Ex post evaluation of the Macro-Financial Assistance operation to Ukraine over the period 2015-2017

Final Report

Written by Juliette Mathis, Oskar Andruszkiewicz, Ana Cordon, Majda Santi (all ICF); Graham Hay, Michael Lee, Jack Spencer (CE); Vitaliy Kravchuk, Kateryna Furmanets (IER)

July 2020

EUROPEAN COMMISSION

Directorate-General for Economic and Financial Affairs

Directorate D: International economic and financial relations, global governance

Unit D.2: Neighbourhood countries – Macro-Financial Assistance

Contact: Mr Dirk Lenaerts

E-mail: Dirk.Lenaerts@ec.europa.eu

European Commission

B-1049 Brussels

EUROPEAN COMMISSION

Ex post evaluation of the Macro-Financial Assistance operation to Ukraine over the period 2015-2017

Final Report

Directorate-General for Economic and Financial Affairs

July, 2020

LEGAL NOTICE

Luxembourg: Publications Office of the European Union, **2020**

ISBN

DOI

Table of Contents

Abbreviations

AA	Association Agreement
AC	Anti-corruption
ACU	Accounting Chamber of Ukraine
BRDO	Better Regulation Delivery Office
CPI	Consumer Price Index
CSDP	Common Security and Defence Policy
CSO(s)	Civil society organisation(s)
DCFTA	Deep and Comprehensive Free Trade Area
DG ECFIN	Directorate-General for Economic and Financial Affairs
DGF	Deposit Guarantee Fund
DPL	Development Policy Loan
DSA	Debt sustainability analysis
EEAS	European External Action Service
EEF	Energy Efficiency Fund
EFF	Extended Fund Facility
EIB	European Investment Bank
EIU	Economist Intelligence Unit
ENP	European Neighbourhood Policy
EUAM	European Union Advisory Mission
FDI	Foreign Direct Investment
FSDPL	Financial Sector Development Policy Loan
GBI-EM	Global Bond Index-Emerging Markets
GCA	Government-controlled areas
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GNI	Gross National Income
IDPs	Internally Displaced Persons
IFIs	International Financial Institutions
IFS	International Financial Statistics
IMF	International Monetary Fund
JRC	Judicial Reform Council
LTO	Large Taxpayer Office
MFA	Macro-Financial Assistance
MONA	Monitoring of Fund Arrangements
MoU	Memorandum of Understanding
NABU	National Anti-Corruption Bureau

NAPC	National Agency for the Prevention of Corruption
NBU	National Bank of Ukraine
NCTS	New Computerised Transit System
NGCA	Non-government-controlled areas
NPLs	Non-performing loans
SOEs	State-owned enterprises
VLAP	Visa Liberalisation Action Plan

Abstract

The MFA III to Ukraine succeeded MFA I and II, two operations with distinct origins and legal bases that were disbursed between 2014 and early 2015. Each of these operations was intended to address the consequences of the crisis that broke out in early 2014 on foot of political uncertainty following the illegal annexation of the Crimean Peninsula by Russia and the subsequent conflict in the east of the country. In absolute terms, with the financial envelope of EUR 1.8 bln, MFA III, adopted in April 2015, was the largest single operation in the history of the MFA instrument and was intended to be disbursed in three equal instalments. The second and third instalments were linked to the fulfilment of 36 structural reform conditions across six areas: namely public finance management, governance and transparency, energy, social safety nets, business environment and financial sector.

This Study constitutes an independent evaluation of the European Union's MFA III to Ukraine. More specifically, it analyses the operation's relevance, coherence, effectiveness, efficiency and EU added value. The study draws on evidence gathered through a mixed-methods approach, comprising both quantitative and qualitative research techniques. The study concludes that the MFA III, in conjunction with other international support, was commensurate with Ukraine's financing needs and crucial to the country avoiding sovereign default in 2015. Considerable progress has been made in the undertaking of reforms over the lifetime of the operation, prompted inter alia by the MFA conditionality. However, ownership of the programme diminished over the course of the operation and MFA III expired on 13 January 2018 without the third and last disbursement, due to the lack of sufficient progress in the implementation of some of the conditionality, notably in the field of anti-corruption (AC). The evaluation found that this was a well-balanced and justified decision, given the circumstances.

Executive Summary

This report presents the results of the ex post evaluation of the Macro-Financial Assistance (MFA) III operation provided to Ukraine over the period 2015-2017. The evaluation was commissioned by the Directorate-General for Economic and Financial Affairs (DG ECFIN). The work was undertaken by ICF, in collaboration with Cambridge Econometrics and local economists from the Kyiv-based Institute for Economic Research and Policy Consulting.

Background to the MFA III operation to Ukraine

The MFA III to Ukraine succeeded MFA I and II, two operations with distinct origins and legal bases that were disbursed between 2014 and early 2015. Each of these operations was intended to address the consequences of the crisis which broke out in early 2014 as a result of political uncertainty following the illegal annexation of the Crimean Peninsula by Russia and the subsequent conflict in the east of the country.

MFA III was not initially included in the support package to Ukraine announced by the European Commission on 5 March 2014 but was only added when the conflict in the east of Ukraine intensified and the economic situation worsened. This new request from the Ukrainian authorities in September 2014 (reiterated in December 2014) was approved in April 2015 and turned the EU commitments, together with other types of assistance, into an unprecedented EUR 13 bln package[1].

The objective of the programme was to alleviate Ukraine's external financing needs, which remained sizable even after the effects of MFA I and II and other donor programmes, and to support the ambitious reform programme initiated under MFA I and II. MFA III was larger than any other previous MFA operation since the establishment of the instrument, with a total amount of EUR 1.8 bln envisaged to be disbursed in three equal instalments between 2015 and early-mid 2016[2].

In total, 36 specific conditions[3] from six areas were attached to the financial envelope: public finance management, governance and transparency, energy, social safety nets, business environment and financial sector. A number of those conditions built on those prescribed under MFA I and II[4].

The first disbursement of EUR 600 mln under MFA III was made in July 2015. It then took nearly 20 months to disburse the second tranche of EUR 600 mln (released in April 2017).

The MFA III operation expired on 13 January 2018 without the third and final disbursement, given the lack of sufficient progress with the implementation of some of the conditions. The Commission approved the non-disbursement in a Cancellation Decision dated 18 January 2018[5].

---

[1] EUR 13 bln = EUR 600 mln (MFA I) + EUR 1,000 mln (MFA II) + EUR 1,800 mln (MFA III) + EUR 9,600 mln (other assistance, including European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD) lending).

[2] The total availability period was two-and-a-half years, as disbursements were initially envisaged to be made more rapidly.

[3] Full list of conditions for MFA III is available in the Annex of the Memorandum of Understanding document, available at: http://ec.europa.eu/economy_finance/international/neighbourhood_policy/doc/mou_eu_ukraine_en.pdf

[4] The areas/issues that built on those envisaged under MFA I and II included: strengthening of the functions of the Accounting Chamber of Ukraine, approximation of the public procurement with the EU acquis, timely submission of Draft State Budget or improvement in the functionality of the social safety net put in place in 2014.

[5] European Commission Decision, C(2018) 405 final. https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-405-F1-EN-MAIN-PART-1.PDF

Purpose of the evaluation

This evaluation assesses, ex post, the contribution of the MFA III facility to the macroeconomic and structural adjustment of Ukraine. In doing so it examines:

- Whether the ex ante considerations determining the design and terms of the operation were appropriate, taking due account of the economic, political and institutional context; and
- Whether the outcome of the programme met the intended objectives.

Methodology

This evaluation was based on a mixed-methods approach and was carried out in line with the requirements set out in the Commission's Better Regulation Guidelines. It relied on various qualitative and quantitative techniques to establish a comprehensive evidence base for the evaluation and to provide the basis for triangulation of findings. The following methods were used to build the evidence base for the evaluation:

- **Desk research:** a review and analysis of all relevant literature, official documentation and macroeconomic data;
- **Semi-structured interviews with key stakeholders:** interviews with relevant staff from DG ECFIN, Support Group for Ukraine, the EU External Action Service, EU Delegation to Ukraine in Kyiv, officials from the relevant ministries and agencies in Ukraine (including the Ministry of Finance, the National Bank of Ukraine, the National Anti-Corruption Bureau and the Ministry of Social Policy), representatives of local civil society organisations (CSOs) and the business community, and representatives of international financial institutions (International Monetary Fund (IMF), World Bank (WB) and EBRD), as well as key bilateral donors;
- **Internal brainstorming session on counterfactual scenarios:** this took place at the interim stage of the evaluation and involved the core members of the ICF and Cambridge Econometrics teams, as well as local economists;
- **An online focus group with the members of local civil society**, including representatives from the Ukrainian CSOs, think tanks and academia;
- **Delphi survey:** established experts' views on the macroeconomic impact of the MFA III on the Ukrainian economy (e.g. Gross Domestic Product (GDP) growth, balance of payments, fiscal balances), as well as the impact of MFA III and its contribution to structural reform in Ukraine;
- **Two in-depth case studies on MFA III promoted reforms** in anti-corruption and the social safety net, respectively, and **one separate case study on the impact of all three MFAs on the international use of the Euro**;
- **Debt sustainability analysis** (DSA): assessed the sustainability of Ukraine's public debt before and after the MFA III operation;
- **Social impact analysis** (SIA): examined the extent to which the MFA III cushioned the social impact of the crisis;
- **Validation workshop:** discussed the emerging study findings with key stakeholders involved in the design and implementation of the operation.

Findings and conclusions of the evaluation

Relevance

Size of the assistance

In absolute terms, MFA III was the largest single operation in the history of the MFA instrument, by some distance. Combined with MFA I and II (EUR 1.6 bln), it accounted for 29 per cent of the total MFA assistance approved between 1990 and 2017 (EUR 11.5 bln). One justification for the scale was '*the political importance of Ukraine for the stability in the European Neighbourhood; the political integration of the country with the EU as reflected by the Association Agreement between the two sides that provisionally entered into force on 1 November 2014*'[6].

Ex post data show that the EU support covered 5 per cent of Ukraine's financing gap over 2015-2017 (instead of the 7 per cent initially envisaged, due to the non-disbursement of the third tranche), or 11 per cent of total official financing.

In terms of the relative size to GDP, the combined first and second tranche of MFA III disbursed in 2015 and 2017 represented 0.7 per cent and 0.6 per cent of annual GDP in 2015 and 2017, respectively. The size of MFA III was therefore material. As put by the Ministry of Finance, '*If you take out restructuring of Eurobonds in 2015, it corresponded to ~15 per cent of total borrowing in 2015 or the amount of annual funding raised on the domestic market that year*'.

Form of the assistance

MFA III financing was provided in the form of highly concessional loans. Given the size of the operation and key factors specific to Ukraine (per capita income, debt sustainability, poverty level), an MFA in the form of grant – or including a grant component - was not an option. The MFA III operation provided in the form of a loan should be looked at in the context of the EU grant support programme provided from 2015-2017 and totaling EUR 840 mln.

MFA loans were provided on concessional terms[7] that could not have been matched by the market at the time, a position that was appreciated by Ukrainian authorities. Although the shorter maturity of the first tranche (five years) was initially received with some disappointment, it is understood that the EU side had only limited leeway in summer 2015, given the deteriorating EU market conditions prompted by the spiraling Greek debt crisis around that time.

Timing of disbursements

Despite the use of the Ordinary Legislative Procedure, the decision-making process for MFA III was extremely fast (the proposal in January was adopted in April, with the MoU signed in May 2015). That speed was welcome, with the first disbursement in July 2015 coming at a time when the country faced huge economic and political challenges (e.g. depleted foreign reserves of only USD 10.3 bln, conflict in the east, capital outflows and sharp depreciation) and had little or no financing alternative. The second tranche disbursed in 2017 was less critical, as the economy had begun to recover.

Conditionalities associated with MFA III support

All thematic areas addressed by MFA III conditionality were relevant. They were derived from the EU-Ukraine Association Agreement and thus were aligned with the country's priorities.

[6] European Commission, 2015. Ex ante evaluation of the MFA III to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

[7] Interest rate of 0.250 per cent for a maturity of five years for the first tranche, and interest rate of 0.750 per cent for a maturity of 14 years for the second tranche.

Most conditions in MFA III pursued macroeconomic objectives (energy, state-owned enterprises, financial sector) or external policies objectives (business environment, trade). Traditional public finance management-related conditionality to reinforce the beneficiary's fiscal governance and protect the EU's financial interests were also included. Other conditions were less typical for an MFA operation albeit very relevant in the case of Ukraine: judiciary reforms were urgently needed to ensure reform progress in other areas, notably in the anti-corruption field (macro-critical in the Ukrainian context), while conditions in relations to the social safety net were very timely, given the developments in Ukraine (anticipated increase in energy tariffs and unfolding humanitarian crisis due to the conflict in the east).

The focus of most of the conditions was (highly) relevant. Some conditions - particularly the ultimate ownership condition in the anti-corruption area - were excessively ambitious, given the initial timeframe[8].

The number of conditions was high in absolute terms (36 conditions - 46 if sub-conditions are considered). Although this may reflect the size of the assistance (more money for more reforms), more sparing use of conditionality might have sustained better motivation throughout the operation.

Overall, design issues were not the main blocking factors that led to non-disbursement of the third tranche. However, hindsight suggests that fewer conditions with reform milestones broken into smaller targets (as under MFA IV) would have helped.

Coherence

MFA III was well aligned with the broad policy framework guiding EU-Ukraine relations, most notably the Association Agreement. Mapping the conditions of the MFA III against the short-term priorities established in the Association Agenda shows how those conditionalities fed into the implementation of the Agenda. MFA III anti-corruption conditions also aligned with the milestones required for visa-free travel for Ukrainian citizens with biometric passports. In addition, MFA III formed part of the wider package of EU supports to Ukraine, including grant assistance, budget support programmes and technical assistance, that targeted the same areas as MFA III (anti-corruption, public finance management, customs, public administration reform, energy efficiency).

MFA III had synergies with the programmes of other international organisations, notably the IMF, WB and EBRD (including at the conditionality level).

Effectiveness

Role and contribution of the MFA in promoting macroeconomic stabilisation

The financial support provided by MFA III and the IMF (and by other EU programmes and international donors) succeeded in stabilising the rapidly deteriorating economic position of the country and Ukraine returned to modest growth in first half of 2016, regained access to the international debt markets in 2017, and has maintained a stable official exchange rate since March 2016.

The majority of Delphi survey[9] respondents believe that the macroeconomic outcomes would have been less favourable in the absence of MFA III – although the absence of the first tranche of MFA III in 2015 would have been more detrimental than the loss of the second disbursement in 2017.

The finding from the counterfactual analysis suggests that in the absence of the MFA's first tranche in 2015 ('Alternative 1'), obtaining alternative financing from financial markets would not have been possible, while the absorption capacity of domestic

[8] MFA III initially meant to be completed by mid-2016.

[9] See Delphi survey results.

market was severely constrained by ongoing restructuring of the banking sector. Raising revenue through higher taxes and/or privatisation would have been similarly impossible, both economically and politically. The most plausible alternative would have involved cuts in capital expenditure and pensions (in real terms - by delaying the unfreezing of indexation in public pension payments).

Had the second tranche not been disbursed ('Alternative 2'), the analysis shows that the most plausible course of action would have been to raise the required financing from the domestic debt market, which had already recovered by 2017. While the broader macroeconomic consequence of this option would likely have been limited, the additional cost of debt stemming from the higher interest rates in domestic borrowing compared to MFA financing, would have reached EUR 29 mln (for a maturity of 18 months and substantially higher for any long-term financing arrangements).

That EUR 29 mln difference in the cost of servicing debt is the estimated cost associated with the non-disbursement of the third tranche by the end of 2017, which was offset by the alternative - but more expensive - financing on the domestic market ('Alternative 3').

Under the no MFA III and no IMF support scenario ('Alternative 4'), Ukraine would not have received the rescue packages provided by the EU and the IMF, amounting to approximately EUR 8.9 bln, according to conservative estimates. Ukraine's ability to source funding from domestic and international debt markets would have been very severely impaired, if available at all. Only very limited cuts to public spending would have been politically feasible, leaving Ukraine likely defaulting on its debts over 2015-2017, with hard-to-predict economic, social and political implications.

Progress achieved in structural reform

Overall, Ukraine has made substantial progress in reform implementation, especially during the initial stages of the operation, all in an exceptionally challenging environment. There has been tangible progress on the ground, going beyond the fulfilment of the specific MFA III conditions *stricto sensu*. For instance, the energy sector is no longer causing budgetary problems, helping the country to get on the path to greater fiscal sustainability. As of 2019, the Naftogaz Group accounted for nearly 16 per cent of total revenues of the state budget[10], compared to 2014, when it was a 'black hole' amounting to 6.2 per cent of the country's GDP that had to be covered by Ukraine's budget[11]. In the public finance management area, the e-procurement system, ProZorro, has been widely acknowledged as a success, both domestically and internationally[12].

Key milestones have been achieved in the fight against corruption, with the institutional architecture now largely in place and some solid advancements made at technical level. Conditions that led to withholding the payment of the third tranche have been implemented beyond the timeframe of MFA III (as part of MFA IV). In the anti-corruption area, continuous reforms (judiciary, law enforcement) are still urgently needed.

[10] See:

http://naftogaz.com/www/3/nakweben.nsf/0/A09B58DD11619020C22584F1002A61B6?OpenDocument&year=2020&month=01&nt=News&

[11] Economist Intelligence Unit (EIU) data available at: http://country.eiu.com/article.aspx?articleid=1566640540&Country=Ukraine&topic=Economy&subtopic=Recent+developments&oid=213295405&aid=1

[12] See, for example: https://www.worldbank.org/content/dam/Worldbank/document/eca/georgia/11-procurement/Ukraine-ENG.pdf

Social impact

Had the MFA III not been provided but IMF support still continued (all but 'Alternative 4'), the counterfactual analysis suggests negative direct impacts stemming from implementation risks to the reform of social safety nets (risk of having less effective compensation mechanisms to protect vulnerable households and risk of increased delays with the resumption of social benefits and services for internally displaced persons (IDPs)).

Alternative 1, in addition to direct negative impacts stemming from the more limited implementation of MFA conditions, would also have had indirect implications, as no alternative financing could have been sourced. Reductions in government spending would have negatively affecting household resources from 2015 (through the pension channel). Under Alternative 2, the indirect effects would have been limited, with the MFA replaced by alternative sources of financing.

In the absence of MFA and IMF support, the default that would have been likely under Alternative 4 would have had severe social implications, such as economic recession, increased rates of unemployment, high levels of inflation and/or cuts to public services and wages.

Debt sustainability

Under the baseline scenario, Ukraine's debt appears to be sustainable. The gross financing needs-to-GDP ratio was at its highest in 2016, still below the IMF's 15 per cent threshold. The debt-to-GDP ratio is structurally superior to 50 per cent, meaning that it remains viable but warrants some scrutiny.

Had the MFA III not been provided but IMF support continued (all except 'Alternative 4'), debt sustainability would have remained virtually unchanged compared to the baseline scenario.

The most likely outcome would have involved a decrease in debt (Alternatives 1 and 3) or, on the contrary, an increase in debt due to the higher cost of borrowing from domestic financial markets (compared to the MFA's concessional rates). Yet, the change in debt burden indicators would have been of limited magnitude. Under Alternative 1, the outcomes would have been slightly more negative, as the cuts to government spending would have resulted in a real decline in Ukraine's GDP.

Under Alternative 4 (no MFA and no IMF), the DSA tool was not applied, given the speculative nature of the likely sovereign debt default impacts.

Efficiency

Capacity

Insufficient administrative and policy-making capacity is consistently reported as an issue in Ukraine (by stakeholders) and is assessed by the WB Government Effectiveness indicator. This highlights the importance of the public administration reforms promoted as part of the MFA and other EU programmes.

Capacity issues were particularly evident where MFA conditions involved some coordination between different institutions and bodies (e.g. IDPs). Overall, however, capacity was only one of many (more significant) factors hindering reforms.

Ownership of reform

The level of ownership of the MFA operation turned out to be more fragile than initially anticipated by the European Commission and other donors between 2015 and 2018, in particular the IMF. Ownership was uneven across the various Ukrainian authorities and bodies in charge of the implementation of the specific conditions. While the ownership at the Ministry of Finance and the National Bank of Ukraine was high, political will among the state leadership gradually fizzled out, especially after the change of government in April 2016. The strong vested interests at the Rada undermined the programme throughout, as exemplified by the numerous issues that emerged during the implementation of anti-corruption conditions.

Despite the challenges, reform advanced in many areas, in part due to the demands of the general public, pressure from the Ukrainian civil society and international players, and reform-oriented stakeholders within government organisations.

EU added value

Given the size of the operation, the EU had a clear financial added value. No single Member State could have supported Ukraine and mobilised financing to the same extent and under the same format of budget support. The first tranche helped to avoid further cuts in government spending, while the second tranche generated financial savings for Ukrainian authorities (some EUR 29 mln) through the concessional interest rates of the MFA III loan and far longer maturation compared to the market (18 months vs 14 years for the MFA second tranche).

Symbolically, it was important that MFA III came from the EU: there was a real expectation that the EU would provide support to Ukraine at such a historically critical time for the country and its people. EU support, combined with other international support, helped to restore confidence in the economy.

The stakeholders consulted shared the view that in the absence of MFA III, the reform process would have been slower and there would have been some gaps in overall reform progress. Certain exceptions included public finance management and financial sector reforms, where MFA conditions were less decisive. MFA III conditions were widely used for leverage by anti-corruption CSOs. There were, however, substantially negative perceptions of the EU's position in relation to the wood ban issue among CSOs, the general public and expressed in Ukraine media.

Reflections on the non-disbursement

The two unmet anti-corruption conditions were key to the Commission's decision not to not disburse the third tranche of MFA funding. While the condition on ultimate ownership was overly ambitious, there was a shared understanding (on the part of the EU and Ukrainian civil society) that vested interests were prevalent and authorities were making insufficient efforts to counter those interests and make progress on the crucial anti-corruption conditions. The non-disbursement decision was thus seen as justified and credible by the EU and Ukrainian civil society. There were no reports of negative political implications, in light of the continuation of other EU support initiatives. Negative economic implications were noted, such as adding slightly to the cost of debt servicing, but these were limited, given the economic context in 2017. Under different circumstances or an unjustified decision, non-disbursement might have had different implications, including worsening the dialogue between Ukraine authorities and the EU.

Анотація

Програма третьої макрофінансової допомоги (МФД ІІІ), яку надав ЄС Україні, є наступницею МФД І та ІІ, двох програм із чіткою метою та юридичним обґрунтуванням, фінансування в рамках яких було надано у період 2014 року – початку 2015 року. Метою кожної програми було подолання наслідків кризи, що виникла на початку 2014 року внаслідок політичної нестабільності після незаконної анексії Криму Росією та подальшого воєнного конфлікту на сході країни.

Програму МФД ІІІ у сумі 1,8 млрд євро було схвалено європейською стороною у квітні 2015 року. Вона була найбільшою програмою макрофінансової допомоги з часу заснування цього інструменту підтримки. Передбачалось, що допомогу в рамках цієї програми буде сплачено у формі трьох рівних траншів. Надання допомоги в межах МФД ІІІ було пов'язане з виконанням тридцяти шести умов у шести сферах, а саме: державне управління та прозорість, управління в сфері публічних фінансів , енергетика, система соціального захисту, ділове середовище та фінансовий сектор.

Це дослідження є незалежною оцінкою надання допомоги з боку ЄС Україні в межах програми МФД ІІІ. Зокрема, в ньому проаналізовано актуальність, ефективність, продуктивність, практичну корисність для ЄС та узгодженість програми із іншими програмами допомо. Дослідження спирається на докази, зібрані з використанням різних методів, що включають як кількісні, так і якісні методи дослідження. У дослідженні зроблено висновок, що програма МФД ІІІ, разом із іншою міжнародною підтримкою, відповідала потребам фінансування України та була вирішальною для впорядкованої реструктуризації державного боргу у 2015 році. Україною було досягнуто значний прогрес у проведенні реформ протягом усього періоду впровадження програми, зокрема завдяки виконанню запропонованих в програмі МФД умов. Однак зацікавленість у впровадженні програми зменшувалася в ході виконання її умов, і програма МФД ІІІ закінчилася 13 січня 2018 року без здійснення третього й останнього траншу через відсутність достатнього прогресу у виконанні деяких умов, зокрема, в сфері боротьби з корупцією. В цілому, за результатами оцінки було встановлено, що це було зваженим й обґрунтованим рішенням з боку ЄС.

Резюме

У цьому звіті представлені результати ретроспективного аналізу програми «Макрофінансова допомога (МФД) III», що була надана Україні протягом 2015–2017 років. Оцінка була замовлена Генеральним управлінням з економічних та фінансових питань (ГУ ЕКФІН). Роботу проводила компанія ICF у співпраці з компанією Cambridge Econometrics і місцевими економістами з Інституту економічних досліджень та політичних консультацій (м.Київ).

Передумови надання МФД III Україні

Програма МФД III Україні є наступницею програм МФД I та II, двох програм із чіткою метою та юридичним обґрунтуванням , фінансування в рамках яких було надано у період 2014 року – початку 2015 року. Метою кожної програми проектів було подолання наслідків кризи, що виникла на початку 2014 року внаслідок політичної нестабільності після незаконної анексії Криму півострова Росією та подальшого воєнного конфлікту на сході країни.

МФД III спочатку не було включено до пакету підтримки України, оголошеного Європейською Комісією 5 березня 2014 року. Цю програму додали лише тоді, коли воєнний конфлікт на сході України загострився, а економічна ситуація погіршилася. Цей новий запит від української влади, початково сформульований у вересні 2014 року та повторений у грудні 2014 року, було схвалено у квітні 2015 року, а зобов’язання ЄС щодо підтримки України разом із іншими видами допомоги досягли безпрецедентного обсягу у 13 млрд євро[13].

Метою програми було задоволення частини потреби України у зовнішньому фінансуванні, що залишалась значною навіть після надання допомоги в межах МФД I і II та інших донорських програм, та підтримати амбітну програму реформ, розпочату в межах МФД I і II. МФД III був більшим, ніж будь-який інший попередній проект МФД з моменту створення цього інструменту: його загальну суму в 1,8 млрд євро передбачалося виплатити трьома рівними траншами у період з 2015 до початку–середини 2016 року[14].

Загалом до програма допомоги містила 36 конкретних умов[15] у шести сферах: державне управління та прозорість, система управління державними фінансами, енергетика, система соціального захисту, ділове середовище та фінансовий сектор. Ряд цих умов ґрунтувались на тих, що було передбачено у програмах МФД I і II[16].

Перший транш у сумі 600 млн євро у рамках МФД III було сплачено в липні 2015 року. Для виплати другого траншу в розмірі 600 млн євро знадобилось майже 20 місяців (сплачено у квітні 2017 року).

Програма МФД III закінчилась 13 січня 2018 р. без виплати третього й остаточного траншу з огляду на відсутність достатнього прогресу у виконанні деяких умов.

[13] 13 млрд євро = 600 млн євро (МФД I) + 1000 млн євро (МФД II) + 1800 млн євро (МФД III) + 9600 млн євро (інша допомога, включаючи кредитування Європейського інвестиційного банку (ЄІБ) та Європейського банку реконструкції та розвитку (ЄБРР)).

[14] Загальний період надання допомоги становив два з половиною роки, оскільки спочатку передбачалося здійснювати більш швидкі виплати.

[15]Повний перелік умов МФД III наведено у Додатку до Меморандуму про взаєморозуміння, що знаходиться за адресою: http://ec.europa.eu/economy_finance/international/neighbourhood_policy/doc/mou_eu_ukraine_en.pdf

[16] Сфери/питання, які ґрунтувались на передбачених у МФД I і II, були: посилення функцій Рахункової палати України, наближення державних закупівель до законодавства ЄС, своєчасне подання Проєкту державного бюджету та покращення функціональності програми соціального захисту, запровадженої у 2014 році.

Комісія затвердила невиплату коштів у рішенні про скасування від 18 січня 2018 р.[17]

Мета оцінки

У цій оцінці проводиться ретроспективний аналіз внеску проекту МФД III у макроекономічну та структурну трансформацію України. У ній досліджуються такі питання:

- Чи були доречними попередні міркування, за якими визначали формат і умови програми, з урахуванням економічного, політичного та інституційного контексту?
- Чи відповідає результат програми наміченим цілям?

Методика

У процесі проведення цієї оцінки застосовувалися різні методи. Вона проводилася відповідно до вимог, викладених у Рекомендаціях із ефективного регулювання Комісії. Було застосовано різні якісні та кількісні методи, щоб створити всебічну фактологічну базу для аналізу та надати основу для перехресної перевірки результатів. Для формування фактологічної бази оцінки використовувалися такі методи:

- **Кабінетне дослідження:** огляд та аналіз усієї дотичної літератури, офіційної документації та макроекономічних даних.
- **Частково структуровані співбесіди з ключовими зацікавленими сторонами:** співбесіди з відповідними працівниками ГД ЕКФІН, Європейської служби зовнішніх справ ЄС, Представництва ЄС в Україні у Києві, посадовими особами відповідних міністерств та відомств в Україні (зокрема Міністерства фінансів, Національного банку України, Національного антикорупційного бюро та Міністерства соціальної політики), представниками місцевих організацій громадянського суспільства (ОГС) та ділового співтовариства, представниками міжнародних фінансових установ (Міжнародного валютного фонду (МВФ), Світового банку (СБ) та ЄБРР)), а також ключовими двосторонніми донорами.
- **Аналіз альтернативних сценаріїв шляхом мозкового штурму:** він проводився на проміжному етапі оцінювання із залученням ключових співробітників ICF і Cambridge Econometrics, а також місцевих економістів.
- **Онлайн фокус-група за участі представників місцевого громадянського суспільства**, зокрема представників українських ОГС, аналітичних центрів і науковців.
- **Метод експертних оцінок (Дельфі метод),** який був покликаний визначити думку визнаних експертів про макроекономічний вплив МФД III на економіку України (наприклад, зростання валового внутрішнього продукту (ВВП), платіжний баланс, збалансованість бюджетів), а також вплив програми МФД III та її внесок на впровадження структурних реформ в Україні.
- **Два поглиблені дослідження ситуації щодо реформ, яким сприяла програма МФД III,** у сферах боротьби з корупцією та покращення соціального захисту й **одне окреме тематичне дослідження впливу всіх трьох програм МФД на міжнародне використання євро**.

[17] Рішення Європейської Комісії, C(2018) 405, остаточне. https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-405-F1-EN-MAIN-PART-1.PDF

- **Аналіз боргової стійкості** (debt sustainability analysis, DSA): оцінка стійкості державного боргу України до та після впровадження МФД III.
- **Аналіз соціального впливу** (АСВ): вивчення внеску програми МФД III до пом'якшення соціальних наслідків кризи.
- **Семінар з перевірки результатів:** обговорення результатів дослідження з ключовими зацікавленими сторонами, що брали участь у розробці та реалізації проекту.

Результати та висновки оцінки

Актуальність

Розмір допомоги

В абсолютних цифрах програма МФД III була найбільшою єдиною операцією в історії інструменту МФД. Разом з МФД I і II (1,6 млрд євро) вона становила 29 відсотків загальної допомоги, схваленої в межах МФД у період із 1990 до 2017 року (11,5 млрд євро). Обґрунтуванням такого великого розміру допомоги було *«політичне значення України для стабільності в європейському регіоні; політична інтеграція країни з ЄС, відображена в Угоді про асоціацію між двома сторонами, що попередньо почали застосовувати з 1 листопада 2014 р.»*[18].

Дані ретроспективного аналізу показують, що підтримка ЄС покрила 5 відсотків розриву у фінансуванні України протягом 2015–2017 років (замість 7 відсотків, передбачених спочатку, через невиплату третього траншу), або 11 відсотків загального офіційного фінансування.

Перший та другий транш МФД III, виплачені у 2015 та 2017 роках, разом становили 0,7 відсотка та 0,6 відсотка річного ВВП відповідно у 2015 та 2017 роках. Отже, розмір МФД III був суттєвим. Як зазначає Міністерство фінансів, *«якщо відняти реструктуризацію єврооблігацій у 2015 році, це відповідало близько 15 відсоткам загальних запозичень у 2015 році або сумі фінансування, залученого на внутрішньому ринку в цьому році»*.

Форма допомоги

Фінансування МФД III надавалося у формі кредитів на дуже пільгових умовах. З огляду на масштаби операції та ключові характерні для України фактори (дохід на одну особу, стійкість державного боргу, рівень бідності) МФД у вигляді гранту, або допомога, яка б включала грантовий компонент, була неможливою. Програму МФД III, надану у формі кредиту, варто розглядати в контексті програми допомоги ЄС у формі грантів, наданих у 2015–2017 роках у загальній сумі 840 млн євро.

Позики МФД надавалися на пільгових умовах,[19] які на той момент ринок не міг запропонувати і які високо оцінили українські органи влади. Незважаючи на те, що коротший термін погашення першого траншу (п'ять років) спочатку був отриманий з деяким розчаруванням, треба розуміти, що влітку 2015 року сторона ЄС мала обмежену свободу дій з огляду на погіршення ринкової кон'юнктури в ЄС внаслідок суттєвого поглиблення боргової кризи Греції.

Терміни виплат

Незважаючи на використання звичайної законодавчої процедури, процес прийняття рішень щодо МФД III був надзвичайно швидким (пропозиція, зроблена в січні, була прийнята в квітні, з підписанням Меморандуму про взаєморозуміння у

[18] Європейська комісія, 2015 рік. Попередня оцінка МФД III для України. Доступна за адресою: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

[19] Процентна ставка 0,250 відсотка з терміном погашенні у п'ять років за першим траншем і процентна ставка 0,750 відсотка з терміном погашення у 14 років за другим траншем.

травні 2015 року). Такий швидкий темп був нагально важливим, оскільки перша виплата в липні 2015 року відбулася як раз в той момент, коли країна зіткнулася з величезними економічними та політичними проблемами (зокрема, скорочення міжнародних резервів всього до 10,3 млрд доларів США, воєнний конфлікт на сході, відплив капіталу та різке знецінення національної валюти), а можливості альтернативного фінансування практично не існувало. Другий транш, виплачений у 2017 році, був не настільки критично важливим, оскільки економіка почала відновлюватися.

Умови, пов'язані з підтримкою МФД III

Усі тематичні сфери, з якими були пов'язані умови МФД III, були доцільними. Вони знайшли своє коріння в Угоді про асоціацію між Україною та ЄС, і тому узгоджувалися з пріоритетами країни.

Більшість умов програми МФД III переслідували макроекономічні цілі (енергетика, державні підприємства, фінансовий сектор) або цілі зовнішньої політики (ділове середовище, торгівля). Також були включені традиційні умови щодо системи управління державними фінансами для посилення належного бюджетного управління бенефіціара та захисту фінансових інтересів ЄС. Інші умови були менш типовими для програми МФД, хоча й дуже актуальними для України: судова реформа була нагально необхідною для забезпечення прогресу реформ в інших сферах, особливо в антикорупційній сфері, яка суттєво впливає на макроекономічну ситуацію в українському контексті, тоді як умови щодо системи соціального захисту були дуже своєчасними з огляду на зміни в Україні (очікуване підвищення тарифів на енергоносії та розгортання гуманітарної кризи через воєнний конфлікт на сході).

Фокус більшості умов був (дуже) актуальним та доречним. Деякі умови — особливо умова, що стосується визначення кінцевих бенефіціарних власників в антикорупційній сфері, — були надмірно амбітними з огляду на початкові часові рамки[20].

Кількість умов була високою в абсолютних цифрах (36 умов, або 46, якщо враховувати додаткові умови). Хоча така кількість може відображати розмір допомоги (більше грошей для проведення більшої кількості реформ), менша кількість умов сприяла б кращій мотивації протягом виконання програми.

Загалом, структура програми не була основною обставиною, що призвела до невиплати третього траншу. Однак аналіз подій свідчить про те, що кращим підходом було б визначення меншої кількості умов з розбиванням реформ на етапи, як це було передбачено у Програмі МФД IV.

Узгодженість

Проект МФД III добре узгоджувався із широкою політичною концепцію, що лежала в основі відносин між ЄС та Україною, зокрема, з Угодою про асоціацію з ЄС. Зіставлення умов МФД III з короткостроковими пріоритетами, встановленими Порядком денним асоціації, показує, як ці умови обумовлені реалізацією Порядку денного. Антикорупційні умови МФД III також узгоджувалися з етапами, виконання яких було необхідне, щоб отримати безвізовий режим для громадян України з біометричними паспортами. Крім того, проект МФД III увійшов до більш широкого пакету підтримки ЄС для України, включаючи грантову допомогу, програми бюджетної підтримки та технічну допомогу, що були спрямовані на ті ж сфери, що і МФД III (боротьба з корупцією, система управління державними фінансами, митниця, реформа державного управління, енергоефективність).

[20] Проект МФД III спочатку мав бути завершений до середини 2016 року.

Програма МФД III мала синергію з програмами інших міжнародних організацій, включно з МВФ, СБ та ЄБРР (в тому числі на рівні визначення умов).

Ефективність

Роль та внесок МФД у сприяння макроекономічній стабілізації

Фінансова підтримка, надана з боку ЄС у межах МФД III та Міжнародним валютним фондом (а також в межах інших програм ЄС та міжнародними донорами), сприяла стабілізації економічної ситуації в Україні, що до того швидко погіршувалась. Економіка України поновила помірне зростання в першій половині 2016 року з відновленням доступу до міжнародних ринків капіталу у 2017 році та підтримкою стабільного офіційного обмінного курсу із березня 2016 року.

Більшість опитуваних за методом експертних оцінок[21] вважають, що макроекономічні результати були б менш сприятливими за відсутності програми МФД III, — хоча відсутність першого траншу МФД III у 2015 році мала б більші негативні наслідки, ніж втрата другого траншу у 2017 році.

Результати аналізу альтернативних сценаріїв свідчать, що за відсутності першого траншу МФД у 2015 році («Альтернатива 1») отримання альтернативного фінансування з фінансових ринків було б неможливим, тоді як здатність запозичень на внутрішньому ринку була сильно обмежена поточною реструктуризацією банківського сектору. Підвищення доходів за рахунок більших податків і/або приватизації було б також неможливим як в економічному, так і в політичному плані. Найбільш правдоподібна альтернатива передбачала б скорочення капітальних витрат і пенсій (фактично шляхом пізнішого відновлення індексації пенсій).

Аналіз показує, що за відсутності другого траншу («Альтернатива 2») найбільш правдоподібними діями уряду було б залучення необхідного фінансування на внутрішньому ринку , який вже відновився до 2017 року. Хоча ширший макроекономічний вплив такого сценарію, ймовірно, був би обмеженим, додаткова вартість боргу внаслідок вищих процентних ставок на внутрішньому ринку порівняно з фінансуванням в межах МФД, досягла б 29 млн євро (зі строком погашення 18 місяців і значно більше для будь-яких довших запозичень).

Ця різниця у вартості обслуговування боргу в 29 млн євро — це орієнтовна вартість, пов’язана з невиплатою третього траншу до кінця 2017 року, що була компенсована альтернативним, але дорожчим, фінансуванням на внутрішньому ринку («Альтернатива 3»).

Відповідно у випадку сценарію відсутності МФД III та відсутності підтримки МВФ («Альтернатива 4»), за консервативними підрахунками, Україна не отримала б пакети допомоги, надані ЄС і МВФ, на суму приблизно 8,9 млрд євро. Можливість України отримувати відповідне фінансування на внутрішньому або зовнішньому ринку капіталу була б дуже серйозно ослаблена, або й взагалі відсутня. Оскільки з політичної точки зору було б можливим лише дуже обмежене скорочення державних видатків, така ситуація, найвірогідніше, призвела би до суверенного дефолту України протягом 2015–2017 років із важко передбачуваними економічними, соціальними та політичними наслідками.

Прогрес у впровадження структурних реформ

В цілому, Україна досягла значного прогресу у впровадженні реформ, особливо на початкових етапах впровадження програми макрофінансової допомоги, все в надзвичайно складних умовах. В багатьох випадках було досягнуто відчутного прогресу, що виходив за рамки виконання конкретних умов МФД III. Наприклад, енергетичний сектор вже не спричиняє бюджетних проблем, що допомагає країні

[21] Див. результати опитування за методом експертних оцінок.

стати на шлях більшої фінансової стійкості. Станом на 2019 рік група компаній «Нафтогаз» перерахувала до Державного бюджету майже 16 відсотків загальних доходів[22], тоді як у 2014 роком вона спричинила «чорну діру» у 6,2 відсотка ВВП, яку потрібно було покрити з бюджету України[23]. У системі управління державними фінансами успішна реалізація електронних закупівель через платформу ProZorro отримала широке визнання як у країні, так і на міжнародному рівні[24].

Також, важливі цілі були досягнуті в боротьбі з корупцією, оскільки інституційну архітектуру значною мірою було створено, і на технічному рівні досягнуто певного прогресу. Умови, що призвели до невиплати третього траншу, були виконані поза рамками МФД III (у рамках МФД IV). У сфері боротьби з корупцією все ще надзвичайно необхідні подальші реформи (наприклад у судовій системі, правозастосування).

Соціальний вплив

Якби допомога у рамках МФД III не була б надана, але підтримка МВФ все ще продовжувалася б (всі альтернативи, окрім «Альтернативи 4»), то аналіз альтернативних сценаріїв свідчить про негативні прямі наслідки, пов'язані з ризиками впровадження реформи системи соціального захисту (ризик менш ефективних механізмів компенсацій для захисту вразливих домогосподарств і ризик збільшення затримок із відновленням соціальних виплат та послуг для внутрішньо переміщених осіб (ВПО)).

Альтернатива 1, окрім прямих негативних наслідків внаслідок більш обмеженого виконання умов МФД, також мала б непрямі наслідки, оскільки жодне альтернативне фінансування неможливо було б отримати. Скорочення державних витрат негативно позначилося б на ресурсах домогосподарств з 2015 року (через канал отримання пенсій). Згідно з Альтернативою 2, непрямі наслідки були б обмеженими; МФД було б замінено альтернативними джерелами фінансування.

За відсутності підтримки МФД та МВФ, дефолт, що міг би бути Альтернативою 4, мав би серйозні негативні соціальні наслідки, такі як економічний спад, підвищення рівня безробіття, високий рівень інфляції й/або скорочення публічних послуг і заробітної плати.

Боргова стійкість

Відповідно до базового сценарію борг України видається стійким. Співвідношення валових потреб у фінансуванні до ВВП було найвищим у 2016 році, але все ж нижче 15-відсоткового порогу МВФ. Співвідношення боргу до ВВП структурно перевищує 50 відсотків, що означає, що він залишається прийнятним, але вимагає певного контролю.

Якби фінансування у межах МФД III не було надане, але підтримка МВФ все ще продовжувалася (всі альтернативи, окрім «Альтернативи 4»), то боргова стійкість залишалася б практично незмінною порівняно з базовим сценарієм.

Найімовірнішим результатом стало б зменшення рівня боргу (Альтернативи 1 та 3) або, навпаки, збільшення боргу через більш високу вартість запозичень на внутрішньому ринку (порівняно з пільговими ставками МФД). Однак зміни показників боргового тягаря мали б обмежений характер. Відповідно до

[22]Див.:

http://naftogaz.com/www/3/nakweben.nsf/0/A09B58DD11619020C22584F1002A61B6?OpenDocument&year=2020&month=01&nt=News&

[23] Дані аналітичного відділу журналу «Економіст» (EIU) знаходяться за адресою: http://country.eiu.com/article.aspx?articleid=1566640540&Country=Ukraine&topic=Economy&subtopic=Recent+developments&oid=213295405&aid=1

[24] Див., наприклад: https://www.worldbank.org/content/dam/Worldbank/document/eca/georgia/11-procurement/Ukraine-ENG.pdf

Альтернативи 1, результати були б дещо більш негативними, оскільки скорочення державних витрат призвело б до зниження реального ВВП України.

За Альтернативою 4 (відсутність МФД і відсутність допомоги МВФ), інструмент оцінки стійкості боргу не застосовувався через спекулятивний характер ймовірних наслідків суверенного дефолту.

Ефективність

Спроможність

Недостатня спроможність державних службовців та політиків є проблемою для України, про що постійно повідомлялось опитаними зацікавленими сторонами та визначено в Показником ефективності урядування СБ. Це підкреслює важливість реформи державного управління, що просувається в межах МФД та інших програм ЄС.

Проблеми зі спроможністю були особливо очевидними, коли умови МФД передбачали певну координацію між різними установами та органами (наприклад, ВПО). Однак у цілому браку спроможності був лише одним із багатьох (і не найбільш значущим) чинником гальмування реформ.

Зацікавленість у проведенні реформ

Рівень готовності до реформ передбачених проектом МФД виявився менш передбачуваним, ніж спочатку передбачали Європейська Комісія та інші донори в 2015–2018 роках, зокрема, МВФ. Ентузіазм до реформ був неоднаковим у різних українських органах влади, відповідальних за виконання конкретних умов. Тоді як рівень зацікавленості у Міністерстві фінансів та Національному банку України був високим, політична воля серед керівництва держави поступово послаблювалася, особливо після зміни уряду в квітні 2016 року. Сильне лобіювання приватних інтересів у Раді підривало програму протягом усього часу її реалізації, про що свідчать численні проблеми, що виникали під час виконання антикорупційних умов.

Незважаючи на проблеми, реформи просувалися у багатьох сферах, частково завдяки вимогам широкої громадськості, тиску з боку українського громадянського суспільства, міжнародних гравців і зацікавлених в реформах осіб, які працювали в урядових організаціях.

Практична користь для ЄС

Враховуючи розмір операції, ЄС витратив кошти ефективно. Жодна держава-член не могла б підтримати Україну та мобілізувати фінансування в тій же мірі та з тим же форматом бюджетної підтримки. Перший транш допоміг уникнути подальших скорочень державних витрат, тоді як другий транш створив фінансові заощадження для українських органів влади (близько 29 млн євро) за рахунок пільгових процентних ставок за кредитом МФД III та набагато більшого терміну погашення порівняно з ринковим (альтернативою на внутрішньому ринку, ймовіно, були запозичення на 18 місяців порівняно з 14 роками для другого траншу МФД).

МФД III також мав значне символічне значення: мали місце реальні очікування того, що ЄС надасть підтримку Україні в такий історично важливий для країни та її народу час. Підтримка ЄС у поєднанні з іншою міжнародною підтримкою допомогла відновити впевненість в економіці.

Опитані зацікавлені сторони поділилися думкою, що за відсутності МФД III процес реформ був би повільнішим і були б деякі прогалини в загальному ході реформ. Певні винятки включали зміни у системі управління державними фінансами та реформи фінансового сектору, де умови МФД були менш вирішальними. Умови МФД III широко використовувались ОГС для боротьби з корупцією. Однак існували негативні думки серед ОГС, широкої громадськості та українських ЗМІ щодо позиції ЄС стосовно питання заборони експорту деревини.

Аналіз невиплати коштів

Дві невиконані антикорупційні умови були ключовими для рішення Комісії не виплачувати третій транш фінансування у межах МФД. Незважаючи на те що умова про кінцевих бенефіціарних власників була надто амбітною, існувало спільне розуміння (з боку ЄС та українського громадянського суспільства), що домінує лобіювання приватних інтересів, а влада докладає недостатньо зусиль для протидії цим інтересам та прогресу у виконанні ключових антикорупційних умов. Таким чином, ЄС та українське громадянське суспільство визнали рішення про невиплату коштів виправданим і таким, що заслуговує на довіру. Повідомлень про негативні політичні наслідки ЄС не зафіксовано і всі програми підтримки з боку ЄС продовжились. Відзначено негативні економічні наслідки, такі як незначне збільшення витрат на обслуговування боргу, але вони були обмеженими внаслідок економічного контексту 2017 року. За інших обставин або у разі прийняття необґрунтованого рішення невиплата коштів могла б мати інші наслідки, зокрема погіршення діалогу між владою України та ЄС.

1 Introduction

This is the Final Report for an independent, external ex post evaluation of the EU's Macro Financial Assistance (MFA) to Ukraine over 2015-2017. The evaluation focuses on the MFA operation approved in 2015 (MFA III) to support Ukraine in the aftermath of the political 2014 crisis. The MFA was EUR 1.8 bln, of which EUR 1.2 bln was effectively disbursed.

MFA I (EUR 610 mln) and MFA II (EUR 1 bln) were previously evaluated[25], while MFA IV (EUR 1 bln) was approved in July 2018 and its two tranches disbursed in November 2018 and May 2020 respectively. All three are thus outside the scope of this evaluation.

The Final Report provides a comprehensive analysis of MFA III along each evaluation criterion foreseen in the Better Regulation Guidelines, together with stand-alone analyses (Social Impact Analysis (SIA), Debt Sustainability Analysis (DSA)). It is accompanied by an annex document (see detail below).

1.1 Structure of this report

The remainder of this Final Report is structured as follows:

- Section 2 provides an overview of the key economic and political developments in Ukraine (i) during the period leading up to the crisis that prompted the MFA assistance and (ii) during the implementation of the operation;
- Section 3 provides a detailed description of the main characteristics of the MFA III operation;
- Section 4 provides a comprehensive overview of the methodological approach to the study;
- Sections 5 to 7 and 10 to 11 provide an assessment against each of the five evaluation criteria;
- Sections 8 and 9 provide the initial results from the SIA and DSA;
- Section 12 includes some broader reflections on MFA conditionality and non-disbursement;
- Section 13 outlines conclusions from the evaluation.

The main report is supported by the following annexes, provided in a stand-alone document:

- Annex 1. List of completed interviews;
- Annex 2. Headline summary from interviews;
- Annex 3. Focus group discussion – MFA III Ukraine – Summary note;
- Annex 4. Analysis of the Delphi survey;
- Annex 5. Relevance and effectiveness of MFA conditionality, by condition tables;
- Annex 6. Coherence tables;
- Annex 7. Case study: MFA III and anti-corruption (AC) reform;
- Annex 8. Case study: Social safety nets for internally displaced persons (IDPs);
- Annex 9. Case study on the use of the euro;

[25] European Commission, 2017. Ex-post Evaluation of the MFA I & II to Ukraine. Available at: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities/ex-post-evaluation-mfa-operations-ukraine_en

- Annex 10. Social Impact Analysis (SIA);
- Annex 11. Debt Sustainability Analysis (DSA);
- Annex 12. List of references;
- Annex 13. Evaluation framework.

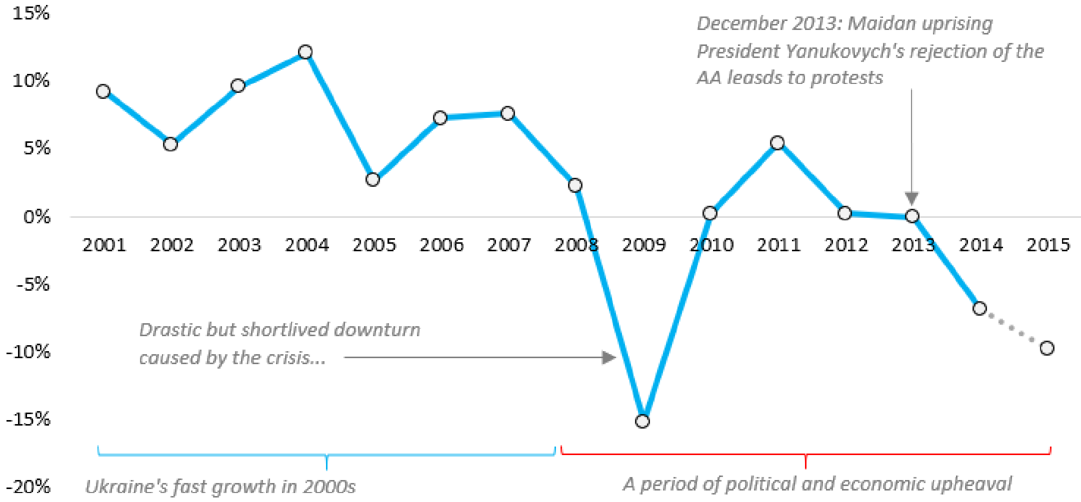
2 Context to the MFA III operation to Ukraine during 2015-2018

This section describes the main political and economic developments in Ukraine that triggered the MFA III operation (Section 2.1) and provides a detailed overview of the main macroeconomic developments during the implementation of the operation during the period 2015-2017 and shortly afterwards (Section 2.2).

2.1 Triggers for the MFA operation

During the period 2000-2007, Ukraine's economy was one of the fastest growing in Eastern Europe, with average annual real Gross Domestic Product (GDP) growth of 7.6 per cent. In the first half of the decade, growth was driven primarily by exports from traditional industries: metals, metallurgy, engineering, chemicals and food[26]. In the wake of rising prices and rapid international economic growth, Ukraine's terms of trade improved significantly[27]. From 2005 onwards, monetisation helped to drive this boom further. Large inflows of foreign capital fuelled domestic consumption and investment, which in turn fostered growth.

Figure 1. Real GDP growth in Ukraine, 2001-2015



Yet despite buoyant GDP growth in the run-up to the global financial crisis, a number of vulnerabilities remained unaddressed, including distorted competition in different markets (e.g. presence of powerful oligarchy obstructing reform) and late liberalisation of prices, energy intensive and underinvested industry, poor public services and rampant corruption and favouritism.

The country was also hit badly by the global financial crisis. The economy went into recession in late 2008 and contracted sharply (by 15.1 per cent[28]) in 2009. Falling prices and reduced global demand for steel (the major export), together with capital outflows, triggered a balance of payments crisis, which further eroded confidence in the currency

[26] Segura, E. (2014). 'Ukraine's Economy Since Independence and Current Situation.' Available at: http://www.usubc.org/site/files/Ukraine_Economy_Since_Independence_update_07_2014-v5.pdf

[27] Sutela, P. (2012). 'The Underachiever: Ukraine's Economy Since 1991.' *Carnegie*. Available at: http://carnegieendowment.org/2012/03/09/underachiever-ukraine-s-economy-since-1991-pub-47451

[28] International Monetary Fund (IMF) (2016). World Economic Outlook (WEO) October 2016.

and the banking system, triggering a system-wide run on deposits. Despite low public debt levels, a fiscal crisis (and, consequently, a sovereign debt crisis) rapidly emerged on the back of a sharply contracting economy, the realisation of contingent liabilities, and the lack of market access[29].

Despite the severity of the crisis, recovery was soon underway and the economy rebounded in mid-2009 and continued into 2010. Growth remained weak in the following years, as the business climate worsened under then-President Viktor Yanukovich.

By the end of 2013, existing imbalances had accumulated and combined with weak governance, little transparency, endemic corruption[30] and a difficult business environment, and in the absence of much-needed structural reform, the outlook was bleak.

Box 1 describes the political events that unfolded after then-President Yanukovich's refusal to sign the proposed Association Agreement (AA) with the EU in November 2013.

Box 1. Euromaidan, shifts in politics and the Russian aggression

At the Eastern Partnership summit in Vilnius on 28-29 November 2013, Ukraine's President, Viktor Yanukovich, refused to sign the AA, including the Deep and Comprehensive Free Trade Area (DCFTA) with the EU. He did, however, agree to a USD 15 bln loan and a beneficial gas deal from Russia.

Rejection of the AA was seen as dismissive of the views of a majority of Ukrainians, while signalling the government's strengthened alignment with Russia. These factors spawned serious unrest among Ukrainian people, who condemned their government's corruption and engaged in major pro-European protests, known as the 'Revolution of Dignity'.

In the wake of the protests, the parliament (*Verkhovna Rada*) voted to impeach President Yanukovich. In January 2014, Prime Minister Azarov resigned, while the President left the country in February 2014. As Speaker of the Parliament, Turchynov assumed the duties of Acting President.

On 26 February 2014, pro-Russian armed forces gradually took over the Crimean Peninsula. An illegal and illegitimate referendum was held in the Autonomous Republic of Crimea and the city of Sevastopol on 16 March 2014 and its outcome was not recognised by the international community. By May 2014 Russian-backed armed formations had gained control of parts of the Donetsk and Luhansk regions in eastern Ukraine. On 7 June, newly elected President Petro Poroshenko took office. Presidential elections were not conducted in non-government-controlled parts of east Ukraine and the illegally annexed Crimean Peninsula. On 27 June, the EU and Ukraine signed the AA.

Following the signature of the Minsk Protocol on 5 September 2014, the 'Package of measures for the implementation of the Minsk Agreements' was signed on 12 February 2015, outlining the steps that would pave the way for the resolution of the conflict. Low-level exchanges of fire continued and the death toll rose. International efforts to find a solution to the conflict continue within the Trilateral Contact Group and the Normandy Format.

The conflict in the east of the country continues to pose significant challenges to Ukraine's reform process, from both a political and economic perspective. The total civilian death toll of the conflict reached at least 3,344, according to

[29] IMF (2011). Country Report No. 11/325: Ukraine: Ex post evaluation of exceptional access under the 2008 Stand-By Arrangement.

[30] Ukraine ranked 144 of 177 countries in the Transparency International Corruption Index in 2013. Available at: https://www.transparency.org/cpi2013/results

the UN Human Rights Monitoring Mission in Ukraine[31]. The number of those killed in the conflict exceeded 13,000.

In 2012, the eastern regions of Donetsk and Luhansk accounted for nearly 16 per cent of national GDP[32].

Source: European Parliament (2015). 'Ukraine's economic challenges.' Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/559497/EPRS_IDA(2015)559497_EN.pdf

The potent combination of a worsening macroeconomic environment and intensification of the conflict in the east, coupled with protracted domestic political uncertainty, eventually translated, in early 2014, into a fully-fledged currency, banking and balance of payment crisis.

Key factors included:

- Large pension and wage increases, coupled with generous energy subsidies, which put pressure on public finances. Overall energy subsidies[24] in Ukraine reached about 7.5 per cent of GDP in 2012. In 2013, Naftogaz reported an operating deficit of 1.9 per cent of GDP. The general government deficit (excluding Naftogaz) widened to 4.75 per cent of GDP in 2013.
- International debt markets were effectively closed to Ukraine at the end of 2013. As the current account deficit widened to about 9 per cent and reserves continued to decline (to 3.5 months of imports by end-October 2013), sovereign debt yields entered double digits and credit default swap spreads widened sharply. By end-2013, international rating agencies had downgraded Ukraine to pre-default levels.
- Sizable foreign exchange market interventions to defend the currency, together with external sovereign debt service and partial clearance of gas payment arrears by Naftogaz, quickly depleted reserves. The National Bank of Ukraine (NBU)'s international reserves dropped further, to USD 15.5 bln in February 2014, equivalent to only 28 per cent of the remaining external debt service in 2014. This forced the NBU to abandon the exchange rate peg and switch to a flexible exchange rate regime. This move triggered considerable exchange rate volatility. From its end-2013 level, the Ukrainian hryvnia (UAH) had depreciated by 30 per cent at the end of April 2014 and by nearly 50 per cent by year end[28]. The large depreciation only added to the domestic costs of imported energy, further depressing domestic demand and adding to the Naftogaz losses.
- The banking system lost some 12 per cent of deposits between early February and the end of March 2014[33]. Impaired banks' liquidity increased the vulnerability of some banks and pushed them to draw on liquidity support from the central bank. The falling value of the hryvnia and economic slowdown damaged banks with negative open foreign exchange positions and put their exposed loan stocks at greater risk. In March 2014, four banks - representing about 3 per cent of the overall deposits base - were informed of their capital shortfalls and, when their owners declined to add extra capital, were covered by temporary administration managed by the Deposit Guarantee Fund (DGF).
- The crisis deepened throughout the year, with household consumption particularly affected, partly due to rapid depreciation being an offshoot of the economic and political uncertainty, although the latter decreased markedly towards the end of

[31] https://www.ohchr.org/Documents/Countries/UA/28thReportUkraine_EN.pdf

[32] IMF (2014). Country report: September 2014.

[33] IMF (2014). Country report: March 2014.

the year with a new pro-European government[34]. Real gross value added declined in all sectors in 2014, except for agriculture and non-market services (e.g. public administration, defence, healthcare, social work), due to the conflict in eastern Ukraine. Uncertainty and instability in the banking sector translated into restricted access to finance and drove the fall in investment. The increase in net exports was caused by faster contraction of imports than exports and reflected sharp reductions in energy imports and a degree of import substitution. In 2014, real GDP shrank by 6.8 per cent (and was expected to fall further in 2015).

- By December 2014, international reserves had dropped to USD 7.5 bln (1.8 months of import). The large depreciation added to the domestic costs of imported energy (further depressing domestic demand and adding to the Naftogaz losses, among others) and, together with the materialisation of Ukraine's contingent liabilities (such as in State-Owned Enterprises (SOEs), commercial banks) and the recession, was one of the main drivers of the increase in the debt-to-GDP ratio. These factors and new borrowings (e.g. from the IMF and the EU) resulted in a sharp rise in debt, to over 70 per cent of GDP at the end of 2014.

Key trends are summarised in Figures A-D presented below.

[34] In October 2014, parliamentary elections were held, with pro-EU parties gaining a decisive win. One month later, Arseniy Yatseniuk was reappointed Prime Minister, while the provisional application of the EU-Ukraine AA (excluding trade provisions) began in November 2014.

Figure A: Dwindling foreign reserves of NBU, in USD mln

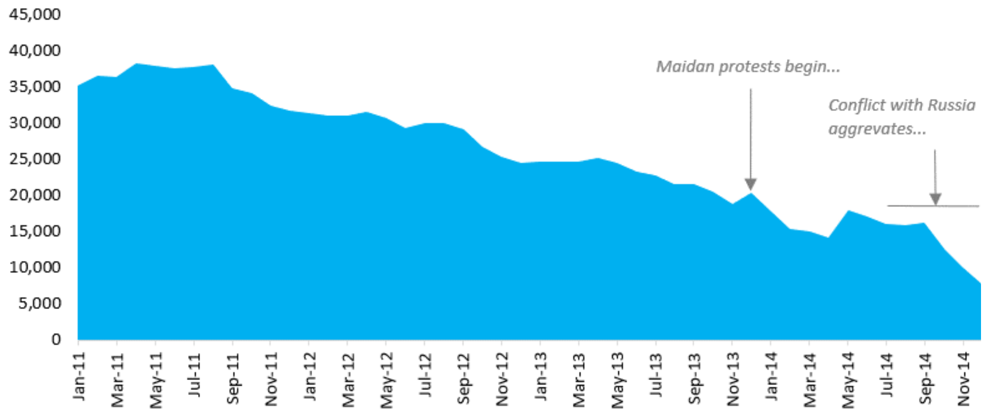


Figure B: Current account deficit, in % of GDP

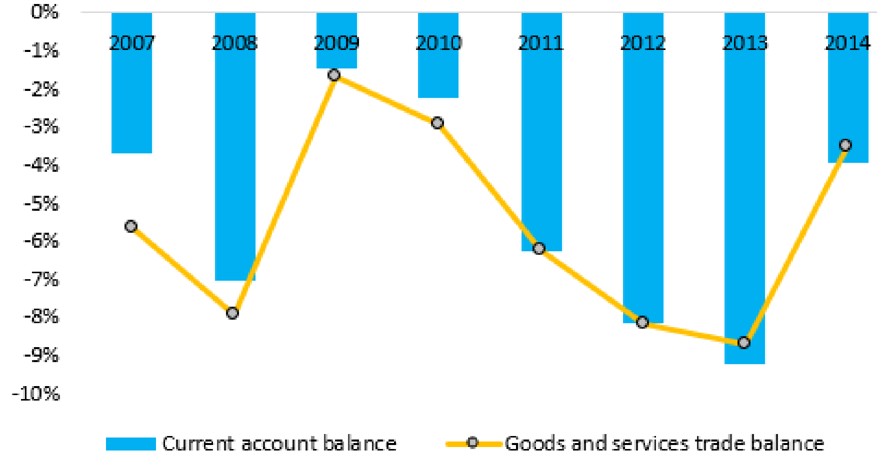


Figure C: General government balance, in % of GDP

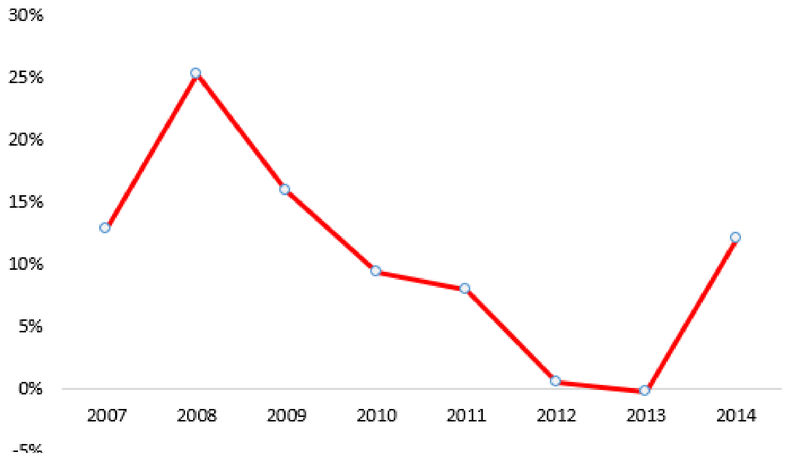
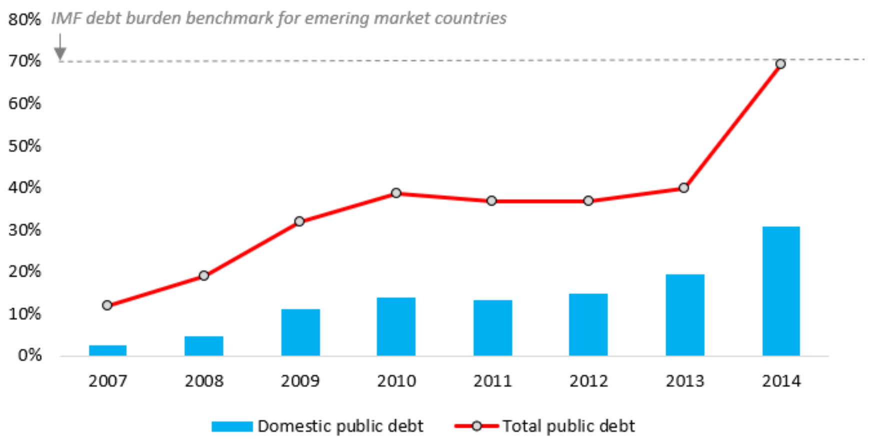


Figure D: Public debt, in % of GDP

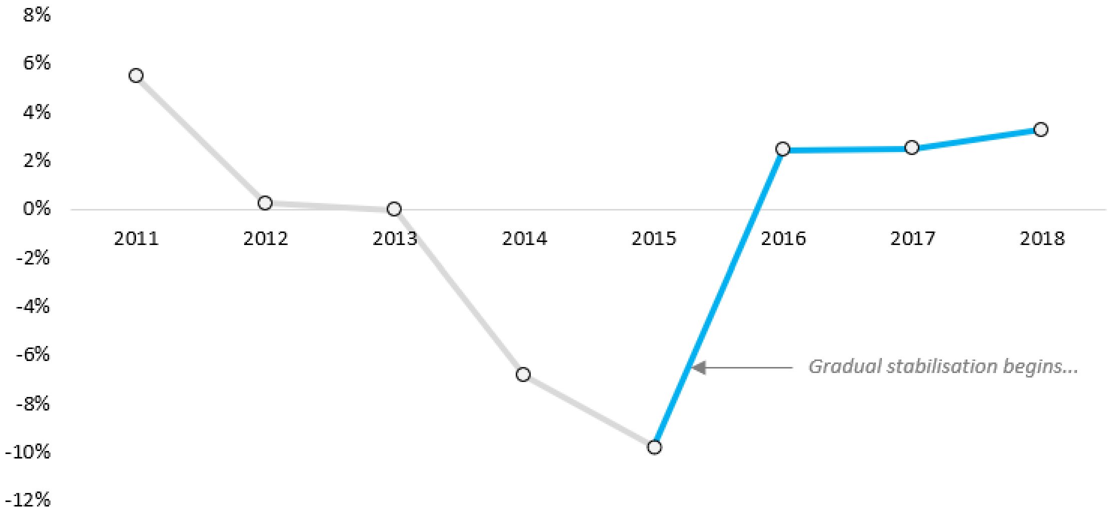


2.2 Main economic developments during the MFA III implementation and immediate outlook

Following a turbulent 2014, GDP continued to decline in 2015, falling by 9.8 per cent as a result of the impact of conflict on economic development of other regions of Ukraine. Broken economic links, uncertainty and depressed business sentiment persisted for much of 2015, with private consumption dropping by almost 20 per cent. That contraction would have been even greater had it not been for a broad-based recovery from mid-2015. Exchange rates stabilised as a result of the financial support provided by international donors and most economic sectors (apart from financial services) improved their performance in Q3 and Q4 2015[35].

A return to modest growth was evident in the first half of 2016, driven by industrial production and trade (5.0 and 2.9 per cent growth in Q1 2016 on a year-on-year basis). Investment in fixed capital jumped by 20 per cent but remained very low as a share of GDP (circa 15 per cent of the total output). Some loosening of the fiscal stance also helped, enabled by the previous strong cuts in expenditure a year earlier and the de-escalation of the conflict in the east. Confidence improved and the rise in steel prices and a bumper harvest allowed the hryvnia to stabilise. Overall, output grew by 2.4 per cent in the whole of 2016.

Figure 2. Real GDP growth in Ukraine, in %, 2011-2018



Source: IMF WEO data

In early 2017, several large enterprises in the east of Ukraine were confiscated by the so-called authorities in the non-government-controlled area. In response, the government of Ukraine imposed a temporary suspension of cargo transfers (other than humanitarian) to and from the area. The economic activity of the seized companies was no longer reported to the statistics office and some producers in the government-controlled part of eastern Ukraine lost their suppliers. Initial NBU estimates placed the negative impact on industrial production at about 4.8 per cent, and 1.3 per cent on GDP[36]. Producers in the controlled part of Ukraine adapted better than expected to new conditions but the negative impact on trade balance was significant, as exports reduced and producers had to import more supplies, such as coal. Strong recovery in investment demand continued, in light of the need to replace outdated equipment and infrastructure.

[35] *ibid.*

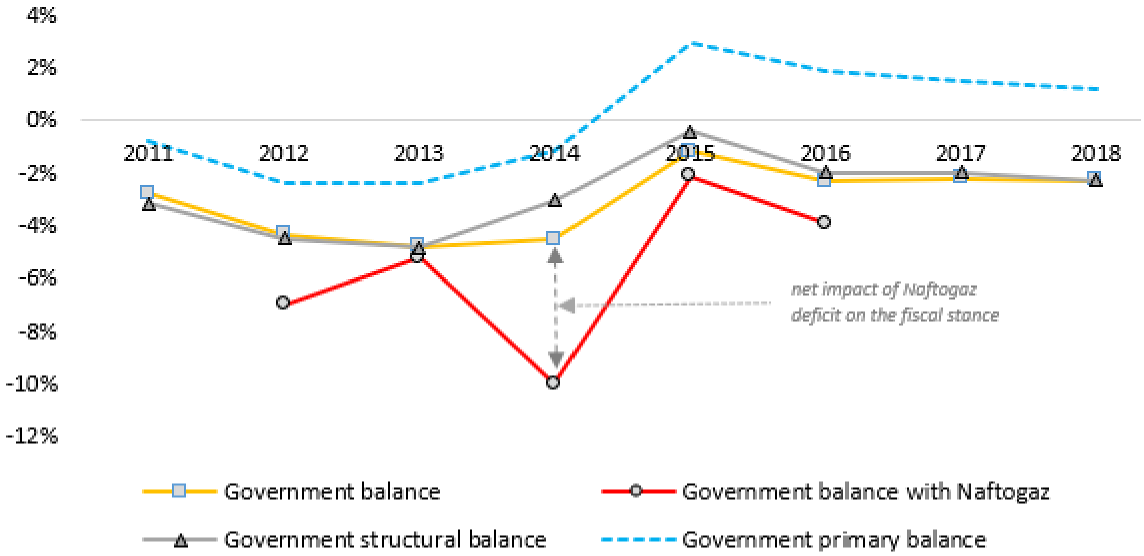
[36] NBU (2017). Inflation Report April 2017, pp. 25-26. Available at: https://bank.gov.ua/admin_uploads/article/IR_2017-Q2_eng.pdf?v=4

Gross accumulation of fixed capital jumped by 16 per cent and reached replacement level for the first time since 2014 (i.e. capital accumulation exceeded consumption). Household consumption grew by 9.5 per cent. This reflected an almost 20 per cent increase in real wages, as labour migration grew. Strong growth in consumer and investor demand was satisfied mainly through imports, while a drop in agricultural output limited export growth. Loss of control over parts of the Luhansk and Donetsk regions also reduced net exports. As a result, GDP growth was limited to 2.5 per cent in 2017. On the back of continuous stabilisation, output grew by nearly 3.3 per cent in 2018.

Budget/ fiscal deficit

2015 saw the government embarking on large-scale fiscal consolidation, freezing wages, pensions and subsidies, increasing excise and personal income tax rates, imposing a temporary surcharge on imports, and a sharp reduction in state aid. The cuts in support to Naftogaz (due to hikes in energy tariffs) had a material impact on the expenditure side. Overall, government expenditure fell from 44.8 per cent of GDP in 2014 to 43 per cent in 2015, and the primary balance reached 3 per cent that year (see Figure 3). A marked increase in revenue in 2015 was determined by increases in excise taxes, higher share of imports in GDP and a one-off transfer of NBU profits.

Figure 3. Government revenue and expenditure, in % of GDP, 2011-2018



Note: 2014 data without Crimea and Sevastopol; 2015/2016 without Crimea, Sevastopol and areas not under the control of the government in the Donetsk and Luhansk regions

Source: IMF WEO April 2019.

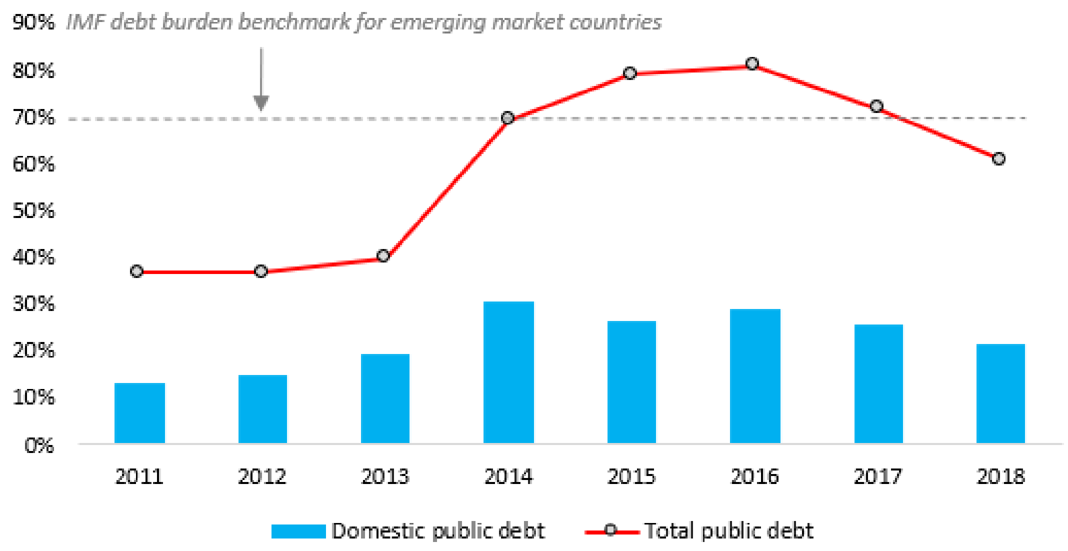
Although expenditure and revenue continued to decline as a share of GDP in 2016, the fall in expenditure was less sharp, which was partly the result of a gradual loosening of the fiscal stance after 2015 (e.g. sharp increase in spending on housing, utility subsidies to compensate for new hikes in energy prices for households, higher spending on defence and security). The fiscal balance improved considerably in 2015, when the government had its first primary balance surplus in more than decade, ahead of a certain degree of deterioration in 2016 (See Figure 3).

Notwithstanding some persistent challenges, the fiscal situation in 2017 looked fairly encouraging. Revenue from value-added tax (VAT) and personal income tax improved, due to better administration and strong wage growth. A lower social security contribution rate and sharp increase in the minimum wage also helped. This offset lower collections from excise and rent payments. At the same time, fiscal expenditure remained lower than planned, due to slow procurement procedures and low privatisation receipts. As a result, the consolidated fiscal deficit reached a record low of 1.4 per cent of GDP and remained at a similar level in 2018.

Public debt

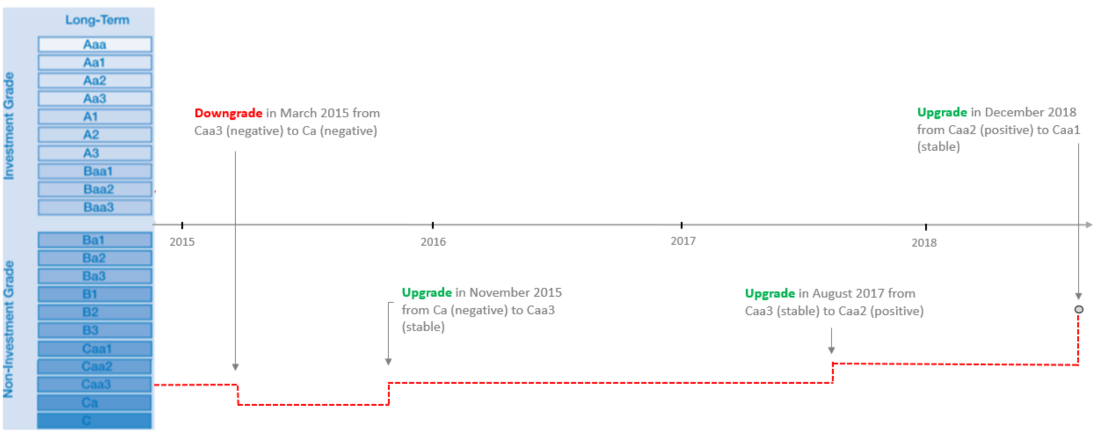
The fiscal consolidation that took place in 2015 did not stop the rise of public debt in 2015, which reached a high of almost 80 per cent level. Its dynamics, however, began to reverse. Indeed, the second half of 2015 brought some long-awaited signs of stability. In November 2015, Ukraine successfully restructured about USD 15 bln of its external debt and achieved a 20 per cent debt reduction[37]. Price increases also started to decelerate, with Moody's upgrading the outlook of sovereign rating to stable in November 2015, pointing to '*…progress of political and economic reforms under auspices of IMF*'[38] (Figure 5). Box 2 details the rationale behind the ratings changes between 2015 and 2018.

Figure 4. Public debt trajectory, in % of GDP, 2011-2018



Source: IMF WEO April 2019

Figure 5. Moody's sovereign rating for Ukraine, 2015 - 2018



[37] Ministry of Finance of Ukraine (2015). Sovereign debt. Available at: http://www.minfin.gov.ua/en/news/view/ukraina-uspishno-zavershyla-restrukturyzatsiiu-derzhavnoho-ta-harantovanoho-derzhavoiu-borhu-na-sumu--mlrd-dol-ssha?category=borg

[38] Moody's (2015) Moody's upgrades Ukraine's sovereign rating to Caa3, outlook stable, 19 November 2015. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-sovereign-rating-to-Caa3-outlook-stable--PR_336283

Source: ICF adapted from Moody's

Box 2. Rationale for Moody's credit rating changes

In March 2015, the country's credit rating was cut by Moody's from Caa3 (outlook negative) to Ca (outlook negative). This was mainly due to the government's plan to restructure the majority of its outstanding Eurobonds, as well as other public sector external debt and the expectation that private creditors would incur substantial losses as a result of the restructuring.

In November 2015, Moody's lifted Ukraine's rating from Ca (outlook negative) to Caa3 (outlook stable). The key drivers for this upgrade were (i) the settlement of the restructuring of USD 15.3 bln in privately-held Eurobonds issued or guaranteed by the government, improving Ukraine's debt-service requirements and external liquidity, and ii) substantial progress in political and economic reform under the IMF-led programme. However, the rating agency indicated that implementation risks under the IMF Extended Fund Facility (EFF) remained significant, given the challenging environment[39].

A further upgrade was announced in mid-2017, when Moody's changed Ukraine's rating from Caa3 (outlook stable) to Caa2 (outlook positive). This upgrade was based on the significant strengthening of Ukraine's external position and the cumulative impact of structural reforms likely to improve debt dynamics[40].

Most recently, the implementation of structural reforms led to another upgrade, from Caa2 (outlook positive) to Caa1 (outlook stable) 2018. This upgrade was prompted by three main factors: (i) the anticipated improvement in the strength of external balance as a consequence of the new Stand-by Arrangement reached with the IMF; ii) progress in adoption of AC reforms; (iii) and an improvement in the country's resilience in the context of the ongoing conflict with Russia[41].

The trend of increasing total public debt as a share of output was eventually contained in 2016. Growth resumed in 2016 and more prudent fiscal policy helped to stabilise that growth at about 80 per cent.

In 2017, the public debt declined to around 72 per cent and has continued to do so. The stabilisation of public finances was marked by Ukraine's return to the global debt markets in 2017, nearly five years since it lost access in 2012[42]. In September 2017, the Ukraine government closed the deal on a USD 3 bln 15-year Eurobond issue (at 7.375 per cent yield)[43]. USD 1.6 bln was directed to the buyout of Eurobonds due to 2019 and 2020 (USD 1.2 bln and USD 0.4 bln, respectively). At the end of August 2017, Moody's[44] upgraded Ukraine's rating to Caa2 (from Caa3) with a positive outlook, given the

[39] Moody's website. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-sovereign-rating-to-Caa3-outlook-stable--PR_336283

[40] Moody's website. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-rating-to-Caa2-from-Caa3-outlook-changed--PR_370205

[41] Moody's website. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-rating-to-Caa1-from-Caa2-outlook-changed--PR_393443

[42] Excluding US guaranteed debt issues in 2013.

[43] https://minfin.gov.ua/news/view/ministerstvo-finansiv-oholosylo-praisynh-vypusku--mlrd-ievrobondiv?category=aspekti-roboti&subcategory=vigotovlennja-blankiv-cinnih-paperiv-dokumentiv-suvoroi-zvitnosti

[44] Moody's rating remains lower than equivalents for S&P and Fitch (B - with stable outlook for both)

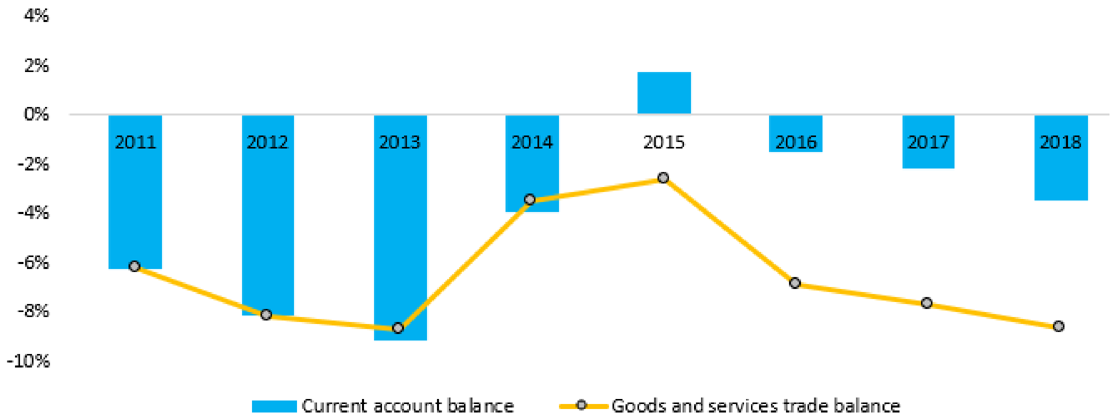
progress in structural reform and an improved external position (increased NBU international reserves)[45].

Nevertheless, the government was challenged by payments on external public and publicly guaranteed debt of more than USD 10 bln[46] in 2018 and 2019. As of 1 January 2018, over USD 4.2 bln of foreign currency domestic bonds were envisaged to mature that year and in 2019[47].

Balance of payments

Since 2014, a large adjustment was observed and the deficit shrank to -3.8 per cent in 2014, before being eliminated in 2015 (surplus of 1.5 per cent).

Figure 6. Current account balance and its main components, 2011-2018[48]



Source: IMF WEO 2019

Overall, the depreciation of hryvnia played a central role in the rebalancing of the current account balance, in particular up to mid-2015 (the fall in imports outstripping the fall in exports). The adjustment was driven by an improvement in the balance of trade, firstly with the EU and Asia, and to some extent as a result of increasing tensions in trade relations between Ukraine and Russia[49] (i.e. lower energy imports). Though, improvements in trade balance of goods with Russia was somewhat offset by the loss of services exports (gas transit/ Russian tourists).

In 2016, deterioration of the current account balance (falling to -1.5 per cent of GDP) was caused by lower commodity prices leading to lower export revenues and strong rebound in investment activity that boosted imports. Imports of machinery and equipment jumped by 38 per cent in dollar terms. Lower energy imports and higher remittances limited the current account deficit.

In 2017, the current account deficit widened slightly, to 2.2 per cent of GDP. Imports (22 per cent growth in dollar terms for merchandise imports) grew strongly in response to

[45] Moody's, August 2017. Moody's upgrades Ukraine's rating to Caa2 from Caa3, outlook changed to positive from stable. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-rating-to-Caa2-from-Caa3-outlook-changed--PR_370205

[46] IER estimate based on debt amortization schedule attached to draft 2018 state budget found at http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=62551 and 2019 Eurobonds buyout results found at http://www.ise.ie/app/announcementDetails.aspx?ID=13366171

[47] IER estimate based on list of domestic bond in circulation as of 01.06.2017 https://minfin.gov.ua/uploads/redactor/files/01.06.2017.xlsx and info on new domestic bond placements at the NBU website https://bank.gov.ua/control/uk/bonds/list

[48] There are discrepancies between the BoP data presented here, sourced from the IMF, and the revised BoP data from the NBU due to the treatment of reinvested income of FDI enterprises. See to compare with NBU data: https://bank.gov.ua/files/ES/BOP_y_en.xlsx

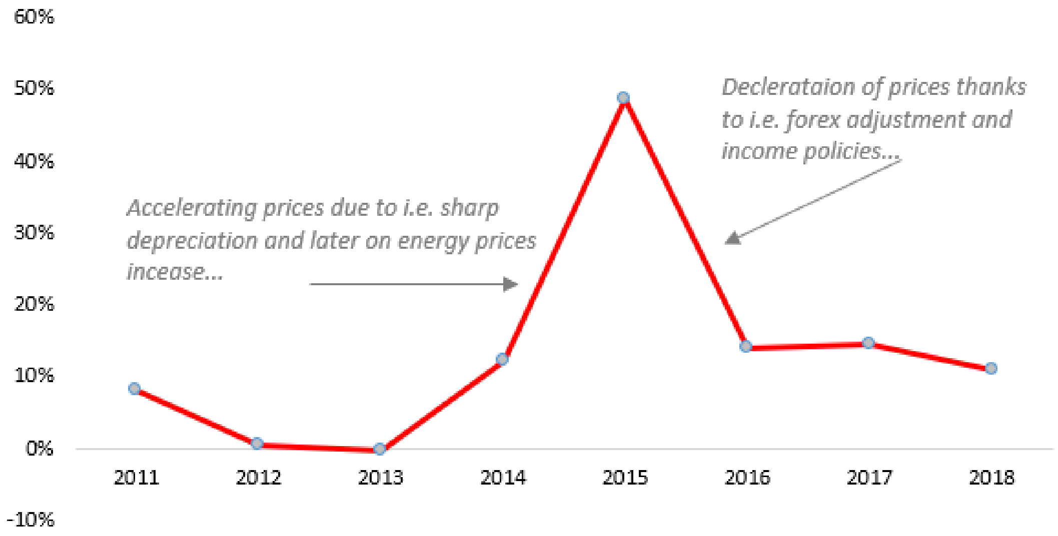
[49] The overall trade volume with Russia shrank from 27 per cent in 2013 to 15 per cent in 2015

rapid growth in domestic and investment demand, as well as higher energy prices. Foreign Direct Investment (FDI) profit transfers increased, due to gradual removal of capital controls. Rising iron ore and steel prices, higher agricultural exports and continued growth in remittances largely offset the impact of higher imports.

Inflation

Inflation began rising quickly from 2014 onwards, driven by the rapid depreciation of the hryvnia caused by the abolishment of the pegged regime and rapidly deteriorating confidence following escalation of the conflict in the east, political instability, and the overall vulnerability of the economy. From its end-2013 level, the hryvnia had depreciated by 30 per cent by the end of April 2014 and by nearly 50 per cent by the end of the year[50]. The most dynamic price increase was observed from Q1 2015 onwards, when increases in energy prices effective on 1 April (end-user price hikes of, on average, 284 per cent) and further (more significant) depreciation of the hryvnia took their toll (Figure 8).

Figure 7. Average annual Consumer Price Index (CPI), 2011-2018

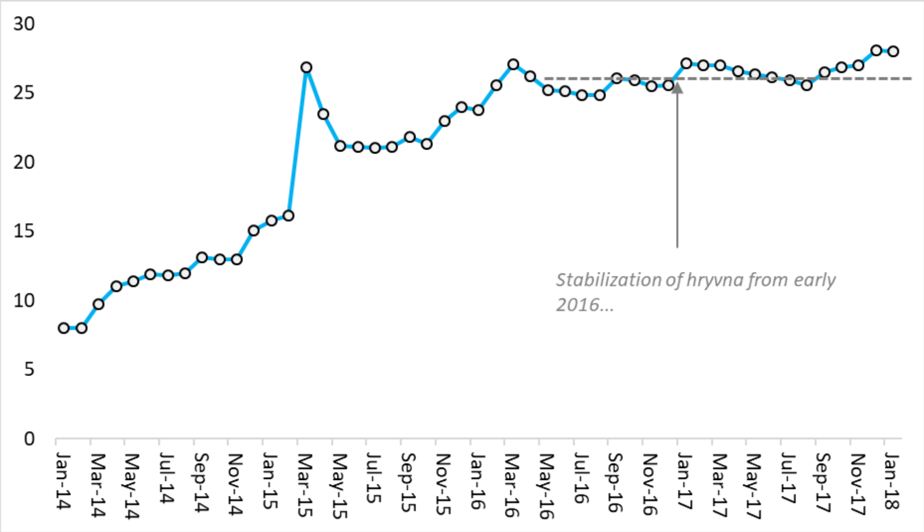


Source: Ukrstat

Note: 2014 data without Crimea and Sevastopol; 2015/2016 without Crimea, Sevastopol and areas not under the control of the government in the Donetsk and Luhansk regions.

[50] Official exchange rate of UAH to USD as of 31 Dec 2013, 30 April 2014 and 31 December 2014. Based on Tullet Prebon and NBU data.

Figure 8. UAH per USD, official exchange rate



Source: NBU

The stabilisation in prices from mid-2015 was facilitated by stabilisation of the exchange rate. From 2016 onwards, a stable exchange rate and subdued demand kept downward pressure on inflation, which, however, remained at double-digit levels, due to the significant increase in administered prices[51].

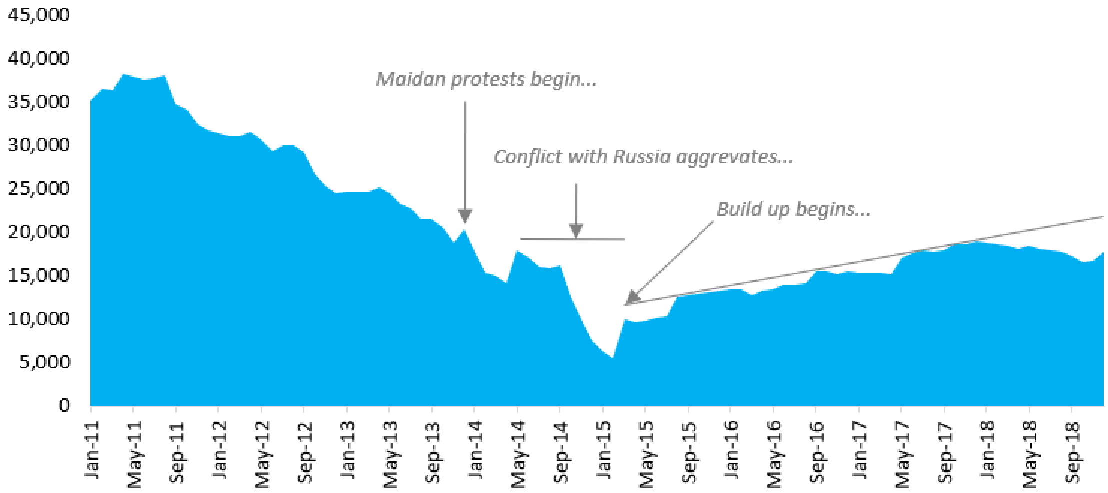
In 2017, administered prices continued to increase, albeit at a slower rate than in 2016. Increase in consumer demand, higher global food prices and 'decompressing' margins pushed up food prices, while higher excise rates drove up prices for alcohol and tobacco. At the same time, NBU monetary policy was moderately successful in anchoring inflation expectations As a result, inflation remained elevated in 2017 but 12-month consumer inflation started to slow down after peaking in August-September 2017. The inflation rate remained at a similar level throughout 2018.

Reserves

Sizable foreign exchange market interventions to defend the currency, together with external sovereign debt service and partial clearance of gas payment arrears by Naftogaz, quickly depleted reserves. The NBU's international reserves dropped to USD 15.5 bln in February 2014, equivalent to only 28 per cent of the remaining external debt service. This forced the NBU to abandon the exchange rate peg and switch to a flexible exchange rate regime, triggering considerable exchange rate volatility. By December 2014, international reserves dropped to USD 7.5 bn (1.8 months of import) (Figure 9). The large depreciation added to the domestic costs of imported energy, further depressing domestic demand and adding to the Naftogaz losses.

[51] IMF (2016). Country report: September 2016.

Figure 9. Official reserves, USD mln, Jan 2011-Dec 2018



Source: NBU

In 2015, the NBU and the Ukrainian government received significant inflows from the IMF, as the new EFF programme was signed (net IMF inflows reached USD 5.2 bln), as well as other official donors. The government debt restructuring[52] helped to reduce government debt service in 2015-2019. However, the hryvnia continued to depreciate against the US dollar and NBU sold foreign currency to limit exchange rate volatility. Despite this, reserves almost doubled, to USD 13.3 bln.

In 2016, smaller inflows from the IMF and foreign currency purchases by the NBU increased reserves, reaching USD 15.5 bln by the end of that year. In 2017, reserves increased further as the government issued 15-year USD 3 bln Eurobond returns to capital markets[53]. Net inflows from the IMF and other donors reduced, while adding to reserves. NBU foreign currency purchases to rebuild reserves were largely offset by the sales needed to reduce exchange rate volatility. NBU reserves reached USD 18.8 bln (3.2 months of future imports) by the end of 2017.

Banking sector

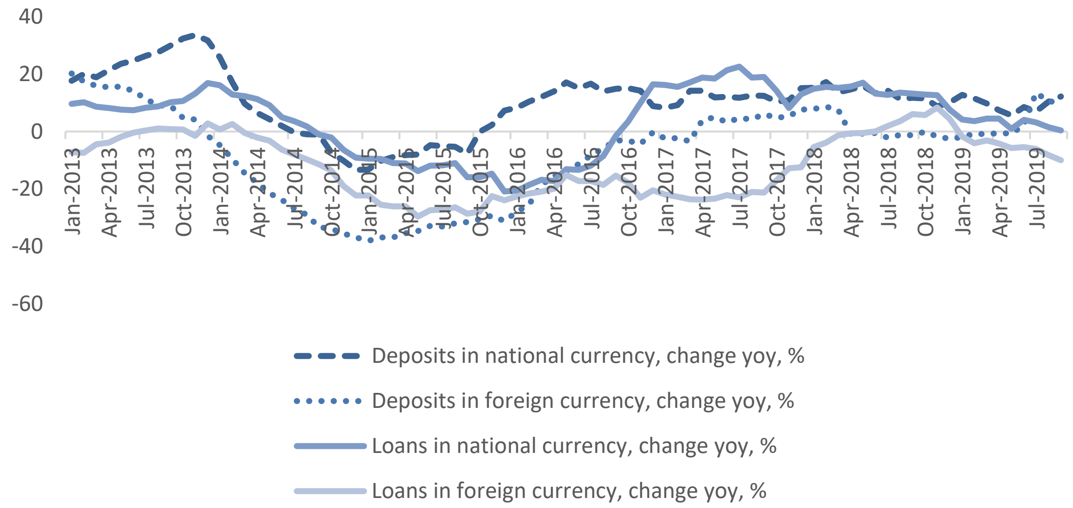
2014 was extremely difficult for the national banking sector. Many Ukrainian banks had exposure to the eastern regions of Donetsk and Luhansk and the Crimean Peninsula, with around 10 per cent of their loan portfolios and an even larger share of collateral located in those regions. In addition, sharp withdrawals of deposits - including those in foreign currencies - had negative impact on banks' liquidity (Figure 10). Coupled with overall economic slowdown, those factors forced the NBU to pursue a clean-up of the sector, notably banks used in tax schemes, money laundering and capital flight. The outcome was 51 bank failures in 2014 and the first half of 2015, which accounted for 22 per cent of the banking sector's assets as of the beginning of 2014[54] (Figure 11).

[52] In November 2015, Ukraine successfully completed a debt restructuring of around USD 15 bln with creditors (source: http://www.minfin.gov.ua/en/news/view/ukraina-uspishno-zavershyla-restrukturyzatsiiu-derzhavnoho-ta-harantovanoho-derzhavoiu-borhu-na-sumu--mlrd-dol-ssha?category=borg)

[53] USD 1.5 bln of the proceeds were used to repurchase Eurobonds maturing in 2019-2020.

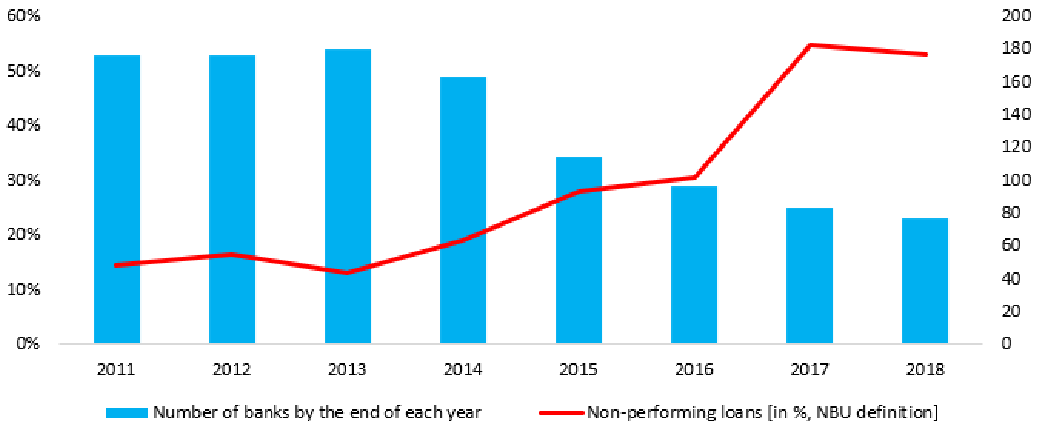
[54] IER (2016). Year 2015 – Economic summary for Ukraine.

Figure 10. Growth of loans and banks deposits, January 2013-July 2019



Source: NBU, IER.

Figure 11. Non-performing loans (NPLs)[left axis] and number of active banks [right axis], 2011-2018



Source: NBU, IER.

Note: Rapid increase in NPLs in 2017 is partly due to a change in NBU definition.

Massive restructuring of the sector, supervised by the NBU, began in 2014 and continued in 2015, eventually reversing the declining tendency in bank deposits towards the end of 2015 (Figure 10). Significantly, despite multiple banks' bankruptcies, most of the household deposits were guaranteed by the DGF, giving potential security for individuals and underpinning confidence.

Overall, between December 2013 and 2016, the total number of active banks shrank from 180 to 117. By the end of 2016, the clean-up process was largely complete. This process culminated with UAH 155 bln bail-out and nationalisation of largest Ukrainian bank, *Privatbank*. Banks' failures largely ceased and over three-quarters of banks were profitable in 2017 (a trend that continued in 2018). The share of NPLs remained high, however, at around 50 per cent in 2017 and 2018, which was the result of the 2014-2015 economic crisis and the absence of effective instruments for the resolution of NPLs.

3 Design and implementation of the MFA III operation

This section describes the main features of the MFA III in Ukraine, including the underlying theory of change for the operation. It also provides a brief commentary on the implementation of the operation, particularly structural reform.

3.1 MFA design: underlying theory of change

The MFA III to Ukraine succeeded MFA I and II, two operations with distinct origins and legal basis that were disbursed during the same period of time (2014 and early 2015). All of these operations had the same objective – to address the consequences of the crisis that broke out in early 2014. MFA III was not initially included in the support package to Ukraine announced by the European Commission on 5 March 2014 but was later added, turning the commitments into a EUR 13 bln package[55].

The Ukrainian authorities requested MFA III in September 2014 (reiterated in a further letter in December 2014) when the conflict in the east of Ukraine was not swiftly resolved and the economic situation was deteriorating further.

MFA III was larger than any other MFA operation since the establishment of the instrument, with a total amount of EUR 1.8 bln envisaged to be disbursed in three equal instalments.

The financial envelope was accompanied by 36 specific conditions[56] from six areas - public finance management, governance and transparency, energy, social safety nets, business environment and the financial sector (see Table 3). A number of those conditions built on those prescribed under MFA I and II[57].

The objective of the programme was to help to alleviate Ukraine's large external financing needs, which remained sizable even after the effects of MFA I and II and other donor programmes, and to support the ambitious reform programme of the authorities initiated under MFA I and II.

The theory of change presented below illustrates how the MFA financial assistance (EUR 1.8 bln, of which EUR 1.2 bln was disbursed) was expected to contribute to these objectives. It also illustrates the role of policy conditionality and dialogue in reducing macroeconomic vulnerabilities. For practical reasons, the theory of change does not detail the specific conditions/outputs - the high number of conditions prevents showing them all on a single figure.

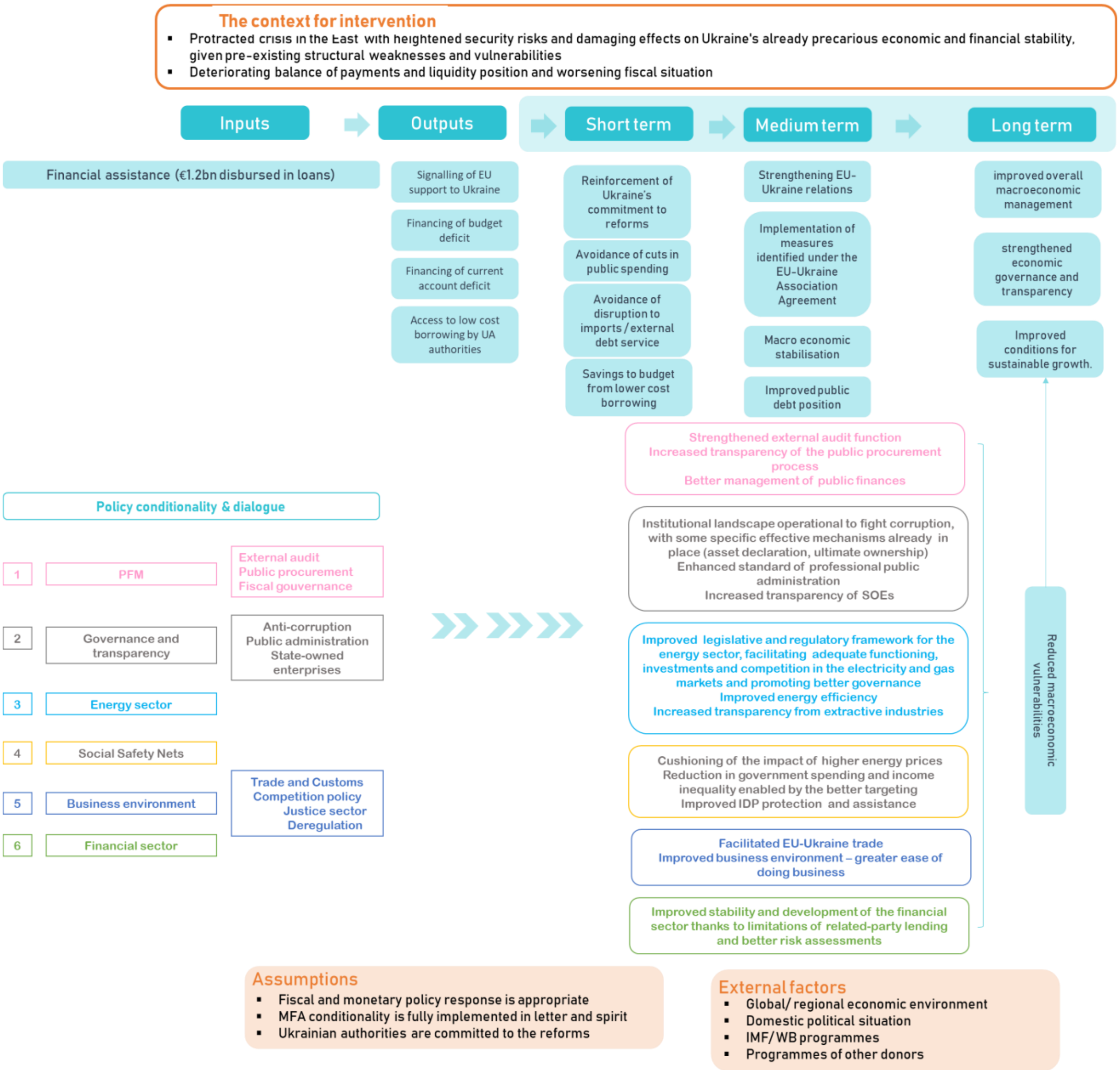
Key underlying assumptions for the sequence of changes to materialise are clearly laid out, together with other factors that might influence the direction and scale of effects.

[55] EUR 13 bln = EUR 600 mln (MFA I) + EUR 1 bln (MFA II) + EUR 1,8 bln (MFA III) + EUR 9,600 mln (other assistance including European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD) lending).

[56] Full list of conditions envisaged under MFA III is available in the Annex of the Memorandum of Understanding (MoU) document, available at: http://ec.europa.eu/economy_finance/international/neighbourhood_policy/doc/mou_eu_ukraine_en.pdf

[57] The areas/issues that built on those envisaged under MFA I and II included strengthening the functions of the Accounting Chamber of Ukraine, approximation of the public procurement with the EU acquis, timely submission of the Draft State Budget, improved functionality of the social safety net put in place in 2014.

Figure 12. Theory of change for MFA III to Ukraine, 2015-2017



3.2 Implementation timetable

The Ukrainian authorities initially requested an amount of EUR 2 bln, increasing to EUR 3 bln in the second request letter. Following the EU ex ante evaluation of the MFA to Ukraine, finalised in January 2015 and the quantitative assessment of Ukraine's financing gap, the European Commission proposed an operation of EUR 1.8 bln (the largest in the history of the MFA)[58]. The main constraint on granting an even bigger operation difficult is, reportedly, the EU's own budgetary constraints. The outstanding amount of MFA loans increased to EUR 3 bln at end 2015, with loans to Ukraine representing 73.5 per cent of total MFA exposure at the time[59].

[58] European Commission (2015). Proposal for the Decision of the European Parliament and of the Council providing MFA to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1476965442393&uri=CELEX:52015PC0005

[59] For more information, see the Report from the Commission to the European Parliament and the Council on guarantees covered by the general budget (Situation at end 2015).

Despite the use of the ordinary legislative procedure (as per the general rule for the adoption of MFA decisions), the European Parliament and Council decision to adopt the assistance came only three months after the Commission proposal (in April 2015). The MoU was signed in May 2015[60], while the Loan Facility Agreement, detailing the financial terms of the macro-financial assistance, entered into force on 13 July 2015 (with an availability period of two and a half years).

The first disbursement of EUR 600 mln, was made in July 2015. It then took nearly 20 months to disburse the second EUR 600 mln (released in April 2017).

The MFA III operation expired on 13 January 2018, without the third and last disbursement, given the lack of sufficient progress on some of the remaining conditionality. The Commission followed the established procedure (see Box 3) and formalised the cancellation a few days later, in a decision dated 18 January 2018[61].

Box 3. Procedure to be followed in case of non-disbursement

The procedure to be followed in case of non-disbursement is the same procedure as for a normal disbursement. An Inter-Service Consultation needs to take place before the adoption of the cancellation/suspension decision. It needs to involve the central services (legal service, Secretary-General, Directorate-General for Budget (DG BUDG)) and all relevant political services (EEAS, DG TRADE and other DGs, depending on the nature of the conditionality).

The MFA decisions capture the steps to be followed in case of non-disbursement. In the case of MFA III to Ukraine, Article 4(5) of Decision (EU) 2015/601 states that 'If the conditions (…) are not met, the Commission **shall temporarily suspend or cancel the disbursement of the Union's macro-financial assistance**. In such cases, it shall inform the European Parliament and the Council of the reasons for that suspension or cancellation'.

The legal provision is clear: if the condition is not fulfilled, the Commission has no choice but to either suspend or cancel the disbursement. It cannot let the operation expire without taking any action. Under the rule of law, and for transparency reasons, a decision has to be taken and the European Parliament and the Council must be informed of the specific reasons behind the non-disbursement.

In that context, a cancellation[62] decision was adopted by DG ECFIN Commissioner and Vice-President Dombrovskis on 18 January 2018[63].

According to the standard procedure, the decision does not need to be published. European Commission decisions taken by the College of Commissioners are, in fact, internal documents. Access to this internal decision can be granted following the procedures set in Regulation (EC) No 1049/2001, and, following a document access request, the Decision was made available.

In the Decision itself, transparency rules were respected: Recitals 6-9 of the Decision detail the reasons behind non-disbursement (i.e. the conditions that

[60] EUR-Lex (2017). Decision (EU) 2015/601. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1476965532409&uri=CELEX:32015D0601

[61] C(2018) 405 final. https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-405-F1-EN-MAIN-PART-1.PDF

[62] In this case, suspension was not an option, given the timing (decision taken at the end of the expiry period).

[63] As per the Rules of Procedures of the Commission, one Commissioner can be empowered to take a decision on behalf of the entire College. More precisely, Article 13, paragraph 2 of the Rules of Procedures of the Commission, reads 'The Commission may also instruct one or more of its Members, with the agreement of the President, to adopt the definitive text of any instrument or of any proposal to be presented to the other institutions the substance of which has already been determined in discussion'.

were not fulfilled)[64]. Ukraine was notified, and the Council and Parliament received the Decision.

The non-disbursement of the third tranche under MFA III was not without precedent but nevertheless remains unusual in the recent history of the MFAs. Prior to the non-disbursement of MFA III, the most recent example was the MFA to Moldova deployed between 2000 and 2002 (Table 1).

Table 1. Overview of MFA operations suspended or cancelled before MFA III to Ukraine

Country	Reference of Council decision	Amount suspended/ cancelled
Hungary I	90/83/EC	260 (suspended)
Baltics	92/542/EC	85 (suspended)
Algeria II	94/938/EC	100 (suspended)
Slovakia	94/939/EC	130 (cancelled)
Belarus	95/132/EC	25 (suspended)
Ukraine III	98/592/EC	92 (cancelled)
Albania III	99/282/EC	20 (cancelled)
Moldova III	00/452/EC 02/1006/EC	15 (cancelled)

Source: successive Commission Staff Working Document accompanying the Report from the Commission on the implementation of Macro-Financial Assistance to third countries

The commitments that were not fulfilled included those related to combating corruption, international trade obligations and financial sector reform. More specifically:

- Measure 5, whereby Ukraine committed to setting up an electronic asset disclosure system for public officials, including a verification mechanism, while starting to verify assets and possible conflicts of interest on the basis of the paper-based asset declarations submitted by officials in 2015.
- Measure 6, whereby Ukraine committed to putting in place mechanisms to verify, post-registration and on a selective basis following clear criteria, the accuracy of the information provided by companies and enforcing compliance with this obligation.
- Measure 17, whereby Ukraine committed to refraining from introducing trade-restricting or trade-distorting measures, in line with its WTO obligations.
- Measure 21, whereby Ukraine committed to establishing a central credit registry.

Table 2 summarises the progress made by the Ukrainian authorities in the implementation of MFA conditionality. Annex 5 provides a more detailed overview of implementation status by condition.

[64] The last Recital of the Cancellation Decision mentions an additional formal reason for non-disbursement: 'For the third instalment, Ukraine has not made a Request for Funds for the amount of EUR 600 mln. Therefore, Clause 7(4) of the Loan Agreement is applicable'.

Table 2. High-level overview of the implementation of MFA conditionality by the Ukrainian authorities

Reform areas Sub-area (number of conditions)	Implementation status (at the time of disbursement/expiry of MFA III)
Public finance management External audit (2) Public procurement (3) Fiscal governance (4)	All conditions fulfilled within agreed timeframe
Governance and transparency AC (4) Public administration (4) State-owned enterprises (1)	Two conditions blocked the disbursement of the third tranche: The electronic asset disclosure system for public officials, and more precisely its ineffective verification system (#5, 3rd tranche) The information on companies' beneficial ownership, which is made available but without a verification system and with enforcement possibilities still lacking (#6, 3rd tranche)
Energy sector (6)	All conditions fulfilled within agreed timeframe
Social safety nets (4)	One waiver regarding the delivery of social assistance to IDPs (#12, 2nd tranche), in relation to the suspension of social payments to around 500,000 IDPs (reinstatement was underway but ongoing at the time of the 2nd tranche disbursement)
Business environment Trade and customs (2) Competition policy (1) Justice sector (1) Deregulation (1)	Trade and customs conditions unmet, essentially because of the wood export ban[65] (waiver for #13, 2nd tranche). Condition still not met before MFA III expiry (#17, 3rd tranche)
Financial sector (2)	One condition blocked the disbursement of third tranche - delays in establishing a central credit registry (#21, 3rd tranche)

[65] The wood export ban refers to the temporary 10-year ban on export of unprocessed timber put in place by Ukraine through the Law of Ukraine No 325-VIII of 9 April 2015. The law imposed a ban on the export of all timber except the pine tree as of 1 November 2015, and as of 1 January 2017 of the pine tree as well. The Explanatory Note to the law mentions a need to reorientate exports from the unprocessed timber to the furniture products and processed timber, for economic and environmental reasons. According to the EU, the wood export ban contradicts Article 35 of the AA that provides a prohibition on export restrictions by the parties or measures of the equivalent effect.

The timeline below represents the main milestones of MFA III, alongside other key developments (main political/economic developments, other MFA operations, IMF assistance).

A fourth MFA operation was approved in July 2018, shortly after the expiry of MFA III. The first disbursement of EUR 500 mln was made in November 2018, the second one in May 2020. MFA IV falls outside the scope of the evaluation.

Figure 13. Implementation timeline – MFA III

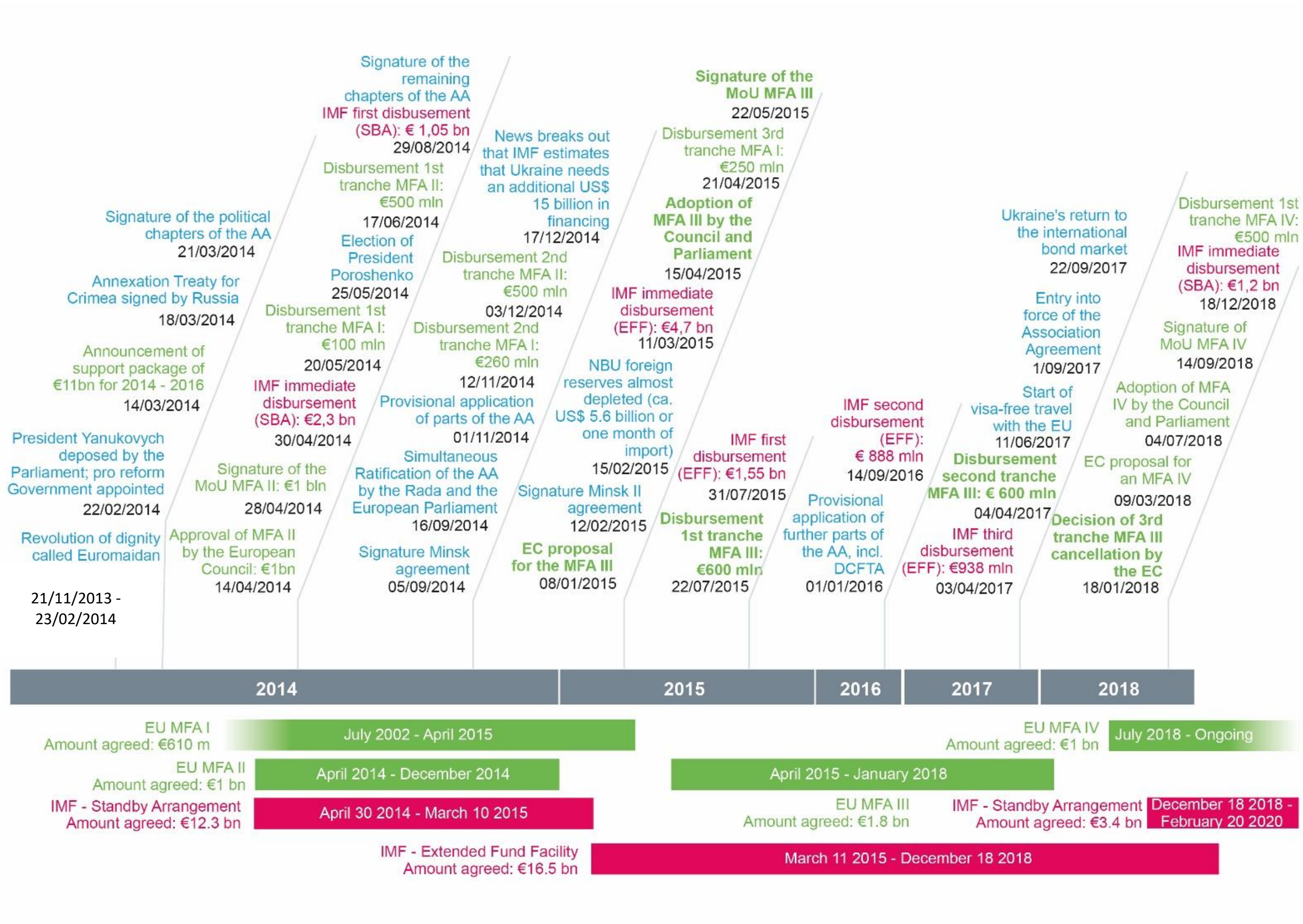


Table 3. Overview of MFA III

Rationale for both operations	Loan characteristics	Main areas of reform	
To *'ease Ukraine's urgent external financing constraints, alleviate its balance of payments and budgetary needs and strengthen its foreign exchange reserve position'* – as per the MoU	EUR 1,800 mln (loan), 3 planned tranches of EUR 600 mln each *1st instalment:* Maturity 4.96 years Coupon 0.25 per cent *2nd instalment:* Maturity 14.01 years Coupon 0.75 per cent	Structural reforms covered the following areas[66]: *Conditionality linked to the second tranche (i.e. the EUR 600 mln disbursed in Apr 2017) (15 conditions in total)* **Public finance management** *External audit (1 condition)* *Public procurement (2 conditions)* *Fiscal governance (2 conditions)* **Governance and transparency** *AC (1 condition)* *Public administration (1 condition)* *State-owned enterprises (1 condition)* **Energy sector** *(2 conditions)* **Social safety nets** *(2 conditions)* **Business environment**	 *Conditionality linked to the third tranche (i.e. the EUR 600 mln not disbursed) (21 conditions in total)* **Public finance management** *External audit (1 condition)* *Public procurement (1 condition]* *Fiscal governance (2 conditions)* **Governance and transparency** *AC (3 conditions)* *Public administration (3 conditions)* **Energy sector** *(4 conditions)* **Social safety nets** *(2 conditions)* **Business environment**

[66] European Commission (2015). Ukraine: Memorandum of Understanding between European Union and Ukraine (MFA III). Available at: https://ec.europa.eu/economy_finance/international/neighbourhood_policy/doc/mou_eu_ukraine_en.pdf

Rationale for both operations	**Loan characteristics**	**Main areas of reform**	
		Trade and customs (1 condition) *Competition policy (1 condition)*	*Trade and customs (2 conditions)* *Justice sector (1 condition)* *Deregulation (1 condition)*
		Financial sector *(1 condition)*	**Financial sector** *(1 condition)*

4 Methodology

4.1 Introduction

This section presents our methodological approach to the evaluation, which was carried out in line with the requirements set out in the Better Regulation Guidelines[67].

The first step was the development of an evaluation framework[68] (see Annex 13) in response to the list of evaluation questions and additional components included in the Terms of Reference (see Box 4). It underpinned the methodological approach for this evaluation and was complemented by the design of a step-by-step methodology (see Figure 14).

Box 4. List of evaluation questions and additional components

List of questions:

- Question 1 (relevance): To what extent was the MFA III operation design (including adequateness of financing envelope, focus of conditionality) appropriate in relation to the outputs to be produced and objectives to be achieved?
- Question 2 (effectiveness): To what extent have the objectives of the MFA III operation been achieved?
- Question 3 (efficiency): Was the disbursement of the financial assistance appropriate in the context of the prevailing economic and financial conditions in the beneficiary country?
- Question 4 (efficiency): In what way has the design of the MFA III assistance conditioned the performance of the operation in respect of its cost and objectives?
- Question 5 (EU added value): What was the rationale for an intervention at EU level and to what extent did the MFA III operation add value compared to other interventions by other international donors, notably the IMF?
- Question 6 (coherence): Were the measures of the MFA operation in line with key principles, objectives and measures taken in other EU external actions to Ukraine?

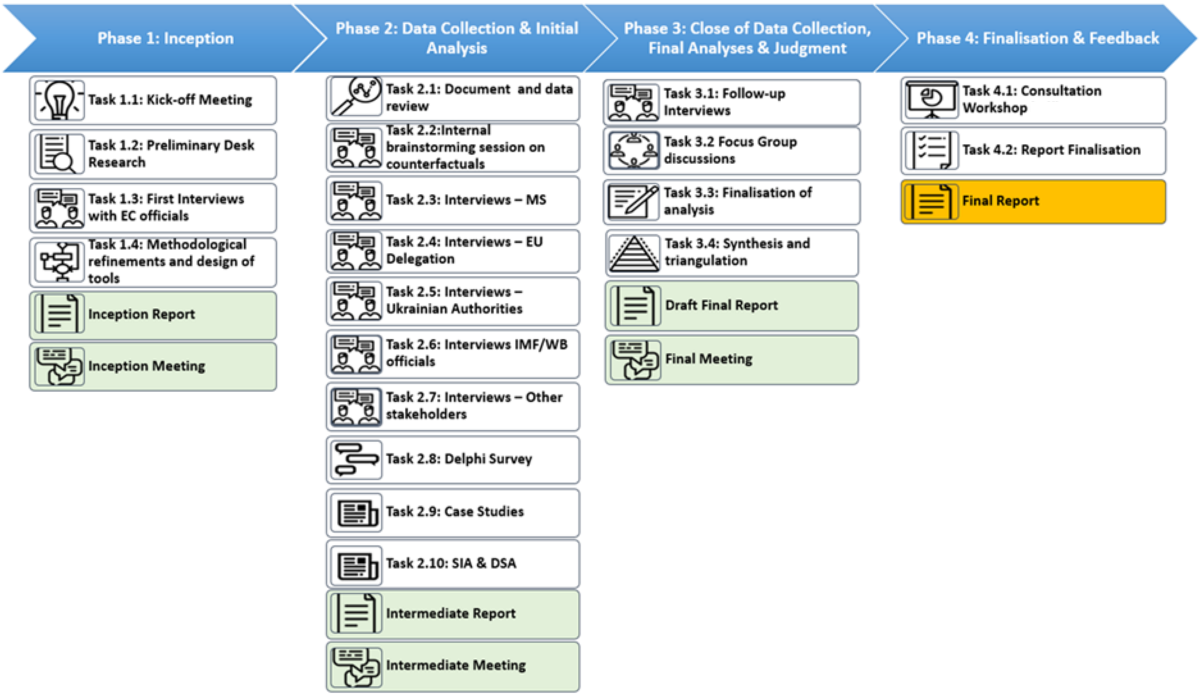
Three additional components:

- Additional component 1: Analysis of the social impact of the MFA III operation (more specifically in relation to the policy measures included in the MoU relating to the social sector and by including social variables in the analysis), including in combination with IMF programme measures;
- Additional component 2: Analysis of the impact of the MFA III operation (in combination with the IMF programme) on the debt sustainability of the country, possibly by drawing on the IMF's DSA.
- Additional component 3: Analysis of the impact of the MFA III and previous MFA operations on the use of the euro in asset and debt management by the beneficiary country.

[67] European Commission (2015). Better Regulation Guidelines. Available at: http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm

[68] The development of the evaluation framework was also guided by the MFA intervention logic. Available at: http://ec.europa.eu/smart-regulation/roadmaps/docs/plan_2016_202_evaluation_ukraine_en.pdf, p. 3.

Figure 14. Step-by-step methodology



4.2 Evaluation design

The evaluation was designed to respond to a specific set of (quantitative and qualitative) evaluation criteria and questions, as articulated in the Terms of Reference. An evaluation matrix was developed to guide the choice and design of specific research methods, as well as to provide a framework for subsequent data analysis and interpretation. The matrix it specified:

- Questions addressed by the evaluation;
- Evidence required to answer each evaluation question;
- Data sources and methods used to compile the required evidence;
- Judgement criteria on which the evaluative conclusions were to be based.

The evaluation framework is presented in Annex 13 and reflects the following key elements of the approach:

- A theory-based approach – this involved making explicit the underlying theory of change for the MFA operation in Ukraine (see section 3.1), and subsequently testing this theory to draw conclusions about whether and how the MFA contributed to observed results. The theory of change was developed on the basis of desk research and subsequently validated through key informant interviews.
- The use of mixed methods – the Study approach combined both quantitative and qualitative research methods to facilitate a deeper understanding of the evaluation issues and to build a rich and comprehensive evidence base for the evaluation.
- Triangulation - multiple lines of inquiry and evidence were used to answer each evaluation question.

4.3 Methods and data sources

Table 4 provides a high-level overview of the data collection methods and analytical techniques used to address each evaluation criterion. A description of how each of these methods were applied to this evaluation is provided in the sub-sections that follow.

Table 4. Overview of the methods and techniques used for the evaluation

	Relevance	Effectiveness	Efficiency	Coherence	EU added value
Documentary review	●●●	●●	●●●	●●●	●●●
Macroeconomic data analysis	●●●	●●●	●●●		
Key informant/ stakeholder interviews	●●●	●●●	●●●	●●●	●●●
Online focus group discussion	●●	●●			●●
Delphi survey	●●	●●			●
Case studies (structural reform)	●●	●●	●●	●	●●
Internal brainstorming session on counterfactual scenarios	●	●●			●
SIA		●●●			
DSA		●●●			

●●● *very important method for addressing the evaluation criterion*

●● *important method for addressing the evaluation criterion*

● *complementary method*

4.3.1 Desk research

The documents reviewed included publicly available information, as well as official documentation provided by the Commission. These are presented in Table 5:

Table 5. Document review – main sources

Type	Description
European Commission files relating to the MFA III operation	• Council Decision 2015/601/EU; • Ex ante assessment; • MoU for MFA III; • Operational assessment; • Preparatory documents submitted to the Economic and Financial Committee; • Documentation on other EU assistance to Ukraine (State Building Contract (SBC) documentation and evaluation report) and the overarching policy framework (including annual report on implementation of the AA).
EU policy-related documentation	• Association Agenda; • Progress reports on Association Agenda;

Type	Description
	• Reports on the implementation of the European Neighbourhood Policy (ENP) and the Visa Liberalisation Action Plan; • Reports on financing spent on EU sector budget support; • Technical assistance project descriptions.
Documentation published by the Ukrainian authorities	• Economic strategies; • Reform programme action plans; • Newswires.
IMF documents	• Letters of Intent submitted by Ukrainian authorities to the IMF; • IMF country reports, reviews; • Some IMF research publications; • Relevant evaluations, including the ex post evaluation of the 2015 EFF programme.
World Bank data and documents	• Country Partnership Strategies; • Programme documents relating to the Bank's Development Policy Loan 2 and Financial Development Policy Loan (DPL) and Financial Sector Development Policy Loan (FSDPL) 1 & 2; • Documents relating to projects supporting relevant reforms.
Other	• Data and reports prepared by other IFIs (e.g. EBRD) and key bilateral donors; • Reports on particular reforms in Ukraine from civil society organisations (CSOs); • Local research publications provided by Ukrainian think tanks and non-governmental organisations (NGOs), e.g. IER; • Academic and grey literature on political and economic developments in Ukraine and its progress with the implementation of structural reforms; • Reports produced by major credit rating agencies.

4.3.2 Macroeconomic data analysis

Macroeconomic data and statistics from various sources (e.g. IMF, World Bank, NBU and Ministry of Finance data) were also compiled and analysed.

Table 6. Key macroeconomic indicators and data sources

Component	Data type	Description	Key data source(s)
The real economy	National accounts	Indicators of macroeconomic performance	Ministry of Finance, IMF

Component	Data type	Description	Key data source(s)
Balance of payments	Balance of payments statistics	Indicators of external sustainability and trade conditions	IMF
Government	Government finance statistics	Indicators of the government's fiscal sustainability (expenditure, budget balance, debt, tax revenue etc.)	Ministry of Finance, IMF, World Bank
Financial System	Monetary statistics	Banking sector, financing condition, interest rates, foreign exchange data, etc.	Ministry of Finance, NBU, IMF
Labour Market	Other economic statistics	Indicators of socioeconomic performance	Ministry of Finance, IMF, World Bank

4.3.3 Interviews with key informants

A total of 40 key informants were consulted for this evaluation. The Study team interviewed European Commission officials and representatives of the EU and Member State political landscape, Ukrainian national authorities and other stakeholders involved in the implementation or monitoring of MFA conditionality, as well as IFIs, the wider donor community, CSOs and businesses representatives. Due to the outbreak of the COVID-19 pandemic, the scheduled visit to Kyiv was cancelled and all interviews were conducted over the phone/via conference calls. Some exchanges took place in a written form to accommodate stakeholders' preferences (need to consult several stakeholders and gather different data within the organisation, preference to avoid conversations in English or use of interpretation services).

Table 7 provides the profiles of those consulted. Annex 1 provides the full list of key informants.

Table 7. Profile of interviewees

Profile	Count of key informants
EU side: Commission officials at headquarters and at the EU Delegation in Kyiv/European External Action Service (EEAS)/Member State representatives	**22**
ECFIN/former ECFIN	3
Support Group for Ukraine (SGUA)	2
Other directorates (DG for Taxation and Customs Union (TAXUD), DG European Civil Protection and Humanitarian Aid Operations (ECHO), legal department, European Economic and Social Committee (EESC), DG Climate Action (CLIMA))	6

Profile	Count of key informants
EEAS	2
EU Delegation in Kyiv/former staff members	9
Member State Permanent Representations	1
Business representatives	1
Ukrainian side: National authorities/ other stakeholders involved/uninvolved in the implementation of the MFA	**10**
Ministry of Finance	3
NBU	4
National Anti-Corruption Bureau (NABU)	1 (written exchange)
Ministry of Social Policy	1 (written exchange)
Ukrainian CSOs	5 (incl. 2 written exchanges)
International donor community	**8**
IMF	2
World Bank	1
EBRD	2
Other (Organisation for Economic Co-operation and Development (OECD), GIZ, SDC-SECO)	3
Total	**40**

The main focus of the interviews varied, depending on the stakeholder type. Interviewees received a copy of the semi-structured questionnaire in advance that was then used to guide the discussion. Box 5 provides a snapshot of the interview focus by stakeholder type. Annex 2 contains some key takeaways by stakeholder type.

Box 5. Focus of interviews, by stakeholder type

EU side

- Interviews with Commission officials covered all key themes of the evaluation. The purpose of the consultations was to deepen the evaluation team's understanding of: the big picture (where the MFA operations fitted within overall EU assistance to Ukraine); the process of designing the operations, including coordination issues with other Commission instruments, and the process of selecting the conditions and negotiating them with the authorities; the overall assessment of the economic impact of the MFA; views on progress made in various reform areas and the role of MFA in achieving these; reasons for the non-disbursement and any implications.

- Interviews with the EU Delegation/SGUA/EEAS also covered: articulation of the MFA with other EU instruments; assessment of progress made in particular reform areas and contribution of MFA to that process; views on non-disbursement.
- Interviews were conducted with other EU bodies to gain a deeper understanding of the technical conditions, e.g. DG TAXUD on custom conditions; DG CLIMA on the wood export ban; DG ECHO on IDP assistance; and the EESC in relation to the monitoring of the AA more generally.
- Interviews with Member State representatives and business representatives were designed to gather their views on the progress on reform and the role of MFA in the context of broader EU assistance.

Ukrainian side

- The same aspects were discussed as with the EU officials, with the Ministry of Finance and NBU also asked about: the design and negotiation process of both MFA operations; impact of MFA operations on the macroeconomic situation; impact of MFA operations on reform areas. There was also a focus on financial and non-financial added value of the MFA operations and implementation aspects (including issues related to non-disbursement).
- Interview with the Ministry of Social Policy to analyse conditions related to social protection (including social safety nets in the energy sector and IDP assistance).
- Interview with the NABU addressed, inter alia, questions about its establishment and the role of international donors, as well as the effectiveness of the agency.
- Interviews with five CSO representatives were conducted before and after the focus group, due to the absence of attendees.

IMF and the donor community

- With the IMF, the focus was on aspects related to the design and negotiation of the support package (overview of the factors leading to the request for IMF assistance, liaison and coordination with the European Commission, notably with respect to selection of conditionality, likely scenario in the absence of the MFA); implementation aspects (e.g. timeliness of MFA disbursement, views on non-disbursement); impact of MFA/IMF assistance on macroeconomic conditions and structural reform.
- With other donors, the interviews focused on the characteristics of their own assistance package and potential complementarities/synergies and/or inconsistencies with MFA III.

Table 11 outlines some limitations related to the completed interview programme and its outputs.

4.3.4 Delphi survey

The Delphi survey sought to establish views of the macroeconomic impact of MFA III on the Ukrainian economy (e.g. GDP growth, balance of payments, fiscal balances), the impact and contribution to the structural reforms in Ukraine, and finally the design and implementation aspects (e.g. size of the operation in relation to the country's financing needs, timing of disbursements, design of conditionality, coordination with IMF/World

Bank and national authorities). Participants were also asked to expand on a plausible scenario where MFA III (or the whole joint assistance package from international community) had not been available. The survey also covered aspects of the role of the MFA in promoting structural reform and the associated social impacts.

Recruitment to the panel was carried out with the support of the local research team. 54 representatives of the following groups/institutions formed the Delphi panel:

- Business representatives and financial/macroeconomic analysts from the private sector (e.g. research departments of commercial banks);
- Researchers from think tanks, experienced commentators of Ukrainian economic policies (i.e. specialist press), independent fiscal policy experts, and academic experts.

The research team took pains to target those respondents likely to have prior knowledge of MFA operations based on their experience with the country context and macroeconomic situation. During the initial round, 21 respondents provided valid feedback, resulting in a 39 per cent response rate. A second round of Delphi survey was not conducted, given the degree of consensus between respondents and the risk of survey fatigue. Table 8 presents the respondents, by type of organisation. Annex 3 provides a summary of the results of the Delphi survey.

Table 8. Details of the Delphi panel respondents

Type of organisation	Number of invitees	Number of responses
Bank – research department	9	2
Businesses and their representatives	4	0
CSOs	6	4
Credit rating agency	5	2
Media/think tanks/ academics	20	8
Media/think tanks/ academics/ CSOs (EU side)	3	2
Research consultancy	5	1
Investment bank	1	1
Other	1	1
Total	**54**	**21**

4.3.5 Focus Group

Rather than a face-to-face session in Kyiv, the focus group discussion was organised online following the outbreak of COVID-19. It consisted of a series of short presentations and live polls intended to trigger open discussion. The online focus group involved seven attendees from Ukrainian CSOs, think tanks and academia in a two-hour discussion, with a facilitator and several presenters.

The main topics covered were:

- Added value of MFA III as part of the broader package of assistance, in terms of (i) visibility of the assistance; (ii) attitudes towards the EU among the general public;
- Issues related to non-disbursement of the third tranche (awareness, justification level, economic and political implications);
- EU and MFA III's contribution to Ukraine's overall reform efforts;
- Three in-depth discussions of specific reform areas: AC and judiciary, business environment, public administration reform.

The summary results of the online focus group are presented in Annex 3. Table 9 gives an overview of the profile of participants.

Table 9. Profile of focus group participants

Organisations represented
• National Institute for Strategic Studies • Centre for Economic Strategy • Kyiv National Taras Shevchenko University • Ukraine VoxUkraine • Better Regulation Delivery Office (BRDO) • Transparency International Ukraine • Institute for War and Peace Reporting

4.3.6 Case studies

4.3.6.1 Case studies on reform areas

Two in-depth case studies on MFA-promoted reforms were developed in the areas of (1) AC reform and (2) social safety net reform.

The case studies addressed the following aspects:

- Rationale behind the selection of specific MFA conditions in the above areas (for AC: #6 2nd tranche, on establishment of AC bodies, #5 3rd tranche, on asset declaration; for Social safety net: #12 2nd tranche, on provision of assistance to IDPs, #16 3rd tranche, on an evaluation of social service delivery to IDPs), as well as the relevance and added value of MFA conditionality;
- Significance of MFA conditionality in the context of the overall need for reform in a particular thematic area/sector;
- How the MFA conditions were implemented and whether the authorities encountered any obstacles in implementing these conditions (e.g. lack of capacity, political or public resistance to change etc.);
- Role and contribution of the MFA in promoting reform, including identification of key 'causal links';
- Short, mid and long-term benefits of the MFA conditions.

In addition, the case studies attempted to draw on some lessons learned from the design and implementation of similar previous reforms by two donors, the World Bank and the IMF.

The case studies were primarily based on desk research and stakeholder interviews, and took into account inputs from local economic experts.

4.3.6.2 Case study on the use of the euro

This case study examined whether the three MFA operations in Ukraine had any impact – via the above channels – in promoting the role of the euro in asset and debt management by Ukrainian authorities. The analysis was broken into two components and covered three dimensions: descriptive, exploratory and explanatory (see Table 10).

Table 10. Overview of the approach to case study analysis

Analytical component	Analytical dimension		
	Descriptive	Exploratory	Explanatory
1. How the use of the euro has evolved in asset and debt management activities of the Ukrainian authorities	X *Descriptive statistics on use of the euro*	X *Factors influencing and driving these changes*	
2. Role and contribution of the MFA - whether and how the MFA operations contributed to any of the observed changes in the use of the euro by Ukrainian authorities		X *How MFA played a role*	X *Whether MFA played a role*

4.3.7 Social Impact Analysis (SIA)

The overarching aim of the SIA was to use evidence from social indicators and primary data to assess the impact of MFA III on the social situation in Ukraine. The analysis considered both direct impacts of policies aimed at supporting vulnerable households affected by energy reform and internally displaced persons (IDPs), and indirect impacts across a broad range of social indicators.

For the purpose of the analysis, direct effects are defined as impacts stemming from conditionalities outlined in the MFA III MoU. Indirect effects are defined as those stemming from wider macroeconomic stability more broadly.

For the purposes of the analysis, the implementation period of the MFA is defined as 2015-2017.

The full SIA is presented in Annex 10. Direct effects are analysed in the first part, which seeks to understand – through a data-driven analysis – the extent to which vulnerable households were compensated by the compensation mechanisms referenced in the MoU conditionalities, and the extent to which social benefits and services were provided to IDPs. The analysis focuses on four policy aims:

- Ensuring that compensation mechanisms designed to protect vulnerable households are fully functional (and take into account the anticipated increase in beneficiaries);

- Ensuring the effective provision of social benefits and services to IDPs, through adequate legislation and funding;
- Cushioning the effects of energy tariff increases, while making progress towards consolidated and better targeted social assistance programmes;
- Evaluation of the delivery of social services to IDPs and effective follow-up.

Evidence from stakeholder interviews was used in conjunction with available empirical data to form an assessment of progress made by Ukrainian authorities. Challenges associated with implementing the main actions were discussed and the evidence of tangible impacts was assessed (to the extent possible). The outcomes discussed in the report can be considered to be linked to the MFA operation. This is because the policies investigated are those specified in the MFA III MoU. The research suggested that there was reason to think that these reforms would have been partial or implemented more slowly, in the absence of such stipulations.

Trends in variables relating to the macroeconomic situation (indirect effects) are analysed in the second part. The aim was to assess developments in socioeconomic variables prior to and (where possible) during/after the MFA period. That section also discusses changes to labour market performance, such as wage growth and unemployment, and the effects on prices that impact the affordability of goods and services. It also discusses impacts to key social outcome variables, such as national poverty levels and living standards.

Finally, the counterfactual analysis aimed to establish what the social situation in Ukraine might have been in the absence of MFA first tranche funding (Alternative 1), in the absence of MFA second tranche funding (Alternative 2), with the disbursal of third tranche MFA funding (Alternative 3) and in the absence of all MFA and IMF funding (Alternative 4). The findings are summarised in Section 7.1.2.

4.3.8 Debt Sustainability Analysis (DSA)

The aim of the DSA was to evaluate the impact of MFA III on the sustainability of Ukraine's public debt. The analysis was conducted within a counterfactual framework in which the baseline of what happened is compared against what would likely have occurred in alternative scenarios. More specifically, the DSA considered four key scenarios: what would have happened if:

1. Ukraine had not received the first tranche of MFA III funding;
2. Ukraine had not received the second tranche of MFA III funding;
3. Ukraine *had* received the third tranche of MFA III funding (which was not disbursed, due to the incomplete implementation of policy commitments);
4. Ukraine had not received any MFA III funding or any IMF assistance.

For each scenario, the most likely counterfactual was determined based on insights obtained from desk research, stakeholder consultation and local economic experts. The implications for key debt sustainability indicators were then assessed in each of these scenarios compared to the baseline.

The full DSA is presented in Annex 11. The first section assesses and describes the baseline and the likely counterfactual in the four scenarios. Ukraine's macroeconomic performance and debt sustainability in the baseline is then outlined in more detail. A description of the data and methods used in the DSA follows. Finally, using the IMF and World Bank DSA tool[69], the study team describes and compares Ukraine's debt sustainability across the scenarios.

[69] The version for countries that can access international financial markets.

4.3.9 Stakeholder validation workshop

The stakeholder workshop aimed to test and validate the emerging findings (at the stage of the Draft Final Report) with stakeholders closely involved in the negotiation and/or implementation of MFA III. It was held online on 6 July 2020 and consisted of a short presentation of the main findings and conclusions (by ICF), followed by some discussion and feedback.

The list of participants included:

- EU: DG ECFIN, SGUA, EEAS, EU Delegation in Kyiv;
- Ukraine: NBU, Ministry of Finance;
- IMF representative.

4.3.10 Finalisation of analysis, synthesis and triangulation

These tasks comprised finalising the analysis carried out under the various tasks. In the second stage, this involved the preparation of this report, where multiple sources of information and multiple methods were synthesised and triangulated so as to report findings in a structured manner under each evaluation question.

Particular efforts were made to draw conclusions on the specificities of MFA III, notably in relation to the number/type of conditions it included and the non-disbursement of the third tranche.

4.4 Caveats and limitations

The caveats and limitations associated with each particular data collection method are presented in Table 11.

Table 11. Limitations and caveats of data collection and analysis

Method	Caveats and limitations
Macroeconomic data analysis	Relatively reliable data with some occasional exceptions. In general, the quality of Ukrainian statistics, including national accounts, is fairly good. Key statistical indicators (e.g. GDP, CPI, industrial production, structural business statistics) are now calculated based on EU or global methodology. However, the statistical methodology was updated quite frequently in recent times and some structural breaks exist, e.g. due to annexation of Crimea and conflict in Donbas. Ukrstat retrospectively calculated most of the key statistical indicators excluding Crimea since 2010 and this was relatively straightforward, as these indicators are usually available at regional as well as national level. The Donbas case is more complex. Some companies in the part of Donbas outside government control continued statistical reporting (e.g. output, wages, employment, investment) while others did not. Household surveys were stopped altogether.
Interviews with key informants	The visit to Kyiv had to be cancelled due to the pandemic. Phone interviews/conference calls were organised instead with those closely involved in the negotiation and/or implementation of the IMF/MFA assistance (e.g. Ministry of Finance, NBU). It was, however, more challenging to secure the participation of the stakeholders in this format. It was not possible to schedule interviews with some Ukrainian institutions (e.g. no response from the Accounting Chamber of Ukraine (ACU) and the Ministry of Energy). Some institutions (e.g. Ministry of Social Protection, NABU) requested to answer the interview questions in writing, which was helpful, despite limiting the scope for follow-up questions. In certain cases (for those not directly involved in the operation), stakeholders had limited knowledge of specific MFA III conditionality or were unable to recall the detail of certain aspects of MFA III or the relevant context, due to the time that elapsed or confusion with MFA IV (or MFA I and II, or other EU programmes). The MFA III MoU was attached as an annex to each topic guide and the timeline of the MFA III presented upfront to limit such confusion.
Delphi panel	One challenge in the context of the Delphi survey was to avoid insufficient familiarity of participants with specific aspects of MFA III. Substantial efforts were made to select a sample of relevant experts, going beyond experts in macroeconomics and recruiting those with specific knowledge in most relevant reform areas as well. In the context of the COVID-19 outbreak and survey fatigue, another challenge was to achieve a satisfactory response rate. In total, after granting some flexibility with the deadline and close follow up, 21 complete

	answers were received, displaying a relatively high level of consensus, resulting in the satisfactory response rate of 39 per cent. Given the low numbers in absolute terms, however, and in order not to mislead the reader, responses are reported using absolute numbers (no percentages are displayed) and analysed in a more qualitative manner. Responses from Delphi survey experts sometimes differed from the Study team's assessment, e.g. on some specific issues (counterfactual questions) where insider knowledge is required. Triangulation of sources has been used before any conclusions are drawn.
Focus group	The focus group had to be held online, which shortened its maximum duration compared to typical face-to-face focus groups. To make the best use of available time (two-hour session), a small set of registration questions was sent to the invitees beforehand to assess participants' specific areas of expertise and tailor the agenda accordingly. Given the experts' profiles and level of familiarity with the MFA conditions, it was not possible to cover one of the two case study topics (IDPs) in any detail. Often, progress in specific reform areas was discussed more generally, without progress necessarily attributed to the MFA condition. Given the online format, the focus group was held in English only. The English level of the participants was checked in advance and for those not sufficiently comfortable to participate in an English-only event, separate interviews in Ukrainian were offered (and conducted by IER colleagues).
Case studies	Case study on reform areas: The focus group discussions did not provide insights into one of the two case study topics (social safety nets), given the participants' profile. The many conditions included under the MFA operation stretched the study resources and took substantial time during interviews with 'generalists', which could otherwise have been used to discuss case study topics (all reform areas and individual conditions had to be covered to some extent). Additional separate interviews centred on case study topics were organised with 'specialists' to compensate for that limitation. Case study on the use of the euro: The workshop on the international role of the euro was cancelled because of the COVID-19 pandemic. Instead, a separate interview was organised with one of the presenters, who shared the workshop presentations with the Study team.
DSA	The nature of the MFA mechanism meant that it was not possible to trace how the MFA funding was used specifically, e.g. maintain public expenditure, meet the foreign debt repayment obligations.

	In addition, the use of IMF data to the extent possible was required for consistency of results but, in some cases, data were not published by the IMF, or other sources were used for additional detail. In the case of IMF data, the main sources were the WEO, International Financial Statistics (IFS), Government Finance Statistics (GFS) data, and IMF country reports on Ukraine. The Study team also used data from the NBU and from the Ministry of Finance. The DSA relied substantially on the insights from Delphi survey experts and relevant stakeholders who were asked to speculate about hypothetical scenarios. All of the limitations and caveats related to the Delphi survey and insights from semi-structured interviews apply equally here. For the counterfactual analysis, the most tangible potential impacts were incorporated within the DSA framework. More uncertain implications of the counterfactual outcomes were not modelled, given the challenges of identifying what the impacts would have been and their magnitude. Estimating the social situation under Alternative 4 (i.e. debt default) is even harder to predict (different countries and events of debt default have had diverse impacts in the past).
SIA	The key difficulty was to determine the extent to which the different social conditions would have occurred across scenarios. Stakeholders engaged only to a limited extent in the hypothetical exercise, where questions were asked related to the potential social impact related to an enhanced social safety net had the MFA condition not been implemented. The difficulty of estimating the social situation under Alternative 4 (i.e. debt default) is even harder to predict (different countries and events of debt default have had diverse impacts in the past).
Stakeholder validation workshop	The detailed presentation of emerging findings had to be held fully online. Despite satisfactory attendance, discussion was limited, although participants clarified that their views were already well represented.

Overall, the reliability and validity of the evaluation is strong:

- Subsequent versions of the evaluation report were subject to critical interview review and review by the Steering Group;
- The evaluation was based on an agreed evaluation framework, which broke down all evaluation criteria into questions and sub-questions and defined judgement criteria in each case;
- The overall findings were based on a large variety of sources and proved consistent with the results of MFA I and II and the IMF evaluation of its EFF programme, which was run independently and in parallel.

5 Relevance of MFA III

Question 1: *To what extent was the MFA operation design (including adequateness of financing envelope, focus of conditionality) appropriate in relation to the outputs to be produced and objectives to be achieved?*

The answer to this question considered the following issues: (i) adequacy of the size of the financial assistance relative to the Ukraine's financing needs, (ii) appropriateness of the form of financial assistance, (iii) timing of the operation, and (iv) design and focus of conditionality, given the country's reform needs, domestic capacity and ownership, the activities of other donors and the inherent characteristics of the MFA instrument itself.

5.1 Issue 1: Size of the financial assistance

In the 2015 ex ante evaluation underpinning the MFA III to Ukraine[70], it was envisaged that the MFA would comprise EUR 1.8 bln of mid-term loans (with no grant component), to be disbursed in three significantly frontloaded installments in 2015 and early 2016. This differed only slightly from the amount of EUR 2 bln requested by the Ukrainian authorities[71] and corresponded to the amount finally adopted by the Council and Parliament.

According to the same ex ante evaluation (and based on the IMF estimates from May 2014[72]), the MFA would have represented 15 per cent of the residual financing gap, estimated at circa USD 15 bln between 2015 and Q1 2016[73]. The EU share was intended to complement the IMF Stand-By-Agreement programme (eventually replaced by the EFF in March 2015) and the World Bank commitments of USD 500 mln and USD 750 mln provided via DPL-1 and FSDPL-1[74], respectively. It was also envisaged to come in parallel with other supports, including US-guaranteed bonds and bilateral assistance from Japan (USD 100 mln) and Canada (EUR 180 mln). In addition, a substantial increase in project financing from the EBRD and EIB was envisaged.

The situation evolved quickly, however. External shocks, such as the escalation of conflict from August 2014, weakening confidence and disrupted industrial production and

[70] European Commission (2015). Ex ante evaluation of the MFA III to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

[71] As per the request put forward by the authorities in September 2014. There was a discrepancy between the amount requested and eventually disbursed as part of MFA I and II. In 2017, the Ukrainian Treasury was not able to provide the evaluation team with any information on whether its request was based on any formal analysis.

[72] Based on the IMF staff report linked to the request for the 2014 SBA.

[73] European Commission (2015). Ex ante evaluation of the MFA III to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

[74] Eventually followed by DPL-2 and FSDPL-2, approved in August and September 2015, respectively

exports, saw the financing gap continue to balloon and, by March 2015, Ukraine's total residual financing needs had climbed to USD 21.4 bln for 2015 alone (compared to the USD 12 bln estimated in 2014). The gap for 2016 and 2017 rose to USD 6.8 bln and USD 6.9 bln, respectively. Around three-quarters of the gap resulted from the pressing need to strengthen official reserves[75].

Stakeholders from the World Bank and the IMF consulted as part of the evaluation of MFA I and II stated that at the time of design of the MFA II, it was already expected that '*MFA I & II are just the beginning of the EU financial support',* given the increasing size of the gap.

In absolute terms, MFA III was the largest single operation in the history of the MFA instrument, by a wide margin. Combined with MFA I and II (EUR 1.6 bln), it accounted for 29 per cent of the total MFA assistance approved between 1990 and 2017 (EUR 11.5 bln). [76]. Such scale was justified by '*the political importance of Ukraine for the stability in the European Neighbourhood; the political integration of the country with the EU as reflected by the Association Agreement between the two sides that provisionally entered into force on 1 November 2014'*[77]. In terms of the proportion of the residual financing gap intended to be covered by MFA III (i.e. 7 per cent), it was perfectly in line with the previous operation[78].

Table 12 illustrates the share of EU support in Ukraine's external financing gap and in total official financing (i) as it was projected (as per IMF's March 2015 assessment for the years 2015-2017, underpinning the EFF programme), and (ii) based on actual numbers. The discrepancies stem from the fact that the actual MFA disbursements took place in July 2015 and April 2017 (as opposed to 2015/2016) and were limited to two tranches.

Table 12. Ukraine's gross external financing gap and financing sources, 2015-2017, USD bln

	Projections				**Actual**				
	2015	2016	2017	Cumulated 2015-2017	2015	2016	2017	Cumulated 2015-2017	Variation c/ projections
Financing gap	***21.4***	***6.8***	***6.9***	***35.1***	***18.6***	***6.3***	***6.2***	***31.1***	*-11%*
Official financial, of which:	*16.3*	*3.5*	*2.5*	***22.3***	*9.8*	*2.8*	*1.8*	***14.4***	*-35%*
IMF	*10*	*2.5*	*2.5*	***15***	*6.5*	*1.0*	*1.0*	***8.5***	*-43%*
EU	*1.8*	*0.7*	*0*	***2.5***	*0.9*	*0.1*	*0.6*	***1.6***	*-36%*
Other multilateral	*1.8*	*0*	*0*	***1.8***	*1.0*	*0.4*	*0.2*	***1.6***	*-11%*

[75] IMF (2015). Country report No. 15/69: March 2015. Available at: https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Ukraine-Request-for-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-Cancellation-42778

[76] European Commission, June 2018. Report from the Commission to the EP and the Council on the implementation of the MFA to third countries in 2017 – Annexes. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018SC0361&from=EN

[77] European Commission (2015). Ex ante evaluation of the MFA III to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

[78] As stated in the European Commission ex ante evaluation, recent MFA operations for ENP countries have covered on average 6.6 per cent of the total financing gap (unweighted average of nine MFA decisions over the period 2009-2014).

	Projections				**Actual**				
Other bilateral incl US	*2.7*	*0.2*	*0*	***2.9***	*1.4*	*1.3*		***2.7***	*-7%*
Debt operation	*5.2*	*3.4*	*4.4*	***13***	*5.7*	*3.5*	*4.4*	***13.6***	*5%*
Other exceptional financing	*…*	*…*	*…*	*…*	*3.1*	*…*	*…*	***3.1***	
EU as a share of gap	**8%**	**10%**	**0%**	**7%**	**5%**	**2%**	**10%**	**5%**	**-2 p.p**
EU as a share of official financing	**11%**	**20%**	**0%**	**11%**	**9%**	**4%**	**33%**	**11%**	**-0.1 p.p**

Source: IMF, March 2015 estimates underpinning the EFF request; IMF, January 2019, actual numbers provided in the context of the SBA request.

Note: EU includes MFA III + remaining disbursement under MFA I + budget support. MFA III represents 75 per cent of that total over 2015-2017.

Looking at the ex post data, the actual financing needs in 2015-2017 (USD 31 bln) were slightly lower than the projections from 2015 (USD 35 bln). Eventually, EU support covered 5 per cent of Ukraine's financing gap, compared to the 7 per cent initially envisaged. This is largely due to the non-disbursement of the third tranche. That said, in terms of its share in total official financing, the share of EU support remained constant, reflecting the fact that IFIs were also encountering implementation issues with their own programmes (IMF disbursements, in particular, were also below projections, at -43 per cent, vs -36 per cent for the EU).

In terms of the relative size to GDP, the combined first and second tranche of MFA III disbursed in 2015 and 2017 represented 0.7 per cent and 0.6 per cent of annual GDP, respectively. For illustrative purposes, the state budget expenditure on security and the judicial system in 2015 was some EUR 2 bln, meaning that the first tranche of MFA III corresponded to around 30 per cent of the annual state expenditure on this item. The size of the MFA III was therefore material, even more so in the context of a persistent current account deficit, the pressing need to build up reserves, and increasing debt amortisation.

Stakeholders from the IMF and World Bank stated that the size of MFA III was adequate and noted the willingness of the EU to '*max out the support to Ukraine*', bearing in mind all the constraints. According to the Ministry of Finance, MFA III was '*a very significant amount of money. If you take out restructuring of Eurobonds in 2015, it corresponded to ~15 per cent of total borrowing in 2015 or the amount of annual funding raised on the domestic market that year'*.

5.2 Issue 2: Form of the financial assistance

By default, as per the 2013 Joint Declaration, the MFA should take the form of a loan, reflecting that it is an instrument to counter short-term and transitory difficulties. Under certain conditions, the recipient country can, however, be eligible for grants or for a combination of loans and grants (see Box 6). In brief, eligibility for a full grant or a blended MFA will depend on (i) the level of economic and social development of a recipient country, (ii) its debt sustainability and repayment capacity. The approach is fairly flexible, however, and hard indicators guide rather than constrain the final case-by-case decision.

Box 6. Main factors influencing the form of MFA instrument

Criterion 1: Level of economic and social development

The level of economic and social development is typically assessed based on the Gross National Income (GNI) per capita and poverty level indicators. GNI per capita is the essential indicator that determines the income category of the World Bank classification. For a country to be eligible for a grant, it needs to be in the lower middle-income category or below[79]. Indicators of poverty level (as per World Bank's figures[80]) usually complement the income category data.

Criterion 2: Debt sustainability and repayment capacity

Debt sustainability (public and external) and repayment capacity is an essential factor influencing decisions about the form of the MFA. Assessing debt sustainability and repayment capacity is a complex process, thus a number of indicators are used. Among the most common are: *external debt over GDP/GNI, external debt over exports*, *net present value of external debt over GNI, external debt service ratio (debt service over exports), public debt over GDP, public external debt over GNI, public debt service to tax revenue.* This list is not exhaustive and may be extended by various liquidity indicators or other types of information, e.g. DSA by the IMF and World Bank[81].

Additional criteria: treatment granted by other international donors and EU's own budgetary constraints

Final steps to refine the analysis include:

- Cross-checking the results of the initial analysis under criterion 1 and 2 against the status that other international donors grant to the country (whether the country in question is eligible for concessional finance, such as lending from the International Development Association (IDA lending));
- Taking into account the EU's budgetary constraints, i.e. the limited availability of funds under the macroeconomic assistance line of the EU budget.

Based on the indicators outlined in Box 6, the ex ante evaluation from 2015 noted that Ukraine did not qualify for a grant component. As of 2014, Ukraine's GNI per capita (based on Atlas method) was USD 3,560[82], i.e. in the upper bound of the lower middle-income country classification[83], the third highest among the six countries of the Eastern Partnership, behind Azerbaijan and Belarus. The GNI per capita in 2014 for Tunisia and Jordan, countries for which the approved MFAs in 2013/14 were entirely loans, was USD 4,160 and USD 3,830, respectively. Another reason highlighted in the ex ante evaluation

[79] https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups

[80] World Bank (2015). Poverty data. Available at: http://data.worldbank.org/topic/poverty#boxes-box-topic_cust_sec

[81] European Commission (2011). Criteria for determining the use of loans and grants in EU Macro-Financial Assistance. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011SC0874&from=EN

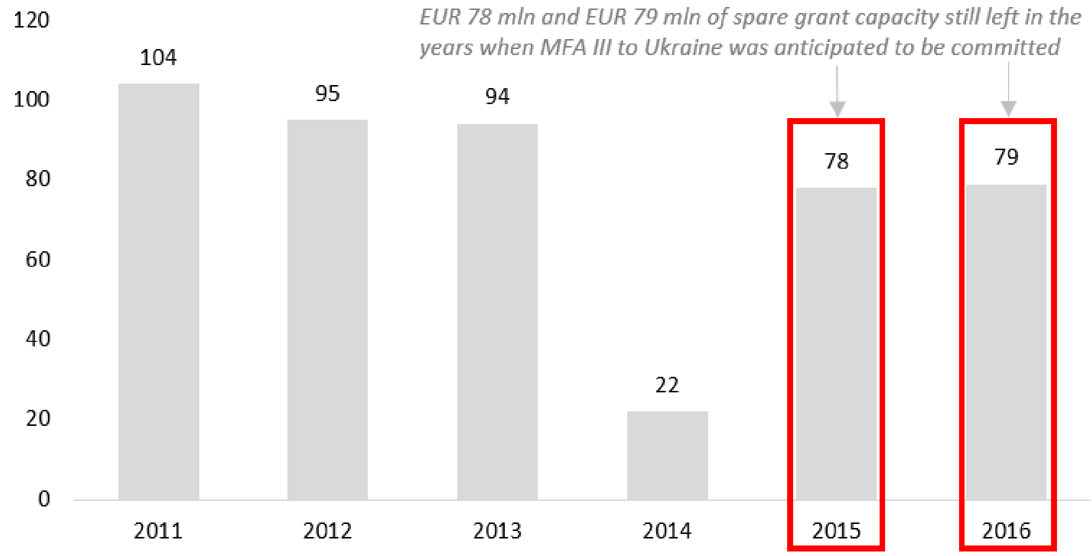
[82] World Bank (2019). GNI per capita – Ukraine. Available at: https://data.worldbank.org/indicator/NY.GNP.PCAP.CD?locations=UA

[83] World Bank (2018). Income classification. Available at: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups

was that '*the proposal to provide the full MFA in the form of loans was also consistent with the treatment granted by the World Bank and the IMF to Ukraine*'[84].

Regarding EU budgetary constraints, Figure 15 gives an indication of the uncommitted budget allocations for MFA grants. It shows that the pipeline of grant operations has been consistently below the budgetary ceilings in recent years. In 2015 and 2016, when the commitment for the MFA III operation was meant to materialise, EUR 78 mln and EUR 79 mln remained uncommitted – only ~9 per cent of the total loan envelope of MFA III, suggesting some major constraint.

Figure 15. Uncommitted budget allocations for MFA grants in the EU budget, in EUR mln



Source: MFA annual reports. Available at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/international-economic-relations/macro-financial-assistance-mfa-non-eu-partner-countries_en

In summary, there was no real alternative to loan for the MFA III operation, not least because it was part of a wider package of EU supports, including grant support and specific project finance. The total grant support actually disbursed over the period 2015-2017 amounted to EUR 840 mln (see Figure 18).

The level of public debt in the recipient country is another criterion that must be considered when assessing the form of the MFA assistance, Ukraine's public debt stood at 70 per cent of GDP as of end-2014 (after rapid deterioration from 40.2 per cent in 2013), and was expected to rise to nearly 80 per cent by end-2015. The DSA (see Section 9) thus examines whether the MFA III loan had a significant impact on Ukraine's indebtedness levels and whether the size and terms of the loan were justifiable from the economic perspective of the recipient.

Finally, the loan itself was provided on concessional terms (interest rate of 0.250 per cent for a maturity of five years for the first tranche, and interest rate of 0.750 per cent for a maturity of 14 years for the second tranche). The vast majority of Delphi survey participants agreed or strongly agreed with the statement that '*MFA III financing was provided by the EU on highly concessional terms, thus cushioning the impact on Ukraine's debt position*'. This concessional form of the MFA was received positively by the Ukrainian authorities (given that there were no other alternatives in 2015 and only more costly options in 2017).

There was some initial disappointment about the lower maturity of the first tranche (revealed preferences were for a minimum maturity of 10 years). There was, however,

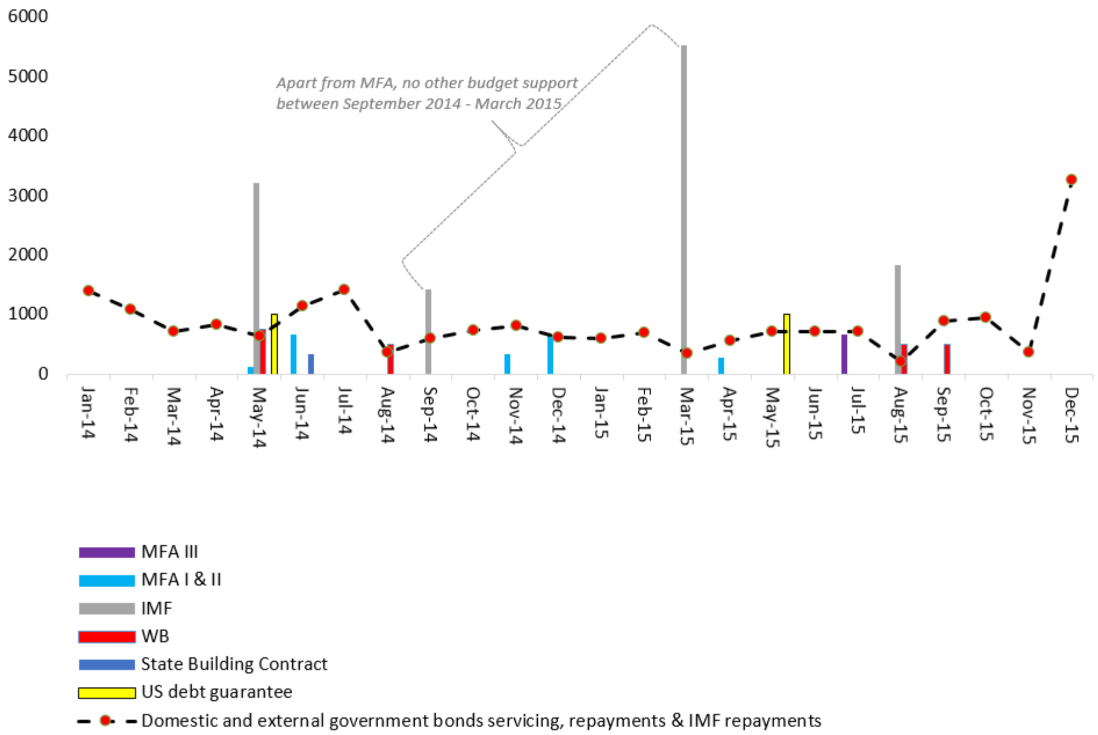
[84] European Commission (2015). Ex ante evaluation of the MFA III to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0001

little margin for the EU at the time, as MFA lending terms reflected EU market conditions at the time of disbursement and, in July 2015, the market conditions were affected by the Greek debt crisis and uncertainties preceding the conclusion of the third economic adjustment programme (EAP) for Greece.

5.3 Issue 3: The timing of MFA disbursements relative to financing needs

Similar to MFA I and II, the timing of MFA III was absolutely essential, given the urgency of the situation in Ukraine. The disbursement of funds within 2015-2017 was considered by stakeholders to be critical support for the country, not least because they signalled continuous support and solidarity for Ukraine at a highly sensitive time. Figure 16 places the MFA financing in the context of other assistance, as well as its debt repayment obligation in 2015, when the first MFA III disbursement took place.

Figure 16. MFA I, II and III, and other budget supports provided to Ukraine in 2015 versus due debt obligations, in USD mln



Source: IMF, World Bank, European Commission, USAID Financial Sector Development Program (*FINREP*-II Project) (for domestic and external government bonds servicing, repayments and IMF repayments).

Notes:

- Values available in EUR were converted into USD at the NBU average official exchange rate for December 2014. Some discrepancies with other estimates due to the exchange rates applied.
- In addition, debt repayment obligations as of November 2015 were eventually restructured – the figure does not include the amounts that were successfully restructured in November 2015.
- December 2015 debt repayments relate mainly to the USD 3 bln Eurobond held by Russia. Ukraine defaulted on this debt, the matter was taken to the court and still unresolved as of April 2020.

At the time of the first MFA III disbursement in June 2015, foreign reserves oscillated around USD 10.3 bln, a slight recovery from the record low in February (USD 5.6 bln). The economy remained extremely vulnerable, with conflict in the East causing disruption in trade and industrial production and the subsequent loss of confidence triggering capital outflows and sharp depreciation[85].

MFA III was likely particularly important in 2015, while somewhat less crucial in 2017, when the economy had stabilised.

5.4 Issue 4: Focus of conditionality

5.4.1 High level analysis

Given the anti-crisis nature of the MFA instrument, the first tranche of MFA assistance is typically released shortly after the signature and ratification of the relevant MoU and associated loan/grant agreements, provided that the IMF programme is on track[86]. The subsequent tranches, however, are conditional on the fulfilment of a number of pre-agreed policy conditions (set out in the MoU), as well as sufficient progress on a parallel IMF programme.

The guideline on EU macro-financial assistance to third countries provides a set of principles to steer the design and selection of MFA conditionality. These include:

- Limited number of structural conditions focusing on reforms related to the core objective of the macro-financial assistance instrument, i.e. restoring short-term economic balance;
- Ensuring a clear link between the nature of structural conditionality and the short timeframe of its implementation to avoid the request for waivers at the time of the disbursement;
- Reducing the number of cross-conditionalities with the IMF/World Bank and selecting for further emphasis those that are in line with EU priorities.

The Joint Declaration of the European Parliament and the Council from August 2013 stipulates that:

- Conditionality should include measures to enhance the efficiency, transparency and accountability of public finance management systems to strengthen the beneficiary country's governance and to protect the EU's financial interests[87];
- EU external policy objectives should be taken into account in designing the policy measures and, as such, conditionality should include measures aimed at mutual market opening and the development of trade that is rule-based and fair, etc.;
- MFA conditionality should be consistent with existing partnership agreements, cooperation agreements or AAs concluded between the EU and the beneficiary and with the macroeconomic adjustment and structural reform programmes implemented by the beneficiary with the support of the IMF.

With the above principles in mind, this sub-section examines the overall relevance of the MFA conditionality package.

5.4.1.1 The extent to which the conditionality was in line with the core objectives of the operation and EU priorities

The MFA operation focused on the following reform areas: public finance management, governance and transparency, energy, social safety nets, business environment and financial sector. The theory of change illustrated in Section 3 shows how specific

[85] IMF, March 2015. Request for EFF Program.

[86] The MFA instrument also gives the option to frontload the conditions. Although not common practice, room for manoeuvre exists and was used in the case of MFA IV to Ukraine.

[87] The public finance management conditions are typically derived from the Operational Assessment (OA) carried out by external consultants to give the Commission reasonable assurance about the reliability of the financial and administrative circuits and procedures of the recipient country before signing the MoU, as per the requirements of the Financial Regulation.

conditionality in each of these areas contributed to one or more of the following outcomes:

- Improved governance and functioning of sectors with macroeconomic significance (energy, SOEs, financial sector);
- Improved economic governance through an improvement in public finance management systems (public finance management reform);
- Improved framework for trading with the EU (business environment).
- Improved public finances (public procurement);
- Setting up of an institutional landscape and improved governance framework (AC);
- Reduction in social inequalities (social safety net reform).

Many of these outcomes have a clear and direct link to either the objectives of the MFA operation (macroeconomic stability) and/or EU external policy objectives (trade policy). Some reform areas are anchored in the approximation of EU Directives (customs). The macro-level importance of AC efforts is now also widely recognised in the literature[88]. Given the planned increase in tariffs following reforms in the energy sector, the focus on better targeting and reinforcement of the energy subsidies was fully justified.

The conditions on social assistance to IDPs were more atypical for an MFA operation and their link with macro-stability was less evident. The case study, however, confirmed that these were timely in this instance.

5.4.1.2 Number of conditions and scope of conditionality

The scale and scope of conditionality should take into account the time required to complete the reforms, as well as the specific characteristics of the MFA instrument. In practice, this means that given the relatively short-term nature of the MFA and the need for swift action by the beneficiary country, it should be possible to implement the required reforms within a window of 6-12 months. This *de facto* limits the number and ambition of conditions that can be attached to MFA operations. The size of the assistance also influences the EU's leverage in requiring reforms in a particular country context.

MFA III had 36 conditions. If sub conditions (conditions where several boxes, not necessarily related, had to be ticked for them to be met[89]) are included, that number reaches 46. Looking at the history of MFA operations, the average number of conditions is 11, for a median amount of EUR 140 mln, although this is of limited useful comparison to a EUR 1.8 bln operation. 36 conditions is an unprecedented number but needs to be viewed in the context of the unprecedented size of MFA-III, the largest-ever such operation and thus with the highest-ever number of conditions. Proportionately, the MFA-III operation counts among those with most assistance per condition[90]. While flexibility is necessary, it should be borne in mind that other MFA operations have had high numbers of conditions for far lower amounts (e.g. Moldova II).

[88] See, for example, IMF (2016). Corruption: costs and mitigating strategies. Staff Discussion Note No. 16/05.

[89] See example of the justice condition which comprised three conditions: *With a view to improving the enforceability of contracts and the business environment, implement the following measures under the National Justice Sector Reform Strategy 2015-2020: (i) implement the qualification and performance evaluation systems for judges foreseen in the Law on fair trial; (ii) adopt a law establishing a more effective enforcement system for civil and administrative cases, in line with European standards; and (iii) amend legislation on the judiciary in line with recommendations of the Venice Commission in order to increase the performance and efficiency of the judiciary.*

[90] Only MFA II had a better ratio but its timeframe was a single year, implemented in parallel with MFA I, to which more conditions were attached.

Table 13. Number of conditions and amount of assistance, MFA operations 2009-2018

Countries / operations		Total number of conditions	Amount of MFA assistance in EUR mln	Amount of MFA assistance per condition
By operation	Ukraine III	36	1,800	50
	Moldova II	28	100	4
	Ukraine I	25	610	24
	Tunisia II	15	500	33
	Lebanon	13	40	3
	Ukraine II	11	1,000	91
	Serbia	11	200	18
	Jordan II	11	200	18
	Georgia II	11	46	4
	Bosnia and Herzegovina	10	100	10
	Tunisia I	9	300	33
	Jordan I	9	180	20
	Armenia	9	100	11
	Georgia I	8	46	6
	Kyrgyzstan	7	30	4
	Moldova I	4	90	23
Median numbers		11	140	18

Source: ICF analysis of MFA MoUs 2009-2018

In addition to the size of the operation, the emergence of the SGUA shortly before the design of the MFA III may also explain the high number of conditions. The European Commission could draw on policy expertise from a wide pool of colleagues in various domains but pressure was strong to cover as much as possible through the MFA, given that it has more leverage than budget support programmes. At the time, the European Union Advisory Mission (EUAM) Ukraine had just formally begun operations. As the EUAM works on police, justice and corruption issues, it was consulted in the context of the MFA. Colleagues from the various EU institutions agreed that ECFIN was successful in running all the necessary consultations while still owning the final decision and restricting the list to a manageable number of conditions.

Box 7. Role, functioning and responsibilities of SGUA and EUAM

SGUA. Created in spring 2014 as a task force to support Ukraine in the implementation of the AA, the SGUA works as a catalyst and facilitator of reform in Ukraine by providing advice either directly or through experts (e.g. from other Commission services or other Member States). Based in Brussels, it is divided into seven different teams that work closely with EUAM, EEAS and the

EU Delegation to Ukraine. Since its inception, the SGUA has focused on the basic reforms required in Ukraine, namely: i) reform planning and governance/rule of law; ii) economic governance; iii) and sectoral policies. The SGUA's positive contribution to Ukraine's progress in key reform areas has been acknowledged. In particular, its information proved very relevant to DG ECFIN's decision-making on the MFA when assessing both the country's financial needs and the degree of pressure required to fulfil conditionality. The SGUA also collaborates with other EU and international bodies (e.g. OECD, IFIs) and Member States, and sets out the wider context for reforms, providing additional strategic direction.

EUAM. Launched in 2014 under the EU's Common Security and Defence Policy (CSDP), the EUAM assists the Ukrainian authorities in moving towards sustainable reform of the civilian security sector through strategic advice and practical support for specific reform measures based on EU standards and international principles of good governance and human rights. The goal is to achieve a civilian security sector that is efficient, accountable and publicly credible. EUAM is an unarmed, non-executive civilian mission, with headquarters in Kyiv and field offices in Lviv, Kharkiv, Odesa and Mariupol, as well as mobile outreach in other regions. EUAM has 365 staff.

Source: Support Group for Ukraine (2016). Activity Report. The first 18 months. Available at: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/neighbourhood/pdf/key-documents/ukraine/20161028-report-sgua.pdf

European Union Advisory Mission (EUAM) official website. Available at https://www.euam-ukraine.eu/

Stakeholders on both the EU and Ukrainian side generally believe that the number of reform conditions should have been lower. One argument given is that IFIs such as the IMF and World Bank typically have fewer conditions for higher amounts of assistance. Looking at the IMF EFF programme in particular, this seems to be the case, not necessarily in the absolute number of conditions examined ahead of each disbursement, but certainly in relation to the size of assistance and prior actions. Each of the disbursements was associated with 20 or 21 conditions according to the data presented in the IMF evaluation of its 2015 EFF programme. Looking at the Monitoring of Fund Arrangements (MONA) database, this represented a total of 58 unique conditions for the four disbursements (total value USD 8.5 bln). The conditionality comprised one-third of prior actions to be completed and two-thirds of structural benchmarks that did not themselves require the use of waivers if not completed.

The views of Delphi experts were more divided in the Delphi survey (nine agreed the number of conditions should have been lower, while six disagreed). Wider civil society did not express strong views on this at the focus group. The number of conditions has effectively been reduced for the MFA IV operation, at least in absolute numbers (18 conditions for an amount of EUR 1 bln).

The analysis on the number of conditions must be made in conjunction with an examination of their ambition. An MFA operation adopted through the Ordinary Legislative Procedure is only valid for a maximum of two-and-a-half years and, in the case of MFA III, the objective was to fully disburse in 2015/beginning of 2016.

Overall, there is consensus that the ambition level of the conditions was quite high. This is true of the MFA programme but also of the parallel IMF programme, according to the IMF evaluation of its 2015 EFF programme. This reflected a willingness to make maximum use of the reform momentum before the window of opportunity closed. That enthusiasm was shared by the Ukrainians, who quickly endorsed all reforms, perhaps without always fully realising the implications in terms of reform efforts. There are cases (e.g. with condition #6, 3rd tranche on ultimate ownership beneficiaries) where it became evident quite late in the process that progress on the conditionality was not fully clear to the Ukrainian side. This reflects both the ambition level of the condition proposed by the EU side and the lack of prioritisation on the Ukrainian side.

The ambition level varied from condition to condition. Some were limited to asking that legislative provisions be effectively applied (e.g. public finance management) while others – such as those targeting the energy sector, whose reform was long overdue – were more ambitious in nature.

The high level of ambition was not necessarily counterproductive, as key progress was made in many areas. It was not the main explanatory factor for the implementing deficit that led to withholding disbursement of the third tranche.

5.4.1.3 Complementarity/cross-conditionality with other EU and IFI programmes

This is discussed under Section 6 on coherence.

5.4.1.4 The extent to which the operation addressed priority areas for reform

At the thematic level, all areas of conditionality were seen as relevant. The ex ante evaluation conducted in 2014 listed six challenging policy areas, all of which were addressed by MFA conditionalities.

Targeted reform areas should be in line with national priorities. Following Maidan, in early 2015, the President approved 'Sustainable Development Strategy Ukraine-2020', setting out structural reform measures for 2015-19 that are necessary to ensure the medium-term macroeconomic stability of Ukraine and the implementation of the AA. Priorities included reform of the national security and defence system, AC reform, judicial and law enforcement reform, decentralisation and public administration reform, deregulation and development of entrepreneurship, healthcare reform and tax reform. In 2017, the Groysman government approved a medium-term priority action plan, setting out the reform plans for 2017-2019 in more detail.

Given that Ukraine's strategic documents are anchored in the AA and that the MFA conditions all feed into the implementation of the same AA (see Section 6), MFA reform areas can be said to be broadly aligned with the authorities' priorities. Wider civil society also tends to be quite positive about the MFA conditionality, except for the trade-related condition (specifically the wood ban issue).

5.4.2 Relevance of specific reform areas and conditionalities

The relevance of each targeted reform area is described below. Alongside the principles discussed above (which provide a general framework for the design of MFA conditionality), the design and selection of specific conditionalities should take account of factors such as national ownership and implementation capacity in order to reduce the risk of implementation deficit and subsequent backtracking.

This section was developed concomitantly and should be read in conjunction with the detailed conditionality tables (see Annex 5).

Box 8. Public finance management

It is standard for the MFA instrument to include conditions to improve the efficiency, transparency and accountability of public finance management systems in order to reinforce the beneficiary country's governance and protect the EU's financial interests[91]. In the case of MFA III, the public finance

[91] Joint Declaration of European Parliament and the Council of 12 August 2013. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013D0778&from=EN

management conditionality was derived in part from the OA conducted in 2014 ahead of MFA II[92]. MFA III conditions followed up MFA II conditions where relevant (e.g. external audit, VAT fund arrears).

Public finance management reform was high on the Ukraine's own reform agenda in the preceding years, with authorities seeking to improve the sustainability of fiscal policies. In August 2013, the government approved the 2013-2017 Public Finance Management System Development Strategy and its relevant Action Plan. This was followed by the 2017-2020 Public Finance Management Strategy, with an update of the strategy for the 2021-2023 period now being discussed[93].

MFA III encompassed conditions in three sub-areas: external audit, public procurement (PP) and fiscal governance. External audit conditions intended to support the implementation of the new ACU law, that had recently extended the remit of the ACU to SOEs. Conditions related to PP aimed to build a more efficient, transparent and competitive PP system, notably via the implementation of an electronic procurement system. Amendments to the PP law also aimed to improve public access to bid evaluation records[94]. On the fiscal governance front, fiscal policy in the country had been hindered by the absence of a medium-term orientation for the state budget and the accumulation of enormous arrears, particularly VAT refund arrears. Financial control and political scrutiny of the state budget have become essential components of the democratic legitimation of public expenditure, and the improvement of budget predictability is now a priority[95]. Likewise, a fairer and more effective administrative system of tax collection was a main objective of the public finance management conditions.

Box 9. Governance and transparency - corruption

The fight against corruption has long been on the list of requirements for the continued development of Ukraine's relations with the EU and was included in the first EU-Ukraine ENP Action Plan endorsed in 2005. Weak institutions and an underdeveloped sense of public service created an environment prone to corruption in Ukraine's entire post-soviet era.

Endemic corruption was a main trigger for the Maidan events and population expectations in early 2014 were high. The Maidan did not end the widespread influence of vested interests or prevent those interests reaching the top echelons of power in Ukraine, however, and the fight against corruption remained high on the policy agenda. The IMF pointed to the macroeconomic

[92] The OA was published in August 2014 to verify that Ukraine's public finance management systems provided sufficient safeguards in view of a forthcoming MFA programme. They also fed into the design of the public finance management conditions.

[93] IMF (2019). Ukraine: Technical Assistance Report. Enhancing the medium-term budget framework and preparing expenditure baseline. Available at https://www.imf.org/en/Publications/CR/Issues/2019/11/22/Ukraine-Technical-Assistance-Report-Enhancing-the-Medium-Term-Budget-Framework-and-Preparing-48835

[94] European Commission (2016). Report from the Commission to the European Parliament and the Council on the implementation of macro-financial assistance to third countries in 2015. Commission Staff Working Document. COM(2016) 376 final.

[95] IMF (2019). Ukraine: Technical Assistance Report. Strengthening public financial management. IMF Country Report No.19/355. Available at https://www.imf.org/en/Publications/CR/Issues/2019/12/04/Ukraine-Technical-Assistance-Report-Strengthening-Public-Financial-Management-48846

implications of widespread corruption[96], while the World Bank argued that corruption was a threat to national security[97].

Like MFA I and II, the AC dimension was present in a number of conditions, from the AC area itself through more implicit action under other areas, such as automatic payment of VAT refunds (fiscal governance), increase in transparency of reporting obligations of SOEs (SOEs). The AC dimension was also an essential element in many of the IMF and World Bank promoted reforms throughout all of their programmes since 2014.

Box 10. Governance and transparency – public administration reform

The reform of public administration is crucial for countries with a transitional economy and is thus a requirement of the AA. The AA made particular reference to the reform of both the civil service and local self-government bodies (with a view to endorsing European principles of public administration), and to the finalisation and adoption of the draft Law on Civil Service Reform[98]. It defined the establishment of an efficient system of public administration as one of the important requirements of democratic governance based on principles of the rule of law, in the context of the public administration being seen as one of the most corrupt institutions in the country.

In recent years, Ukraine has clearly demonstrated its commitment to modernising public governance, including public administration reform, with the support of the EU and in close collaboration with other donors (OECD, EBRD GIZ). At the time of launching MFA III, the EU had a budget support programme concentrating on public administration reform, which was encountering delays because of insufficient progress with the pre-conditions. MFA III was thus an opportunity to drive further reform in this area through the design of a set of reforms (e.g. recruitment based on merit) that would, in turn, help the implementation of reforms in other areas (i.e. public finance management, banking sector, energy sector).

Box 11. Governance and transparency – SOEs

The Ukrainian government controls a large quantity of economic assets, both directly (about half of the land is in public hands) and through public enterprises, with assets valued at more than 60 per cent of GDP in 2014[99] . Public enterprises generated 22 per cent of value added in the non-financial

[96] IMF (2014). Government of Ukraine Report on diagnostic study of governance issues pertaining to corruption, the business climate and the effectiveness of the judiciary. Available at: https://www.imf.org/external/pubs/ft/scr/2014/cr14263-a.pdf

[97] World Bank (2016). Asset declarations: a threat to privacy or a powerful anti-corruption tool? Available at: https://www.worldbank.org/en/news/opinion/2016/09/26/asset-declarations-a-threat-to-privacy-or-a-powerful-anti-corruption-tool

[98] EU-Ukraine Association Agenda - endorsed by the EU-Ukraine Association Council on 16 March 2015. Available at: http://eeas.europa.eu/archives/docs/ukraine/docs/st06978_15_en.pdf

[99] https://www.imf.org/external/pubs/ft/scr/2016/cr1631.pdf

corporation sector in 2015[100]. However, many enterprises were making losses and remained potential sources of fiscal risk. In 2014, the Ministry of Finance estimated that almost 2.5 per cent of GDP was directed to SOEs for mandated programmes and cost-recovery purposes. SOE operations were also a source of corruption because of the lack of appropriate control mechanisms and insufficient transparency.

Box 12. Judicial sector[101]

The reform of the judiciary has been acknowledged as a pressing issue for Ukraine. The principle of respect for the rule of law featured prominently in the AA as indispensable for Ukraine to further associate politically with the EU. The lack of progress in this area undermined progress in other areas. For instance, despite the significant improvements in AC, such as the setting-up of the institutional infrastructure, there has been a striking lack of court verdicts on high officials facing corruption allegations, severely undermining public trust in the judiciary system. Generally, public trust in the core state institutions in Ukraine remains low, including compared to its peers in the European Eastern Neighbourhood. No statistics are available on the courts specifically, but 79 per cent of the population did not trust the judiciary in 2015[102], while 59 per cent did not trust it in 2018[103].

Box 13. Energy sector

Since its independence in 1990, the lack of reform in Ukraine's energy sector undermined its public finances, economic growth and job creation, and left the door open to political pressure from foreign energy suppliers. For years, Russia used the large dependence on its gas supply as a political weapon, threatening Ukraine with gas cut-offs and price increases[104]. Another problem was the high presence of oligarchs in state-run energy companies, together with domestic corruption that used price differences and subsidies to achieve higher profits at the expense of the State[105]. Many changes were needed to make the market more transparent and accountable, particularly regarding the energy regulatory authority (NEURC), which was not politically independent (directly attached to the Presidency). Progress was also needed in order to secure a long-term role for Ukraine in the European energy security policy.

Some items on the national reform agenda include the adoption of a 'Gas Sector Reform Plan' in March 2015 (meant to increase its energy efficiency, reduce its dependency on Russia and meet the EU's natural gas standards by allowing competition in the sector). Some progress was made under MFA I and II and the IMF programmes, notably the unbundling of Naftogaz.

[100] IER calculation, based on data from 'National accounts of Ukraine for 2015' Ukrstat publication. Available at: http://www.ukrstat.gov.ua/druk/publicat/kat_u/2017/zb/02/zb_nru2015pdf.zip, p. 143.

[101] The justice sector condition under the business environment area (condition #19, 3rd tranche) has sub-conditions: (i) and iii) are related to judiciary and presented here separately. ii) is related to business environment and presented under business environment.

[102] https://newjustice.org.ua/wp-content/uploads/2018/05/2015_FAIR_July_Public_Survey_Lustration__ENG.pdf

[103] https://newjustice.org.ua/wp-content/uploads/2018/11/1_NJ_October_2018_SurveyPublic_Results_ENG.pdf

[104] Russia cut off gas supplies to Ukraine in 2006, 2008 and 2009.

[105] Balmaceda M. (2008). *Energy dependency, politics and corruption in the former Soviet Union: Russia's power, oligarch's profits and Ukraine's missing energy policy, 1995-2006*. Abingdon: Routledge.

However, Ukraine's energy sector remained one of the least efficient in the world due to high levels of subsidies[106] and much needed to be done to meet the commitments made as part of the Energy Community Treaty. In 2015, Ukraine's greatest economic vulnerability was its energy consumption, with its energy intensity (ratio of energy used to economic output) almost twice the EU average[107].

Box 14. Social safety nets - energy sector

Elevated poverty levels[108], continuing fiscal pressure and an inefficient and subsidised energy model meant that social assistance reforms were a key priority for Ukraine in 2014-15.

In 2013, average households paid just 20 per cent of the full import price of gas. Large energy subsidies generated adverse effects on the economy and the environment, promoting inefficient resource allocation and excessive energy consumption[109], without ever targeting those who really needed it. The universality of the subsidy and different levels of energy consumption patterns across income deciles ended up benefitting richer households - only 13 per cent of the subsidies were used by the bottom quintile[110]. The regressive structure of the energy model also generated disincentives to enhance energy efficiency levels, while the subsidy structure was extremely costly for public finances. Reforms to the energy market in Ukraine thus increased energy prices substantially. The retail price of gas increased by 587 per cent in three years, from UAH 1,089 per tcm in 2014 for most consumers to UAH 6,958 in May 2017. Ukraine also removed the unsustainable energy subsidies by unifying household and industrial natural gas tariffs and setting them at the level of import parity in 2016[111].

MFA III conditionalities aimed to strengthening the social safety net (delivered through different utility subsidy schemes) in order to cushion the impacts of energy reform and improve its targeting[112]. This reinforced similar policy conditions promoted by the IMF programme.

---

[106] Financial Times (2014). Ukraine's economy: broken down, August 2014. Available at: https://www.ft.com/content/63e0a202-26fb-11e4-a46a-00144feabdc0

[107] IER calculations based on data from BP's Statistical Review of World Energy https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/xlsx/energy-economics/statistical-review/bp-stats-review-2020-all-data.xlsx and GDP at constant prices from the World Bank https://data.worldbank.org/indicator/NY.GDP.MKTP.PP.KD

[108] In 2015, the poverty rate – in terms of the actual subsistence minimum – was 52 per cent. In 2016, there were 1.7 million IDPs and 2.8 million people with disabilities. According to the United Nations Development Programme (UNDP), about 60 per cent lived below the poverty line. UNDP (2016). Human Development Report 2016. Human Development for Everyone. Available at: https://www.ua.undp.org/content/ukraine/en/home/presscenter/pressreleases/2017/03/30/too-many-lives-scarcely-touched-by-human-development-progress-un-report-finds.html

[109] Ogarenko, I. and Hubacek, K. (2013). Eliminating indirect energy subsidies in Ukraine: estimation of environmental and socioeconomic effects using input–output modelling. *Economic Structures,* 2 (7). available at: https://doi.org/10.1186/2193-2409-2-7

[110] World Bank, (2017). ESMAP: 'Ukraine'. Available at: (http://documents.worldbank.org/curated/en/884621506493335975/pdf/120076-26-9-2017-11-9-3-FINALESMAPCountryBriefUkraine.pdf).

[111] *ibid.*

[112] European Commission (2015). Proposal for a Decision of the European Parliament and of the Council Providing Macro-Financial Assistance to Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015PC0005&from=EN

Box 15. Social safety nets - IDPs

The first IDPs began to flee in April 2014 and IDP waves intensified from August to October 2014. At the time, Ukraine faced significant threats to its territorial integrity and socioeconomic situation, but had no experience of dealing with an IDP crisis, making an immediate and appropriate response difficult. An assistance programme for persons forced to leave their homes as a result of the conflict in eastern Ukraine was launched by the Ukrainian government in November 2014 for an initial period of six months. A few months later, at the time of the MFA III negotiations, the need to extend the programme beyond that initial period became evident and the MFA leverage was used to ensure that the programme would be renewed beyond its original timeframe. The MFA also supported an evaluation of policies in favour of IDPs, given the lack of comprehensive and neutral information at the time.

Box 16. Business environment – trade and customs, deregulation

Conditionality in the area of trade and customs promoted by the MFA III followed up MFA I and II conditions and were in line with Ukraine's commitments under the AA/DCFTA. The rationale of the customs conditions was to give Ukrainian businesses faster and broader access to the EU single market and deepen the trade relations between Ukraine and the EU, by adding further steps to comply with the European customs legislation and facilitating simplified border crossing of trusted traders.

The focus on removing trade barriers and trade irritants is particularly relevant for EU businesses, but was questioned by some stakeholders in the context of the wood export ban issue.

MFA III included two conditions to improve the business environment in general and facilitate FDI in Ukraine, which had been severely affected by the conflict with Russia. More precisely, the conditions entailed reducing the number of permits and simplifying permit and licensing procedures, and ensuring effective enforcement of contracts.

Box 17. Financial sector

The financial sector in Ukraine underwent major changes in recent years, with a particularly deep overhaul in 2014 and 2015. The shared objective was to build a new and sustained post-crisis banking sector, with new and more transparent rules in place to strengthen public confidence in the banking system. MFA III, as well as other donors (particularly the IMF), supported the reform of the sector.

More specifically, MFA III conditions were intended to address the high level of credit exposure to related parties and enhance transparency of the level of credit risks.

6 Coherence

Question 6: *Were the measures of the MFA operation in line with key principles, objectives and measures taken in other EU external actions towards Ukraine?*

6.1 Policy frameworks and principles

Ukraine is a priority partner for the EU. More than EUR 15 bln in grants and loans have been mobilised by the EU and the financial institutions since 2014 to support the country's reform process[113].

In recent years, EU–Ukraine cooperation, underpinned by two broad frameworks, the ENP[114] and the Eastern Partnership[115], have strived for progressive economic integration and the deepening of political cooperation. With lengthy negotiations dating back to 2007, several milestones were achieved with the signature of the AA in 2014, followed by the entry into force of (i) the same AA, in 2017[116], (ii) the DCFTA, in 2016, and (iii) visa-free travel for Ukrainian citizens with biometric passports, as of June 2017.

6.1.1 Signature of the AA

The Maidan events in early 2014 accelerated the signature process of the AA. The first political chapters of the AA were signed in March 2014[117], with the remainder signed on 27 June 2014. The AA replaced the outdated Partnership and Cooperation Agreement (signed in 1994) as the basic legal framework of EU-Ukraine relations[118].

The political purpose of the AA is to deepen the political association and economic integration of Ukraine with the EU. This means working towards and upholding fundamental European values of democracy, the rule of law and respect for human rights and norms of the European security order. This is intended to be achieved through increased cooperation and approximation of EU law. The DCFTA is an integral part of the AA.

The AA entered fully into force on 1 September 2017, having been provisionally applied since November 2014 (January 2016 for the DCFTA)[119]. To guide the process of reforms and define priorities, an updated version of the AA was adopted by the EU-Ukraine Association Council on 16 March 2015[120].

Similar to the AA, the MFA operations served both as a political signal and a driver for reform at a more granular level.

Mapping the conditions of the MFA III against the short-term priorities established in the AA shows how MFA operations' conditionalities fed into the implementation of the AA. Reforms related to democracy, rule of law, human rights and fundamental freedoms were not addressed by MFA conditionalities, as these are areas outside the typical scope of this instrument.

---

[113] EU Neighbours (2020). Facts and figures about EU-Ukraine relations. Available at: https://www.euneighbours.eu/en/east/stay-informed/publications/facts-and-figures-about-eu-ukraine-relations-0

[114] EEAS (2017). Policy. Available at: http://ec.europa.eu/world/enp/policy_en.htm

[115] EEAS (2017). Eastern Partnership. Available at: http://eeas.europa.eu/eastern/index_en.htm

[116] Political and cooperation provisions of the AA have been provisionally applied since November 2014.

[117] EU External Action (2015). EU-Ukraine relations. Available at: http://eeas.europa.eu/archives/docs/statements/docs/2014/140514_02_en.pdf

[118] Article 479 EU-Ukraine AA.

[119] European Commission (2017). EU-Ukraine Association Agreement fully enters into force. Available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_17_3045

[120] EU-Ukraine Association Agenda to prepare and facilitate the implementation of the Association Agreement As endorsed by the EU-Ukraine Association Council on 16 March 2015. Available at: http://eeas.europa.eu/archives/docs/ukraine/docs/st06978_15_en.pdf

Table 14. High level comparison of the AA's short-term priority for action and MFA III areas of conditionality

AA short-term priority for action	MFA III
Constitutional reform	X
Election reform	X
Preventing and combating corruption	✓
Judicial reform	✓
Public administration reform	✓
Deregulation	✓
Public procurement reform	✓
Taxation reform, including VAT refunds	✓
External audit	✓
Energy sector reform	✓

6.1.2 Visa Liberalisation Action Plan (VLAP)

The visa-free regime deal entered into force on 11 June 2017, allowing Ukrainian citizens with a biometric passport to enter the Schengen Area for a period of stay of 90 days in any 180-day period[121]. In 2008, the Commission initiated a dialogue on visa liberalisation with Ukraine with the aim of identifying all of the relevant conditions necessary to fulfil before EU visa-free travel could be granted. These are primarily linked to the Justice and Home Affairs (JHA) area. The only area that MFA and VLAP have in common is the fight against corruption (covered in VLAP since 2011). Table 15 maps the MFA III conditions against the relevant VLAP benchmarks that had to be achieved at the time MFA III was designed and over the lifetime of the operation, together with their implementation status.

[121] European Commission – Migration and Home Affairs. Visa liberalisation with Moldova, Ukraine and Georgia. Available at https://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/eastern-partnership/visa-liberalisation-moldova-ukraine-and-georgia_en

Table 15. Conditions under MFA III and VLAP (common areas only)

	MFA III	VLAP
AC	Condition 6, Second tranche under MFA III. *Establish a National Anti-Corruption Bureau, a specialised Anti-Corruption Prosecution Office and a National Agency for the Prevention of Corruption, ensuring that they are independent and operational, i.e. endowed with the financial resources, staff and equipment required to perform their functions.* Condition 5 Third tranche under MFA III. *Set up an electronic asset disclosure system for public officials, including a verification mechanism, while starting to verify assets and possible conflicts of interest on the basis of the paper-based asset declarations submitted by officials in 2015.* Condition 6 Third tranche under MFA III. *Following the establishment of an online database on beneficial ownership of companies, put in place mechanisms to verify, post-registration and on a selective basis following clear criteria, the accuracy of the information provided by companies and enforce compliance with this obligation.* Condition 7 Third tranche under MFA III. *In order to ensure that officials accused of corruption cannot benefit from the proceeds of their corruption offences: (i) designate an institution to act as Asset Recovery Office; and (ii) adopt operational guidelines, including a framework for inter-agency cooperation, for the implementation of extended and civil confiscation provisions.*	The Fifth Progress Report on the Implementation by Ukraine of the Action Plan on Visa Liberalisation (8 May 2015) is the first progress report on the second phase of the VLAP, where the state of implementation of the legislative and policy framework is assessed. Progress made until then in the AC field (Block 3) was at legislative level. However, the report noted the lack of prioritisation and coherence in the measures implemented. The AC benchmark was deemed to be only partially achieved at this stage. The European Commission made further recommendations: - *Ensure anti-corruption coordination mechanism to implement the anticorruption strategy and ensure a consistent approach at political level*. - *Establish an operational and independent National Anti-Corruption Bureau, a specialised anti-corruption prosecution office and a National Agency for Prevention of Corruption, with clear guidelines for inter-agency cooperation.* - *Put in place procedures to ensure: the timely publication of all current asset declarations; effective verification of assets and conflicts of interest of public officials; full operability and accuracy of central electronic databases, including on asset declarations and beneficial ownership; and a unified web portal disclosing public expenditure.*

	- Establish a national Asset Recovery Office and effective inter-agency coordination to establish an asset recovery record. *- Pursue the immunity reforms related to judges and Members of Parliament.* The Sixth (and last) Progress Report on the Implementation by Ukraine of the Action Plan on Visa Liberalisation (18 December 2015) stated that under the second phase of the action plan Ukraine was progressing on legislative and institutional aspects of AC policies. As a result of the progress made and additional commitments of the Ukrainian government, the AC benchmark was deemed to have been achieved. The AC areas under Block 3 included: *Creation of the National Anti-Corruption Bureau (NABU) and appointment of its head following an open and competitive process.* *Establishment of the National Agency for the Prevention of Corruption (NAPC) and election of the Agency's board. The NAPC is entrusted with the task of checking asset declarations.*

Source: MFA III MoU and VLAP fifth progress report, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0200&from=EN; VLAP sixth progress report available at: https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-905-EN-F1-1.PDF

6.2 EU financial cooperation with Ukraine

In March 2014, the European Commission announced a comprehensive support package to Ukraine incorporating short and medium-term measures: '*to help stabilise the economic and financial situation in Ukraine, assist with the transition, encourage political and economic reforms and support inclusive development for the benefit of all Ukrainians'.* The package drew on the EU budget directly on the one hand, and increased lending from the EIB and EBRD on the other[122].

Overall, the anticipated support for the period 2015-2020 initially amounted to EUR 11.2 bln but progressively increased to EUR 15 bln (when MFA III and later MFA IV were approved). The share made up by all four MFA instruments is 30 per cent of the rescue package.

Table 16. EU financial support

Source	**Actual situation of commitments (EUR mln)**
I. EUROPEAN UNION BUDGET (2014-2019)	6,461.5
I.1 Overall development assistance 2014-2019	*1,472.2*
I.2 Foreign Policy Instrument	*246.5*
I.3 Other support from the EU budget	*332.8*
I.4 Macro-financial assistance (concessional loans)	*4,410 (Programmes I-IV)*
II. FINANCIAL INSTITUTIONS	8,600
EIB (2014-2016)	*4,600*
EBRD (for five years)	*4,000*
GRAND TOTAL	**15,061.5**
EU Member State bilateral support	1,378.1

Source: SGUA

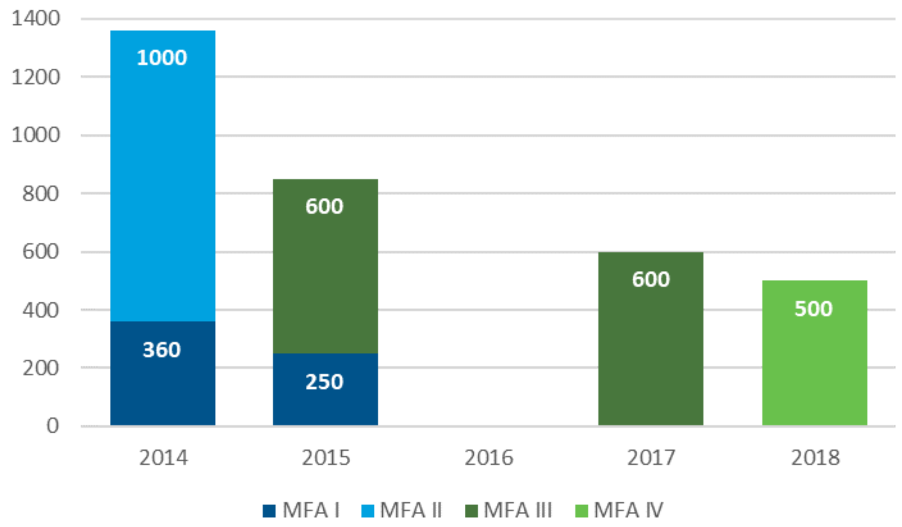
6.3 Coherence with other EU programmes and initiatives

6.3.1 MFA III and other MFA operations

Overall, between 2014 and 2018 Ukraine benefitted from a total of EUR 3.3 bln of EU MFA loans (MFA I, II, III and IV combined) (see Figure 17). This includes EUR 1.6 bln disbursed in 2014-2015 as part of MFA I and MFA II operations, and EUR 1.2 bln disbursed in 2015-2017 as part of MFA III. This third operation represents 36.25 per cent of total MFA support in terms of disbursements.

[122] European Commission (2014). European Commission's support package to Ukraine. Available at: http://europa.eu/rapid/press-release_MEMO-14-159_en.htm

Figure 17. MFA to Ukraine, by MFA operation, 2014-2018, in EUR mln (disbursement data)



Source: *Annual reports on the implementation of the EU's instruments for financing external actions*

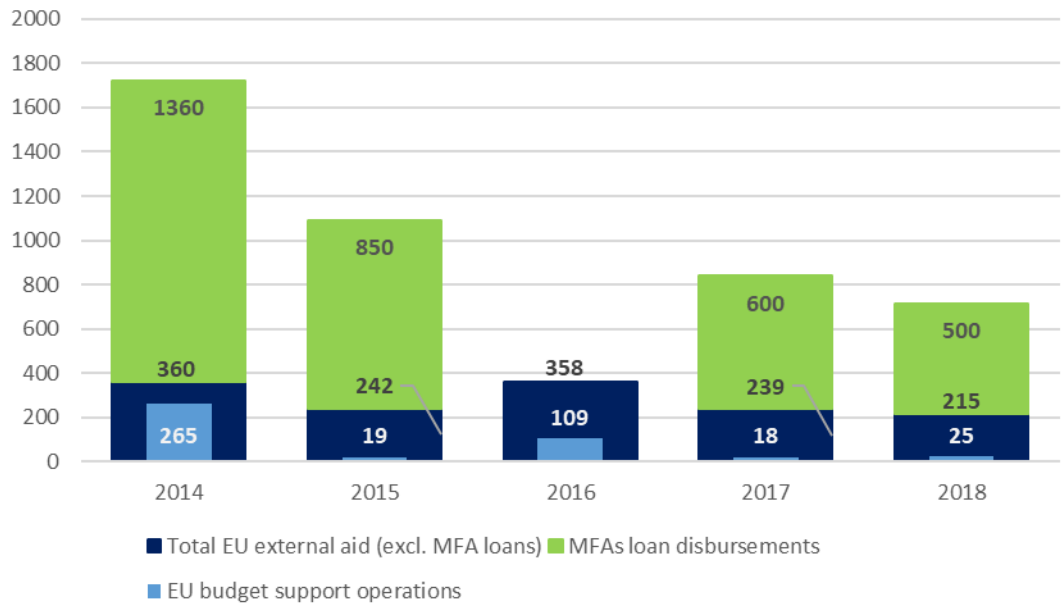
In some policy areas, MFA III seemed to continue the measures initiated in MFA I and II (see **Error! Reference source not found.**). This was the case for the public finance management reform area, where MFA III conditions were complementary and aimed to deepen the reforms already underway. MFA III continued to focus on some reform areas while specifying more concrete actions than MFA I and II (e.g. AC: establishment of the Anti-Corruption Bureau). By contrast, some reform areas were introduced only by MFA III: public administration (e.g. open and competitive selection process system for civil servants); competition (e.g. a more efficient competition policy); deregulation (e.g. simplified permits and licences for businesses); and judicial reform (e.g. qualification and evaluation system of judges). MFA IV is designed to continue addressing most of the reform areas MFA III covered, while adding conditions in new reform areas, such as the health system (e.g. implementation of the reform of healthcare financing).

6.3.2 MFA in the context of the overall EU budget support package

Figure 18 looks at MFA disbursements in the context of total EU external aid and EU 'budget support' assistance. While all types of aid are coherent elements of the broader support provided to Ukraine, only budget support assistance is intended to stabilise the macroeconomic situation while encouraging reform.

Overall, between 2014 and 2018, EUR 3.3 bln was disbursed via MFA operations (MFA I, II, III, IV), while budget support programmes amounted to EUR 436 mln.

Figure 18. EU external aid to Ukraine, by type, and MFA, 2014-2018, in EUR mln (disbursement data)



Source: Annual reports on the implementation of the EU's instruments for financing external actions; budget support - trends and results reports; ECFIN website for information on MFA (available at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/international-economic-relations/enlargement-and-neighbouring-countries/neighbouring-countries-eu/neighbourhood-countries/Ukraine_en).

Note: The data refer only to external aid financed through the EU budget and do not include bilateral aid from Member States.

After the MFA, the most sizable budget support programme implemented in Ukraine is the SBC, with a total disbursement of EUR 305 mln between 2014 and 2016. The SBC is grant assistance that supports addressing short-term economic problems in Ukraine (first fixed tranche) and preparing for in-depth reform in the context of political association and economic integration with the EU on the basis of the AA/DCFTA (second variable tranche)[123]. The first tranche of EUR 250 mln was disbursed upfront in June 2014[124] while the second and last variable tranche (to a maximum of EUR 105 mln) was only partly disbursed (EUR 55 mln) by the end of 2016.

The remaining budget support programmes under which disbursements were made between 2014 and 2018 consist of sectoral programmes in the areas of energy and public administration. These are explored in the following sub-sections.

6.3.2.1 State Building Contract (SBC)

The SBC was the responsibility of DG Neighbourhood and Enlargement Negotiations (NEAR). The SBC provided budget support as specified in European Commission guidelines. This was similar in some respects to the MFA – both involved 'the transfer of financial resources to the National Treasury of a partner country, following the respect by the latter of agreed conditions for payment'[125]. However, differences

[123] See budget support guidelines at: https://ec.europa.eu/europeaid/sites/devco/files/methodology-budget-support-guidelines-201209_en_3.pdf

[124] During the same month as the first tranche of MFA II (EUR 500 mln).

[125] Budget support guidelines. Available at: https://ec.europa.eu/europeaid/sites/devco/files/methodology-budget-support-guidelines-201209_en_3.pdf .

exist[126]. Conceptually, the MFA is intended for exceptional use only, unlike budget support programmes, which are meant to provide a regular financial support framework for structural changes or - more generally - the economic and social development of the beneficiary countries. SBC was grant assistance. Unlike the MFA, it does not have a limited availability period and fixed tranches. Rather, disbursement is proportionate to progress made.

The SBC was adopted in 2014 in response to the rapidly changing environment and the need for reform. It was part of a EUR 365 mln special measure, comprising the SBC itself (EUR 355 mln) and a EUR 10 mln support programme for civil society[127].

The SBC had two general objectives: to support the government of Ukraine in addressing short-term economic problems (a first fixed tranche); and to prepare for in-depth reform in the context of political association and economic integration with the EU on the basis of the AA/DCFTA (a second variable tranche). Apart from the financial incentive, the SBC relied on policy dialogue with government and civil society to promote structural reform. Assessments of progress – on the basis of which decisions about disbursements are made – are based on reports by third parties (government ministries, the Venice Commission, OECD SIGMA, OSCE Office for Democratic Institutions and Human Rights (ODIHR), civil society). To ensure that civil society played its overseeing role, the SBC programme envisaged strengthening the capacities of civil society. This was done through the additional EUR 10 mln support programme to civil society, which was implemented through grants (calls for proposals – with some co-financing from the granted organisations) and technical assistance projects.

The first tranche of EUR 250 mln was provided upfront in June 2014[128], with the main objective of macroeconomic stabilisation. The second (and last) variable tranche of maximum EUR 105 mln (conditional on progress with reforms), was initially planned to be disbursed by the end of 2015. However, it was only partly disbursed (EUR 55 mln) by the end of 2016, reflecting only partial compliance with the benchmarks that had been set.

Reform areas targeted by the SBC included: fight against corruption and preparation for public administration reform, including reform of the national civil service and service in local self-government bodies; improved public finance management; constitutional reform; and electoral reforms. At the time MFA III was designed, the SBC programme was in place but the benchmarks for the second tranche were yet to be met. MFA III reinforced the message (with additional firepower) on several key conditions (with very similar wording) in respect of setting up the verification of the asset declaration system, the entry in force of the Law on civil service, and the transparency around PP contracts. Additional synergies can be found in the wider areas of AC, judicial system reform and public finance management.

6.3.3 EU sectoral budget support

Budget support to Ukraine started in 2008 and was tied to reforms in six areas: energy strategy, energy efficiency, trade, environment, transport and border protection[129]. Most of the EU budget support provided between 2014 and 2018 was

[126] See budget support guidelines at: https://ec.europa.eu/europeaid/sites/devco/files/methodology-budget-support-guidelines-201209_en_3.pdf

[127] The EUR 10 mln support programme to civil society (which aims at strengthening CSOs so that they are better equipped to participate in the reform process) is not a budget support-type instrument. It is implemented through grants (calls for proposals – with some co-financing from the granted organisation) and technical assistance projects to complement the SBC and make sure civil society that can effect oversight of the bodies.

[128] During the same month as the first tranche of MFA II (EUR 500 mln).

[129] Open Society Foundation (2014). Report on budget support provided to Moldova, Georgia and Ukraine. Available at: http://archive.eap-csf.eu/assets/files/WG1_EU%20Budget%20support_last_en.pdf

linked to the SBC discussed above. Only EUR 131 mln was provided under various sectoral budget support programmes[130]. Between 2014 and 2018, the number of those programmes was scaled back, from six to two. The only new commitment made during that period (in 2016) was for the Public Administration Reform Programme (EUR 90 mln).

As highlighted during interviews and evident from programme documentation, there was a high level of synergy between the two programmes in relation to the adoption of the public administration reform strategy (reportedly a prerequisite for the launch of the public administration reform programme that the MFA helped to unblock) and the adoption of merit-based recruitment systems (still being pushed through as part of the public administration reform).

The other ongoing programme is that of the energy sector (EUR 28.5 mln), which dates back from 2013[131]. Indicators for the disbursement of the variable tranches have been updated to reflect current priorities. Synergies with MFA III conditions are evident, as the energy sector continues to push for Extractive Industries Transparency Initiative milestones to be achieved. Like the linked IMF EFF programme, it also promotes the reform of energy tariffs.

6.3.4 The extent to which the MFA operation complemented external/international support programmes

The EU MFA is generally intended to supplement the assistance provided by the IMF and other donors. More specifically, its disbursement is generally conditional on 'a satisfactory track record in the implementation of the Extended Fund Facility (EFF) agreed between Ukraine and the International Monetary Fund', as well as on a 'positive assessment […] of progress made with respect to economic stabilisation and structural reforms'[132]. MFA conditionalities often complement the reform package associated with the IMF's arrangements with beneficiary countries.

Annex 6 compares the focus areas of all MFAs (including MFA III) with IMF (SBA/EFF) and World Bank (F/DPL-1 and F/DPL-2) conditionality, highlighting areas of complementarity, cross-conditionality and specific conditionality[133]. It also maps the EBRD's focus of work in the policy domain (policy dialogue, technical assistance at policy level).

That mapping shows many synergies between donors, in most areas. Many cases of cross-conditionality at the same or different points in time can be observed. The list below provides some examples of these synergies:

- In the case of the implementation of a PP system in line with EU standards (MFA I), the IMF introduced a similar condition, calling for the adoption of a new PP law. Likewise, the World Bank also urged the adoption of a new PP law reducing the exemptions in competitive procurements (World Bank, DPL 1). In parallel, the EBRD established commitments to engage in technical assistance projects, training and cooperation in the area of PP. MFA III then followed up with the introduction of an e-procurement system.
- While MFA III called for the creation of the NABU, the Specialised Anti-Corruption Prosecution Office (SAPO) and the NAPC, MFA IV envisaged a fully operational High Anti-Corruption Court and an anti-money laundering law. The

[130] Budget support. Trends and results reports.

[131] The implementation has been lagging behind. Its signature dates back to the Poroshenko era and it has suffered from a lack of ownership on the Ukrainian side. It played no significant role in the advancement of the reforms in the energy domain in Ukraine and will expire at the end of 2020. Its complementarities with MFA III will not be further explored.

[132] European Commission (2015). Memorandum of Understanding between the European Union and Ukraine.

[133] In the Ukrainian context, the first and second FDPLs (approved in August 2014 and September 2015, respectively) will be screened for any links.

IMF also aspired to strengthen NABU's powers and establish an anti-money laundering framework. All IFIs consistently pushed for the verification of the asset declaration system, similar to MFA III and IV.

- In relation to NBU reform, the EU put in place conditions on systemic banks (MFA II) and on related counterparties (MFA III). By contrast, the IMF tied its support to conditions related to internal control rules and governance and autonomy framework of the NBU. This last condition was reinforced by the World Bank, which also introduced the implementation of a crisis management strategy (DPL 1). For its part, the EBRD argued for the recapitalisation of viable banks and financing of corporates.
- On energy sector reform, the EU and the IMF pushed for the adoption of a new Gas Market Law (IMF) and secondary legislation (MFA III). The EU (MFA III), the World Bank (WB DPL2) and the EBRD instead linked their support to strengthening the independence of the regulator. Both EBRD and MFA III are active promoters of energy efficiency. All donors were involved in promoting social safety nets in the wake of increased energy prices.
- The EU was the only donor supporting reforms in the trade area (MFA I, II and III), with complementary technical assistance project support from the EBRD.

Several reform areas saw more of a role split:

- Only MFA III focused on social safety nets for IDPs;
- Agriculture was addressed by both the IMF and World Bank but not by the MFA;
- Monetary policy and pensions were only addressed by the IMF;
- Only MFA IV introduced conditions to reform healthcare financing.

6.3.5 EU technical assistance programmes fostering progress in MFA III areas of focus

Other than budget support, several relevant technical assistance programmes (implemented indirectly via implementing agencies) were established to advance the reforms in MFA III's focus areas (see Annex 6).

7 Effectiveness of the MFA

Question 2: *To what extent have the objectives of the MFA operation been achieved?*

The objectives of MFA III to Ukraine, as set out in the MoU, were to 'to ease the Country's external financing constraints, alleviate its balance of payments and budgetary needs, strengthen its foreign exchange reserve position'. It also aimed to support structural reform.

Two strands of analysis are needed to answer the question on effectiveness:

Part 1: The role of MFA III in promoting macroeconomic stability, easing external financing constraints and alleviating Ukraine's balance of payments and budgetary needs.

Part 2: Effectiveness of structural reforms.

7.1 Part 1: The role of MFA III in easing external financing constraints, alleviating Ukraine's balance of payments and budgetary needs and strengthening the exchange rate

To assess the role of MFA III in promoting macroeconomic stability, easing external financing constraints and alleviating Ukraine's balance of payments and budgetary needs, a two-step approach has been applied:

- Step 1: Examining the observed macroeconomic outcomes

This step involves the analysis of the actual developments and the extent to which MFA III objectives were achieved, irrespective of its actual role.

- Step 2: Assessing the role and contribution of MFA III to observed outcomes

Based on the context explored in Step 1, Step 2 takes a qualitative approach to assess the role and contribution of MFA III. It comprises inferences from the desk research (including the analysis of macroeconomic data), semi-structured interviews, Delphi survey, and views of local economic experts, and explores the potential consequences had the MFA III (with or without IMF support) not been deployed.

A summary of the DSA evaluating the role of MFA III for the sustainability of the public debt during the implementation period also substantiated this assessment.

7.1.1 Step 1: Examining the observed outcomes compared to the initial projections

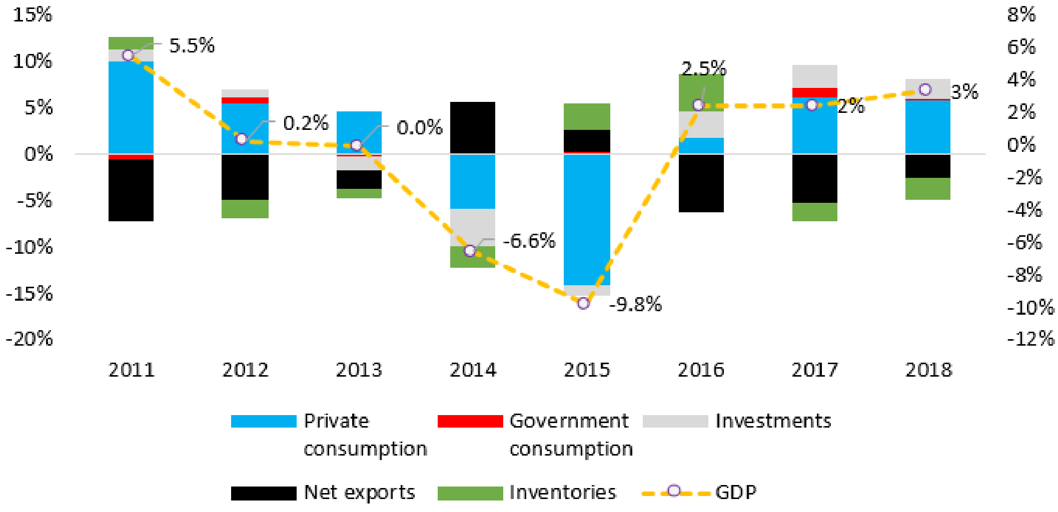
This section describes the evolution and underlying factors behind GDP growth and continues with an analysis of the external sector, public sector finances, inflation and the situation in the banking sector. It draws on the analysis of these variables for the period 2014-2016 that was conducted as part of the evaluation of the MFA I and II assistance[134], substantiated by an analysis of more recent developments in 2017.

GDP growth

The decomposition of the key drivers of GDP is presented in Figure 19.

[134] European Commission (2017). Ex post evaluation of the MFA I and II to Ukraine. Available at: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities/ex-post-evaluation-mfa-operations-ukraine_en

Figure 19. Decomposition of real GDP trend, 2011-2018



Source: *Ukrstat and IMF WEO*

From 2014, the escalation of the conflict in the East was taking its toll on industrial production and tax collection in the region. The crisis was aggravated through the year, with household consumption particularly badly hit when the economic and political uncertainty saw the hryvnia depreciate rapidly. Real gross value added fell in all sectors in 2014. The only exceptions were agriculture and non-market services (public administration, defence, healthcare, social work). Uncertainty and instability in the banking sector led to restrictions in access to financing and was responsible for the fall in investment. The rise in net exports was driven by faster contraction of imports than exports and corresponded to a sharp decline in energy imports and (some) import substitution[135].

Output continued to fall in 2015 (by 9.8 per cent) as a result of the implications of the conflict for the economic development of other regions of Ukraine. Disrupted economic links, the lack of certainty and gloomy business sentiment continued in the first half of 2015, with private consumption dropping by 15 per cent (year-on-year). The recession would have been even deeper had there not been a broad-based recovery from mid-2015, when the foreign exchange rate stabilised (thanks to the financial support provided) and most economic sectors (apart from financial services) performed better in Q3 and Q4 2015[136].

In 2016, private consumption - traditionally a key engine of growth - rose modestly and growth was also propped up by an increase in investment. For instance, the investment in fixed capital grew by 20 per cent, despite hovering at a very low level as a share of GDP (circa 15 per cent). Investment was stimulated by the need to replace obsolete equipment after a number of years of major under-investment. The fall in net exports was determined by increased demand for imported investment products and goods, and a rise in household spending that in turn fuelled import growth. Exports were still constrained by conflict in the industrial Donbas and trade disputes with Russia. All in all, the economy rose by 2.3 per cent in 2016 and the stabilisation that commenced in mid-2015 had solidified by the end of 2016.

In 2017, real private final consumption jumped by 9.5 per cent, due to real disposable income growth at 10.9 per cent. Higher investment in equipment and larger fiscal capital outlays helped real gross fixed accumulation to recover by 16.1 per cent. At the same time, higher domestic demand caused rapid import growth (at 12.6 per

[135] IER (2016). Year 2015 – Economic summary for Ukraine.

[136] *ibid.*

cent). Exports increased by only 3.8 per cent (primarily due to higher exports to the EU). As a result, the real net export contribution to real GDP growth was negative, at 5.2 percentage points (p.p.)[137]

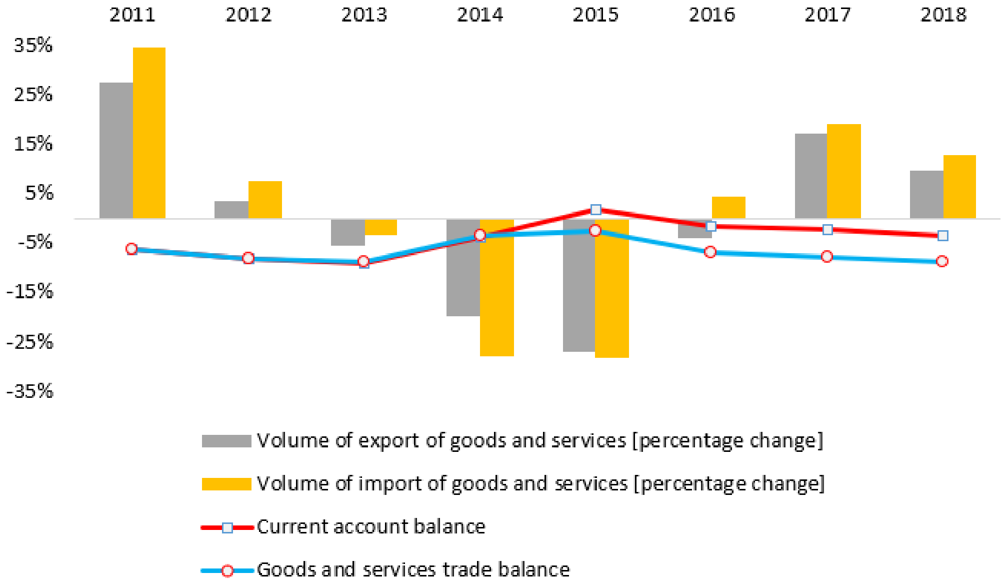
External sector

The current account deficit grew rapidly in the run-up to early 2014. It reached -8.4 per cent of GDP in 2012 and increased to -9.1 per cent in 2013 (Figure 20). From then on, however, a sizable adjustment took place and the deficit reduced to -3.4 per cent in 2014, with a current account surplus reported in 2015 (1.8 per cent). The current account deficit returned at -1.4 per cent in 2016, and then increased moderately in 2017, reaching -2.2 per cent.

Generally, the depreciation of the hryvnia was pivotal in the improvement of the current account balance, especially up to mid-2015 (the fall in imports exceeding the fall in exports). The adjustment took place on the back of an amelioration of the trade balance, primarily with the EU and Asia partners, and to certain extent as a consequence of rising tensions in trade relations between Ukraine and Russia[138], leading to a decrease in energy imports. Improvement in the trade balance of goods with Russia was to some extent offset by the decline in exports of services (Russian tourists and transit of gas). The worsening of the current account balance in 2016 was driven by a sizable rebound in investment activity that propped up imports (see above), as well as the gradual rebound in commodity prices (including gas and oil) that still offset the rise in steel and grain prices so welcome to Ukrainian exporters.

In 2017, the current account deficit widened slightly, to -2.2 per cent of GDP. Consumption growth and moderate recovery fuelled an increase in trade deficit and investment income payments. This effect was partly offset by higher remittances from Ukrainian labour migrants.

Figure 20. Current account balance and its main components, 2011-2018



Source: *NBU and Ukrstat*

[137] IER (2018). Monthly economic monitor Ukraine No.4 (210), April 2018.

Available at http://www.ier.com.ua/en/publications/regular_products/monthly_economic_monitoring/?pid=5846

[138] The overall trade volume with Russia shrank from 27 per cent in 2013 to 15 per cent in 2015.

General government budget

From 2012, government revenue and expenditure fell as a share of GDP. In 2014, public expenditure was somewhat contained, given the liquidity constraints and delayed budgetary payments channelled to the areas in the East affected by the conflict with Russia. In addition, the authorities embarked on fiscal consolidation, which allowed them to successfully negotiate the IMF SBA (e.g. financing for most of the programmes comprising social spending and capital outlays was lowered). Traditionally generous state aid to coal mines and agriculture was curtailed, while the rise in wage payments was restricted. The decline in revenue in 2014 was driven by a sharp drop in tax collection from the Eastern regions (including Donbas) since the escalation of the conflict.

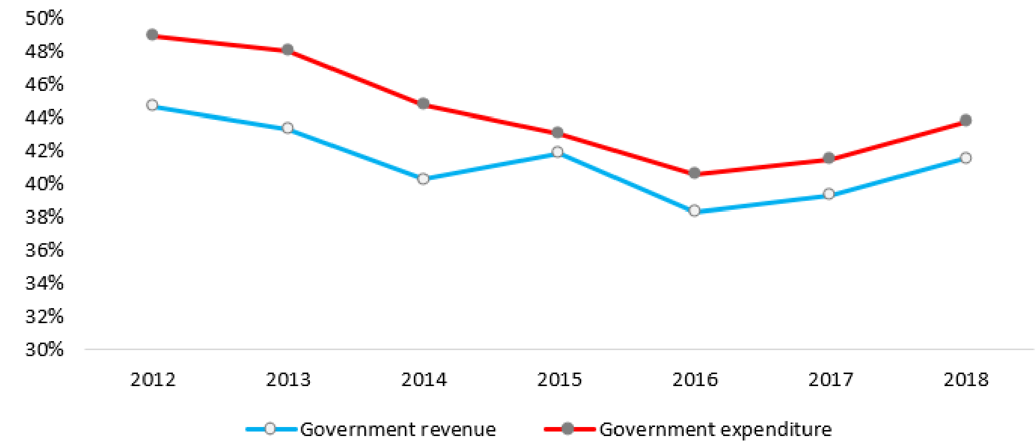
Fiscal adjustment reached an apex in 2015, when the government pressed ahead with the full scale fiscal consolidation, concentrating chiefly on public wages, pensions and subsidies. For instance, the cuts in subsidies to the Naftogaz (compensated by the rise in energy tariffs) had a considerable impact on expenditure. More generally, government expenditure declined from 48.1 per cent of GDP in 2013 to 43 per cent in 2015, while the primary balance rose to 3 per cent for the whole year (Figure 21).

In 2016, both expenditure and revenue continued to fall as a proportion of GDP, with the former declining more, as an offshoot of a steady loosening of the fiscal stance after consolidation in 2015 (e.g. sizable rise in spending on housing and utility subsidies to offset the new round of increases in energy prices for households, and increase in spending on defence and security due to continued conflict in the East). Overall, the fiscal balance ameliorated substantially in 2015, after which modest deterioration was observed, alongside some loosening in expenditure that year (Figure 22).

In 2017, stronger than forecasted increases in nominal GDP led to rapid growth in government revenues. Nominal revenues increased by 29.9 per cent, due to higher collections of all major sources of revenue. Increased wages and more efficient tax administration resulted in the growth of revenue from VAT and income taxes. The growth of non-tax revenue was primarily supported by higher dividends of state-owned companies and a larger transfer of the NBU profit. The government also received UAH 30 bln from special confiscation. Consolidated fiscal deficit was 2.8 times lower than planned, at 1.4 per cent of GDP. This reflected strong revenue and lower than planned consolidated fiscal expenditure. As usual, the capital outlays were most under-financed (by 22 per cent of planned), although their financing surged in December[139].

[139] IER (2018). Monthly economic monitor Ukraine No.2 (207), February 2018. Available at: http://www.ier.com.ua/en/publications/regular_products/monthly_economic_monitoring/?pid=5846

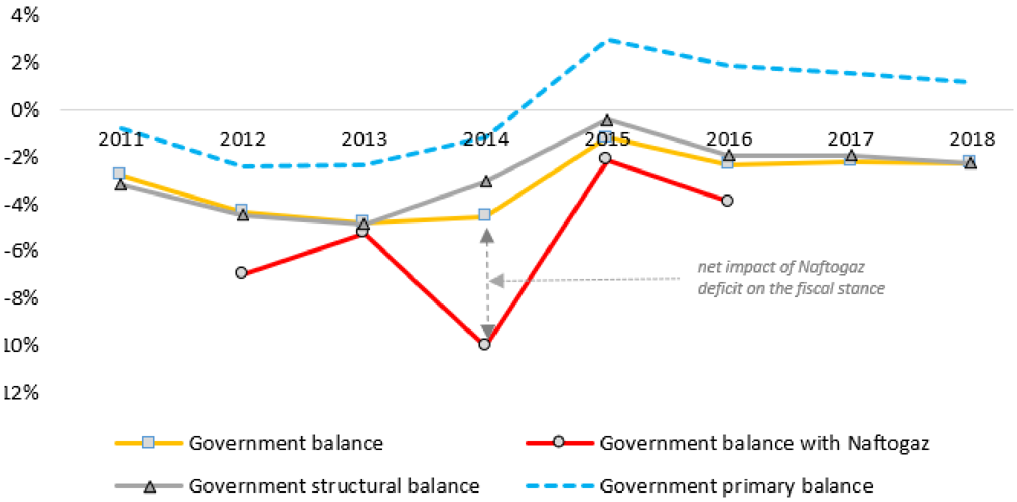
Figure 21. Government revenue and expenditure, in % of GDP, 2012-18



Note: 2014 data without Crimea and Sevastopol; 2015/2016 without Crimea, Sevastopol and areas not under the control of the government in the Donetsk and Luhansk regions.

Source: *IMF WEO*

Figure 22. Fiscal balance in Ukraine, in % of GDP, 2011-18



Note: 2014 data without Crimea and Sevastopol; 2015/2016 without Crimea, Sevastopol and areas not under the control of the government in the Donetsk and Luhansk regions.

Source: *IMF WEO*

Public debt

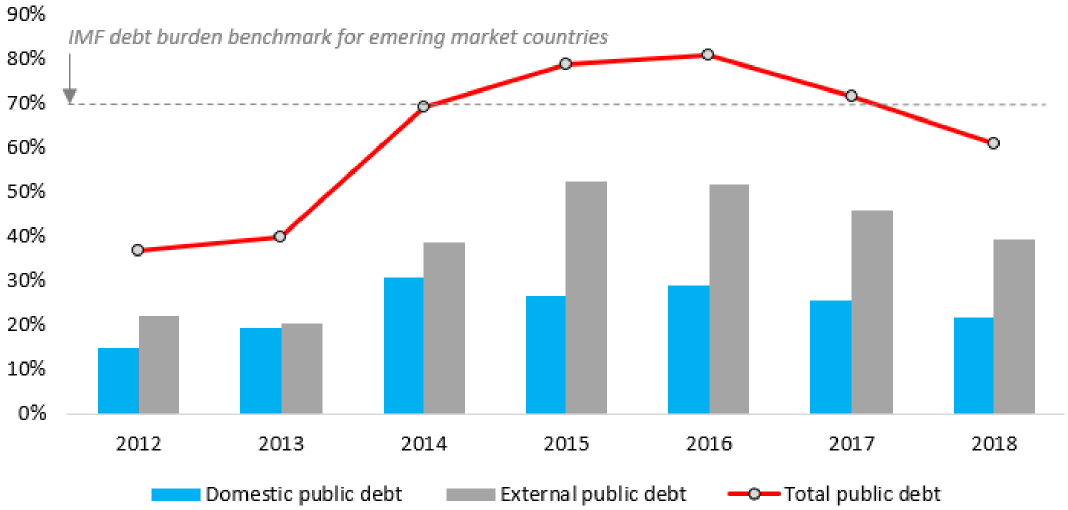
At a relatively contained pace, 2012 and 2013 witnessed a stable rise of the public debt to GDP ratio (Figure 23). By December 2013, public debt increased to 40.5 per cent of GDP, the proportion that was still below the IMF's 70 per cent debt burden threshold (above which debt sustainability is at high risk for an emerging market countries like Ukraine).

The subsequent worsening in both the economic and political environment (given the flaring conflict in the East of the country) led to a deterioration in economic performance. A sharp recession in 2014, when the real GDP declined by 6.6 per cent, severe depreciation of the hryvnia and the contingent liabilities that materialised (including those in SOEs and commercial banks) were some of the key determinants of the rise in the debt-to-GDP ratio. These factors, together with new borrowings (e.g. from the IMF and the EU) translated into the debt ballooning to over 70 per cent of GDP by the end of 2014, or nearly 30 p.p. in just 12 months.

Even had the debt-to-GDP ratio risen to 79 per cent, the trend of rapid expansion in public debt slowed in 2015 and was entirely contained by the end of 2016. The coordinated support from the EU, the IMF and other international financial institutions provided in 2014 and 2015 was reflected in the rapid increase in the level of external public debt, although partly offset in November 2015, when Ukraine successfully restructured around USD 15 bln of its external debt, negotiating a 20 per cent haircut[140].

Public debt stabilised at about 80 per cent of GDP in 2016, thanks to the economic recovery gaining speed and the primary fiscal balance, even if the bailout of *Privatbank* and some state-owned banks added over 5 p.p. of output to public debt. 2017 was the first year when the public debt was on a downward trajectory, falling to 72 per cent of GDP, while the government again managed to achieve primary surplus and nominal GDP increased by one-quarter.

Figure 23. Public debt trajectory, in % of GDP, 2012-2018



Source: *IMF WEO*

Inflation

Inflation in Ukraine was fully contained in 2012 and 2013 (Figure 24). More specifically, after a mere 0.6 per cent of average annual CPI inflation in 2012, a slight deflation (-0.3 per cent) was reported in 2013. This was a consequence of faltering consumer demand, some trade irritants introduced by Russia (that in turn lifted up the domestic supply of cheaper food items) and a fall in global food prices (see Food and Agriculture Organization of the United Nations (FAO) Food Price Index)[141]. However, the following years saw a very different level of inflation pressure, with the average annual CPI attaining 12, 49 and 15 per cent in 2014, 2015 and 2016, respectively[142].

Undoubtedly, the crucial factor behind the rapid price rises observed from 2014 onwards was a sharp fall in value of the hryvnia, triggered by the abolishment of the pegged regime and rapidly waning confidence in the face of escalating conflict in the East, rising political instability and overall vulnerability of the economy.

---

[140] Ministry of Finance of Ukraine (2015). Sovereign debt. Available at: http://www.minfin.gov.ua/en/news/view/ukraina-uspishno-zavershyla-restrukturyzatsiiu-derzhavnoho-ta-harantovanoho-derzhavoiu-borhu-na-sumu--mlrd-dol-ssha?category=borg

[141] FAO (2017). Food Price Index. Available at: http://www.fao.org/worldfoodsituation/foodpricesindex/en/

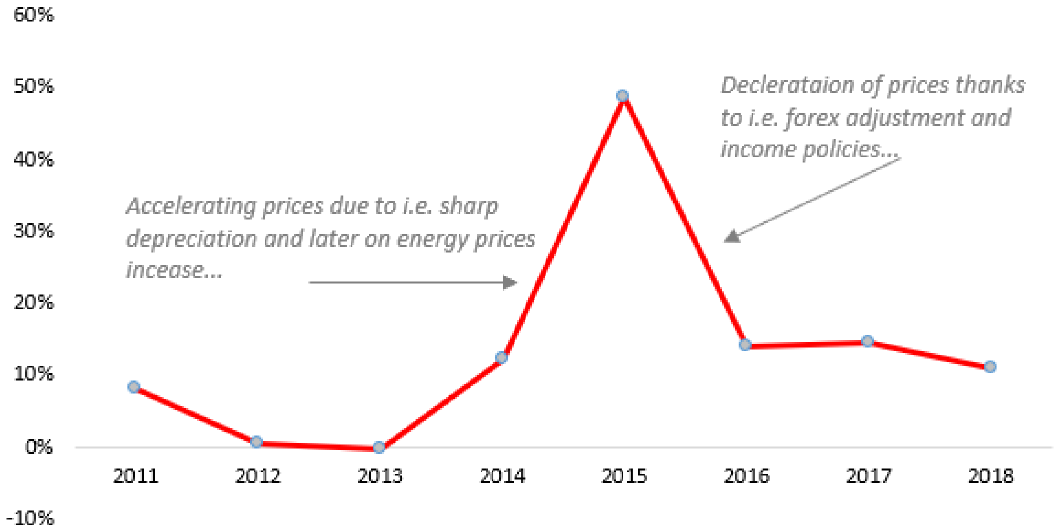
[142] IMF (2016). WEO October 2016. Available at: https://www.imf.org/external/pubs/ft/weo/2016/02/weodata/weorept.aspx?pr.x=41&pr.y=10&sy=2010&ey=2021&scsm=1&ssd=1&sort=country&ds=.&br=1&c=926&s=PCPIPCH&grp=0&a=

Prices shot up dramatically from Q1 2015 onwards, when the impacts of the hikes in energy prices (end-user price hikes of 284 per cent, on average) introduced on 1 April and the hryvnia depreciated further.

From mid-2015 onwards, a gradual stabilisation in inflation coincided with the stabilisation of the foreign exchange rate (Figure 25). From 2016 onwards, the stable foreign exchange rate and somewhat subdued demand constrained inflation, although it remained at double-digit levels due to the substantial rise in administered prices[143].

In 2017, inflation remained high, at 14.4 per cent, compared to 13.9 per cent in 2016. Key underpinning factors were the rise in food prices, steady recovery in consumer demand and an increase in labour costs. More specifically, food prices rose by 13 per cent in 2017, while housing and utility costs surged by 27 per cent[144]

Figure 24. CPI, in %, 2011-2018



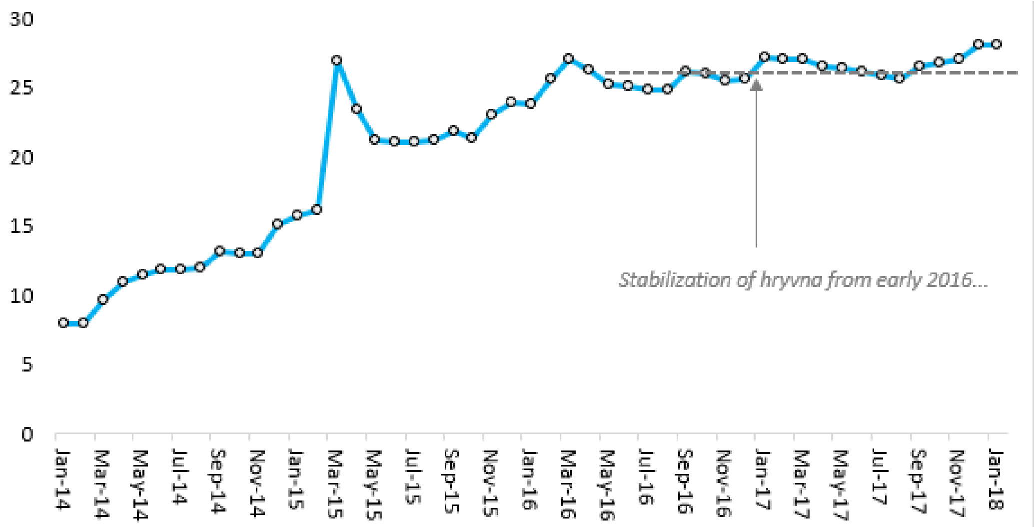
Source: *Ukrstat*

Note: 2014 data without Crimea and Sevastopol; 2015/2016 without Crimea, Sevastopol and areas not under the control of the government in the Donetsk and Luhansk regions.

[143] IMF (2016). Country report, September 2016..

[144] IER (2018). Monthly economic monitor Ukraine No.2 (207), February 2018. Available at: http://www.ier.com.ua/en/publications/regular_products/monthly_economic_monitoring/?pid=5846

Figure 25. UAH per USD, official exchange rate



Source: *NBU*

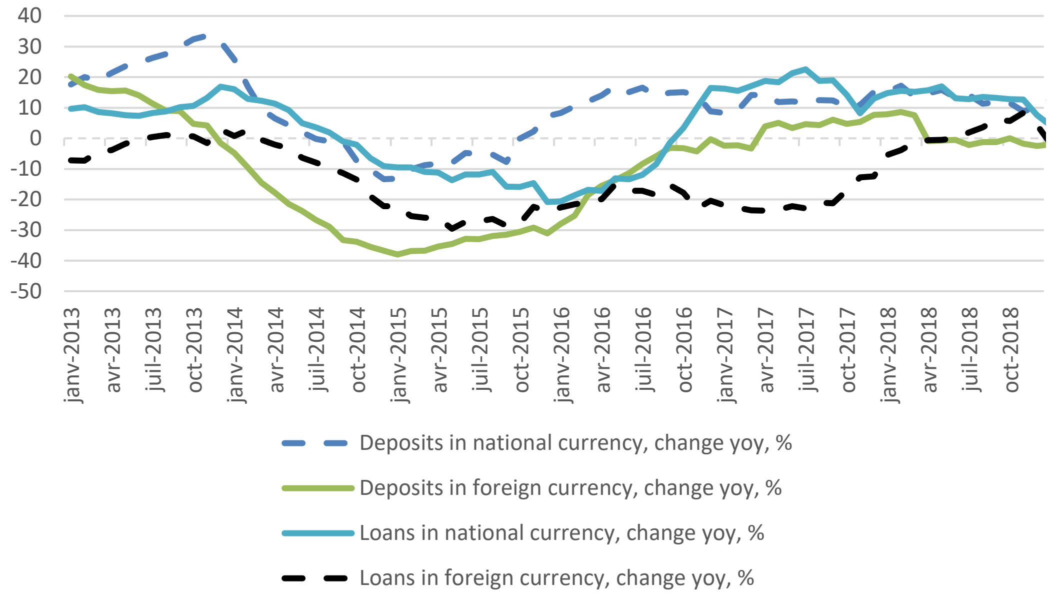
Banking sector

2014 was an exceptionally challenging year for the Ukrainian banking sector. Many domestic banks had exposure in the Donbas and Crimea regions, with an average 10 per cent of loans and an even greater share of collateral located there. Banks' capital positions and liquidity were severely affected by sizable deposit outflows, including those in foreign currencies (Figure 26). Together with the deterioration in the real economy, the NBU had no choice but to pursue the clean-up of the sector, liquidating banks that were used as a cover for various tax schemes and money-laundering activities. The outcome of this large-scale restructuring was staggering - 51 bank failures took place in 2014 and the first half of 2015, corresponding to 22 per cent of the total banking sector's assets as of January 2014[145].

Supervised by the NBU, the overhaul of the sector continued in 2015, although the fall in bank deposits was eventually reversed later in 2015. Crucially, however, despite multiple bankruptcies of banks, the majority of household deposits were guaranteed by the DGF, providing security for individuals and maintaining confidence in the system. Between December 2013 and December 2015, the total number of active credit institutions fell from 180 to 117, 35 per cent reduction (Figure 27). The process of this large-scale restructuring was largely completed by summer 2016. Bank shutdowns were no longer observed and 70 per cent of credit institutions reported an operating profit from 2015 (despite huge losses in the banking sector that year). Major vulnerabilities persisted, however. The share of NPLs remained very high, at around 30 per cent in 2016 and in excess of 50 per cent in 2017. This elevated level of NPLs was the consequence of the 2014-2015 economic crisis, but also the absence of effective instruments for the resolution of NPLs, despite strengthened supervision by the NBU.

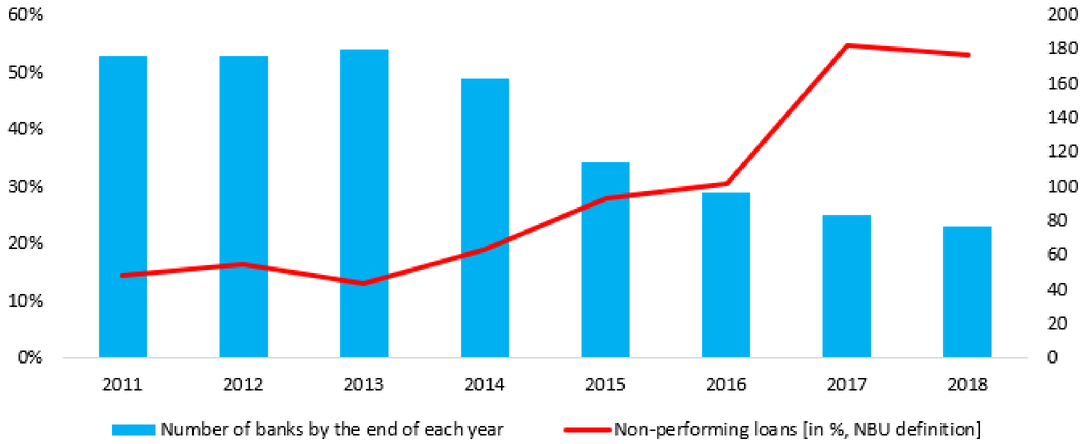
[145] IER (2016). Year 2015 – Economic summary for Ukraine.

Figure 26. Growth of loans and banks deposits, 2013-2018



Source: *NBU, IER*

Figure 27. NPLs (left axis) and number of active banks (right axis), 2011-2018



Source: *NBU, IER*

7.1.2 Step 2: Assessing the role and contribution of MFA III to observed outcomes

It is conceptually and methodological challenging to isolate the effect of MFA III from other interventions (IMF programme, support from other donors, other EU interventions) and the various exogenous and/or unobservable factors. Many previous MFA evaluations conducted up to 2015 relied on counterfactual modelling to assess the role of the MFA specifically (estimating unobserved counterfactual outcomes with the help of macroeconomic models, and then comparing those hypothetical counterfactual outcomes with observed macroeconomic outcomes that in turn allow the net effect to be gauged).

This approach has some important limitations, however. Firstly, it is challenging (if not impossible) to derive a credible and a clear quantitative counterfactual in a crisis context. Secondly, this approach offered limited insights for European Commission staff members. Given the formative nature of this evaluation, it instead relied on a qualitative approach to assess the role and contribution of the MFA III operation, as was the case under the evaluation of the MFA I and II operations. This approach drew inferences from the following sources of evidence:

- Literature review covering IMF reports, ECFIN documents relating to the operation (e.g. mission reports), analytical reports produced by other donors and international organisations, financial press, grey literature on economic developments in Ukraine during the period of interest;
- Discussions with the Steering Group during the kick-off, inception and interim meetings organised in Brussels/online;
- Trend analysis of macroeconomic data;
- Semi-structured interviews with key stakeholders, including Commission, IMF, World Bank and EBRD staff, as well as experts from the Ukrainian Ministry of Finance and the NBU;
- Brainstorming session on 27 February 2020, with key inputs from local economic experts;
- Critical reviews of the initial counterfactual options provided by local economic experts from IER;
- Results of the Delphi survey.

Insights from the online focus group with non-governmental stakeholders did not cover this analysis and its findings are omitted here.

7.1.2.1 Presentation of the different counterfactual positions

For the possible counterfactual positions (i.e. what might have happened in the absence of MFA financing), there are four distinct alternatives:

- Alternative 1: No disbursement of the first MFA III tranche of EUR 600 mln in July 2015 and plausible alternatives to it;
- Alternative 2: No disbursement of the second MFA III tranche of EUR 600 mln in April 2017 and plausible alternatives to it;
- Alternative 3: The disbursement of the third tranche of the MFA in the Autumn 2017 (cancelled in late 2017);
- Alternative 4: No MFA III <u>and</u> no IMF EFF operation.

Given the almost overlap in the timing of the disbursement dates under MFA I and II (May 2014 – April 2015) and the first disbursement under MFA III (July 2015), supported by findings from the past evaluation and the insights gathered during the scoping interviews for this study, it appeared plausible that counterfactual scenarios for Alternative 1 would be largely the same as those distilled as part of the evaluation of MFA I and II. Indeed, the validity of this assumption was tested and confirmed by interviews with the key stakeholders, brainstorming session and the Delphi survey. In turn, the exercises for Alternatives 2, 3 and 4 presented here comprised a new analysis.

The following sections consider the four counterfactual alternatives. They begin with a joint discussion of Alternatives 1 and 2 (no MFA disbursements in 2015 and 2017, respectively), and then consider Alternative 3 (disbursement of third tranche in Autumn 2017), followed by Alternative 4 (no MFA III <u>and</u> IMF).

More generally, the counterfactual options discussed in the following sections are not necessarily mutually exclusive, as it is plausible that a combination of two or more sources of financing could have been used. Finally, the economic outcomes stemming from the most plausible option under each of the four alternatives are discussed in Section 9, together with the findings of the DSA.

7.1.2.2 Alternatives 1 and 2

Figure 28 and Figure 29 present possible alternative sources of finance had the first and second MFA III disbursements been absent, but where IMF funding was available (without compensating for the loss of the first MFA III tranche). These propositions were tested with Delphi survey respondents, through data analysis, a brainstorming session with local economists and selected interviews stakeholders who had sufficient knowledge[146].

Overall, there was a strong consensus on plausible options for Alternative 1, which were already well established as a result of the ex post evaluation of MFA I and II[147]. In brief, financing from the international market would have been impossible (Ukraine had lost access to the markets by 2015). Raising finance domestically would also have been challenging, given that domestic banks remained under stress throughout most of 2015. Likewise, increased financing from the IMF and World Bank would have been highly unlikely. One of the most plausible options in the hypothetical case of the absence of EUR 600 mln in mid-2015 would have been fiscal adjustment in the form of expenditure cuts. More specifically, a mix of cuts in capital expenditure, corresponding to circa EUR 450 mln savings and pension payments (in real terms only) corresponding to circa EUR 150 mln in savings.

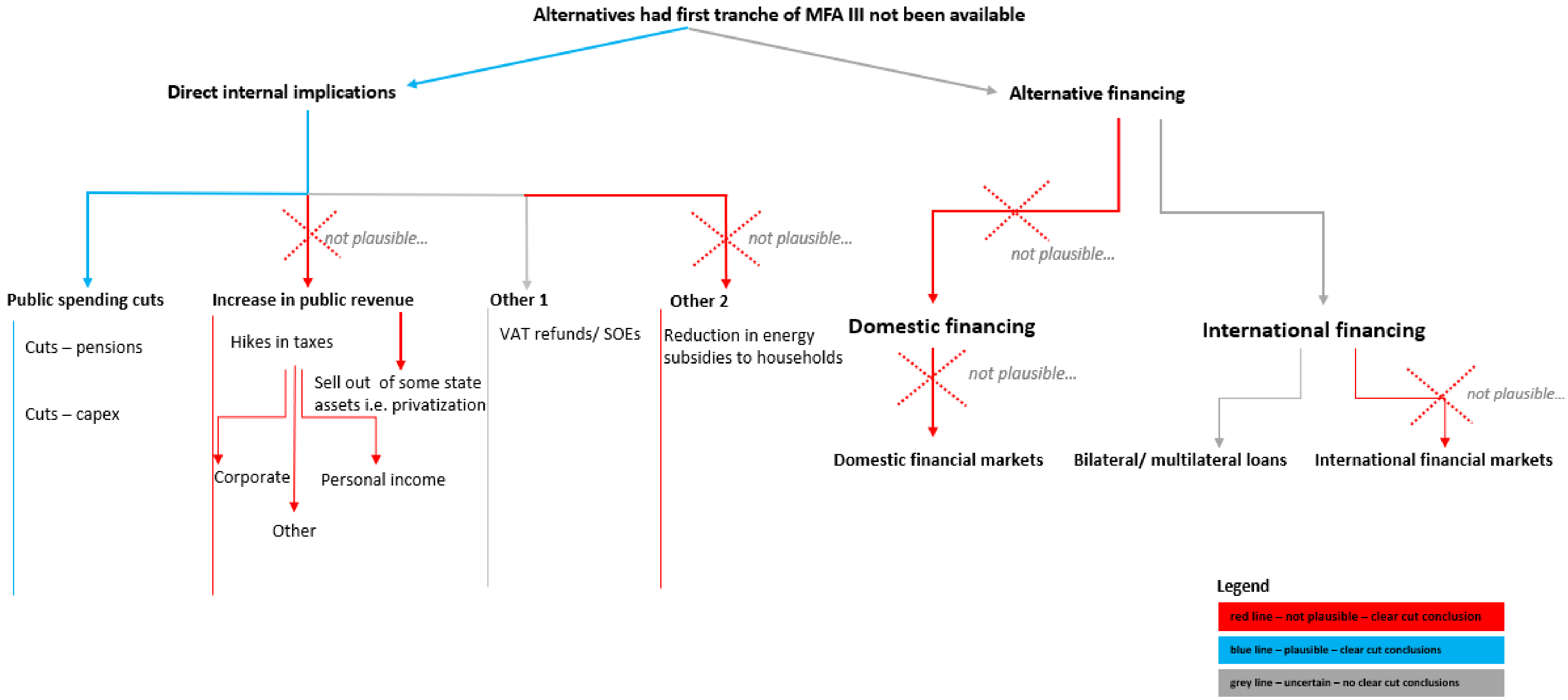
In turn, the analysis shows that the most plausible course of action for Alternative 2 would have been to raise the required financing from the domestic debt market. More detailed discussion of both alternatives, examining the possibility of attracting additional finance from financial markets (domestic and international), bilateral and multilateral donors, and through national fiscal measures, is provided below.

---

146 DG ECFIN, Ministry of Finance in Ukraine, World Bank, IMF, NBU.

147 ICF (2017). Ex post evaluation of the MFA I & II to Ukraine. Available at: https://ec.europa.eu/info/sites/info/files/economy-finance/evaluation_of_mfa_i_and_ii_to_ukraine_-_final_report_ecfin.pdf

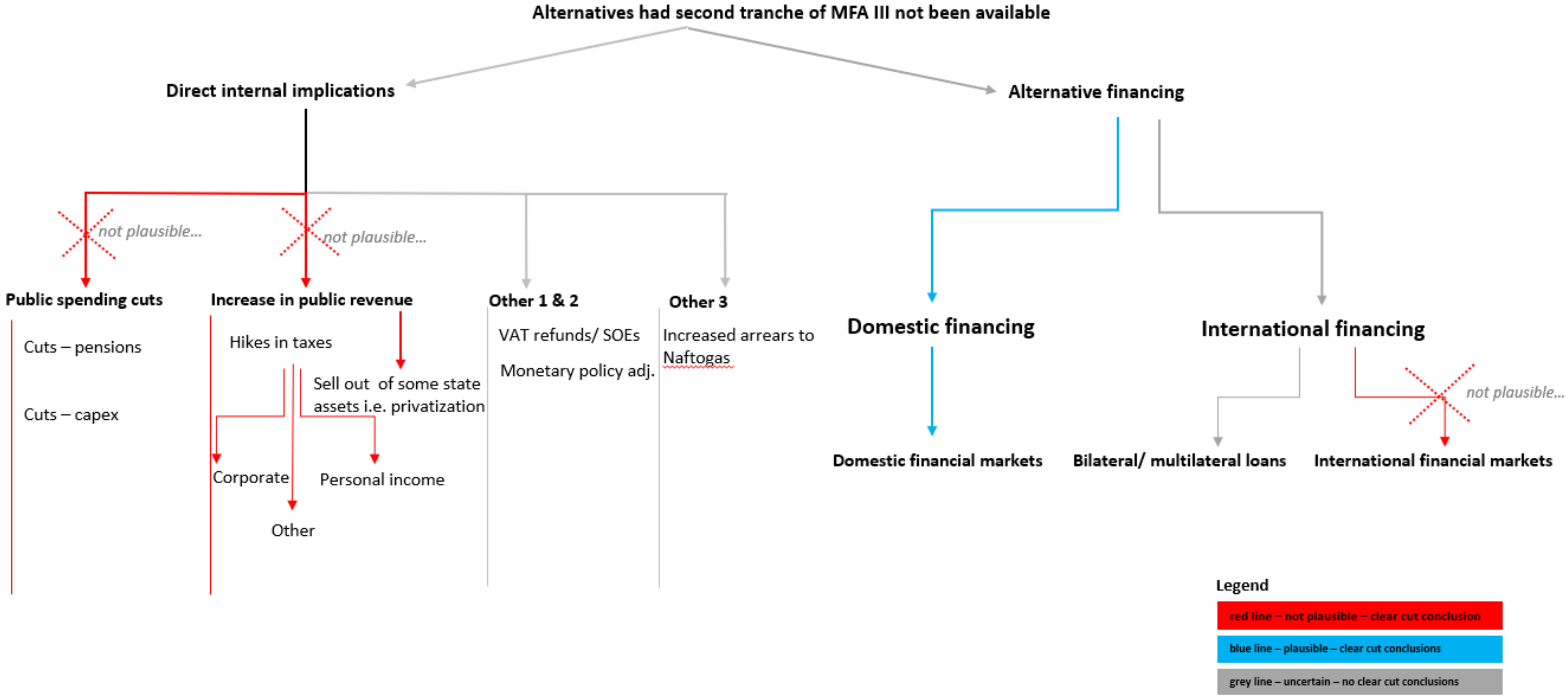
Figure 28. Alternative 1: options for obtaining finance had the first MFA III tranche of EUR 600 mln not been disbursed (but with IMF support continuing)



Source: *ICF.*

Note Some potential alternatives that were seen as likely by Delphi survey respondents but not discussed in detail in this report could not be categorically rejected based on the incomplete evidence available to the Study team. This is the case for monetary policy adjustment (if the NBU had allowed the hyrvnia to depreciate further), increased arrears from Naftogaz and reduced transfers to local authority budgets, especially in the context of decentralisation where there were real problems with under-financing of local budgets. Taken together with the DSA, the cuts in CAPEX and pensions were considered the most plausible alternative.

Figure 29. Alternative 2: options for obtaining finance had the second MFA III tranche of EUR 600 mln not been disbursed (but with IMF support continuing)



Domestic financial markets

Had the first tranche of the MFA III not been provided, the availability of financing from domestic markets was viewed as among the least plausible alternatives, according to Delphi respondents. All key stakeholders, including the IMF, World Bank and NBU, categorically rejected this hypothesis.

Domestic banks were under pressure and lending was heavily constrained, having dropped in real terms in 2014 and for most of 2015. Throughout 2015, the NBU liquidated banks and withdrew banking licences, with the total number of credit institutions falling from 163 in 2014 to 114 in 2015 (25 per cent of total banking assets). Households' deposits in hryvnia and foreign currency rose by 7 and 3 per cent between 2014 and 2015, respectively, although remaining at a very low level. NPLs surged from 19 per cent in 2014 to 28 per cent in 2015[148] and while the solvency of many banks, including some of those of systemic importance, was not questioned by local analysts in the second half of 2015, their capital position remained fragile. Indeed, due to increasing pressure, banks elevated deposit interest rates to around 20 per cent in late 2014 - a clear symptom of undercapitalisation. More fundamentally, the domestic market was very shallow in 2015. Over that year, the treasury managed to issue debt of just USD 0.6 bln at very short maturity (<1 year) and high yield (8.7 per cent p.a.) and around half of all placements organised by the treasury between 2015-2016 failed to attract any bids. Securing any additional financing from domestic lenders seems very unlikely and even if theoretically plausible, would have come at exorbitant cost.

The availability of financing from the domestic market to offset the hypothetical absence of the second MFA III tranche (Alternative 2) was considered more realistic in 2017 than in 2015. The total debt issuance on the domestic market in 2017 reached some USD 1.9 bln[149], compared to USD 0.6 bln in 2015, and the interviewee from the Debt Department at the Ministry of Finance acknowledged that domestic market became more accessible at that time, a view shared by other experts, including those from the IMF. The Delphi respondents also found this option one of the most plausible, with 71 per cent indicating the domestic market as a likely/very likely alternative. However, while the yields also compressed (averaging around 5 per cent per annum in 2017, versus 8.7 per cent in 2015[150]), this was markedly higher than the cost of the MFA's debt. Equally, the longest maturity the treasury could access on the domestic market in 2017 was only three years, compared to up to 15 years for the MFA loan[151].

International financial markets

The possibility of securing financing on the international financial markets as an alternative to the first tranche of MFA III (Alternative 1) was roundly dismissed. In the course of 2013, the Ukrainian authorities had lost access to international financial markets and this remained the case in 2015, when the debt restructuring took place. Delphi survey results corroborated this finding.

However, as an alternative to the second MFA III tranche disbursed in April 2017 (Alternative 2), this option would have been somewhat plausible. Delphi survey respondents ranked it among the most plausible options (71 per cent indicating it as likely/very likely), on par with financing from the domestic market. Nevertheless, the extent to which it was likely is still inconclusive, for several reasons.

The fiscal situation stabilised markedly from late 2015 onwards. In mid-2017, an upgrade of the Moody's credit rating from Caa3 (stable) to Caa2 (positive) was announced (see Figure 5).

---

[148] NBU data.

[149] Although the bulk of it was used to refinance the existing debt.

[150] Ministry of Finance data.

[151] Recipient country has a choice in the maturity of the MFA loan, ranging from five to 15 years.

This upgrade was based on the significant strengthening of Ukraine's external position and the cumulative impact of structural reforms likely to improve debt dynamics[152].

After several years, Ukraine regained access to international markets in September 2017, raising a USD 3 bln bond issue with maturity of 15 years and a yield of 7.35 per cent, an issuance oversubscribed by around 300 per cent[153]. More generally, the JP Morgan Global Bond Index-Emerging Markets (GBI-EM) [154] rated the overall outlook for 2015 as challenging[155] but it improved slightly in 2016[156], followed by marked amelioration in 2017, with a fall in risk premia across the markets, linked to relatively low inflation and healthy growth rates[157].

High currency volatility typically discourages investors in emerging markets, as it may affect the real rate of return, although the foreign exchange rate of hryvnia was broadly stable from early 2016 onwards (see Figure 25).

Doubts persist, however. In April 2017, there was still no clarity on the outcome of the negotiations with the IMF on the progress of the EFF programme - arguably a prerequisite for successful issuance[158]. Given the crucial – though nuanced - timing, the Ministry of Finance believes that it would not have been feasible to raise the financing on the international markets in April or May of that year.

Multilateral/bilateral loans

Under Alternative 1, increased assistance from the World Bank and/or the IMF and a greater financial package from bilateral donors were chosen as likely/very likely by the majority of the Delphi respondents, with noticeably fewer opting for 2017 (Alternative 2). The latter is in line with the Study team's understanding that it is plausible that Ukraine would not have received any additional financing from other multilateral donors. Throughout 2017, the lack of satisfactory progress in AC reform became a major strain on the relationship between Ukraine and the IMF[159]. As a result, since April 2017, no further disbursements were made under the IMF EFF programme and it eventually became one of the key issues leading to the cancelation of the programme altogether in December 2018[160].

Even for the first tranche disbursed in 2015, the stakeholders interviewed were very sceptical about the availability of further multilateral/ bilateral loans (given how their programmes are constructed, where there is no scope for swift top-up of financial envelopes, conditioned on the approval of the Board of Directors in the IMF's case). Interviews with the IMF and the World Bank stated that the possibility of maxing out the assistance had already been

[152] Moody's website. Available at: https://www.moodys.com/research/Moodys-upgrades-Ukraines-rating-to-Caa2-from-Caa3-outlook-changed--PR_370205

[153] Financial Times (2017). Ukraine prices USD 3 bln bond deal at 7.375 per cent. Available at: https://www.ft.com/content/d227d1b0-49c2-361a-8279-9c66c62e1783

[154] Tracks total returns for traded external (foreign currency denominated fixed income) debt instruments in emerging markets. The regular Emerging Markets Bond Index (EMBI) index covers USD-denominated Brady bonds, loans and Eurobonds.

[155] JP Morgan (2015). Emerging market debt outlook. Available at: https://am.jpmorgan.com/blobcontent/1383212490929/83456/Emerging_market_debt_outlook_2015_US.PDF

[156] https://www.morganstanley.com/im/publication/insights/investment-insights/ii_emoutlook_en.pdf

[157] BNP Paribas (2017). Several factors that have contributed to the outperformance by emerging markets bonds. Available at: https://www.bnpparibas-am.lu/intermediary-fund-selector/its-not-the-time-to-buy-an-emerging-market-debt-index-its-alphas-turn-now/

[158] Moody's regularly referred to the IMF programme as one of the material (and positive) factors in deriving the credit rating for Ukraine.

[159] IMF (2017). Statement of the IMF Director on Ukraine. Available at: https://www.imf.org/en/News/Articles/2017/12/08/pr17474-statement-by-the-imf-managing-director-on-ukraine

[160] IMF (2020). Ex post evaluation of the EFF to Ukraine. Available at: https://www.imf.org/en/Publications/CR/Issues/2020/06/16/Ukraine-Ex-Post-Evaluation-of-Exceptional-Access-Under-the-2015-Extended-Arrangement-Press-49518?cid=em-COM-123-41725

exhausted for the SBA and EFF programmes, with no further room to increase the financial envelope had some other donors, including the European Union, pulled out.

In terms of the support from bilateral partners, Ukraine received regular support from the US between 2014 and 2016 in the form of the USD 1 bln guarantee backing the issuance of the public debt in 2014, 2015 and 2016, respectively. However, this type of support cannot be made available at short notice as it requires a relevant appropriation to be made in the budget. For 2017, given that no appropriation was requested, making this support available would have required legislative action (if even possible). Some budget financing was also provided jointly by Canada, Turkey and Germany. Overall, however, the support from other countries was typically in the form of technical assistance, project financing or foreign exchange swaps, and local experts expressed the view that additional bilateral financing, would have been unlikely, especially in 2017.

Fiscal adjustment

Regarding fiscal adjustment as an alternative to the first MFA III tranche, in principle the authorities could have resorted to some revenue and/or expenditure measures.

DG ECFIN, the IMF, World Bank, NBU and the Ministry of Finance were sceptical about the plausibility of mobilising additional revenue (such as tax hikes) in 2015. One-off measures, such as privatisation, were also seen as unlikely under Alternative 1. Delphi respondents also ruled out both 'Increased revenue from increased taxes' and 'Privatisation' from feasible alternatives. Besides, the potential size of proceeds from the firesale of state assets at the time when markets were dipping, and striking 'a fair price' would have been challenging, as was the risk of having unwelcome types of investors. The available data[161] show that the privatisation process practically stalled between 2013 and 2016. More specifically, while the proceeds in 2012 were UAH 6.7 bln, they averaged UAH 570 mln per year between 2013-2016. 2017, a relevant year in the context of Alternative 2, was somewhat different. The government sold its minority stakes in the regional electricity distribution companies to majority owner (DTEK - Akhmetov's company). However, according to local experts from the IER, further sales would have been politically painful (and fiscally unsound), given that the sale of stakes in the DTEK had already attracted some criticism for being below a fair value.

With only limited possibilities to raise revenue, cuts in public expenditure could have been an option to replace the financing from the first tranche. Indeed, these were highlighted as the likely source by virtually all key stakeholders (DG ECFIN, IMF, World Bank, NBU, Ministry of Finance), although there was no full consensus on the type of cuts.

All interviewees agreed that no immaterial expenditure items possible to cut were left at that time and any choice would have been very hard. The IMF asserted that '…*historically the first and relatively easiest item to cut for the authorities in Ukraine was to cut capital expenditure (CAPEX)*', something that was confirmed by the local economic experts. CAPEX was already at a very low level (~USD 1.9 bln) in 2015 when major fiscal consolidation took place, on the back of the EFF programme. Yet, arguably, it was not 'cut to the bone', as was the case in 2014, when CAPEX stood at only ~USD 0.8 bln, its lowest level since the financial crisis. There was thus some – limited - space to cut in 2015. Cuts in capital expenditure was the most likely alternative chosen by Delphi respondents, with 86 per cent indicating it as likely/very likely.

The interviewee from the Ministry of Finance speculated that while some items (e.g. wages of military personnel) would have been absolutely out of the question in 2015 when the conflict was still intense, one of the possibilities would have been a reduction in pension-related expenditure (in real terms). Around half of the Delphi panel also selected increased pension system arrears as likely/very likely. More specifically, Ukrstat data show that nominal average pensions increased just over 15 per cent cumulatively over 2014 and 2015, compared to 79

[161] Data from Ministry of Finance.

per cent increase in consumer prices[162], largely as a result of pensions being essentially frozen between December 2013 and September 2015. However, unfreezing of pensions was brought forward from December 2015 to September 2015, as higher than expected inflation led to higher nominal budget revenue. One option for authorities could have been to stick to existing plans, resulting in higher than expected cuts in pensions (in real terms). Such a measure would have saved about UAH 4 bln (~ EUR 150 mln) in pension fund transfers, which could have been complemented by CAPEX cuts savings.

Given the feasibility of raising financing from the domestic market discussed earlier, fiscal adjustment would not have been necessary under Alternative 2.

7.1.2.3 Alternative 3

Alternative 3 explores the hypothetical implications of the third tranche of the MFA III (EUR 600 mln) having been disbursed in autumn 2017 (in addition to the first and second tranche); a course of events that did not take place, due to insufficient progress in implementing some of the MFA III conditions.

A review of the draft budget for 2017 indicates that the government was expecting the third MFA tranche in 2017. Its absence therefore left a gap that had to be addressed, either by alternative financing or through some adjustment of public expenditure.

According to the Delphi respondents, had the third tranche been available, three options were most likely:

- Increased capital expenditure (75 per cent of respondents saw it as likely/very likely);
- Reduced financing from international markets (66 per cent of respondents saw it as likely/very likely);
- Reduced financing from domestic markets (57 per cent of respondents saw it as likely/very likely).

Had the third tranche been available, Delphi respondent and some interviewees saw the potential reduction in borrowing from the international financial markets effected in September 2017 (USD 3 bln via Eurobonds' issuance) as likely/very likely. Nevertheless, it seems that due to the timing of the cancelation of the third tranche (which took place after the issuance in September 2017), this option would not, in fact, have been possible.

Instead, based on the evidence - but also coherent with the logic of inferencing presented under Alternative 2 - reduced financing from domestic markets seems the most plausible alternative in this case. According to the information provided by the Ministry of Finance, once it became clear that the third tranche would not be available, the treasury decided to turn to the domestic banks in December 2017 and issue USD 600 mln debt with maturity of 1.5 years (redeemable after six months) and interest rates of around 400 basis points p.a.

Thus, given that the third tranche was firmly expected and that its absence triggered additional borrowing on the domestic market corresponding to a nearly identical amount, it seems reasonable to assume that the presence of the third tranche would not have triggered additional capital expenditure, despite the perspective shared by some Delphi experts.

7.1.2.4 Alternative 4

The combined MFA III and IMF (EFF) financing provided in 2015, 2016 and 2017 totalled USD 8 bln, USD 1 bln, and USD 1.7 bln, respectively. In terms of the country's GDP, this accounted for 8.8 per cent, 1 per cent and 1.5 per cent of the output in 2015, 2016 and 2017, respectively. This would have been a very sizable gap, in particular in 2015. It is very likely that the absence of EU and IMF support would have triggered the pull-out of the World Bank

[162] January 2016 to January 2014 average pension (UAH 1,700 vs UAH 1,526), December 2015 CPI vs December 2013 CPI (187.7 vs 104.3 Dec. 2010=100).

(which supported Ukraine with an additional USD 1 bln in 2015 alone) and made the issuance of USD 3 bln on the international financial markets in September 2017 impossible.

Similar to the conclusions of the ex post evaluation of the MFA I and II and considerations on the hypothetical absence of the MFA I and II and IMF (SBA) programmes, had MFA III and IMF (EFF) support been absent, the country would have faced the prospect of increasing borrowing requirements due to a struggling economy (and fall in tax receipts) and a weak domestic currency but constant expenditure pressures. Locked out of international capital markets as it was (and with plausibly exorbitant costs of borrowing on the domestic market), it is hard to conceive how Ukraine's debt would not have become unsustainable and led to a potentially disorderly default (see DSA in Section 9). This would likely have been accompanied by an even greater depreciation in hryvnia, hyper-inflation and a more substantial fall in real incomes and standards of living, and a considerable rise in the poverty rate.

Ultimately, it is plausible that a lack of international support at a time when Ukraine was in a desperate situation and in a state of war could have threatened the sovereignty of the country and would have had damaging and long-lasting effects on the EU's reputation in Ukraine and its ability to pursue the ambitions of the AA.

7.2 Part 2: Effectiveness of structural reforms

The following section outlines the framework used to assess the effectiveness of the MFA-induced reforms (sub-section 7.2.1) and the results of this assessment (sub-section 7.2.2).

7.2.1 Analytical framework

The following issues were taken into consideration in analysing the effectiveness of MFA III conditions:

- Action(s) taken by the Ukrainian authorities to fulfil the conditionality;
- Any evidence of implementation deficit, i.e. the difference between *de jure* and *de facto* reform;
- Relevance and importance of MFA-promoted reform;
- Level of ownership of the programme and the capacity of the authorities to implement it;
- Role of the MFA III contribution to reform progress;
- Observed or expected short-term benefits of the reform;
- Evidence for actual or expected impact of reforms (direct and indirect).

The analysis presented below is based on documentary and literature review, stakeholder interviews and focus group discussions. It is complemented by case studies on AC and IDPs (see Annexes 7 and 8).

7.2.2 Assessment of the effectiveness of MFA conditionality

The boxes below provide key summary conclusions drawn at reform level. For a detailed assessment of corresponding individual conditions using the analytical framework presented above, see Annex 5.

Overall, progress has been made, especially during the initial stages of the operation, in an exceptionally difficult environment. Conditions that saw the payment of the third tranche withheld were implemented beyond the timeframe of MFA III. Only one issue - related to the wood ban – remains unresolved.

In many cases, tangible progress was made on the ground, e.g. energy and financial sector reform, PP. Key steps were achieved in the fight against corruption, with the institutional framework now largely in place and progress made at the technical level. In the AC area however, wider changes (e.g. in relation to the judiciary, law enforcement) are needed for beneficial outcomes to be more tangible.

Box 18. Public finance management

Ukraine has made significant progress in public finance management reform, notably by: improving its macroeconomic and budget forecasting tools; building a fairer tax collection system; and increasing transparency in the public finance management system through measures such as the introduction of the e-procurement system 'ProZzorro'[163]. According to the Public Expenditure and Financial Accountability (PEFA) Report 2019[164], the assessment of public finance management reform has improved over the years, with the external audit dimension improving from C+ to B+. As arrears decreased during the 2016-2019 period (less than 1 per cent), the stock of expenditure was upgraded from B to A. Likewise, the macroeconomic and fiscal forecasting dimension improved from B+ to A in 2019. The PP sphere kept its A score, as did the budget preparation process indicator, obtaining a B.

Regarding external audit measures, publication of the ACU's reports and information notes have become established practice since August 2015, which has increased Ukraine's good governance. Likewise, the extension of the ACU's remit to SOEs strengthened transparency and public accountability by providing for the publication of audit reports – although the ACU is still subject to some restrictions, and transparency and accountability of SOEs activities needs to be improved.

The reform of the PP system represents one of the flagship reforms of Ukraine and is considered a success story, with the success of ProZorro widely acknowledged[165]. Sense of ownership is high. Ukraine joined the Agreement on Government Procurement (GPA) in 2016 and is following a roadmap for the progressive approximation of national PP law to EU law, as per the AA. The roadmap, approved by the Association Council[166], has a timeframe of five-six years and contains annual milestones. On fiscal governance, the implementation of measures such as the timely submission of the state budget and the limitation of cases allowing amendments to the state budget, via modification of Article 52 of the Budget Code, have had a positive impact in increasing the predictability and credibility of the budget and fiscal policy. Additionally, public finance management conditions have led to improvements in tax compliance and reduced tax evasion. Tax revenues in Ukraine increased by 50 per cent between 2016-2018 and all large taxpayers (2,200) were brought under the Large Taxpayer Office (LTO). Finally, public sector payment arrears decreased substantially in recent years, providing greater transparency and fairness in granting VAT refunds.

Public finance management is an area where the government had ownership and as such it is very likely that the Ukrainian authorities would have made progress without MFA III. However, PP aside, the results of the Delphi survey confirm that progress may have been more limited and/or delayed[167] in the absence of MFA III.

[163] World Bank (2019). 2019 Public Expenditure and Financial Accountability (PEFA) Performance Assessment Report. Available at: https://www.pefa.org/node/3676

[164] *ibid.*

[165] See, for instance: https://www.worldbank.org/content/dam/Worldbank/document/eca/georgia/11-procurement/Ukraine-ENG.pdf

[166] Decision No 1/2018 of the EU-Ukraine Association Committee in Trade Configuration.

[167] According to the Delphi survey, the majority of respondents (19 out of 21) are positive that Ukrainian authorities would have made progress in this area without MFA III. More specifically, one-third of respondents (seven) answered '*Yes, but at a slower pace*' and eight said '*Yes, but not fully/with some gaps*'.

Box 19. Governance and transparency, AC

Significant progress has been achieved over the last six years or so. According to the officials from the World Bank, IMF and EU interviewed as part of this evaluation, the relative number and scope of the AC reforms undertaken in Ukraine during that time has been '*unprecedented*'. New institutional architecture has been established from scratch, with independent organisations such as NABU, and a number of legislative acts came into force. Conditionalities of the international donors, including the EU, gradually changed focus from supporting the set-up of AC architecture in Ukraine to its roll-out and implementation on the ground.

There was a general consensus that while the first phase of the broad AC reform (setting up the overall architecture of the system) has been completed, progress with more nuanced and yet equally crucial reforms has been disappointing. In particular, reforms focused on the judicial system and enforcement to ensure that AC investigations, including those revealed from the declarations submitted via the asset disclosure system, are progressed by the courts and unlawful actions are punished with the binding rulings, have not advanced sufficiently. Lack of progress in the establishment of the High Anti-Corruption Court was one of the key reasons for the stalemate and premature termination of the IMF EFF programme.

Progress on AC reforms advanced unevenly, due in part to some vested interests. The EU, IMF and World Bank all pointed to a number of Members of Parliament (MPs) who regularly attempted to reverse or limit the scope of the reforms (e.g. asset declaration system, beneficial ownership register).

Illustrating these challenges, more than six years after the Maidan protests, corruption remains a major concern for the general public and for individual communities (e.g. domestic business and foreign investors). A national public opinion survey of residents of Ukraine, conducted between 21 April and 5 May 2017 by the International Republication Institute with support from the government of Canada, revealed that the three most important issues for Ukraine are conflict with Russia, government corruption and low industrial production. According to the European Business Association (EBA) and Dragon Capital's survey of private business from spring 2017, widespread corruption was the most important obstacle to foreign investment in Ukraine (8.5 on the 1-10 scale, where 10 is most important)[168]. The more recent Gallup World Pool in early 2019 revealed that 91 per cent of Ukrainians believe that corruption is widespread in government, the lowest confidence rate in the world[169]. In 2019, Transparency International ranked Ukraine 126/180, with a Corruption Perception Index of 30, on a scale from 0 (highly corrupt) to 100 (very clean). This represents progress of 4 points since 2014[170]. The average global score was 43.

[168] EBA (2017). Foreign Investor Survey – 2017. Available at: http://eba.com.ua/static/2017_09_13_InvestorSurveyResults_16_9.pdf

[169] Gallup (2019). World-low 9 per cent of Ukrainians confident in government. Available at: https://news.gallup.com/poll/247976/world-low-ukrainians-confident-government.aspx

[170] Transparency International (2020). Corruption Perception Index. Available at: https://www.transparency.org/country/UKR

Looking at the main triggers of reform, an OECD report[171] noted that inclusion of AC reform in the VLAP benchmarks and among the criteria for signing the AA served as '*a major incentive and boost for relevant legislative reforms*' from 2014 to 2017. Similarly, the AA implementation highlighted the importance of the VLAP, as well as public demand. Undoubtfully, the role of the IMF - whose subsequent programmes contained a substantial number of AC conditions - was also crucial. This was consistent throughout the discussions with officials as part of the ex post evaluation of MFA I and II, and with the EEAS and Member States' Permanent Representations. By contrast, interviews conducted as part of this and the previous evaluation revealed less specific reference to MFA conditionalities as a major trigger for reforms, although the EU Delegation stressed the very active stance of local CSOs in monitoring the implementation of progress in AC reforms and indeed, political pressure exercised by the EU throughout the implementation. For some reforms, other donors played a more decisive role in advancing AC reform (e.g. leading role of the IMF in conceptualisation and establishment of NABU).

Box 20. Governance and transparency, public administration reform

Several important steps towards reforming Ukraine's public administration were made over the lifetime of MFA III, including the adoption of a legislative package on the civil service and a public administration reform strategy, compliant with SIGMA principles, in June 2016[172].

Some results are tangible, for example the recruitment of civil servants and the online vacancies portal (career.gov.ua) through which some 30,000 candidates have applied[173]. Institutional structures now exist, with public administration reform directorates in place. However, weaknesses persist and public administration still does not work efficiently. The Ukrainian administration remains oversized and underpaid and thus fails to attract qualified local experts into the public sector. In addition, the 2018 OECD baseline measurement report pointed out that there is a need to guarantee citizens' rights in interactions with public administration, through a general law on administrative procedures. Overall, progress is going in the right direction, but the pace of implementation is rather slow and with some setbacks (e.g. politically motivated dismissals). This is to be expected, given the nature of the reforms.

Stakeholders' do not believe that the government was the driving force in public administration reform, stating that the EU had a leading role as a horizontal donor, pushing for reform with the help of its implementing partners. In that context, progress is more directly attributable to EU involvement - including but not limited to the MFA instrument.

Box 21. Governance and transparency – SOEs

MFA conditions in this area focused on specific points in relation to corporate governance (more precisely, corporatisation, i.e. conversion into joint stock companies) and external audit.

[171] OECD (2015). Anti-corruption reforms in Ukraine. Round 3 Monitoring of the. Istanbul Anti-Corruption Action Plan.

[172] https://www.kmu.gov.ua/storage/app/sites/1/reform%20office/01_strategy_eng.pdf The time horizon of the strategy has been extended to 2021

[173] Ukraine Reform Conference, Toronto, 2019.

Conditions were met but progress in this area was challenging. There is no comprehensive overview of the outcome of these reforms (e.g. number of SOEs from the list that have been converted to joint stock companies, extent to which audit recommendations were implemented at SOE level).

In the field of corporate governance more generally, one milestone - concerning all SOEs - was achieved when the legal foundations for establishing independent and professional supervisory boards at SOEs were adopted. This horizontal legislative change aside, improvements in this field are somewhat incremental, one SOE after another, as technical assistance becomes available (e.g. from the EBRD).

There is now a requirement for the largest SOEs to undertake an independent external audit but, according to the OECD[174], implementation of this requirement has been extremely poor.

Overall, the EU/MFA contribution to the SOE reform process seems quite limited, although more substantial in certain fields, notably external audit of SOEs (see also public finance management conditions).

Box 22. Judicial sector[175]

There were significant developments in the process of improving the integrity, transparency and efficiency of the judicial system in 2016/2017. The vetting exercise, despite falling short of expectations in terms of implementation and actual follow-up of cases, had a significant announcement effect, with 2,000 judges resigning rather than going through the process, opening positions for new legal professionals to enter the system. To date, however, many newly open positions remained unfilled, raising concerns about staffing levels.

In relation to the amendment of the legislation, the Ukrainian authorities went beyond the MFA requirements and legislative changes to undertake constitutional reform. The changes are assessed as being significant, increasing the independence of the judiciary, de-politicising the selection process for judges and facilitating the dismissal of judges not meeting integrity criteria. Over the lifetime of the MFA operation, a new Supreme Court was also set up, which is considered a good reform step, despite not being required by the MFA.

Justice sector reforms in Ukraine are the result of concerted efforts supported by EU technical assistance programmes (PRAVO project and its predecessor). In 2014, Ukraine established a Judicial Reform Council (JRC), uniting many actors at the highest policy-making level, donors and CSOs, with the aim of acting as a justice sector reform 'owner' and coordinating the implementation of the Justice Sector Reform Strategy 2015–2020 (JSRS)[176]. The PRAVO project is supporting the JRC. Overall, the MFA conditions reinforced the EU message.

Box 23. Energy sector

[174] OECD (2018). Anti-corruption reforms in Ukraine: prevention and prosecution of corruption in state-owned enterprises.

[175] The justice sector condition under the business environment area (condition #19, 3rd tranche) has sub-conditions: (i) and iii) are related to the judiciary and are presented here separately. ii) is related to the business environment and is presented in that section.

[176] https://www.pravojustice.eu/what-we-do

There was substantial progress in all targeted sub-areas. The benefits of the reforms are already tangible – the energy sector is no longer causing budgetary problems, instead helping to stabilise the country. For example, the Naftogaz group accounted for nearly 16 per cent of total revenue in the state budget in 2019[177].

Reforms in this area typically encountered fierce opposition. Together with the actions of other donors (especially the IMF, which imposed demanding conditions in terms of tariff increases, endorsed by the EU), MFA III was a key reinforcing factor that accelerated the reforms, giving pro-reformers EU backing (see, for example, RPR, Dixi Group)

Today's problems are completely different in nature to those of 2015. They relate to having a competitive market, characterised by fairer prices, a more diversified energy supply, and increased compliance with EU energy regulations. Progress in the gas market has gone further than the electricity market, where cross-subsidisation persists (highly subsidised consumer prices paid by energy suppliers).

Energy efficiency will remain an issue in the coming years. The issue is now higher on the country's radar, as illustrated by the new 'Energy Strategy of Ukraine', adopted in 2017, which has a strong focus on renewable energy and the recent requirement for all utilities to install heat and hot water meters[178]. The total installed capacity of the 'green' energy sector has grown exponentially in recent years, from 1.44 per cent share in electricity generation[179] by the end of 2017 to 10.8 per cent[180], to the point of outgrowing the absorption capacity of the transmission system and triggering plans to reduce renewable subsidies.

Box 24. Social safety nets - energy

The social safety net reform in the energy sector took a two-step approach. The condition in the second tranche focused on ensuring increased coverage of the existing schemes so as to cushion the impacts of the energy reform. It worked well, albeit at a higher cost than originally envisaged: the rise in tariffs and the associated increase of eligible households, along with the simplification of the procedures required for financial assistance, led to an expansion in the coverage of the subsidies which had not been fully anticipated[181]. In a second step (third tranche condition), the requirement to compensate vulnerable households was still essential, but the aim also was to allow for better targeting and to limit the fiscal implications of the programmes. The Ministry of Social Policy in Ukraine adjusted the benchmarks of the housing and utilities subsidies scheme to limit outlays, improve targeting and encourage energy efficiency. More specifically, this involved lowering the subsidised threshold for gas

[177] See: http://naftogaz.com/www/3/nakweben.nsf/0/A09B58DD11619020C22584F1002A61B6?OpenDocument&year=2020&month=01&nt=News&

[178] See: https://censor.net.ua/en/news/450036/law_on_mandatory_installation_of_heat_and_water_meters_in_residential_buildings_comes_into_force

[179] https://www.tandfonline.com/doi/full/10.1080/15387216.2019.1593210

[180] https://ua.energy/installed-capacity-of-the-ips-of-ukraine/

[181] IMF (2020). Ex post evaluation of exceptional access under the 2015 extended arrangement - press release and staff report. Available at: https://www.imf.org/en/Publications/CR/Issues/2020/06/16/Ukraine-Ex-Post-Evaluation-of-Exceptional-Access-Under-the-2015-Extended-Arrangement-Press-49518?cid=em-COM-123-41725

consumption, from 7m^3 gas per m^2 floorspace to 5.5 m^3 gas per m^2 floorspace. Additional measures involved tightening controls to prevent applicants under-reporting their income, and the gradual phasing out of energy privilege programmes (including the Housing and Utility Privileges (PRIV) programme)[182]. In the years following the tighter measures, the number of households receiving subsidies and the average payment of housing and utility services decreased. In the heating period 2018-2019, over four million households received subsidies and the average payment was about UAH 1,700[183]. By early 2020, the number of households receiving subsidies decreased to 2.8 million and the average payment decreased to UAH 1,200[184].

Social safety net reform in the energy sector was an area where the IMF, World Bank and EBRD were all very active, and the MFA condition reinforced that message.

Box 25. Social safety nets - IDPs

There were two MFA conditions on IDPs. Condition #16 of the third tranche consisted of preparing a first evaluation of social service delivery to IDPs and ensuring effective follow-up. The MFA condition was useful, as the report was not only undertaken by two independent experts but, at the insistence of DG ECFIN, was made available on the website of the Ministry of Social Policy[185]. The evaluation provided various recommendations[186], with follow-up actions reported by the Ministry of Social Policy. The Study team understands that no major gap has been identified in the implementation of the recommendations[187]. The report was widely shared with CSOs, the United Nations Human Rights Agency (UNHCR) and other international organisations and reportedly informed the delivery of humanitarian response by donors in Ukraine.

The other IDP condition (#12, 2nd tranche) focused on results (‘*Ensure the effective provision of social benefits and services to internally displaced persons (IDPs) through adequate legislation and funding*’). It was a useful means of exerting pressure on the authorities to reactivate the Ukrainian authorities’ IDP programme in 2016 after its suspension. It is reasonable to assume that the process would likely have taken longer without the MFA condition, which is an achievement in itself. However, it was not sufficient to prevent a deterioration of the living situation for those in the non-government- controlled areas of the Donetsk and Luhansk regions.

Box 26. Business environment – trade and customs, deregulation

[182] Beneficiaries of energy privileges schemes are gradually being transferred to the housing and utilities subsidies scheme and (since 2016) benefits from the two schemes cannot be combined.

[183] Ministry of Social Policy (2020). *Interviews*.

[184] *ibid.*

[185] http://www.msp.gov.ua/news/13403.html

[186] Recommendations covered the following themes: ‘Suspension of Payments’, ‘Voting’, ‘Birth, Marriage and Death Certificates’, ‘Elderly and Disabled Pensions’, ‘Database’, ‘Legal Aid’, ‘Coordination’, ‘Strategy’, ‘Resources’, ‘Psycho-social support’, ‘Compensation’, ‘Sharing Data’, ‘Health System’, ‘Means Testing’, ‘Accommodation’ and ‘Employment’.

[187] European Commission (2017). Note to the European Parliament and the Council Macro-Financial Assistance to Ukraine: Third Disbursement Under MFA III.

Despite the success in reorienting Ukraine's exports towards the EU (the EU has now become Ukraine's primary export market), the trade area has been a difficult one. The condition on the need to meet Ukraine's World Trade Organization (WTO) obligations and refrain from introducing new trade-restricting or trade-distorting measures has been problematic ever since the introduction of the wood export ban in autumn 2015. MFA III may have been a contributory factor preventing the introduction of further trade distortion measures but that particular trade irritant was not be solved within its timeframe and the issue remains with an arbitration panel. The condition obtained a waiver ahead of the disbursement of the second tranche, before becoming one of the reasons for the non-disbursement of the third tranche. The wood export ban has, over time, grown from a technical problem of relatively limited economic significance to a political major issue.

In parallel, there was some progress on the alignment of national legislation with EU customs legislation. The key milestones were not achieved within the timeframe of the MFA III itself (the Parliament adopted the Law on the Regime of Common Transit and the on Authorised Economic Operators in September 2019[188]) but the preparatory work was done. MFA III was one driving factor for progress in the customs area, alongside other EU programmes (sectoral budget support programme in the area of public finance management already at the time of MFA III, new EU funded technical assistance programme "Public Finance Management Support Programme for Ukraine (EU4PFM) and its Customs Component launched in 2019).

Deregulation was quite high on Ukraine's reform agenda. Formal procedures for starting business are now relatively straightforward in Ukraine, as evidenced by positive trends in ease of doing business indicators (gain of 12 positions in Doing Business Ranking between 2016-2019). First steps for the effective enforcement of contracts were also taken, with the creation of the role of private enforcement officers who are authorised to enforce court decisions (with certain exceptions), alongside the state enforcement officers. Focus group participants referred to the need to ensure properties rights and the rule of law as the main potential driver to attract FDI in the future.

Box 27. Financial sector

The significant efforts of the NBU on this front have been widely acknowledged[189]. In the pursuit of a healthy and stable banking system, the sector has experienced significant regulatory changes that saw the closure of multiple banks. Substantial progress has been observed on reducing systemic risks. On the condition to limit related-party lending by banks, the country has undertaken a related-party lending diagnostic review and put the necessary measures in place. Additionally, the condition on the set up of a credit registry has also been fulfilled, with the approval of the relevant law in March 2018. However, small loans are still excluded from the NBU registry and the obligation of banks to consider information contained in the registry was temporarily suspended due to COVID-19.

[188] EEAS (2019). Association implementation report.

[189] NBU (2019). NBU publishes 2018 progress report on comprehensive programme for financial sector development. Available at: https://old.bank.gov.ua/control/en/publish/article?art_id=89102892

VoxUkraine (2019). Statement on the attacks on the former NBU Governor, Valeria Gontareva. Available at https://voxukraine.org/en/statement-regarding-the-attacks-on-the-former-nbu-governor-valeria-gontareva/

MFA support has been relevant in guaranteeing the implementation of due reform more quickly and efficiently. It reinforced the IMF conditionality in the case of third-party lending and contributed to drawing the importance of the central credit registry to Parliament's attention. Given how unpopular the setting up of the central credit registry was, it is unlikely that the final draft would have been adopted without pressure from the international community (the first draft reflected the interests of the credit bureaus).

8 Social Impact Analysis (SIA)

Key findings of the SIA include:

- **The cushioning effect of housing and utility subsidies** – The housing and utility subsidies that were bolstered during the MFA operation period had the effect of cushioning the impacts of higher prices resulting from energy reform. For the average household, however, the price increases associated with housing and utilities were not fully offset. The new subsidy schemes were easier to access and more progressively structured, and it is plausible that vulnerable households were better protected. However, available expenditure and income data do not provide sufficient information about social outcomes by income decile.
- **Mixed findings for the provision of social services for IDPs** – The temporary social assistance programmes for IDPs (set up as interim measures during the conflict in the East) were made permanent. However, the suspension of social payments to many IDPs is likely to have damaged the living standards of many Ukrainian citizens. Steps taken after the suspension of social payments also showed mixed results. By early 2017, while the vast majority of applications for the resumption of social payments had been processed, the initial administrative response to these applications was slow and left a considerable minority IDPs with their social payments suspended.
- **Tentative improvements to labour markets and social outcomes** – Although unemployment rates and inflation were high during and after the MFA III operation, there are tentative signs of improvements to labour markets and social outcomes. A key factor in these improvements is the pace of nominal wage growth, which exceeded consumer price inflation during and after the MFA III operations. Evidence on average household expenditure and income similarly shows that the growth in household resources outpaced growth in household expenditure over 2016-2018.
- **Some negative impacts associated with no first tranche MFA III (Alternative 1)** – Reductions in government spending may have been necessitated by the absence of the first tranche of the MFA. In particular, the government may have responded by delaying the unfreezing of increases in public pension payments (decreasing the value of these payments in real terms), negatively affecting household resources from 2015.
- **Likely negative impacts stemming from the absence of second tranche conditionalities (Alternative 2)** – The absence of second tranche conditionalities would likely have had an impact on the pace and depth of reform of social safety nets. This would have impacted the social situation in Ukraine, considering the need for compensation mechanisms to protect vulnerable households and the importance of the resumption of social benefits and services for IDPs. The absence of budgetary support (provided by MFA) would likely have been offset by increased domestic financing, with limited social impacts.
- **Limited impacts of the addition of third tranche MFA (Alternative 3)** – Similar to Alternative 2, the additional budgetary support is unlikely to have resulted in any material change to fiscal policy (thus limited impact on the social situation). Some stakeholders noted that the disbursement of the third tranche of MFA III would have

had negative impacts on the credibility of MFA conditionalities, because the third tranche conditions were not fulfilled.

- **A sovereign debt crisis in the absence of MFA and IMF support** – The absence of any support from the IMF and MFA would likely have created a sovereign debt crisis. Such a crisis typically blights the macroeconomy with issues such as economic recession, increased rates of unemployment, high levels of inflation and/or cuts to public services and wages, all of which would have had a substantial negative effect on the social situation in Ukraine.

9 Debt Sustainability Analysis (DSA)

In response to the conflict and the abandoning of the peg between the hryvnia and the USD, the hryvnia lost nearly 70 per cent of its value between 2013 and 2017. In conjunction, real GDP declined substantially in 2014 and 2015. With hryvnia depreciation and foreign currency debt forming around 60 per cent of the government's debt stock in 2014, nominal gross public debt increased from 40.8 per cent of GDP in 2013 to 70.5 per cent in 2014.

In the baseline, over 2015-2017, nominal gross public debt as a percentage of GDP was projected[190] to be higher than levels observed during 2013-2014, at 79.8 per cent in 2015 and 81.9 per cent in 2016. Even though this ratio was projected to fall somewhat in 2017 (driven by a primary surplus and real GDP growth), it remained at elevated levels (72.8 per cent). A debt-to-GDP ratio persistently above 50 per cent implies heightened risk and warrants higher levels of scrutiny to assess debt sustainability.

Similarly, the public gross financing needs-to-GDP ratio was projected to increase rapidly as a result of the growing cost of servicing public debt over the same period. In the baseline, the projections indicated the gross financing needs-to-GDP ratio increasing from 6.0 per cent in 2014 to 12.5 per cent in 2015. Despite debt restructuring in 2015, the ratio increased further to 13.3 per cent in 2016, due to an additional UAH 121 bln financing required for the recapitalisation of domestic banks.

Had Ukraine not received the first tranche of MFA III funding in July 2015 (Alternative 1), the Study team assessed that the most likely government response would have involved cuts to public spending - specifically to pension payments, public services and cuts to capital expenditure, such as investment in infrastructure. Other options, such as issuing new debt in domestic and international markets, were considered unfeasible given the weak banking sector and the fragile circumstances that followed the 2014 crisis. Public borrowing would thus have decreased by the amount of the first tranche of funding (EUR 600 mln, or UAH 16 bln). The presence of other donors in Ukraine, notably the IMF, was expected to cushion the hryvnia from the negative impact of not having received the first tranche, thus no impact on the exchange rate was assumed. Government revenues were not expected to have been substantially affected in this scenario, although the longer term revenue implications (of somewhat reduced growth) are less clear.

Through fiscal multiplier analysis, it is estimated that cuts to government spending would have resulted in a real decline in Ukraine's GDP of EUR 860 mln in 2015 and EUR 860 mln in 2016 (or over 1 per cent of real GDP in those years). Notwithstanding this, the combination of reduced borrowing and lower GDP would have resulted in a relatively unchanged debt sustainability position compared to the baseline: nominal gross public debt as a percentage of GDP was projected to have been higher by just 0.1 p.p. in the absence of tranche one in 2015

[190] For 2015, 2016 and 2017, the presented values are projections modelled using data on Ukraine's debt profile and sources of finance over that period. Imputations and estimates were used to compensate for data gaps. As a result of these estimates, the projected values for indicators in 2015, 2016 and 2017 may diverge from the historical values reported in statistical publications.

and 2016 compared to the baseline and lower by 0.7 p.p. in 2017 (as a result of the lower financing needs).

Had Ukraine not received the second tranche of MFA III funding in April 2017 (Alternative 2) , the Study team assessed that the most likely counterfactual would have been for the Ukrainian government to borrow the equivalent amount from domestic debt markets to fill the financing gap. In contrast to the situation in 2015 (during which the first tranche of MFA III was disbursed), by 2017 the risk to debt sustainability had moderated somewhat as the economy improved and the situation in the East stabilised (marked in part by the oversubscription of the September 2017 debt issuance) in the baseline.

Assuming borrowing terms similar to Ukraine’s 2017 USD-denominated issuance of debt maturity at 1.5 years and interest rates of 4.0 per cent (compared with the MFA III second tranche interest rate of 0.75 per cent p.a.), the DSA indicated potential additional interest payments of approximately EUR 29.3 mln over the one-and-a-half years of the alternative borrowing terms. Debt-to-GDP and gross financing needs ratios would have remained unchanged and, accordingly, debt sustainability would likely not have been substantially affected. If Ukraine had had to seek alternative long-term financing arrangements to roll over the domestic issuance upon its maturity, the potential cost of additional interest payments over the 14-year period covered by the MFA second tranche (had Ukraine not received this tranche) could potentially have been a lot higher (but likely still viable given Ukraine’s successful debt issuances in 2018 and 2019 in the baseline).

In the scenario in which Ukraine received the third tranche of MFA III funding (Alternative 3), the Ukrainian government would have been able to reduce domestic borrowing by the same amount. Accordingly, the release of the MFA III third tranche would have resulted in loans to the Ukrainian government at more favourable terms than the debt that was actually issued.

Assuming third tranche terms as those offered by the EU in the MFA III second tranche (14 years maturity and an interest rate of 0.75 per cent p.a.), the lower interest rate (3.25 p.p. lower than that of the domestic debt issuance in the baseline) would have resulted in lower interest payments of EUR 29.3 mln over the one-and-a-half years that the domestic debt issuance would have covered. Debt sustainability would not have changed markedly as a result of receiving the third tranche.

Under the no MFA, no IMF scenario, Ukraine would not have received the rescue packages provided by the EU and the IMF. In addition to not receiving funding amounting to approximately EUR 8.9 bln, no MFA III and no IMF funding would likely have severely impaired Ukraine’s ability to source funding from domestic and international debt markets and would have decreased the availability of assistance from sources such as the World Bank and the EBRD. The conditions that came with the IMF and EU support packages would likely have encouraged reforms that would have further improved Ukraine’s finances. In the absence of those conditionalities, Ukraine’s debt burden would probably have increased. In conjunction with the assessment that very limited cuts to public spending would have been politically feasible, it was judged that Ukraine would most likely have defaulted on its debts over 2015-2017. Given the likelihood of sovereign debt default and the speculative nature of subsequent impacts on the Ukrainian economic and political situation, the DSA tool was not applied for Alternative 4.

Taking these findings together, the DSA analysis suggested that the improved economic situation strengthened Ukraine’s debt position and increased the feasibility of alternative debt financing to MFA III in 2017. More fragile conditions in 2015 meant that in the absence of the first tranche, the government would have had to make politically difficult cuts that would have had slightly higher (albeit still limited) impacts on the country’s debt sustainability. Potentially, cuts to public spending in Alternative 1 (specifically to infrastructure) could have had longer term implications for productivity and government revenue, further undermining the debt sustainability position.

10 Efficiency

Question 3: *Was the disbursement of the financial assistance appropriate in the context of the prevailing economic and financial conditions in the beneficiary country?*

This question is addressed by an analysis of the timing of disbursements (see Relevance section)

Question 4: *In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its cost and its objectives?*

This question is addressed by analysing:

- Entry conditions for the MFA operation (ownership and capacity for reform);
- Flexibility of the operation to adjust to contextual changes;
- Effectiveness of the dialogue between the European Commission and Ukrainian authorities;
- Effectiveness of monitoring of the MFA operation;
- Visibility of the MFA and surrounding communication activities.

10.1 Timing of the disbursement of financial assistance

A discussion of the timing of the disbursements can be found in Section 5 (Relevance).

10.2 Design of MFA assistance and efficiency of implementation

10.2.1 Ownership of the programme by the Ukrainian authorities

In the two years following Maidan, efforts were made to reform Ukraine quickly. A long list of commitments were made under the AA and MFA III and key milestones were achieved (e.g. e-procurement system, gas sector).

In 2016, however, the pace of reform slowed. The impacts of the efforts made to curb corruption were undermined by the remaining deficiencies of the judicial system.

Already evident under MFA I and II, different ministries/bodies embraced the reform process with varying levels of commitment: the Ministry of Finance and NBU were among the key promoters of reform, while progress was slower and more difficult where other ministries, agencies or stakeholders needed to be involved (e.g. Parliament, Ukrainian independent authorities for the AC conditionality[191]).

Overall, the authorities' level of ownership was uneven and slowed over the timeframe of the operation. In many areas, reforms were promoted thanks to public demand, pressure from Ukrainian civil society, international players and reform-oriented stakeholders within the governmental organisations, but full political will among State leadership seemed, in some instances, to be lacking. There was active resistance, for example, with laws aimed at reducing the effectiveness of the reform regularly submitted and enacted by the Parliament (e.g. when activists involved in combating corruption were required to declare their assets or when illegal enrichment was decriminalised by the Constitutional Court of Ukraine). Similarly, there was conflict between 'old' staff and newly appointed pro-reformers within the public administration.

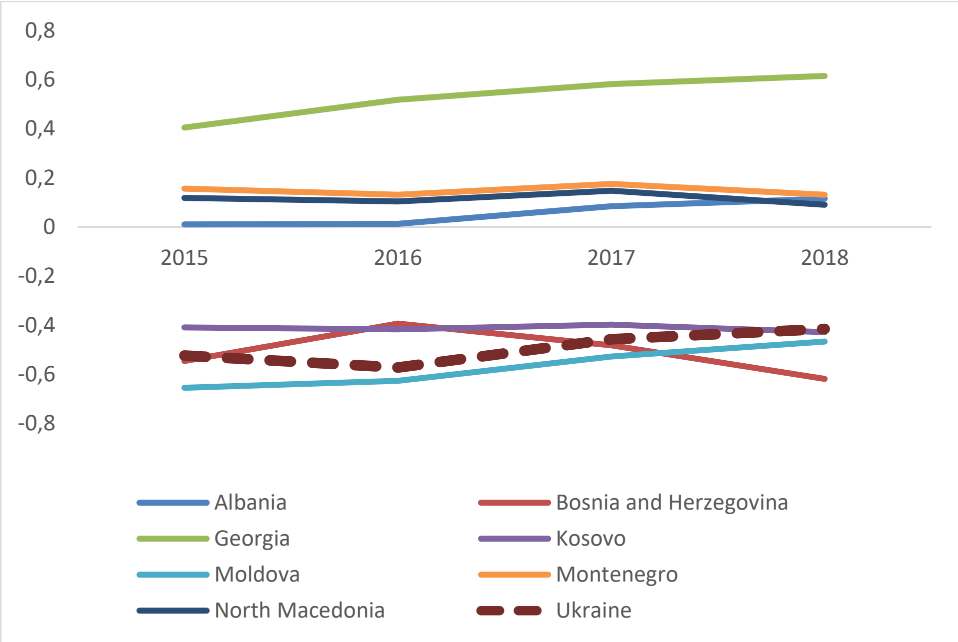
[191] View expressed by the EU Delegation in Kyiv.

10.2.2 Capacity for reform

Lack of administrative and policy-making capacity was an issue in Ukraine.

The World Bank's Government Effectiveness indicator (which captures the quality of public service provision, quality of the bureaucracy, competence of civil servants, independence of the civil service from political pressures, and credibility of the government's commitment to policies) places Ukraine in the bottom group, compared to its Eastern neighbourhood peers, far behind Georgia.

Figure 30. Indicator of government effectiveness: Ukraine vs peers, 2015-2018



Source: World Bank's Worldwide Governance Indicators

Note: score on the aggregate indicator is in units of a standard normal distribution, i.e. ranging from approximately -2.5 to 2.5.

This capacity issue is summarised by EBRD's Ukraine Reform Architecture team as a matter of (i) civil servants 'playing for time', outlasting the ministers; (ii) too many strategies, with too little implementation; (iii) 'Flying experts'; and (iv) insufficient capacity to coordinate support actions.

Even where present, capacity issues did not seem to cause the lack of progress on some key reforms, according to the stakeholders consulted during the interviews and the focus group. Many complementary technical assistance programmes were put in place by the EU and others to assist the authorities in their efforts (see Section 6.3.5).

10.2.3 Flexibility and adjustments to implementation given exogenous factors

In general, the MFA instrument provides for some flexibility and if the MFA condition(s) is not met but the beneficiary country is making good overall progress and corrective actions are in place, the Authorising Officer by Delegation or Sub-delegation may decide to grant waivers. These waivers should be adequately documented[192]. In the case of MFA III, the second tranche was disbursed after 20 months and required the granting of two waivers. The first was granted in relation to the condition on delivery of social assistance to IDPs (# 12, 2nd

[192] European Commission (2008). Guideline on Macro-Financial Assistance to third countries.

tranche). The second waiver was related to one trade condition, more specifically the issue of the wood export ban (# 13, 2nd tranche).

More importantly, the last tranche of the MFA III was eventually cancelled, which itself is rather rare for MFA operations. This was primarily due to issues related to the fulfillment of two of the third tranche's AC conditions: verification of the asset declaration system and ultimate ownership beneficiaries. Two other conditions were also unmet – in the financial sector area, on a central credit registry and in the trade sector, on the lifting of the wood ban. All four conditions are listed as triggers for the non-disbursement in the Cancellation Decision. The interviews revealed, however, that the lack of progress on the AC conditions weighed heavily in the non-disbursement decision. Insufficient progress of some reforms under the IMF EFF programme was an additional factor (again, AC conditions particularly)[193]. Opinion polls on attitudes towards the EU frequently confirm that the general public in Ukraine associates the EU (very) strongly with the rule of law and transparency. In that context, there is a view (confirmed at the focus group) that it would have damaged the EU's reputation (and that of pro-reformers in Ukraine) if the disbursement had taken place under those circumstances. EU and other IFI stakeholders tended to support the EU choice, preferring to highlight the positive impact of the non-disbursement ('disciplinary effect') as a trigger to focus on reform and take conditions more seriously. Some observed that the EU could have been firmer with the second tranche, pointing out that waivers were granted after the Ukrainian side intervened at the political level, and were concerned about the message that it sent.

The non-disbursement of the third tranche had negative economic consequences, according to the Delphi experts. However, there was consensus among the stakeholders interviewed (and the Study team) that, by late 2017, the macroeconomic conditions had improved significantly in Ukraine. The decision was therefore adequately balanced, in light of the MFA III's macroeconomic objectives. The non-disbursement could not, in view of the Study team, be ascribed to a lack of sufficient flexibility from the EU side.

10.2.4 Liaison with Ukrainian authorities

As with any MFA operation, effective dialogue between the Ukrainian authorities and the EU (via DG ECFIN and the EU Delegation in Kyiv) was essential in reaching a common understanding and commitment to the conditionality and proper management of disbursements.

The two main channels through which this dialogue took place were:

- Missions of the DG ECFIN staff to Ukraine, typically involving two/three experts from the DG, lasting a few days and organised every four-five months, to assess progress in the implementation of reforms;
- Regular discussions through the EU Delegation in Kyiv, SGUA, EEAS, EUAM;
- MFA-related aspects were occasionally discussed at political level, e.g. through official letters sent by Vice-President, Dombrovskis, or bilateral dialogue between Commission President Juncker and Poroshenko. These discussions focused on some problematic issues that emerged during the implementation (e.g. establishment of NABU, set-up of the asset declaration system, wood export ban issues, IDP issue).

Similar to the previous MFA I and II operations, the Ministry of Finance of Ukraine coordinated the implementation of the MFA III operation on the Ukrainian side. Overall, there was good cooperation between the Ukrainian authorities (led by the Ministry of Finance) and DG ECFIN, EU Delegation, SGUA and EEAS. Excellent collaboration between the NBU and EU staff was instrumental in the implementation of the conditions in the financial sector area. Coordination

[193] European Parliament (2018). Further MFA to Ukraine. Available at: http://www.europarl.europa.eu/RegData/etudes/ATAG/2018/623530/EPRS_ATA(2018)623530_EN.pdf

within the Ukrainian side seems to have been more challenging, given the lack of ownership beyond the Ministry of Finance and NBU.

10.2.5 Visibility of the MFA

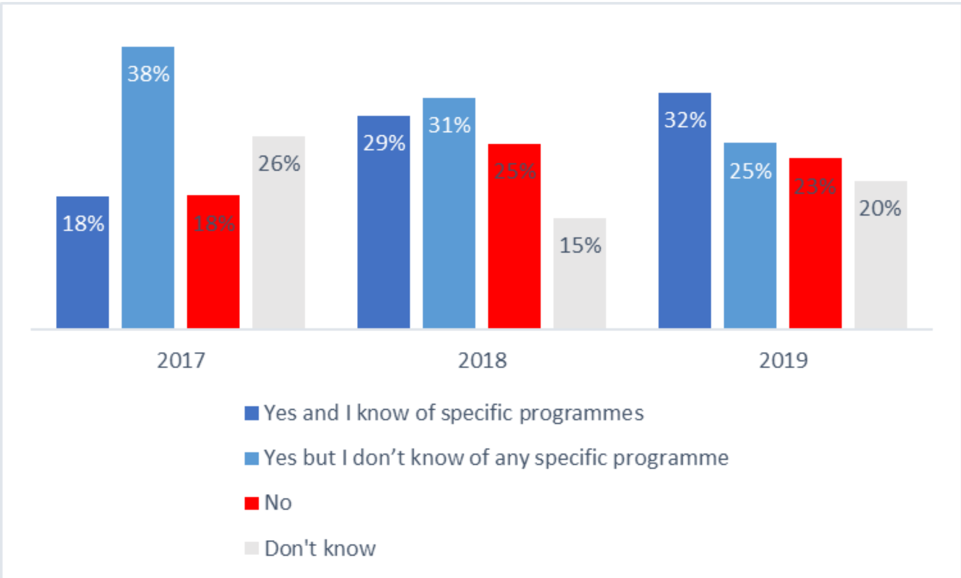
Overall, the evidence suggests that MFA III had limited visibility, although this varies depending on the audience and the reform area. Knowledge seems to be restricted to specific reform areas or some key facts (amount, number of tranches, link to the IMF programme). This is not surprising and seems to be aligned with findings from previous MFA evaluations.

While this Study did not envisage a systematic media content analysis to gauge the media coverage of the MFA III, previous evaluations of MFA I and II undertook a separate media content analysis (Twitter, the press), which provided further evidence of the limited visibility of MFA. Key findings from the Twitter analysis concluded that conversations about MFA I, II and III in English, Russian and Ukrainian were predominantly neutral – tweets typically made brief reference to the announcements of the loan disbursements with an indication of the actual amount. Additionally, tweet volumes spiked around the dates of disbursements, otherwise the volume of tweets related to MFA was low. Like the Twitter analysis, most of the press articles appeared shortly before or after MFAs disbursements. The vast majority of articles (85 per cent) were neutral and 15 per cent had a positive tone. Very few articles discussed the potential impact of the MFA.

Contributing factors to a low level of MFA III awareness include: i) complexity of public finance and macroeconomic issues for the general public; ii) lack of publicity on MFA conditionalities, financial aspects of the support (e.g. interest rate) and impacts of the programme; iii) confusion of MFA operations with other EU and IFI programmes conducted in parallel, making it harder to distinguish the source of the funding.

Annual opinion polls conducted as part of the project 'OPEN Neighbourhood – Communication for a stronger partnership: connecting with citizens across the Eastern Neighbourhood' showed that the share of those with knowledge of specific EU programme represented only a fraction of those with general awareness that the EU provides support.

Figure 31. As far as you know, does the European Union provide Ukraine with financial support?



Source: EU NEIGHBOURS East (2019). Annual survey report, Ukraine, 2019

Where respondents are aware of specific EU programmes, they tend to be related to education, health or energy. Programmes on economic reform/business promotion are at the bottom of that list.

Experts typically have greater awareness of MFA III than the general public. However, even among the Delphi panel, only one in two declared that they knew the specifics of the macro-financial assistance provided to Ukraine. Among participants in the focus group, the share was one in four.

The MFA AC conditions attracted wider interest from the professionals/activists in the field and from the general public, with specific conditionalities discussed extensively in the Ukrainian media[194]. The communication organised by some CSOs was one contributing factor.

EC activities to promote MFA assistance included press conferences and press releases at the time of the approval of the operation, the signature of the MoU and the subsequent disbursements[195]. The press releases described general budget allocations, particular conditions included in the operation, progress made by Ukraine in achieving agreed milestones, and the release/delay of MFA disbursements. The communication between DG ECFIN and the EU Delegation in Kyiv ahead of the disbursements was described by stakeholders as very effective, which created clarity for disbursement/non-disbursement, both in the press and for all concerned.

10.2.6 Monitoring process

Monitoring of MFA III drew on a number of sources:

- Regular progress reports submitted by the Ukrainian authorities;
- Regular missions of the DG ECFIN staff to Kyiv, combined with desk research by DG ECFIN and experts from the EU DEL and SGUA;
- Various assistance provided by the EU Delegation, including logistical support (e.g. preparation of the missions, or coordination in scheduling the phone calls between DG ECFIN and Ukraine), as well as data collection, its analysis and interpretation, underpinning the implementation of specific conditions;

Given the complementarity with the conditionality of other donors, there was regular and close collaboration with other donors, in particular the IMF (e.g. AC and public finance management reforms). Overall, the regular and effective dialogue between the Commission, the IMF and the World Bank was highlighted independently by the staff from all three institutions, both at the design and monitoring phases.

Overall, the monitoring activities conducted by the European Commission were quite similar to those carried out by the IMF. The Fund, as part of its EFF programme, envisaged 15 quarterly reviews, entailing the technical mission to Ukraine and close involvement of the IMF representative based in Kyiv[196].

In Ukraine, even more than in other third countries that had received MFA assistance in recent years, CSO/NGOs played a particularly active and crucial role in monitoring the implementation of the conditionalities, including the assessment of progress vis-à-vis the progress communicated by the authorities. This was particularly relevant for the conditions related to the IDPs and AC measures.

[194] See, for example, https://www.kyivpost.com/article/opinion/op-ed/daria-kaleniuk-tough-anti-corruption-conditions-essential.html

[195] See, for instance, the press release accompanying the second disbursement of EUR 600 mln in March 2017. Available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_17_643

[196] IMF (2015). Ex post evaluation of the EFF programme. Available at: https://www.imf.org/en/Publications/CR/Issues/2020/06/16/Ukraine-Ex-Post-Evaluation-of-Exceptional-Access-Under-the-2015-Extended-Arrangement-Press-49518

The previous evaluation of the MFA I and II found that some mission reports indicated certain issues in relation to the insufficient provision of information by the Ukrainian authorities, such as insufficient data related to the condition for VAT refund arrears or inconsistencies in the data on Naftogaz collection rates. However, this evaluation has not identified any specific weaknesses in this respect, neither in the course of the review of the mission reports nor during discussions with the relevant DG ECFIN staff.

11 EU added value

Question 5: *What was the rationale for an intervention at EU level and to what extent did the MFA operation add value compared to other interventions by other international donors? Did the operation actually lead to the expected impacts and added value of international cooperation, and what can be learned for future operations?*

Judgement criteria

- Financial added value - the availability of MFA on highly attractive terms generated budgetary savings for Ukrainian authorities;
- EU Member States would not have been able to mobilise resources of a similar nature (in terms of size and form) and/ or within the same timeframe in the absence of the MFA;
- MFA III reinforced the Ukraine government's commitment to socioeconomic reform;
- The EU had a discernible influence on the choice and design of reforms promoted by other actors;
- Leverage in pulling together and accelerating a multi-donor package;
- Evidence of signalling and confidence-building.

11.1 Financial added value

Financial added value is an important aspect of added value to examine, more specifically whether individual Member States could have mobilised the resources at the scale required. European Commission statistics illustrate that this would not have been the case, with Member States mobilising EUR 1.4 bln post-Maidan (compared to the Commission's EUR 15 bln commitments under the whole package)[197].

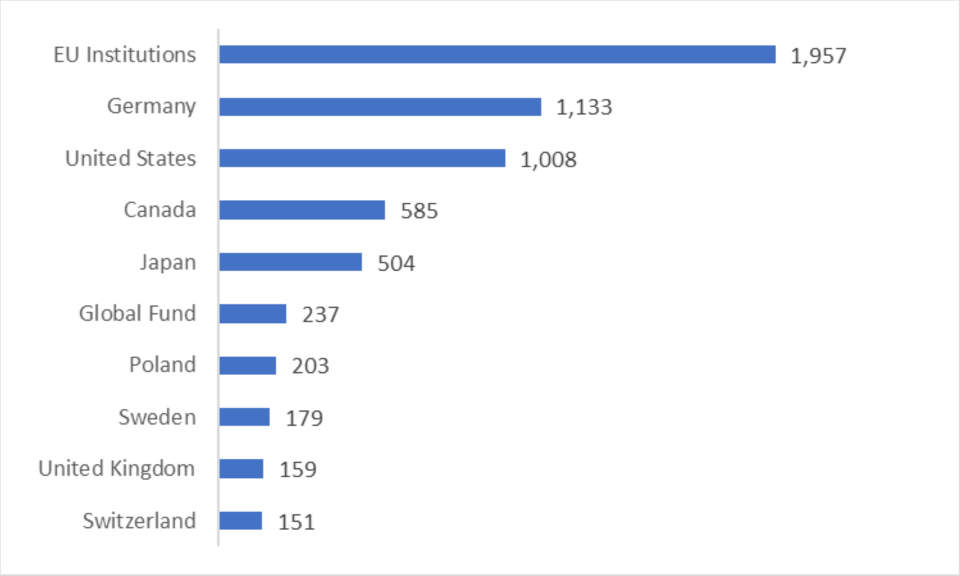
Ukraine benefitted from the support of both bilateral and multilateral donors (see Figure 32).

EU institutions ranked first among the top donors to Ukraine over the period 2014-2018. Germany, Poland, Sweden and France are the Member States in the top 10 providers of Official Development Assistance (ODA)[198].

[197] https://ec.europa.eu/neighbourhood-enlargement/neighbourhood/countries/ukraine_en

198 OECD (n.d.) ODA definition. Available at: http://www.oecd.org/dac/stats/officialdevelopmentassistancedefinitionandcoverage.htm

Figure 32. Top providers of Official Development Assistance to Ukraine, total 2014-2018, USD mln



Source: OECD statistics

Regarding the form of support provided, the evaluation of MFA I and II and the rapid review of available data show that Member State-level aid typically takes the form of project support e.g. DFID for the UK[199] rather than budget support. One exception was the KfW loan of USD 220 mln disbursed in 2015 as budget support. Further budget support was disbursed from Japan in 2014 and 2016 for a total amount of USD 434 mln, Norway 24 mln (in 2015) and France 0.7 mln (2014-2016)[200].

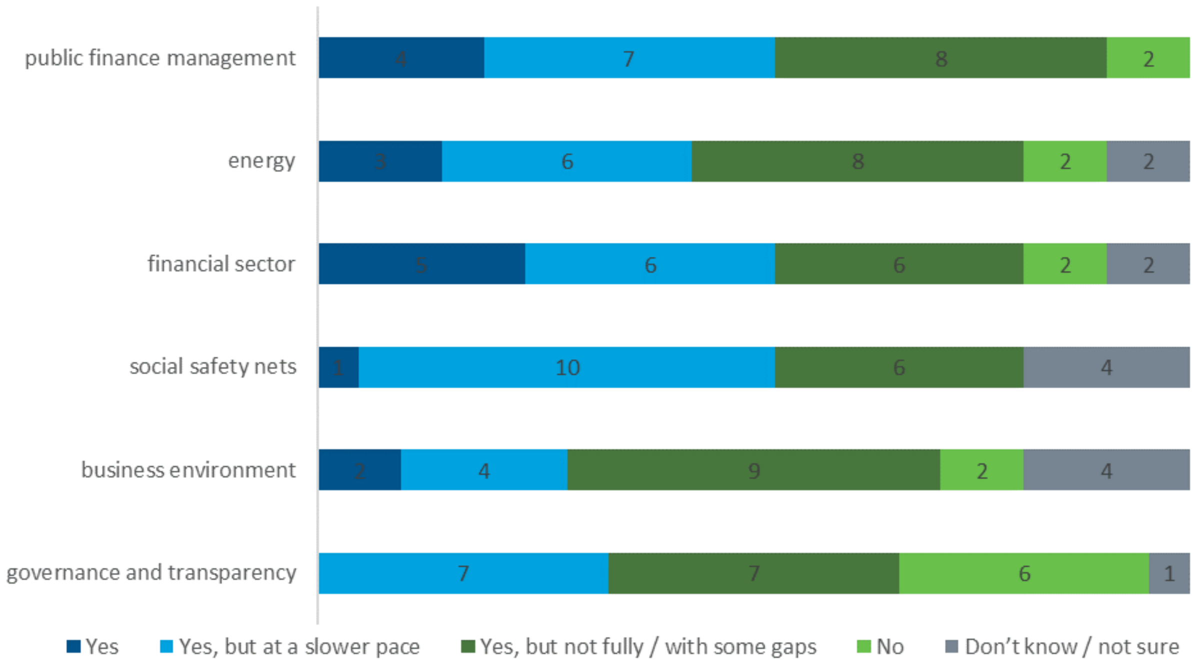
11.2 Reinforcement of government commitment to reforms

The Delphi experts observed that in the absence of the MFA, the reform process would have been slower and would have experienced some gaps.

199 UK (2018). DFID assistance in Ukraine. Available at: https://www.gov.uk/government/news/uk-programme-assistance-to-ukraine-2018-2019

200 OECD Creditor Reporting System.

Figure 33. Progress in reform areas in the absence of MFA III



Source: *Delphi survey. Base: all (n=21)*

The views of the focus group participants were no different. More specifically, they flagged the AC field and public administration reform as two areas where the EU push was particularly helpful. In the AC field, they reported that progress was driven first by strong public demand and second by a strong push from international partners of Ukraine. In the public administration reform domain, they noted the prevalence of the EU footprint, particularly given the complementary technical assistance programmes put in place.

Two areas where experts were more confident that progress would have been made even without the MFA are public finance management and the financial sector. This is consistent with other evidence collected, e.g. on the fact that the new PP system was a flagship initiative of the government. Even in these areas where there is sufficient ownership, international support can play a role in supporting ongoing efforts by being an argument for pro-reformers in case reform is blocked at Parliament. This was the case for condition #21, 3rd tranche, on the central credit registry, for which the NBU had ownership but faced resistance at the Parliament, in light of the lobbying by the credit bureaus.

11.3 Signalling effect to civil society and the general population

The AA (and discussions on other agreements, such as VLAP) created a real expectation that the EU would provide support to Ukraine at a time of crisis, as already noted under the evaluation of MFA I and II. Participants in the Delphi survey unanimously agreed that MFA III financing sent a strong signal of EU support to Ukraine.

Although general public attitudes in Ukraine towards the EU cannot be exclusively attributed to the MFA, annual opinion polls conducted as part of the project 'OPEN Neighbourhood – Communication for a stronger partnership: connecting with citizens across the Eastern Neighbourhood'[201] showed that the percentage of people holding a positive image of the EU

[201] EU Neighbours East (2019). Perceptions of the European Union. Public Opinion in Ukraine. Annual Surveys 2018 and 2019. Available at https://www.euneighbours.eu/sites/default/files/publications/2019-

rose from 49 per cent in 2016 to 56 per cent in 2019[202]. The focus group participants believed that MFA III was part of the overall EU package to Ukraine that altogether may have contributed to the positive image of the EU.

For AC CSOs, the MFA conditions were used as a means of leverage. In that context, they found the non-disbursement decision justified and generally reported that a disbursement under such circumstances would likely have represented a blow to the reputation of the EU, given how strongly the EU is associated with the rule of law: 'rule of law/human rights and equality' was the first thing spontaneously mentioned in relation to the EU by 11 per cent of respondents, second only to 'economic prosperity/high standards of living' (27 per cent)[203] .

Despite this overall positive image, one focus group participant highlighted that some Russian-inspired narratives had emerged on the negative impact of foreign assistance to Ukraine[204]. More generally, the MFA requirement to lift the wood export ban was viewed negatively by the focus group audience[205].

11.4 Confidence boosting effect on the private sector

Similar to MFA I and II[206], MFA III did not seem to impact private sector confidence in any clear-cut way. Nonetheless, although it is not possible to gauge the magnitude of the confidence boost effect induced by MFA III, it is clear that there was some political signalling effect, which combined with the IMF package to provide a seal of approval.

The stakeholders/focus group participants did not single out any specific evidence documenting the concrete impact of MFA III on business confidence. However, the Delphi survey found that experts had an almost unanimous view on the effect of MFA on general confidence, with the vast majority of respondents (18 out of 21) strongly agreeing/agreeing that 'the MFA III helped to restore confidence in the economy'.

While an analysis of the evolution of the foreign exchange rate over the period 2015-2018 does not allow the attribution of specific movements to the two MFA III disbursements, there was rapid appreciation of the hryvnia between late February and mid-March 2015 (Figure 8). This corresponds to the times when the IMF programme was negotiated and concluded and the parameters of MFA III were finalised. This suggests that MFA III, in conjunction with the IMF programme, contributed somewhat to this appreciation.

Ratings issued by the largest credit rating agencies (Moody's, S&P, Fitch) are typically carefully followed by the private sector and have a direct and meaningful impact on business confidence. Box 28 shows the summary of the main drivers of Fitch sovereign ratings for Ukraine, which reported downgrades and upgrades that were concluded throughout the period late-2013 through to 2018. While the weight attached to the IMF assistance was clearly greater, references to the EU support in general and to the MFA III operation more specifically

07/EUNEIGHBOURS%20east_AS2019report_UKRAINE.pdf
https://www.euneighbours.eu/sites/default/files/publications/2019-07/EUNEIGHBOURS%20east_AS2019_Factsheet_UKRAINE_ENG.pdf

[202] The trend was not linear, however, and there was a drop to 43 per cent in 2017.

[203] EU Neighbours East (2019). Perceptions of the European Union. Public Opinion in Ukraine. Annual Surveys 2018 and 2019. Available at https://www.euneighbours.eu/sites/default/files/publications/2019-07/EUNEIGHBOURS%20east_AS2019report_UKRAINE.pdf
https://www.euneighbours.eu/sites/default/files/publications/2019-07/EUNEIGHBOURS%20east_AS2019_Factsheet_UKRAINE_ENG.pdf

[204] This was also captured by the social media analysis conducted as part of the evaluation of MFA I and II to Ukraine

[205] See, for example, http://www.democracyhouse.com.ua/en/2018/round-timber-export-ban-historical-background-and-positions-of-stakeholders/

[206] See European Commission (2017). Ex post evaluation of MFA I and II to Ukraine. Available at: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities/ex-post-evaluation-mfa-operations-ukraine_en

also featured in the Fitch communication justifying its rating decision. A review of the Moody's sovereign ratings from the same period[207] paints a similar picture, although it contains no explicit reference to MFA I, II or III in its rating decisions issued between 2014-2018.

Box 28. Trajectory and key determinants of Ukraine's credit ratings – example of Fitch, 2013-2018

Fitch's Ukraine ratings – from sharp downgrades to gradual lift-ups

Between late 2013 and early 2014, Fitch downgraded its Ukraine sovereign debt rating twice: from B (e.g. 'junk status' – highly speculative) in early November 2013 to CCC (i.e. 'highly vulnerable to default') on 28 February 2014. The key rationale was the plummeting reserves of NBU, political instability, increased difficulty in sovereign access to external financing and worries that the IMF financing might not be deployed. Other, less critical aspects were surging NPLs in the financial system and the risk of sharp and uncontrolled depreciation. A further downgrade to 'C' (default status) was announced in August 2015, as Ukraine stopped some external debt repayments in the context of the ongoing debt restructuring negotiations.

The first upgrade, showing some signs of gradual stabilisation, occurred on 18 November 2015. The main factors determining that decision were the successful closure of the debt restructuring negotiations, which helped in the context of the public debt sustainability and stabilisation of the national currency. In November 2016, another upgrade was made, this time to 'B-'. This time, the main reasons were the easing of external financing pressure, rise in reserves, falling inflation and the stabilisation of the hryvnia. The modest resumption of growth was also noted. Throughout 2017 and 2018, the rating remained unchanged, with the next upgrade to 'B+' taking place in September 2019.

Almost all of Fitch's communication made explicit and extensive reference to the IMF programmes, which were often seen as a critical factor anchoring the country's economic performance and debt sustainability and a key stimulus for progress in structural reform. References to the EU support, whether MFA or via other channels, were much less frequent and had less 'weight' attached. Nevertheless, they still appeared in several instance in the form of general references to 'multilateral donor support' (e.g. 11 November 2016), explicit reference to critical importance of 'IMF and EU funding' (13 and 28 February 2014), explicit reference to EU MFA propping up reserves (18 April 2017) and explicit reference to the AA as a factor supporting confidence, investment and demand (8 November 2013).

Beyond the financial aspects, some individual conditions also had positive effects on the business community. These notably included (i) condition #4, 3rd tranche, on the reduction of public sector payment arrears, which had an immediate effect, and (ii) custom-related condition (#18, 3rd tranche), which will facilitate cross-border trade in the longer term.

[207] Moody's, 2014-2018. Ukraine. Available at: https://www.moodys.com/credit-ratings/Ukraine-Government-of-credit-rating-600037040?stop_mobi=yes

12 Broader reflections on non-disbursement and design of MFA conditionality

Given its exceptional character, the non-disbursement decision has been subjected to more detailed analysis over the course of this evaluation, to cover in-depth the underpinning factors, its perceptions and consequences.

Some broader reflections on the design of effective conditions were also developed from studying the 'atypical' conditions included in the MFA III operation.

12.1 Reflections on non-disbursement

Key facts

The MFA III operation expired on 13 January 2018, without the third and last disbursement being made, given the lack of sufficient progress with the implementation of some of the conditionalities. More specifically, the commitments on four concrete conditions were not sufficiently fulfilled:

- Condition 5 (AC), whereby Ukraine committed to setting-up an electronic asset disclosure system for public officials, including a verification mechanism, while starting to verify assets and possible conflicts of interest on the basis of the paper-based asset declarations submitted by officials in 2015;
- Condition 6 (AC), whereby Ukraine committed to putting in place mechanisms to verify, post-registration and on a selective basis following clear criteria, the accuracy of the information provided by companies and enforcing compliance with this obligation;
- Condition 17 (trade), whereby Ukraine committed to refraining from introducing trade-restricting or trade-distorting measures, in line with its WTO obligations;
- Condition 21 (financial sector), whereby Ukraine committed to establishing a central credit registry.

Insufficient progress on some reforms under the IMF EFF programme was an additional factor. There, too, conditions related to AC measures were the most problematic[208]. The Cancellation Decision was officially approved on 18 January 2018[209].

Factors leading to non-disbursement

In the four blocking conditions underpinning the Commission's non-disbursement decision, the issues which weighed most heavily were related to the non-fulfilment of the two specific AC conditions. By then, the wood export ban had become a major political issue and it is uncertain that a waiver could have been negotiated for the third tranche, similar to the second tranche. The fourth blocking condition (financial sector) was of relatively minor importance and was solved quickly after the expiration of the operation, in line with expectations at the time.

The main reasons for not implementing the AC conditions within the agreed timeframe were a lack of political will (e.g. absence of champion inside the government to push the reform), entrenched bureaucracy (slowing the process) and resistance from some stakeholders in Ukraine, who regularly attempted to reverse or limit the scope of the AC reforms. Key pro-reforming forces included civil society and the international community, led by the IMF, European Commission and the World Bank, which all agreed that vested interests were the key element. Had those vested interests been less present, or had the

[208] European Parliament (2018). Further MFA to Ukraine. Available at: http://www.europarl.europa.eu/RegData/etudes/ATAG/2018/623530/EPRS_ATA(2018)623530_EN.pdf

[209] C(2018) 405 final. Available at: https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-405-F1-EN-MAIN-PART-1.PDF

Ukrainian authorities put more efforts in overcoming them, the conditions could have been met. Interviews conducted as part of this evaluation pointed towards a material drop in ownership of the reforms in early 2016, making progress more difficult.

Perceptions of the non-disbursement decision

With the exception of the Ukrainian authorities (which challenged the achievability of the conditions within the agreed timeframe), the non-disbursement decision was generally seen as justified, by both the services consulted ahead of the adoption of the Cancellation/Suspension Decision (e.g. EEAS, SGUA, EU Delegation) and civil society in Ukraine.

Welcoming the disciplinary effect of the non-disbursement, the majority of the online focus group participants thought that it was justified, given the non-fulfilment of key AC conditions, in particular. EU credibility was reportedly at stake: turning a blind eye to the major shortcomings in reform progress by the Ukrainian authorities would have signalled EU willingness to compromise on its reform requirements. For instance, opinion polls on attitudes towards the EU in Ukraine traditionally show that the general public associates the EU (very) strongly with the rule of law and transparency (see Section 11). If the disbursement had taken place under the circumstances at the time, it might have had long-lasting consequences, rendering the 'MFA argument' - often used by AC CSOs for leverage – less powerful.

The EU had already shown some flexibility when disbursing the second tranche (albeit with some delays) by using the waivers. In early 2017, the waivers concerned the social assistance to IDP condition (# 12, 2nd tranche) and the trade-related condition (# 13, 2nd tranche). There seems to be a shared understanding that any further flexibility would have been counter-productive. The flexibility showed by the EU regarding the IDP condition was largely welcomed, with consensus that progress had been made, despite some outstanding issues. On the wood export ban, however, there were opposing views. Some on the EU side believed that the EU should have been firmer with the second tranche, claiming that these waivers were granted only after the Ukrainian side had intervened at the political level. They were already concerned that the granting of waivers might send a message on the decision-making process within the Commission, particularly at a time when the Ukrainian authorities were failing repeatedly on their commitments. With some exceptions, civil society stakeholders spoke of their support for the waiver, rejecting a pure 'checklist approach'. While admitting the need to respect WTO commitments and agreeing that, technically speaking, the condition might not be met, they put forward two considerations: (i) the wood export ban issue was not central to the broader context of Ukraine's reform path, and (ii) there were valid reasons behind the wood export ban[210]. In that context, civil society likely would have seen the withholding of disbursement (be it the second or third tranche) solely for that reason as unjustified.

Consequences

This evaluation has not found any evidence of negative political impacts originating from the non-disbursement decision. Based on the insights from the EU side and other IFIs, the collaboration between the Commission and the Ukrainian authorities remained unaffected. If anything, the positive impact of the non-disbursement was mentioned by the Commission staff directly involved in the design and implementation of the subsequent MFA IV operation, e.g. the 'disciplinary effect' that led to greater focus of the Ukrainian authorities on the implementation of the conditions and resulted in more honest policy dialogue between the two sides. Some focus group participants noted that the EU needs to walk a fine line when deciding on non-disbursement. In other

[210] Main arguments referred to: (i) the need to address an environmental issue to prevent deforestation of the Carpathian mountains; (ii) the aim to export furniture, processed wood rather than raw wood, with a view to protecting/developing local industries.

circumstances, if repeated too often or considered unjustified, non-disbursement could have undermined the EU-Ukrainian relationship and had international relation implications (pushing Ukraine towards others - including Russia - to meet its financing needs).

Looking at consequences at the economic level, the non-disbursement of the third tranche had some negative implications, according to the Delphi experts and Ukrainian authorities. However, that impact remained limited (see Section 9). The macroeconomic data show that in late 2017, the macroeconomic environment in Ukraine had already improved markedly. The stakeholders interviewed and the Study team believe that the decision was adequately balanced, in light of MFA III's macroeconomic objectives.

Another mitigating factor for the non-disbursement of the third tranche was the continuation of EU support to Ukraine. The non-disbursement did not end all EU programmes and the EU remained firm in its commitment to Ukraine. In particular, a new MFA IV operation was proposed as early as March 2018, two months after the cancellation of the third tranche under MFA III. The short interval between both operations meant that the MFA IV was sometimes presented as a replacement programme in the Ukrainian authorities' communications, according to stakeholders based in Kyiv. This is not to say that MFA IV was intended as such – the adoption of MFA IV followed the regular procedure and stemmed from an existing need, like every other operation. In addition, in terms of actual disbursement of funds, some time elapsed between MFA III and IV - the first disbursement under the MFA IV was made in December 2018. Lastly, stakeholders (other than the Ukrainian authorities) valued the firm hand of the EU in introducing conditions to be met ahead of the MFA IV first tranche, including in relation to MFA III unmet conditions[211]. This is believed to have safeguarded EU credibility: ignoring the unmet conditions in the subsequent operation would have watered down the effects of the non-disbursement of the third tranche.

12.2 Reflections on MFA conditionality

This evaluation raises some lessons learned in respect of conditionality that might usefully be considered during the design and implementation of future MFA operations.

Firstly, the number of conditions was too high for the timeline envisaged for the operation. The sheer number of conditions under MFA III (36 in total, 46 if sub-conditions are counted) did not lead to the non-disbursement of the third tranche but it may have impacted the implementation of the operation. The initial assumption that the MFA III conditionality could be successfully implemented in the short interval between 2015 and early 2016 was, with hindsight, overly optimistic. Many stakeholders on both the EU and Ukrainian side mentioned the benefits of prioritising and focusing on a lower number of conditions. A high number of conditions can have an overwhelming and/or discouraging effect and also distract attention and finite resources from the main priorities. It is generally seen as good practice to make more prudent use of conditionality[212], even though the reality of the design of a programme - with number of EU stakeholders wishing to leave their stamp on the conditionality - may be challenging and require a decisive halt to the continuous expansion of the conditionality list. The IMF reached a similar conclusion in its recent evaluation.

[211] MFA IV's first tranche was tied to conditions in relation to the verification system for electronic asset declarations and the verification of information on companies' beneficial ownership. The issue of the wood export ban is to be followed up through another setting (the dispute settlement mechanism). The issue with the delayed law in the financial sector area was solved in the meantime.

[212] See references in the Guideline on EU MFA assistance to third countries to 'limited number of structural conditions' and the 'principle of parsimony' referenced in IMF 2002 guiding principles on conditionality.

Some conditions had a high level of ambition and, with the benefit of hindsight, reforms could have been broken down into smaller steps.

- In general, setting an ambitious condition without defining the exact steps is an appropriate means of avoiding micro-management. However, in a context where ownership is suboptimal, a step-by-step approach is needed. It is always challenging to assess ownership level ex ante and the context may change over the lifetime of the operation, but the fact that MFA conditions cannot be renegotiated without amending the MoU and going through the whole decision-making process only adds to the challenge. Under the current framework, it is not easy for the Commission to switch from a flexible to a more hands-on approach.
- In the context of MFA III, the high level of ambition of the conditionality was appropriate in many areas, for instance in the energy sector, where key progress was made.
- One condition that led to withholding the disbursement of the third tranche was labelled as particularly ambitious, although, again, its level of ambition was not the sole explanatory factor: this is the beneficial ownership condition. In fact, with the exception of the UK, no Member State has such a system in place. One good point is that technical assistance was provided at the request of the Ukrainian authorities, albeit quite late in the process. The condition could have been kept in reserve for later or its scope could have been limited to make it more achievable. The MFA IV condition is more precise, specifying how to collect the necessary information so as to be systematic (i.e. company registration process). MFA III was less specific and more ambitious, mentioning the need to set up mechanisms (i) to verify the information provided, and (ii) to enforce compliance with the transparency obligation[213].
- Accordingly, the condition related to the verification of the asset declaration, once incorporated under MFA IV, was broken into two main actions: (i) putting the system in place, and (ii) demonstrating its actual use[214].

The conditions (# 13, 2nd tranche; # 17, 3rd tranche) **related to the need to avoid introduction of new trade-restricting or trade-distorting measures proved problematic**. Despite this type of condition being aligned with the guidelines on the drafting of MFA conditions (included in the Joint Declaration of European Parliament and

[213] MFA IV condition read: '*To ensure effective verification of information on companies' beneficial ownership in the Unified State Register of Legal Entities, Individual Entrepreneurs and Public Associations, amend the company registration process so as to require – whenever a legal entity seeks to register or change its entry – additional information on beneficial ownership, notably (a) the type of beneficial ownership, (b) the percentage of each beneficial owner's interest, (c) a description of the ownership structure in case a legal entity is not directly and wholly owned by its members/shareholders, and (d) a reasoned explanation in case no beneficial owner can be stated'*. MFA III condition read: '*Following the establishment of an online database on beneficial ownership of companies, put in place mechanisms to verify, post-registration and on a selective basis following clear criteria, the accuracy of the information provided by companies and enforce compliance with this obligation.'*

[214] MFA IV condition for the first tranche read: '*To put in place an automated verification system for electronic asset declarations of persons authorised to perform functions of the state and local self-government and thereby detect and prevent corruption, the Ukrainian authorities will (a) ensure the upgrade of the verification module to enable logical and arithmetic control of electronic asset declarations, obtaining the necessary certificate of compliance for this module, take ownership of the module and put it into operational use, and (b) conclude the technical protocols on automatic data exchange between the verification module and relevant state registers and establish these connections.'* MFA IV condition for the second tranche read: *'Operate a fully functional verification system for electronic asset declarations of persons authorised to perform functions of the state and local self-government proving effective in detecting undeclared income and assets, based on automated verification software and automated access to information held in relevant state registers. On this basis, verify at least 1,000 declarations of high-level officials (including from the executive, the Parliament and the judiciary) and adopt the corresponding verification decisions.'* MFA III condition read: '*Set up an electronic asset disclosure system for public officials, including a verification mechanism, while starting to verify assets and possible conflicts of interest on the basis of the paper-based asset declarations submitted by officials in 2015*.'

the Council from August 2013), and Ukraine's commitment under the AA, the Study team would advise that the use of this type of condition be carefully considered in future, for two main reasons.

- It risks adding fuel to the fire, exacerbating issues that could otherwise remain at the technical level. Dispute settlement mechanisms exist to deal with specific issues as they arise and encompass phases of consultation that increase the chances of finding a mutually agreed solution. Should an issue arise, having reference to the non-introduction of new trade-restricting or trade-distorting measures as an MFA condition entails that a specific issue of relatively minor macroeconomic significance can grow out of proportion quite quickly. It can contribute to an escalation of the issue beyond the technical sphere - as happened with the wood export ban issue, when it was discussed at the Ukraine–EU summit in Brussels in November 2016, directly between European Commission President Juncker and Ukrainian President Poroshenko[215]. Resolving trade irritants are typically beyond the timeframe of an MFA[216].
- It entails reputational risk for the EU. When asking for the wood ban to be lifted, the EU is perceived as pursuing its own trade agenda (primarily in the interest of those Member States with a wood processing industry) at a time when the country is in crisis. This may be legitimate from the EU point of view and coherent with Ukraine's commitments under the DCFTA or WTO, but it is not central to Ukraine's reform path. The use of this type of conditionality focused on trade liberalisation is controversial (see Report prepared for the Norwegian Ministry of Foreign Affairs as a background for the Oslo Conditionality Conference, November 2006)[217]. Ukrainian civil society still associates the wood export ban with an environmental objective and reports argue that the trade restrictions are justified on the grounds of public policy and to protect nature, as permitted under the DCFTA[218]. The effectiveness of the wood export ban in terms of environmental benefits is far from being demonstrated[219]. On the contrary, there is evidence that problems persisted despite the ban since i) it applies restrictions only to international and not national players, and ii) exports, including to EU companies, continue to take place, although illegally[220]. The EU has, however, lost the communication battle. Ukrainian civil society and forest experts[221] point out that if environmental protection were the EU's main motive, lifting the wood export ban would not have become a priority and an end in itself. Better forestry management practices and better controls at the borders should be put in place first, before the forest can be exploited altogether, whether to satisfy domestic or international demand. In that context, even if, in parallel, the EU provides assistance for better forestry

[215] http://www.enpi-fleg.org/news/ukrainian-timber-export-ban-to-be-or-not-to-be/

[216] The actual duration of dispute settlement procedures are typically longer than the targeted duration of 12-15 months indicated on the WTO website. The average duration of those requests submitted between 2007 and 2011 was found to be 28 months. For more information, see Reich, A. (2017). The effectiveness of the WTO dispute settlement system: a statistical analysis. SSRN Electronic Journal. 10.2139/ssrn.2997094.

[217] https://www.regjeringen.no/globalassets/upload/kilde/ud/rap/2006/0164/ddd/pdfv/300495-7final_conditionality_report.pdf

[218] Earthsight (2018). Complicit in corruption: how billion-dollar firms and EU governments are failing Ukraine's forests. Available at: https://www.earthsight.org.uk/investigations/complicit-in-corruption

[219] See, for instance, https://ukraineworld.org/articles/reforms/why-ukrainian-forests-dont-benefit-ban-wood-export-interview

[220] Earthsight's analysis reveals that by December 2017, EU customs authorities had recorded importing almost 1 million cubic metres of logs from Ukraine, which were supposed to be banned from export.

[221] http://www.enpi-fleg.org/news/ukrainian-timber-export-ban-to-be-or-not-to-be/

management[222], its insistence on lifting the wood export ban is perceived very negatively by civil society, both in the media[223] and during the focus group.

The Study team researched the extent to which it was appropriate to include 'atypical'[224] conditions in the MFA programme, such as those linked to the judiciary or IDP. The main findings included:

- As per the Joint Declaration of European Parliament and the Council from August 2013, MFA conditions should have a clear and direct **link either to the objectives of the MFA operation (macroeconomic stability) and/or EU external policy objectives.** EU external policy objectives are more all-encompassing than trade policy and 'atypical' conditions are not, by definition, excluded from the MFA scope;
- **Conditions related to the judiciary are relevant and important**. Working on the judiciary means tackling the fundamentals and confronting the political and institutional obstacles to reform. If left unaddressed, a weak judiciary system will continually undermine reform progress in other areas. Such conditions are **helpful in advancing progress, provided that a number of prerequisites are in place**. In the case of Ukraine, conducive factors in implementing judiciary reform included:
  - Rule of law is a commitment under the AA so that the agenda is not imposed from outside;
  - According to those in charge of the MFA programme on the EU side, there are domestic supporters of judiciary reform holding key positions in Ukraine;
  - Active CSOs are pushing in the same direction as international players;
  - Other donors, in particular the IMF, have been traditionally active in this area, amplifying the leverage of the EU.

On the contrary, imposing judicial reform on a country while there is no **ownership** is generally ineffective and wasteful, according to lessons from donor experience[225]. In this case, the focus could instead be to allow the **environment** to be more **conducive** in the first instance (e.g. promoting transparency obligations).

Some specific design issues need to be considered:

  - realistically, broader judiciary reforms need to be broken into steps so that they can be implemented within the timeframe of an MFA;
  - the limits of the MFA instrument and an external player like the EU, in promoting judiciary reforms in a third country should be acknowledged. Certain changes in relation to the judiciary need to be brought by constitutional amendment, which can be called for through political dialogue but certainly not included under an MFA programme. That type of conditionality would not be seen as giving the beneficiary country sufficient policy space and could even be seen as impinging upon its sovereignty.

At the time of MFA III, the IDP was a **major issue** in Ukraine, with the authorities registering around 1.5 million people as IDP – this is a significant number in absolute terms and as a share of Ukraine's population (3.5 per cent). The MFA leverage was seen as **useful** to put pressure on the authorities to extend their support programme and

[222] http://www.enpi-fleg.org/ru/about/about-fleg/

[223] This was also captured by the social media analysis conducted as part of the evaluation of MFA I and II.

[224] By contrast, typical conditions cover public finance management, conditions with clear and direct link to the macroeconomic objectives of the operation, and trade conditions.

[225] US General Accounting Office (2993). Assistance for justice administration, 14 (GAO/B-252458, 1993)

reinstate the social assistance once it had been suspended, despite the broader and more mixed results (see Box 25 and Annex 8). Over time, the IDP issue became linked to that of the eligibility for pensions. Individuals from the non-government-controlled area could receive their pensions only if they registered as IDPs, while, according to the EU/UN, all people held the legitimate right to receive a pension, regardless of their IDP status. With the benefit of hindsight, the MFA condition calling to 'e*nsure the effective provision of social benefits and services to internally displaced persons (IDPs) through adequate legislation and funding*' may have been **insufficiently precise and overly results-oriented** to ensure a shared understanding of what was meant exactly. Although the issue was debated, subsequent operations included no MFA condition on pensions. If such a condition were to be proposed as part of an MFA, there would be a need to ensure that the condition is precise, that there is backing for it (from internationally agreed principles or from rulings in Ukraine, e.g. the Supreme Court in Ukraine[226]), and that the authorities are ready to endorse such a condition, which may be a stumbling block, given the material differences in views.

[226] In 2018, the Grand Chamber of the Supreme Court ruled that the suspension of pensions was unlawful.

13 Conclusions

The following section summarises the key findings for each of the evaluation criterion that addressed the specific evaluation questions (Box 4).

Relevance

- **Size of the MFA III financial assistance**: The MFA III financial envelope of EUR 1.8 bln was of an 'unprecedented' scale. In absolute terms, the size of MFA III was the largest single operation in the history of the MFA instrument, by a wide margin. The size of the operation was justified and appropriate, given the financing needs of Ukraine at that time, the political importance of the country for the stability in the European Neighbourhood and the political integration of the country with the EU. It was also seen as adequate by other key multilateral partners, including the IMF and the World Bank.
- **Form of the MFA III financial assistance:** The financial assistance came in the form of loan rather than a grant or a combination of both. This was determined by the application of agreed principles, defined with reference to the per capita income of Ukraine, debt sustainability and eligibility for concessionary finance. The absence of the grant component should also be seen in the context of the availability of non-refundable financing from other EU programmes. The loan itself was provided on concessional terms that would not have been available on the markets (interest rate of 0.250 per cent for a maturity of five years for the first tranche, and interest rate of 0.750 per cent for a maturity of 14 years for the second tranche). Overall, the chosen form was appropriate and consistent with the treatment granted by the IMF and the World Bank.
- **Timing of the disbursements:** Similar to MFA I and II, the timing of the MFA III operation was essential, given the urgency of the situation in Ukraine, and the disbursement of funds within the slot 2015-2017 was considered by stakeholders to be critical support for the country. Overall, the operation was negotiated and concluded extremely quickly, despite the use of the Ordinary Legislative Procedure. The first MFA III disbursement, in July 2015, was particularly crucial given the challenging fiscal and economic situation of the country.
- **Focus of the MFA III conditionality:** At the thematic level, all six areas of MFA III conditionality (public finance management, governance and transparency, energy, social safety nets, business environment and financial sector) were relevant and consistent with country priorities and the EU-Ukraine AA. At the level of specific conditions, most reforms were (highly) relevant (e.g. setting-up of three AC bodies, asset declaration system, legislative package on the civil service, related-party lending criteria, Gas Market Law). Yet, the ultimate beneficial ownership condition in the AC area was excessively ambitious.
- **Number of conditions:** Overall, the number of conditions was high in absolute terms (36 conditions - 46 if sub-conditions are considered). To some extent, this reflected the size of the assistance and the principle of 'more money for more reform' and considerable reform enthusiasm in the aftermath of the 'Revolution of Dignity'. Yet, given the relatively short-term nature of the MFA instrument (in case of MFA III, the initially envisaged implementation timeframe was Q2 2015-Q1 2016) and the relatively high ambitiousness of the conditionality package, it appears that more sparing use of conditionality might have sustained better motivation of authorities throughout the operation. In hindsight, the evaluation of the IMF EFF programme similarly found out that more parsimonious use of its conditions could have been beneficial.

Coherence

- **Coherence with a broad policy framework guiding the EU-Ukraine relationship:** The evaluation found that the MFA III, like MFA I and II, was well aligned with the key priorities guiding EU-Ukraine relations, with conditionalities reflecting the key areas of focus of the AA and the VLAP.
- **Coherence of MFA III conditionality with overall EU budget support package:** The SBC was the most sizable budget support programme implemented in Ukraine over the lifetime of MFA III. At the time MFA III was being designed, the SBC programme was already running. In some cases, where conditionality of both instruments was very similar, MFA III reinforced the message, given its additional firepower (e.g. verification of the asset declaration system, entry in force of the Law on civil service, transparency around PP contracts). Otherwise, the programmes were coherent at the thematic level (AC and public finance management reform). The evaluation did not find any contradictions or unintended duplications in the conditionality of MFA III and the SBC.
- **Coherence of the MFA conditionality with conditionality of other donors (e.g. the IMF, the World Bank**): The evaluation found that MFA III had a number of synergies with the programmes of other international organisations, notably the IMF, World Bank and, to some extent, the EBRD. Areas where the MFA complemented the efforts of the IMF included AC, for instance. At the same time, there were some conditions where the MFA III was the sole financial incentive used by the donor community to promote a given condition (e.g. conditionality on IDPs). The evaluation did not find any contradictions or unintended duplications in conditionality between the MFA III vis-a-vis conditionality of other donors.

Effectiveness

- **Stabilising effect of MFA III (and other donors):** The financial support provided by MFA III and the IMF (and by other EU programmes and international donors) succeeded in stabilising the rapidly deteriorating economic position of Ukraine. The country returned to modest growth in the first half of 2016, maintained a stable official exchange rate since March 2016, and regained access to the international debt markets in 2017.
- **In the absence of MFA III disbursements:** Available evidence suggests that had the first tranche of the MFA III disbursed in July 2015 not been available (Alternative 1), obtaining alternative financing from domestic or/and international sources was not plausible. Faced with no other options, the authorities would have had to resort to public spending cuts in 2015 that would likely have affected capital expenditure and pension transfers (in real terms). The absence of this tranche would have been particularly acute for the Treasury, given the limited fiscal headroom in 2015. Had the second tranche of the MFA disbursed in April 2017 not been available (Alternative 2), the evaluation found that authorities would possibly have raised the required financing from the domestic debt market, which had already recovered from major clean-up and restructuring by 2017. Yet, the higher interest rates in domestic borrowing compared to MFA financing would have meant additional cost of debt servicing, reaching at least EUR 29 mln (for a maturity of 18 months and substantially higher for any long-term financing arrangements). Conversely, had the third tranche of the MFA III been disbursed in Autumn 2017 (Alternative 3), the Treasury would have not raised the corresponding funding from the domestic debt market in December 2017.

- **In the absence of MFA III and IMF disbursement**: The absence of both donors would have had dramatic economic, social and political implications for Ukraine. In absolute terms, Ukraine would not have received the rescue packages provided by the EU and the IMF, amounting to approximately EUR 8.9 bln, according to conservative estimates, and this would likely have been increased by the absence of support from other donors (e.g. the World Bank) and most certainly coupled with the inability to access international financial markets in September 2017, given the critical role of the donors. In parallel, only very limited cuts to public spending would have been politically feasible, making it likely that Ukraine would have defaulted on its debts over 2015-2017, with hard-to-predict economic, social and political implications. No MFA III and IMF support might have resulted in the absence of very substantial progress in many reform area (where progress was induced by the conditionalities of the donors). For the EU specifically, the absence of MFA III would have had a very damaging and long-lasting effect on the EU reputation in Ukraine and its ability to pursue the ambitions of the AA.
- **Effectiveness of the reforms**: Overall, Ukraine has made substantial progress in reform implementation, especially during the initial stages of the operation, often going beyond the fulfilment of the specific MFA III conditions *stricto sensu,* and all in an exceptionally challenging environment. Examples of particularly effective reforms include conditions from the energy sector area, public finance management (e.g. procurement system, ProZorro), financial sector (with excellent leadership of the NBU) but also the AC area, which saw considerable progress, despite some outstanding issues (e.g. asset declaration system, ultimate beneficiary ownership conditions).

SIA/DSA

- **SIA:** The absence of MFA III would have had a range of direct and indirect implications**.** Negative direct impacts stemming from implementation risks to the reform of social safety nets could have led to less effective compensation mechanisms to protect vulnerable households and risk of increased delays with the resumption of social benefits and services for IDPs. Indirectly, reductions in government spending would have negatively affected household resources in 2015 (through the pension channel). In the absence of MFA and IMF support, the likely default would have had severe social implications, such as economic recession, increased rates of unemployment, high levels of inflation, cuts to public services and wages, and - more broadly - fuelling of political instability.
- **DSA:** The evaluation found that had the MFA III not been provided but IMF support continued (all alternatives except 'Alternative 4'), debt sustainability would have remained virtually unchanged compared to the baseline scenario. The most plausible outcome is slightly more negative under Alternative 1, as the cuts to government spending would have resulted in a real decline in Ukraine's GDP. In Alternative 2, the counterfactual implied an increase in debt due to the higher cost of borrowing from domestic financial markets (compared to the MFA's concessional rates). The extra cost of Alternative 2 would have been aligned to the extra cost of the non-disbursement of the third tranche. Overall, however, the change in debt burden indicators would have been of limited magnitude, except under Alternative 4 where default would have been a likely outcome.

Efficiency

- **Ownership of the programme by Ukrainian authorities:** Overall, the level of ownership turned out to be more fragile than initially anticipated by the

European Commission, or by the IMF and the World Bank, as observed throughout their programmes. After robust kick-off, reform enthusiasm fizzled somewhat from Q2 2016 onwards. At the institutional level, ownership was uneven. While the ownership at the Ministry of Finance and the NBU was consistently high, some of the other institutions were less determined (e.g. National Agency for the Prevention of Corruption). The key factor explaining this lower than initially hoped-for ownership was resistance from vested interests (including oligarchs and some Ukrainian MPs), which had relatively strong leverage over authorities in Ukraine, as demonstrated by the protracted delays in some AC reforms. Lower ownership in the AC area was partly offset by diligent monitoring and the continuous pressure applied by the vibrant community of Ukrainian CSOs on the successive governments.

- **Capacity to implement MFA III conditionality:** While capacity constituted an issue in certain cases during the implementation of the operation, it was only one of many (more significant) factors hindering reforms.
- **Degree of flexibility and adjustments in implementation of MFA III given external factors:** The evaluation found that the decision to grant two waivers ahead of the second tranche, as well as the decision to suspend the third MFA III tranche, were well-balanced and justified. The former took into account the likelihood of sufficient progress in both reforms going forward. The latter, driven to a considerable extent by the non-fulfilment of two prominent AC conditions, correctly assessed the potential economic implications of the non-disbursement, as well as potentially negative implications (e.g. reputational risks for the EU) of being seen as lax with respect to critically important conditions in a key sphere of interest and competence of the EU in Ukraine.
- **Visibility of MFA III:** Overall, despite the significant size of the financial envelope, the evidence suggests that MFA III had no better visibility than other MFA evaluations, although this varied depending on the audience. One exception was those informed about the AC field, who had very specific knowledge of MFA III conditions (as they were actively promoted by Ukrainian CSOs).
- **Monitoring the implementation of MFA III:** Overall, the monitoring of the operation was appropriately conceptualised and implemented. It mostly drew on (i) regular progress reports submitted by Ukrainian authorities, (ii) regular missions of the DG ECFIN staff to Kyiv and (iii) desk research and exchanges with experts from the EU Delegation, SGUA and EEAS, facilitating the verification of progress with selected conditions.

EU added value

- **Financial added value of MFA III:** While Ukraine benefitted from both bilateral and multilateral support since the 'Revolution of Dignity', the former has lagged in terms of volume and concessions. It is clear that while some EU Member States and certain individual third countries could and have mobilized extra resources to support Ukraine, they could not have done it at a scale matching MFA III. The EU role was therefore instrumental in pulling together this additional support. In addition, a substantial part of the bilateral support comes in the form of project financing, as opposed to the MFA-type financing, where a government is not constrained in its use of the funding.
- **Symbolic value of MFA III:** The MFA III operation came at a very challenging time for Ukraine and its people, who had demonstrated their European aspirations with exceptional spirit in winter 2013-2014. While somewhat expected, given the plausible continuation of support based on the developments under MFA I and II, NFA III was nevertheless a strong sign of

solidarity and support for a country facing exceptional economic, social and political challenges, including continuous violation of its territorial integrity by Russian armed forces.

- **Additional boost of MFA III for the reform process:** Evidence confirmed that the EU support in the form of the MFA III offered an additional boost to the reform process in Ukraine, although the strength of that effect varied across the reform areas. For instance, two areas where progress would likely have been made even without the MFA are public finance management and the financial sector. On the other hand, the areas where the MFA III role in stimulating reform was clear were AC and public administration. For instance, the MFA conditionality was often used as a means of leverage over the government by the CSOs operating in Ukraine, especially in the area of AC. MFA III and the need for sufficient progress in structural reforms was also raised at the EU-Ukraine political level.
- **Confidence boosting effect of MFA III on the private sector:** As in the case of MFA I and II[227], MFA III did not seem to impact private sector confidence in a clear-cut way. Some specific conditions could have had some direct impact on the business community (PP, automated process for VAT) and the overall MFA III package may have contributed to the appreciation of the domestic currency. References to 'EU support' also featured explicitly in the communication of credit rating agencies, like Fitch.

Impact of all three MFA operations on the use of the euro in asset and debt management of Ukraine

- **The use of euro in asset and debt management of Ukraine:** The MFA operations in Ukraine did not include any conditionalities or involve any specific diplomatic efforts aimed at promoting the use of euro. However, by increasing the stock of EUR-denominated debt, the MFA played a role in encouraging the Ukrainian authorities to go to the EUR Eurobond market. The medium-term state debt management strategy of the Ukrainian authorities envisages a diversification of the currency mix of their public debt and construction of EUR-denominated Eurobond yield curve. The use of MFA was thus aligned with the authorities' plans.

[227] See European Commission (2017). Ex post evaluation of the MFA I and II to Ukraine. Available at: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities/ex-post-evaluation-mfa-operations-ukraine_en

Publications Office

doi: