relocate, and entrepreneurs starting new firms.

Recommendation: LED projects be challenged to state how they will support local economic development leadership in the Ukraine context, how important “publics” will be engaged, how the broad public will become invested, and how the business community will be served and brought into the economic development process. In short, how a common vision will be created and shared goals formulated.

Marketing, presentation and promotion skills --- A major function of economic development offices is promotion and marketing of the locality. In the West, the marketing staff is often the largest staff component and the marketing function is generally allocated a major portion of the economic development budget. However, the concept of marketing is not well understood in Ukraine and the skills for doing it are not widely present among local government staff. Asked to prepare materials to market their locality, the SPA EDO staff in the nine localities initially focused on the glorious past history of their communities, the black soils, cultural amenities, and the large, but now defunct industries that used to dominate their economies. There was no understanding of what the business audience to whom they were making presentations wanted to hear, or was likely to be looking for. The SPA worked extensively with EDO staff on presentation skills and held repeated practice sessions oriented to improving these skills. The SPA also assisted the EDO staff improve the content of their presentations, use Power Point, and orient the content to a specific audience. The results (see the CDROM), as seen in presentations by community EDO staff to the Governor, the US Ambassador, to business meetings, and at conferences, show significant improvement, but are still far from the professional level common in the US or Europe.

Recommendations: Marketing and presentation skills training be a significant component of future LED assistance and have both a domestic and international orientation. It is recommended that a future LED project include significant exposure of EDO staff to examples of high impact economic development marketing through the Internet and by participation in study tours, conferences, trade fairs and other venues where localities promote their advantages, attractiveness and business

environment. For the most part, Ukraine as a whole, and all its cities, but perhaps Kyiv, are invisible and little better known internationally ten years after independence than during the Soviet period. Croatia, with a population little larger than Kharkiv Oblast, has far greater international exposure than all of Ukraine.

Training approach --- Training and technical assistance to the communities during the planning process was limited to providing examples, reviewing the process and results. For the initial four communities in the SPA there was no formal training in strategic planning. The absence of formal training was deliberate because:

- Most of the community representatives assigned to the SPA project are local government staff. They are capable, but generally have not been in positions of responsibility requiring creative independent decision making. Initially, many were continuing to perform their previous assignments and were attracted to working on the SPA because it represented a challenge and learning opportunity. Most worked nights and weekends to accomplish the tasks required. The majority are women. This is not a population used to taking leadership or comfortable stepping outside the box.
- Management culture in Ukraine remains extremely top-down with very little delegation of authority. The habitual coping mode is to check every decision with the boss. This work environment stifles creativity, risk taking and motivation. The response to formal training tends to reflect habits learned in school and the incentive system at work. Trainees seek expert methodology and expert opinion to avoid the risk of making independent decisions, or taking actions that might be judged wrong. Breaking these habits is difficult, but the results can be remarkable. By refusing to state how the tasks assigned were to be done and through giving permission to develop their own approach, the local government staff involved in the SPA were encouraged to be creative and their competence was assumed and supported. By holding regular meetings where experience was shared, progress reviewed and encouragement given they gained confidence in their capacities.

These participants were successful to the point where their administrations, their bosses, appreciated their results, supported their work, and have increased their responsibility and authority. One measure of their success is that new mayors were elected in March of 2002 in three of the four communities. They brought in their own key people, but in all cases, retained the EDO staff and continued commitment to the strategic planning process and implementation of the plans.

Recommendations: Future LED projects be encouraged to minimize expert, especially foreign expert led training and limit formal training to skills development. The training approach should challenge participants to solve problems, exhibit leadership and take risks. Unfortunately, international technical assistance usually focuses on technique because that is easy to define and train, but in the absence of vision and leadership, methodologies, techniques and technical skills are like strategic plans. They end up shelved and unused. An open ended, non prescriptive training approach is facilitated by creating an incentive system in the project which rewards different solutions to challenges encountered in the planning process, in establishing EDOs, in delivering services to businesses and in making presentations to different audiences. The LED project should

include, as it did in the SPA, the capacity to support initiatives instigated by EDOs: examples, an economic development oriented brochure for a town celebration in Bogoduchiev (\$300); medals to award individuals making major contributions to economic development of Merefa (\$700); an ED pamphlet for Chuhuiv (\$350), entrepreneurship training in several cities (\$500/event). In all cases the project only contributed to the total cost, but this contribution was important as support for the idea and the EDO staff proposing the activity, as well as helping financially.

Visible results — The Oblast administration's demand for immediate visible results from economic development planning has abated. Hopefully, this reflects a better appreciation for the long-term nature of economic development interventions and appreciation of the increased capability of SPA communities to actively improve their local economies. However, as mentioned earlier, intermediate successes are needed to maintain commitment to and support for the process. Several intermediate results have resulted from SPA activities. By actively seeking a firm that could utilize its available facilities, Merefa's EDO attracted a gas equipment manufacturer to locate a new manufacturing plant in one of the facilities. This involved Internet searches, Internet communication, and trips to Kyiv by Merefa representatives to make the case for their locality. Without this active approach, it is very unlikely the company would have discovered Merefa and consider locating a factory there. A similar success occurred in Kupyansk when the Mayor encountered several representatives of foreign firms seeking to locate businesses in Kharkiv Oblast, but who were encountering many barriers in Kharkiv City. He invited them to Kupyansk, promised his EDO would assist them, and the two firms are now operating in Kupyansk.

Recommendation: As strategic plans are developed and implemented it is important to identify short-term results that can be accomplished and publicized.

Final Summary and Conclusions

On the whole, the SPA experience in promoting economic development in smaller Kharkiv communities has been positive. Perhaps the most important result has been increased recognition in these communities that they must take an active role in determining their economic future and that local actions can make a difference. Some of the methods used in the SPA can be scaled to a larger national LED project, such as economic development strategic planning and the establishment of local EDOs. The informal training and mentoring approach of the SPA is less easily applied in a large project working in major municipalities. Nurturing leadership, involving and uniting the public and major stakeholders around a shared vision, and achieving visible results may be more difficult in larger more diverse communities. On the other hand, larger communities and a large project have greater resources and greater power to change the conditions that promote or inhibit business development. Although a local focus is appropriate, local economic development in Ukraine remains highly dependent on national policies and legislation. A national LED project needs to consider how national questions affecting local economic development will be addressed.

Prepared by: Paul Hoover
Chief of Party

December, 2002

ANNEX A**ME&A CONTRACT PHASE I****CDROM****The Kharkiv Regional Economy
Summary and Analysis of the Kharkiv Economy by Sectors**

? . Profile of the Kharkiv Region Economy

? . Current Trends of the Kharkiv Economy

? . The 17 Sector Profiles:

- ? 01. Agriculture Profile
- ? 02. Mining Profile
- ? 03. Utilities Profile
- ? 04. Food Processing Profile
- ? 05. Light Industry Profile
- ? 06. Chemical and Petrochemical Industry Profile (Pharmaceutical and Medicine Manufacturing Sector Profile)
- ? 07. Construction Materials Industry Profile
- ? 08. Machinery and Metal Manufacturing Profile
- ? 09. Construction Services Profile
- ? 10. Transportation Services Profile
- ? 11. Information Services Profile
- ? 12. Science Services Profile
- ? 13. Health Care Profile
- ? 14. Accommodation Services Profile
- ? 15. Food Services Profile
- ? 16. Finance and Insurance Profile
- ? 17. Trade Profile

D. Annexes:

- D01. Strategic Management of Region Economic Development
 - D02. Small and Medium Enterprises in Kharkiv Oblast: assessments and recommendations
 - D03. Legal and Regulatory Framework of Business in Ukraine
 - D04. Eastern Ukraine Regional Employment and Wage Study
-

ANNEX B**Kharkiv Partnership Strategic Planning Activity Phases II & III
Reports and Reference Materials****CDROM
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- Introduction to the CDROM
- ME&A Contract Final Report
- Phase II. Component I. Sector Assessment
 - Methodology
 - Reports
 - Meat Sector
 - IT Sector
- Phase II Component II. and Phase III. The Small City Strategic Planning Activity (SPA)
 - Workplans
 - City selection process
 - EDO equipment specifications and tenders
 - Status reports
 - Economic Development background materials
 - Training materials
 - Press reports
 - City specific materials
 - Work plans and SP process
 - Economic diagnostics
 - Surveys
 - Reports
 - Vision statements
 - Public participation
 - Hearings
 - Communication, media samples, press reports
 - Strategic plans (SP)
 - SP implementation
 - Monitoring plans
 - Status and results reports
 - Economic Development Offices (EDO)
 - Locality marketing and promotion
 - City brochures
 - City slide shows
 - City websites
 - Staff and contact information
 - ED Association
 - Charter
 - Business plan

ANNEX C**ECONOMIC DEVELOPMENT OFFICES****Contact Information 01-01-03****ECONOMIC DEVELOPMENT OFFICES IN SMALL TOWNS AND RAIONS OF
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