

USAID/Ukraine

Annual Report

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Ukraine

Performance:

The Country Setting and Important Challenges: Ukraine remains critical to United States foreign policy objectives due to its strategic position and its importance to regional stability. After a prolonged stagnation, Ukraine has made important progress in developing and implementing provisionally stable macroeconomic policies, establishing a legal and regulatory environment more conducive to private sector growth, and strengthening financial institutions. However, considerably less progress has been made in establishing sound democratic institutions and practices. While there are promising signs of reform in elected local governments, parliament and the judiciary, vested interests, weak political accountability, corruption, unequal enforcement of the rule of law, and tightly controlled media still cast serious shadows over Ukraine's democratic transition. Civil society organizations, political parties and other civic associations are still in a nascent stage of development. In the education and health protection sectors, a scarcity of resources continues to impinge on the state's ability to provide adequate services, and systems are characterized by obsolete equipment, low staff morale and outdated practices.

Political developments in Ukraine in 2003 were relatively stagnant. Pro-presidential forces managed to increase their presence in the Parliament and form a coalition government at the end of 2002. Increased media censorship and pressure on parliament members and local governments to join the pro-presidential voting bloc have dramatically reduced opportunities for constructive cooperation between leading political groups. Continuing to shuffle key political appointments, President Kuchma was able to strengthen his own position while also meeting the growing political demands made by major parties within the pro-presidential voting bloc. Political bickering and factional loyalties have largely continued to hinder the GOU's ability to pursue a comprehensive and coherent national development policy. One result, therefore, is that key economic groups continued to influence disproportionately the policy decisions of most national political institutions and significant numbers of local institutions. Spontaneous and mostly reactive, in the short run, domestic and foreign policies helped the current regime to effectively maintain the status quo, thus FY03 was effectively lost for improving governance and democracy in Ukraine.

The discouraging political developments have overshadowed important macroeconomic developments. Prudent macroeconomic policies, robust consumer spending and external demand were major factors behind the continuous expansion of the Ukrainian economy in FY03. The poor grain harvest has been offset by vibrant industrial growth. In January-September 2003, real GDP growth rate exceeded 6 percent while inflation was 4 percent. The government managed to maintain a positive budget balance and a stable foreign exchange rate, and continued building up net international reserves at the National Bank of Ukraine. Improvements were also made to the state procurement process and auditing procedures, and the design and administration of social transfers.

The USAID/Ukraine Program: In the reporting period, the Mission's overall strategic goal - increased social and economic well-being of all Ukrainians within a framework of democratic governance - was addressed by fostering economic reforms that encourage investment and growth; by directly reaching Ukrainians through programs in agriculture and small and medium enterprise (SME) development; by strengthening both government institutions and civil society to improve democratic governance; and by protecting the health and welfare of the population through systemic reforms and targeted interventions. The Mission continued strengthening its cooperation with the private sector, local governments, and NGOs and reduced the direct support to national government programs. The Mission has increased its share of targeted assistance and capacity building focusing on the following areas: HIV/AIDS, agriculture, credit and SME development, local governance, civil society, media, and health protection. The approach has proven to be effective and encouraging results were achieved.

Key Achievements by Strategic Objective:

Improved Investment Climate: Ukraine's financial sector is both small and weak compared to other former Soviet republics. However, over the past year the banking system has grown larger and stronger. Banking assets have increased to a respectable 40 percent of GDP, but capitalization remains below 5 percent of GDP. Banking deposits have tripled over the past two years. Still, less than 5 percent of the country's small and medium enterprises and farmers borrow from the banking system. Commercial banks need better legislation, new financial instruments and technical assistance (training) to increase their commercial lending. The capital market in Ukraine is almost non-existent. All non-bank financial markets, including stocks, bonds, financial leasing, credit unions, etc., represent less than 5 percent of the banking system. Ukraine does not have a capital market law that protects investors. It has not adopted internationally recognized corporate governance or accounting practices. The capital market lacks regulatory supervision that is transparent and enforced in order to bring credibility and investors into the capital market.

USAID has realized some important achievements, however. One of the best methods to reduce money laundering and corruption is to increase the ability of enterprise accountants to produce and to understand financial reports based on International Financial Reporting Standards. USAID has successfully introduced into Ukraine the CIS Regional Certified International Professional Accountants program of training, examination and certification of accountants, raising the standards of the Ukrainian accounting profession. Former Soviet bookkeepers, 85 percent of whom are women, are becoming internationally recognized, professional accountants. These accountants are making their enterprises more competitive within the global economy while USAID's certification program also makes it easier for such enterprises to attract foreign investment

The International Business Standards - Corporate Governance project is helping to move the business and financial culture of Ukraine towards compliance with international standards of information disclosure to investors, and more effective enforcement of capital markets laws and regulations. In FY03, the project strengthened the financial information disclosure requirements for bond issuers, worked closely with the National Bank of Ukraine (NBU) to mandate stronger norms for corporate governance by Supervisory Boards, and assisted the PFTS (stock exchange) to improve and expand its electronic information system to provide financial disclosure information on public issuers. Together with PFTS, the project sponsored a "Best Annual Report Competition" to introduce international standards to financial reporting by major companies. In addition, the IBS-CG project with the NBU established and developed a corporate governance training program for Bank Supervisory Councils. The cooperation with leading national Law Academies resulted in a series of judicial seminars on corporate dispute resolution for Commercial Court Judges to promote consistent application of financial and corporate law. As a result, the Supreme Court of Ukraine will publish a compilation of interpretations and directions that will help lower courts more consistently apply the law in commercial cases.

In 2003, the Banking Supervision project was one of the more successful projects in the financial sector. Under the dynamic leadership of newly appointed Governor of the NBU, the National Bank dropped all resistance to reform of banking supervision. The NBU developed and adopted a "Comprehensive Program for the Development of the Banking System of Ukraine for 2003-2005," which includes the adoption of risk-based supervision at the NBU. To implement this plan, the bank established a Risk-Based Supervision Task Force, which is aggressively implementing this completely new approach to banking supervision. The project worked closely with the task force to complete the operation and inspection manuals required to apply risk-based supervision. UkrSotsBank, the country's fifth largest bank, volunteered to be the first bank to test the NBU's new risk-based inspection methodology.

Under the Mission's SME and Agricultural Strategic Objective, Ukraine's fourth year of economic growth (now 5.7 percent of GDP) enabled SMEs to develop new goods and services to meet increased internal demand. The SME sector now employs over 4,350,000 people. The value of goods and services produced by SMEs has increased from 22,900,000,000 UAH in 1999 to 25,182,000,000 UAH in 2003. A successful deregulation program mounted by USAID enabled the rapid growth in the number of SMEs.

There are currently 2,660,000 businesses (legal entities and private entrepreneurs) registered, up from 1,793,000 registered in 1999. Through the development of one-stop-shops for business registration in the regions, business registration time was cut in many cities from 30 to 14 days. One-stop-shops will be established nationally in the near future. In addition, USAID's sustained effort to improve business skills and business association management has led to increased output of goods and services to meet demand.

USAID-funded assistance to SMEs has led to an improved regulatory environment, increased management capacity and an ever more assertive industry that is effectively represented at all levels of government by business associations. Specifically, in 2003, SMEs benefited from the implementation of 210 regulatory acts by regional authorities and city councils; the operation of 20 one-stop-shops for business registration that reduce business registration time from 30 to 14 days; the convening of 211 community roundtables and 143 formal public hearings that paved the way for this progressive regulatory change; and the enactment of a national law on Regulatory Policy. These measures improved local budgets and contributed to the significant legalization of business in Ukraine.

Business management education programs supporting SMEs made significant strides in 2003 due to more training of faculty and administrators, greater access to modern textbooks, and improved evaluation and accreditation procedures. One-hundred-fifty faculties received training on how to design and deliver undergraduate courses in business education. In addition, over 11,000 women received training. More than 3,000 started their own businesses (30 percent of the graduates). On average, three additional jobs were created for every woman trained. Seventy percent of these new jobs were created for women. Seven-hundred-twenty-six loans have been made to women through credit unions to start new businesses.

Sustained economic growth has led to increased deposits at commercial banks, a decline in interest rates for loans, and a greater willingness on the part of banks to lend to SMEs and agriculture. The DCA agricultural credit program in its first months of performance enabled the issuance of more than \$160,000 of credit to small holders and mid-sized farmers, and the groundwork has been laid for an extended lending program this year. The EBRD Micro Lending program (USAID is the major donor) continued the upward trend of loan disbursement levels with 2,500 loans disbursed on average per month during 2003. Lending results were above predictions and reached over 3,000 loans in September 2003 with an average loan amount of \$4,800. As a result, the total loan portfolio increased by 15 percent during the fourth quarter of 2003 to \$86.1 million outstanding to micro and small businesses. The program is available in 23 regions and in 42 cities in Ukraine.

The mission's democracy and governance programs achieved only modest accomplishments in most areas. Citizen's participation in civil society organizations is reported to have increased by 2.5 percent since last year; coalition building among political parties was strengthened; and election administration during parliamentary repeat and by-elections in certain constituency centers improved. Finally, quality of news produced from targeted regional outlets improved, as did public awareness of important reforms. CSO's advocacy campaigns have also led to some improvements in media and CSO legislation. For example, concerns about government censorship culminated in the Public Hearings on Censorship and Freedom of Speech, conducted in December 2002, which were followed by some improvements in media legislation. USAID-supported media experts and organizations contributed to this successful cooperation with Parliament in addressing freedom of speech issues.

While the low income of most Ukrainians continues to make financial sustainability of CSOs and independent media outlets difficult to achieve (and dependence on international donors remains high), more CSOs have begun to provide cost-sharing, usually in the form of in-kind contributions. Leading NGOs, such as think tanks, have managed to diversify their funding base through inter-sectoral partnerships and developing services that can be used by a broader constituency. There have also been cases of some NGOs that were successful in cost recovery due to their involvement in specific service sectors. Furthermore, there have been examples when the government paid for high-quality assistance provided by think tanks and NGOs. Some regional media outlets and publications have become more financially independent by accessing credit and tapping into a growing advertising market.

Regarding the political environment, political factions are gradually increasing cooperation. Several political blocs have been formed among political parties that have received USAID training. Four factions worked together extensively in the post-election period on issues such as committee assignments, draft laws and public protests, to a degree that surprised many political analysts. This cooperation is significant for extremely fragmented parties and ability to represent the interests of their members and constituents. In this regard it should also be noted that there has been an on-going battle in the Parliament over various constitutional reforms drafts. The outcome of this process may have a major impact on the shape of Ukraine's future political life and perhaps require some adjustments to democratization programs.

USAID's anti-corruption program centers on a regional anti-corruption NGO coalition model to protect and promote transparency, and fight corruption at the local and regional levels. NGOs in several communities expressed interest in replicating this model. The program is planning to respond through an innovative "mentoring program," whereby the existing coalitions will provide advice to NGOs in smaller towns on how to form and run successful anti-corruption NGO coalitions. During the past year citizen advocacy offices have provided legal consultations to more than 7,000 people, to some of them over telephone hotlines. Program lawyers helped to resolve more than 1,000 corruption cases that involved violations of citizens' rights by corrupt officials. Other specific program achievements include: establishment of a transparent systems of municipal property management, and the introduction of transparent policies in secondary school finance and personnel management.

The Mission's health portfolio developed a five-year HIV/AIDS strategy which is committed to keeping Ukrainian HIV prevalence to less than 5 percent by 2008. Efforts will focus on improving delivery of information and services to high-risk populations and subsequently changing their risky behaviors, improving the enabling environment, including improving voluntary counseling and testing services, and reducing stigma and discrimination. USAID also continued to support the shift in health care services from more costly tertiary care to more community-based comprehensive primary health care and family medicine clinics. The U.S. Ukrainian partnership program has established 18 demonstration centers in six regions. Over the last three years, these model centers have become the catalyst for the establishment of 483 family medicine clinics in pilot areas, with approximately 200 new clinics in 2003. The newly established centers are being financed locally and are staffed by better trained family medicine providers. This resulted in decreased number of patient referrals for more costly specialized health care.

USAID's maternal and infant health program also complements ongoing efforts in reproductive health policy and to field tests new standards of care. This includes up-to-date safe motherhood approaches and both pre-natal and post-natal care. USAID also fund a primary health care initiative to increase access to health education, to improve health awareness, and to expand community-based health promotion efforts and self-responsibility.

USAID has helped establish birth registries and a birth defects surveillance system in five pilot regions. These systems guided the program in designing targeted prevention programs, such as piloting flour fortification with folic acid in order to prevent the occurrence of neural tube defects. Support to the continued implementation of DOTS has helped to ensure effective diagnosis and treatment of tuberculosis in the pilot Donetsk region. The tuberculosis cure rate was increased by 30 percent under the DOTS treatment approach. Continued support to this program will be needed to provide convincing evidence to Ukrainian policymakers to implement DOTS nationwide.

Country Close and Graduation:

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):

- Number of new SME registrations
- Number of SME employees
- Tax payments from SMEs and agriculture

2.1 Legal and regulatory environment supports growth

2.2 Enhanced management of SMEs and agriculture

2.3 Increased access to land and credit

2.4 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):

- EBRD Investment Climate/Business Environment Index

1.1 Business legal environment improved

1.2 Budget management improved

1.3 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 active in civil society organizations
- Citizens who are involved in civic action

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):

- Local Good Government Index
- Public confidence in good governance of the Verkhovna Rada

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):

- 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

- 121-0340 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**