

# **ANNEX 1: ACTION FICHE (SUPPORT FOR THE IMPLEMENTATION OF THE TRANSPORT STRATEGY IN UKRAINE)**

## **Action Fiche UKRAINE**

### **THIS TEXT EXISTS ONLY IN ENGLISH**

#### **1. IDENTIFICATION**

Title/Number	Support for the Implementation of the Transport Strategy of Ukraine CRIS: ENPI/2009/20398		
Total cost	<i>EUR 65 million (EC contribution)</i>		
Aid method / Method of implementation	<i>Sector budget support (centralised management)</i>		
DAC-code	21010	Sector	Transport

#### **2. RATIONALE AND COUNTRY CONTEXT**

##### **2.1. Country context and rationale for SPSP**

###### ***2.1.1. Economic and social situation and poverty analysis***

Ukraine is a lower middle-income country with a gross national income per capita of USD 2,550 in 2007 (GNI per capita, Atlas method), which after a period of deep economic recession (1992-1999) has been growing at an average rate of 7.5% per year. During that same period, thanks to efforts on social spending rather than to the direct effect of economic growth, poverty in the country has dramatically shrunk from more than 30% of the total population (estimated at 52 million in 1999) to about 5% of the total population (now estimated at 47 million). Ukraine has been excluded from the list of aid-recipient countries by a number of donors since 2000.

During the past seven years Ukraine's economy has grown very rapidly, with real GDP annual growth averaging 7%. Production-side factors such as utilization of large excess capacities and favourable conditions in the external markets were coupled with solid domestic demand growth (averaging 15% in annual terms over the period), stimulated by generous governmental incomes policies and credit boom driven by strong capital inflows.

By the middle of 2008, the economy was overheating. Credit growth exceeded 70%, inflation surged to 30%, wage growth settled in the 30–40% range, imports surged at an annual rate of 50–60%, driving the current account deficit to as high as 7% of GDP by Q2 2008. However, economic growth started to slow down in the third quarter of 2008 as Ukraine was subjected to a sharp reversal of external capital flows in the context of the deepening global financial crisis and worsening conditions in Ukraine's main exports markets. At present, the credit crunch has already suppressed domestic demand while external demand remains weak for Ukraine's main exports of steel and chemicals. The very good harvest could not overshadow the rapid contracting of the manufacturing sector. The IMF now projects a deepening recession in 2009. In this context, the IMF approved on 5 November 2008 a two-year stand-by arrangement for USD 16.5 billion to help Ukraine restore financial and economic stability. USD 4.5 billion was disbursed immediately to replenish the international reserves of the National Bank of Ukraine (NBU) which had intervened in the foreign exchange markets to limit the depreciation pressures on the Ukrainian currency (*hryvnia*).

Though Ukraine has extensive human capital, natural resources and industrial potential it still faces significant medium-term barriers for sustainable growth. The main challenges are: (i) improvement

of competitiveness and the investment climate, (ii) modernisation of public infrastructure, (iii) strengthening of economic and public governance, and (iv) improvement of the quality of public services.

### **2.1.2. National development policy**

Since 2004 the Government of Ukraine has followed a pro-European path and its major goal is association with EU and EU-Atlantic alliance. The main national development policy document, which is the Government Action Programme "Ukrainian Breakthrough: For People, but not for Politicians", and other transport sector policy documents, are consistent in setting the priorities of approximation to EU legislation and accomplishing negotiations on the Association Agreement.

The concept for a national sustainable transport policy is in place. However, the comprehensive transport sector development strategy is under preparation with the support of the TA project "Support to the Integration of Ukraine to the Trans-European Transport Network TEN-T". Currently the strategic priorities and actions to be taken are reflected in the programmes, targeted to solve specific sub-sector or cross-sector issues.

The Government of Ukraine demonstrates high level of ownership of the above-indicated national development policy. In 2008 the Coordination Bureau for European and Euro-Atlantic Integration was established in the Secretariat of the Cabinet of Ministers of Ukraine in order to improve the coordination system of European integration at the political level. This bureau which should be fully staffed during 2009 is accountable directly to the Vice Prime Minister for European and International Integration. There is good cooperation with the Ministry of Transport and Communications of Ukraine (MoTC) in the framework of the integration to the trans-European transport network, Baku initiative and other. The MoTC has also committed to start implementing the newly developed transport strategy from the beginning of 2010.

## **2.2. Sector context: policies and challenges**

### *(1) Transport sector context*

The policy, strategy and reform programme for the transport sector is mostly represented in the "Concept of Stable National Transport Policy of Development of all Types of Transport and Principles of Transport Policy" (The Concept) that was approved by the Ministry of Transport and Communications (MoTC) in May 2007. This document contains the main lines for strategic development for the sector up to 2015. Ukraine is also implementing a number of specific programmes, such as those aiming to prepare the transport systems for the Euro 2012 football championship, to develop Ukraine as a transit country, to develop national network of international corridors, sea ports, airports, road transport, etc.

The main strategic priorities given in the Concept are: technical and technological modernisation of transport; development of a market environment in transport; improvement of safety of transport systems; integration with the European Union; development of export of transport services.

The general reform programme is also outlined in the Concept, and it includes structural reforms to reorganise the management of the transport sector; financial reforms in the provision of transport infrastructure and services; market reforms to increase competition and the participation of the private sector; regulatory reforms to place emphasis on the delivery of safe and environmentally-friendly transport services.

In general the transport infrastructure of Ukraine, despite some bottlenecks, has sufficient capacity but is in unsatisfactory condition. Travel speeds are slow and costs are high. According to the initial assessment by the MoTC, the needs for investment in transport infrastructure reach approximately USD 30 billion in the coming decade, most of which should be attracted from non-budget sources.

Safety is a key concern in all transport sub-sectors. Ukraine has a high road traffic accident rate and it is increasing at an alarming speed. In parallel to a number of measures taken to reduce it, the specific programme on road safety is under development (assistance is provided under the relevant twinning project). Ukrainian ships and a number of airlines are blacklisted in EU.

Ukraine has considerable opportunity to develop transit traffic, and this is outlined in the Concept paper and other documents, addressing the need to improve customs procedures, interoperability, introduce data exchange systems, etc.

As regards the integration to EU in transport sector, the EU and Ukraine are negotiating the Association Agreement as well as the Common Aviation Area agreement, both of which will include significant commitments for the transport sector. The legal approximation process is managed by the MoTC based on annually approved plans for regulatory acts preparation in all transport sub-sectors.

(2) *Sector budget and its medium term financial perspectives*

The sector budget financial control procedures are in compliance with international requirements, but remain based on an annual budget process, planning and approval of which remains a complex political processes.

(3) *Coordination process with the beneficiary country and other donor*

The coordination structures with the Ukraine and MoTC in particular also other donors is in place. For donor activities and coordination process description see section 2.5 and 2.6. The coordination of activities between the European Commission Delegation and the MoTC is carried out on the daily basis, the MoTC is highly cooperative.

(4) *Institutional capacity*

The MoTC was founded in 1992 (in 2004 the communications related functions were added). Under its responsibility there are several transport sub-sector administrations, except the State Road Service, which is not under its direct control. The key department, which shall coordinate the implementation of the SBS operation is Transport and Communication System Development and Coordination Department, which is also responsible for the development of transport sector policies and strategies, coordinating infrastructure development and cooperation with donors. Therefore, the necessary management structures are in place to secure appropriate governance of the sector, however, the institutional capacity needs to be further strengthened, in particular, as regards human resource systematic development and national transport policy/strategy/reform implementation, monitoring, etc.

(5) *Performance monitoring for the implementation of policies and strategies*

The State Committee of Statistics prepares regular reports on transport performance and development. Once the comprehensive transport strategy is in place, the Government of Ukraine will develop a Performance Assessment Framework.

(6) *Macroeconomic framework*

The information is provided under point 2.1.1.

(7) *Public Financial Management*

Public financial management is generally assessed as acceptable (World Bank PEFA Report, 2006). In October 2007 the Ukrainian Government has approved the Strategy for the Modernization of Public Finance Management System and a revised version of the Concept of Development of Public Internal Financial Control for the period up to 2015 (including the relevant Action Plan).

Control is carried out at all levels of the budgetary process and clearly stated in Article 26 of the Budget. It ensures: (a) continuous evaluation of adequacy and consistency of a budget-funded entity with the requirements of internal financial control; (b) evaluation of consistency of results with the chosen tasks and plans; (c) information to the senior management of the budget-funded entity on the results of each check-up (evaluation, investigation, study or audit) conducted by the internal financial control units.

It is envisaged in particular that public internal financial control will be improved, in line with the recommendations of the on-going EC-funded twinning project with the Control and Audit Department (KRU) at the Ministry of Finance. A Central Harmonisation Unit for internal audit was established in KRU and a decision was made to transform KRU into a public audit body already in 2008.

In the course of 2008 a significant step forward was made by the Ukrainian authorities in improving the situation in the public procurement (PP) area. On 21 March 2008 the Law was adopted abolishing the PP legislation in force since 2006 which was not in line with EC practices and which undermined fair competition in the PP area. Immediately after, the Cabinet of Ministers of Ukraine approved the Interim provisions governing PP actions in Ukraine until the adoption of the new law. The new PP Law (prepared by the Ministry of Economy of Ukraine) passed the first reading in the Parliament on 20 May 2008. While drafting the Law, a series of consultations with the IFIs were held and the EU experts working in Ukrainian-European Policy and Legal Advice Centre (UEPLAC) project have been invited to join the group and provide their comments<sup>1</sup>. Due to the situation of political instability affecting Parliament, the draft law is currently still pending.

### **2.3. Eligibility for budget support**

The MoTC has committed to start implementation of the newly developed comprehensive national transport strategy from the beginning of the year 2010. For more detailed assessment see sections 2.1.2 and 2.2.

The macroeconomic stability criterion is met in general, but due to recent negative trend in country's economic growth, the macroeconomic situation needs to be carefully monitored. The economic program that has now been approved in line with IMF recommendations should provide an appropriate framework to improve the macroeconomic situation through prudent fiscal and monetary policies.

The PFM eligibility criterion is met and a PFM Reform strategy is in place (see § 2.2).

### **2.4. Lessons learnt**

The budget support modality was introduced in Ukraine for the first time in the energy sector under the ENPI AAP 2007. Two other budget support operations, in the areas of energy efficiency and of technical barriers to trade (TBT), have been adopted under AAP 2008 and FAs are expected to be signed during 2009. Two sector budget support programmes, for the transport and environment sectors, are programmed under AAP 2009.

Under the budget support programme in the energy sector (AAP 2007), the disbursement of the first fixed tranche has been approved in December 2008 and hence it is too early to draw comprehensive lessons from the experience so far. It has taken time for policy makers in the Ministry of Economy, Ministry of Finance and the relevant sector ministries to understand and appreciate this new implementing modality. However, interest in budget support has grown gradually throughout 2008 as the modality has become better known among key stakeholders and there is now firm commitment to it, not least in view of the more constrained budget situation. Nonetheless, low administrative capacity among implementing ministries and agencies remains a key concern and more attention must be given to improve monitoring and evaluation of sector policies and to strengthen related statistics. Emphasis should also be placed on improving the overall budget system and medium-term expenditure frameworks, both at central level as well as with line ministries.

At the same time, with an increasing number of Sector Budget Support operations in place by 2010, it will be critical that there is a tight follow up of commitments and conditionalities among the various programmes by the Cabinet of Ministers, including synergies to be achieved with related conditionalities among IFI programme in order to improve coordination and performance on key reforms.

### **2.5. Complementary actions**

Currently there are seven EC-funded transport projects ongoing in Ukraine, 5 of which have started in the second half of 2008. The current interventions will end by 2011. Therefore currently sufficient assistance and

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<sup>1 1</sup> The draft PP law is still pending approval. While the World Bank considers its revised content in line with their requirements, SIGMA experts funded by the Commission consider that the draft law is not in line with European standards. In the frame of the SIGMA programme, Ukraine has retained PP as one of the priorities to tackle. A revision of the draft law by the SIGMA experts was proposed and in principle accepted by the Ukrainian authorities. The proposal was reiterated at the Cooperation Council held in November 2008.

expertise is provided to the MoTC. Two of the seven projects cover transport as a whole – the Twinning Project on transport policy design and implementation, and the TA project to support Ukraine's integration to TEN-T. Under these 2 projects the national transport policy shall be reviewed and the strategy together with its implementation plans shall be developed. This project also supports MoTC in preparation for the SBS and will support SBS Operation implementation during the first year. In addition, Ukraine benefits from EU assistance in the framework of the TRACECA programme.

As regards other donors, the World Bank (WB) is providing Ukraine with general budget support under successive Development Policy Support loans totalling 500 million US\$ per annum. WB, EBRD and EIB are negotiating with Ukraine specific loans for further transport infrastructure development (in particular regarding rails and roads). WB is also currently carrying out a study on trade and transport in Ukraine. Other donors contribute mainly in the very specific fields through support to short studies or contributing to legislation process.

## **2.6. Donor coordination**

There are a good number of donors involved in the transport sector in Ukraine. Regular Member States meetings are organized by the EC Delegation where among other issues the assistance to Ukraine's transport sector are discussed. Good cooperation has been established with other donors, such as the WB, EBRD, EIB and USAID in sharing the plans and results of the activities in transport sector (also see section 2.5).

As regards overall system of donor coordination of Ukraine, in 2007 a Donor-Government Working Group was established. Ministry of Economy, which in charge of donor coordination, organizes bi-annual Working Group meetings and maintains a web-site. The lead donors of the sub-Working Groups on transportation and information technologies are EBRD and the European Commission. The donor coordination at the Ministry level in transport sector is carried out by the Transport and Communication System Development and Coordination Department, which also intend to reinforce the activities of the donor coordination sub-working group on transport.

## **3. DESCRIPTION**

### **3.1. Objectives**

The overall objective of the SBS operation is to reinforce Ukraine-EU cooperation for addressing the priorities of the Ukraine-EU ENP Action Plan and other EU agreements in the transport sector.

The specific objectives of the SBS operation, which comply with the Ukrainian long term priorities in transport sector shall be as follows:

- to support the implementation of the institutional reforms in transport sector in Ukraine;
- to contribute to further legal approximation and alignment of Ukraine to EC and international norms and standards in the transport sector of Ukraine and to the integration of Ukraine to the EU transport systems;
- to contribute to the improvement of the transport infrastructure development of Ukraine.

### **3.2. Expected results and main activities**

The results of SBS operation are expected in the following five areas of activities:

*Result 1: Implementation of the institutional reforms in transport sector of Ukraine is well advanced*

In principle all of the transport sub-sectors (rail, road, aviation, maritime and inland waterways) are undergoing a reform process. It is envisaged to implement the restructuring policy and reorganise the administration mainly by separating regulatory responsibilities from operational (in particular railways and ports). The measures shall also be taken to improve regulatory environment in terms of access to the market and social aspects in roads, maritime and inland waterways sectors. Therefore, the SBS would contribute to the implementation of these reforms, which are a pre-condition for the development of the transport sector and achievement of the long-term Ukraine's objectives as it would create more favourable investment environment, better access to the market, and a higher level of EU integration, where the institutional setup is regulated by EU/international provisions (railway and aviation in particular).

*Result 2: The safety and security in transport sector is improved*

Safety is an issue of particular importance in Ukraine due to high death/accident rates (i.e. in roads 7 times higher than in EU; Ukrainian ships and some airlines are banned in EU) and measures for its improvement must be taken in all the transport areas: roads, railways, aviation, maritime and inland waterways. Therefore, the SBS shall contribute to the further improvements in these fields focusing on introduction of the international/EU rules and standards, which would contribute to the reduction of the accidents rates, improve the quality of the transport services and contribute to the integration of the Ukrainian Transport Sector to EU Transport Network.

*Result 3: The movement of transport flows through Ukraine is improved*

As Ukraine is a major transit country, the activities in this area shall contribute to the increased capacities and conditions for transit of passengers and goods through roads, railways, air, sea and river. The activities shall focus on the better integration to the TEN-T through cooperation with EU and other countries in the region, facilitation of the border crossing, customs procedures and information exchange systems, and taking measures concerning intermodality and interoperability. The implementation of these activities shall facilitate trade and transport flows along the main axis (corridors). These activities shall concentrate on the implementation of the EU and international rules and standards.

*Result 4: The conditions of the transport infrastructure development are improved*

The transport infrastructure of Ukraine is in need of major upgrading, and, therefore, Ukraine is taking steps to attract more financing from the external resources (private, IFIs). The SBS shall contribute to the infrastructure development through legislative measures introducing new financing mechanisms (concessions, PPP, user charge system, budget and special funds revenue-expenditure systems by functions and other). The actions shall be taken to improve the transport infrastructure planning, management and monitoring, including traffic management systems, infrastructure status monitoring, as well as establishment of a platform for efficient donor coordination and use of their funds. Also particular emphasis shall be put on the infrastructure project preparation process and quality, in particular as regards national requirements for the feasibility studies and application of the environmental impact assessment.

*Result 5: The administrative capacity to develop and implement the national transport strategy is improved*

The MoTC faces a number of challenges as regards administrative capacity to develop and implement national transport policy and strategy (including necessary reforms). Therefore, in this field a number of issues concerning improvement of management processes and systems, human resource development, improvement of transport statistics, etc shall be addresses. This activity is horizontal; therefore, it will contribute to all the priorities of SBS.

### **3.3. Risks and assumptions**

In addition to the general political risk in Ukraine relating to the instability of the Government and/or major changes in the overall orientation of the Government policies, a number of specific risks and assumptions with regard to the sector programme have been identified as follows:

*Assumptions*

Ukraine will keep to its commitments under the Transport chapters of the EU-Ukraine ENP Action Plan and will continue demonstrating strong interest in close cooperation as regards the proposed measures.

Ukraine and the EU will negotiate and conclude the New Practical Instrument before the start of the SBS operation, which will further confirm the mutual commitment and policy objectives for the transport sector in the coming years. Ukraine and the EU will continue to negotiate and conclude the Association Agreement and the Common Aviation Area Agreement.

Ukraine will not substantially revise the key objectives of the transport policy. In line with the latter, Ukraine will develop and approve a coherent transport strategy before the start of SBS operation, and will implement relevant action plans. The Government of Ukraine will continue to show commitment to the foreseen reforms, translating these into concrete policies and related legal regulations during the SBS time spam.

The Medium Term Expenditure Framework for the sector is developed and applied in the Ministry of Transport and Communications as per guidelines established by the Ministry of Finance.

### *Risks*

One or several of the ministries, agencies or other bodies involved in the SBS operation might either be reluctant or not have the capacity to cooperate in an orderly manner. This risk can be mitigated via the use of dialogue mechanisms and the provisions of adequate technical assistance.

There is no consensus within the Government of Ukraine and with other stakeholders on the national transport policy/strategy and related action plans. This risk can be mitigated by involving all stakeholders in the preparation process and having a good mechanism for coordination of the activities in place.

The Government achieves no progress in implementing reforms in the field of public finance management, particularly with regard to public procurement and external audit. The active participation of the national and international community in the dialogue on these issues will contribute to mitigating this risk.

In the light of the current financial crisis, the Government might not demonstrate sufficient commitment to the implementation of stability oriented macroeconomic policies. The long decision making process may result in delays in achieving key sector results. In order to mitigate this risk, a thorough analysis shall be carried out to set up realistic outputs. The technical assistance to improve the cooperation between the MoTC, relevant Parliament Committees and Ministry of Justice could help to mitigate this risk to some extent.

## **3.4. Stakeholders**

The main partner for the implementation of the SBS operation will be the Ministry of Transport and Communications of Ukraine. Other ministries and bodies carrying out some particular functions in the transport sector (in particular Ministry of Interior and State Road Service) shall be involved in the SBS activities.

The Ministry of Finance will provide information on progress in the implementation of the PFM reform and account for the adequate use of budget resources. The Ministry of Economy, coordinator of EU-related activities in Ukraine, will be closely involved in the management of the Operation as will be the Coordination Bureau for European and Euro-Atlantic Integration.

Most activities foreseen under this Operation shall have great impact on the operators and users, therefore, the consultations with carriers, operators etc. will be conducted regularly, and as relevant.

## **3.5. Crosscutting Issues**

The existing national and sector (transport) strategic documents have included considerations on cross-cutting issues, such as environment (alignment to EU norms as regards environmental standards (CO2 emissions) in transport sector, wider application of the environment impact assessments for infrastructure projects), energy efficiency (through optimisation of the transport system management, regulation and control, improved infrastructure and operating conditions), border crossing (improvement of the border crossing procedures, introducing data exchange and monitoring systems), statistics (measures related to the relevant and reliable statistical data collection and use). These aspects shall be further strengthened in the new comprehensive transport sector strategy and supported, where relevant, by specific Technical Assistance.

## **4. IMPLEMENTATION ISSUES**

### **4.1. Method of implementation**

The sector programme will be implemented under direct centralised management. Budget support will be untargeted and funds will be disbursed directly to the account of the Treasury of the Government of Ukraine. In line with its budget procedures, the Government of Ukraine will establish a decision for the receipt and use of tranches received.

No specific TA component is foreseen under this proposed measure. Provision for technical support accompanying this SBS programme through technical assistance and twinning operations will be made

available under the AAP 2008 and the AAP 2009 measure for *Twinning and ENP Support Technical Assistance* (see relevant Action Fiche), as well as under future AAP 2010. The twinning would mainly aim at the capacity strengthening. The technical assistance shall ensure sufficient implementation, providing support in monitoring, reporting, visibility, and other relevant activities, as well as evaluation and audit as relevant,.

#### **4.2. Procurement and grant award procedures**

No procurement or grant award procedure is foreseen separate to the disbursement of budget support tranches. It is foreseen that complementary Technical Assistance in support of the sector budget support programme will be procured under ongoing and/or future TA/Twinning facilities.

#### **4.3. Budget and calendar**

The total budget of the SBS operation is EUR 65 million. The implementation period of the SBS operation extends in principle over 48 months. The provisional start of the programme is January 2010 provided the Financing Agreement is signed and the comprehensive national transport strategy is in force.

It is anticipated that 4 mixed tranches (fixed and variable tranches, except the first up-front tranche) of respectively EUR 15.0, 20.0, 20.0 and 10.0 million (one per year) will take place during the implementation period.

#### **4.4. Performance monitoring and criteria for disbursement**

Performance of the sector budget support programme will be monitored by a Joint European Commission - Government of Ukraine Monitoring Group (JMG) established for this purpose. The Joint Monitoring Group will include beside the representatives of the Government (in particular Coordination Bureau for European and Euro-Atlantic Integration of the Secretariat of the Cabinet of Ministers), Ministry of Transport and Communications and other key Government Ministries and authorities responsible for the attainment of the sector objectives, including the Ministry of Finance, the Ministry of Economy and the Ministry of Justice.

The standard general eligibility conditions will apply for the disbursement of all tranches. In addition, specific disbursement conditions will be agreed upon in the Financing Agreement for the disbursement of tranches. This may include the adoption of the national strategy, the establishment of the Joint Monitoring Group as well as decisions for the receipt and use of budget support relating to this programme.

Performance indicators for the variable tranche will be determined for the key areas of the transport policy identified above, using a mix of output and process indicators also by transport mode, and reflecting the policy priorities as established in the EU-Ukraine ENP Action Plan among others. A limited number of performance indicators will be used determining the size of variable tranches, reflecting these priorities, while making the assessment of progress manageable.

#### **4.5. Evaluation and audit**

No specific evaluations or audits are foreseen for this SBS programme. Should a need for independent evaluation/audit arise during the implementation of the programme, it shall be financed from other sources as necessary, in particular from GTAF.

The beneficiary government will make available the audit report of the country's Independent Audit Institution on an annual basis.

#### **4.6. Communication and visibility**

The Government of Ukraine and the Delegation of the European Commission to Ukraine will ensure adequate visibility of the assistance provided through the budget support programme. Complementary TA and Twinning projects will also make reference to the sector budget support programme through their visibility tools and communications, as appropriate. The Government of Ukraine will acknowledge and mention the receipt of budget support funds received from the EC in press releases, including those dealing with budgetary assistance provided by other international donors.