Ex-post evaluation of Macro Financial Assistance Operations I & II to Ukraine

Final Report

Written by ICF in association with Cambridge Econometrics and the Institute for Economic Research and Policy Consulting

November 2017

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SPECIFIC CONTRACT No ECFIN-227-2016/SI2.746565

implementing Framework contract No ECFIN-014-2016

November, 2017

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List of abbreviations and acronyms

AA	Association Agreement
ACU	Accounting Chamber of Ukraine
AMCU	Antimonopoly Committee of Ukraine
AML	Anti-Money Laundering
BOP	Balance of Payments
CDS	Credit Default Swap
CMU	Cabinet of Ministers of Ukraine
CPI	Consumer Price Index
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
EBRD	European Bank of Reconstruction and Development
EC	European Commission
ECA	European Court of Auditors
EEAS	European External Action Service
EFF	Extended Fund Facility
EITI	Extractive Industries Transparency Initiative
EU	European Union
EU DEL	EU Delegation
EUR	Euro
EIB	European Investment Bank
ENP	European Neighbourhood Policy
FDI	Foreign Direct Investment
FSDPL	Financial Sector Development Policy Loans
FYROM	Former Yugoslav Republic of Macedonia
GATT	General Agreement on Tariffs and Trade

GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GNI	Gross National Income
GRECO	Council of Europe's Group of States against Corruption
IDA	International Development Association
IDR	Issuer Default Rating
IFRS	International Financial Reporting Standards
ISDA	International Swaps and Derivatives Association
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
MFA	Macro-Financial Assistance
MoU	Memorandum of Understanding
NABU	National Anti-corruption Bureau of Ukraine
NAPC	National Agency for Prevention of Corruption
NERC	National Electricity Regulatory Commission
NPLs	Non-Performing Loans
NBU	National Bank of Ukraine
OA	Operational Assessment
OECD	Organisation for Economic Co-operation and Development
OSCE/ODIHR	Organization for Security and Co-operation in Europe / Office for Democratic Institutions and Human Rights
PCA	Partnership and Cooperation Agreements
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PIFC	Public Internal Financial Control
PPP	Purchasing Power Parity
PPS	Purchasing Power Standards
RD	Restricted Default
SGUA	Support Group for Ukraine

SBA	Stand-By Arrangement
SBC	State Building Contract
SIA	Social Impact Analysis
SOE	State-owned enterprises
TFEU	Treaty on the Functioning of the European Union
UAH	Ukrainian Hryvnia
UN	United Nations
USD	United States Dollar
WB	World Bank
WEO	World Economic Outlook
WTO	World Trade Organisation
VAT	Value Added Tax
VLAP	Visa Liberalisation Action Plans

Abstract

On 14th April 2014, the Council of the European Union adopted a decision providing Macro-Financial Assistance II (MFA II) - in the form of a loan of EUR 1 billion - to Ukraine. The MFA II was deployed under *the urgency procedure* (Article 213 TFEU) that did not require the approval of the European Parliament, critical given the urgency of the crisis in Ukraine and the need for a swift response. The MFA I operation of EUR 610 million was also deployed, which combined previously undisbursed operations based on two earlier decisions from 2002 (EUR 110 million) and 2010 (EUR 500 million). Both, MFA I and II supported the country's recovery from the adverse impact of the economic, financial and political crisis in 2014, amplified by Russian aggression that began with the illegal annexation of the Crimean Peninsula. The assistance was disbursed in five tranches between May 2014 and April 2015 alongside IMF assistance and contributions from other donors. The MFA I and II disbursements were linked to the fulfilment of structural reform conditions related, inter alia, to reforms in the areas of Public Finance Management including anti-corruption measures, energy, financial sector, and trade and taxation. This independent evaluation examined the added value, impacts (including the social one), design and implementation of both MFA operations in Ukraine and found them to be relevant, effective and efficiently implemented.

Résumé

Le 14 avril 2014, le Conseil de l'Union européenne a adopté une décision octroyant une assistance macrofinancière II (AMF II), sous forme d'un prêt de 1 milliard d'euros, à l'Ukraine. L'opération d'AMF II a été déployée au titre de la procédure d'urgence (article 213 TFUE) qui n'exigeait pas l'approbation du Parlement européen, ce qui était essentiel compte tenu de l'urgence de la crise en Ukraine et de la nécessité d'apporter une réponse rapide. L'opération d'AMF I de 610 millions d'euros qui combinait des opérations antérieures non versées sur la base de deux décisions antérieures de 2002 (110 millions d'euros) et 2010 (500 millions d'euros) a également été déployée. Les opérations d'AMF I et II ont soutenu la relance du pays face aux conséquences négatives de la crise économique, financière et politique de 2014, amplifiée par l'agression russe qui a commencé par l'annexion illégale de la péninsule de Crimée. L'assistance a été versée en cinq tranches entre mai 2014 et avril 2015 en complément de l'assistance du FMI et des contributions d'autres donateurs. Les versements d'AMF I et II dépendaient du respect des conditions de réforme structurelle liées notamment à des réformes dans les domaines suivants : gestion des finances publiques, dont mesures anticorruption, énergie, secteur financier, commerce et fiscalité. La présente évaluation indépendante a examiné la valeur ajoutée, les conséquences (y compris sociales), la structure et la mise en œuvre des deux opérations d'AMF en Ukraine et les a trouvé pertinentes, efficaces et mises en œuvre de manière efficiente.

Executive Summary

This report presents the results of the ex-post evaluation of the Macro-Financial Assistance operations I and II (MFA I and II) provided to Ukraine over the period 2014-2015. The evaluation was commissioned by the Directorate-General for Economic and Financial Affairs (DG ECFIN). The work was undertaken by ICF with inputs from Cambridge Econometrics and local economists from the Kyiv based Institute for Economic Research and Policy Consulting.

MFA I and II operations in Ukraine

Dramatic political events unfolded after the unexpected refusal to sign the proposed Association Agreement (AA) with the EU in November 2013 by Ukraine's then President Viktor Yanukovich. The *volte face* was viewed by a majority of Ukrainians as a blunt rejection of the democratic will of the nation and a striking sign of corruption. The reaction led to fierce social unrest coined subsequently as "EuroMaidan" or "Revolution of Dignity". As a result, Prime Minister Azarov resigned in January 2014, the President left the country on 22nd February and a new government with prime minister Arseniy Yatsenyuk sworn in on 27th February. While the new government was organising, the Crimean parliament building was seized by Russian forces and pro-Russian armed men began to take over the rest of the Crimean Peninsula.

The domestic political uncertainty, illegal annexation of the Crimean Peninsula, the conflict in the east of the country provoked by Russia's destabilising actions, and a rapidly worsening macroeconomic environment translated into a fully-fledged currency, banking and balance of payment crisis that began in early 2014[1]

Already in late 2013, the main credit rating agencies downgraded Ukraine to pre-default levels. The subsequent crisis did not only dampen overall investment and business confidence, but it also hit export oriented industries and had a negative impact on tax collection rates feeding into budgetary deficit. Forced by mounting pressure and depleting foreign reserves (down to only USD 15.5 billion by February 2014), the National Bank of Ukraine had to eventually abandon the exchange rate peg with the USD and hryvna lost nearly 30 per cent again the dollar between February and April 2014. Weak domestic currency only aggravated the fiscal stance increasing real costs of imports (including energy) and depressing private consumption. In parallel, bank runs were reported in parts of the country and several of the smaller banks collapsed in early 2014. Concerns about the solvency of some systemically important banks emerged.

In this context, In February 2014 Ukrainian authorities formally requested MFA II, and the decision of the Council of the EU related to the provision of a EUR 1 billion loan was adopted on April 14th.[2] Given the extreme urgency of the situation in Ukraine, and unlike all past MFA operations, adopting the Decision was very quick, using *the urgency procedure* (Article 213 TFEU) that did not require the approval of the European Parliament. The previous MFA I operation of EUR 610 million (comprising two earlier decisions from 2002 (EUR 110 million)[3] and 2010 (EUR 500 million)[4] that had not been disbursed by early 2014 was also available. Consequently, the combination of MFA I and II operations allowed lending of EUR 1.61 billion, planned over five installments:

[1] IMF, 2015. Ex-post evaluation of 2014 SBA

[2] Council decision of 14 April 2014 providing Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:111:FULL&from=EN

[3] Council decision of 12 July 2002 providing supplementary Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32002D0639&from=EN

[4] Decision of the European Parliament and of the Council of 7 July 2010 providing Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2010:179:FULL&from=EN

- 1st installment under MFA I of EUR 100 million in May 2014;
- 2nd installment under MFA I of EUR 260 million in November 2014;
- 3rd installment under MFA I of EUR 250 million in April 2015;
- 1st installment under MFA II of EUR 500 million in June 2014;
- 2nd installment under MFA II of EUR 500 million in December 2014.

The disbursement under both MFA operations was, inter alia, dependent on the satisfactory fulfilment of 35 reform conditions that focused on the following areas:

- Energy (7 conditions);
- Financial Sector (5 conditions);
- Public Finance Management including anti-corruption measures (14 conditions), and
- Trade and Taxation (9 conditions).

Purpose of the evaluation[5]

This evaluation assesses, ex post, the contribution of the MFA I and II facility to the macro-economic and structural adjustment of Ukraine. In so doing 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 objectives.

The current MFA III operation was out of the scope of this evaluation.

The method of approach

This evaluation was based on a mixed methods approach and was carried out in line with the requirements set out in the Better Regulation guidelines. It relied on various qualitative and quantitative techniques that allowed the establishment of a comprehensive evidence base from which it was possible to triangulate results and to make the necessary judgements. The evidence base was assembled from:

- Desk research entailing review of literature and official documentation;
- Semi-structured interviews with key stakeholders of which a number were undertaken face-to-face in the course of two study visits to Kyiv and one to Washington D.C. Interviews were held with relevant staff from the European Commission, the EU Delegation to Ukraine in Kyiv, officials from relevant ministries and agencies in Ukraine (including Ministry of Finance and the National Bank of Ukraine and representatives from international financial institutions (EBRD, IMF and the World Bank);
- A Delphi survey of carefully selected experts in macroeconomics and public finance to establish plausible counterfactual descriptions of the possible economic situation had MFA I and II (and IMF) assistance not been provided;
- A Focus Group with non-governmental actors organized in Kyiv to gather perspective from dynamic local business and civil society;
- Debt Sustainability Analysis assessing the sustainability of the public debt prior and during the MFA I and II operations, and potential implications given plausible counterfactual scenario(s), based on macroeconomic statistics provided by international financial institutions and data obtained from Ministry of Finance of Ukraine;
- Social Impact Analysis concentrating on the social outcomes and impacts driven by both MFA operations based on data on social trends from Ministry of Social Policy and State Statistics Service of Ukraine; and

[5] Provision for the ex-post evaluation was included in the decision for the assistance, and was also included in the Memorandum of Understanding between the EU and Ukraine

- Press and Twitter analysis to provide further evidence of the visibility and perceptions of the MFA I and II operations.

Main findings and conclusions of the evaluation

The main conclusions from the evaluation are that the MFA, in part because of the sped of its deployment, had a positive impact on Ukraine's economy helping to stabilize the financial situation and avoided measures (such as further public spending cuts) that would have had serious negative social impacts. It also contributed to the reform effort in the country. The implementation of the operations was very quick compared to other MFA operations, resulting from the deployment of *the urgency procedure* (Article 213 TFEU) and the pressure on the Ukraine government to accept the terms of the loans. The short time available did not affect negatively the design and implementation of the operations, with many of the reform requirements articulated in the Association Agreement.

MFA I and II assistance provided a much needed sign of solidarity with the country and its aspiration for further integration with the EU.

It is very unlikely that Member States could have delivered such assistance in the time and scale of the EU. Key international donors did not have the scope for further loans and the MFA effectively filled the financing gap.

(i) Design and terms of the operations

Scale of assistance

The scale of the support provided[6] was based on the scale of the financial needs identified in Ukraine in 2002 and 2010 (MFA I) and 2014 (MFA II), although in the case of MFA II the fast speed of the deterioration in the economy meant the needs were hard to assess. The scale of support in MFA II was also agreed in light of the assistance offered by other international and national donors and as part of an internationally coordinated programme of support anchored by the financial contribution from the IMF, and based on its assessment of financial residual gap. In the context of financial need (for 2014 and 2015) assessed in early 2014 of some USD 22.5 billion[7], the EUR 1.6 billion (USD 2.2 billion) financing from MFA I and II was sufficient to make a telling contribution, especially given the timing of disbursements in 2014 when the MFA finance accounted for 18 per cent of initially estimated financing need for that year.

Form of assistance

The form of assistance – loan and / or grant finance for budget support – is determined by the application of agreed principles. In the case of Ukraine these principles were considered in the ex-ante assessment and found to rule out any use of grant financing. The ex-post evaluation confirms the validity of this assessment.

Conditioning of support

The ex post evaluation has examined the relevance of the individual conditions specified in MFA I and II and finds that they are highly relevant to the political, economic and institutional conditions at the time. As conditions to be achieved in the short-term (6-12 months), they were suitably ambitious and well targeted, given the ex-ante assessment of the most urgent requirements for reform. The reforms have complemented those specified in IMF and World Bank programmes, and were based on well-coordinated analysis and discussion between the major donors, and with the

[6] EUR 610 million in MFA I and EUR 1,000m in MFA II, provided as loans for budget support. Total support of EUR 1.6 billion = USD 2.2 billion in 2014 exchange rates

[7] USD 10 billion for 2014 and USD 12.5 billion for 2015

Ukraine authorities. The specified conditions were also coherent with other EU programmes, including the State Building Contract. The conditioning has subsequently provided the basis for continued reform conditions supported by MFA III.

Visibility

The visibility of the MFA I and II assistance was lower than initially expected given its timing, scale and circumstances of delivery, especially the details of reform conditions. There could have been more pro-active efforts to communicate with a wider audience on the potential benefits of certain MFA conditions e.g. the enhancement of the social safety net which sought to protect the most vulnerable household in Ukraine from necessary increases in household energy costs.

(ii) Achievement of objectives

Measurement of objectives

The ex-ante assessment established two indicators with which to measure the fulfilment of the objectives of the assistance in the ex post evaluation:

- Progress with macroeconomic and financial stabilisation, notably by assessing the degree of adherence to the IMF-supported programme;
- Progress with the implementation of structural reforms, notably the specific policy actions identified as conditions for disbursement of the assistance, specified in the Memoranda of Understanding (MoU) for MFA I and II

Progress with macroeconomic and financial stabilisation

Both MFA MoUs make it explicit that the MFA support is intended to complement the support and conditions specified by the IMF. The reform conditions for stabilisation set out in the MoUs are consistent with agreements established between Ukraine authorities and the IMF. Comparison of reform conditions specified in the MFA I and II with those contained in the IMF SBA confirms a high level of consistency.

The financial support provided by the IMF and MFA I and II (and other donors) has been successful in stabilising a rapidly deteriorating economic position. Whilst the MFA I and II was not considered to be essential to the stabilisation relative to the initially envisaged IMF SBA support programme (of USD 17 billion over 2 years)[8], the majority of experts consulted[9] considered that without MFA support, real GDP would have contracted more sharply in 2014 and 2015 and that the growth which returned in 2016 (of 2.3 per cent), would have been lower. Had the MFA I and II been absent, public cuts including some layoffs of public sector staff and even more drastic reduction in real wages would have been the likely outcomes. Plausibly, this could have pushed some households into poverty.

Progress with the implementation of structural reforms

Implementation of the structural reforms specified in the conditioning of support, has been assessed to be effective. Progress has been made across all the specified areas. The need to provide waivers where reforms had not progressed sufficiently but where disbursements were due was confined to two conditions (VAT refund arrears and adoption of the draft budgetary plan for 2015) and were well justified.

Particularly strong progress was made in the case of conditions under the PFM namely, the extension of the remit of the ACU to government revenue, ensuring sufficient allocation of financial resources to external audit functions and the reform of public procurement.

[8] Out of this, however, only USD 4.6 billion was disbursed in two tranches in 2014. In March 2015, the SBA was replaced by a four-year Extended Fund Facility (EFF) of around USD 17.5 billion.

[9] See results of the Delphi survey

The evaluation considered the risk of 'back-tracking', the risk that some reforms might be reversed or at least halted. This was considered by stakeholders to be a risk in relation to the progress made on anti-corruption measures. However, in other areas, in particular the financial sector and public procurement, the general view was that reforms were largely irreversible.

(iii) Coherence

Both MFA operations were coherent with the key priorities guiding the EU – UA relations established in the Association Agreement, reflected in the alignment of reforms. There were no reported gaps in the planned reforms. The evaluation also demonstrated the internal coherence with other components of the EU support package, in particular the State Building Contract (SBC) and EBRD / EIB financing activities.

The evaluation found some positive synergy between the terms negotiated under the Visa Liberalisation Treaty and both MFAs relating to anti-corruption incentives. MFA I and II operations were also well aligned with national reform programmes.

(iv) EU Added Value

The added value of the MFA I and II in part derived from the speed with which the EU mobilised and coordinated resources. The scale of the operations were such that it adequately supported the finance from other international donors. Given the speed and scale of response it is considered unlikely that Member States could have mobilised resources in a similar fashion.

The MFA also utilised its political influence to secure progress on difficult reforms including some anti-corruption conditions and provides a clear example of EU Added Value.

The MFA I and II assistance had also a symbolic importance. It was presented to the country (and society) as a demonstration of the willingness to support the Ukraine at the time of severe financial, economic and security crises. The absence of EU support would have had far reaching, negative implications for the response to the crises and for future relationship with Ukraine, and the region.

Current implementation status

Shortly after completion of the MFA I and II, the MFA III operation to Ukraine, with a planned assistance of EUR 1.8 billion loan, continued the process of recovery and reform. The economic situation stabilized from mid-2015 onwards and recovery began in early 2016. Although the conflict with Russia continues to weigh on the economy, social and political situation, the country has stabilized. Ukraine returned to international financial markets in September 2017. Although large challenges remain, including the fight against corruption and further reforms in areas covered by the MFA I and II, the international community including the EU, EBRD, EIB, IMF, and the WB continues its broad support to Ukraine.

Note de synthèse

Le présent rapport présente les résultats de l'évaluation ex post des opérations d'assistance macrofinancière I et II (AMF I et II) octroyées à l'Ukraine pendant la période 2014-2015. L'évaluation a été demandée par la direction générale des affaires économiques et financières (DG ECFIN). Le travail a été réalisé par ICF en collaboration avec Cambridge Econometrics et des économistes locaux de l'IER (Institut de recherche économique et de conseil) de Kiev.

Opérations AMF I et II en Ukraine

Des événements politiques dramatiques se sont déroulés après le refus inattendu du président ukrainien Viktor Ianoukovitch de signer la proposition d'accord d'association (AA) avec l'UE en novembre 2013. Cette volte-face a été perçue par la majorité des Ukrainiens comme un rejet brutal de la volonté démocratique de la nation et un signe évident de corruption. Cette réaction a entraîné d'intenses troubles sociaux ultérieurement surnommés « Euromaïdan » ou « Révolution de la dignité ». Suite à cela, le Premier ministre Mykola Azarov a démissionné en janvier 2014, le président a quitté le pays le 22 février et un nouveau gouvernement mené par le Premier ministre Arseni Iatseniouk a prêté serment le 27 février. Tandis que le nouveau gouvernement s'organisait, les forces russes se sont emparées du bâtiment du Parlement de Crimée et des hommes armés pro-russes ont commencé à prendre possession du reste de la péninsule de Crimée.

L'incertitude politique nationale, l'annexion illégale de la péninsule de Crimée, le conflit dans l'est du pays provoqué par des actions de déstabilisation de la part de la Russie et la dégradation rapide de la situation macroéconomique se sont traduits par une véritable crise monétaire, bancaire et de la balance des paiements qui a commencé début 2014.[10]

Dès fin 2013, les principales agences de notation ont rétrogradé l'Ukraine au rang des pays présentant un risque de défaillance. La crise ultérieure n'a pas seulement affaibli la confiance générale des investisseurs et des entreprises, elle a également frappé les industries tournées vers l'export et a eu des effets négatifs sur les taux de recouvrement des impôts entraînant un déficit budgétaire. Contrainte par la pression grandissante et des réserves de change en voie d'épuisement (15,5 milliards de dollars américains seulement en février 2014), la Banque nationale d'Ukraine a finalement dû abandonner l'ancrage du taux de change avec le dollar américain et l'hryvnia a perdu près de 30 pour cent par rapport au dollar entre février et avril 2014. La faiblesse de la monnaie nationale n'a fait qu'aggraver la position budgétaire, en augmentant les coûts réels des importations (y compris l'énergie) et en pesant sur la consommation privée. En parallèle, des retraits massifs de dépôts bancaires ont été signalés dans certaines régions du pays et plusieurs des plus petites banques se sont effondrées début 2014. Des inquiétudes se sont fait jour concernant la solvabilité de certaines banques d'importance systémique.

Dans ce contexte, les autorités ukrainiennes ont officiellement demandé l'AMF II en février 2014 et la décision du Conseil de l'UE relative à l'octroi d'un prêt de 1 milliard d'euros a été adoptée le 14 avril.[11] Compte tenu de l'urgence extrême de la situation en Ukraine et contrairement à toutes les opérations d'AMF passées, l'adoption de la décision a été très rapide au moyen de la procédure d'urgence (article 213 TFUE) qui n'exigeait pas l'approbation du Parlement européen. La précédente opération d'AMF I de 610 millions d'euros (consistant en deux décisions antérieures de 2002 – 110

[10] FMI, 2015. Évaluation ex post de l'accord de confirmation de 2014

[11] Décision du Conseil du 14 avril 2014 octroyant une assistance macrofinancière à l'Ukraine. Disponible à l'adresse suivante : http://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=OJ:L:2014:111:FULL&from=FR

millions d'euros — [12] et 2010 – 500 millions d'euros)[13] qui n'avait pas été versée début 2014 était également disponible. Par conséquent, la combinaison des opérations d'AMF I et II a permis de prêter 1,61 milliard d'euros en cinq versements :

- 1er versement au titre de l'AMF I de 100 millions d'euros en mai 2014 ;
- 2e versement au titre de l'AMF I de 260 millions d'euros en novembre 2014 ;
- 3e versement au titre de l'AMF I de 250 millions d'euros en avril 2015 ;
- 1er versement au titre de l'AMF II de 500 millions d'euros en juin 2014 ;
- 2e versement au titre de l'AMF II de 500 millions d'euros en décembre 2014.

Le versement au titre des deux opérations d'AMF dépendait, entre autres, du respect des 35 conditions de réforme portant sur les domaines suivants :

- énergie (7 conditions) ;
- secteur financier (5 conditions) ;
- gestion des finances publiques comprenant des mesures anticorruption (14 conditions), et
- commerce et fiscalité (9 conditions).

Objet de l'évaluation[14]

La présente évaluation examine, a posteriori, l'apport des AMF I et II à l'adaptation macroéconomique et structurelle de l'Ukraine. À cet effet, elle examine :

- si les considérations ex ante déterminant la structure et les modalités de l'opération étaient adaptées, compte tenu du contexte économique, politique et institutionnel ; et
- si le programme a rempli les objectifs.
- L'opération d'AMF III en cours n'entrait pas dans le champ de cette évaluation.

La méthode d'approche

La présente évaluation est basée sur une approche de méthodes mixtes et a été réalisée conformément aux exigences énoncées dans les lignes directrices pour une meilleure règlementation. Elle s'appuie sur différentes techniques qualitatives et quantitatives qui ont permis d'établir une base de faits complète à partir de laquelle il a été possible de trianguler les résultats et de poser les jugements nécessaires. La base de faits repose sur les éléments suivants :

- Une recherche documentaire incluant un examen de la littérature et de la documentation officielle ;
- Des entretiens semi-guidés avec les principaux acteurs, dont un certain nombre ont été menés en face à face au cours des deux visites d'étude à Kiev et de la visite à Washington D.C. Les entretiens ont eu lieu avec le personnel compétent de la Commission européenne, de la Délégation de l'UE en Ukraine à Kiev, des représentants des ministères et organismes concernés en Ukraine (y compris le ministère des Finances et la Banque nationale d'Ukraine) et des représentants d'établissements financiers internationaux (BERD, FMI et Banque mondiale)) ;
- Une enquête Delphi auprès d'experts soigneusement sélectionnés dans le domaine de la macroéconomie et des finances publiques afin d'établir des

[12] Décision du Conseil du 12 juillet 2002 octroyant une assistance macrofinancière supplémentaire à l'Ukraine. Disponible à l'adresse suivante : http://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CELEX:32002D0639&from=FR

[13] Décision du Parlement européen et du Conseil du 7 juillet 2010 octroyant une assistance macrofinancière à l'Ukraine. Disponible à l'adresse suivante : http://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=OJ:L:2010:179:FULL&from=FR

[14] La fourniture d'une évaluation ex post était incluse dans la décision d'assistance et était également incluse dans le protocole d'accord entre l'UE et l'Ukraine.

descriptions contrefactuelles plausibles de la situation économique éventuelle en cas de refus des AMF I et II (et de l'aide du FMI) ;

- Un groupe de réflexion avec des acteurs non gouvernementaux organisé à Kiev pour recueillir le point de vue des entreprises locales dynamiques et de la société civile ;
- Une analyse de la viabilité de la dette évaluant la viabilité de la dette publique avant et pendant les opérations d'AMF I et II, et les implications potentielles compte tenu de scénarios contrefactuels plausibles, basés sur des statistiques macroéconomiques fournies par des établissements financiers internationaux et des données obtenues auprès du ministère ukrainien des Finances ;
- Une analyse de l'impact social axée sur les conséquences et impacts sociaux dus aux deux opérations d'AMF sur la base de données relatives aux tendances sociales du ministère de la Politique sociale et du Service des statistiques d'Ukraine ; et
- Une analyse de la presse et de Twitter pour fournir d'autres preuves de la visibilité et de la perception des opérations d'AMF I et II.

Principales constatations et conclusions de l'évaluation

Les principales conclusions de l'évaluation sont que l'AMF, en partie en raison de la vitesse de son déploiement, a eu un impact positif sur l'économie ukrainienne en aidant à stabiliser la situation financière et a évité des mesures (telles que d'autres réductions des dépenses publiques) qui auraient eu de graves conséquences sociales négatives. Elle a également contribué à l'effort de réforme du pays. La mise en œuvre des opérations a été très rapide, comparée à d'autres opérations d'AMF, du fait du déploiement de la procédure d'urgence (article 213 TFUE) et de la pression exercée sur le gouvernement ukrainien afin qu'il accepte les conditions des prêts. Le peu de temps disponible n'a pas affecté la structure et la mise en œuvre des opérations, de nombreuses exigences de réforme étant articulées dans l'accord d'association.

Les AMF I et II ont donné un signal indispensable de solidarité avec le pays et son aspiration à s'intégrer davantage dans l'UE.

Il est très improbable que des États membres aient pu fournir cette assistance dans des délais et une portée similaires à ceux de l'UE. Les principaux donateurs internationaux n'avaient pas la possibilité d'octroyer d'autres prêts et l'AMF a effectivement comblé le déficit de financement.

(i) Structure et modalités des opérations

Portée de l'assistance

La portée de l'aide accordée[15] était basée sur l'ampleur des besoins financiers identifiés en Ukraine en 2002 et 2010 (AMF I) et en 2014 (AMF II) bien que dans le cas de l'AMF II la vitesse rapide de détérioration de l'économie faisait que les besoins étaient difficiles à évaluer. La portée de l'aide de l'AMF II a également été convenue au vu de l'assistance proposée par d'autres donateurs internationaux et nationaux et dans le cadre d'un programme d'aide coordonné au niveau international rattaché à la contribution financière du FMI et basé sur son évaluation du déficit de financement résiduel. Dans le contexte de difficultés financières (pour 2014 et 2015) évaluées début 2014 à près de 22,5 milliards de dollars américains[16], le financement de 1,6 milliard d'euros (2,2 milliards de dollars américains) des AMF I et II était suffisant pour apporter une contribution marquante, notamment compte tenu du calendrier des versements en 2014 lorsque le financement de l'AMF représentait 18 pour cent du besoin en financement initialement estimé pour cette année-là.

[15] 610 millions d'euros dans l'AMF I et 1 milliard d'euros dans l'AMF II, octroyés sous forme de prêts en appui budgétaire. Aide totale de 1,6 milliard d'euros = 2,2 milliards de dollars américains au taux de change de 2014

[16] 10 milliards de dollars américains pour 2014 et 12,5 milliards de dollars américains pour 2015

Forme de l’assistance

La forme de l’assistance (prêt et/ou aide non remboursable en appui budgétaire) est déterminée par l’application des principes convenus. Dans le cas de l’Ukraine, ces principes ont été pris en compte dans l’évaluation ex ante et ont conduit à l’exclusion de l’utilisation d’aides non remboursables. L’évaluation ex post confirme la validité de cette évaluation.

Condition de l’aide

L’évaluation ex post a évalué la pertinence des différentes conditions indiquées dans les AMF I et II et conclut qu’elles sont très pertinentes dans les conditions politiques, économiques et institutionnelles de l’époque. En tant que conditions devant être remplies à court terme (6–12 mois), elles étaient suffisamment ambitieuses et bien ciblées compte tenu de l’évaluation ex ante des besoins de réforme les plus urgents. Les réformes ont complété celles indiquées dans les programmes du FMI et de la Banque mondiale et étaient basées sur une analyse bien coordonnée et une discussion entre les principaux donateurs et avec les autorités ukrainiennes. Les conditions indiquées étaient également cohérentes avec les autres programmes de l’UE, y compris le contrat d’appui à la consolidation de l’État. Les conditions ont ensuite fourni la base aux conditions de poursuite des réformes soutenues par l’AMF III.

Visibilité

La visibilité des AMF I et II, notamment les détails des conditions de réforme, était plus faible que prévu initialement étant donné leur calendrier, leur portée et les circonstances de leur délivrance. Il aurait pu y avoir davantage d’efforts proactifs pour communiquer avec un public plus large sur les avantages potentiels de certaines conditions de l’AMF, tels que l’amélioration du réseau de sécurité sociale qui vise à protéger les foyers ukrainiens les plus vulnérables des augmentations inévitables des coûts de l’énergie domestique.

(ii) Réalisation des objectifs

Mesure des objectifs

L’évaluation ex ante a établi deux indicateurs permettant de mesurer la réalisation des objectifs de l’assistance dans l’évaluation ex post :

- Progrès en matière de stabilisation macroéconomique et financière, notamment en évaluant le degré de conformité au programme soutenu par le FMI ;
- Progrès en matière de mise en œuvre de réformes structurelles, notamment les mesures de politique publique spécifiques identifiées comme des conditions au versement de l’assistance, indiquées dans les protocoles d’accord des AMF I et II

Progrès en matière de stabilisation macroéconomique et financière

Les deux protocoles d’accord des AMF indiquent expressément que l’aide de l’AMF est destinée à compléter l’aide et les conditions précisées par le FMI. Les conditions de réforme en vue de la stabilisation indiquées dans les protocoles d’accord sont cohérentes avec les accords établis entre les autorités ukrainiennes et le FMI. La comparaison des conditions de réforme indiquées dans les AMF I et II avec celles visées dans l’accord de confirmation du FMI confirme un degré de conformité élevé.

L’aide financière accordée par le FMI et les AFM I et II (et autres donateurs) a permis de stabiliser une situation économique qui se dégradait rapidement. Tandis que les AMF I et II n’étaient pas considérées comme essentielles à la stabilisation par rapport au programme d’aide de l’accord de confirmation du FMI initialement envisagé (de 17 milliards de dollars américains sur 2 ans)[17], la majorité des experts consultés[18] ont estimé que sans l'aide de l'AMF, le PIB réel se serait contracté plus fortement en 2014 et 2015 et que la croissance qui a repris en 2016 (de 2,3 pour cent) aurait été inférieure. En l'absence des AMF I et II, des réductions des dépenses publiques, y compris certains licenciements de personnel du secteur public et une baisse encore plus forte des salaires auraient probablement eu lieu. Vraisemblablement, cela aurait pu faire basculer certains ménages dans la pauvreté.

Progrès en matière de mise en œuvre des réformes structurelles

La mise en œuvre des réformes structurelles indiquées dans les conditions de l'aide a été jugée efficace. Des progrès ont été réalisés dans tous les domaines indiqués. Les exonérations nécessaires là où des réformes n'avaient pas suffisamment progressé, mais où des versements étaient dus, étaient confinées à deux conditions (arriérés de remboursement de TVA et adoption du projet de plan budgétaire pour 2015) et étaient totalement justifiées.

Des progrès particulièrement importants ont été réalisés concernant les conditions au titre de la gestion des finances publiques, à savoir l'extension des attributions de la Chambre des comptes d'Ukraine aux recettes publiques, assurant l'attribution suffisante de ressources financières aux fonctions d'audit externe et à la réforme des marchés publics.

L'évaluation a tenu compte du risque de « marche arrière », à savoir le risque que certaines réformes puissent être annulées ou du moins stoppées. Les acteurs ont considéré qu'il s'agissait d'un risque limité aux progrès réalisés en matière de mesures anticorruption. Dans les autres domaines, en particulier dans le secteur financier et sur les marchés publics, l'opinion générale était que les réformes étaient en grande partie irréversibles.

(iii) Cohérence

Les deux opérations d'AMF étaient cohérentes avec les priorités essentielles guidant les relations entre l'UE et l'Ukraine établies dans l'accord d'association et reflétées dans la convergence des réformes. Aucun écart n'a été signalé dans les réformes envisagées. L'évaluation a également démontré la cohérence interne avec d'autres éléments du soutien de l'UE, notamment le contrat d'appui à la consolidation de l'État et les activités de financement de la BERD/BEI.

L'évaluation a identifié une certaine synergie positive entre les modalités négociées dans le cadre du traité de libéralisation du régime des visas et les deux AMF en ce qui concerne les incitations anticorruption. Les opérations d'AMF I et II convergeaient également avec les programmes de réforme nationaux.

(iv) Valeur ajoutée de l'UE

La valeur ajoutée des AMF I et II découle en partie de la vitesse à laquelle l'UE a mobilisé et coordonné ses ressources. La portée des opérations était telle qu'elle a bien étayé le financement en provenance d'autres donateurs internationaux. Étant donné la vitesse et la portée de la réponse, il est peu probable que des États membres aient pu mobiliser des ressources de manière similaire.

L'AMF a également utilisé son influence politique pour sécuriser les progrès sur des réformes difficiles, y compris certaines conditions anticorruption, et fournit un exemple évident de valeur ajoutée de l'UE.

[17] Dont toutefois seuls 4,6 milliards de dollars américains ont été versés en deux tranches en 2014. En mars 2015, l'accord de confirmation a été remplacé par un mécanisme élargi de crédit sur quatre ans d'environ 17,5 milliards de dollars américains.

[18] cf. résultats de l'enquête Delphi

L’aide des AMF I et II a également eu une importance symbolique. Elle a été présentée au pays (et à la société) comme une démonstration de la volonté de soutenir l’Ukraine en ces temps de graves crises financière, économique et sécuritaire. L’absence de soutien de la part de l’UE aurait eu des conséquences négatives considérables quant à la réponse à la crise et aux relations futures avec l’Ukraine et la région.

État actuel de la mise en œuvre

Rapidement après la réalisation des AMF I et II, l’opération AMF III à destination de l’Ukraine, qui prévoit une assistance de 1,8 milliard d’euros sous forme de prêts, a permis de poursuivre le processus de relance et de réforme du pays. La situation économique s’est stabilisée depuis mi-2015 et la reprise a commencé début 2016. Bien que le conflit avec la Russie continue à peser sur la situation économique, sociale et politique, le pays s’est stabilisé. L’Ukraine est revenue sur les marchés financiers internationaux en septembre 2017. Bien que d’importants défis demeurent, notamment la lutte contre la corruption et d’autres réformes dans les domaines couverts par les AMF I et II, la communauté internationale, y compris l’UE, la BERD, la BEI, le FMI et la BM, continuent d’apporter un large soutien à l’Ukraine.

1 Introduction

1.1 This Report

This is the Final Report for an independent, external ex-post evaluation of the EU's Macro Financial Assistance (MFA) to Ukraine over the period 2014-2015.

The Final Report provides answers to all evaluation questions along with the conclusions.

1.2 Scope and objectives of the evaluation

The evaluation focused on the following two MFA operations provided to Ukraine between May 2014 and April 2015:

- MFA I (EUR 610 million) comprising two previously undisbursed operations
  - EUR 110 million (loan) approved in July 2002 (02/639/EC) to support Ukraine's transition to a market economy
  - EUR 500 million (loan) approved in July 2010 (388/2010/EU) to help Ukraine deal with the impact of the 2009 economic crisis
- MFA II (EUR 1 billion loan) approved in April 2014 (2014/215/EU).

A third MFA operation (MFA III) for EUR 1.8 billion which was approved in April 2015 (2015/601/EU), falls outside the scope of the evaluation as it is still being implemented.

This evaluation assessed, ex post, the contribution of the MFA I and II facility to the macro-economic and structural adjustment of Ukraine.

The evaluation aimed to draw lessons with respect to the EU's financial assistance:

- 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 objectives.

The overall objective of this evaluation was to provide an independent assessment of the above operation, focusing in particular on the following three areas of analysis:

- Economic impact of the MFA assistance operation on the economy of Ukraine (e.g. GDP growth, balance of payments, exchange rates, fiscal balances); with and without IMF involvement;
- Value added of EU intervention (stand-alone and in combination with IMF intervention) provided through the operation;
- Sustainability of the country's external position as a result of the assistance.
- In support of the above objectives, the Terms of Reference (ToR) listed a series of specific evaluation questions for this study (see Section 3).

1.3 Structure of this Report

The remainder of this Report is structured as follows:

- Section 2 provides an overview of the key economic and political developments in Ukraine during the period leading up to the crises that prompted the IMF-EU assistance as well as in the period over which the EU MFAs were implemented. It also details the scope and main characteristics of the two MFA operations;
- Section 3 presents the methodological approach to the study, and outlines the main caveats and limitations;

- Section 4 provides a brief update on policy implementation since the completion of the MFA I and II operation;
- Sections 5 to 9 provide the assessment against each of the five evaluation criteria including conclusions for each of them;
- Sections 10 and 11 focus on Debt Sustainability and Social Impact Analysis respectively, and
- Section 12 provides the conclusions.

The main report is supported by the stand alone Annex document provided separately which is composed of:

- Annex 1: MFA I and II conditionality
- Annex 2: Evaluation framework
- Annex 3: Completed work, caveats & limitations
- Annex 4: List of completed interviews & participants of the Focus Group and Stakeholder Workshop
- Annex 5: Summary of Delphi Panel survey
- Annex 6: Summary note from the Focus Group
- Annex 7: Debt Sustainability Analysis
- Annex 8: Social Impact Analysis
- Annex 9: Media Analysis
- Annex 10: Conditionality tables
- Annex 11: Timeline of economic and political events 2014-2016
- Annex 12: Summary overview of other donors’ programmes

2 Context and content of the Macro-financial assistance to Ukraine during 2014-2015

2.1 Introduction to the analysis

This section describes the context and subject matter of the evaluation in the following sections:

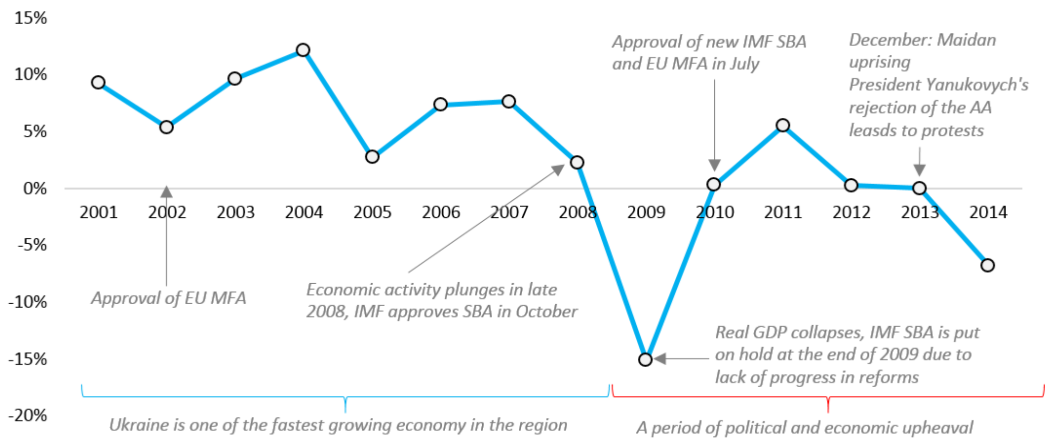
- Section 2.2 describes the overall macroeconomic and political background that triggered the need for the two MFA operations, implemented during 2014-2015;
- Section 2.3 outlines the key considerations behind the MFA design;
- Section 2.4 outlines the main macroeconomic developments during the implementation of the operations.

The analysis was based mainly on desk research including the official documentation provided by DG ECFIN, inputs from local economists in the Institute for Economic Research and Policy Consulting (IER) in Kyiv and a series of interviews, especially with Commission officials in DG ECFIN but also from IMF and World Bank.

2.2 Economic and political context leading to the need for MFA operations

Ukraine had a period of buoyant growth during 2000-2007 when real GDP growth averaged 7.6 per cent per annum (Figure 2.1).

Figure 2.1 Real GDP growth in Ukraine, 2001-2014



Source: *based on IMF WEO October 2016 data*

Ukraine was hit badly by the global financial crisis in 2008 and the economy entered into a recession in late 2008 and contracted sharply (by 15.1 per cent[19]) in 2009. Falling prices and global demand for steel (the major export) as well as capital outflows triggered a balance of payments crisis, which also eroded confidence in the currency 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.[20]Against the above backdrop, the IMF approved exceptional access support for Ukraine in early November 2008 under a front-loaded 24-month Stand-by Arrangement (SBA). The programme was however, put on hold towards the end of 2009 as the Government backtracked on some proposed reforms.

Gradual economic recovery began in mid-2009 and continued in 2010. The banking sector started to stabilise whilst steel demand and prices picked up, although at a slow pace. Yet, recovery in 2010 and 2011 proved to be short-lived and started fading away in early 2012. Annual GDP growth rate in 2012 was negligible (Figure 2.1) and the economy entered recession from mid-2012 with five consecutive quarters of negative growth. Zero annual growth in 2013 was a result only of 3.4 per cent growth over the last quarter of 2013 (see trajectory of quarterly growth rates in Figure 2.6).

Existing imbalances that accumulated until late 2013 combined with weak governance, little transparency, endemic corruption[21] and a difficult business environment that were not tackled with much needed structural reforms under former President Viktor Yanukovich, added to the bleak prospects for the finish of 2013 and the following year 2014.

Dramatic political events then unfolded after the refusal to sign the proposed Association Agreement (AA) with the EU in November 2013 by Ukraine's then President Viktor Yanukovich (See Box 2.1) precipitated a downturn.

Box 2.1 Political events added to the severity of the crisis…

At the Eastern Partnership summit in Vilnius on 28-29 November 2013, Ukraine's then President Viktor Yanukovich refused to sign the Association Agreement (AA) with the EU, including the Deep and Comprehensive Free Trade Area (DCFTA).

[19] IMF, WEO October 2016.

[20] IMF, 2011, Country Report No. 11/325: Ukraine: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-By Arrangement

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

President Yanukovich however, agreed to a USD15 billion loan and a beneficial gas deal from Russia.

President Yanukovych's rejection of the Association Agreement was regarded as a dismissal of the views of a majority of Ukrainians, while signalling the government's strengthened alignment with Russia. These factors spawned a serious uproar amongst Ukrainian people, in which they condemned their government's corruption. These major pro-European protests led to the so-called "EuroMaidan" or "protest of Dignity".

In the wake of the protests, the Parliament voted for the impeachment of President Yanukovich. In January 2014 Prime Minister Azarov resigned while the President left the country in February 2014.

On February 26th pro-Russian armed men gradually began to take over the Crimean peninsula, the day after the Crimean parliament building was seized by Russian forces.

The conflict in the east of the country provoked by Russia's destabilising actions continues to pose significant challenges to Ukraine's reform process from a political and economic perspective. The UN has recorded over 10,000 people killed and almost 24,000 injuries.

In 2012, the Eastern regions of Donetsk and Luhansk accounted for nearly 16 per cent of national GDP[22].

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 on the one hand and intensification of the conflict in the East coupled with protracted domestic political uncertainty on the other translated eventually into a fully-fledged currency, banking and balance of payment crisis that began in early 2014[23] (see timeline in A2.1). 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 7½ percent of GDP in 2012[25]. In 2013, Naftogaz reported an operating deficit of 1.9 per cent of GDP. The general government deficit (excluding Naftogaz) widened to 4¾ percent of GDP in 2013[26].
- International debt markets were effectively closed for Ukraine at the end of 2013. As the current account deficit widened to about 9 percent and reserves kept on declining (to 3½ months of imports by end-October 2013), sovereign debt yields went into double digits and CDS spreads widened sharply. International rating agencies downgraded Ukraine to pre-default levels by end-2013[27];
- 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 further dropped to USD15½ billion in February 2014 and equivalent to only 28 percent of the remaining external debt service in 2014. This forced the

[22] IMF, September 2014. Country Report.

[23] IMF, 2015. Ex-post evaluation of 2014 SBA

[24] On and off budget subsidies. Relatively well-off households capturing substantial part of it

[25] IMF, April 2014, Country Report

[26] Ukraine Ministry of Finance data.

[27] IMF, WEO October 2016.

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 hryvnia depreciated by 30 percent by end of April 2014 and by nearly 50 percent by year end[28]. The large depreciation also added to the domestic costs of imported energy, further depressing domestic demand and adding to Naftogaz's losses; and,

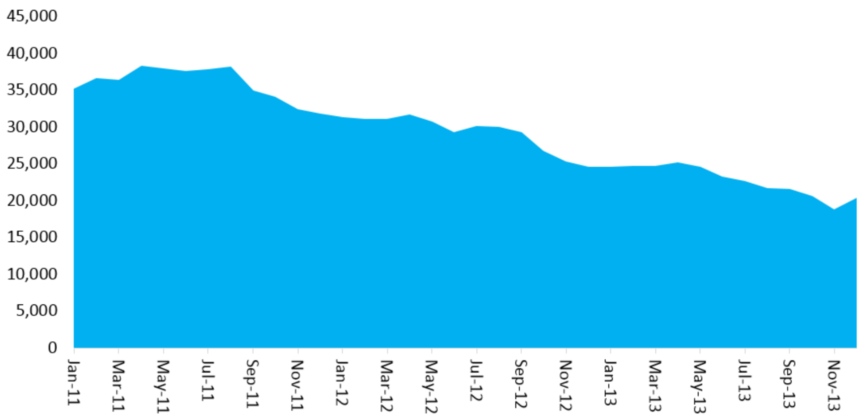
- The banking system lost circa 12 percent of deposits between early February and end of March 2014[29]. Impaired banks' liquidity increased vulnerability of some banks and pushed them to draw on liquidity support from the central bank. The falling value of the hryvna and economic slowdown damaged banks with negative open foreign exchange positions and put their exposed loan stocks at greater risk. In March 2014, four banks representing circa 3 percent of overall deposits base were informed about their capital shortfalls and—after their owners declined to add extra capital—were covered by temporary administration managed by the Deposit Guarantee Fund (DGF).

Key trends are summarised in Figure 2.2 to Figure 2.5 presented below

[28] 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.

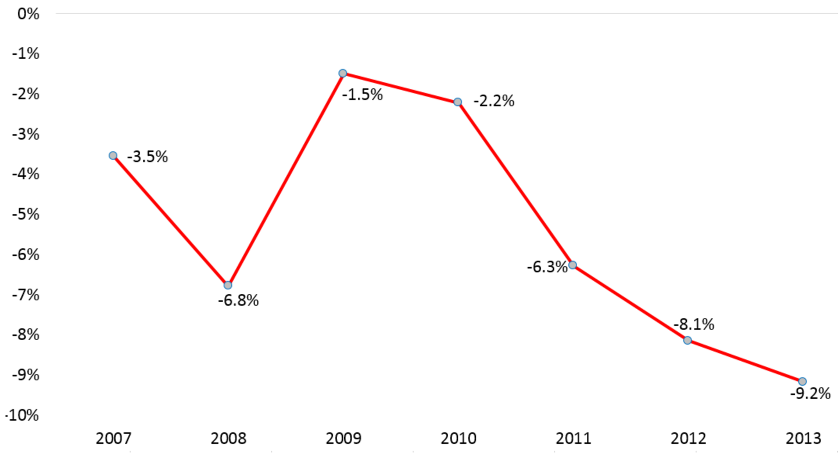
[29] IMF, April 2014. Country Report.

Figure 2.2 Dwindling foreign reserves of NBU, in USD million



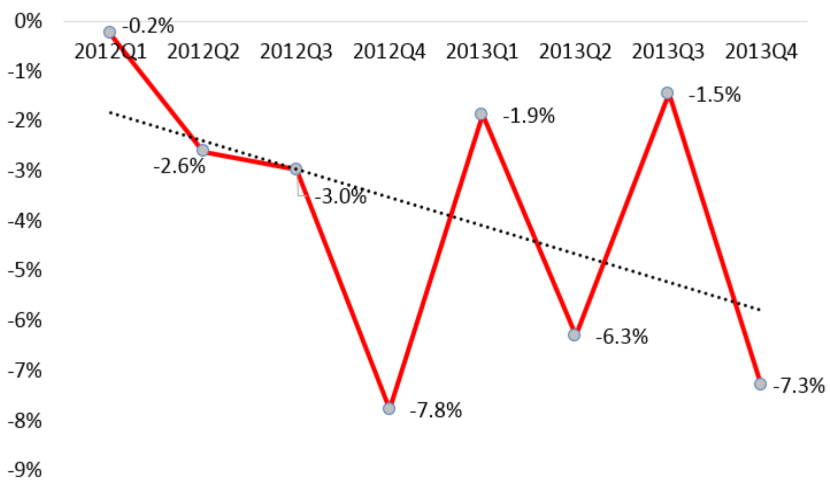
Source: *National Bank of Ukraine*

Figure 2.3 Current account deficit, in % of GDP



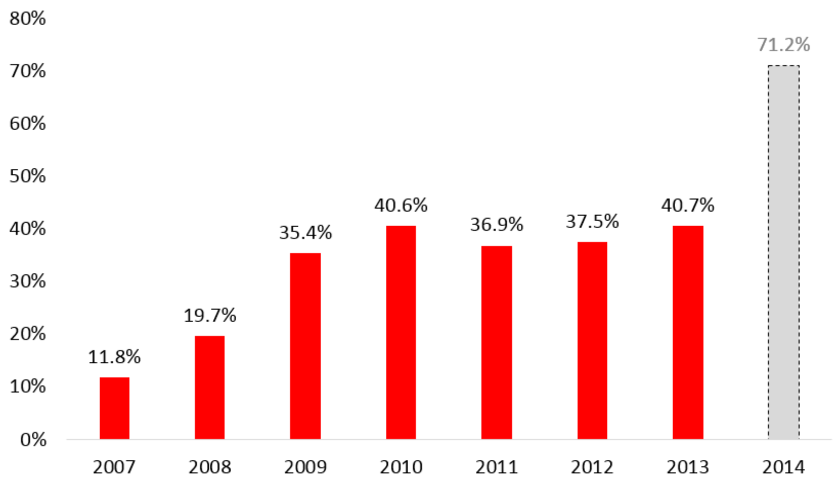
Source: *IMF, WEO October 2016*

Figure 2.4 General government balance [excl. Naftogaz], in % of GDP



Source: *Ministry of Finance of Ukraine*

Figure 2.5 Public debt, in % of GDP



Source: *IMF, WEO October 2016*

2.3 Design and implementation of MFA I and II

Against this economic and political backdrop, the Ukrainian authorities sought international financial assistance from the IMF, the EU, and other international financial institutions and bilateral donors. This section describes the MFA support.

2.3.1 Key features of the two operations

Early MFA operations in the 1990s preceded MFA I (Table 2.1). MFA I was adopted in 2002 with an amount of EUR 110 million and supplemented in 2010 with another EUR 500 million in loans, but no final approval implementing the operation was forthcoming until the economic and financial crisis in 2013/14. The delay was caused by the absence of the necessary IMF programmes and disappointing progress in reforms by Ukrainian authorities. In turn, MFA II was proposed and approved in the rapid record time (it took only several weeks between the beginning of the negotiations and their finalization); a pace imposed by the urgency of situation in Ukraine in early 2014.

MFA I and MFA II combined, allowed for the disbursement of €1.61 billion to Ukraine in the form of loans *via* a total of five tranches during the course of 2014 and 2015[30]. After approval in April 2015, MFA III was also deployed. This operation is outside of the scope of the evaluation but remains a relevant contextual factor. The history of MFA operations in Ukraine is summarized in Table 2.1.

Table 2.1 Ukraine: History of MFA operations granted to Ukraine

	Date of Council Decision	Reference of Council decision	Max amount	Dates of disbursement	Amounts of disbursement (EUR m)	Totals	Undisbursed
	22.12.94	94/940/EC	85	Dec-95	85	85	
	23.10.95	95/442/EC	200	Aug-96	50	200	
				Oct-96	50		
				Sep-97	100		
	15.10.98	98/592/EC	150	Jul-99	58	58	92 (cancelled)
MFA I	**12.07.02**	**02/639/EC**	**110**	**May-14**	**100**	**110**	
				Nov-14	**10**		
	07.07.10	**388/2010/EU**	**500**	**Nov-14**	**250**	**500**	
				Apr-15	**250**		
MFA II	**14.04.14**	**2014/215/EU**	**1000**	**Jun-14**	**500**	**1000**	
				Dec-14	**500**		
MFA III	15.04.15	2015/601/EU	**1800**	Jul-15	600	1200	600
				Apr-17	600		

Source: European Commission (2003) Implementation of macro-financial assistance to third countries in 2002. COM(2003)444 final. Available at: http://eur-lex.europa.eu/legal-

[30] MEMO/14/159: European Commission's support to Ukraine. Available at: http://europa.eu/rapid/press-release_MEMO-14-159_en.htm

content/en/TXT/?uri=CELEX%3A52004DC0523; and
http://ec.europa.eu/economy_finance/international/neighbourhood_policy/ukraine_en.htm

As noted, although both operations were disbursed during the same period of time (2014 and last tranche of MFA I in early 2015), they originated at different times as described further below.

2.3.1.1 MFA I

MFA I (EUR 610 million) merged together macro-financial assistance based on two earlier decisions, from 2002 (EUR 110 million)[31] and 2010 (EUR 500 million)[32]. The EUR 110 million was not disbursed because of the rapid improvements in the external financing position of Ukraine in 2002-2005, as reflected by the fact that the concomitant SBA was also treated as precautionary[33]. In the case of the second decision (EUR 500 million), it was envisaged as a response to the 2009 economic crisis but as the country recovered from it relatively quickly and there was no active IMF programme, it was not disbursed.

Renewed negotiations on MFA policy conditionality related to the combined amount which started in 2010. These were, however, unsuccessful due to lack of agreement on key reform areas[34]. In early 2013 agreement was finally reached at a technical level, and the Memorandum of Understanding (MoU)[35] and Loan Agreement were finally signed in February 2013. Their ratification by the Ukrainian Parliament took place in March 2014. MFA I funding was conditional on the IMF reaching agreement with Ukraine and became available in April 2014 when a new SBA between the Ukrainian national authorities and the IMF was agreed[36].

2.3.1.2 MFA II

The process of preparation and adoption of MFA II (EUR 1 billion) was very different. MFA II was designed within several weeks given the time pressure associated with responding to due to critical economic situation in Ukraine. In February 2014 Ukrainian authorities formally requested MFA II, and the decision of the Council of the EU was adopted in April 14th.[37]

Unlike all past MFA operations, adopting the Decision was extremely fast as it followed *the urgency procedure* (Article 213 TFEU) that did not require the approval of the European Parliament. Quite exceptionally, the MFA even preceded by a few weeks the 2014 IMF SBA.

It has been the first and only time an MFA decision has been adopted on the basis of Article 213. Although the Commission was cautious of not re-opening inter-institutional discussions about the most adequate procedure to adopt MFA decisions

[31] Council decision of 12 July 2002 providing supplementary Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32002D0639&from=EN

[32] Decision of the European Parliament and of the Council of 7 July 2010 providing Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2010:179:FULL&from=EN

[33] European Commission (2005) Implementation of macro-financial assistance to third countries in 2004. Commission staff working document. SEC (2005) 747 final. Available at:http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52005SC0747

[34] European Commission (2012) Implementation of macro-financial assistance to third countries in 2011. SWD(2012) 181 final. Available at: http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52012SC0181

[35] Memorandum of Understanding between the European Union and Ukraine for Macro-Financial Assistance for Ukraine of up to EUR 610 million. Available at: http://ec.europa.eu/economy_finance/eu_borrower/mou/mou_eu_ukraine1_en.pdf

[36] European Commission (2015) Implementation of macro-financial assistance to third countries in 2014. COM(2015) 290 final. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1466169244778&uri=CELEX:52015DC0290

[37] Council decision of 14 April 2014 providing Macro-Financial Assistance to Ukraine. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:111:FULL&from=EN

and did not want to give the impression of setting a precedent (see Recitals 4, 5 and 6 of the 2014 Decision), there were several reasons calling for the use of the urgency procedure in this particular case.

Firstly, there was across the board political will for rapid adoption and disbursement of MFA in early 2014 and this in turn was a consequence of an exceptionally difficult economic, financial and geopolitical situation that the country found itself in. The European Council conclusions of 20-21 March 2014 for instance say that "the European Council urges the Council to rapidly agree on macro-financial assistance".[38]

Secondly, the use of the ordinary legislative procedure would have barred the approval of the MFA to precede the approval of the IMF SBA which took place only on 30 April 2014. As per Principle 5 of the 2013 Joint Declaration of the European Parliament and the Council of 12 August 2013[39], the amount of the assistance would have had to be calculated on the basis of "a complete quantitative assessment and transparent supporting documentation" produced in cooperation with other IFIs, notably the IMF. The use of the *urgency procedure meant* the 2013 Joint Declaration did not apply and the MFA could be approved even though the financing gap was not yet precisely determined.

Thirdly, the use of the ordinary legislative procedure would have led to the adoption of the Decision around the summer time, when no borrowing activity takes place on the market for the EU (NB: MFA loans are financed by borrowings on the capital markets). And again, given the urgency of the situation in Ukraine, there was virtually no room for manoeuvre in terms of longer deliberations.

The urgency procedure had some impacts on the characteristics of MFA II. MFA II had an availability period of a maximum one year (Article 1, paragraph 5 of the 2014 Decision) while usually the availability period is 2.5 years (see MFA I 2010 Decision or MFA III 2015 Decision). In addition, the Decision did not fix the number of tranches. Article 4, paragraph 1 of the 2014 Decision included the following provision: "If, exceptionally, circumstances so require, the Union macro-financial assistance may be made available in one single loan instalment." The number of tranches was finally fixed in the MoU a few weeks later, once the financing needs of Ukraine had become somewhat clearer.

2.3.2 MFA I and II as part of the EU support package

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 EU budget directly one the one hand and increased lending from the European Investment Bank and European Bank of reconstruction and Development on the other[40].

Overall, the anticipated support for the period between 2015 and 2020 amounted to EUR 11.2 billion of which around 14 per cent was expected to be provided in the form of grants (development and crisis related assistance) and the rest in the form of loans. MFA I and II made up 14 per cent of the total and loans from EIB and EBRD stood for 72 per cent[41]. The amount was afterwards increased by EUR 1.8 billion (when MFA III

[38] https://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/141749.pdf

[39] Joint Declaration by the European Parliament and the Council adopted together with the decision providing further macro-financial assistance to Georgia, OJ L 218, 14.8.2013, p. 15.

[40] European Commission, 2014. European Commission's Support Package to Ukraine. Available at: http://europa.eu/rapid/press-release_MEMO-14-159_en.htm

[41] MFA I & II was budget support, EIB and EBRD loans were related to specific projects

was approved) – turning the commitments into a EUR 13 billion package[42] and the share made up by all three MFA instruments was 34 per cent of the rescue package.

2.3.3 MFA Conditionality

In terms of the conditions which needed to be met to trigger disbursements, these also included pre-conditions related to the need for the beneficiary country to have effective democratic mechanisms in place and to respect the rule of law and human rights (article 2 of 2014 Decision). The fulfilment of this condition is monitored in cooperation with the European External Action Service (EEAS) throughout the lifecycle of the MFA operation. The MoU[43] also specified that the quantitative performance criteria are those attached to the 2014 IMF SBA.

As far as policy conditionality was concerned, both MFA operations focused on the same structural reform priorities namely: (i) Public Finance Management (and anti-corruption), (ii) Trade and taxation, (iii) Energy sector reform, and (iv) Financial sector restructuring. As for all MFA operations, policy conditions were not linked to the first instalment, which is only conditional on a satisfactory track record of the IMF programme. The SBA put forward by IMF in 2014 used extensively prior actions given Ukraine's poor track record with implementing reforms.

Design of the conditionality, apart from discussions with Ukrainian authorities, also included discussions with the EU Delegation in Kyiv, the EEAS, and DG Budget/former DG Markt, among others) as well as extensive external coordination, primarily with the IMF and World Bank, and to some extent with the EBRD and the EIB.

In addition, the Operational Assessment of the Financial Circuits and Procedures of Ukraine, commissioned by the European Commission and delivered by external consultants in order to ensure that the public finance management (PFM) system provided sufficient safeguards in view of a forthcoming MFA programme, also fed into the design of conditions in the PFM sector.

MFA loans were provided on very preferential terms given the prevailing market conditions at the time. Maturity and interest rates differed for each tranche but generally varied between 10 and 15 years and between 0.519 per cent and 1.875 per cent, respectively. Bullet capital repayment at final maturity was envisaged for all tranches except the final one under MFA I, which was an amortising loan where repayment of the principal was extended over the last 5 years of the 15-year maturity[44]. Table 2.2 shows the details for each tranche.

Table 2.2 Lending terms for MFA I and II

	amount	disbursement	maturity	coupon
MFA I	EUR 100 mln	20/05/2014	04/04/2024	1.875%
MFA II	EUR 500 mln	17/06/2014	04/04/2024	1.875%
MFA I	EUR 260 mln	12/11/2014	04/10/2029	1.375%
MFA II	EUR 500 mln	03/12/2014	04/10/2029	1.375%
MFA I	EUR 250 mln	21/04/2015	04/04/2030	0.519%
Total	**EUR 1,610 mln**			

[42] EUR 13 billion = EUR 600 mln (MFA I) + EUR 1,000 mln (MFA II) + EUR 1,800 mln (MFA III) + EUR 9,600 mln (other assistance including EIB and EBRD lending)

[43] Memorandum of Understanding between the European Union and Ukraine for Macro-Financial Assistance for Ukraine of up to EUR 610 million. Available at: http://ec.europa.eu/economy_finance/eu_borrower/mou/mou_eu_ukraine1_en.pdf

[44] DG ECFIN data.

MFA I and II lending terms were also competitive compared to other official financial support.[45]

Overall, given the urgency of the situation in Ukraine in early 2014, negotiations to finalise MFA I and II took an exceptionally short period of time compared to all past MFA operations and by all international standards (i.e. typical time involving the design and negotiation of a budget support operation by World Bank[46] and IMF is 4-6 months).

2.4 Economic developments during implementation

The following section presents a brief overview of economic developments that took place between early 2014 and mid-2015, the interval when the implementation of the MFA I and II took place. The following period from mid-2015 onwards when macroeconomic stabilization appeared, and then solidified subsequently, is discussed in Section 4.1.

More detailed analysis of trajectory as well as the underlying drivers behind several macro-variables that were critical over both intervals is presented in Section 6.1.

Finally, Annex 11 consists of detailed timeline which tracks down major political and economic events in the chronological order and marks major disbursements from IMF and the EU. It therefore gives a comprehensive overview of Ukraine's journey from very severe crisis in 2014 and first half of 2015 through gradual stabilization and some first signs of recovery observed in 2016.

2.4.1 Evolution between Q1 2014 to Q2 2015

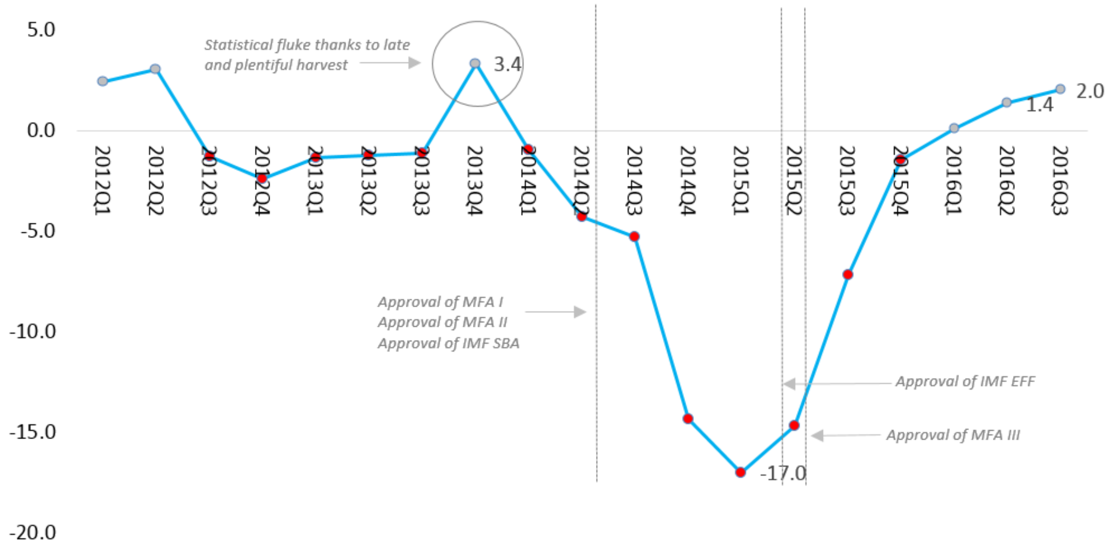
The newly formed government led by Arseniy Yatsenyuk that began its mandate on 27th February 2014 had to deal with a rapidly deteriorating crisis. After abandoning exchange rate peg with USD, the hryvna was depreciating sharply losing nearly 30 per cent of its value between February and April 2014. Escalation of the conflict in the East was taking its toll on, *inter alia*, export oriented industrial production, household consumption, public expenditure (defence related spending) and tax collection in the Eastern region. Indirectly, it was also eroding the business and consumer confidence and defined gradually worsening relations with Russia. Assistance pledged by the EU and IMF in April 2014, as well as by other international partners such as the World Bank and the USA, had helped to contain the crisis, but only to certain degree. Real GDP had actually started to contract in 2013[47].

[45] For example, the maturity of the IMF SBA - repayment was due within 3¼-5 years. Each tranche meant to be repaid in eight equal quarterly instalments beginning 3¼ years after the date of each disbursement. The lending rate of the SBA comprised (a) market determined SDR interest rate (minimum floor of 5 basis points) and a margin (100 basis points), (b) a surcharge of 200 basis points paid on the amount of credit outstanding above 187.5 percent of quota and (c) commitment fee of 30 basis points. In addition, the service charge of 50 basis points was envisaged after each amount was drawn

[46] For instance, the gold standard for WB to design and negotiate fairly standard support programme is 4-5 months

[47] Growth blip in Q4 2013 depicted in Figure 2.6 was a statistical fluke due to late and plentiful harvest[47].

Figure 2.6 Quarterly real GDP growth rate, in %



Source: *National Bank of Ukraine*

Contrary to initial assumptions made by IMF, the conflict in the East did not subside. In fact, the reverse happened with further escalation of the conflict. By August 2014, it was estimated that the GDP of Eastern regions affected by the conflict shrank by circa 15-20 per on a year on year basis[48]. Apart from agriculture that grew by 25.6 per cent in Q3 2014, other sectors declined.

Besides the direct impacts, the conflict was also denting business confidence with series of spill over effects including fall in private consumption and capital outflows.

The hryvnia exchange rate with USD weakened from UAH 7.99 to USD 1 in mid-February 2014 to UAH 15.77 for USD 1 at the end of 2014[49]. Inflation that was largely driven by the sharp exchange rate depreciation and increase in energy prices reached nearly 25 per cent by the end 2014 while banks had to deal with larger than expected deposit outflows. International reserves fell from USD 15.4 billion in February 2014 to only USD 7.5 billion as of December, mainly due to recourse provided for debt service payments and to clear gas arrears and import gas.

In addition, the gas dispute with Russia that began in April 2014 affected confidence and added additional pressure on the forex. At its peak, it resulted in interruptions in supply between June and September. To resolve it USD 3.1 billion payment was made to Gazprom, which increased pressure on international reserves and raised some concerns about the ability of the government to make external payments.

The conflict in the East, to which fallout from the gas dispute with Russia only added, was a major reason that initial assumptions of the IMF on recovery were not met[50].Deteriorating relations between Ukraine and Russia translated also into hostile trade policies imposed by the latter, offset to a small degree by a reorientation of Ukrainian trade towards the EU.

Conflict and economic weaknesses led to large additional financing needs beyond those envisaged in the IMF 2014 SBA programme[51]. The overall impact of the above

[48] IMF, September 2014. Country Report. Available at: https://www.imf.org/external/pubs/cat/longres.aspx?sk=41878.0

[49] Refers to official exchange rate as of NBU data.

[50] IMF, 2015. Ex-post evaluation of SBA to Ukraine.

[51] Fitch, February 2015. Fitch downgrades Ukraine's FC IDR to 'CC'. Available at: https://www.fitchratings.com/site/pr/979727

economic and political developments was that the Ukrainian economy recorded the largest contraction in five years in 2014, falling by 6.6 per cent. In late 2014 it was evident that Ukraine needed additional and substantial financing.

The country entered 2015 in a very severe crisis which was further amplified in first months of 2015, by the resumption of military activity in the East and ongoing uncertainty about the new IMF programme. Q1 2015 ended with the deepest recession as GDP contracted by 17 per cent.

On February 5, in an effort to eliminate the parallel currency market, the NBU halted its foreign exchange auctions allowing the interbank exchange rate to converge to the parallel market rate. As a result, the hryvnia fell immediately to around UAH 24–25 for USD 1. Confidence hit rock bottom as foreign exchange reserves fell to a record low of USD 5.6 billion in February 2015.

Public finances were also strained as the general government debt (excl. Naftogaz) reached 4.8 per cent and public debt rose to 70 per cent of GDP at the end of 2014. In February and March 2015 downgrades by Fitch[52] and Moody's[53] took place pointing also to the high possibility of the restructuring of the external debt.

Overall, the consequences of prolonged conflict in the East became fully evident in early 2015. The economic and political crisis and the conflict pushed the country to the brink of bankruptcy and, on 11 March 2015, the IMF approved a new USD 17.5 billion bailout package[54]. The agreement was part of an international effort to shore up Ukraine's USD 40 billion financing gap for the next four years.

3 Methodological approach

3.1 Introduction

This section presents our methodological approach to the evaluation carried out in line with the requirements set out in the Better Regulation guidelines[55]. The first step has been the development of an evaluation framework[56], which has underpinned the whole work and methods of approach carried out over the lifecycle of the evaluation, followed by the implementation of a step-by-step methodology, comprising data collection and analysis phases.

The section is structured as follows: it firstly presents the evaluation framework, then the step-by-step methodology before turning to limitations and caveats.

3.2 Evaluation framework

The evaluation has drawn upon a set of evaluation questions relating to five main criteria: relevance, effectiveness, efficiency, EU added value and coherence. The evaluation presents analysis and conclusions to the evaluation questions in the sections reporting against each of the evaluation criteria. Two additional components: Debt Sustainability and Social Impact Analysis; have been also considered and feed

[52] Ibidem

[53] Moody's, Match 2015. Moody's downgrades Ukraine's sovereign debt ratings to Ca, outlook remains negative.

[54] SBA was cancelled and was replaced with a new Extended Fund Facility (EFF) programme. The EFF made available funding of circa EUR 15.4 billion, but importantly, offered also the longer maturity (4 years) than SBA. (up to 10 years). The first repayment under EFF is due September 2018.

[55] European Commission, May 2015. Better Regulation Guidelines. Available at: http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm

[56] 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)

into the response to evaluation questions, in particular effectiveness one. Box 3.1 provides the evaluation questions and the evaluation criterion to which it relates.

Box 3.1 Evaluation questions

- *Question 1 (relevance related): 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?*
- *Question 2 (effectiveness related): To what extent have the objectives of the MFA operation been achieved?*
- *Question 3 (efficiency related): 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 related): In what way has the design of the MFA assistance conditioned the performance of the operation in respect to its cost and its objectives?*
- *Question 5 (EU-added value related): 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?*
- *Question 6 (coherence related): Were the measures of the MFA operation in line with key principles, objectives and measures taken in other EU external actions towards Ukraine?*

The ToR also stipulates two additional components to be addressed by the team:

- 1: Debt Sustainability Analysis: *An analysis of the impact of the MFA operation (also in combination with the IMF programme) on the debt sustainability of the country, possibly by drawing on the IMF's DSA's.*
- 2: Social Impact Analysis: *An analysis of social impact of the MFA 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.*

Those evaluation questions have been further broken into sets of quantitative and qualitative indicators that were ultimately used to answer each of them. Judgement criteria and sources of information have also presented as illustrated in 0. The full evaluation framework in presented in Annex 2

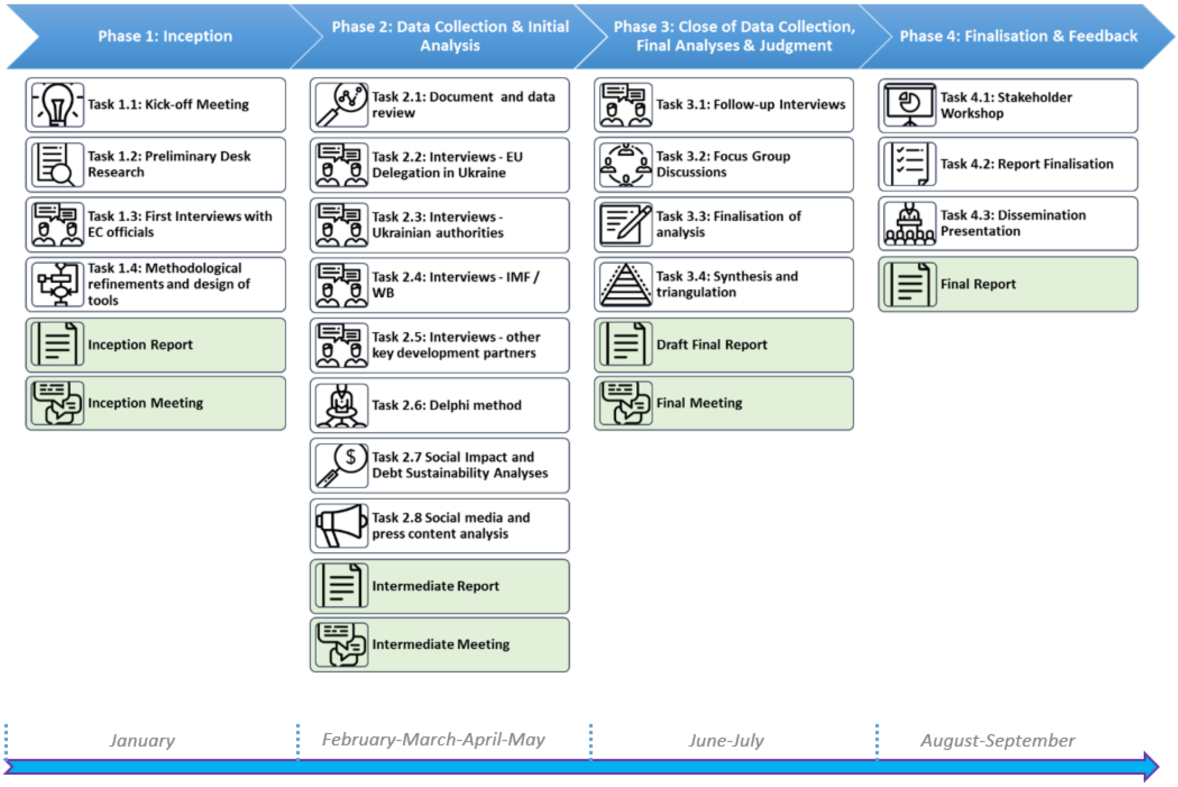
Table 3.1 Framework for answering Evaluation Question 1: To what extent was the MFA operation design (including adequateness of financing envelope, focus of conditionality) appropriate in relation to the outputs to be produced and objectives to be achieved

Judgement criteria	Quantitative analysis	Qualitative analysis	Sources of information
The size of the financial assistance was adequate in relation to Ukraine's financing needs and given the constraints of the Genval criteria Form of support was appropriate given Ukraine's debt position and income status MFA conditionalities were consistent with and relevant to Ukrainian needs and EU's and other donors' programmes and realistic given the short term nature of the instrument The MFA package was generally regarded as relevant to Ukraine's needs by stakeholders, local economists, media etc.	Analysis of financing needs in 2014- 2015 (as done by IMF) and the role of MFA in meeting these needs Comparison between projected and actual financing needs – reasons for deviations and relevance and appropriateness of MFA in light of any changes Analysis of Ukraine's debt position and GDP data to examine if loan form was appropriate	Degree of consensus among key stakeholders/ key informants regarding the relevance and importance of the MFA (in absolute and relative terms) Stakeholders and local economists' assessment of the use of a loan and focus of the conditionality; Examination of whether the focus of MFA conditionality was relevant and appropriate in Ukrainian context bearing also in mind the characteristics of the MFA instrument. In particular, the relevance focused on: (i) adequacy of the size of the financial assistance, (ii) appropriateness of the form of financial assistance, and (iii) design and focus of conditionality Analysis of synergies with the IMF SBA programme / other EU programmes	Desk review: • Ex-ante evaluation of MFA to Ukraine; • The two Memorandums of Understanding (MoU) and Loan Agreements • Reports and supporting documentation submitted by the Ukrainian authorities to the European Commission on the fulfilment of the structural reform criteria; • Commission's assessment of compliance with conditionality requirements (i.e. after mission reviews); • IMF research including Country Reports; • Other reports i.e. on the progress of PFM reforms accompanied with performance indicators/metrics. Semi-structured interviews: • EC officials: DG ECFIN, DG NEAR • EEAS • IMF/ WB officials; • Other bilateral/ multilateral donors supporting given reforms in Ukraine (i.e. USAID, GIZ); • Ukrainian authorities including also Ministry of Finance and Central Bank of Ukraine; • EU Delegation in Ukraine. Focus group with non-government stakeholders Stakeholder Workshop Twitter and press content analysis

3.3 Step-by-step methodology

Figure 3.1 Step by step methodology outlines our step-by step methodology: a data collection phase followed by an analysis and triangulation phase.

Figure 3.1 Step by step methodology



The main components of our key primary and secondary data collection exercise were: Desk research, Interviews with key informants, Delphi Panel, Focus Group, Stakeholder Workshop, Debt Sustainability Analysis, Social Impact Analysis and Twitter and press content analysis. The description of the type of work behind those tasks is presented in this section.

3.3.1 Desk research

This task was carried with the aim to build a complete and comprehensive understanding of the MFA operation in Ukraine within the team, to develop an initial overview of the context for the MFA operations in Ukraine and extract the key findings and evidence emerging from available material with respect to the evaluation questions. These early findings were later tested through empirical research.

Documents covered included publicly available information as well as official documentation provided by the Commission, more precisely:

- European Commission files relating to the MFA I & II operations, notably:
  - Council Decisions 02/639/EC, 388/2010/EU, 2014/215/EC;
  - Ex-ante assessment;
  - Memoranda of Understanding for MFA I and II operations;
  - Operational Assessment;
  - Preparatory documents submitted to the Economic and Financial Committee.
- EU policy-related documentation: Association Agenda, progress reports on Association Agenda, reports on the implementation of the European Neighbourhood policy and the Visa Liberalisation Action plan, reports on

financing spent on EU Sector Budget Support, projects implemented as a follow-up to the announcement of the support package to Ukraine in March 2014,

- Documentation published by the UA authorities such as economic strategies, reform programmes, action plans;
- IMF documents namely, the Letters of Intent submitted by Ukrainian authorities to the IMF, IMF Country Reports and some IMF specific research publications and evaluations i.e. ex-post evaluation of SBA 2014 programme;
- World Bank documents such as Country Partnership Strategies, program documents relating to the Bank's Development Policy Loan 1 & 2 and Financial DPL 1 & 2, documents relating to projects supporting relevant reforms;
- Local research publications provided by Ukrainian think-tanks and non-governmental organizations 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.

Macroeconomic data and statistics from various sources (e.g. IMF, World Bank, National Bank of Ukraine and Ministry of Finance data) were also compiled and analysed. These covered a number of dimensions including: Gross Domestic Product (GDP) and its components; Balance of Payments (BoP) statistics; Public finance statistics and Monetary statistics. The review of macroeconomic data and statistics covered the period before, during and after the MFA implementation and involved a detailed analysis of the trajectory of key indicators, underlying drivers and deviations of key macroeconomic indicators from the projections made by IMF.

3.3.2 Interviews with key informants

We interviewed EC officials and representatives of the EU and Member States political landscape, Ukrainian national authorities and other stakeholders involved in the implementation of the MFA conditionality as well as IFIs and the wider donor community. This represented a total of 46 interviews – only six of which were conducted over the phone or via exchange of emails. The rationale for these interviews to be face-to-face was to facilitate contacts, to allow for the administration of longer questionnaires given the scope of topics to be covered, to be able to use body language and non-verbal cues to guide the interviewer (e.g. which reform areas generated signs of enthusiasm / reluctance) and to facilitate the use of visual aids (e.g. list of conditionalities).

Table 3.2 provides the breakdown of interviews by the type of stakeholder. The interviews purposely targeted those officials which were employed during the time of the MFA I and II implementation, regardless of whether they were still working at the same institution or not. Five of these interviews were scoping interviews undertaken at the inception stage. They helped the team to produce more tailored topic guides for the rest of the interview programme.

Annex 4 provides the full list of interviewees.

Table 3.2 Profile of interviewees

Profile	Count of interviewees
EC officials at the headquarters and at the EU Delegation in Kyiv/ European External Action Service / Member States representatives	**21**
ECFIN / former ECFIN	8
Former Head of Cabinet	1
EU Delegation in Kyiv	3
Support Group for Ukraine (SGUA)	2
Permanent representations (PL, UK, DE, LV)	5
European External Action Service (EEAS)	2
National authorities / other stakeholders involved in the implementation of the MFA	**14**
Ministry of Finance	4
Accounting Chamber of Ukraine	2
Ministry of Economic Development and Trade	2
Ministry of Social Policy	2
Naftogaz	1
National Anti-Corruption Bureau	1
National Bank of Ukraine	2
International donor community	**12**
IMF	5
World Bank	3
EBRD	2
GIZ	2
Grand Total	**47**

The main focus of 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. The full set of interview guides is not available in an annex as each and every respondent received a slightly different topic guide depending on his / her profile (e.g. focus on energy-related conditionalities with Naftogaz; coverage of design aspects related to MFA I only in case the official moved on from Ukrainian file before the design of MFA II began).

Box 3.2 provides a snapshot of the interview focus by stakeholder type.

Box 3.2 Focus of interviews by stakeholder type

EC officials and representatives of the EU and Member States political landscape

- Interviews with EC officials covered all key themes of the evaluation. The purpose of the consultations were to deepen the evaluation team understanding regarding 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 instruments of the EC 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 progresses made in various reform areas and role of MFA in achieving these.

- Interviews with the SGUA/ EEAS covered as well a range of the above mentioned topics, in particular: articulation of MFA with other EU instruments / as part of the wider EU-Ukraine relationships, assessment of progress made with reforms and contribution of MFA to that process.
- Interviews with MS representatives were similarly designed to gather their views on the progresses made with reforms and the role of MFA in the context of other instruments at the EU and also national level.

National authorities / other stakeholders involved in the implementation of the MFA

- The same aspects as with the EU officials were discussed but from the authorities point of view: Design and negotiation process of both MFA operations; Impact of MFA operations on 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 (Domestic political and institutional constraints, timeliness of disbursements).
- With entities such the Accounting Chamber of Ukraine and the National Anti-Corruption Bureau of Ukraine for the PFM sector (including anti-corruption measures) as well as the State-Owned-Enterprise Naftogaz, the discussions were restricted to particular topic areas – e.g. to the conditionalities relevant to their sectors and their relative impacts.
- ***IMF and the donor community***
- With the IMF, the focus was on aspects related to 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 ith respect tow selection of conditionality, likely scenario in the absence of the MFA); implementation aspects (e.g. timelines of MFA disbursement); Impact of MFA / IMF assistance on macroeconomic conditions and structural reforms.
- With other donors, the interviews focused on the characteristics of their own assistance package and potential complementarities / synergies and/or inconsistencies with the MFA I and II operations.

NB: Table 3.6 outlines some limitations related to the completed interview programme and the outputs from it

3.3.3 Delphi Panel

The Delphi survey sought to establish views on the role and contribution of the MFA in achieving macroeconomic stability, easing external financing constraints and alleviating Ukraine’s balance of payments and budgetary needs. In particular, participants were asked to elaborate on plausible scenario would MFA I and II (or the whole joined assistance package from international community) not have been available. The survey also covered aspects related to the role of both MFA operations in promoting structural reforms and their social impacts. The structure of the questionnaire was largely driven by the insights gathered during key informant interviews. Pilot test of the questionnaire was also conducted before launching the survey.

The recruitment to the panel was carried out with the support of the local research team at IER and with advice from DG ECFIN and the EU Delegation in Kyiv. We included 65 representatives of the following groups / institutions in the Delphi panel:

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

The research team made specific efforts 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, 34 respondents provided the valid feedback which resulted in 53 per cent response rate. The first round of survey results yielded a high level of consensus among the participants in terms of most likely alternative for the MFA. Given the high level of consensus in the first round, a second round had only exploratory character and sought to get additional insights in relation to four specific questions where some divergence of opinions still emerged. Among 65 experts who received the second questionnaire 21 responded which resulted in 32 per cent response rate. Table 3.3 provides the details of the background of respondents by type of organisation, for the rounds that were carried out. A provides a summary of the results of the Delphi survey.

Table 3.3 Details of the Delphi Panel that were invited and responded

Type of organisation	Number of invitees	Number of respondents in 1st round	Number of respondents inn 2nd round
Think Tank	17	11	5
Academia	7	8	5
Bank	10	6	1
Credit Rating Agency	5	3	2
Investment Fund	3	3	0
Media	5	3	1
Consulting	11	1	2
Other	7	6	5
Grand Total	**65**	**41** (out of which **34** full valid answers)	**21**

3.3.4 Focus Group

The focus group discussion was organised in Kyiv to collect the views and opinions of a wider group of non-government stakeholders (who have not been directly involved in the operations) on various aspects and most notably the non-financial value added of both MFA operations. The group dynamic was particularly useful to have a candid discussion on, inter alia, the reforms undertaken in Ukraine since the EuroMaidan protests, their outcomes and perceptions of the role of MFA in promoting these reforms, and benchmarking the MFA with the IMF and WB operations as appropriate. Discussion covered also aspects related to visibility and confidence boosting effects of the MFA and communication.

The half-day focus group was held with a small group of think-tank directors, non-governmental/ private sector representatives, academics and, economic journalists –

selected and invited in consultation with our local experts, the EU delegation and the Steering Group. Table 3.4 gives an overview of the profile of participants, Annex 4 provides the full list of participants, and Annex 6 the summary notes of the discussions.

Table 3.4 Profile of the Focus group participants

Organization types	Number of participants
Think-tanks	5
University	2
Press	2
Bank/ credit rating agency	2
Association of employers	1
NGO	1
Grand Total	**13**

3.3.5 Stakeholder Workshop

The stakeholder workshop was organised 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 the IMF/MFA assistance. It was organised via video-conference from Brussels.

The specific agenda comprised a presentation of the main findings by ICF followed by some discussion.

Participants included DG ECFIN, EU Delegation in Kiev, IMF, National Bank of Ukraine and Ukraine Ministry of Finance (see Table 3.5 and Annex 4 for a full list of participants)

Table 3.5 Profile of the Stakeholder Workshop participants

Organization types	Number of participants
DG ECFIN, European Commission	6
EU Delegation in Kiev	1
IMF	3
National Bank of Ukraine	1
Ukraine Ministry of Finance	3
Grand Total	**14**

3.3.6 Debt Sustainability Analysis

The assessment of the debt sustainability involved the analysis of the debt sustainability: (i) before MFA I & II and (ii) during and after MFA I & II, and then subsequent assessment given hypothetical scenarios had MFA I and II (and MFA I and II and IMF assistance) not been disbursed. Two key debt indicators used were the public debt-to-GDP ratio and the gross public financing needs-to-GDP ratio. The approach followed closely the methodology applied by the IMF and considered number of relevant factors that had or could have had material impact on the debt sustainability i.e. fiscal policies pursued by Ukrainian policies, available sources of funding, impact of exogenous factors (i.e. conflict in the East) and most importantly hypothetical impact had the MFA I & II (and more broadly the EU support package) been absent.

Key sources of data included inter alia: insights from Delphi survey; insights from selected semi-structured interviews, predominantly with the IMF, WB and Ministry of Finance; insights from local experts; insights from the focus group; review of macroeconomic data; and review of the IMF documentation and guidelines on debt sustainability analysis.

The summary of the assessment in presented in Section 10 while the full analysis is available in Annex 7.

3.3.7 Social Impact Analysis

The potential social impacts of the Macro-Financial Assistance (MFA) focused to a considerable extent on the impact of one specific condition that had a clear social dimension: '…*to compensate vulnerable households for the increase in gas prices by strengthening the social safety net in a targeted manner*'. This was the only explicit condition related to the social situation. The analysis drew on available secondary data (i.e. data provided by the local experts, ILO, EU and IMF publication) and insights gathered from local stakeholders i.e. Ministry of Social Policy and Naftogaz.

The assessment also reviewed a number of social trends occurring before and since the MFA operations (i.e. households spending, income distribution, unemployment or poverty rate) to illustrate the social impact of the economic trends in the time period concerned – as indirectly MFA will have had a social impact reflected in the performance of the labour market, especially in terms of avoided job losses and the avoided loss in real incomes (as a result of the financial support and the boost provided to the economy).

The summary from the analysis in presented in Section 11 while the full analysis is available in Annex 8.

3.3.8 Social media and press content analysis

The aims of the social media (Twitter) and press content analysis were primarily to: (1) analyse in a systematic manner the visibility of MFA I and II (quantitative stage - counts of references obtained) and (2) strengthen the evidence base for issues related to public acceptability of reforms and their perceptions of the relevance and impact of MFA support (qualitative part – sentiment analysis).

Keywords used were the same for Twitter and press content analysis. These included (along with spelling and word order variations): '*Macro Financial Assistance to Ukraine*'; '*EU loan to Ukraine*'; '*EU credit/s to Ukraine*'; '*financial assistance to Ukraine'*; and '*EU support to Ukraine'*.

Summary of specific methods for press content analysis and social media analysis are presented below while the full versions of both analyses are available in the Annex 9.

3.3.8.1 Press content analysis

Three media outlets: "Dzerkalo Tyzhnya", "Novoye Vremya" and "Delo" were selected for this analysis primarily for the quality of their economic columns. The analysis covered their online and printed versions for the period from January 1st, 2014 till June 30th, 2015.

Initial search returned an initial selection of 424 articles, from which 105 individual articles that related to MFA I & II were analysed in detail in terms of the content of the publication and tone used.

3.3.8.2 Twitter analysis

Social media analysis was related to tweets in three languages: English, Russian and Ukrainian for the period from January 1st, 2014 till December 31st, 2015. It covered a similar sequencing than for the press (quantitative counts followed by an analysis of the sentiment of the tweets), with the additional step required to qualify the profile of those sharing the tweets.

A total of 2,642 tweets in English, Russian and Ukrainian were considered as most relevant to this analysis (57 per cent of all tweets were in Russian, 32 per cent in English and 11 per cent in Ukrainian). The volume found to be specifically related to MFA I and MFA II was 300 English tweets (or 36 per cent of the relevant English language tweets) and 500 Russian + Ukrainian language tweets (or 28 per cent of the relevant English language tweets).

3.3.9 Finalization of analysis, synthesis and triangulation

This task implied finalising the analysis made under the various tasks and producing relevant annexes, including:

- Analyse and report the results of the Delphi survey and focus group
- Analyse and report the results of the Debt Sustainability Analysis and Social Impact Analysis;
- Analyse and report the results of Social Media and Press content analysis.

In the second stage, this task led to the preparation of this report where synthesis and triangulation of multiple sources of information and multiple types of methods has taken place to report findings in a structured manner under each evaluation question.

3.4 Discussion of validity and reliability of the findings

The below elements of the methodological approach enhance the reliability and validity of the overall findings of this evaluation. Based on these elements we believe that the overall reliability and validity of the evaluation is strong.

Table 3.6 Overview of the main elements underpinning reliability and validity of findings

Elements of the methodology	Discussion	Judgement
Validity of overall judgements	The evaluation was based on an agreed evaluation framework which broke down all evaluation criteria into questions and sub-questions and defined judgement criteria for all The evaluation framework was agreed with the steering group prior to the design of data collection tools	Strong
Generalisation of findings	We believe that the overall findings can be considered as representative of the range of views with sufficient confidence because: Quantitative fieldwork is based on reliable statistical data For qualitative fieldwork the respondents to interviews, Delphi survey and focus group were selected using category based purposeful sampling	Medium to strong
Reliability of overall evaluation design	The evaluation collected data from a large variety of sources. It also combined a breadth of data collection and data analysis techniques. Findings are systematically triangulated using a variety of sources	Strong

The caveats and limitations which nevertheless remain associated to each particular data collection method are presented Table 3.7.

Table 3.7 Limitations and caveats of data collection and analysis

Method	Caveats and limitations
Desk research	*Relatively reliable data with some occasional exceptions:* In general, quality of Ukrainian statistics including national accounts is relatively good. Key statistical indicators (i.e. 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 i.e. due to annexation of Crimea and conflict in Donbas. Ukrstat retrospectively calculated most of key statistical indicators excluding Crimea since 2010 and this was relatively straightforward as these indicators are usually available on regional as well as national level. Donbas case is more complex. Some companies in the part of Donbas outside of government control continued statistical reporting (i.e. on output, wages, employment, investment etc.) while others did not. Household surveys were stopped altogether. Thus reduction in economic activity in controlled part of Ukraine in 2014 and 2015 was likely slightly smaller than national figures. It this context, analysis of labour market developments prior and after 2014 still remains challenging. Data provided by Ministry of Finance is reliable.
Interviews with key informants	Interviews covered typically informants who were closely involved in the negotiation and/or implementation of the IMF/MFA assistance. Nonetheless, there were also cases i.e. among initially shortlisted stakeholders in Ukrainian authorities, where relevant staff was not employed anymore in a given institution (i.e. partly driven by typically high turnover in UA public sector). In certain cases, stakeholders were also unable to recall in detail certain aspects related to the MFA operations or/and relevant context due to the time that elapsed since those operations. In addition, some interviewees had initially confused some discussed aspects of MFA operations by referring in their answers to MFA III, instead of MFA I and II operations. Finally, in some sporadic cases certain initially shortlisted stakeholders did not respond to the interview invitation.
Delphi Panel	Although substantial effort was made to ensure the highest relevance and validity of responses (i.e. by vary thorough selection of sample), Delphi survey in general may exhibit certain weaknesses. In the context of the MFA, the major risks related to insufficient familiarity of participants with the aspects of the MFA operation and the tendency to stick to strong own views based on own interpretation of historical developments. There has been also more than 3 years since the first disbursement under MFA I was made and hence some memory loss was unavoidable. Therefore, although nearly all respondents stated that they had been familiar with MFA prior to the survey (to different degree) and there was generally high consensus on most of the aspects, the findings from this exercise should be still considered with certain degree of caution.

Method	Caveats and limitations
Focus Group	The scope of the focus group discussions was limited by definition. The focus group focussed on issues such as visibility of EU support, its role in promoting reforms and it covered also the overall assessment of the reforms' pace in Ukraine since the EuroMaidan protests in 2014. All stakeholders had prior knowledge of the MFA and in some cases demonstrated very good understanding of specific aspects related to MFA I and II (i.e. one interviewee led on the comparative research project covering assistance programmes provided to Ukraine over last years, including MFA I & II. However, the evaluation team had to also clarify in a few instances that some conditions (i.e. related to wood ban), were out of the scope of the evaluation.
Stakeholder Workshop	As in case of the interview programme, some of the relevant staff from the Ministry of Finance and the World Bank that was initially shortlisted to take part in the workshop, was eventually not available. This has potentially somehow affected the granularity and relevance of the insights that were provided during the workshop.
Debt Sustainability Analysis	It is difficult to isolate and quantify the impact of MFA I and II because they were combined with other finance (i.e. IMF and WB assistance) and no record is available on the amounts that specifically went to debt operations. More generally, the nature of the MFA mechanism implies that it was not possible to trace down how MFA funding was used specifically i.e. maintain public expenditure, meet the foreign debt repayment obligations etc. The DSA relied substantially on the insights from Delphi survey experts and relevant stakeholders which were asked to speculate about the hypothetical scenarios that did not take place. All limitations and caveats related to Delphi survey and insights from semi-structured interviews apply here as well.
Social Impact Analysis	Ministry of Social Policy in Ukraine engaged only to limited extent in the hypothetical exercise where questions related to potential social impact related to enhanced social safety net had MFA condition not been implemented were asked. In addition, the internal analysis related to enhanced social safety net and which underpinned the design and implementation of the scheme, was eventually shared by the World Bank office in Ukraine which impacted the quality of the analysis.
Social media and press content analysis	<u>For press analysis</u> While great effort has been made to ensure that researchers conducting the analysis are sufficiently familiar with the MFA instrument and relevant background, not all aspects may have been grasped fully with some implications for the interpretation of the analysed content; The qualitative content analysis involves considerable degree of judgment i.e. while coding a given tweet/ press article as positive/ neutral or negative. Hence, some coding and interpretation may not have been entirely consistent throughout the whole process of analysis.

Method	Caveats and limitations
	For Twitter analysis: This analysis was based only on publicly available data and content from Twitter; A combination of manual review of sample data and automatic filtering terms was used to exclude off-topic and irrelevant posts to the greatest extent possible but since Crimson Hexagon only offers a sample of raw posts, there might still be stray irrelevant posts that didn't get caught in the filtering process. These should only be up to a maximum of 5 per cent; Audience breakdown of users who posted in English is based on sample size n = 265, 95 per cent confidence interval and 5 per cent margin of error; For Twitter analysis, material number of tweets were generated from bot accounts. Most prolific bot accounts were excluded from the analysis, though the data set may still include some bot/spam account that posted once or twice as screening of the whole sample would be very labour intensive.

4 Implementation state of play

4.1 Economic developments after the implementation

This section presents the evolution of the economy since the completion of MFA I and II operations up to the current time.

4.1.1 Evolution from Q2 2015 - stabilisation and gradual recovery

In response to the critical situation in early 2015, the government committed to a strong fiscal consolidation in that year focusing on increasing tax revenues (increase in excise tax rates, increase in personal income tax, temporary surcharge on imports, freeze in public wages, pensions and social payments as well as sharp reduction in state aid) along with a series of measures focusing on reducing the huge Naftogaz deficit including an increase in bill collection and end-user price increases. Consequently, the Naftogaz' deficit fell from 5.5 per cent in 2014 to 1 per cent of GDP in 2015.

Partly as a result of ongoing tensions with Russia and rapidly falling imports including imports of energy, the current account deficit saw huge adjustment and was nearly eliminated in 2015 (-0.3 per cent of GDP).

Indeed, the second half of 2015 brought some much awaited signs of stability. Rate of price increase started to decelerate and in November 2015 Moody's upgraded the outlook of sovereign rating to stable pointing to '*…progress of political and economic reforms under auspices of IMF'*[57].

The return to modest growth commenced in first half of 2016. It was driven by industrial production and trade (5.4 and 3.7 per cent growth in Q1 2016 on y-o-y basis). Some loosening of the fiscal stance enabled by the previous strong cuts in expenditures a year earlier and the de-escalation of the conflict in the East also helped. Improvement in confidence was observed, and the rise in steel prices and a

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

bumper harvest allowed the hryvna to stabilise. Overall, the output grew by 2.3 per cent in the whole of 2016.

Government debt restructuring[58], inflows from official donors and foreign currency purchases by the central bank helped to rebuild reserves that reached USD 15.5 billion as of December 2016[59].

Most recently, the growth continued with GDP increasing by 2.5 and 2.3 per cent in Q1 and Q2 2017 respectively[60] and was driven by private consumption and some return of capital investment.

The conflict with Russia continues to weigh on the economy, albeit less than in its early stage. Exports of goods and services went down in real terms (by 0.4 and 2.1 per cent in Q1 and Q2 2017 respectively[61]) while coal imports increased (due to blockade of Donbass). FDI still has not recovered to the levels in the pre-conflict period. At the same time though, exchange rate volatility has been low, the hryvnia strengthened from UAH 27 per USD to UAH 26 per USD between January and September 2017, and NBU international reserves exceeded USD 18 billion at the end of August 2017 for the first time since 2013. In a recent survey, investors seem to be largely preoccupied by the corruption (perceived as most burning issue in Ukraine) while military conflict was ranked as fourth most important problem[62].

The fiscal situation in 2017 looks so far to be fairly encouraging, but with challenges remaining. In the first seven months of 2017, consolidated fiscal revenues grew by 45.7 per cent on the y-o-y basis. Higher VAT and PIT collections made the largest contribution to this growth. At the same time, fiscal expenditures remained underfinanced due to lower than planned borrowings and low privatization receipts. As a result, the consolidated budget was in surplus at UAH 52.8 billion in the seven months of the year. The fiscal deficit target for 2017 is set at 2.7 per cent of GDP, according to the State Budget Law.

Stabilization of public finances has also been marked by Ukraine's recent return to the global debt markets in 2017, nearly four years since it lost the access in 2013. In September 2017, the Ukraine government closed the deal on a USD 3 billion 15-year Eurobond issue (at 7.375 per cent yield).[63] USD 1.6 billion were directed to the buyout of Eurobonds due to 2019 and 2020 (USD 1.2 billion and USD 0.4 billion, respectively). Nonetheless, the Government will be still challenged by payments on external public and publicly guaranteed debt in 2018 and 2019 of more than USD 10 billion.[64] As of September 2017 there were also over USD 3 billion of foreign currency domestic bonds that will mature in 2018 and 2019[65].

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[58] In November 2015, Ukraine successfully completed a debt restructuring of around $15 billion 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)

[59] IMF, WEO July 2017. Available at: https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx

[60] http://www.ukrstat.gov.ua/operativ/operativ2017/vvp/ind_vvp/ind_2017e.htm Note this page is expected to be updated with revised figures in March 2018 and final figures in March 2019)

[61] Ibid

[62] http://eba.com.ua/static/2017_09_13_InvestorSurveyResults_16_9.pdf and see also VoxUkraine, 2017. Foraign Direct Investment in Ukraine: War and Peace. Available at: https://voxukraine.org/2017/02/02/investments-in-ukraine-en/

[63] Ukraine Ministry of Finance, 2017. Financial data. Available at: https://minfin.gov.ua/news/view/ministerstvo-finansiv-oholosylo-praisynh-vypusku--mlrd-ievrobondiv?category=aspekti-roboti&subcategory=vigotovlennja-blankiv-cinnih-paperiv-dokumentiv-suvoroi-zvitnosti

[64] 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

[65] 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

At the end of August 2017, Moody's[66] upgraded Ukraine's rating to Caa2 (from Caa3) with a positive outlook given the progress in structural reforms and improved external position (increased NBU international reserves)[67].

4.2 Policy implementation

The following section provides a brief snapshot on the MFA III operation which was planned as the follow-on operation in Ukraine as well as key programmes deployed by other donors that followed MFA I and II.

4.2.1 MFA III

At the end of 2014, faced with a deteriorating economic situation on the one hand and the conflict in the East with bleak prospects for a swift resolution which dented the confidence, the Ukrainian government recognised a need for a follow-on operation to MFA II and requested the third MFA assistance in late 2014. After European Commission proposal for MFA III made in January 2015[68], the European Parliament and Council decision to adopt the assistance followed in April 2015 and the Memorandum of Understanding was signed on 22nd of May 2015[69]. The objective of the programme was to help alleviate Ukraine's large external financing needs and to support the ambitious reform programme of the authorities started under MFA I and II.

MFA III was larger than previous operations with the total amount of EUR 1.8 billion envisaged to be disbursed in three equal instalments. Through the MFA III, the EU sought to cover the urgent financing needs faced by Ukraine remaining after the effects of MFA I and II and of other donor programmes, while supporting the actions established under previous programmes to achieve the country's economic stabilisation[70].

In total, 36 specific conditions[71] from the area of public finance management, governance and transparency, the energy sector, the social safety nets, business environment and financial sector were attached to the financial envelope. Apart from new reforms, there have been also set of conditions that took further those prescribed under MFA I and II[72].

The first disbursement of EUR 600 million was made on in July 2015. It then took nearly 20 months to disburse the second tranche of EUR 600 million (released in April 2017). The MFA III operation expires in early January 2018 and the third and last disbursement would need to be agreed by that time. It will be subject to sufficient

66 Note that Moody's rating still remains lower than equivalents for S&P and Fitch (B- with stable outlook for both)

67 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

68 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

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

70 European Commission, July 2015. EU commission disburses EUR 600 assistance to Ukraine. Available at: http://europa.eu/rapid/press-release_IP-15-5423_en.htm

71 Full list of conditions envisaged under 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

72 The areas/ issues that built on those envisaged under MFA I and II included, inter alia, 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 the improvement in the functionality of the social safety net that was put in place back in 2014

progress in the implementation of the remaining conditionality as well as sufficient progress with IMF EFF assistance.

4.2.2 Assistance from other donors

The following section provides a snapshot of the assistance programmes provided by the IMF, World Bank, EIB and EBRD that followed MFA I and II operations.

4.2.2.1 IMF 2015 Extended Fund Facility

In light of the conditions that pushed the government to request the MFA III (see Section 4.2.1) it became also evident that deeper reforms in the longer term, requiring greater financial assistance than envisaged under the SBA agreed in early 2014, were necessary. In March 2015 a new four-year programme under the Extended Fund Facility (EFF) with exceptional access of 900 percent of quota (SDR 12.348 billion, or circa USD 17.5 billion) was approved, with nearly USD 5 billion being immediately disbursed. The reforms built and deepen those commenced under SBA[73].

Apart from the initial disbursement, three further tranches under the EFF have been released so far: USD 1.7 billion in August 2015, and USD 1 billion in September 2016 and April 2017 respectively, amounting to the total of USD 8.7 billion[74].

Overall, while the EFF program had a good start, further progress in implementation has been more mixed. The latest third review of the programme has concluded: '…*While there have been important achievements in the energy and financial sectors, there was limited progress in reforming and privatizing state-owned enterprises, land and pension reforms, and effectively tackling corruption*.[75]'

4.2.2.2 World Bank

Following the disbursement of First Development Policy Loan (DPL-1) and First Programmatic Financial Sector Development Policy Loan (FSDPL-)1 in May and August 2014 respectively, the World Bank continued to provide its assistance in the form of budget support from then on with DPL-2[76] and FSDPL-2[77] approved in August and September 2015 respectively.

DPL -2 of the size of USD 500 million was accompanied by the series of structural reforms focusing on promotion of good governance transparency and accountability of public sector, improvement in efficiency of utility subsidies, and strengthening of the regulatory framework and reduction of costs of doing business. In turn, FSDPL-2 at amount of USD 500 million focused on reforms related strictly to the Ukrainian banking sector[78]. In its own evaluations, progress in most of the reforms under both programmes was assessed as 'satisfactory'[79].

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[73] IMF, March 2015. IMF Executive Board Approves 4-year USD 17.5 billion Extended Fund Facility for Ukraine, US5 billion for immediate disbursement. Available at: http://www.imf.org/en/News/Articles/2015/09/14/01/49/pr15107

[74] IMF, September 2017. Ukraine's transactions with the Fund. Available at: https://www.imf.org/external/np/fin/tad/extrans1.aspx?memberKey1=993&endDate=2017-09-22&finposition_flag=YES

[75] IMF, April 2017. Country Report No.17/83. Available at: https://www.imf.org/en/Publications/CR/Issues/2017/04/04/Ukraine-2016-Article-IV-Consultation-and-third-review-under-the-Extended-Arrangement-44798

[76] World Bank, August 2015. DPL-2. Available at: http://projects.worldbank.org/P151479?lang=en

[77] World Bank, September 2015. FSDPL-2. Available at: http://projects.worldbank.org/P151941?lang=en

[78] World Bank, August 2015, FSDPL-1. Programme Document. Available at: http://documents.worldbank.org/curated/en/160241468185384276/pdf/95400-PGD-P151941-R2015-0172-1-Box393189B-OUO-9.pdf

[79] See for instance World Bank Implementation Report from DPL-1 available at: http://documents.worldbank.org/curated/en/898881499374165601/pdf/ICR00004070-05012017.pdf

In parallel, the World Bank has been also providing technical assistance and financing of individual projects in Ukraine, continuing marked increase in its engagement and commitment that began since 2014[80].

4.2.2.3 EIB and EBRD

In spring 2014, the European Commission announced a comprehensive EUR 11 billion assistance package (see Section 2.3.2) to support Ukraine. This envisaged the financing of EUR 3 billion of investment projects by the EIB over the period 2014-2016, and similar amount from the EBRD[81]. Available data from both institutions suggest that those targets have been met.

Between 2014-2016, the EIB signed projects to the value of EUR 3 billion, which effectively doubled the amount committed between 2011-2013 (EUR 1.67 billion). Projects related to the financing of SMEs and MidCaps companies, energy infrastructure and social infrastructure (e.g. in health sector) accounted for 80 per cent of overall EIB support between 2014-2016[82].

The EBRD, which is among the biggest lenders in Ukraine, and channelled over EUR 2.8 billion between 2014-2016[83]. Key areas of its focus have been banking and energy sector, and financing of private corporates[84]

5 Relevance of the MFA

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?*

To answer this question, three essential issues will be taken into consideration namely (i) adequacy of the size of the financial assistance, (ii) appropriateness of the form of financial assistance, and (iii) design and focus of conditionality

5.1 Size of the financial assistance

In the ex-ante evaluation for MFA II[85], it was envisaged that MFA II (and MFA I) would contribute to closing the residual financing gap for the years 2014 and 2015. At the time, the availability of the *ready to use* funding from the MFA I was very timely given the immediate financial need. The MoU signed in February 2013 was ratified by the Ukrainian Parliament in March 2014 – representing the last step in the procedure before disbursement could be made.

At that time (mid-March 2014), the precise size of Ukraine's external financing needs for that period was still unknown, but assessed as significant[86]. Preliminary projections became available only a few weeks later when the IMF released its staff report linked to the request for the 2014 SBA (see Table 5.1). The size of the gap was estimated at USD 10 billion in 2014 and USD 12.5 billion in 2015.

[80] World Bank, 2017. Projects & operations. Available at: http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=UA

[81] EBRD, 2014. EBRD steps up lending to Ukraine as part of international support package. Available at: http://www.ebrd.com/news/2014/ebrd-steps-up-lending-to-ukraine-as-part-of-international-support-package.html

[82] EIB, 2017. Investing in Ukraine. Available at: http://www.eib.org/attachments/country/eib_in_ukraine_en.pdf

[83] EBRD, 2017. EBRD Ukraine data. Available at: http://www.ebrd.com/where-we-are/ukraine/data.html

[84] EBRD, 2017. Ukraine overview. Available at: http://www.ebrd.com/where-we-are/ukraine/overview.html

[85] European Commission (2014) Ex-ante evaluation statement on EU macro-financial assistance to Ukraine. SWD(2014) 112 final. Available at: http://ec.europa.eu/economy_finance/eu_borrower/documents/ex-ante_evaluation_statement_ukraine_en_.pdf

[86] Recollection of the IMF gathered during the study team mission to Washington in April 2017

Table 5.1 Ukraine 's Gross External Financing Requirements, 2011-17, USD billion

	2011	2012	2013	2014	2015	2016	2017
			Est.	Projection			
Total financing requirements	**71.1**	**85.5**	**73.7**	**63**	**58**	**55**	**57.6**
Total financing sources	**67.4**	**79.7**	**73**	**51.8**	**53.1**	**56.2**	**58.6**
Increase in gross reserves	-3.1	-7.2	-4.1	-1.2	7.5	5.6	2.6
Errors and omissions	0.2	0.5	-0.1	0	0	0	0
Total financing needs	**0.3**	**-1.9**	**-3.3**	**10**	**12.5**	**4.4**	**1.7**
Funding of the gap							
IMF	*0*	*-3.4*	*-5.6*	*3.7*	*7.1*	*1.1*	*-1.2*
Official creditors	0.3	1.5	2.3	6.3	5.4	3.3	2.8
World Bank	*0.2*	*0.9*	*0.3*	*1.9*	*1.6*	*0.4*	*0.3*
EU	*0.1*	*0.1*	*0.1*	*2.2*	*0.6*	*0.1*	*0.1*
Incl. from MFA I + MFA II [1]				*1.9*	*0.3*		
EBRD/EIB/Others	*0*	*0.5*	*2*	*2.2*	*3.1*	*2.8*	*2.5*
MFA as a share of residual gap [1]				*19%*	*2%*		

Source: *IMF country report 14/106 based on NBU; and IMF staff estimates and projections.*

[1] ICF calculations for share of MFA based on actual phasing of disbursement of MFA I and II. Xrate conversion using InforEuro (with the rate of April 2014).

The EU MFA I and II pledged USD 2.2 billion. In absolute terms, this has been qualified as being of an "unprecedented level"[87]. Indeed, the size of MFA I and II combined (EUR 1.6 billion in total – supplemented by an additional disbursement of EUR 600 million in July 2015 under MFA III) accounts for 35 per cent of all MFA assistance disbursed over 23 years to partner countries between 1991 and 2013 (EUR 4.57 billion)[88].

The contribution of the MFA instrument was anticipated to be largely frontloaded: with the disbursement of MFA II expected to be made in full during 2014 as per the ex-ante evaluation. Both MFA meant to account for circa 19 per cent of the 2014 gap, but only for 2 per cent of the 2015 gap[89].

However, there was some awareness in early 2014 that the combined MFA I and II assistance may not be sufficient, also due to the volatility of the situation (the need of additional financing became somehow evident in mid-2014). For instance, the Ukrainian Ministry of Finance had initially suggested that a greater amount may be required, though the evaluation team did not manage to establish whether the Ukraine MoF based its request on any formal analysis[90]. IMF had also been aware at the ex-

[87] European Commission (2015) Implementation of macro-financial assistance to third countries in 2014. COM(2015) 290 final. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1466169244778&uri=CELEX:52015DC0290

[88] European Commission, 2016. Reports of the Commission on the implementation of the MFA. 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#documents

[89] ICF calculation based on the IMF estimation of residual financial gap for 2014 and 2015 and the actual MFA I and II disbursements.

[90] Ukrainian Treasury was not able to provide sufficient information

ante stage that greater support may be needed. MFA III with additional support of EUR 1.8 billion is some recognition of the further need for support.

And indeed, Ukraine's total financing needs proved later to be much higher, climbing to USD 20 billion for the year 2015 (compared to the 12.5 billion estimated)[91].

5.2 Form of the financial assistance

According to the 2013 Joint Declaration of the European Parliament and the Council[92] (Principle 3), the MFA should take the form of a loan unless there are exceptional arguments for the use of grant funding. These arguments should be based on the per capita income of the recipient country, its ability to repay loans, and the extent to which international financial institutions apply concessional terms. As the ex-ante evaluation for MFA II[93] indicated, the European Commission justified its decision to opt for a loan-only operation on the grounds that Ukraine is a middle-income country (GNI of USD 3,500 in 2012), with a manageable public-debt ratio (41 per cent of GDP at the end of 2013) and is ineligible for concessional financing from either the IDA or the IMF.

Although, some stakeholders argued that the size of the MFA I and II could have been greater[94], none of the consulted stakeholders contested the form of the financial assistance delivered under MFA I and II with no suggestion that in hindsight a grant component should have been used. It is also worth noting that the MFA was part of a wider EU rescue package including grant support and specific project finance.

5.3 Focus of conditionality

MFA assistance is released conditional upon the fulfilment of a number of pre-agreed policy conditions. **Specific conditions that were part of the package of the MFA I and II operations are listed in Annex 1**.

In general, there are several issues that need to be considered when specifying the conditions for securing MFA support:

- Conditionality aimed at addressing country's needs for reform

In the case of Ukraine, as is the case usually, the decision on which type of reform conditions would be pursued through the MFA programme was made following a country-specific needs-assessment conducted by the Commission. In the case of MFA II both a recent ex-ante evaluation and an operational assessment (focused on a specific reform area such as public finance management) were produced. More generally, all interviewed international donors have suggested that the core requirements for reform were fairly obvious at an early stage.

The effort to design the conditionality was largely related to MFA II since the conditionality of MFA I had been already agreed in 2013. Despite the time that had elapsed the MFA I conditions were considered by the EC relevant enough to be retained.

The detailed assessment of the relevance of conditionalities (section 5.4 below) confirms that most conditions in MFA I were still relevant at the time of

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91 IMF, March 2015. Country Report No. 15/69. 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

92 European Parliament legislative resolution of 4 July 2013 on the joint text approved by the Conciliation Committee for a decision of the European Parliament and of the Council providing further macro-financial assistance for Georgia (PE-CONS 00038/2013 – C7-0168/2013 – 2010/0390(COD))

93 European Commission (2014) Ex-ante evaluation statement on EU macro-financial assistance to Ukraine. SWD(2014) 112 final. Available at: http://ec.europa.eu/economy_finance/eu_borrower/documents/ex-ante_evaluation_statement_ukraine_en_.pdf

94 Views expressed for instance by the IMF

implementation, with the exception of three MFA I conditions in the trade and financial sector areas[95] that had been fully implemented before the actual implementation of the operation.

Targeted reform areas in MFA I and II were in line with the country priorities, i.e. with the Programme for Economic Reforms for 2010-2014 in the case of Ukraine[96]. Trade, energy, financial sector PFM reforms all featured predominantly, and anti-corruption measures were also identified.

The focus of conditionality also reflected co-operation with international donors to ensure complementarity and the avoidance of overlaps, most notably with the IMF SBA programme, but also the World Bank's DPL-1 and FSDPL-1, and assistance provided by the EBRD, which all shared the same broad set of priorities, as assessed in early 2014.

- Coherence with overall MFA objectives

Conditions were designed to ensure coherence with the general objective of the operation, i.e. restoring economic balance. With the policy conditionality associated to its MFA operation in Ukraine, the ex-ante evaluation specifically highlighted that the aim was to "*improve the overall macroeconomic management and the conditions for sustainable growth*"[97]. There was no dissent among consulted stakeholders[98] that the identified priorities were essential for a sustainable recovery.

- Conditionality taking into account the time required to complete the reforms as well as the nature of the MFA instrument;

Given the relatively short term nature of the MFA and the need for a swift response, the required reforms have to be generally possible to implement in a period of 6 to 12 months. Detailed examination of the design of the conditionalities in the PFM sector for example, confirms this factor was taken into account. More specifically, the Operational Assessment provided a list of more than 30 high and medium priorities to be implemented to foster PFM in Ukraine[99]. These were generally ambitious and far-reaching reforms (e.g. changes to the MoF structure, gradual integration of Extra-Budgetary-Funds into the Consolidated Budget), which were unlikely to be implemented before the intended disbursement of the second tranche and were therefore not included. Overall, there was no case identified of poorly timed or overly ambitions conditions under MFA I and II operations.

- Coordination / complementarity with other EU programmes

MFA conditionalities were designed to support the implementation of the Association Agenda. This objective has been clearly stated in the MFA ex-ante evaluation and the conditionalities indeed focused on key priorities for reforms: Fight against corruption, Public procurement reform; Taxation reform; External audit; Energy Sector Reform. Conditionalities related to trade may also facilitated the implementation of the DCFTA.

At a more granular level of detail, MFA conditionalities also appear to have good degree of complementarity with other EU instruments, including the conditionalities set out in the financing agreement of the "State Building Contract", which, with MFA operations, represents another major deliverable of the support package to Ukraine announced by the European Commission in March 2014. The "State Building Contract"

[95] See conditions 7, 14 and 20 under MFA I presented in the Annex 1.

[96] http://www.usubc.org/site/files/Ukraine_Program_of_Economic_Reforms_2010-2014.pdf

[97] European Commission (2014) Ex-ante evaluation statement on EU macro-financial assistance to Ukraine. SWD(2014) 112 final. Available at: http://ec.europa.eu/economy_finance/eu_borrower/documents/ex-ante_evaluation_statement_ukraine_en_.pdf

[98] Those who took part in the individual interviews as well as through focus group

[99] BDO & Four Assist Limited Development Consulting, August 2014. Operational Assessment of the financial circuits and procedures in Ukraine.

is worth EUR 355 million of grant aid, coming in the form of budget support. Disbursements under the "State Building Contract" have also been linked to progress in reforms in some key areas including anti-corruption and public finance management.

- Coordination/ complementarity with other external programmes (i.e. IMF SBA)

MFA reforms complemented those from the IMF reform package. Table 5.2 compares the focus areas of MFA with SBA conditionality and Ukraine's own priorities, differentiating synergies, cross-conditionalities and specific conditionalities.

Table 5.2 High level comparison of MFA and IMF conditionality

Priority	EU MFA I and II	IMF 2014 SBA	UA programme of reforms
PFM including reinforcement of the Accounting Chamber of Ukraine	✓	✓ **(more restricted scope: only in relation to Public Procurement)**	✓
Anti-corruption	✓	✓	✓ **(not prominent)**
Trade policy: application of WTO commitments	✓	**X**	✓
Fiscal policy	✓ **(VAT refunds)**	✓	✓
Energy policy:	✓	✓	✓
Raising tariffs	**X**	✓	✓
Introducing a social safety net	✓	**X**	✓
Participating in the Extractive Industry Transparency Initiative	✓	**X**	
Financial policy	✓	✓	✓

Certain conditions were primarily a function of the discussion with other international donors. For instance, conditions related to the Extractive Industries Transparency Initiative (EITI) became an EU-only concern after the World Bank sought to reduce its number of conditions. The EU also took some responsibility for the enhancement of the social safety net in response to the energy tariff adjustments promoted by the IMF.

5.4 Assessment of the relevance of conditions

This section examines the relevance of the MFA I and II conditionality. The assessment was based on:

- evidence of consistency with identified weaknesses and priorities for reform;
- feasibility of implementation (partly reflected in the national ownership of the reform), and;
- complementarity with other EU and international donor priorities.

Assessment starts with an overview of the relevance at the thematic level and then continues with an assessment of each specific condition which is presented in the tabular format in Annex 10.

Box 5.1 Assessment of the relevance of the areas of the MFA I and II conditionality – Public Finance Management (PFM) – anti-corruption

PFM - anti-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, low morale and an underdeveloped sense of public service have made many public officials liable to corruption over Ukraine's entire post-soviet era[100].

In 2013, Transparency International scored Ukraine at 25 on a scale from 0 (highly corrupt) to 100 (very clean)[101]. Endemic corruption was also a main trigger of the Maidan events and population expectations in early 2014 were high.

Anti-corruption dimension was also an essential item of many of the IMF and WB promoted reforms[102]. Although progress has been made, more than three years after the EuroMaidan protests corruption is still a major concern and block to inward investment.

According to European Business Association and Dragon Capital's survey of private business from Spring 2017, the widespread corruption is the most important obstacle to foreign investment in Ukraine (8.5 on the 1-10 scale where 10 most important)[103].

A national public opinion survey of residents of Ukraine conducted between April 21st and May 5th 2017 by the International Republication Institute with support from the government of Canada revealed that the three most important issues for Ukraine are war with Russia, government corruption and low industrial production.

Overall assessment of relevance: (Very) High

Box 5.2 Assessment of the relevance of the areas of the MFA I and II conditionality – Public Finance Management (PFM) – other

PFM – other: Without proper PFM systems, proper use of MFA funds could not be guaranteed. The protection of the EU's financial interests is always guaranteed ex-ante but PFM reforms are always included among the list of conditionalities as there is typically material scope for improvement. The MFA I 2010 Decision[104] specifically called for PFM-related conditions.

PFM was an area where significant weaknesses persisted up to the point in 2011, where the EU budget support operations had to be interrupted, notably in light of the drawbacks in the public procurement sphere.

Conditionalities focused on specific aspects that were likely to be implemented in the relatively short space of time before the intended disbursement of the second tranche, rather than on the far reaching priorities identified in the Operational Assessment[105].

Overall assessment of relevance: High

[100] The Economist, April 16th 2016. Clean-up crew. Available at: http://www.economist.com/news/europe/21697000-ukraine-broken-its-civic-activists-are-trying-build-new-country-clean-up-crew

[101] Transparency International 2013, Corruption Perception Index. Available at: https://www.transparency.org/cpi2013/results#myAnchor1

[102] As stated during the mission in Washington D.C.

[103] Kyiv Post, June 2017. Top 12 recent investments in Ukraine.

[104] Article 2 of Decision No 388/2010/Eu of the European Parliament and of the Council of 7 July 2010 providing MacroFinancial Assistance to Ukraine

[105] The Operational Assessment was undertaken in April 2014 to check Ukraine's PFM systems provided sufficient safeguards in view of a forthcoming MFA programme, also fed into the design of the conditions in the PFM sector.

Box 5.3 Assessment of the relevance of the areas of the MFA I and II conditionality – Trade and taxation

Trade and taxation: This reform area promoted reforms aimed at implementing the AA / DCFTA in line with the Ukrainian priority of further integration with the EU (see programme of economic reforms 2010-2014).

It was also particularly relevant for EU businesses (as well as Ukrainian businesses) because it focused on removing trade barriers and trade irritants and improvement of the general business climate. As in many other reforms some conditions had a very strong anti-corruption dimension (i.e. elimination of the VAT refund arrears)

Overall assessment of relevance: High

Box 5.4 Assessment of the relevance of the areas of the MFA I and II conditionality – energy sector

Energy sector: The Ukraine energy sector has been one of the least efficient in the world due to high levels of subsidies[106]. This has been burdensome on the government budget and from an environmental / climate change point of view but has also had an impact on the competitiveness of the economy. In addition, there has also been an important political dimension of needing to reduce dependence on fuel imports from Russia.

Some stakeholders stressed that Ukraine's greatest economic vulnerability was its energy consumption. Ukraine's energy intensity as of 2013 – the ratio of energy used to economic output was twice that of Russia and ten times the OECD average. Hence, the IMF SBA was also contingent on energy reform[107].

The reform of the energy sector was one of the priorities of the government in its 2010-2014 programme but previous reform efforts had been unsuccessful i.e. internal prices for electricity were well below the prices in neighboring countries[108] , the efforts to put in place a targeted social scheme had failed, Naftogaz's deficit was a persistent[109] and a huge drag on public finance. Although not -explicitly focused on energy efficiency, MFA conditionalities did address some urgent issues.

Some of the conditions in this area had synergies with the fight against corruption as the energy sector was identified as an area with particularly high levels of corruption.

Overall assessment of relevance: High

Box 5.5 Assessment of the relevance of the areas of the MFA I and II conditionality – financial sector

Financial sector: The reform of the financial sector was one of the priorities of the government identified in the programme of economic reforms 2010-2014 and this approximation of EU law is among the objectives of the Association Agreement. More generally, the need of immediate diagnostics and restructuring of the banking system was also high on the agenda of World Bank, IMF and EBRD, not least because of the potential

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

[107] Ibidem

[108] Ukraine MoE, 2015. http://www.nerc.gov.ua/data/filearch/catalog1/Prezentatsia_optymizatsia_taryfiv_na_electro.pdf

[109] IMF, 2016. Ex-post evaluation of 2014 SBA.

spillover effects on the real economy (and performance of support programmes) from the risk of insolvency of a large number of banks including systemically important ones.

Some of the conditions in this area had also an anti-corruption dimension.

Overall assessment of relevance: High

5.5 Conclusions on relevance

5.5.1 Size of the financial assistance

The size of the MFA I and II represented a major investment by the EU in recognition of the critical economic and political situation in Ukraine. Some stakeholders considered the sum could have been greater, though the request and approval for MFA III was a recognition of the need for continued support.

The relevance of the MFA I and II was strengthened by its frontloaded character (87 per cent of all funding was disbursed in 2014) and aided by the remarkable speed taken to establish the MFA operations.

5.5.2 Form of the assistance

Given accepted principles, the level of economic and social development of Ukraine, and its debt sustainability and repayment capacity at the time of the negotiations of the MFA I and II, required the support to be provided in the form of a loan rather than a grant (or combination of both).

5.5.3 Focus of conditionality

The relevance of the conditionality was generally high or very high, albeit there were a few exceptions[110]. The ambition of the conditions was appropriate as the basis for short-measures notwithstanding the major long-term programme of reform required in Ukraine.

At the thematic level, all areas of conditionality were highly relevant. This was especially true for anti-corruption measures, and noted as such by national stakeholders. Given the endemic level of the corruption in Ukraine that often obstructed structural reforms, and the fact that it was indeed a key catalyst of the EuroMaidan protests, the importance of addressing these measures was very high.

In fact, the anti-corruption dimension was also present in a number of conditions from other areas i.e. clear up of VAT refund arrears (trade and taxation area), the improvement of implementation of the legislation on the disclosure of ultimate ownership of banks (financial sector) and the increase in transparency of financial reporting by Naftogaz (energy sector). At the thematic level, none of the stakeholders including participants in the focus group pointed to any additional area that should have been covered by the MFA I and II but was excluded.

At the level of specific condition, for most of the conditions the relevance was high. An emblematic example was the extension of the remit of the ACU to cover public revenue. Its previous exclusion was not only an archaic but also a major source of fraud and corruption. Similarly, VAT refund arrears was a persistent problem in Ukraine long before MFA I and II becoming eventually a significant trade irritant for domestic and foreign (including EU) companies, and again – a major source of corruption.

There were three specific conditions of which relevance was negligible namely, condition related to an introduction of up-to-date product coding system for foreign trade purposes based on the Harmonized System 2007, alignment of customs valuation practices with WTO standards (both from trade and taxation area), and the amendment of legislation, notably the accounting law, to ensure the application of the

[110] See specific conditions in the conditionality Tables in Annex 9 where relevance was assessed as 'low'.

International Financial Reporting Standards to all financial market participants by 2014 at the latest (financial sector area). All there were part of the MFA I package and were already fulfilled prior to the implementation of the MFA I and II, reflecting in part the fact that MFA I conditionality was negotiated between 2010 and 2012, i.e. two years prior to the entry into force of the MoU.

6 Effectiveness of the MFA

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

The objectives of MFA to Ukraine are, as set out, inter alia, in the Memoranda of Understanding (MoU)[111] to "ease Ukraine's urgent external financing constraints, alleviate its balance of payments and budgetary needs and strengthen its foreign exchange reserve position". Beyond this, the objectives are also to support structural reforms.

There are therefore, two strands of analysis to answering the question on effectiveness:

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

Part 2: Effectiveness of structural reforms

6.1 Part 1: The role of MFA in promoting macroeconomic stability

In order to assess the role of MFA 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 I & II objectives have been achieved, irrespective of the actual role of the MFA I & II.

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

Based on the context explored in Step 1, Step 2 involves a qualitatively driven approach to assess the role and contribution of the MFA I & II. It relies on inferences taken from the desk research, interviews, Delphi survey, insights from the focus group and expert opinions, and seeks to explore the potential consequences had the MFA I and II (with or without IMF support) not been provided. In addition, summary of the Debt Sustainability Analysis evaluating the role of the MFA for the sustainability of the public debt during the implementation period is added to this assessment.

6.1.1 Step 1: Examining the observed macroeconomic outcomes

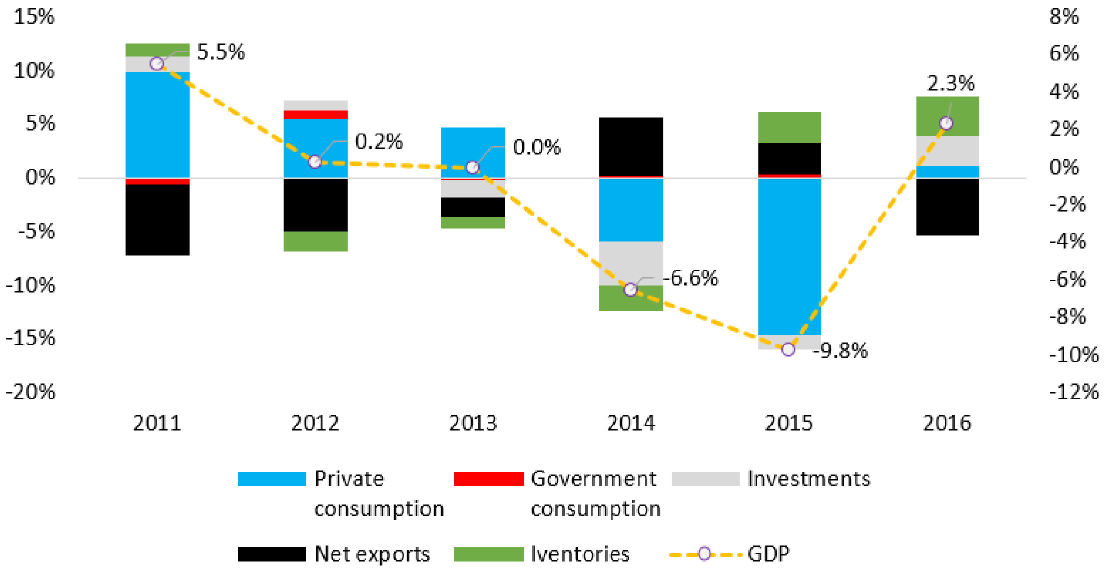
The following section describes the evolution and underlying factors behind the GDP growth and its main components, external sector, public sector finances, inflation and banking sector.

GDP growth

The decomposition on the key drivers country's GDP is presented in Figure 6.1.

[111] MoU for MFA I and MoU for MFA II signed in February/March 2013 and May 2014 respectively.

Figure 6.1 Decomposition of real GDP trend, 2011-2016



Source: *Ukrstat and IMF*

Note: 2016 data is provisional and subject to change

Since 2014, the escalation of the conflict in the East was taking its toll on, *inter alia*, industrial production and tax collection in the Eastern region. Crisis was deepening through the year with household consumption being particularly affected, partly due to rapid depreciation being an offshoot of the economic and political uncertainty. Real gross value added declined in all sectors in 2014, except for agriculture and nonmarket services such as public administration and defence as well as healthcare and social work, due to conflict in the Eastern Ukraine. Uncertainty and instability in banking sector that translated into restricted access to finance stood behind the fall in investment. The increase in net export was caused by faster contraction of imports than exports, and reflected also sharp reduction in energy imports and some import substitution.[112]

GDP continued to decline in 2015, by 9.8 per cent as a result of the impact of conflict on economic development of other regions of Ukraine through broken economic links, uncertainty and depressed business sentiment, which persisted for much of 2015 - as result private consumption fell by 15 per cent. Yet, the contraction would have been even greater but from mid-2015 a broad-based recovery began. Exchange rate stabilised as a result of the financial support provided and most economic sectors (apart from financial services) improved their performance in Q3 and Q4 2015[113].

In 2016, private consumption, a main motor of growth in Ukraine, picked up modestly and the growth was also supported by rise in investment. Investment in fixed capital jumped by 20 per cent but it remained very low as a share of GDP at 15 per cent of the total. It was driven by the need to replace obsolete equipment after several years of severe under investment. The decline in net export was a consequence of increased demand for imported investment goods and increase in consumer spending that drove import growth, while exports was still hammered by conflict in Donbas and trade conflict with Russia. Overall, the economy grew by 2.3 per cent that year and the stabilization that began in mid-2015 was already well anchored by the end of 2016.

[112] IER, 2016. Year 2015 – Economic summary for Ukraine.

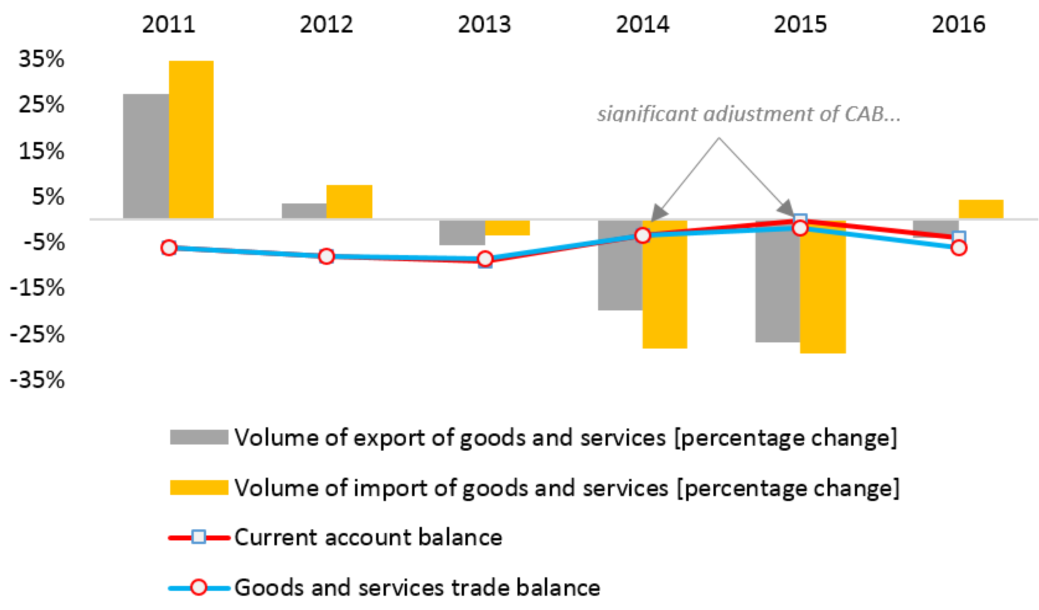
[113] Ibidem.

External sector

The current account balance was worsening rapidly in the run up to early 2014. Current account deficit was -8.1 per cent in 2012 and fell further to -9.2 per cent in 2013 (Figure 6.2). Since then, large adjustment was observed and deficit shrank to -3.8 in 2014 and was nearly eliminated in 2015 (-0.3 per cent). More recently, the deficit increase again to -4.1 per cent in 2016.

In general, the depreciation of hryvna played a central role in the rebalancing of the current account balance, in particular up to mid-2015 (the fall in imports being greater than the fall in exports). The adjustment was driven by an improvement of balance of trade, firstly with the EU and Asia, and to some extent also as a result of increasing tensions in trade relations between Ukraine and Russia[114] (i.e. lower energy imports). Though, improvement in trade balance of goods with Russia was somehow offset by loss of services export (gas transit/ Russian tourists). The deterioration of the current account balance in 2016 was fuelled by a strong rebound in investment activity that boosted imports (see above) and recovery in commodity prices (incl. energy) that still offset the increase in steel and grain prices that helped exporters.

Figure 6.2 Current account balance and its main components



Source: *NBU and Ukrstat*

General government budget

Since 2012 the government revenue and expenditure have been falling in relation to GDP (0). In 2014 expenditures were somehow curtailed, owing to liquidity constraints and stalled budgetary payments to the conflict areas in the East. The government implemented also first fiscal consolidation measures which then allowed it to negotiate SBA with the IMF i.e. financing of most programs including social spending and capital outlays was reduced. In addition, the state aid to coal mines and agriculture was reduced while increases in wage payments were restricted. On the revenue side, the fall in revenue in 2014 was determined by sharp reduction in tax collection from Donbass regions since the escalation of the conflict.

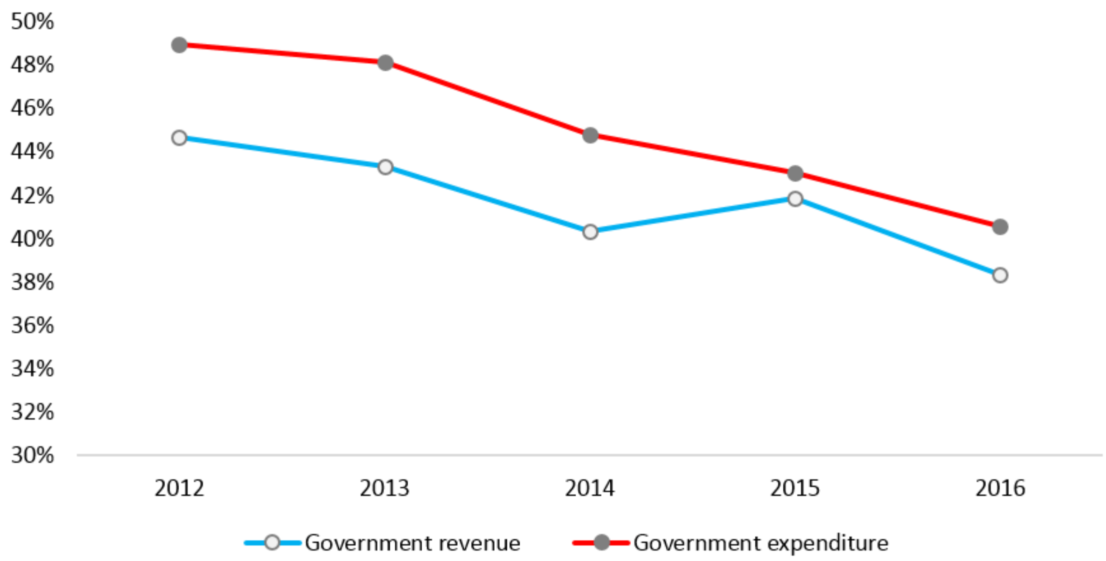
2015 saw already the government embarking on full scale fiscal consolidation focusing, *inter alia*, on wages, pensions and subsidies. The cuts in support to the Naftogaz (due to hikes in energy tariffs) had also very material impact on the

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

expenditure side. Overall, government expenditure fell from 48.1 per cent of GDP in 2013 to 43 per cent in 2015 and primary balance reached 3 per cent that year (Figure 6.4).

Although, the expenditures and revenue kept declining as a share of GDP in 2016 (Figure 6.3), the dynamic of the former was higher which was partly the result of gradual loosening of fiscal stance after tight 2015 (e.g. sharp increase in spending on housing and utility subsidies to compensate for new hikes in energy prices for households, and higher spending on defence and security). The fiscal balance improved markedly in 2015 after which certain deterioration, also as a result of some fiscal loosening over that year, took place (Figure 6.4)

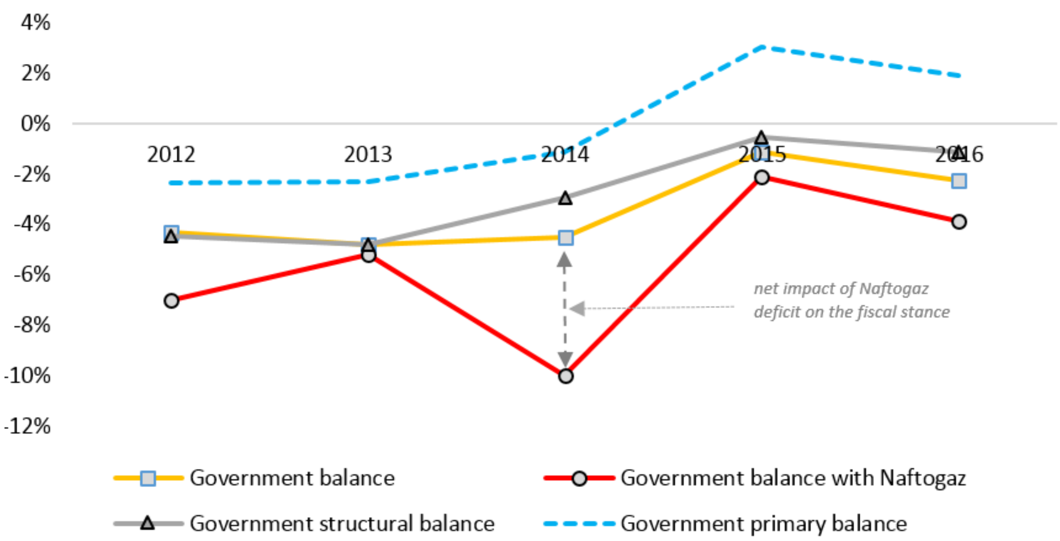
Figure 6.3 Government revenue and expenditure, in % of GDP



Note: 2014 data without Crimea and Sevastopol, 2015/16 without Crimea and Sevastopol and areas not under the control of the Government in Donetsk and Luhansk regions

Source: *IMF WEO April 2017*

Figure 6.4 Fiscal Balance in Ukraine, in % of GDP



Note: 2014 data without Crimea and Sevastopol, 2015/16 without Crimea and Sevastopol and areas not under the control of the Government in Donetsk and Luhansk regions

Source: *IMF WEO April 2017*

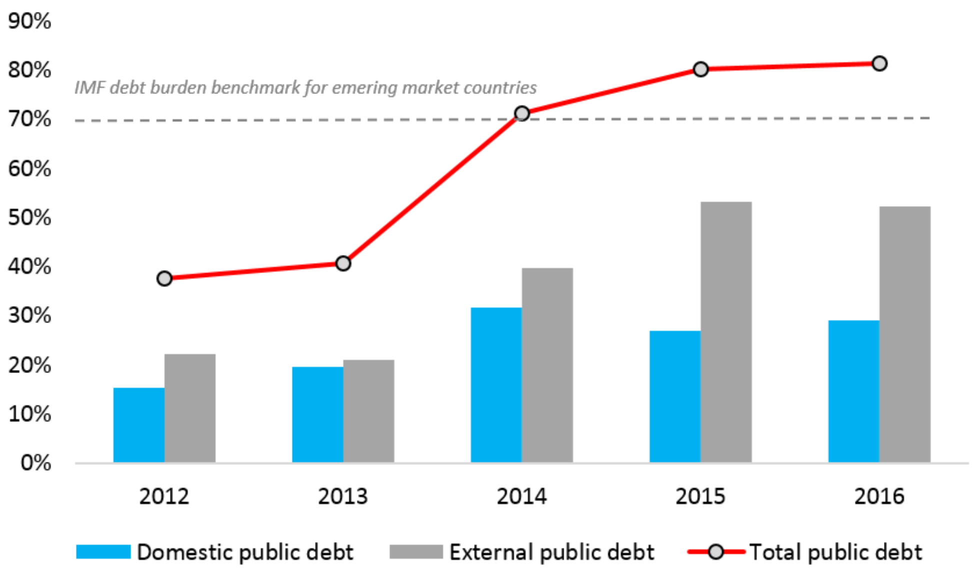
Public debt

Although at relatively slow pace, 2012 and 2013 saw already a stable increase of the public debt to GDP ratio (Figure 6.5). By 2013 public debt rose to 40.5 per cent[115] of GDP which was still below the IMF's 70 per cent debt burden benchmark above which debt sustainability is at high risk for an emerging market country like Ukraine.[116]

The subsequent deterioration in the economic and political environment, including the conflict in the East of Ukraine, caused a worsening of economic situation. The deep recession in 2014 during which real GDP contracted by 6.6 per cent, sharp depreciation of the Hryvnia and the materialisation of Ukraine's contingent liabilities (such as in SOEs, commercial banks) were some 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 sharp rise in debt to over 70 per cent of GDP by the end of 2014.

Nonetheless, the trend of rapidly increasing total public debt was somehow contained from 2016 onwards. Although in 2014 and 2015 Ukraine received coordinated support from the EU, the IMF and other international financial institutions which was reflected in the marked rise in the level of external public debt, in November 2015 Ukraine also successfully restructured about USD 15 billion of its external debt and achieved a 20 per cent debt reduction.[117] Resumed growth in 2016 helped to stabilize the public debt at about 80 per cent.

Figure 6.5 Public debt trajectory, in % of GDP



Source: IMF

Inflation

In 2012 and 2013 the inflation in Ukraine was very much contained (Figure 6.6). In fact, after a mere 0.6 per cent of average annual CPI inflation in 2012, the economy was in slight deflation in 2013 (-0.3 per cent). This reflected weak consumer demand, trade irritants with Russia (that increased domestic supply of food items) and lower global food prices (according to FAO Food Price Index)[118] . Yet, the average annual CPI

115 IMF.

116 IMF.

[117] 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

[118] FAO, 2017. Food Price Index. Available at: http://www.fao.org/worldfoodsituation/foodpricesindex/en/

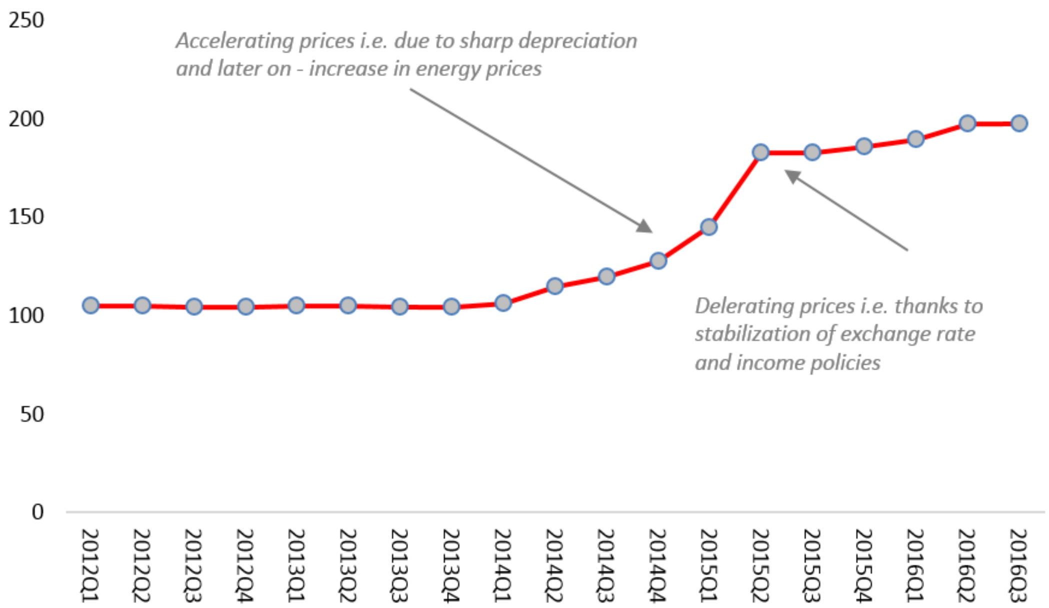
in the following years reached 12, 49 and 15 per cent in 2014, 2015 and 2016 respectively[119].

The absolutely crucial factor behind the sharp price increase from 2014 onwards was rapid depreciation of hryvna caused by the abolishment of the pegged regime and rapidly deteriorating confidence that in turn was a result of the escalation of the conflict in the East, political instability as well as overall vulnerability of the economy.

The most dynamic price increase was observed from Q1 2015 onwards when increases in energy prices effective on April 1st (end-user price hikes by average 284 per cent) and further depreciation of hryvna took their toll.

Stabilization in prices from mid-2015 coincided with stabilization of exchange rate (Figure 6.7). From 2016 onwards, stable exchange rate and subdued demand kept downward pressure on inflation, which, however, remained elevated at double-digit levels due to the significant increase of administered prices[120].

Figure 6.6 CPI Index, December 2010=100



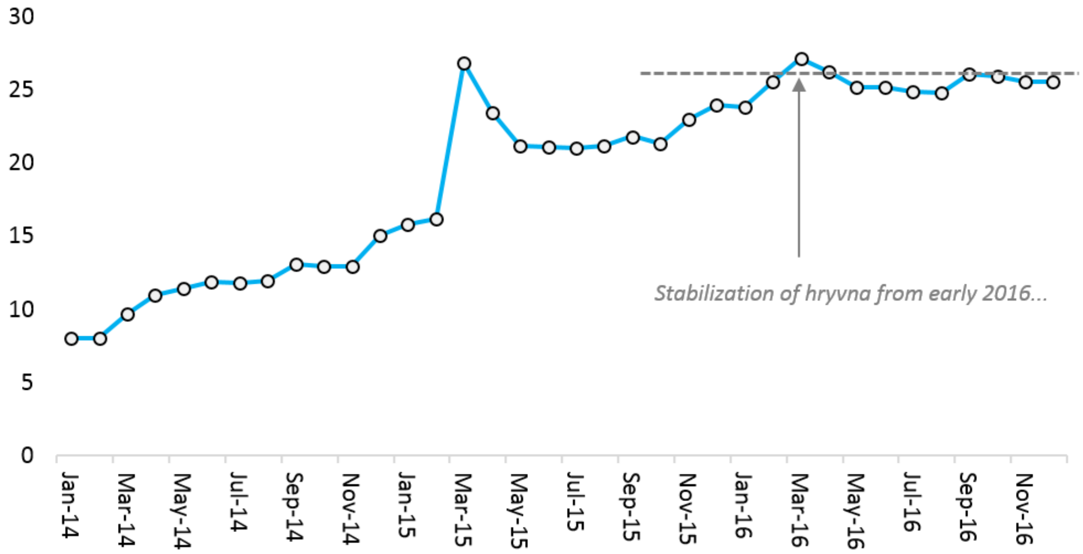
Source: *Ukrstat*

Note: 2014 data without Crimea and Sevastopol, 2015/16 without Crimea and Sevastopol and areas not under the control of the Government in Donetsk and Luhansk regions

[119] IMF, 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=

[120] IMF, September 2016. Country Report.

Figure 6.7 UAH per USD, official exchange rate



Source: *NBU*

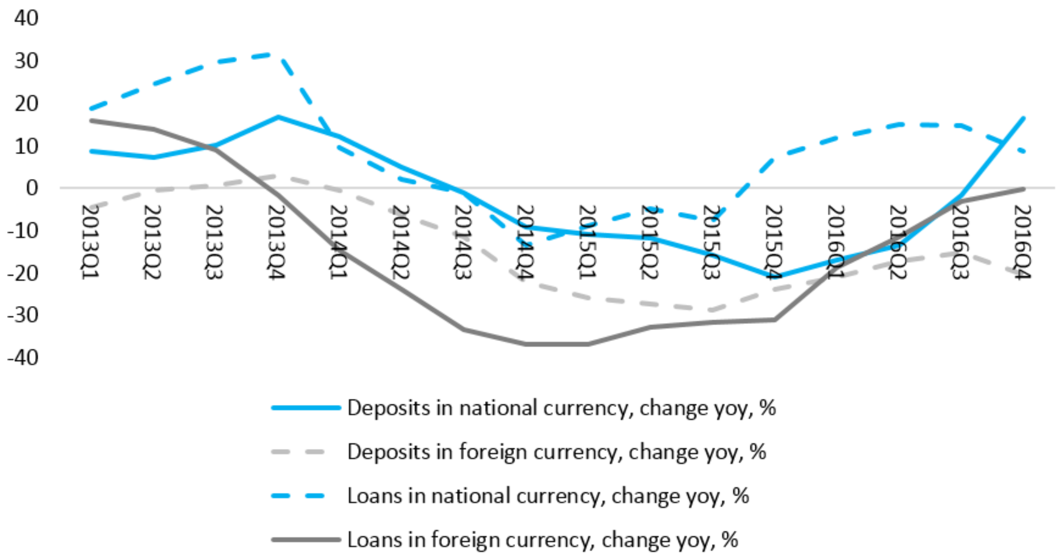
Banking sector

2014 was extremely difficult for national banking sector. Many Ukrainian banks had exposure to Donbas and Crimea with around 10 per cent of loans and 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 6.8). Coupled with overall economic slowdown, those factors forced the NBU to purse the clean-up of the sector from banks used in tax schemes, money laundering and capital flight. The outcome was 51 bank failures in 2014 and first half of 2015 which accounted for 22 per cent of the banking sector's assets as of the beginning of 2014[121].

Massive restructuring of the sector supervised by the NBU continued in 2015 though declining tendency in banks deposits was reversed later on during the year. Importantly though, despite multiple banks' bankruptcies, most of the household deposits were guaranteed by the Deposit Guarantee Fund giving potential security for individuals and underpinning the confidence. Overall, between December 2013 and 2015, total number of active banks shrank from 180 to 117 (Figure 6.9). By mid-2016 the process of huge clean-up of the system was largely completed. Banks' shut downs largely ceased and 70 per cent of banks reported operating profit for 2015 (the banking sector reported huge loss in that year). Still, the share of non-performing loans (NPLs) remained high (circa 30 per cent in 2016 and above 50 per cent in Q2 2017), which was the result of the 2014-2015 economic crisis, the absence of effective instruments for the resolution of NPLs but was also the strengthened supervision by the NBU.

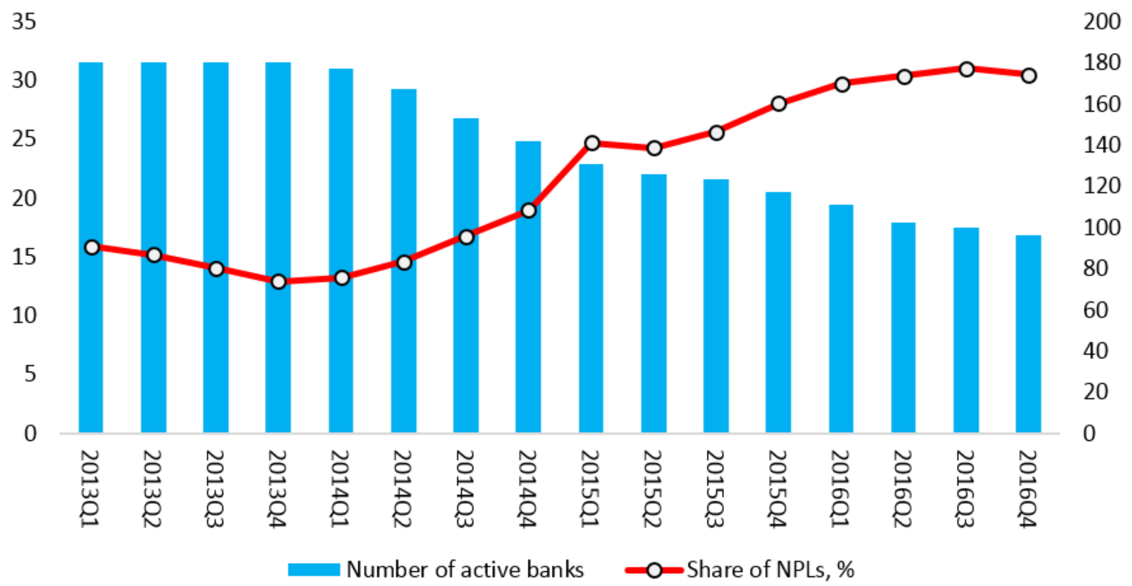
[121] IER, 2016. Year 2015 – Economic summary for Ukraine

Figure 6.8 Growth of loans and banks deposits



Source: *NBU, IER*

Figure 6.9 Non-Performing Loans [left axis] and number of active banks [right axis], 2013-2016



Source: *NBU, IER*

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

It is conceptually and methodological challenging to disentangle the effect of MFA from other interventions (such as the IMF programme, other EU interventions, support from other donors etc.) and other exogenous factors and/ or unobservable factors. Previous MFA evaluations have relied upon counterfactual modelling to do so (i.e. estimating unobserved counterfactual outcomes with the help of macroeconomic models and then comparing these hypothetical counterfactual outcomes with observed macroeconomic outcomes). This approach has some important limitations. Firstly, it is almost impossible to establish a credible and a clear quantitative counterfactual in a crisis context. Secondly, this approach has yielded little by way of meaningful insights. Given the formative nature of the evaluation, we used a qualitative driven approach to assess the role and contribution of the MFA. This approach draws inferences from desk research, interviews, Delphi survey, Debt Sustainability Analysis, opinions of local experts as well as insights from the focus group with non-governmental stakeholders that was organised in Kyiv.

We firstly consider the dimensions of the MFA operations (size, form of support, timing) that contribute to effectiveness and then the possible counterfactual position (what might have happened in the absence of MFA operations).

6.1.2.1 The dimensions of the MFA operations

The size of MFA relative to Ukraine's financing needs

It should be borne in mind that the size of the MFA I, EUR 610 million, was a 'leftover' from the earlier undisbursed operations, was fixed and available to use, subject to conditionality, as it stood in early 2014. It was the size of the MFA II operation which had to be assessed and agreed, even though the available funding of MFA I was of course a relevant factor as both operations combined.

Consideration of the size of the commitment required from each donor was informed by the residual finance gap estimated by the IMF as a part of the 2014 SBA support programme (USD 10 billion and 12.5 billion for the years 2014 and 2015 respectively[122]).

The scale of need, and hence the MFA allocation, was recognised as severe, and represented the largest ever single country allocation, and accounted for 35 per cent of the total EU MFA budget allocations made since MFA support was initiated.

The resulting share of the total international commitment represented by the MFA was 10 per cent for the two years. MFA I and II disbursement accounted for ~1.4 per cent of GDP in 2014. While IMF support provided *via* SBA in 2014 was critical given its size, the combined MFA I & II envelope (USD 1.8 billion in 2014) had still exceeded the World Bank budget support disbursed in 2014 *via* DPL 1 and FSDPL 1 (USD 1.25 billion). Respective shares for 2015 are small but this is effectively a consequence of the duration of MFA I and II (April 2014 – May 2015) and the negotiation of MFA III that followed from May 2015.

Consulted stakeholders at the IMF and WB stressed the exceptionally high uncertainty that prevailed when the size of residual financial gap was being estimated and the size of individual support provided by both institutions was being negotiated. IMF indicated, however, that already at the time of the ex-ante evaluation of the SBA programme in 2014 it had been anticipated that larger scale assistance would be needed and expressed the view that a higher level of EU support would have been preferable. And yet, it also acknowledged that there was an awareness that '*MFA I & II are just the beginning of the EU financial support*[123]' and that more assistance will follow – a view that was later on confirmed through the consultation with Ministry of Finance in Kyiv. MFA III, although out of the scope of this evaluation, was therefore anticipated as part of a continuing commitment of the EU to Ukraine.

It is noted that the funding for MFA II was not constrained by budgetary considerations related to the Guarantee Fund for External Actions, although the budgetary implications of the support programmes were examined, together with the significant increase in EIB financing as part of the EU support package for Ukraine.[124]

[122] as per IMF estimation at the SBA request time

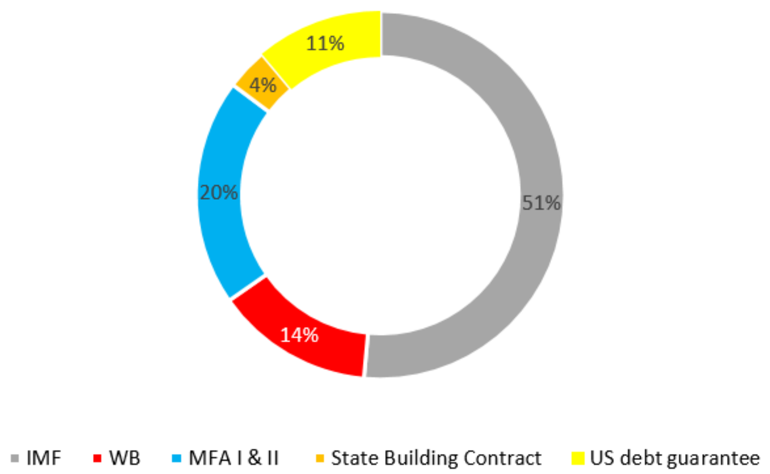
[123] Chief of the IMF missions to Ukraine in 2014

[124] The EU guarantees under the 'external mandate' of the EIB account for the largest item in the Guarantee Fund for External Actions

The form of the MFA assistance

The assessment of the effectiveness of the MFA has also considered that the MFA provides budget support type assistance. This support differs fundamentally from the conventional project financing, and provides the recipient with the flexibility to earmark the loans for whatever use is deemed most appropriate. MFA accounted for 20 per cent (Figure 6.10) of budget support in 2014.

Figure 6.10 Share of selected support programmes in the budget support type assistance, 2014



Source: *IMF, WB, EC*

Note: although different in form than loans, the graph does include the US guarantees of the issuance of USD 2 billion sovereign bonds (USD 1 billion in May 2014 and USD 1 billion in May 2015) as the funding that was raised was also used for budget support.

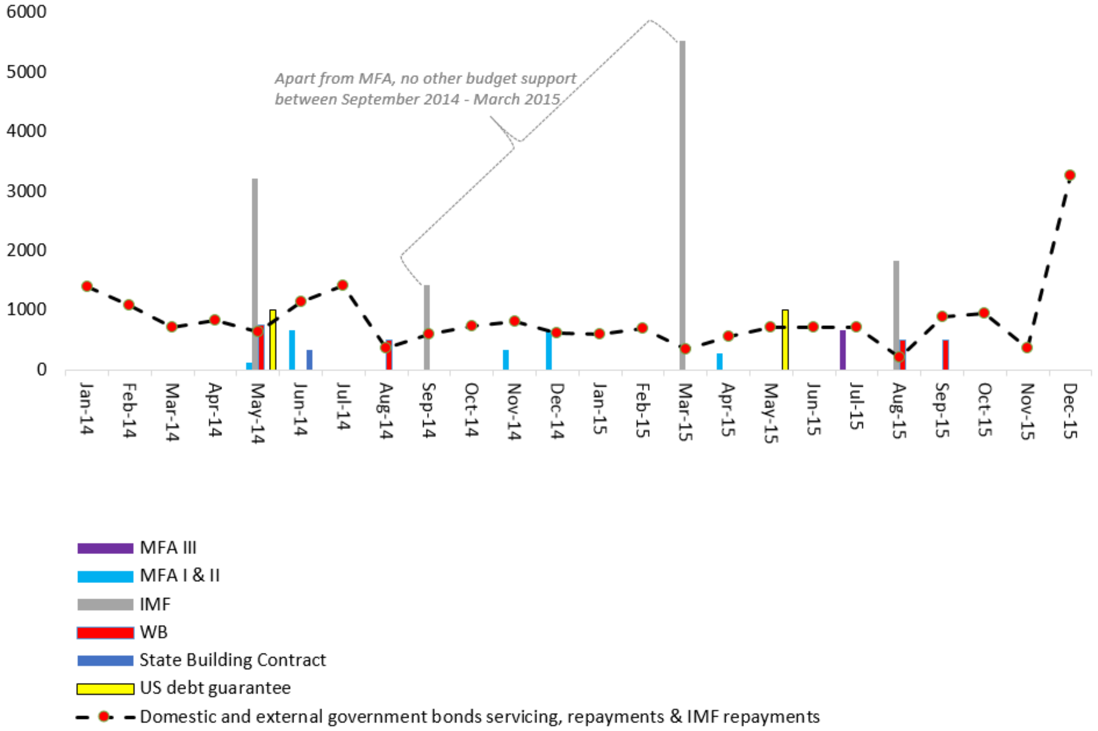
Generally, given the nature of the MFA, it is not possible to establish what is the exact destination of MFA funding.[125]

The timing of MFA disbursements relative to financing needs

The timing of the MFA operations was of an absolute essence given the urgency of the situation in Ukraine, and the disbursement of funds at the time of the first crisis is considered by stakeholders to have been very important. Not least because the timing of the disbursements signalled the support and solidarity of the EU for Ukraine at a highly sensitive time, with Ukraine facing continuing external shocks and a major financing need (Figure 6.11).

[125] In terms of the destination of the MFA I & II funding, the disbursements were made to the forex account of the Ministry of Finance at the Central Bank adding into foreign reserves. Subsequent responsibility for the allocation of the funding rests with the Ministry of Finance (in line with the approved State Budget Law) which can make payments in foreign currency or convert the funding into hryvnia in which case the amount of foreign reserves decreases. In case of the funding from MFA I & II, it was a deficit financing item. Yet, as MFA in principle is not earmarked for any spending and, thus, it is has been challenging to establish how the money were exactly spent.

Figure 6.11 MFA I & II, and other budget support type assistance provided to Ukraine in 2014/15 versus due debt obligations, in million USD



Source: *IMF, WB, EC, USAID/FINREP-II (for domestic and external gov. bonds servicing, repayments & IMF repayments)*

Note 1: Values available in EUR were converted into USD at the NBU average official exchange rate for 2014. EUR 19 million of Sectoral Budget Support is not included.

Note 2 & 3: Some discrepancies with other estimations may also exist due to exchange rates applied. In addition, debt repayment obligations as of November 2015 was eventually restructured – presented figure does take the debt restructuring operation into account. Note that the December 2015 debt repayments relate mainly to the USD 3 billion Eurobond held by Russia. Ukraine defaulted on this debt and is now disputing it in a London-based arbitrage court

At the time of the second MFA I and second MFA II disbursements in November and December 2014, foreign reserves were heading towards their record low levels (USD 9.7 billion and USD 7.5 billion in November and December 2014 respectively).

It suggests that MFA I & II was particularly important in 2014 while less so in 2015. Apart from EUR 760 million disbursed in November and December 2014, there was no other foreign assistance in the form of budget support provided within a time slot of September 2014 – March 2015 (0).

6.1.2.2 The counterfactual position

As noted, unlike previous MFA evaluations, the counterfactual position has not been modelled econometrically, but is rather constructed on the basis of views and judgements of the stakeholders, combined with the data on key trends.

Whether financing could have been available from other sources to replace MFA and on what terms

Assessing the plausibility of alternative developments had MFA not been in operation is an inherently difficult exercise and any results merit caution. The review is based on evidence gathered through the Delphi survey, along with the insights from interviews with relevant international and local stakeholders as well as through the workshop. These responses revealed a strong consensus for some scenarios.

Figure 6.12 presents a stylised diagram establishing initial propositions in terms of possible alternative sources of finance had MFA I & II been absent, but where IMF funding was available, but not compensating for the loss of MFA funds. These propositions have been tested with Delphi survey respondents and through selected interviews with those stakeholders that could be reasonably expected to have sufficient knowledge[126].

Discussions examined possibilities for attracting additional finance from financial markets (domestic and international) and through national fiscal measures.

Domestic financial markets

In terms of the availability of financing from domestic markets, had MFA I & II not been provided, 83 per cent of Delphi respondents stated that funding from this source was either very unlikely or not plausible at all. In the same vein, all key stakeholders including IMF, World Bank and NBU categorically rejected the hypothesis.

Domestic banks were under stress and lending was heavily constrained - lending fell in real terms over 2014. Households' deposits in hryvnia declined by 22 per cent in 2014 while foreign currency deposits shrank by 40 per cent (or by USD 9 billion). Non-performing loans rose from 13 to 19 per cent over 2014[127] and the solvency of many banks, including some of those of systemic importance, was being questioned some local analysts. Indeed, due to increasing pressure, banks elevated deposits' interest rates to around 20 per cent in late 2014 – a clear symptom of undercapitalisation. In this context, securing any additional financing from domestic lenders seems very unlikely and even if theoretically plausible, it would have come at exorbitant cost. In addition, securing financing in hryvnia, as opposed to euros or dollars, given rapid depreciation and foreign debt repayment obligations, would have had limited impact on the alleviation of external financing needs.

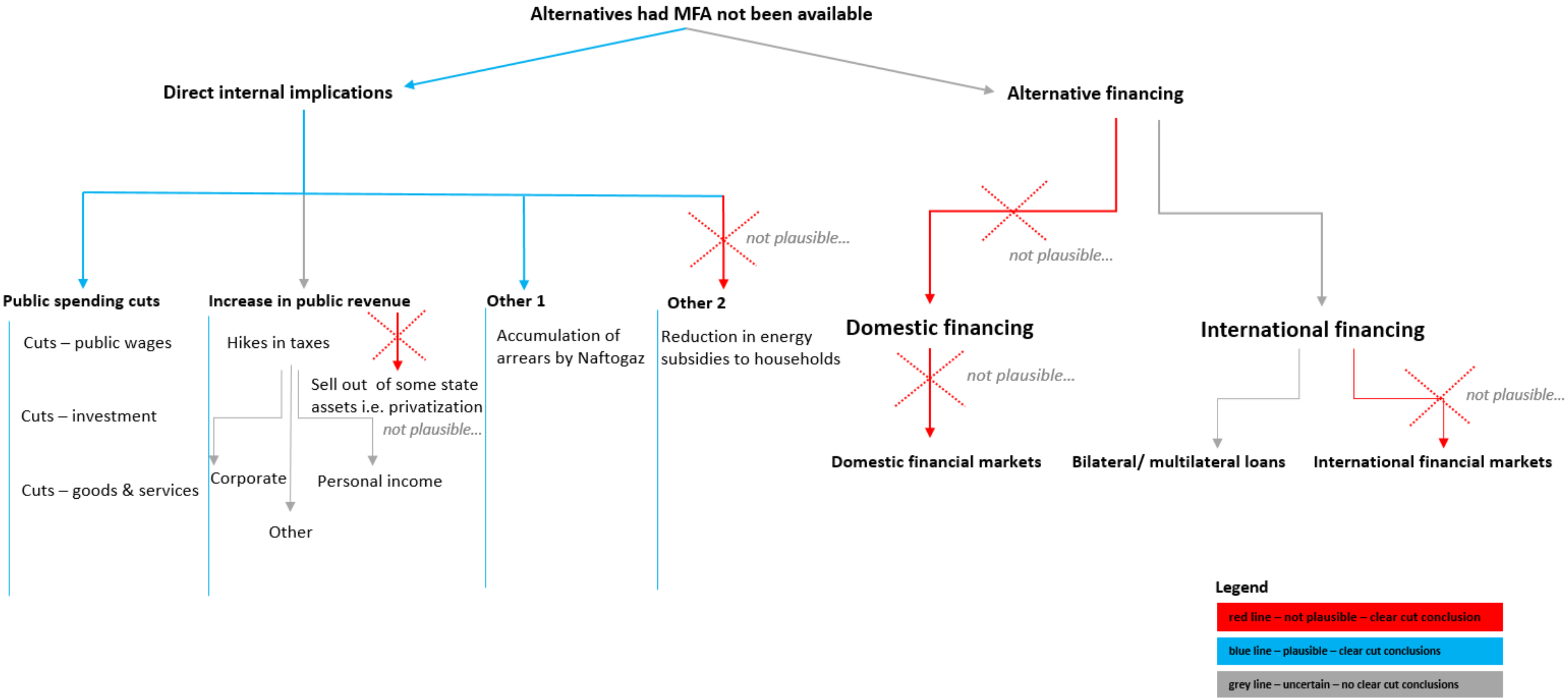
International finance markets

In terms of alternative access to foreign financing, no clear-cut conclusions can be drawn. In the course of 2013 the Ukrainian authorities lost access to international financial markets. Yet, at least some Delphi respondents stated that the authorities could probably have raised equivalent funds (EUR 1.61 billion) from other international sources probably through bilateral loans (from the USA or other countries) or further multilateral loans (from the World Bank or other sources). However, the majority found this very unlikely or not plausible at all. Interviewed stakeholders were also very sceptical about the availability of further multilateral/ bilateral loans. IMF and World Bank stated that such possibility had already been explored for SBA and EFF programmes with no further room to increase the financial envelope.

[126] Ministry of Finance in Ukraine, World Bank, IMF, National Bank of Ukraine and EBRD

[127] NBU data.

Figure 6.12 Alternatives scenarios for obtaining finance had MFA I & II not been available (but with IMF support continuing)



Source: *ICF*

Fiscal adjustment

There was a strong consensus that there were very limited prospects for additional fiscal adjustment by the authorities. 70 per cent of Delphi respondents stated that raising taxes would have been very unlikely or not plausible at all. While IMF indicated that some additional revenue could have been perhaps raised, it also argued that raising the taxes during the recession would have been a measure of 'absolute necessity'. In the same vein, privatization was also seen as a very unlikely source of alternative finance. Nearly two thirds of Delphi experts saw it as very unlikely or not plausible and so did NBU, WB and IMF. The potential size of proceeds from the sell offs of state assets, at the time when markets were dipping was also considered problematic. The risk of having unwelcome types of investors was also noted. The Ministry of Finance was unable to provide convincing evidence that privatization would have been a likely alternative and available data[128] shows that this process practically stalled between 2012 and 2015 falling from UAH 6.8 billion and UAH 1.5 billion in 2012 and 2013 respectively to UAH 0.5 billion and UAH 0.2 billion in 2014 and 2015 respectively.

Given the very limited possibility to raise revenue, cuts in public expenditures were indeed highlighted as the likely source by a majority of survey respondents (62 per cent) and by international partners (WB, EBRD, NBU and IMF). In terms of specific areas that would have been affected by cuts, IMF asserted that '…*those would have been probably of the same nature that had been actually targeted, but cuts would have been even further*' listing, *inter alia*, pubic wages, capital investments (already very low) and some social assistance programmes. Whether they would have been sufficiently deep to fill in the gap after the MFA I & II remains a valid question. Though, IMF also argued that arrears would have most likely risen. There was a strong consensus among non-governmental experts who attended the focus group in Kyiv that the enhanced social safety net that sought to counterbalance the effects of tariff increases would not have been affected, largely because this would have undermined the effectiveness of the parallel tariff increases, and would have been politically very unpopular at the time when patience was running low. Results from the second round of Delphi survey corroborated those views.

Whether the economic outcomes would have been weaker or different in the absence of the MFA financial support

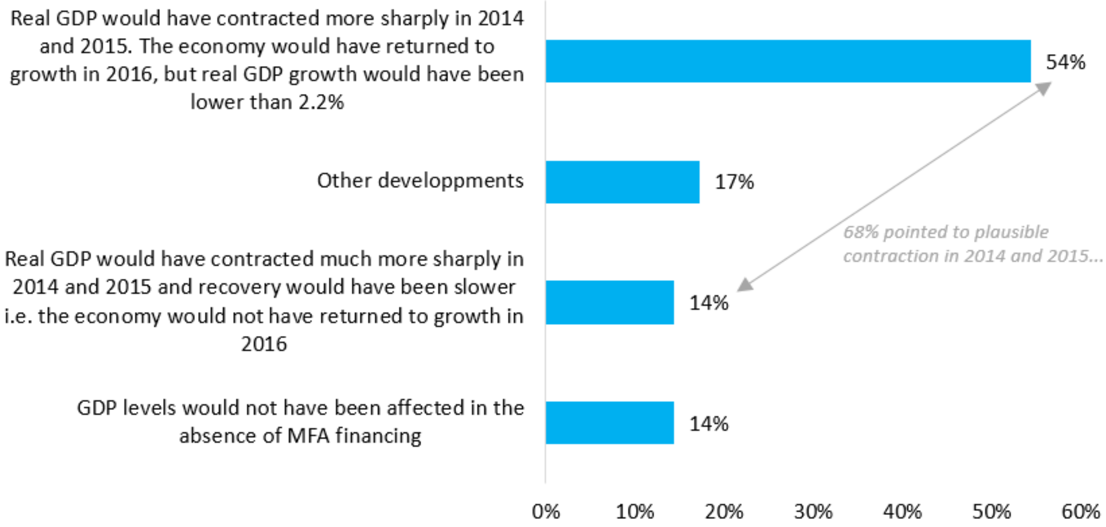
The MFA I & II disbursements made in the course of 2014 specifically equalled USD 1.8 billion and this corresponded to approximately 1.4 per cent of the Ukraine's GDP in 2014. For comparison, the MFA I & II disbursements in 2014 were an equivalent of nearly 40 per cent of total healthcare budget, 50 per cent of total security and judicial related budget, or 80 per cent of total defence budget[129].

Delphi experts were explicitly asked to gauge the impact of the absence of MFA loans provided between May 2014 and April 2015 on economic activity. Nearly 70 per cent pointed out that GDP would have contracted (much) more sharply in 2014 and 2015 of which 80 per cent considered that the economy would then have returned to growth in 2016, albeit real GDP growth would have been lower than 2.3 per cent (see Figure 6.13).

[128] Data from Ministry of Finance

[129] Data from Ukrstat

Figure 6.13 Hypothetical impact of absence of MFA I & II on the economic activity



Source: *Delphi survey*

As noted above, the most plausible adjustment to the loss of MFA funding considered by Delphi experts, IMF, World Bank interviewees and relevant experts from the focus group was possible reduced government spending. Since this would have included a cut in public sector wages, this would also have meant a loss of public sector employment and associated household consumption. Some experts also suggested a greater pressure on the hryvnia foreign exchange rate had MFA not been provided with adverse effects in business confidence.

The hypothetical possibility that the absence of MFA I & II alone would have led to a sovereign debt default in 2014 is considered less likely based on gathered evidence[130].

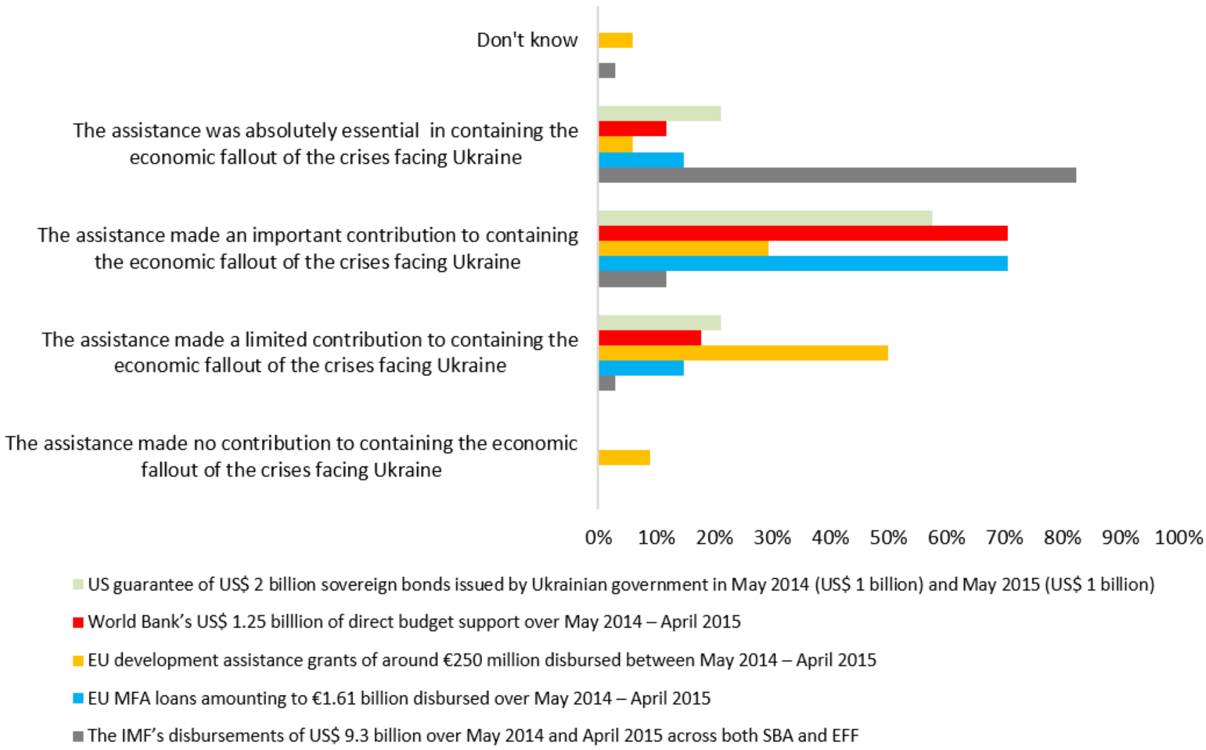
However, the analysis also concludes that the IMF was essential in containing the economic impacts from the crisis (Figure 6.14).

Section 10 presents summary of key findings from the Debt Sustainability Analysis (full analysis can be found in Annex 7).

The relative contribution of the MFA I & II was assessed by Delphi experts (0). The large majority view that it was important, but not absolutely essential.

[130] Opinion of Delphi respondents remained somehow divided here though. See Annex 5

Figure 6.14 The relative importance of MFA I & II – views of Delphi experts



Source: ICF Delphi survey

However, the outcomes from a scenario where MFA and IMF support was absent, were considered to be more dramatic. The view of the key donors was very clear here. EBRD believes that it prevented the economy from entire collapse pointing even to the risk of losing sovereignty by Ukraine.

IMF observed that '…*we would see large spontaneous disorderly adjustment leading to hyperinflation, a big plunge in GDP. Developments similar to those that took place in Zimbabwe*'. Without IMF assistance, it also seems very unlikely that the debt restructuring would have taken place in 2015; and the prospect of default/ earlier and less favourable (for Ukraine) debt restructuring would have been very real.

Whether the economic outcomes would have been weaker or different in the absence of the MFA conditionalities

The absence of MFA I & II promoted reforms could have had an impact on economic activity. Assuming at least 'some' causality between MFA operations and certain outcomes i.e. increased liquidity of the banking sector and expanded lending, reduction of VAT arrears and subsequent increase in the availability of working capital to business, fewer trade-distorting measures or an increase in the collection rate of Naftogaz and a lower deficit, then MFA I & II contributed to the stabilization of the economy.

According to the World Bank, one of the most crucial reforms of which failure could have potentially resulted in the entire derailing of the support programme was the condition related to strengthening the social safety net in order to compensate vulnerable households for the increase in energy prices that took place in the course of 2014 and 2015. The absence of the safety net was perceived to have potentially dramatic implications including social unrest, rise in political instability and risk of backtracking on other important reforms[131], with subsequent significant economic impacts.

At the micro level, the IMF estimated price elasticity of gas consumption by Ukrainian households in the range of -0.26 to -0.28 depending on income quintile[132]. A lack of subsidies would have had a meaningful and negative impact on household consumption[133].

Symbolically, the absence of the EU MFA I & II support and promotion of reform could not have been compensated in another form and its absence would have been likely to have had a damaging effect on the EU's reputation and relationship with Ukraine[134]. MFA I & II were perceived as an important signal of 'solidarity' with Ukraine, sent during an extremely difficult period for the country.

If and how MFA reinforced IMF / World Bank reforms

In general, many of the MFA I & II conditions related to similar actions as those targeted by the IMF SBA and World Banks DPL - 1 and FSDPL – 1 programmes. The MFA was considered to have often played a *reinforcing* role, but at the same time instrumental in a number of cases.

This includes the specific conditions on the social safety net noted above. It was highlighted by the WB and later on validated by the IMF that in this specific case contributions from each donor were highly complementary. While IMF led the effort to level up the energy prices to fiscally sustainable level, WB and the EU concentrated on the implementation of enhanced social safety net. More specifically, the WB role was strongly focused on the diagnostics and analytics (i.e. simulation on the potential number of eligible households and take up of subsidies done in early 2014 for Ministry of Social Policy and Ministry of Finance). However, it was the EU that had the 'political leverage' and ability to push for the safety net and to monitor the progress in implementation of the reform at the highest political level.

The EU also had a similar influence in the case of the VAT related conditions given its 'political weight[135]' and ability to effectively raise the argument with national authorities. Reform in the public procurement area was considered to be another area where the EU played a crucial role, especially given its inclusion in the EU-Ukraine Association Agreement negotiations and the Public Procurement Directive as a template.

6.2 Part 2: Effectiveness of structural reforms

The following section provides the information on the framework used to assess the effectiveness of the MFA I and II induced reforms (Section 6.2.1) and the results from this assessment (Section 6.2.2).

6.2.1 Analytical framework

All four reform areas to which conditionalities were attached have been examined namely, (i) Public Finance Management (and Anti-corruption), (ii) Trade and taxation, (iii) Energy sector reform and (iv) Financial sector restructuring.

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[131] Increase in energy tariffs are typically extremely sensitive issues where success rate of governments is low and social unrest is not unusual (i.e. 2014 tariff increases in Jordan)

[132] The IMF working paper on Ukraine gas pricing policy (Ukraine Gas Pricing Policy: Distributional Consequences of Tariff Increases by Pritha Mitra and Ruben Atoyan, 2012, IMF Working Paper WP/12/ 247

[133] A finding supported in new research - Energy Tariff Reform in Ukraine: Estimated Effects and Policy Options: Vasily Astrov and Leon Podkaminer, WiiW, Research Report 416, February 2017

[134] Views expressed by non-governmental stakeholders from focus group, Kyiv, June 2017

[135] The Ministry of Finance referred to specific role of the EU as 'an additional leverage' in certain cases - the fact that a given reform was covered by the EU conditionality [apart from other donor(s)] was used in internal negotiations with other sections of government.

An analysis of the effectiveness of MFA conditions when it comes to the promotion of structural reforms has focused on assessing:

- The nature and scope of the conditionality attached to the MFA operation;
- The implementation of the conditionality;
- Evidence for actual or expected impact of reforms (both direct and indirect); and
- The level of ownership of the programme and the capacity of the authorities to implement it;
- Evidence of MFA contribution to the reform progress.

The above assessment was based on the following sources of evidence:

- Review of documentation including compliance statements and evidence provided by the recipient government and the Commission's assessment of progress;
- Stakeholder interviews exploring the following issues:
  - Implementation and durability of the reforms;
  - Additionality (the specific role of MFA in promoting the reforms);
  - Complementarity with conditions attached to assistance provided by other multilateral/ bilateral donors;
  - Overall impact of structural reform.
- Insights gathered from the focus group with non-governmental stakeholders that took place in Kyiv in June 2017.

6.2.2 Assessment of the effectiveness of MFA I & II individual conditionality

The assessment of effectiveness is made at the level of individual conditions. This is reported in Annex 10. We provide a summary of progress at the thematic level recognising the plethora of other factors that influence outcomes, Box 6.1 - 0 provide a snapshot of the progress made during and after the MFA I and II operations, and where possible indicates the plausible MFA I and II contribution.

Box 6.1 Progress in fight against anti-corruption

PFM - anti-corruption: Significant progresses made over last 3 years (new legislative and institutional framework). Nonetheless, although much resources have been allocated, many challenges persist i.e. the difficulties in recruitment process at the NAPC (lawsuits filed against the Government by the civil society with respect to the process whereby those appointing NAPC members were elected – which triggered re-elections and a stalled process[136]). More generally, the institutional framework is largely in place but law enforcement has been one of the major challenges and some of the signs of suspension /back-tracking of certain reforms have been observed as well. As more transparency and anti-corruption were direct triggers of the "EuroMaidan" or "Revolution of Dignity", the anti-corruption dimension was reflected in most of the conditions, including non-PFM. The EC played a crucial role (also via actions of the EU Delegation and through support to NGOs) but other donors were also considering curbing corruption as a main priority[137].

[136] EESC, 2017. Anti-corruption policy in Ukraine. http://www.eesc.europa.eu/resources/docs/anticorruption_ukr--2.pdf

[137] Interviews with WB and IMF

Regarding the main triggers of reforms, OECD report[138] notes that inclusion of anti-corruption reforms among benchmarks under the Visa Liberalisation Action Plan and among criteria for signing EU-Ukraine Association Agreement served as "*a major incentive and boost for relevant legislative reforms*". Along the same lines, the AA implementation highlights again the importance of the Visa Liberalisation Action Plan as well as of public demand. This is consistent with the message from the EEAS and Member States permanent representations[139]. By contrast, there is less specific reference to MFA conditionalities as a major trigger for reforms, albeit the EU Delegation stressed out very active stance of local NGOs monitoring the implementation of progress in anti-corruption reforms and indeed, political pressure exercised by the EU throughout the implementation.

Overall level of ownership by the authorities seemed uneven (reforms promoted thanks to public demand, international players and reforms-oriented stakeholders within the governmental organisations but raising doubts about the full political will in the state leadership in some instances) – leading to some implementation deficit, according to NGOs such as Transparency International.

Box 6.2 Progress in other PFM related areas

PFM - other: Significant progresses was made, in particular in the area of public procurement but also budgetary procedures. Though, weaknesses still to be addressed around internal audit (i.e. cultural change in the audit functions and the need to go over the inspection mindset), Anti-Monopoly Committee (need to address resource constraints).

Box 6.3 Progress in trade and taxation area

Trade and taxation: Overall MFA conditionality has been a positive contributing factor in the trade and taxation area. In the trade sector with respect to WTO commitments specifically, progresses were made already at the time of MFA implementation and lasted since then – although there were recently some reversals with trade distorting measures being adopted (within the scope of MFA III though). W.r.t. to VAT arrears, considerable progress was made but only recently (not at the time of MFA implementation). VAT arrears are not as acute issues as they were. Nonetheless, it remains to be seen whether substantial improvement has lasting character

Box 6.4 Progress in energy sector area

Energy sector: There was some substantial progresses including examples of breakthroughs after years of stagnation, especially in the gas sector. Together with actions of other donors and strong domestic ownership, MFA played a central role, also in the context of the AA. Still, EU action within the scope of the MFA could be seen as a key reinforcing factor rather than leading promoter.

[138] OECD (2015) Anti-Corruption Reforms in. UKRAINE. Round 3 Monitoring of the. Istanbul Anti-Corruption Action Plan

[139] Emerson, M. and Movchan, V. May 2017. Deepening EU-Ukrainian Relations: what, why and how? Available at: http://www.3dcftas.eu/publications/key/deepening-eu-ukrainian-relations-what-why-and-how

Overall, energy efficiency has been a major issue and will remain so given the scale and number of areas where reforms need to be advanced. Though, it has also remained a focus on international partners (including EC and MFA III).

Box 6.5 Progress in financial sector

Financial sector: The reforms in the financial sector that took place over last three years are considered a remarkable success by all key stakeholders including EBRD, WB, IMF, EU Delegation and experts from IER. This progress is particularly important given the poor state of the sector in 2014 where a number of risks such as insolvency of systemically important banks were material. The approximation of the sector to compliance to the standards established in EU legislation has been a major factor stimulating the reform effort but other donors played important roles.

The 'clean-up' of the sector resulted in the closure of a number of banks due to poor or fraudulent banking practices and a reduction in the number of banks from 180 in 2013 to 96 in 2016. Despite some persistent issues such as the high level of non-performing loans[140], the sector is now more transparent and stable. In 2016, 57 out 90 banks reported pre-tax profits[141]. In addition, very substantial improvements have been made in terms of the quality of financial supervision conducted by the NBU (several banks were closed for money laundering; beneficiary owners of all still operating banks were disclosed; stress tests were conducted for 60 largest banks, proper supervision was confirmed in a number of court cases). The reforms in financial sectors have been also seen as those where the risk of backtracking is the smallest one.

6.3 Conclusions on effectiveness

Conclusions on effectiveness are presented in relation to stabilizing the macroeconomic situation in Ukraine (6.3.1) and the progress of structural reforms (6.3.2).

6.3.1 Effectiveness of the role of MFA I and II in promoting macroeconomic stability

- The combined size of MFA I and II (EUR 1.6 billion or USD 2.2 billion) was unprecedented given the scale of past operations and it was a significant contribution to the overall rescue package negotiated in 2014. The financing need in 2014 was assessed to be USD 10 billion. The MFA disbursements in the year addressed 18 per cent of this need, a significant contribution. Disbursements in 2015 relative to need were much smaller (2 per cent) as other international assistance became available. The timing as well as the scale of disbursements therefore meant that the MFA I and II had a significant economic impact, especially in 2014.
- Some national stakeholders considered the size of MFA I and II should have been higher, given expectations that the level of financing need would rise (as it subsequently did). However, the need for further financing had already been anticipated in the form of MFA III.

[140] See 0

[141] 90 banks remained active as of 11.05.2017 when final financial reports for 2016 were due

- Bearing in mind all caveats and inherent uncertainty related to the assessment of the hypothetical scenarios had MFA I and II not been provided, the available options to government in 2014 and early 2015 were extremely limited. Alternative financing from domestic or international markets would have been almost certainly impossible, and any bilateral support seemed also unlikely. As a result, fiscal adjustment with cuts in government expenditure corresponding fairly closely to the equivalent amount of missing MFA I and II support may have been necessary. Wages and employment in public sector would have been likely targets with subsequent fall in private consumption/ rise in unemployment pushing also some most vulnerable households into poverty (see Annex 8). The absence of the MFA would have also impacted private confidence, which was already running very low.

Consequently, this would effectively mean greater contraction of economic output and a delayed recovery. It is considered plausible by the majority of experts that the economic stabilization that took place from mid-2015 onwards would have been delayed had MFA I and II not been operational. It is also a clear view that while the MFA was important but not primary determinant to avoid unsustainable debts, the absence of the IMF would certainly have led to default and was *sine qua non* condition to the recovery from the crisis.

In terms of the sustainability of the public debt (for more see Section 10), given the size of the MFA, its absence would not have been critical in terms of sustainability *per se*, even in 2014 when 87 per cent of the total envelope was disbursed. But it did avoid choices which would have otherwise led to lower output growth, slower recovery and in the longer run higher public debt metrics.

6.3.2 Effectiveness of MFA I and II conditionality

Ukraine fulfilled the economic and structural policy conditions related to the disbursement of the MFA I and II in a satisfactory manner, even though the disbursement schedule since April 2014 indicates some delays in implementation and hence disbursement. The effectiveness of the reform process should be understood in the context of an exceptionally difficult environment, with an armed conflict in the East of Ukraine, a rapidly deteriorating economic situation and high levels of political instability.

The effectiveness of the MFA I and II conditions depended to varying degrees on wider donor support. Other EU initiatives were also important, especially the effect of the Visa Liberalisation Action Plan on the anti-corruption reforms. The MFA I & II conditionality often acted as the ‘amplifier’ of the requirement for reform. Cases where MFA I and II conditionalities were the sole international determinant of a reform were rare.

Condtionalities where the MFA I and II played the most significant role were in the advancement of reforms in Public Finance Management (PFM) and the social safety net.

- In the case of PFM, the extension of the remit of the ACU to include government revenue, ensuring sufficient allocation of financial resources to external audit functions, removing non-competitive tendering procedures and increasing the transparency of the public procurement process are important examples. The latter one was linked directly to the new e-procurement system ‘ProZorro[142]’ which was pointed by local Transparency International as the most successful anti-corruption reform in recent years (NB: in 2016 the system won a World Procurement Award in 2016 and the World Bank plans to use it for the

[142] https://prozorro.gov.ua/en

procurement of its Ukrainian projects[143]). Although not strictly speaking PFM reform, MFAs were also instrumental in the attempt to clear VAT refund arrears.

- In the case of the social safety net, the reform ensured that there was a swift and comprehensive reform of the existing housing and utilities subsidy (HUS) scheme to cover households for the increase in tariffs required by the reforms of the energy sector. Not only did it safeguard, lower income households, it enabled the energy sector reforms to proceed without major social unrest.

The impact on effectiveness was also supported by the ability of the Ukraine authorities to use the MFA as 'cover' for their own reforms. For example, the Ministry of Finance and Naftogaz were able to use the 'MFA argument' in their internal negotiations related to specific reforms.

Some international donors anticipated that the 'window of opportunity' the period with the greatest scope for Ukraine authorities to advance reform, will soon begin to close. Some decline in the level of authorities' ownership of reform was observed from 2015 onwards with implications for implementation of planned reforms and some delay or 'back-tracking' on past reforms. It was considered that reforms in the financial and energy sectors and the public procurement area are the least likely to see backtracking.

There were two conditions which required waivers across all tranches of both operations namely, the settlement of VAT refund claims and submission of the draft 2015 budget to Parliament. While the draft budget has been usually submitted on time, the problem related to delays in refunding the VAT claims, which was also the source of large scale corruption, was already a major cause of concern before the financial crisis. The delay in submission of the draft budget was caused by the upcoming elections. In terms of the VAT claims, the EC noted some progress, but also highlighted the need to undertake further steps. VAT refund arrears was therefore still a focus of MFA III policy conditionality.

In addition, there were some delays in compliance with the conditions attached to the release of the second tranche under MFA II. The delay (looking at the planned and actual disbursement date) was however minor.

7 Efficiency of the MFA

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

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 operations to adjust to changes in context and/or feedback)
- The effectiveness of dialogue between the European Commission and Ukrainian authorities
- The effectiveness of monitoring of the MFA operation
- The coordination of donor activity

[143] Financial Times, 2017. Ukraine's reform drive is powering ahead. Available at: https://www.ft.com/content/3f3ab4b4-9229-11e7-bdfa-eda243196c2c

- The existence of an EU leverage effect on the Ukrainian government to maintain the focus on reform

7.1 Timing of the disbursement of financial assistance

The timing of disbursements has been analysed in the previous section when assessing the effectiveness of the MFA (see especially Section 5.1.2.1 and Figure 5.11). In particular, it recognised the importance, given the economic and political context, including intensification of the conflict in the East, that MFA disbursements in 2014 were front loaded (87 per cent of the MFA was disbursed in that year) and that some early disbursement could be made. The MFA was agreed in April 2014 and early disbursement was made in May and June 2014. The need for this early disbursement was recognised in the conditionalities incorporated in MFA II.

However, the need for the fulfilment of conditionalities was respected, with the consequence that there were delays, specifically, the decision to postpone the disbursement of the second tranche under MFA II (EUR 500 million) because of the missed deadline for conditions[144] taken by the mission in September 2014. Similarly, due to the fact that some conditions were not satisfactory met[145] based on the assessment made in the January 2015 mission, the fourth and last tranche of the MFA I (EUR 250 million) was delayed by two months with approval by the last mission that took place at end of March 2015).

The decisions to delay disbursements were justified given, *inter alia*, the importance of the conditions. In the first case it was also helped by the opportunity for a stricter approach prior to the urgent financing needs in early 2015. In the latter case the decision to postpone disbursement was aided by the fact that the second IMF review under the SBA agreement, originally planned to be approved in December 2014, was still not completed as of late January 2015.

7.2 Design of MFA I and II assistance and efficiency of implementation

7.2.1 Ownership of the programme by the Ukraine authorities

All donors recalled a very tangible and positive change in the Ukraine authorities' willingness to pursue ambitious reforms in early 2014 compared to generally limited willingness during period of government under former President Yanukovych. The opportunity to pursue the ambitions of the Association Agreement and to demonstrate support for enhanced relations with the EU ensured a high level of ownership of the MFA process and acceptance of the necessary reform process under MFA I and II.

International donors understood that 2014 and 2015 provided a '*window of opportunity'* during which the more demanding reforms can be frontloaded before the pursuit of challenging reforms could decelerate. Different Ministries embraced the reform process with differing levels of commitment: the Ministry of Finance was perhaps the most determined promoter of reforms among all Ukrainian institutions while the State Fiscal Service was an example of where the interest in reform was low[146].

In general, since the MFA conditionalities focused on the priority areas identified in the Association Agenda (AA), there was the added incentive for the authorities given their commitment to the AA. The AA was subsequently negotiated by both sides and

[144] Related to approval of 2015 draft budget, amended law on the ACU and annual financial reports of Naftogaz

[145] Related to increase in financial resources of ACU, VAT refund arrears and progress in implementation of Ukraine's obligations under Energy Community Treaty

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

formally endorsed in 2015.[147] As a consequence there was no example of inconsistency of the MFA I & II conditionality with the wider national reform plans framed by the negotiation of the AA.

7.2.2 Capacity for reform

In the case of Ukraine, the number of specific conditions and need for reform capacity was higher compared to other recent MFA programmes[148]. This was a consequence of the 'merger' of MFA I & MFA II operations of which MFA I was in turn the result of the consolidation of two earlier non-activated operations. In addition, the nature of the crisis in Ukraine required deep and wide reforms.

However, despite the high number of conditions associated with MFA I (25 conditions in total) and MFA II (11 conditions)[149] neither DG ECFIN nor the Ukraine authorities indicated any specific issues with capacity, did not report any problems with coordination, or the possible fatigue of Ukraine authorities for reform, that might have arisen from the large number of conditions.

Moreover, the evidence suggests that conditionality was ambitious enough to secure the necessary progress but not so onerous as to delay the provision of finance. Only two conditions (VAT refund arrears and adoption of the draft budgetary plan for 2015) required waivers to be granted (see 7.2.3 below).

7.2.3 Flexibility and adjustments to implementation given exogenous factors

Flexibility is most clearly observed in the willingness to apply waivers where conditions have not been sufficiently met but the need for disbursement is urgent. There were three waivers granted in the course of the implementation of the MFA I & II that related to two specific conditions namely, the clearance of VAT refund arrears and the submission (to Verkhovna Rada) and publication of the draft budget for 2015 by 15th September 2014.

In the case of the former condition, waivers were granted in October 2014 and March 2015 respectively. The overriding rationale in October 2014 was '…*to do not add to already significantly worsening fiscal situation affected by deeper than anticipated recession and lower revenue from Eastern regions*[150]', even though some progress in reduction of arrears was indeed observed in the second half of 2014. The IMF strongly advocated an accommodating stance in this case, because of the deteriorating fiscal position and the need for disbursement. The waiver granted in October 2014 ultimately allowed the disbursement of the second tranche under MFA I (EUR 260 million) in November 2014 and was followed by another waiver in March 2015 which allowed the disbursement of the last MFA I tranche (EUR 250 million) in April 2015, again for the same reason. Given the fiscal considerations, approval of waivers appears fully justified.

When deciding to grant the waiver for the requirement for a timely submission of the draft budget for 2015, the Commission took into account a letter of comfort received from the IMF, which provided assurances that such a waiver would not endanger the implementation of the IMF programme for the country. The Member States Committee on the MFA did not object to the Commission's intention to grant waivers.

[147] 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

[148] For instance, 9 in MFAs to Tunisia and Jordan provided in 2014 and 8 in MFA to Georgia provided in 2013.

[149] The number slightly exaggerates the reform burden because several conditions were repeated due to delays (e.g.. conditions related to the refund of VAT arrears or the increase in Naftogaz collection rate).

[150] European Commission, December 2014. MFA to Ukraine – note to the Council, EP and Economic and Financial Committee

Consequently, the Commission adopted on 24 November its decision to release the second instalment under MFA II[151].

in discussion with the Team, the EU Delegation pointed to the difficult environment in which both conditions had to be implemented and stressed that waivers played a crucial role given generally less flexible nature of the MFA instrument (unlike IMF support programmes which are dynamic, MFA conditions once agreed in the MoU cannot be changed).

7.2.4 Dialogue and communication about the MFAs

7.2.4.1 Liaison with Ukraine authorities

Effective dialogue between the Ukraine authorities and the EU (DG ECFIN and the EU Delegation) was critical in supporting the understanding and commitment to conditionalities and management of disbursements. Dialogue was based on formal and regular missions led by DG ECFIN to understand and assess implementation issues, and regular discussion through the EU Delegation in Kyiv (see the review of monitoring procedures below).

The Ministry of Finance of Ukraine coordinated the implementation of the operations. Very good cooperation was emphasised independently by both, EU Delegation and Ministry of Finance.

In addition to formal channels of dialogue, the EU was also able to influence the Ukraine authorities to raise particular reform problems in the political process and able in one or two examples (such as the establishment of the anti-corruption bureau) to encourage intervention at the highest political levels. Although the political cycle affected progress of the implementation (i.e. the parliamentary elections in 2014 was indicated by the authorities as a factor for the lack of the timely fulfilment of one condition[152]), it did not weigh on the quality of the communication.

7.2.4.2 Visibility of MFA I and II

Given the unprecedented size of the MFA I and II operations and the political context, one could expect more than marginal interest from the Ukraine media.

However, anecdotal evidence from the interviews with the EU Delegation and participants of the focus group suggest that the visibility and awareness of MFA I and II was limited. For instance, although participants of the focus group were aware of some general features of MFA I and II, knowledge about the conditionalities was negligible.

In a separate media content analysis[153] involving Twitter and the press, focused on the assessment of the visibility of and presentation of both MFA operations added further evidence of the limited visibility, with the main focus of attention on the timing and value of disbursements, see below (Box 7.1).

Box 7.1 Key findings from Twitter and press analysis

Twitter analysis

- **Tweets volume spiked around the dates of disbursements**, otherwise the volume of tweets related to MFA I and II was low. Yet, there was nearly no English tweets in November and December 2014, even though EUR 260 million (under MFA I) and EUR 500 million (under MFA II) disbursements took place;

[151] European Commission, 2015. Mission Report from January 2015

[152] Condition under MFA I: *the government will submit by 15 September the first draft of the national budget for 2015*

[153] Annex 10 presents a detailed description of the methodological approach and findings from both analyses.

- The conversations about MFA I, II and III in English, Russian and Ukrainian was **predominantly neutral**. Tweets had typically a form of brief reference to the announcements of the loan disbursements with indication of actual amount;
- **There was very limited number of tweets going into detail of operations** i.e. type of conditionality attached or possible implications of specific reforms;
- Individuals and mass media were two most prolific groups of authors. Tweets from EU institutions/agencies or individuals associated with the EU were rare. They accounted for 6% of tweets in English and only about 1% of tweets in Russian/Ukrainian;
- The IMF programme was only very occasionally mentioned in the context of the MFA.

Press analysis

- Most of the articles appeared shortly prior to or after the MFAs disbursements;
- 85% of articles were neutral and 15% of articles had positive tone. **There was no single negative article related to the MFA I and II**;
- More than 80% of articles contained references to specific MFA conditions. **Yet, those did not go beyond a brief listing of conditionality**. No specific discussion about their importance/ progress in implementation/ benefits/ impacts was discussed;
- Very few articles discussed the potential impact of the MFA;
- If MFA was mentioned in the context of other donors, not surprisingly it was IMF. Its impact was perceived as greater (i.e. via impact on policy formulation) and conditions described in greater detail (i.e. their importance/ progress in implementation).

7.2.4.3 EU communication activities supporting the implementation of MFA I and II

Communication activity by the EU describes the purpose and progress of MFA operations. Communications are coordinated from headquarters in Brussels, managed by DG COMM[154] supported by the relevant Commission Services. The EU national delegations are also involved in the process. This approach was the case for MFA I and II in Ukraine (and has continued under MFA III).

Communications are intended to maintain the awareness of local stakeholders (including Member States at local level) and the wider public of the role and contribution played by MFA operations and supports the transparency of EU activity. These communications relate to the main milestone of each operation and include public announcements on the signature of the MoU, agreements reached on levels of disbursements of each MFA tranche and progress on the achievement of specific conditionalities. Press releases are prepared which describe general budget allocations, particular conditions included in the operation, and report progress achieved by Ukraine in achieving agreed milestones, and on the release/ delay of MFA disbursements.

[154] In particular, DG COMM is responsible for the Spokesperson's Service (SPP) which operates under the political authority of the President of the Commission and in cooperation with national representations of the European Commission. Formal systems to prepare and agree press releases involving consultation between DGs are in place

Coordination by DG COMM and DG ECFIN includes establishing the content, choice of place, the frequency and timing of the announcements and ensuring this is consistent at EU and local levels[155].

The evidence gathered, *inter alia*, from the focus group organized with the non-governmental stakeholders, from interviews with the EU Delegation in Kyiv, as well as from the specific media analysis suggests that there is some room for improvement in the coordination of communications relating to the Ukraine MFA I and II operations between HQ and the national level, especially relating to the timing, but also the content, of communications. There is also a suggestion that more rather than less communication, especially aimed at local stakeholders, could be beneficial in maintaining transparency and an understanding of issues affecting progress.

Particular examples of coordination problems between DG ECFIN and EU Delegation in Kyiv cited include:

- limited coordination and sharing of HQ draft press releases with the EU Delegation prior to their publication; especially in respect to providing news of actual disbursements (rather than planned disbursements)[156]; and
- lack of joint planning and conduct of communication activity that could help to improve awareness of the positive benefits of the MFA or of particular barriers to reform, which in turn could catalyse greater local support for operations. DG COMM have highlighted the difficulties of drafting press releases on conditionalities because of their political sensitivity and sometimes technical complexity, and therefore improvement might require more planning and resources than might be available or expected. Additional communication, perhaps along the lines of the IMF reporting, would require substantial time and resources because of the necessity for individual approval from Member States.

Other examples of problems with communication cited include:

- the impression sometimes created among some stakeholders in Ukraine when announcing news of disbursements that 'new money' is being provided when in fact it is the same sum of money, as it progresses through planned to actual payment[157]; and
- content which related only to generic aspects of the assistance, typically the date and size of disbursement; with very little in-depth communication about the rationale and potential impact and benefits of the reforms, for example the influence of MFA operations on the revisions to the housing and utility subsidies (HUS) and the delivery of the social 'safety-net.

The potential consequence of these communication weaknesses is some confusion, and loss of credibility of the EU among national and local authorities, NGOs and general public. In this regard the EU Delegation suggest that better preparation of 'defensive' arguments/communication where new announcements might appear to contradict earlier statements would be helpful.

More importantly there is an 'opportunity cost' of not disseminating more fully the fact of the MFA support for reforms, which might catalyse stronger local support for reforms. These consequences had little effect on the short-term delivery of the operations, but have longer-term implications in terms of failing to help shape opinion

[155] Substantial coordination is undertaken to DG COMM to ensure effective consultation across stakeholders including EEAS, DG Budget, DG DEVCO, DG NEAR as well as Cabinet of Economic and Financial Affairs and the Cabinet of the President. .

[156] It should be noted that, because of the uncertainties in the actual timing of payments partly relating to the use of financial markets to source funds, there are inherent difficulties in timing announcements of actual disbursements

[157] Insight shared by the EU Delegation in Kyiv

and support. Communication officers from DG ECFIN highlight the difficulties of providing such communications in a highly political environment but consider that some improvement involving increased collaboration with the EU Delegation is possible.

Inevitably, given the sensitive political and complex economic context, communication challenges have continued to persist under MFA III[158].

7.2.5 Monitoring processes

The monitoring of the operation was based on progress reports on reforms submitted by Ukraine authorities, on field missions performed on a regular basis by DG ECFIN officials, and on continuous desk research by DG ECFIN and other Commission services, in particular the Support Group for Ukraine. The EU Delegation was also involved in the monitoring process, mainly in the form of logistical support (i.e. arrangements preceding field missions) as well as provision of relevant data and its own interpretation of progress of some conditions. The Ministry of Finance was the main partner in terms of coordination of monitoring functions. The key outputs of the monitoring process were mission reports prepared by DG ECFIN.

Given the high degree of complementarity with the conditionality of other donors (i.e. very similar areas of focus, and in some cases identical reforms), part of the monitoring function was implicitly embedded in monitoring activities undertaken by other donors, especially by the IMF. There was a regular and very effective dialogue with other donors in place, a fact emphasised by representatives from IMF, WB and EBRD.

Given the severity of the crisis in Ukraine, apart from monitoring of the fulfilment of conditionality, emphasis in monitoring activity was also placed on gathering the latest information on macroeconomic developments

On several occasions, the mission reports indicated issues that related to the insufficient provision of information provided by the Ukraine authorities for example, insufficient data related to the condition for VAT refund arrears, or inconsistencies in the data on Naftogaz collection rates. Some of these information failures influenced the decisions to delay disbursements. However, the evaluation has not identified any specific weaknesses in the arrangements or approaches to data collection between DG ECFIN and the national authorities.

7.2.6 The consequences of a joint EU and IMF/WB position on the negotiations with the national authorities

There were a number of conditions where the MFA played a reinforcing/ amplifying role for actions supported by other donors. Particularly clear cut cases related to enhancement of the social safety net (requiring coordination with WB and IMF), elimination of VAT refund arears (coordination with IMF and WB) and reforms to the public procurement requirements focused on greater transparency and reduction of exemptions from competitive procurement procedures (coordination with WB).

The planning and coordination of reforms associated with the increase in energy tariffs, led by the IMF, in tandem with the development of the change in the HUS system targeting the poorest households is probably the strongest example, of efficient and timely reforms, given the financial necessity to raise energy prices. It is not difficult to imagine the social unrest had the energy prices increase not been matched by targeted household subsidies, to alleviate the impacts of higher costs, especially for the lowest income households.

[158] See for example the press article indicating hampering role of the MFA III in the reform effort in Ukraine available at: http://www.eurointegration.com.ua/articles/2017/03/14/7062948/ which is an example of the communication difficulty in explaining the rationale of trade related conditionalities

More generally, international donors praised the ability of the EU to exercise 'political pressure' at the highest decision making level in cases where reforms became blocked[159]. This type of influence is not necessarily something that is shared by the 'technical institutions such as IMF and WB.

7.2.7 Leverage of Ukraine authorities

The ability of the Ukraine authorities to use the MFA process to accelerate their own reform plans was evident in a number of Ministries, and hence where the MFA was able to 'leverage' quicker and deeper reform.

Perhaps the strongest example based on interviews with the Ukraine authorities was the Ministry of Finance and the National Bank of Ukraine and their willingness to pursue the necessary reforms in public finance management area and the financial system, particularly the banking sector.

Leverage was also evident in the case of Naftogaz which used the 'MFA argument' in its discussions with government to advocate for quicker progress on certain reforms related to increase in gas payment collection rate, or Accounting Chamber of Ukraine whose extension of remit by SOEs and public revenue were included in the conditionality but still faced some resistance in the public administration.

7.3 Conclusions

The timing of disbursement was appropriate given the prevailing macroeconomic conditions. Flexibility was demonstrated where necessary. The postponements that were made were justified but also adequately paced i.e. taking into account the financing needs of the authorities at particular time. The decisions to grant the waivers were also adequately consulted and justified, and did not impair the efficiency of operations.

The ownership of the programme by the authorities and dialogue between the EU and Ukraine authorities was relatively high and conducive to the efficiency of operations, taking advantage of the 'window of opportunity' for reform, which had already started to close in 2015. Good quality coordination with other donors and the ability to leverage a higher pace of reform in certain areas ensured the efficiency of the operations.

Monitoring processes of the implementation of both MFA operations were appropriate. There were some cases of gaps in the provision of information/data by the authorities which had some influence on the timing of disbursements, but there were no evidence to suggest that it was a function of weak monitoring.

The review of the visibility of the operations and the EU internal coordination of communication activity indicates scope for improvement. Ultimately, the long-term success of a programme is conditional upon the citizens' buy-in for reforms.

8 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?*

Positive aspects of EU engagement include:

- Evidence of the financial added value of EU support – national authorities would have struggled to meet their financing needs in absence of the EU MFA

[159] Interview with the EBRD

- Evidence that MFA reinforced the government's commitment to socio-economic reform
- EU had a discernible influence on the design and application of conditionalities
- Leverage in pulling together and accelerating a multi-donor package
- Evidence of signalling and confidence building

8.1 Financial added value

The primary rationale for the MFA operation is to support and complement the IMF operation in securing macroeconomic stabilisation and to assist by addressing the financing needs of countries in crisis. As discussed in previous sections this support has been effective and efficiently delivered, based on the close cooperation with the IMF and other international donors.

The added value in part derives from the fact the EU can mobilise and coordinate resources at a speed and a scale that individual Member States could not. It is difficult to see how a Member State led response could have improved on the remarkable speed with which the EU negotiated and delivered the first MFA disbursement, or could assemble the scale of resources required. It would have required a Member State, with experience of cooperating with the IMF, to be willing to coordinate across countries, and to raise substantial levels of finance at short notice; or instead to commit unilaterally to provide financial support at the required scale (depending on other bi-lateral decisions) and IMF cooperation. There is no available precedent to demonstrate these possibilities.

Instead there is an accepted reliance by Member States on the EU taking the lead and to coordinated support for the MFA operations, evidenced by the willingness of the European Parliament (albeit in recess) to agree the operation on quick time, despite the unprecedented scale of funding provided.

8.2 Reinforcing the Ukraine call for reform and conditionality design

The EU had been negotiating through the Association Agreement (AA) a programme of reform with Ukraine prior to the crisis. In the wake of the 'EuroMaidan' protests, the AA process was restarted. The AA process had already established the priorities for reform, which were subsequently reflected in the MFA conditionalities. This has meant the design of MFA I and II operations was fully supportive of national reform priorities and that the EU had substantial insight and influence over the selection of priorities and the associated conditionalities; adding value compared to other international donors.

Some EU led reforms, in particular those with directed to anti-corruption measures, were closely followed, and supported, by active civil society organizations.

8.3 Leverage from the coordination with international donors

As noted in Section 6, the EU established a strong level of coordination with the IMF and the World Bank. On this basis there was negotiation and agreement between donors for the responsibility for reforms, allocating them to where they best met the respective donor priorities and strengths, and ensuring full complementarity. Examples of this have been discussed in Section 6.

Annex 12 summarises the focus of MFA I and II operations and the relevant programmes of IMF, EBRD and World Bank.

MFA I and II had a complementary character and to this end, its size and form was also a function of the size of the residual financing gap and commitments of other international (and bilateral) donors. Moreover, the EU support was a material factor for other donors, including the IMF. MFA II was approved before the IMF SBA and the IMF clearly stated in its ex-post evaluation of the 2014 SBA that EU engagement (notably the signature of the Association Agreement) spoke in favour of the IMF's Board decision to approve the SBA[160].

The interviews conducted with the IMF, World Bank, EBRD and the EU-delegation revealed the consensus over a number of design and implementation aspects:

- The design of the response to the Ukraine crisis required active and quick co-operation of all international partners, both in terms of financial commitments and agreement on the type of conditionalities proposed;
- The EU was a constructive party to these discussions, based in part on the understanding of conditions and priorities gained from the negotiations of the Association Agreement, which also provided reassurance that conditionalities would be respected (given the poor track record of Ukraine of implementation of past programmes);
- The ability of the EU to pull together the MFA I (already in place) and MFA II in a very short period of time provided impetus and confidence to other donors that the package could be concluded and implemented on time;
- The willingness of the EU to lead on areas of reforms where its political weight could be considered to leverage difficult reforms, providing additional confidence to the other donors. Key areas included public finance management (including anti-corruption measure and public procurement), VAT reforms and the social safety net.

8.4 Signalling effect to the population and civil society

Previous ex-post evaluations of MFA operations[161] suggest that the real added value of the MFA operations from the perspectives of recipient countries is the political signalling effect ("seal of European approval") of the stabilisation/ macroeconomic recovery programmes with consequent confidence-boosting effects for civil society, the wider donor community and the private sector.

The participants at the non-governmental stakeholder workshop, agreed that because of the longstanding AA negotiation (and parallel discussions on other agreements such as Visa Liberalisation) that there was a real expectation that the EU would provide support, whereas the intentions of other donors was less clearly defined. The problem would have been had the EU failed to provide support. Participants at the workshop argued a failure to support would have likely represented a fatal blow to the reputation of the EU with long terms consequences for the country and the EU role in the region.

MFA support was taken as a clear sign that the EU was prepared to meet its commitments and to assist in resolving the crisis. In so doing the MFA operation provided the 'sign of solidarity'[162]that helped to reduce instability and to buy time for the political process and the implementation of agreed reforms.

Ninety-four per cent of Delphi respondents agreed with the proposition that MFA financing had sent a strong signal of EU support to Ukraine - as one respondent put it, it was a "*symbolic instrument of EU goodwill towards Ukraine*".

[160] IMF (2016) Ex Post Evaluation of Exceptional Access under the 2014 Stand-By Arrangement, IMF Country Report No. 16/320. See page 7

[161] European Commission, 2017. Completed evaluations. Available at: http://ec.europa.eu/dgs/economy_finance/evaluation/completed/index_en.htm

[162] This signalling effect and its positive consequences has been identified by all international donors and investors as a critical benefit in allowing the time for international programmes to operate.

8.5 Confidence boosting effect on the private sector

MFA I and II did not influence private sector confidence in a clear-cut way, identifiable from attribution to specific outcomes such as changes in the exchange rate after MFA disbursement. Yet, although it is not possible to gauge the magnitude of the confidence boost effect, evidence suggests that MFA I and II did have some positive impact in this respect, but perhaps no more than from the activities of other donors.

For example, ratings assigned by leading credit rating agencies are closely followed by the private sector and have a direct impact on business confidence. Box 7.1 presents the summary of key drivers of Fitch (a leading credit rating agency) which reported downgrades and upgrades that were made in the course of the late 2013-2016 period. While weight attached to the influence of IMF support was clearly greater, reference to EU support that encapsulated MFA I and II operations was made in the main announcements justifying the rating decisions.

Box 8.1 Evolution and key drivers of Ukraine's credit ratings – example of Fitch, 2013 - 2016

Fitch Ukraine's ratings – from deep downgrades towards improvement

In late 2013 and early 2014, Fitch downgraded Ukraine sovereign debt rating twice: from B (i.e. "junk status" – highly speculative) in early November 2013 to CCC (i.e. highly vulnerable to default) in February 28th 2014. The main reasons were depleting reserves of National Bank of Ukraine, political instability, deterioration of sovereign access to external financing and concerns that the IMF financing might not be provided. Other factors, albeit less critical ones, were high level of non-performing loans (NPLs) in the financial system and risk of steep and uncontrolled depreciation. Further downgrade to 'C' (default status) took place in August 2015 as Ukraine suspended certain external debt repayments in view of the ongoing debt restructuring talks.

First upgrade, marking some signs of stabilisation, took place on 18th November 2015. Key factors weighting on that decision were, inter alia, the successful completion of the debt restructuring negotiations that supported public debt sustainability and stabilization of hryvnia. Most recently (in November 2016), another upgrade, this time to 'B' took place. Key rationale was easing of external financing pressure, increase in reserves, declining inflation and currency stabilisation. Some return of growth was also noted.

In general, most of Fitch communication contained explicit and extensive references to IMF programmes which were often assessed as a critical determinant of the country's economic health. Reference to the EU support was substantially less frequent and got less 'weight'. Yet, it still appeared in several instance in the form of inexplicit references to 'multilateral donors support' (i.e. 11th November 2016) and explicit reference to critical importance of 'IMF and EU funding' (13th and 28th February 2014) or explicit references to the Association Agreement as a factor supporting confidence, investment and demand (8th of November 2013).

Furthermore, the progress in addressing the problem of VAT refund arrears was closely monitored by the business community. Although implementation was patchy and necessitated a waiver at one point in 2014, the level of arrears has continued to decline, to the relief of business in Ukraine as stated by the representative of the national employers' association.

The Delphi Panel had mixed views on the effect of MFA on business confidence. Although the majority of respondents (53 per cent) considered there to be a positive effect on business confidence, a third disagreed that the MFA had contributed to business confidence. However, there was a consensus among workshop participants that although hard to capture in a concrete way, MFA operations had some positive impact.

Available evidence from the Twitter and press analysis does not allow attribution of any concrete effects on business confidence related to MFA I and II, although the simple fact of the progress made in coverage by the media presumably had some effect, but not noticeably distinguishing the MFA from other donor programmes.

8.6 Conclusions

The MFA operations provided clear added value, both in terms of delivering on its key rationale, and by its ability to bring insight and confidence to the design and implementation of the combined international donor package, which other bilateral donors, apart from the US, could not match. It also seems clear that Member States in isolation or combination could not have delivered equivalent support in the time and the scale of the EU.

EU support also had a symbolic importance which other international donors because of their lack of political engagement could not offer. EU support was a sign of solidarity with a country that found itself trapped in a very severe economic and political crisis and whose sovereignty and territorial integrity were being violated by the Russian armed forces. A lack of EU support would have signalled a lack of commitment and a breach of confidence, with very negative implications for the EU reputation and its leverage in the region. The MFA encouraged also civil society organisations in Ukraine in their call for major reforms in the area of anti-corruption as well as modernisation of government institutions, where both have subsequently reinforced MFA actions.

9 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?*

The EU has long been committed to support Ukraine's economic and political reforms. Two broad frameworks, the European Neighbourhood Policy (ENP)[163] and the Eastern Partnership[164], have been in place, to gradually accompany Ukraine towards political association and economic integration. A milestone was achieved in 2014 with the signature of the Association Agreement. MFA operations can be seen as additional instrument feeding into that close relationship.

9.1 Policy frameworks and principles

Two broad frameworks underpin the EU-Ukraine relationship: the European Neighbourhood Policy (ENP)[165] and the Eastern Partnership[166].

9.1.1 The European Neighbourhood Policy (ENP)

The ENP was launched in 2004 '*to give new impetus to cooperation with the EU's neighbours following enlargement*'[167]. The overall objective of the ENP is to promote stability, security and well-being in the region, in the mutual interests of the EU and its neighbours, through the encouragement of a commitment to shared values and the effective implementation of political, economic, social and institutional reforms in partner countries. Implementation of the ENP relies on country-specific ENP Action Plans, which set out in concrete terms how the EU proposes to work more closely with the country concerned.

[163] EEAS, 2017. Policy. Available at: http://ec.europa.eu/world/enp/policy_en.htm

[164] EEAS, 2017. Eastern Partnership. Available at: http://eeas.europa.eu/eastern/index_en.htm

[165] EEAS, 2017. Policy. Available at: http://ec.europa.eu/world/enp/policy_en.htm

[166] EEAS, 2017. Eastern Partnership. Available at: http://eeas.europa.eu/eastern/index_en.htm

[167] COM(2004) 373 Communication from the Commission of 12 May 2004, entitled "European Neighbourhood Policy - Strategy paper"

The first EU-Ukraine ENP Action Plan was approved by the European Commission in 2004 and endorsed by the EU-Ukraine Cooperation Council in 2005. It spanned over a three-year period and sought to accelerate Ukraine's political and economic transition, tackle problems and challenges of common interest, strengthen links and intensify the relations between Ukraine and the EU. It was then replaced by the 'Association Agenda' in 2009. The latter set out key priorities for structural reform in Ukraine, notably: (i) reform of the judiciary; (ii) respect for the rule of law and human rights, transparency and democratic accountability; (iii) fight against corruption; and (iv) the establishment of a fully-functioning market economy.

To help Ukraine meet the set ENP objectives, the EU has offered various types of support. MFA support was one amongst other forms of assistance provided to Ukraine to help advance reforms and European integration in Ukraine (see Box 9.1).

Box 9.1 EU support through the ENP

- **Financial support**: the EU has offered grants worth EUR12 billion for ENP-related projects from 2007 to 2013. Financial support included also budget support and humanitarian assistance. Since 1991, the EU has been the largest donor to Ukraine, with assistance provided by the European Community amounting to over EUR 35 billion, including both grants and loans. The level of financial support has generally been increasing over the past decade.
- **Economic integration and access to EU markets**: trade between the EU and its ENP partners is significant. In 2014, Ukraine was the EU's 25th largest trading partner and 22nd largest export market. Over the first 9 months of 2015, 32.9 per cent of all Ukrainian goods exported went to the EU. On the other hand, nearly 40 per cent of goods imported came from the EU. EU-Ukraine trade in goods reached EUR 20.4 billion over the first 9 months of 2015. The main goods Ukraine exports to the EU are ferrous metals, iron ore, electric machinery and cereals whereas the main goods the EU exports to Ukraine include: machinery, transport equipment, chemicals, textile and clothing, and agricultural products.
- **Foreign Direct Investment:** The EU is also the largest foreign investor in Ukraine. FDI from EU countries has steadily increased over the past decade while EBRD is single biggest individual investor.
- **Easier travel to the EU:** this is facilitated through the Visa Liberalisation Dialogue launched in October 2008. Since June 2017 no visas are required from Ukrainian citizens with biometric passports to enter the Schengen zone for short term.
- **Technical and policy support**: this includes regular analysis and dialogue with ENP countries on macroeconomic and financial developments.

Source: *EU External Action. Available at: https://eeas.europa.eu/topics/energy-diplomacy/1937/ukraine-and-the-eu_en*

9.1.2 The Eastern Partnership (EaP)

The ENP has synergies with relevant regional cooperation frameworks, i.e. in the case of the countries in Eastern Europe and the Southern Caucasus, with the Eastern Partnership. The Eastern Partnership was initiated in 2009 and, in addition to Ukraine, covers Georgia, Armenia, Azerbaijan, Belarus and Moldova[168]. It builds upon pre-existing bilateral Partnership and Cooperation Agreements (the PCA between the EU and Ukraine came into force in 1998).

[168] EEAS, 2017. EU Delegation in Georgia. Available at http://eeas.europa.eu/delegations/georgia/eu_georgia/political_relations/political_framework/eastern_partnership/index_en.htm

9.1.3 The signature of the Association Agreement

The Maidan events in early 2014 accelerated the signature process of AA. The first political chapters of the AA were signed in March 2014[169] followed by subsequent ones on 27 June 2014.

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 meant to be achieved through increased cooperation and approximation of EU law. An integral part of the AA is also a Deep and Comprehensive Free Trade Area (DCFTA).

The AA entered into force on 1 September 2017 but had been provisionally applied since November 2014 (January 2016 as far as the DCFTA is concerned). To guide the process of reforms and define priorities, an updated version of the Association Agenda has been adopted by the EU-Ukraine Association Council on 16 March 2015[170].

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

By mapping the conditions of the MFA I and II against the short-term priorities established in the Association Agenda, one can see how MFA operations' conditionalities fed into the implementation of the Association Agenda. Reforms related to democracy, rule of law, human rights and fundamental freedoms were not addressed by MFA conditionalities as these are areas that are usually not covered by this instrument.

Table 9.1 High level comparison of Association Agenda's short-term priority for action and MFA I and II areas of conditionality

Short-term priority for action	MFA I and II priority
Constitutional reform	X
Election reform	X
Preventing and combating corruption	✓
Judicial reform	X (not part of the MFA I and II) ✓ (now in MFA III)
Public administration reform	✓ ✓ (now in MFA III)
Deregulation	X (not part of the MFA I and II) ✓ (now in MFA III)
Public procurement reform	✓
Taxation reform, including VAT refunds	✓
External audit	✓
Energy sector reform	✓

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

[170] 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

9.2 Coherence with other EU programmes and initiatives

9.2.1 MFA in the context of the overall support package

In March 2014 the European Commission announced a comprehensive support package to Ukraine incorporating short and medium term measures to: '*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 EU budget directly and envisaged an increase in lending from the European Investment Bank and European Bank of Reconstruction and Development[171].

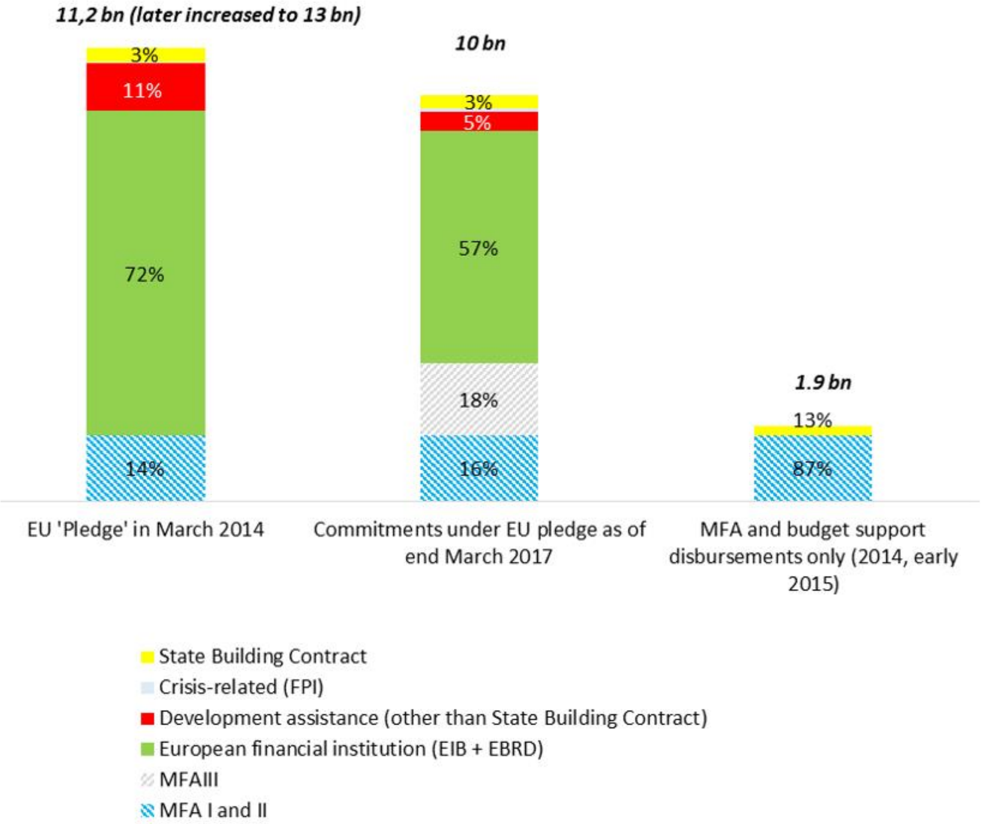
Overall, the anticipated support for the period between 2015 and 2020 amounted to EUR 11.2 billion of which around 14 per cent was expected to be provided in the form of grants (development and crisis related assistance) and the rest in the form of loans (see 0). MFA I and II made up 14 per cent of the total package, and loans from EIB and EBRD stood for 72 per cent[172]. The amount was afterwards increased by EUR 1.8 billion (when MFA III was approved) – turning the commitments into a EUR 13 billion package with subsequent share of all three MFA instruments being 34 per cent.

It should be noted that the EU pledge related to commitments (money being mobilised) and not to actual disbursements. Thus, commitments to date, presented in the second bar of 0 are being followed up by EC services and currently make up EUR 10 billion (including MFA III) while disbursement figures are not readily available. The share of MFA I and II in terms of commitments to date remains broadly similar compared to the initial pledge (16 per cent vs 14 per cent).

[171] European Commission, 2014. European Commission's Support Package to Ukraine. Available at: http://europa.eu/rapid/press-release_MEMO-14-159_en.htm

[172] Yet, while MFA I & II was budget support, EIB and EBRD loans were related to specific projects

Figure 9.1 MFA I and II in perspective: EU pledge, commitments to date and disbursements under budget support type of instrument only



Source: *Factsheet on EU- Ukraine relations avalable at : https://eeas.europa.eu/headquarters/headquarters-homepage_en/4081/%20EUUkraine%20relations,%20factsheet.*

Data cross-checked with DG ECFIN and SGUA for further details

Note: *The feasibility of tracking down disbursement figures (in relation to the pledge) was explored but could not be pursued due to the fact that disbursements are recorded irrespective of their year of commitment and irrespective of whether commitment was made as part of the 2014 package (or before/after).*

Third bar of 0 depicts MFA disbursements in the context of the overall EU 'budget support' assistance exclusively, as this type of aid is the most relevant for estimating the EU contribution to covering Ukraine's financial gap. Indeed, both MFA and other budget support instruments such as the State Building Contract (SBC), provided funds to the government with the primary aim to stabilise the macro-economic situation of the country and at the same time to encourage the reform process. Apart from MFA, the second most sizable budget support in 2014 and early 2015 was the SBC (providing a first tranche of EUR 250 million)[173] - with an additional EUR 19 million coming from sectoral budget support (Border management - 14.76 million and Environment – 4.3 million; not displayed on the graph). The coherence of MFA with the budget support provided by the SBC is discussed under 9.2.2.

The remaining part of the package was different in nature as EIB and EBRD provided financing of bankable investment projects which are meant to bring positive benefits over the longer term. Project financing and MFA I and II financing were intended to

[173] An additional variable tranche of max EUR 105 m was available, conditional upon progress with structural reforms. Initially planned to be disbursed end 2015, the second tranche was only partly disbursed by the end 2016 (55m) reflecting the partial compliance with the list of conditionalities.

complement each other and in this respect they were coherent elements of the broader support provided to Ukraine.

9.2.2 State Building Contract

The State Building Contract (SBC) was the responsibility of DG NEAR. The SBC provided budget support as specified in EC guidelines, i.e. in some aspects similar type of instrument to MFA – in the present case, 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"[174]. However, differences exist[175]. 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 MFA, it does not have a limited availability period and fixed tranches – disbursement is proportionate to progress made.

The SBC was adopted in 2014, in response to the rapidly changing environment and the need of for reforms. It was part of a EUR 365 million Special Measure composed of the SBC itself (EUR 355 million) and complemented by a EUR 10 million support programme to civil society[176].

The SBC has had two general objectives namely, 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 financial incentive, the SBC has also relied on policy dialogue with government and civil society to promote the structural reforms. Assessment of progresses made with reforms – on the basis of which decisions about disbursements are made – are based on reports made by third parties: the government ministries, the Venice Commission, OECD SIGMA, OSCE/ODIHR and civil society. To make sure that civil society plays its overseeing role, the SBC programme envisaged the strengthening of the capacities of the civil society. This was made through the additional EUR 10 million 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.

In terms of disbursements, the first tranche of EUR 250 million was provided upfront in June 2014[177], mainly with the objective of macro-economic stabilisation. This EUR 250 million made up almost all of the non-MFA EU budget support disbursed during the period concerned by this evaluation. The second and last variable tranche of maximum EUR 105 million (conditional upon progress with reforms), was planned initially to be disbursed by the end of 2015. Yet, it was only partly disbursed (EUR 55 million) by the end of 2016 which reflected partial compliance with the benchmarks which had been set.

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

[175] For details, see budget support guidelines available at: https://ec.europa.eu/europeaid/sites/devco/files/methodology-budget-support-guidelines-201209_en_3.pdf

[176] The EUR 10 million support programme to civil society, which aims at strengthening civil society organisations so that they are better equipped to participate in the reform process, is not a budget-support type of 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 can effect oversight of the bodies

[177] i.e. in the same month that the first tranche of MFA II (EUR 500 million) was disbursed

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 PFM and reform of the justice sector. There were three common areas of conditionality between the MFA I & II and SBC, namely public procurement, public finance management and anti-corruption.

Evidence gathered *via* desk research, semi-structured interviews and from the workshop did not provide any suggestion of duplication of effort or inconsistencies – a similar conclusion to that found in the recent ECA report[178]. Commission staff, comment in interview that at the time MFA I and II and SBC were being designed, there was effective coordination between DG ECFIN and DG NEAR.

9.2.3 Visa Liberalisation Action Plan

In 2008, the Commission initiated a dialogue on visa liberalisation with Ukraine with the aim of identifying all the relevant conditions which would be necessary to fulfil before EU visa-free travel could be granted. These are primarily linked to the Justice and Home Affairs area. The only area that MFA and VLAP have in common is the fight against corruption (covered in VLAP since 2011). Table 9.2 maps in detail the MFA I and II conditions against the benchmarks in VLAP which were still to be met by May 2014, the time when the two MFA programme were launched.

Table 9.2 Conditions under MFA I and II and VLAP – (common areas only)

	MFA I and II	VLAP
Anti-corruption	Condition 3 under MFA I. *Adopt a national anti-corruption strategy that is in line with international best practice and a State Programme with time-bound deliverables to implement it.* Condition 17 under MFA I. *Implement comprehensive anti-corruption legislation in line with the recommendations made by the Council of Europe's Group of States against Corruption (GRECO) and other international standards.* Condition 4 under MFA II. *Implementation of the Law on Principles of Preventing and Counteracting Corruption (2011), article 12, which foresees annual declaration of assets (property, income, expenses and financial obligations) by persons defined in the legislation as declaration subjects. The government will prepare a draft law setting up an independent body with sufficient financial and human resources to*	The Fourth Report on the implementation by Ukraine of the Action Plan on Visa Liberalisation, dated 27.5.2014 concluded that Ukraine had met the benchmarks under the first phase of the action plan (related to the legislative and policy framework) and that assessment of the benchmarks under the second phase could be launched. These were related to the effective implementation of the legislative and policy framework. For corruption matters under Block 3, these comprised: *Implementation of legislation on preventing and fighting corruption, ensuring the efficient functioning of the independent anti-corruption agency; development of ethical codes and training on anti-corruption, especially targeting public officials involved in law enforcement* *and the judiciary;*

[178] ECA (2016) Special report no 32/2016: EU assistance to Ukraine. 07/12/2016.

	MFA I and II	VLAP
	ensure proper implementation and enforcement of the legislation.	*Implementation of relevant UN and Council of Europe Conventions, as well as GRECO recommendations in the above mentioned areas.*

Source: *MFA MoU and VLAP and fourth progress report available at: https://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/eastern-partnership/visa-liberalisation-moldova-ukraine-and-georgia_en*

The implementation of the VLAP has been a priority for all governments (visa-free regime brings tangible results for all citizens) and has been indicated by some interviewed stakeholders as well as participants of the workshop as a very effective incentive for reforms for subsequent governments. By the end of 2015, the progress towards all benchmarks was assessed as satisfactory.[179] The formal decision to agree EU visa-free travel came into effect on 11 June 2017. There was no evidence of duplication and/or inconsistency between the VLAP and MFA I and II conditionality: both pushed in the same direction.

9.3 Conclusions

The existing evidence suggests that the MFA I and II were coherent with key principles, objectives and measures taken in other EU external actions towards Ukraine.
In terms of the financing component of both MFAs and their coherence with the other elements of the 'EU support package' agreed in 2014, MFA I and II complemented substantial project financing support deployed via EIB and EBRD and grant financing channelled via SBC.
There was also coherent alignment of conditionality with EU priorities and no evidence of any incoherence of conditionality with other EU instruments/ initiatives SBC and VLAP.

10 Debt Sustainability Analysis

In the wake of the global financial and economic crises, Ukraine's public debt-to-GDP ratio increased substantially over 2007-2010, before stabilising at around 40 per cent over 2010-2013, even though GDP growth weakened to close to zero in 2012 and 2013.

Ukraine's consolidated budget was in deficit in each year from 2010 to 2013. Ukraine also saw an increase in the share of its expenditure budget going to public debt servicing over 2010-2013. In 2010 public debt-related payments were 5.1 per cent of the expenditure budget. This rose to 7.9 per cent in 2013. In addition, the Naftogaz operational deficit was substantial (1.9 per cent of GDP in 2013) and contributed to Ukraine's overall debt balance. Naftogaz ran up this deficit mainly because of its poor collection rate, in addition to tariff subsidies amounting to about 7 per cent of GDP.

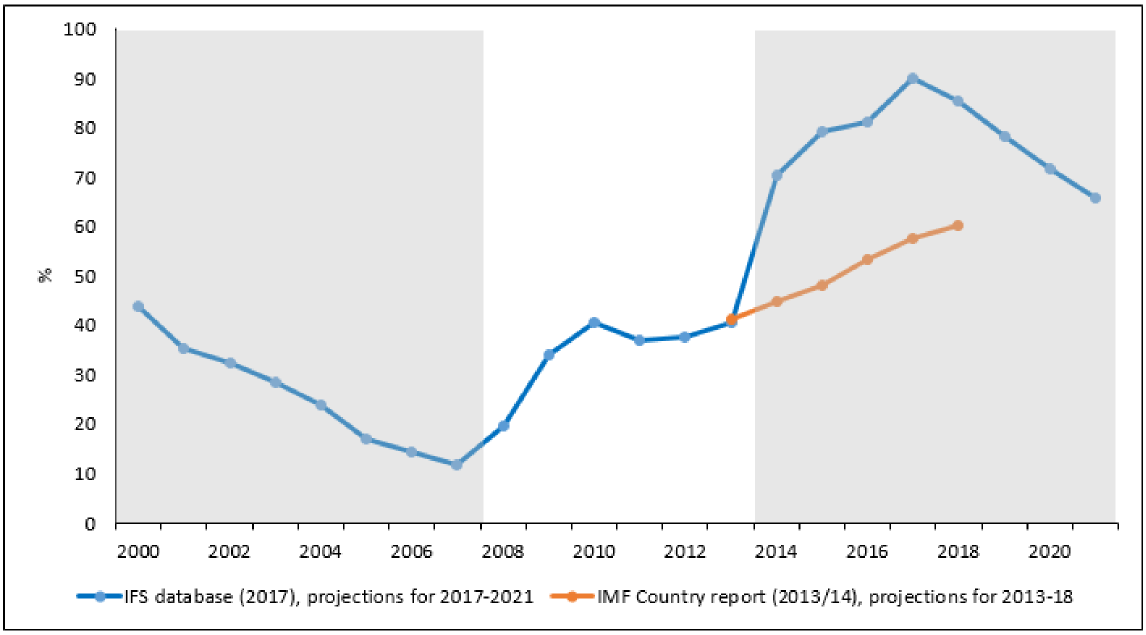
At the end of 2013, Ukraine's public debt stood at US$ 73 billion. This was composed of central and local government debt (82 per cent) as well as government guarantees (18 per cent). Just under half of government debt and around three-quarters of government guarantees was external; the rest was internal.

At the time of disbursement of MFA I & II, the economic and political situation in Ukraine was rapidly deteriorating. Following the abandoning of the dollar peg in February 2014, the Hryvnia depreciated rapidly, losing 40 per cent of its value against the USD by late-March. The Ukrainian economy was contracting, weakened by poor

[179] See for instancehttps://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/eastern-partnership/visa-liberalisation-moldova-ukraine-and-georgia_en

export performance and rising inflation. Political tensions and the sudden escape from the country by former president Yanukovych were followed by the illegal annexation of the Crimean peninsula and conflict in the east of the country provoked by Russia's destabilising actions.

Figure 10.1 General gross government debt-to-GDP



Source: *International Financial Statistics (IFS) database (IMF) and IMF Country Report No.14/145.*

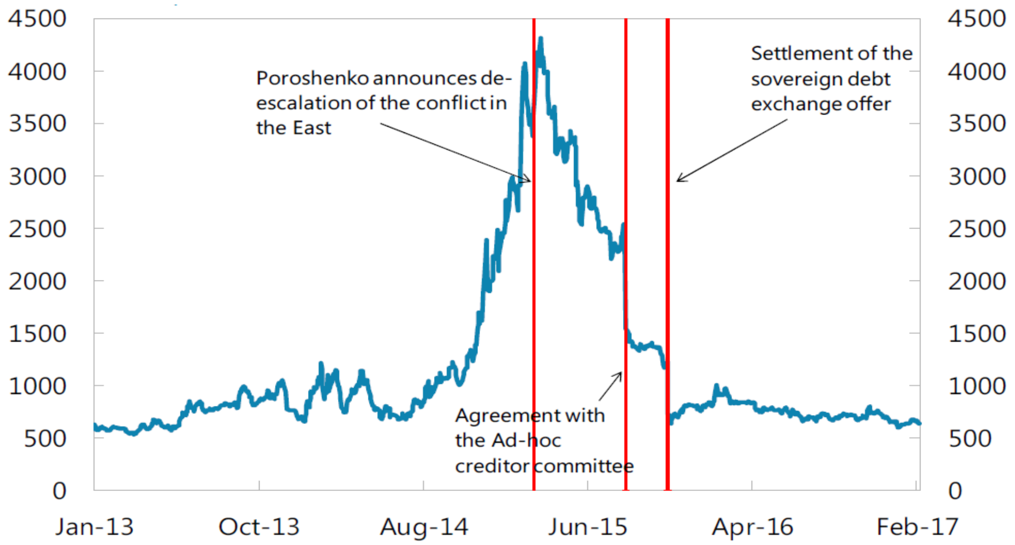
At the end of 2013, and ignoring what we now know was to follow in 2014, Ukraine's debt position appeared to be sustainable – debt-to-GDP ratio was around 40 per cent. However, *based on the IMF's projections at the end of 2013*, the trajectory was for the debt-to-GDP ratio to rise to 60 per cent in 2018, as represented by the orange line in Figure 10.1. This is below the IMF's high-risk benchmark of 70 per cent. However, given how weak the Ukrainian economy had been over 2012-13, a projected 50 per cent increase in the debt-to-GDP ratio over five years suggests that, at the same time, the risks to sustainability were increasing.

In reality, the materialisation of Ukraine's contingent liabilities (such as key state-owned enterprises and banks), resulted in a sharp increase in public debt, which exceeded 70 per cent of GDP by the end of 2014 (as represented by the blue line in Figure 10.1). Set against a weak economy and currency, a deteriorating political environment and being locked out of financial markets, the sharp rise in public debt that materialised over 2014 increased the likelihood of default. This would have been especially so without MFA, which accounted for a third of the funds received, and support from other international donors.

The impact of the MFAs was to help in alleviating an acute liquidity crisis which would have further undermined an already over-stretched government budget. This issue was exacerbated by the fact that, following the downgrading of Ukraine's credit rating both by Moody's and Fitch's scale in 2013, access to external finance would have been highly limited and prohibitively expensive. Findings from stakeholder interviews and the Delphi survey indicated that, had it not been for the assistance of the EU and other international donors, adjustments would have been more likely to take the form of cuts to public sector wages and investment, social assistance programmes and to some extent tax rises. Such measures would have weighed down on GDP growth and ultimately had a negative effect on debt sustainability.

The MFA I and II signalled to Ukrainian creditors and investors that the EU was supporting Ukraine at a time of massive financing need. Both MFAs leveraged the EU's political capital which, combined with broader international support, promoted conducive conditions in which Ukraine could work with creditors to find a solution to Ukraine's debt problems. The signalled support of the EU, and the resultant boost to investor confidence, is likely to have eased the impact of capital flight, which would have intensified without the support (see EMBIG spreads in the figure below).

Figure 10.2 EMBI Global Spread, basis points



Source: *Bloomberg via IMF Country Report No. 17/83, page 55.*

While MFA I & II played an important role as a signalling mechanism, it is important to note that the scale of the financial support in 2015 was relatively small. Total MFA I & II disbursement during that year was EUR 250 million, which was dwarfed by Ukraine's external financing needs (estimated at USD 27 billion over 2014-2016 under the IMF SBA). Hence, as such, the direct impact of MFA I & II on public debt in 2015 was relatively minor.

The material result of MFA in 2015 was the successful debt restructuring operation which took place in the second half of that year. By November 2015, Ukraine had successfully restructured about USD 15 billion of its external debt and achieved a 20 per cent debt reduction. This debt operation contributed towards the second objective of the IMF programme with gross government debt-to-GDP now projected to be 67 per cent in 2021.

The impact of MFA I and II can also be seen through the reforms they promoted. Structural reforms including those with direct implications for fiscal stance were initiated and ultimately helped to put Ukraine's debt back on a sustainable path. Typically, MFA reforms reinforced those of WB and IMF, in particular, contributing to structural changes in the energy sector. These reforms aimed to improve collection rates for Naftogaz, discouraging the accumulation of debt by Naftogaz, debt that was quasi-fiscal due to its State guarantee. The restructuring of Naftogaz was supported by enhancement of the social safety net, protecting vulnerable households.

MFA I & II also supported reforms aimed at the increase in transparency and improvement of the governance of the banking sector. In late 2013, Ukraine's banking system was exceptionally weak. Bank runs were reported in parts of the country and several of the smaller banks collapsed. However, the Government's bank rescue package was insufficient and the Deposit Guarantee Scheme (DGS) was not adequately capitalised to cover the 50 – 60 banks under its remit. MFA supported government efforts to strengthen the banking system, aiding the recapitalisation of some systemically important banks and facilitating the debt reprofiling that took place among the banks' creditors.

It is difficult to isolate and quantify the impact of MFA I and II because they were combined with other financial support. In addition, the size of the MFA I and II (EUR 1.61 billion) was relatively small compared to Ukraine's financing needs or the IMF package from which about USD 10 billion was disbursed during the period of MFA I and II. However, the timing of MFA disbursements was highly propitious, in providing support, confidence and credibility at an extremely difficult time. Furthermore, MFA I and MFA II contributed to the overall impact of finance packages from international financial institutions.

Full debt sustainability analysis is presented in Annex 10.

11 Social Impact Analysis

Annex 8 provides a detailed overview of the social context and some effects of policies on social indicators, including plausible effects of the MFA I and II. This is to some extent constrained by the difficulties of obtaining consistent time trend data given the effects of the conflict in the East[180].

The SIA has examined in particular the social effects of the implementation of conditions introduced in the context of the need for energy sector reform and the need for higher prices. Although not a conditionality of the MFA, the IMF condition for the removal of universal subsidies to the energy sector with attendant price increases provided the context for the operation of the MFA condition for the strengthening of a social safety net. This safety net sought to protect lower income households against the effect of higher energy (especially gas) prices on income by providing subsidies.

The World Bank estimated in 2014 that if the planned tariff increases were implemented without any changes to social protection for poorer households, poverty could be expected to increase by 4 percentage points (to 13 per cent)[181].

An explicit condition of the Memorandum of Understanding (MoU) for MFA I and II was the requirement to compensate vulnerable households for the increase in gas prices by strengthening the national social safety net, formerly called the Housing and Utilities Subsidy (HUS). Enhancement of the social safety net was also part of the conditionality of the World Bank Development Policy Loan 1[182].

Before 2014, if a household's housing and utility bill was above 15 per cent of household income (or 10 per cent for non-working household), the household was protected by the HUS (which covered the rest of payment).

In July, 2014, the government started paying special compensation to households with per capita income below a minimum subsistence income. The payment covered the full difference in the utility bill of households before and after hikes in tariffs for gas, electricity and heating, compensating for the full price increase. The special compensation was complementary to the usual housing and utility subsidy. The compensation was envisaged for the heating season of 2014/15, after which another wave of changes in housing and utility subsidies was envisaged.

From October 1, 2014, the government introduced amendments to the provision of housing and utility subsidies. It introduced new social housing and utility usage caps instead of previous standards. These caps were defined by household size, with compensation payments limited to covering the costs of the specified use of gas,

[180] IER have examined the reliability of the available data on social trends, especially on the labour market and incomes and concluded that the need for adjustments given the annexation of Crimea and the effects of conflict in the Donbass Region makes general conclusions hazardous.

[181] IBRD 2014 (p23)

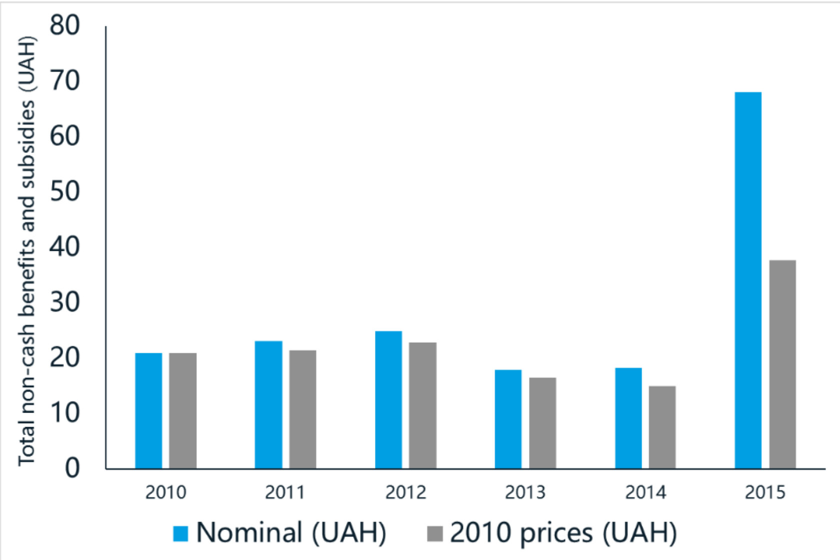
[182] World Bank, 2017. DPL-1. Available at: http://projects.worldbank.org/P150313?lang=en

water and electricity consumption. If households exceed the usage cap the extra payment is excluded from subsidies and paid directly by the household.

At the same time, the government changed the formula for the calculation of the share of the housing and utility bill over which the household becomes eligible for the subsidy. Under the revised HUS, a maximum utility payment is now set, depending on income after which subsidies are paid. Households with per capita income at the level of the minimum subsistence level will spend no more than 7.5 per cent of their income on their utility bill if they apply for subsidies. Middle income earners (defined as 4 times subsistence minimum) will have to spend over 30 per cent of their income on utilities to be eligible for subsidy. The new formula aimed at targeting the subsidy to poorer households with a reduction of payments to richer households compared to the HUS.

Aggregate data[183] on the allocation of total household resources (reported on the basis of household budget survey) supports the suggestion that households are receiving more social assistance to cover utilities, electricity and fuel. Subsidies to pay for housing and utilities (water, heating), electricity and fuel increased as a percentage of total monthly resources (average) from 0.4 per cent in 2014 to 1.3 per cent in 2015. In absolute (nominal) terms, this constitutes an increase from 18.25 UAH to 68.01 UAH in 2015 (or to 45.74 UAH in constant 2014 prices) (Figure 11.1).

Figure 11.1 Average monthly subsidies per household to pay for housing and utilities, electricity & fuel (UAH)



Source: *State Statistics Service of Ukraine*

Under the eligibility criteria established for the safety net, the number of households that received housing and utilities subsidies (HUS) has increased dramatically (from 1.6 million in 2014 to nearly 6.7 million by March 2017[184].

The rise in tariffs and the associated increase of eligible households, along with the simplification of the procedures required for financial assistance, led to a considerable expansion in the coverage of HUS. By December 2015, 30.5 per cent of households received housing subsidies, and total spending on HUS was 2.8 times greater in 2015 than the previous year (UAH 6.8 billion).

[183] State Statistics Service of Ukraine [accessed here]

[184] WB, April 2017. The World Bank in Ukraine. Country Snapshot. Available at: http://pubdocs.worldbank.org/en/700481492598099956/Ukraine-Snapshot13Apr2017.pdf

The effectiveness of the new HUS in providing compensation by income group has not been identified and the impact on poverty not established. However, since the new HUS provides subsidies for very low income households once the utility bill (as long as usage is below the cap) reaches 7.5 per cent of income, compared to 15 per cent of income under the old HUS, it would seem likely, subject to the operation of the usage caps, that the reforms have effectively protected these households. However, the World Bank report that disposable incomes contracted significantly in 2015 from the deep recession and high inflation. Moderate poverty (applying the World Bank's national methodology for Ukraine) increased from 15 per cent in 2014 to 22 per cent in 2015, while the poverty rate (under US$5/day in 2005 purchasing power parity, or PPP) increased from 3.3 per cent in 2014 to 5.8 per cent in 2015.[185]

2014 and 2015 saw a very substantial fall in real incomes (Annex 8), especially in the public sector as a result of fiscal consolidation. Given that the findings from Debt Sustainability Analysis suggest that further cuts in public spending would have been the main alternative to in the absence of MFA I and II, it seems plausible that the MFA operations as part of the support provided, contributed to avoiding further loss of incomes, and the lay-off of public sector employees. This in turn may suggest that poverty levels and poverty rates would have been higher in the absence of MFA operations. The enhanced social safety net cushioned the shock of increased energy prices, facilitated their political acceptability and in the long-run, contributed to the reduction of fiscal imbalances.

Furthermore, the social impact of both MFA operations was also exhibited in the support that the two operations provided to civil society in Ukraine. As discussed in Annex 6 and 8, experts who took part in the focus group in Kiev pointed to the stimulus that MFA I and II provided to the activity of civil society organisations in Ukraine and their crucial role in supporting reforms and maintaining the pursuit of the ambition behind the original Association Agreement. The signature of the MFA had indeed the effect of signalling continued support for the reforms and provided much needed confidence that the EU strongly supported the interests of Ukraine civil society. As a result, this fostered a 'virtuous' circle whereby the reform process encouraged civil society, and civil society supported the reform process.

More generally, leaving aside the specific condition on the social safety net which had the most clear-cut social dimension, other MFA I and II conditions had other cumulative social consequences. For instance, anti-corruption action embedded in a number of MFA I and II conditions addressed one of the most pressing social issues in Ukraine, reducing the acceptance of corruption and social apathy, as well as the costs of inefficiencies generated by corruption.

12 Conclusions

This evaluation has assessed, ex post, the contribution of the MFA I and II facility to the macroeconomic and structural adjustment of Ukraine. In so doing 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 objectives.

[185] World Bank, 2017. Ukraine – Overview. Available at: http://www.worldbank.org/en/country/ukraine/overview#4

12.1 Conclusions on the design (Relevance) and implementation (Efficiency and Coherence) of the operation

12.1.1 Relevance of assistance

12.1.1.1 Scale of assistance

The MFA provided budget support of EUR 610 million in MFA I and EUR 1,000 million in MFA II. The total support of EUR 1.6 billion (USD 2.2 billion in 2014 exchange rates) was disbursed during 2014 and early 2015.

The scale of assistance was based on the scale of the financial needs identified in Ukraine in 2002 and 2010 (MFA I) and 2014 (MFA II), although in the case of MFA II the rapid speed of the deterioration in the economy meant the needs were hard to assess. The scale of support in MFA II was also agreed in light of the assistance offered by other international and national donors and as part of an internationally coordinated programme of support anchored by the financial contribution from the IMF.

The financial need was assessed by the IMF, in early 2014, to be some USD 10 billion in 2014 and USD 12.5 billion in 2015. MFA support represented 10 per cent of the overall financial need. However, MFA support came on stream quicker than other sources and contributed USD 1.8 billion in 2014. This made a telling contribution of 20 per cent of the overall budget support from international donors provided that year and an early signal of support and solidarity.

12.1.1.2 Form of assistance

The form of assistance – loan and / or grant finance for budget support – is determined by the application of agreed principles, defined with reference to the per capita income of Ukraine, debt sustainability and the eligibility for concessionary finance. These principles were considered in the ex-ante assessment and found to rule out any use of grant financing.

12.1.1.3 Conditioning of support

The ex post evaluation has examined the relevance of the individual conditions specified in MFA I and II and finds that they are highly relevant to the political, economic and institutional conditions at the time, reflecting the ex-ante and related operational assessment of the most urgent requirements for reform. As conditions to be achieved in the short-term (six to twelve months), and the anticipated need for swift disbursements given the severity of the crisis, they were suitably ambitious and well targeted.

MFA I and II operations had a combined total of 35 conditions, to be simultaneously implemented. The number represented the scale and urgency of the challenge of reforms required. There was no evidence that the number of conditions was too onerous. Only two conditions required waivers, and a further three were found to have already been implemented by the commencement of the operations.

The reforms have complemented those specified in IMF and World Bank programmes, and were based on well-coordinated analyses and discussion between the major donors and with the Ukraine authorities. The specified conditions were also coherent with other EU programmes, especially the State Building Contract. The conditioning has subsequently provided the basis for continued reform conditions supported by MFA III.

12.1.2 Efficiency of the MFA operations

The timing of disbursement was appropriate given the prevailing macroeconomic conditions. Flexibility was demonstrated where necessary. The postponements that were made were justified but also adequately paced e.g. taking into account the financing needs of the authorities at the particular time. The decisions to grant the waivers were also adequately consulted and justified, and did not impair the efficiency of operations.

The ownership of the programme by the authorities and dialogue between the EU and Ukraine authorities was relatively high and conducive to the efficiency of operations, taking advantage of the 'window of opportunity' for reform. Good quality coordination with other donors and the ability to leverage a higher pace of reform in certain areas ensured the efficiency of the operations.

The review of the visibility of the operations and the EU internal coordination of communication activity indicates scope for improvement with a number of problems identified. Ultimately, the long-term success of a programme is conditional upon the citizens' buy-in for reforms.

12.1.2.1 Monitoring of the MFA operations

Monitoring of the progress in implementation of both operations took place v*ia* continuous monitoring of the reform process in Ukraine by the Commission services and DG ECFIN missions to Ukraine. This is assessed to have been adequately structured and executed providing an informed basis for disbursement decisions. DG ECFIN drew also properly on the information and advice of the various Commission services, and in particular the Support Group for Ukraine, as well as the EU Delegation in Kyiv. The necessary degree of attention was placed on the close and regular monitoring of Ukraine's financing needs which enabled informed decisions about the scope for postponement of disbursements in the event of delays in reform and to weigh the degree of pressure required to fulfil conditionality on the one hand, and the financing position of the government on the other.

12.1.3 Coherence with other EU priorities & interventions

Both MFAs were well aligned with the key priorities guiding the EU – UA relations reflecting the key areas of focus of the Association Agreement in the conditionalities.

Both operations were coherent with other components of the EU support package. In particular review of activities carried out by the State Building Contract (SBC) and EBRD / EIB financing found no evidence of duplication or inconsistency of conditionalities or terms and conditions.

There was positive synergy between EU actions, especially on measures to tackle corruption and the need for transparency, with MFA measures complementing those with the SBC and the terms negotiated under the Visa Liberalisation Treaty.

12.2 Conclusions on the effectiveness and added value of MFA I and II in supporting macroeconomic and financial stabilization and structural reform

12.2.1 The effectiveness of MFA I and II on macroeconomic and financial stability including debt sustainability

Both MFA MoUs make it explicit that the MFA support is intended to complement the support and conditions specified by the IMF. The reform conditions for stabilisation set out in the MoU are consistent with agreements established between Ukraine authorities and the IMF. Comparison of reform conditions specified in the MFAs with those contained in the IMF SBA confirms a high level of consistency.

The financial support provided by the IMF and MFA (and other donors) has been successful in stabilising a rapidly deteriorating economic position. Whilst the MFA was not considered to be essential to the stabilisation relative to the IMF support (of USD 17 billion) the majority of experts consulted considered that without MFA support, real GDP would have contracted more sharply in 2014 and 2015 and that the growth which returned in 2016 (of 2.3 per cent), would have been lower.

Available evidence suggests that had the MFA I and II not been available, obtaining alternative financing from domestic or/and international sources was not plausible. Faced with no other options, the authorities would have had to pursue even deeper public spending cuts than those that occurred in 2014 and 2015, with limited scope to increase taxes. Cuts in wages and jobs in the public sector and in capital investment would have been the most likely options. These cuts in turn would have resulted in higher unemployment and the further reduction of household incomes. Consequently, the MFA operations assisted in reducing the negative social impact related to higher unemployment and increases in the poverty rate in Ukraine.

It is also likely that the absence of the MFA would have led to some deterioration of confidence with implications for the Hryvnia exchange rate (depreciation) and even higher inflation.

The size of MFA I and II suggests that the absence of support would not have triggered a sovereign debt default in 2014. However, the MFAs helped to alleviate an acute liquidity crisis which affected Ukraine's forex market in 2014.

The MFAs, combined with broader international support, promoted conducive conditions in which the Ukraine authorities could work with creditors to find a solution to national debt problems. One result was the successful debt restructuring operation in the second half of 2015 which included a 20 per cent haircut. The direct impact of MFA I and II on the debt sustainability level in 2015 was smaller than in 2014 given that total MFA I & II disbursement during 2015 was EUR 250 million.

The impact of MFA I and II on debt sustainability also arose from the reforms promoted, reinforcing those of WB and IMF. Examples include the enhancement of social safety net which supported the restructuring of Naftogaz and the associated debt reduction, and reforms aimed at the increase in transparency and improvement of the governance of the banking sector.

In addition, the signalling effect to Ukraine creditors and investors that the EU was supporting Ukraine at a time of massive financing need, meant that the MFA I and II also had a symbolic importance. It was a sign of EU solidarity at the time when the country and its people desperately needed it.

The hypothetical absence of the joint assistance of MFA I and II <u>and</u> IMF support programme would probably have had dramatic consequences. Faced with the prospect of increasing borrowing requirements due to a weak economy (and falling tax receipts) and a weak currency but sustained expenditure pressures, and locked out of international capital markets, it is hard to see how Ukraine's debt would not have become unsustainable and led to a default. This would probably have been accompanied by an even greater depreciation of Hryvnia, with hyperinflation and even greater decline in real incomes and the standard of living, with a significant increase in the poverty rate. Ultimately, a lack of the international support could have threatened the sovereignty of the country, and would have had a very damaging effect on the EU reputation in Ukraine and its ability to pursue the ambitions of the Association Agreement.

12.2.2 The effectiveness of MFA I and II in advancing structural reforms

Implementation of the structural reforms specified in the conditioning of support, has been assessed to be effective. Progress has been made across all the specified areas. The need to provide waivers where reforms had not progressed sufficiently but where disbursements were due was confined to two conditions (VAT refund arrears and adoption of the draft budgetary plan for 2015) and was well justified.

Particularly strong progress was made in the case of conditions under the PFM namely, the extension of the remit of the ACU to government revenue, ensuring sufficient allocation of financial resources to external audit functions and the reform of public procurement.

The evaluation considered the risk of 'back-tracking', the risk that some reforms might be reversed or at least halted. This was considered to be a risk in relation to the progress made on anti-corruption measures, partly because of major issues stemming from poor law enforcement and partly because changes are still ongoing and thus easier to stall and to reverse later. However, in other areas, in particular the financial sector and public procurement, the general view was that reforms were largely irreversible.

Overall, despite individual cases of delayed disbursements and waivers that had to be granted for two conditions, structural reforms incorporated under MFA I and II were fulfilled in a satisfactory manner.

In general, the MFA I and II often played a reinforcing role contributing to the reforms pursued by IMF and WB, rather than acting as the sole and leading promoter. Yet, there are also examples of some conditions, in particular in the area of the PFM, where the stimulus of both operations was instrumental.

In the case of specific condition related to the enhancement of the social safety net, reform had a very strong social impact. MFA along with the WB helped to safeguard lower income households from the effects of increases in energy tariffs avoiding higher levels of poverty, and it enabled the energy sector reforms to proceed without major social unrest. It was a reform where failure could have had serious consequences for the progress of the whole MFA I and II operations as well as programmes implemented by other donors.

12.2.3The EU added value of MFA I and II

The MFA operations provided clear added value, both in terms of delivering on its key rationale, and by its ability to bring insight and confidence to the design and implementation of the combined international donor package, which other donors could not match. It also seems clear that Member States in isolation or combination could not have delivered equivalent support in the time and the scale of the EU.

EU support also had a symbolic importance which other international donors could not deliver because of their lack of political engagement in Ukraine. EU support was a sign of solidarity with a country that found itself trapped in a very severe economic and political crisis and whose sovereignty and territorial integrity were being violated by the Russian armed forces. A lack of EU support would have signalled a lack of commitment and a breach of confidence, with very negative implications for the EU reputation and its leverage in the region. Given the support, the MFA encouraged civil society organisation in Ukraine in their call for major reforms to remove corruption and to modernise government institutions and activities; activity which has subsequently reinforced MFA actions.

12.2.4Social impact of the MFA I and II

The MFA operations had a significant positive social impact in Ukraine.

In the absence of the MFA I and II substantial public spending cuts would have probably resulted in the layoff of some public sector staff combined with wage reduction and a fall in spending on suppliers. The plausible consequence would have been some rise in poverty levels, especially amongst vulnerable households with members employed in public sector (e.g. in 2014, the average salary in the education and healthcare sector was already over 20 per cent lower than the average salary for the whole economy).

Specific condition related to the enhancement of the social safety net and requirement for changes in existing social protection (through HUS) was essential. Achievement of this condition ensured that the necessary reforms of the energy sector were advanced without significant rises in poverty. Lack of sufficient protection for the most vulnerable households could have otherwise led to social unrest, a weakening of civil society's support for reform and in the worst case scenario, derailing of the whole programme.

More generally, leaving aside the specific condition on social safety net which had the most clear-cut social dimension, other MFA I and II conditionsalso had some social consequences. For instance, even though this study does not trace them down specifically, the clear anti-corruption dimension embedded in a number of MFA I and II conditions addressed one of the most pressing social issues in Ukraine and conceivably reduced the acceptance of corruption and related frustrations and social apathy, as well as the costs of stemming from the corruption.

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