



*United States Agency for International Development
Regional Mission for Ukraine, Belarus and Moldova*

USAID/Ukraine

COUNTRY STRATEGIC PLAN

for

2003 – 2007

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ACRONYMS

CEUME	Consortium for Enhancement of Business Management Education
CHAP	Community Humanitarian Assistance Program
CIDA	Canadian International Development Assistance
CSO	Civil society organization
DFI	Direct foreign investment
DFID	Department for International Development of the British Embassy
GDA	Global development alliance
GDP	Gross domestic product
GOU	Government of Ukraine
EBRD	European Bank for Reconstruction and Development
EC	European Commission
E&E Bureau	USAID's Bureau for Europe and Eurasia
EPAC	Environmental Public Advocacy Center
EUR/ACE	Bureau for European and Eurasian Affairs, Office for U.S. Assistance to Europe and Eurasia
EU-TACIS	European Union-Technical Assistance to Commonwealth of Independent States
FY	Fiscal year
GDP	Gross domestic product
GIS	Geographic information system
GOU	Government of Ukraine
IAS	International accounting standards
IBRD	International Bank for Reconstruction and Development (World Bank)
IFES	International Federation of Electoral Systems
IMF	International Monetary Fund
IR	Intermediate result
IRF	International Renaissance Foundation
LEAP	Local environmental action plan
MOE	Ministry of Economy
MOF	Ministry of Finance
MPP	Mission Performance Plan (of the U.S. Embassy)
NBU	National Bank of Ukraine
NGO	Non-government organization
OECD	Organization of Economic Cooperation and Development
OYB	Operational Year Budget
OSCE	Organization for Security and Cooperation in Europe
PAUCI	Poland-America-Ukraine Cooperation Initiative
SME	Small and medium enterprise
SME/AG	Small, medium and agricultural enterprises
SO	Strategic objective
SOE	State-owned enterprise
STI/HIV/AIDS	Sexually transmitted infections/human immunodeficiency virus/acquired immunodeficiency syndrome
UNDP	United Nations Development Program

ULRMC	Ukrainian Land and Resource Management Center
UNICEF	United Nations Children’s Fund
USAID	United States Agency for International Development
USAID/Ukraine	USAID’s mission in Ukraine
USG	United States Government
VAT	Value added tax
WTO	World Trade Organization

Executive Summary

The overarching goal of the new strategy is to “improve the economic and social well being of all Ukrainians within a framework of democratic governance.” Analysis showed that for this goal to be achieved, improvements are needed in the following five areas: (1) investment climate; (2) growth of SMEs and agriculture; (3) increased engagement of Ukrainians in building their democracy and economy; (4) the effectiveness and accountability of government institutions; and (5) delivery of social services.

USAID’s operating environment has greatly changed since the former 1999-2002 strategy was developed. The former strategy was formulated amid the 1998 collapse of Russia’s financial system and reflected great concern over its impact on Ukraine’s economy, which had already experienced seven years of progressive decline. Ukraine lagged behind in overall macroeconomic and structural reforms, and the executive branch dominated significant spheres of economic activity. In this context, the former strategy was driven by a new focus on local governance, and pressed for the most fundamental reforms in the market transition process within the overall context of the IMF program. Strengthening institutions for a functional democracy was seen as critical, along with support for the social safety net.

Ukraine’s economic performance has improved. Strong economic growth in 2000 and 2001 can be partly attributed to important structural reforms in such key sectors as energy and agriculture. The breadth and depth of the recovery – across economic sectors, for consumption as well as for investment, and for domestic consumption as well as for exports – suggest the economic recovery *can be* sustainable. On the political governance side, Parliament has begun to play a more independent role relative to the executive, local government has been strengthened, though the presidency remains dominant, and civil society organizations are beginning to take an active role in public life. March 2002 parliamentary elections showed a marked decline for communist and leftist forces, providing an opportunity for a pro-reform legislative agenda. While fundamental problems remain, the new strategy is being developed in a far more propitious and hopeful environment. Under the new strategy, USAID will help Ukraine consolidate progress made so far and build on that progress to assure the country’s future as a democratic state with a market-oriented economy.

To some extent, activities under the proposed strategy represent movement to fine-tune existing activities building on previous successes. For example, in banking supervision, USAID succeeded in creating a respected supervision institution. However, the rapidly growing banking sector now requires supervision through more sophisticated techniques such as risk-based internal controls. Similarly, USAID succeeded under the previous strategy in obtaining parliamentary and presidential approval of a Land Code. Assistance in implementing the land titling provisions of the law is now required to make private ownership of land a reality for Ukrainians. A new activity proposed by the Mission is support for agribusiness marketing, in part to acknowledge the strides Ukraine has made in reforming its agricultural policies, and the resultant high level of growth in that sector. The basic institutions of civil society were strengthened under the previous strategy. Now, more multi-faceted assistance is required to make civil society institutions more effective.

Proposed new strategic objectives are:

SO 1: *Improved Investment Climate*, to sustain Ukraine's economic growth will require higher levels of investment, including foreign investment. This will address economic growth issues at the macroeconomic level.

SO 2: *Accelerated Growth of SMEs and Agriculture*, will address economic growth issues at the micro-economic level by promoting growth of SMEs and farms. Support will also be provided to assist business organizations to become more effective advocates on policy and regulatory matters in addition to SMEs and agricultural producer groups.

SO 3: *Citizenry Increasingly Engaged in Promoting their Interests and Rights for a more Democratic Market-Oriented State* will seek to strengthen democracy in Ukraine from the grass-roots level. Assistance will be provided to civil society organizations and NGOs in advocacy techniques and coalition building so that issues of public policy receive broad public hearing, and pressure to reduce corruption and improve accountability of public organizations is intensified. Assistance will be also provided to strengthen the professionalism of an independent media.

SO 4: *Government Institutions Are More Effective, Transparent and Accountable to their Citizens* will assist Ukraine's parliament in becoming a more effective counterweight to executive power, while also strengthening local governance. It will also improve the legislative process, which has been an important impediment to economic transition by imposing excessive delays in passage of needed legislation. Enabling adherence to the rule of law will also be a central component of this objective.

SO 5: *Improved Social Conditions and Health Status* will address pressing problems of pension reform, trafficking of human beings, the spread of HIV/AIDS and tuberculosis, and reproductive health.

Special Objectives: The Mission will continue its environmental protection activities through 2004 as a special objective. It also proposes to implement three cross-cutting initiatives that support other strategic objectives such as: (1) the Poland-America-Ukraine initiative (PAUCI), designed to assist Ukraine in benefiting from Poland's experience in economic and social transition; (2) participant training; and, (3) the Kharkiv Partnership which is designed to assist in the revitalization of the Kharkiv Oblast economy.

PART I: ANALYSIS OF ASSISTANCE ENVIRONMENT AND RATIONALE FOR STRATEGIC CHOICES

Following a particularly difficult transition period from 1991 to 1999, Ukraine is now showing steady progress in building a viable nation-state based on democratic principles and a market economy. Ukraine's progress in establishing a legal, fiscal and regulatory environment conducive to private sector growth and the creation of a viable market economy is clearly evident. Less certain is whether Ukraine is making as much progress as it could in establishing sound democratic practices and institutions. While there are promising signs of reform in local government, Parliament and the judiciary, corruption and unequal enforcement of rule of law cast serious shadows over Ukraine's democratic transition. The media, civil society organizations, political parties and other civic associations are still in a nascent stage of development and many social service providers retain inefficient, Soviet-era structures that are unable to meet the needs of the general populace.

USAID/Ukraine's FY2003-2007 strategy builds on past successes in the economic arena and places more emphasis on empowering Ukraine's emerging civil society and democratic institutions. The Mission's overall strategic goal, *increased social and economic well-being of all Ukrainians within a framework of democratic governance*, will be addressed by fostering economic reforms that encourage investment and growth; by directly reaching Ukrainians through programs in agriculture and small and medium enterprise development; by strengthening both government institutions and civil society to improve democratic governance; and by protecting the health and welfare of the population through systemic reforms and targeted interventions.

The strategy outlined in this document fully supports the United States Government's Mission Performance Plan (MPP) for Ukraine. Specifically, it supports achievement of two of the Embassy's three goals: democracy and market-oriented economic growth.¹ These same political and economic objectives are shared by the vast majority of Ukrainians, as well as reform-oriented government officials who want Ukraine to take its rightful place in the European community through accession to the World Trade Organization (WTO) and by joining the European Union. This strategy is also consistent with Agency and Bureau pillars, goals and strategic objectives.

Country Conditions

Economic Situation: Although gross domestic product (GDP) declined for nine years following independence, in the last two years Ukraine has seen a remarkable, broad-based economic recovery. GDP grew 5.9 percent in 2000 and 9 percent in 2001, with strong growth in both domestic demand and exports, agriculture as well as industry, and investment as well as consumption. This strong growth has been accompanied by macroeconomic stability. While inflation reached 10,000 percent in the mid-1990s, it was down to 25.4 percent in 2000 and 6 percent in 2001. At the same time, the Government of Ukraine (GOU) reduced the budget deficit to under 1.7 percent in 2001, well within guidelines set by the International Monetary Fund (IMF). These official statistics most probably understate Ukraine's growth in personal income levels and GDP since 40 to 60 percent of GDP is generated by the informal sector, and therefore not yet recorded in official GDP statistics. Forecasted economic growth for 2002 ranges from 4.5 to 6.0 percent.

To a great extent, privatization of urban real estate and industries has stimulated this recent growth. In the agricultural sector, the collective farm system has been eliminated and 6.75 million former

¹ The third MPP goal is national security.

collective farm members have received the right to hold land titles. More industry is also being privately managed, particularly in agribusiness, where privatization of medium-sized companies is now virtually complete. Given these successes, it is not surprising that Ukraine's highest growth in exports for 2001 was in agribusiness.

Payments discipline in the economy also improved, especially in the energy sector, and there are signs that public confidence in the banking system is beginning to return. The level of deposits in the banking system, which at 11 percent of GDP in 1998 was one of the lowest among NIS countries, had since risen to 18 percent of GDP by 2001. There is also evidence of strong growth in lending to the private sector and a huge increase in lending to agriculture. The World Bank estimates that if the banking system continues to improve at its present pace, the system will mobilize an additional \$1-2 billion in resources each year by 2005.

In the energy sector, the GOU privatized six of the country's 27 district electric distribution plants in 2001 and signaled its intent to proceed with privatization of another 9 plants in 2002. Once these are privatized, the GOU plans to privatize its generating plants.

Social Trends: Ukraine had an estimated population of 49 million at the end of 2000, almost 54 percent of which are women. Since independence, Ukraine's population has declined by approximately 2 million people due, in large part, to a declining birth rate. The average number of children born to women during their childbearing years dropped from 1.7 in 1991 to 1.1 in 1999. It is believed that this decrease is due to the economic decline during this period, with young couples postponing having children until the economy improves. Emigration has also had a negative impact on Ukraine's population.

Because of the low birth rate, emigration and other historical factors, approximately 15 percent of all Ukrainians are over 65, a high ratio compared with most other middle-income countries. The large elderly population presents special challenges for Ukraine. Low wage workers, already living on the margin, must frequently support aging family members; the elderly require more health care; and the high number of pensioners strains the pension system. Because of their longer life expectancy, a large proportion of the elderly are women.

The death rate in Ukraine increased from 12.9 percent in 1991 to 14.8 percent in 1999, while life expectancy declined from 70.1 years in 1970-75 to 66.1 years in 1995-2000. The United Nations ranked Ukraine 74th, just ahead of Kazakhstan, in its Human Development Index for 2001. Although Ukraine's expenditures on health care are in line with those of comparable countries in the region, in absolute terms, Ukraine spends about half as much per person per year as the average middle-income country. The social and economic costs of inadequate health care are reflected in not only the life expectancy statistics, but also in the rising rates of tuberculosis, HIV/AIDS infection, alcoholism and substance abuse. Domestic violence and human trafficking are also serious concerns. Social issues continue to contribute to high rates of maternal and infant mortality, complicated pregnancies, and miscarriages, all of which are twice as high in Ukraine as in developed western countries. Due to the high cost of contraceptives and lack of knowledge, abortion continues to be the most common form of birth control.

GOU/World Bank/United Nations Development Program (UNDP) poverty assessments indicate that almost 30 percent of Ukraine's population lives below the poverty line (defined as hryvnya 268 or approximately \$50/month). Lack of jobs is a critical issue. An estimated 12 percent of the available labor force is unemployed and an even higher percentage is underemployed. In July 1999, 70

percent of those officially registered as unemployed were women. In 2001, an estimated 40 percent of the population received either social insurance or social assistance benefits. Fourteen million pensioners are supported by 23 million workers; 4 million poor families receive housing subsidies; 2.7 million jobless receive unemployment compensation; and 2.9 million families (with 4.3 million children under 18) receive family allowances.

Ukraine's population is highly educated, with universal adult literacy. Both men and women have equal access to education. The transition, however, has placed great strains on the education system, which is now characterized by unmotivated, low-paid teachers, dilapidated buildings and outdated textbooks and teaching methodologies. As a result, the education system is unable to prepare youth for the challenges of living and working in a free market and democratic society.

Political Situation: Between 1999-2001, Ukraine continued its uneven, halting progress in political and economic reforms. President Leonid Kuchma was re-elected to a five-year term in 1999, and though the vote likely reflected the will of the electorate, the election was marred by unbalanced media coverage and efforts by the administration to influence voters by pressuring local leaders and officials. In by-elections for 10 parliamentary seats in 2000, the opposition complained of voting irregularities.

In an April 2000 referendum, which observers described as marked by inappropriate government involvement in voter turnout, voters approved changes to the Constitution that would have created a bicameral legislature and expanded presidential power to dissolve the 450-member Parliament. Though the Constitutional Court ruled that the president's subsequent draft law to amend the Constitution was constitutional, Parliament has hedged on passing legislation that would undermine the separation of powers. While a full-blown Constitutional crisis has been averted, the president has vowed that he will pursue implementation of the referendum.

In late 1999 President Kuchma appointed Victor Yushchenko, former chairman of the National Bank of Ukraine, as Prime Minister. His government pushed through reforms, with the help of a short-lived pro-reform coalition in Parliament that dramatically decreased wage arrears and moved away from barter and non-cash payments, particularly in the energy sector. However, as a result of intense political competition, the Parliament voted no-confidence in Victor Yushchenko in April 2001 and confirmed Anatoli Kinakh as the new Prime Minister in May 2001. Given Ukraine's remarkable macro-economic stabilization over the last two years, including real growth in GDP, a low budget deficit and low inflation, the Kinakh government has not veered significantly from the reform course set by its predecessor.

The results of the 2002 Parliamentary elections were surprising. The Socialist Party and the Tymoshenko bloc were not expected to clear the hurdle of obtaining at least four percent of the vote to qualify for parliamentary representation. However, six parties/blocs cleared the four percent, including the Tymoshenko bloc, the Socialists, the Yushchenko Our Ukraine Bloc, the pro-presidential For United Ukraine, the Communists, and the Social Democrats. The other notable aspect of the 2002 election was that the Communists, the largest force in Ukraine's parliament since independence, saw its representation cut nearly in half, from 113 deputies in the previous assembly to 66 members. This new parliament, with Communists no longer representing the largest bloc, is expected to be generally pro-reform and to support Ukraine's European integration. At issue is whether the pro and anti-presidential reform groups will be interested in and able to form together a coalition to adopt reform legislation, especially with Presidential elections looming on the horizon in 2004 and potential candidates competing for the limelight in Parliament.

Democracy and Governance: In June 2001 the Parliament adopted the so-called “small judicial reform,” which saw amendments to 12 laws and changes in the Civil and Criminal Procedures Codes. The reforms represent the first tentative steps toward an independent judiciary, though political interference from the executive branch and entrenched corruption remain serious roadblocks. In February, 2002, the Law on the Judiciary was finally passed. The new law strengthens the judiciary by redesigning the court structure, establishing standards for judicial candidates, allowing a judicial council to initiate recommendations for seats (rather than the President unilaterally appointing judges), defining disciplinary proceedings, and resolving procurement issues.

While there have been improvements in access to objective public information and in press and media freedom, much remains to be done. Critical journalists are often subject to harassment in various forms, from frequent inspections by tax authorities to interventions by police and other state authorities. Libel laws are abused to intimidate journalists, and in some cases have resulted in the closure of publications. The bases for granting and revoking media licenses are nontransparent. During the last several years two well-known journalists have been murdered. Despite this intimidating environment, new voices are emerging in the non-state media, and coalition-building and wider coverage are encouraging signs of political dissent.

Government scrutiny of and pressure on media and local officials intensified in the run-up to the March 2002 parliamentary elections. There were also serious allegations of anti-presidential opposition candidates and blocs being denied equal access to media and of supporters and campaign workers being harassed.

Civil society was more involved than ever in the 2002 parliamentary/local elections. Community groups are also working in conjunction with business groups and local governments to improve responsiveness and transparency at the local level. Unfortunately, at the national level, there is still not a nurturing environment in place which encourages and promotes the establishment of a strong civil society. The recently completed Civil Society Assessment confirmed that while tremendous progress has been made in laying the foundation for a vibrant civil society in Ukraine, its roots are still shallow. Corruption remains a serious development challenge in Ukraine. Ukraine ranks 83 out of 91 countries surveyed by Transparency International in the 2001 Corruption Perception Index (the higher the number the higher the perception of corruption). Azerbaijan was the only former Soviet state ranked as more corrupt.

Despite the poor ranking in 2001 Ukraine had moved up the scale from its previous ranking of 87 in 2000. A nation-wide 2001 Public Opinion Survey of Ukrainian citizens showed that Ukrainians viewed corruption as less problematic in 2001, a year that saw the first upturn in the economy, than in previous years. However their lack of confidence in government institutions remains, and is linked to perceptions of corruption in these institutions.

USAID/Ukraine’s Achievements: 1999-2002

USAID has been providing assistance to Ukraine since 1992 to facilitate its transition from a centrally planned and authoritarian society to a market-based and democratic one. In the earliest years, the main focus of the USAID program was on macroeconomic stabilization, laying down the basic precepts of commercial law and on dismantling state control of resources through privatization. However, progress in working with central government policy reform was disappointingly slow, and

this was reflected in the continuing economic stagnation. Thus the 1999-2002 strategy proposed a new direction.

USAID/Ukraine's strategy for 1999-2002 was written during one of the bleakest periods of Ukraine's transition. The economy, which had spiraled downward since independence, was being further threatened by the economic crisis in Russia. Ukraine's pace of structural reforms had been disappointing. People were frustrated as the standard of living declined and disappointed that democracy produced limited tangible benefits. In this environment, USAID developed a strategy which, while continuing to emphasize the importance of economic stabilization, (particularly in complying with the IMF program), adopted a greater emphasis on programs at the local level as a means of improving people's lives and building demand for reform from the bottom up. A review of USAID's results under this strategy reveals that, for the most part, the goals of the strategy were met.

Economic Restructuring: USAID/Ukraine's activities and long-term partnership with GOU counterparts contributed to the markedly improved economic situation in Ukraine since 1999. In the area of fiscal management, USAID helped to build capacity in policy formulation and budgeting, culminating in the passage of a significantly improved Budget Code, which for the first time transfers resources to local governments on a transparent basis. USAID assistance in banking supervision led to nearly all banks complying with National Bank of Ukraine reserve, loan loss and security requirements. With USAID assistance in tax policy and administration, the GOU introduced a value added tax (VAT) and an enterprise profit tax, which provide the GOU with improved sources of revenue for the state budget and encourage entrepreneurs to move from the shadow to the formal economy.

Legal Reforms and Strengthening of Creditor Rights: To promote more prudent lending, USAID advisors developed in 1998 an amended law and an operational pledge registry for movable property that is subject to claims of creditors. This registry is now in use by banks and notaries on a nationwide basis and provides rapid, low-cost information to inform lenders whether property in question has already been pledged.

Agriculture: Ukraine's agricultural sector was radically transformed by the elimination of the collective farm system. USAID assisted in this effort by supporting the restructuring of collective agricultural enterprises and the issuance of some 224,657 land titles. To complement the privatization effort, USAID helped establish 10 national farmer associations, which now represent private sector agricultural interests to the GOU. These associations were instrumental in the development and passage of the landmark Land Code, which lays the groundwork for the creation of a land market and limits government control over land and the future land market. USAID assistance was also instrumental in the preparation, adoption and coordination of over 200 reform-oriented pieces of agriculture-related legislation. In addition, USAID launched an extension program and established several partnerships to help transfer technologies and stimulate the growth of agricultural support industries.

Private Sector Development: With USAID assistance for accounting reform, Ukrainian Accounting Standards, based on International Accounting Standards (IAS), were adopted and are increasingly being used by private enterprises. In addition, 200,000 students were trained in business education. USAID's focus on small and medium enterprise (SME) development resulted in significant improvements in the SME policy environment. Critical achievements include the streamlining procedures that reduced the average business registration processing time from 24 days to 6 days and the average cost of registration from \$480 to \$186, streamlining business licensing procedures

reduced the cost of obtaining a license from \$618 to \$250; and restricting business inspections by government agencies to 14 per year per business. In addition, a multi-year deregulation effort culminated in 150 outdated, conflicting, or unlawful regulations being repealed or amended USAID support for the EBRD's Microfinance lending program resulted in the granting of about 1000 loans per month for a total of \$14.5 million. Sixty-eight percent of the loans finance businesses with less than 10 employees and the repayment rate for loans has been over 99 percent.

Energy and Environment: Largely due to USAID's leadership, reform in the energy sector is, in many respects, greater than anywhere else in the region. Six electric distribution companies were privatized in April 2001 and nine more should be sold by the end of 2002. In addition, USAID played a key role in helping the Ministry of Fuel and Energy focus on cash collections, rather than payment in barter or in-kind, thus significantly improving the financial condition of the energy sector. USAID was instrumental in building capacity in and consolidating the independence of the Independent National Energy Regulatory Commission (NERC).

In 2000 and 2001, increases in cash payments for energy at municipal and industrial facilities combined with their need to replace outdated capital stock and to reduce pollution fees to create a favorable climate for investment in energy efficient environmental improvements, helped USAID leverage local resources to make environmental investments or management changes at over 25 facilities and promote reductions in greenhouse gas emissions in another 25 projects prepared for investment. USAID small grants to environmental NGOs also demonstrated that modest results could be achieved to improve environmental quality at the local level and build partnerships between citizens and local authorities. USAID's legal assistance supported almost 50 successful challenges against violations of environmental laws.

Democracy and Governance: USAID programs achieved demonstrable success in promoting democratic reform and decentralization. Success was most evident at the municipal level where USAID and other donors helped produce an environment in which cities were increasingly autonomous. The passage of key legislation, including the Law on Local Self Governance and the Budget Code, which provided for transparent, formula-based budget transfers from the national government to municipalities were the culmination of many years of effort. USAID support, available to the 448 designated Ukrainian cities, resulted in 365 cities joining the Association of Ukrainian Cities, 152 cities establishing permanent citizen advisory boards, and 121 cities regularly holding public hearings on local issues. A majority of the larger cities have also installed USAID-developed budget and financial management systems.

USAID also helped the Parliament become increasingly independent and transparent, with improvements in the committee system and internal management. In the judicial sector, the new "Small" Judiciary Reform legislation and the February 2002 passage of the Law on Judiciary offer renewed hope for judicial reform.

USAID played a key role in the March 2002 parliamentary elections, becoming engaged in the elections well beforehand by supporting the development of the civil society groups and the training of political parties. USAID contributed to more objective reporting by media, NGOs informed more voters, political parties were more attuned to constituents needs, and the election process was more transparent through election monitoring and USAID-financed training of 28,000 poll commissioners. OSCE noted the significant improvement in the conduct of the elections over 1998. An important conclusion was that people voted their minds; their votes were not based on pressure from central authorities. It is now important to consolidate these improvements.

USAID's civil society programs strengthened civic groups, associations, traditional NGOs and non-partisan think tanks and also encouraged citizens to be more active in political and economic decision-making. USAID's support for an independent media helped to provide citizens with better access to information so that they could be constructively involved in decision-making.

Social Sector: The USAID-funded network of Women's Wellness Centers, five neonatal resuscitation centers and National Infection Control Training Center contributed, among other things, to a 50 per cent reduction in the abortion rate. Other USAID-funded programs improved Ukraine's ability to screen for birth defects, screen victims of the Chernobyl nuclear accident and prevent the spread of tuberculosis and STI/HIV/AIDS. Health partnerships between American and Ukrainian health facilities and communities helped strengthen modern family medicine. The 10 model clinics opened with USAID funding were the catalyst for the establishment of 129 family medicine clinics by 2001. In addition, USAID provided a broad array of humanitarian aid, including disaster relief, supplies for orphanages, and commodities for vulnerable groups.

USAID also helped design and implement several social protection programs, including housing subsidies, models to forecast unemployment insurance, employment fund revenues and expenditures, and a new system for reporting wages and contributions to the State Pension Fund. Pension reform activities resulted in 14 million public pensioners receiving benefits on time. USAID also helped the GOU initiate a broad-based public awareness and anti-trafficking program. Three counseling centers and five women's business training centers have helped 15,000 women since 1998.

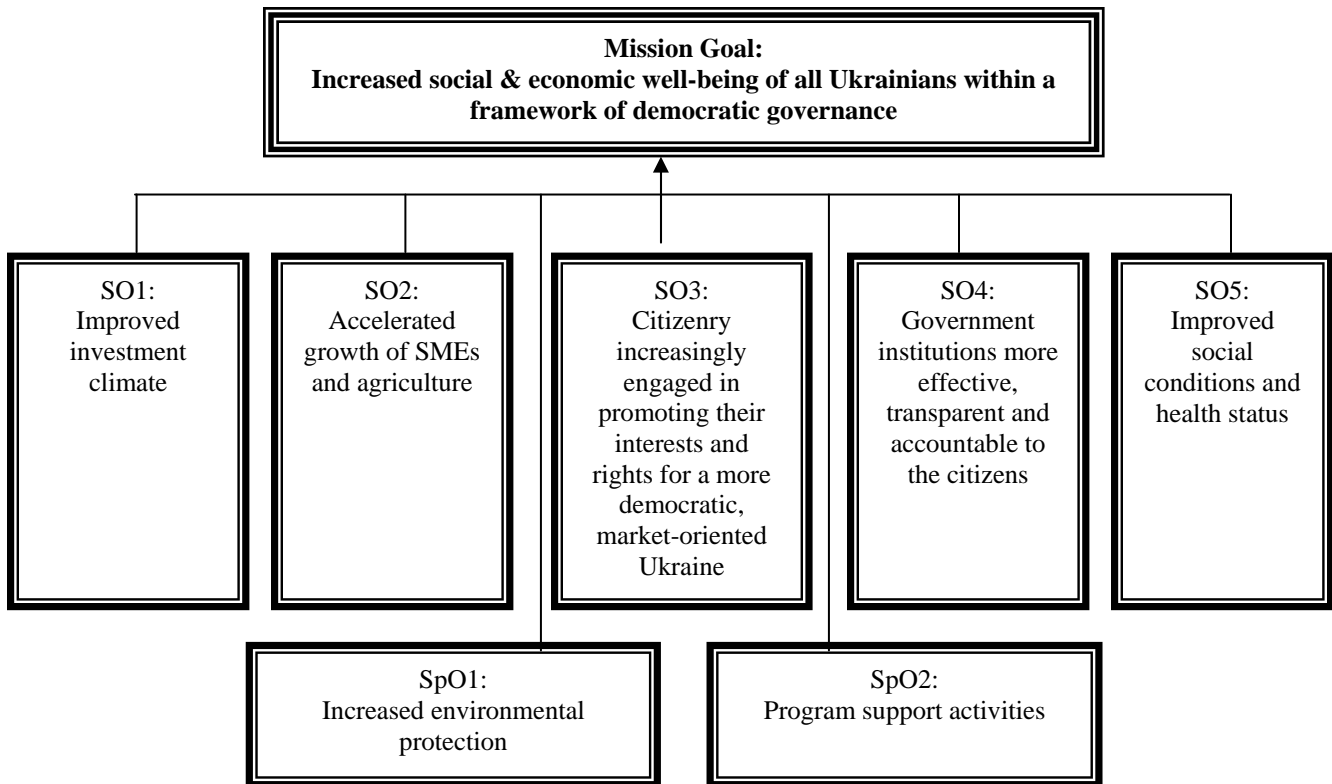
A Framework for USAID Assistance, FY2003-2007

USAID/Ukraine believes that Ukraine's recent strong economic performance represents the product of years of sustained effort for economic and democratic reforms by Ukrainians, USAID and other donors. The Mission's strategy for FY2003-2007 builds upon these reforms and seeks to move Ukraine beyond transition to a new period of sustainable economic growth in which all Ukrainians benefit from new social, economic and political systems. The Mission defines this new strategic goal as **increased social and economic well-being for all Ukrainians within a framework of democratic governance.**

Improving Ukrainian's well-being is contingent on continued, broad-based economic growth. Sustained growth cannot occur unless the investment climate in Ukraine improves sufficiently to attract increasing levels of both domestic and foreign investment. Significant investment is needed to modernize equipment, update technology and make Ukrainian enterprises more competitive. The Mission has identified agriculture and SMEs as the two key sectors of the economy in which USAID could play a significant role. To accelerate Ukraine's democratic transition, the Mission will continue to work on two fronts: 1) empowering civil society so that Ukrainians themselves could increasingly demand transparency and accountability from their government, and 2) improving the responsiveness of government institutions to constituent needs and strengthening the democratic system of checks and balances, particularly by strengthening the rule of law as a foundation for economic and political life. Finally, the Mission will support interventions in the social/humanitarian sector that are critical to meet both the short-term needs of the population and to improve the long-term efficiency of social service delivery. The USAID program for 2003-2007 will have five strategic objectives, presented in the Mission results framework and discussed below, which are necessary and sufficient to achieve the Mission's overarching goal.

- SO1** **Improved investment climate.**
- SO2** **Accelerated growth of SMEs and agriculture.**
- SO3** **Citizenry increasingly engaged in promoting their interests and rights for a more democratic, market-oriented Ukraine.**
- SO4** **Government institutions more effective, transparent and accountable to the citizens.**
- SO5** **Improved social conditions and health status.**

Four critical assumptions underlie the developmental hypothesis presented in this strategy: First, that the GOU will remain committed to economic and political reform; second, the GOU will continue to allow donor support for nongovernmental and civil society organizations; third, that macro-economic stability and recovery of the economy will continue; and, fourth, that the GOU will remain committed to meeting the political and economic prerequisites for full integration with European institutions.



Improved Investment Climate: USAID/Ukraine’s emphasis on the “investment climate” as a strategic objective represents an evolution from the previous strategic plan for 1999-2002. In that plan, the Mission’s objectives were related to establishing “a more competitive and market oriented financial sector” and “legal systems that better support...market reforms.” Those objectives reflected the concerns with dismantling the Soviet economic and political system of central planning and autocratic rule that characterized the early transition period. While remnants of that system continue to exist, a focus on dismantling alone is no longer appropriate. The new USAID emphasis has shifted to focus on the top priority in Ukraine today—helping to ensure that the economic growth that resumed in 2000 can continue and is broad-based. Specifically, the Mission determined that sustainable growth is constrained by the poor investment climate, which inhibits both domestic and foreign investment needed to allow private enterprise to flourish and become competitive.

To improve the investment climate, the Mission determined that an integrated approach to addressing fiscal, energy², financial, and commercial legal constraints was necessary.

Accelerated Growth of SMEs and Agriculture: USAID involvement in small/medium enterprise development and agriculture are critical to achieve the Mission’s goal. The decision to combine the two into one strategic objective was made due to the similar problems encountered by both sectors, e.g. a difficult legal and regulatory environment, shortage of management skills, lack of access to land and credit and lack of organized markets, etc. SME/AG growth is expected to create jobs and increase income, which will contribute to improved standards of living for a wide sector of the population.

Citizenry Increasingly Engaged in Promoting their Interests and Rights for a More Democratic Market-Oriented Ukraine: While this new SO continues to address many of the same constraints to civic activism that were targeted under the previous strategy – lack of access to information, weak civil society organizations and political parties, and lack of credibility and competition in the electoral process – there are two significant differences. Whereas the previous strategy strove for citizen participation in policy discussions, this strategy raises expectations of citizen involvement to a higher level by galvanizing them to assume a proactive role in defending their rights and interests. Second, this strategy structures the intended results and indicators to capture actions by not only formal, but also non-formal organizations to defend rights and promote government accountability.

² In the energy sector, this SO will take a more generic approach to strengthening energy markets. Initially, the Mission will focus on the electricity subsector, and judge whether to address other subsectors (oil, gas) as conditions warrant.

Government Institutions More Effective, Transparent and Accountable to their Citizens:

Progress in democratic development in Ukraine requires not only a vibrant civil society, but also the responsive and accountable government that ensures adherence to the rule of law. Rather than viewing each government institution separately, as was the case in the previous strategy, this strategy approaches good governance as a coordinated objective, reflecting the very real political and economic synergies between the various branches and levels of government. This approach reflects, from a citizen's perspective, that the basic tenets of good governance (transparency, accountability and effectiveness) are not unique to a particular level or branch of government. Rather, the public expects all government services to be provided in the context of good governance.

The lack of a system of checks and balances within and between the branches and levels of government is one of the greatest constraints to effective, transparent and accountable governance in Ukraine. The new strategy focuses on strengthening the independence of the legislative, executive and judicial branches of power, and promoting decentralization and empowerment of municipalities.

Improved Social Conditions and Health Status: To achieve the Mission's goal will require improvement in the basic quality of life for Ukrainians, including social protection, health and humanitarian and disaster assistance. These programs were melded into one strategic objective. Efforts to reform the health sector and improve family health care will continue. But increased emphasis has been placed on preventive measures to reduce the risk and the spread of tuberculosis, HIV/AIDS infection and other communicable diseases, and alcoholism and substance abuse.

Given this broader approach, anti-trafficking activities are now incorporated into this SO. By 2004, USAID humanitarian assistance should be completed, freeing up resources to launch a new program to address the growing numbers of street children, orphans and others susceptible to exploitation, violence, discrimination and neglect.

Special Objective: Increased Environmental Protection: Under the previous strategy, USAID provided assistance to Ukraine in developing environmental policy related to global climate change, and in preparing projects to reduce greenhouse gas emissions. A more modest level of assistance was provided for improving environmental management at enterprises, and promoting citizen environmental action at the local level. In this strategy, given the more limited availability of funds, USAID has determined that national-level environmental policy activities are no longer within its manageable interest, and that environment would not be a strategic objective, but rather a special objective. Environmental protection activities at the local level will continue.

Special Objective: Program Support Initiatives: USAID/Ukraine will continue to implement selected activities, including the Kharkiv Partnership, the Poland-America-Ukraine Cooperation Initiative (PAUCI), and participant training. These are all activities which support multiple Mission objectives and, therefore, are consolidated into the Mission's second Special Objective.

Prospects for Transition

Compared to the situation in 1999, USAID is cautiously optimistic about Ukraine's future. After two years of economic growth, the Ukrainian people are also becoming more optimistic. There is a general feeling that the worst may be over. Entrepreneurs and farmers are making money. Pensioners are receiving their pensions on time. Government revenues are increasing. Civil society is now much more engaged than during the previous strategy period, but their gains need to be

strengthened and consolidated. These factors should make it easier for the GOU to adopt reforms. At the same time, it is clear that Ukraine's reform process in the social and democratic spheres will take longer than expected. Capacity at all levels -- from government officials to farmers -- continues to be weak.

The recent 2002 Parliamentary elections, as well as the outcome of the Presidential elections in 2004, will influence the pace of Ukraine's transition and integration into Europe.

Other Donor Activity

USAID and its programs have both a direct and indirect impact on World Bank and IMF lending in Ukraine. USAID/Ukraine consults directly with these institutions as they formulate, evaluate and monitor their programs and provides input to USAID/Washington on new lending proposals and loan conditions. USAID technical assistance also improves the ability of the GOU to meet conditionalities set under IBRD and IMF lending programs.

The European Bank for Reconstruction and Development (EBRD) is currently the largest donor organization in Ukraine. It supports a diversified portfolio in micro-enterprise lending, enterprise development, privatization, financial sector reform, rehabilitation of infrastructure and rationalization of the energy sector. The World Bank is the second largest donor, with over half of its portfolio in the areas of public sector management, community development, institutional development and rural finance. The UNDP funds programs in democracy and governance, poverty reduction, conflict prevention (particularly in the Crimea), agricultural policy and HIV/AIDS.

USAID is Ukraine's largest bilateral donor, followed by the European Union-Technical Assistance to Commonwealth of Independent States (EU-TACIS). The EU-TACIS concentrates in three areas: institutional, legal and administrative reforms; economic reform and private sector development; and ameliorating the social consequences of transition. Germany provides assistance in SME development, agriculture, energy and the social sectors. Canada supports programs in agriculture and the social sectors. In addition, two non-profit organizations have fairly large programs in Ukraine. The Soros Foundation is working mainly to build civil society and develop independent media, while the Mott Foundation is actively supporting programs to build civic society and improve ethnic relations.

Donor coordination in Ukraine is excellent. A number of working groups and task forces, including those on elections, power, anti-trafficking, HIV/AIDS and local government, meet regularly for coordination and information sharing. The Mission cooperates with the EU and Germany in the energy sector, the World Bank and EU-TACIS in policy reform, the World Bank and the EU in the social sectors, the UNDP on HIV/AIDS, the EBRD in SME development, and with Canada, UNDP, Germany and the EU-TACIS in agriculture.

USAID coordinates closely with other USG agencies that manage large programs in Ukraine. The DOJ has a \$4 million judicial reform program it is designing. Treasury provides assistance to the banking sector and macroeconomic reform. USDA cooperates closely with USAID on development of the USG overall agricultural strategy. USDA provides short term training for mid and senior level agriculture specialists. USDA also sponsors faculty exchange programs which provide 6 months training at US Land Grant Universities. In democracy, USAID coordinates closely with the Public Affairs section of the Embassy on their international visitors program, the PAS managed Democracy Commission small grants and their media fund.

Both Annex G and the individual SO sections of the strategic plan contain more detailed discussions of other donor programs and USAID donor coordination efforts.

Other Issues

The Global Development Alliance: Under its new strategy, USAID/Ukraine will continue to support a number of Global Development Alliance (GDA)-like activities that have already been initiated, while searching for additional opportunities. GDA-like activities that will continue are, for the most part, public-private alliances. Examples include:

- USAID has established seven U.S.-Ukraine energy utility partnerships to support the privatization process through exchange visits, workshops, internships and the exchange of information.
- Under the Consortium for Enhancement of Business Management Education (CEUME), the University of Minnesota contributes 30 percent of the costs of strengthening the 47 Ukrainian business schools and universities participating in the program.
- Winrock International contributes 33 percent of the costs of a program that is helping women to become more active participants in the Ukrainian economy and advocate for the transition to a market-based economy.
- The Community Humanitarian Assistance Program (CHAP) leverages humanitarian resources from both private donors in the U.S. and NGOs in Ukraine. The target for the 2001-2004 program is for 50 percent of all donated commodities to be donated by private donors. Given that the program expects to deliver \$7 million of commodities per year, annual private donations equal \$2-4 million.
- The Community Partnerships for Training and Education activity incorporates cost-sharing from both the implementing agency and the Ukrainian cities and training centers receiving assistance. In addition, the program assists partners in finding other sources of funding for partnership activities such as sister-city relationships.
- The Health Partnerships program is helping to establish and promote sustainable U.S./Ukraine health partnerships that foster more effective and efficient delivery of health services in the region.

Areas of Potential Conflict: In spite of its large size and diversity, Ukraine is relatively untroubled by the ethnic and linguistic conflicts that plague many of its neighbors. Only the Crimean Tatars issue and the issue of social stratification are judged to presently have potential to cause internal unrest.

As discussed more thoroughly in Annex E, the Crimean Tatars, who returned to their homeland in the early 1990s following almost 50 years of exile, continue to struggle with repatriation and reintegration. While some of their problems have been resolved, lack of representation in the Crimean government and lack of legal recognition of the Crimean Tatars as “indigenous people” remain key outstanding issues. A number of international organizations are working in the Crimea to help facilitate reintegration of the Crimean Tatars through economic development activities, mediation and capacity building. EUR/ACE has financed humanitarian activities in Crimea. USAID has made a commitment to assist with land titling efforts in the region once agreement is reached between the Crimean Tatars and the Crimean government regarding privatization of state-held land.

The second possible area of potential conflict is the fact that the general population believes that a small number of Ukrainians are conspicuously benefiting from the transition process while most

people perceive themselves poor. This inequity is contributing to a lack of confidence in the future and uncertainty about democracy and free market economics for many Ukrainians. Although this issue has caused no major incidents to date, unless broad-based economic growth occurs and the benefits of this growth are spread more widely, a backlash is possible.

The third potential area for conflict is Eastern Ukraine. Economic depression in the region due to increasing unemployment and underemployment in the coal and steel sectors could provoke social unrest. The coal industry, in particular, has a history of being a hot spot for social unrest.

The Environment: In 2001, USAID carried out a biodiversity analysis as required by FAA 119. A summary of this analysis is attached to and forms part of the Environmental Annex to this strategy. Although USAID did not agree with all of its conclusions, the analysis did identify what is required to conserve biodiversity in Ukraine. In spite of the fact that biodiversity conservation is not a central theme of this strategy, several programs will help meet some of the biodiversity conservation needs identified in the analysis.

PART II: STRATEGIC OBJECTIVE PLANS

SO1: IMPROVED INVESTMENT CLIMATE

During the first 10 years of independence, Ukraine was faced with the task of dismantling the centrally planned economy, as well as developing a whole new set of institutions, which did not exist in the former Communist system. It was a period of economic contraction, macroeconomic instability and a risky, unpredictable financial and regulatory environment, which provided a poor climate for private investment in the economy. Beginning in 1999 and increasingly during 2000 and 2001, Ukraine made some notable improvements in the investment climate. As a result, GDP grew by 6 percent in 2000 and by a further 9 percent in 2001, led by a vigorous expansion of Ukrainian exports and industrial output. USAID helped lay the foundation for this economic recovery by its sustained support over the previous seven years of training and technical assistance which promoted the fiscal, monetary, structural, and macroeconomic reforms that led to this growth. The GOU also achieved a more consistent degree of control over the level of government spending, reduced the fiscal deficit, and, with sound monetary policy, reduced inflation to 6 percent in 2001. Finally, many important legal changes occurred to clarify the rights of investors and creditors, to protect businesses against arbitrary inspections by tax and regulatory authorities and to reduce rent-seeking behavior by government officials. In response to these developments, gross fixed investment in Ukraine increased substantially in 2000-01, primarily due to domestic investment. Foreign direct investment remains less than 10 percent of Ukraine's gross fixed investment and actually declined in 2001. Among former Soviet states, the OECD notes that only Belarus has a lower level of cumulative foreign direct investment than Ukraine's \$83 per capita.

I. Problem Analysis

The major issues and problems constraining investment in Ukraine are the lack of an independent court system, weak shareholders' rights, a capricious tax system, an inadequate legal framework, weak tax and budget management, distorted structural economic policies, such as price and payments distortions in the electric power sector, and inefficient allocation of resources in the financial sector. These problems are briefly summarized below. Additional background information and more in-depth analysis can be found in Annexes K, L, and M.

Legal framework. Ukraine's commercial legal framework continues to inhibit investment. Major problems relating to the adequacy of existing laws in the areas of collateral, bankruptcy and company law remain. In the area of collateral, major defects remain in the laws pertaining to mortgages of real property, especially the lack of clear rights and procedures for foreclosure by creditors in the event of default. Conflicts exist among patchwork commercial laws that raise doubt about the validity of contracts and enforcement. In the area of company law, "red directors" of companies that were privatized in the past, or are to be privatized in the future, have so far blocked passage of a company law that would protect minority shareholders' rights, require disclosure, and facilitate future mergers and acquisitions.

The weakness in Ukraine's legal framework is compounded by unreliable enforcement mechanisms in both court judgments and alternative private enforcement mechanisms. While an improved bankruptcy law was adopted in 2000, Ukraine needs to improve awareness and skills in managing the bankruptcy process. A regrettable 95 percent of bankruptcy cases in Ukraine are still resolved by liquidation of the company. In the great majority of those cases, through a debtor-led bankruptcy

proceeding, the economic and employment losses could have been minimized by preserving the company as an ongoing concern.

Tax and budget policy. Even though the government has reduced total government spending and the budget deficit to reasonable levels since 1999, the design and execution of budget policies should be more realistic, more transparent, and less heavily concentrated in the hands of central-government decision-makers. Budget planning and execution still seldom reflect priorities of the constituents, are only beginning to be decentralized and often do not use the government's scarce resources efficiently. Expenditure and revenue targets are often not met, as the Ministry of Finance (MOF) lacks a sound planning strategy for the budget, such as multi-year budget planning.

Because of a combination of excessive tax preferences and weaknesses in tax administration, the GOU must maintain excessively high effective tax rates. The USAID-funded SME Survey Update identified the existing tax system as the most important problem for businesses in Ukraine in 1999 and the second most important problem in 2001.

Structural policies. Improved structural policies are needed to correct price distortions and state management practices that lead to wasted resources in the parts of the economy that remain under state control (e.g., about 25 percent of industry; about 40 percent of the entire economy). This is particularly true in the energy sector. Direct and indirect subsidies alone are estimated to constitute at least 10 percent of budgetary resources. In addition, state-owned enterprises (SOEs) often block or inhibit the development of competing or independent private enterprises that otherwise could grow rapidly. Furthermore, poor investment choices are often made in the state-owned sector of the economy because SOEs are not required to generate profits or to base their investment decisions on valid "feasibility tests" that a private enterprise would require.

Mobilization of financial resources. Inefficiencies in both attracting deposits and lending practices result in investment resources not being allocated to the most productive uses in the economy. The widespread losses suffered by depositors during the early and mid 1990s caused the public to lose confidence in Ukraine's financial institutions. The perception of high risk remains, leaving the public unwilling to deposit funds in these institutions. Meanwhile, the small amounts of funds that banks and other financial institutions do attract are generally re-lent to enterprises at very high rates of interest (partly reflecting high non-repayment). In addition, despite partial acceptance of international accounting standards, the lack of business skills in enterprises, including the limited number of certified accountants and unreliable auditing, leads to a lack of transparent, accountable financial records, resulting in unreliable financial reports and to greater risks in bank lending.

Energy sector. Unrealistic pricing continues to be the major problem in Ukraine's energy sector, especially in the electric power sub-sector. Average tariffs charged in Ukraine in 2000 were 2.0 cents per kilowatt-hour for households and 2.3 cents per kilowatt-hour for industry, compared to EBRD estimated, real long-run marginal cost of 8 cents per kilowatt-hour. This pervasive under pricing leads to waste, inadequate incentives to make energy-saving investments and over reliance on energy imports.

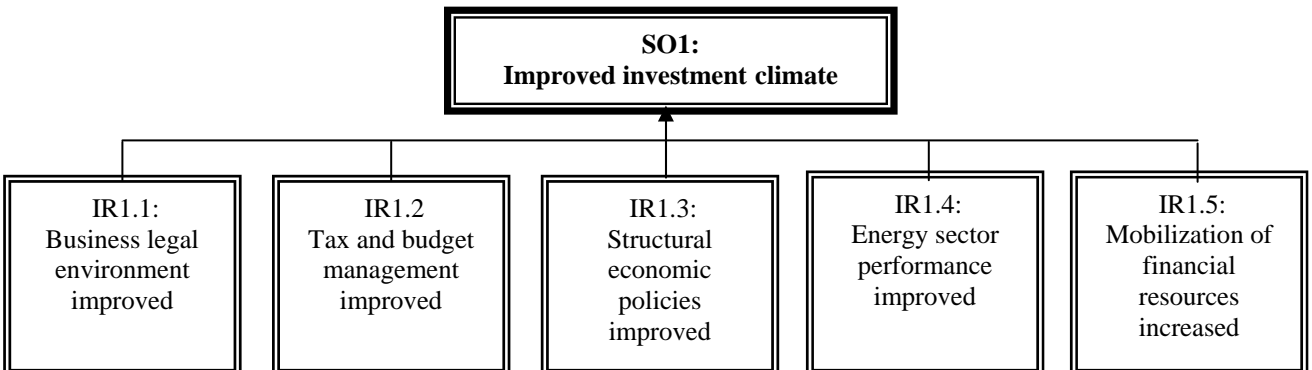
A second major problem in the power sector is the lack of payments discipline in the retail electricity market, resulting in high levels of nonpayment or non-cash payment by major customers. This, in turn, leads to insufficient cash flow either to adequately cover the operational and maintenance costs of electricity generating and distribution companies or to provide an incentive for new capital investment. The third problem is that the government often interferes directly in the

wholesale electricity market to deal with financial “problems” that will not and cannot be fully resolved until tariffs are raised to realistic levels.

In the gas and coal sectors, distortions are also severe, but hidden behind a mask of state ownership and non-transparent transactions between state enterprises and powerful enterprises controlled by private ‘oligarchs.’ In the gas sector, this system results in the ‘dissipation’ of valuable state resources (such as the ‘transit gas’ from Russia, in lieu of cash payments) into inefficient or corrupt uses – rather than accrual of cash to the state treasury.

II. Proposed Program

The Mission believes that an integrated approach to fiscal, energy, financial, and commercial legal constraints is required to improve Ukraine’s investment climate. Specifically, achievement of this SO is dependent upon a) **establishment of a legal foundation** that clearly delineates the “rules of the game,” secures property rights and provides predictable, formal and enforceable means of redress; b) **tax and fiscal policies** that provide a more transparent and efficient system of expenditures and taxes; c) **structural adjustment policies** that promote private development and reduce the web of direct and indirect state subsidies; d) **a financial sector that mobilizes resources for investment** and gives financial intermediaries and capital markets a key role in guiding investment to the highest and best uses in the economy; and e) **development of an efficient and unsubsidized market for energy** that minimizes distortions in pricing of energy and government interference in retail and wholesale markets



At the SO level, results will be measured by the investment climate index that is prepared annually by the EBRD. This is a systematic, quantified assessment of conditions, including liberalization of markets, the commercial legal environment, the quality of financial institutions, macro stabilization, privatization, reduction of subsidies and effective regulation of infrastructure industries.

Improved legal framework and mechanisms to enhance the business investment environment.

USAID will help to develop key pieces of commercial legislation and remove conflicts between Soviet-era or patchwork commercial laws and the new Civil Code, vetoed by President Kuchma in February 2002, but expected to be revised and enacted later in 2002. New or amended legislation will help ensure the power and effectiveness of financial regulatory agencies, produce a mortgage law with effective foreclosure provisions and refine laws on insolvency, enterprise restructuring, and the prevention of fraudulent conveyance of property.

USAID will work with the GOU and State Enforcement Service, the courts, and other legal institutions to improve legislation for judicial enforcement by clearly defining deadlines for

enforcement actions, setting a procedure for appealing action of the state executory officer, and establishing mechanisms for controlling the cost of the enforcement process. In addition, technical assistance will clarify regulatory procedures, provide the public with an opportunity to comment on regulatory changes, introduce restrictions on conflicts of interest between regulatory bodies, and establish an expedient and cost-effective process of appeals.

One possible indicator of Ukraine's progress will be its ranking (now 3 on a scale of 1 to 4+) on the EBRD Index of the Legal Environment – designed to measure annually the “extensiveness” and “effectiveness” of the commercial legal system in each EBRD recipient country. The Mission will also track key pieces of Ukrainian legislation – such as the Joint Stock Company and Mortgage Laws – in key areas where current laws are deficient.

Improved tax and budget management. During Ukraine strategy period, USAID will focus on budget policy and tax reform. Program budgeting and multi-year budgeting will be introduced to central and local government decision-makers to enable them to make more realistic and sustainable budget choices. If additional resources are made available, USAID will extend this technical assistance to key local government decision-makers as well. To have the greatest potential impact on the quality of the investment climate, USAID should stand ready to support intensified, high-level assistance to improve all of the major taxes, including value-added, income, excise, and payroll taxes. However, counterparts in the Executive and Parliament must agree on sound tax legislation and the elimination of poorly targeted tax preferences and privileges. If resources are available, tax policy interventions by USAID may also extend to the development of a property tax as a pillar of the municipal revenue base.

USAID budget policy assistance will improve the efficiency of the government in providing services and making possible more adequate funding for social programs. The tax program will help improve compliance and thus make possible the reduction of effective tax rates that impose a heavy burden on honest tax-paying enterprises. Achievements will be measured by tracking the budget deficit.

Improved structural economic policies. USAID activities during 2003-2004 will continue to build capacity within the Ministry of Economy (MOE) to develop and analyze policies that promote competition and private market development, that minimize economic distortions by reducing direct and indirect subsidies, and that impose more market discipline on SOEs. For example, government-owned steel companies should not only be expected to pay their workers and suppliers, but should also generate profits for the government. Looking beyond 2004, the Ministry of Economy will need to strengthen its capabilities – and to push faster structural reforms – relating, for example, to: agricultural-credit interventions; competition in railroad and other transport sub-sectors; and the debunking of “national security” arguments for maintaining government control over steel and other manufacturing industries.

Given that the donors leading the dialogue on structural policies (the World Bank and the IMF) have little grant technical assistance to offer after 2004, the outlook for ongoing donor technical assistance in this area is unpromising. The Mission should therefore retain the flexibility to fill part of that void if the GOU shows strong commitment to structural reforms and if additional USAID resources become available. Otherwise USAID assistance for this component will phase out during 2003/2004.

As a result of USAID assistance with structural economic policies, markets will function according to private sector principles and the role of the state in the economy will be reduced. Achievement of results will be measured by the decrease in government owned/managed activities to total GDP. This

now stands at about 40 percent in Ukraine, versus 20 percent in the Czech Republic, the region's most privatized economy.

Reliable and competitive energy sector. To create a reliable and unsubsidized electricity sub-sector by the end of 2007, USAID will focus on three areas: restructuring the wholesale electricity market so that generators supply power to the system at the lowest economic cost; assisting electric distribution companies and electric generating companies to receive full cash collections from power customers; and privatizing the sub-sector to spur progress in the two areas above as well as to attract external capital to finance needed investment for modernization and replacement.

USAID should consider expanding its strategic interventions into the gas sector if the GOU demonstrates improved and adequate commitment toward transparency and privatization of part or all of the conglomerate Naftogaz. Possible commencement of USAID activities in the gas sector would also depend upon the availability of additional budget resources.

By 2004, Ukraine's power sector should have completed the process of imposing full cash payments on customers and should have privatized its four thermal generation companies and all but a few of the 27 electricity distribution companies. Achievement of a well-functioning wholesale electricity market will need to evolve over a longer time, related to the gradual phase-out of energy subsidies and to increasing tariffs. USAID assistance to the National Energy Regulatory Commission and to the Wholesale Energy Market may thus continue after 2004, to help adapt successful experience from other countries to the design of the wholesale market and to improve the tariff methodology. USAID will measure overall results in terms of electricity outages per year as well as by movement of prices toward long-run marginal cost.

Increased mobilization of resources through banks, capital markets, intermediaries. USAID programs will support GOU capacity to regulate and oversee financial intermediaries -- principally by government agencies that supervise bank and non-bank financial intermediaries. USAID will also support: transparent corporate governance practices; training and certification of accountants that will enable listed Ukrainian companies to report in International Accounting Standards, as required, starting in 2003; and institutional reforms that help develop the market for long-term finance in Ukraine.

USAID will measure results in terms of the total growth of deposits in banks and non-bank intermediaries in relation to Ukraine's GDP. Bank deposits/GDP, has risen from about 12 to about 18 percent of GDP over the past four years and might realistically exceed 30 percent of GDP by 2007.

III. Other Donor Support

The two areas in which donor coordination is likely to be most important are the energy sector and the financial sector.

In the energy sector, there is a powerful alliance of entrenched, energy-intensive industries and local-government providers of communal services that are resistant to a reduction in subsidies. Major donors in the electric power sub-sector -- the EBRD, the World Bank, USAID, and the EU -- will continue to coordinate their efforts to apply technical assistance, large foreign loans with conditionality, and other restructuring policy advice toward the goal of a reliable, unsubsidized electricity market. Policy conditions on EBRD infrastructure loans and, in 2000-03, on the World

Bank's programmatic adjustment loans, are important complements to USAID's provision of technical assistance.

In the financial sector, USAID and the IMF are providing resident technical advisors to the National Bank of Ukraine (NBU) in different aspects of regulation of the banking system; a U.S. Treasury advisor is expected soon. USAID and the World Bank are likely to be the donors most involved in development of Ukraine's regulator for non-bank financial intermediaries. Therefore, coordination between USAID and the World Bank must remain close, particularly during negotiation of financial sector policy conditions in the World Bank's programmatic adjustment loans.

SO2: ACCELERATED GROWTH OF SMEs AND AGRICULTURE

Small and medium enterprises (SMEs) and agriculture (AG) play a critical role in the economic and social well being of Ukrainians. SMEs, 30 percent of which are women-owned, now employ over half of the workforce of Ukraine and absorb large numbers of workers dislocated by the restructuring of privatized state enterprises. Agriculture continues as one of the principal economic drivers of the Ukrainian economy and accounts for nearly 14 percent of Ukrainian GDP and 13 percent of total exports. Privately owned SME and agricultural enterprises (SME/AGs) are also a crucial counterforce to the past traditions of central government control over economics and politics. USAID remains committed to supporting the growth of private enterprise, specifically SMEs and agriculture, as an essential element of the transition to a market economy.

With Ukraine now experiencing its first positive economic growth since the breakup of the former Soviet Union, thirty percent of small businesses reported stronger sales in 2001 and almost 70 percent expect improved sales and profits for 2002. After many years of decline, agricultural output also rose by 9 percent in 2000 and 12 percent in 2001. About 67 percent of Ukraine's farms reported profits in 2001. Continued growth and development in these crucial sectors, however, requires an on-going effort.

I. Problem Analysis

The four major constraints to the continued growth and development of SME/AGs are the poor and inefficient policy, legal and regulatory environment, the lack of business and management skills among entrepreneurs, the lack of access to land and credit and the lack of organized markets. These issues are summarized below, with additional background information and more in-depth analysis provided in the Agriculture Sector Assessment and SME Sector Assessment attached to this document.

Poor and inefficient policy, legal and regulatory environment. The single biggest impediment to sustainable SME/AG growth is Ukraine's lack of progress in economic and commercial reforms that create a more competitive marketplace. Anachronistic Soviet-era laws, policies and regulations, which were designed to control every aspect of activity under a "command economy," do not promote free market activities. For example, in the agricultural sector, the government has been reluctant to relinquish ownership and control of the seed industry. As a result, the government agency which produces commercial seed uses its regulatory authority to limit private sector companies from registering or producing new varieties of seed. While over the last decade more than 80 percent of government ownership and control of the agricultural sector has been dismantled, what remains is inappropriate and contributes to impeding economic and market efficiency.

Similarly, conflicting, ambiguous laws and regulations create a regulatory gauntlet that imposes serious burdens on SME/AGs. In spite of improvements, business owners still expend significant amounts of time and money in obtaining licenses, leasing premises (usually from the state), certifying their products, and complying with the myriad of inspections by government agencies. Conflicts between various laws and regulations allow corruption to thrive at all levels, as officials extort "unofficial payments" to help entrepreneurs resolve their regulatory problems expeditiously. Avoidance of these laws forces businesses to operate illegally, outside of the tax structure, thus further hindering economic growth. Finally, the lack of transparent legislative procedures that promote representation by the business and agricultural community in the policy-making process

contributes to a lack of effective policy implementation. Efforts to engage the public in regulatory reform are further hindered by the fact that advocacy organizations in Ukraine are still undeveloped. **Lack of business and management skills among entrepreneurs.** Successful participation in a market economy depends on managers having good information on which to base rational decisions. SME/AG managers continue to lack the basic skills (marketing, accounting and business planning) that they need to survive and grow in an environment of increased domestic and international competition and conflicting information. Women entrepreneurs, in particular, have had little opportunity to develop such skills, as they traditionally have not held managerial positions nor had access to training.

Although considerable progress has been made in changing attitudes and improving farmer and entrepreneurial skills, additional work is needed to resolve a number of supply and demand issues. On the supply side, business management education is still at a very low level. Serious gaps exist in the range and quality of services available to entrepreneurs from business service providers, agricultural extension services, education facilities and research institutions. On the demand side, entrepreneurs do not always recognize the value of business skills training, technical assistance and business information. Many SME/AGs remain reluctant (and often financially unable) to purchase consulting services or otherwise access sources of management and staff skill development.

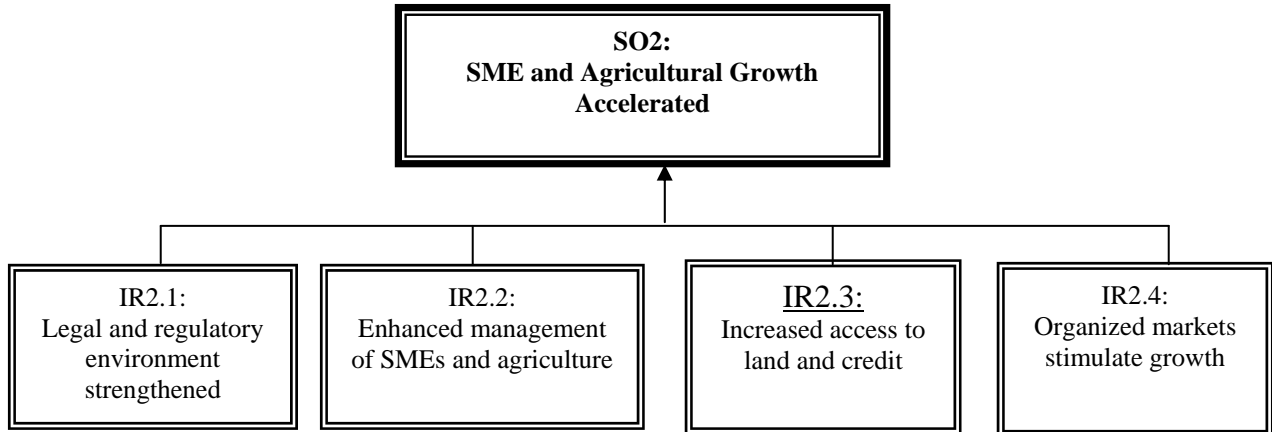
Insufficient access to land and credit. Ukrainian SME/AGs perceive the lack of access to land and credit as one of the greatest obstacles to growth. There is limited access to credit, especially in rural areas. There are indications that women entrepreneurs have even more difficulty than male entrepreneurs in accessing credit. Small businesses typically do not borrow from Ukrainian banks due to collateral requirements and high interest rates. Bankers perceive excessively high risk in lending to small businesses. Alternative sources of financing, such as NGO micro-finance institutions and credit unions need regulatory changes and additional technical assistance before they can be a significant credit source. Yet there has been an increase in capital lending and the GOU has subsidized some credit for large farmers. The use of land as a source of collateral is still hindered because rural land privatization has not progressed to the extent that an active land market has developed. Finally, state control over land transactions and use is still strong and the state continues to own assets and monopolies that impede the growth of private SME/AGs.

Lack of organized markets. In order to improve agricultural sector productivity, farmers need to be able to purchase affordable inputs and have access to dependable markets. The concept of a “market” is still developing in rural Ukraine and many small producers do not fully understand how they are supposed to operate in a market economy. Limited resources, lack of access to credit, a complicated regulatory environment and limited management skills of both farmers and businesses further constrain market development. Government interference in the marketplace is an additional impediment.

II. Proposed Program

Because of the key role that agriculture and SMEs play in Ukraine’s economy, the Mission’s goal cannot be achieved without accelerated growth in these two sectors. To achieve the strategic objective, the Mission has identified four intermediate results as being *necessary and sufficient*. The results framework below, is a continuation of the previous strategy, but with a longer term view and an increased emphasis on local capacity development.

To monitor progress at the SO level, the Mission will track the following indicators: tax information from small and medium businesses and agricultural producers; registration of new SMEs; SME employment; and agricultural sector profitability. The national statistics that will provide the data for these indicators are not gender disaggregated. However, USAID will be able to monitor the impact of its activities on both men and women through gender disaggregated information provided by survey data gathered by USAID contractors.



Legal and regulatory environment strengthened. USAID will focus on facilitating interaction among representatives from SMEs, agriculture and government, leading to the identification, passage and enforcement of policies, laws and regulations that foster open market competition. This includes developing a closer working relationship with local governments on economic reform and local business development as well as a stronger collective voice for SME and agricultural enterprises through associations, cooperatives and other advocacy organizations. In the agricultural sector, key policy changes will be promoted, including: development of legislation and regulations for private crop insurance, continued deregulation of grain and oilseed transportation, introduction of cooperatives and cooperative banks, and GOU budgetary support for agricultural extension. Agriculture and SME programs will complement each other by working at the local and national levels with leaders of government, business and agriculture to remove legal and regulatory barriers to SME/AG growth while simultaneously developing advocacy mechanisms on SME/AG issues.

USAID efforts are expected to result in laws and regulations that promote competition and lower the costs of compliance; encourage business associations and cooperatives that are more responsive and effective advocates of SME/AG needs at both the local and national levels; and help local and national governments regulate a fair and open marketplace that encourages private investment and entrepreneurship. USAID will measure results by a small business survey of member satisfaction with the policy and regulatory climate and World Bank/EBRD annual surveys on the regulatory environment.

Management strengthened. USAID will build on the success of past business education/agricultural extension projects, but place more emphasis on local sustainability and accountability. This will require developing a broad array of quality business and agricultural support providers and improving the qualifications of individual trainers, consultants and educators. USAID will strengthen undergraduate business management education and support the development of graduate education; foster university and business community partnerships in support of business management education; develop local capacity for SME/AG business service providers including an agricultural extension service that utilizes the capacity of local institutions to provide entrepreneurs/producers with access to information, training and technology; develop and implement

an administrative reform program to make SME/AG educational institutions more responsive to industry needs; and promote the education of farmer property rights, including lease options. Gender considerations will be incorporated into all training, technical assistance and outreach interventions.

This approach will result in a group of educators and institutions with the capacity to sustain and further develop business management education in Ukraine. USAID will monitor progress through baseline and follow-up SME/AG self-assessment surveys which measure change in management and technical skills and through the number of SME/AGs receiving support from agricultural extension services, business service centers and associations.

Land and credit access increased. USAID will support the development of a land market through support for land privatization and increase the capacity of domestic lenders to supply credit to Ukraine's SME/AG sectors. Specifically, USAID will provide technical assistance to banks to develop micro-lending programs to reach more SME/AGs and improve the legislative environment to allow banks to lend to a larger number of SME/AGs. Two changes are viewed as critical. First, the law on collateral needs to be amended to reduce the administrative costs and loan losses due to banks in case of default. Second, banks need to be allowed to accept land as collateral and to foreclose in case of default. USAID will also explore alternative sources of credit, such as NGO micro-lending, credit unions and credit cooperatives, which would require legislative changes to improve lending practices by non-bank financial institutions. Finally, USAID will improve SME/AG operations so that financial institutions consider them more viable credit risks. USAID will continue to issue land titles and work with the World Bank to support the creation of a land title registry to develop effective mortgage and collateral systems. As a result of these interventions, SME/AGs will have access to a wider range of credit and farmers will own their own land and be able to buy, sell and mortgage that land. Indicators for monitoring progress include: 1) the number of SME/AGs receiving credit, 2) the volume of lending to SME/AGs, and 3) the number of land titles issued to SME/AGs.

Organized markets stimulate growth: The provision of land titles and credit alone will not be sufficient to improve farm productivity or to develop viable, competitive farms. Farmers need to be able to purchase affordable inputs appropriate to their scale of production and have access to dependable markets for their outputs. To help stimulate market development, USAID will improve farmer access to input and output markets by strengthening associations (women's associations will be specifically targeted) and promote policies that minimize government interventions in agriculture markets. This assistance will result in farmers having greater access to productive inputs and markets for their goods, increased delivery of good quality, low cost food to domestic consumers, reform of market regulations, and greater internal and external competition. In sum, there will be greater opportunity for small producers to improve their income and growth potential. Progress will be monitored through: 1) the growth rate of produce and inputs sold through organized markets and 2) reported retail sales.

III. Other Donor Support

USAID/Ukraine works closely with other donors to enhance the impact of activities in the SME/AG sectors. The World Bank plans to implement two major agriculture programs in land registry and land titling under a \$250 million agricultural sector loan. USAID will implement technical assistance programs on land privatization that supplement World Bank efforts to establish a real estate registry. The EBRD will continue to provide funds for microcredit loans in the SME/AG sector, with a significant financial contribution from USAID.

USAID will continue to coordinate with the UNDP on agricultural policy changes as well as with Canada and the UNDP on programs to develop credit unions. Great Britain is funding agricultural extension, Germany provides support for macro-economic policy and the development of agribusiness advisory services, the EU is supporting the development of business consultancy centers, and Canada and the Netherlands both fund activities in the livestock and dairy sectors. TACIS has also been involved in economic education and plans to continue working with a small number of educational institutions in the future. USDA sponsors short term training for agrarian specialists and 6 month faculty exchanges at US Land Grant Universities.

SO3: CITIZENRY INCREASINGLY ENGAGED IN PROMOTING THEIR INTERESTS AND RIGHTS FOR A MORE DEMOCRATIC, MARKET-ORIENTED UKRAINE

While the foundations for civil society were established during the previous strategy period, there is now need to build on these gains by assisting Civil Society Organizations in becoming more effective advocates in protecting and expanding citizens' rights and in promoting participatory democracy. This strategic objective will strengthen CSOs by increasing their responsiveness to citizen needs, which will also help to improve their prospects for institutional sustainability.

I. Problem Analysis

Improved governance is essential for Ukraine's continued political and economic development. Such improvement is, however, unlikely to occur without increased citizen demand for accountability by public institutions. Citizens need more objective information about key political, economic and social issues. They also need effective institutions, in particular, political parties and CSOs through which they can find expression. Finally, shortcomings in the present electoral system need to be overcome to achieve public accountability and a higher level of confidence in government.

While there have been improvements in public access to accurate, unbiased information, much remains to be done. Non state newspapers, radio and television stations, and internet news sites do exist, but the present legal framework does not provide adequate safeguards to protect free press and speech. Uneven application of regulations, including the questionable revoking of broadcast licenses, remains a problem although some outlets have successfully defended themselves in legal and regulatory matters when provided well-informed legal advice. Journalists and editors are harassed by state tax and security authorities, and sometimes threatened with physical harm. Two noted journalists have been murdered during the last several years, and this has resulted in a general atmosphere of fear and intimidation in the journalistic profession. Numerous CSOs are active in promoting press freedom and public access to quality news and information. These organizations need support in becoming effective advocates, in expanding their own base of public support, and in increasing their outreach to Ukraine's citizens.

On the positive side, the last several years have also seen a strengthening of civil society organizations and of public policy-oriented "think tanks," and this has improved the flow of political and economic information to the public. Moreover, media outlets appear to be more likely to include sensitive content if it is or is derived from a USAID-supported production. For example, critical election public service announcements were aired by several dozen regional television stations, documents they would not have produced themselves.

While the government still seeks to limit press freedom to dampen criticism of its policies, other pressures to restrict press freedom come from powerful oligarchs representing narrow interests, who either own or control media outlets. Ukraine badly needs further development of a free media that represents broad public interests.

Economic and internal constraints also inhibit the development of the media, although some long-term media partners have begun to attain a more secure financial footing following extensive training. However, even these stronger partners still have little ability to expand their businesses without access to use credit. While USAID training for media professionals have improved the quality of journalism in certain cases, economic realities and other issues have stunted improvement

in professional and ethical standards among journalists. Previous initiatives to support professional associations failed, but more recent efforts have resulted in the birth of two new associations, one of which has become a key partner in improving the legal and regulatory environment. There are few advocates for independent media and most media organizations lack experience in managing their enterprises as private businesses, making many economically unviable. There is a dearth of competent lawyers who specialize in protecting freedom of the press. Because of these numerous constraints, there is a relatively small cadre of civil society activists, media outlets and government officials promoting freedom of the press and providing quality news and information.

Civil society organizations (CSOs) show steady, if incremental, signs of becoming more effective constituent advocates. For example, leading up to the 2002 parliamentary elections, many CSOs effectively engaged parliamentarians regarding the content of several pending laws drew public attention to the flaws in the electoral process and mounted voter education campaigns. Several CSOs cooperated with one another more than in the past and their outreach to the media showed considerable improvement. However, the legal framework protecting freedom of association requires improvement. Ukraine's laws constrain CSO financial sustainability and local philanthropy remains limited, leaving CSOs overly dependent on foreign donors. Organizational limitations persist as well. Most CSOs involved in public advocacy focus only nominally on constituency and membership building. In short, financial, administrative, management and advocacy skills of CSOs need to be strengthened, particularly outside of Kyiv.

Political parties also require strengthening to become more effective vehicles for representing citizen rights and interests. Parties tend to lack concrete platforms and those that do attempt to identify policy goals, fail to demonstrate how those goals differ from competitors. Parties tend to be personality based, tied to the leaders who fund and run them. Internal policies and procedures are not democratic, limiting the degree to which members can influence party platforms and decisions. As a result, political parties have trouble recruiting and retaining members. Less than 5 percent of the Ukrainian population belongs to a political party. Recent years have shown some progress in the consolidation of diverse political factions into blocs. Assistance is needed for these blocs to turn into effective political parties that represent constituent interests

USAID's work with political parties in Ukraine has had limited success to date, as reflected in low party membership rates and public opinion polls revealing low public credibility. However, party members, as elected representatives, have a unique ability to influence government policies. Ukraine does have a degree of political competition that is absent in many other countries. As the 2002 parliamentary elections demonstrate, political and economic elites do not have a single set of interests, and opposition parties can compete and win seats, even against a ruling faction that enjoys the many benefits of incumbency. This political competition provides a basis upon which to build a more competitive, democratic system in Ukraine.

Ukraine's electoral process, the most elemental component of a democracy, must also demonstrate openness, competitiveness and credibility. Election laws and administrative procedures are not yet adequate and political parties have been unable to assume and administer the responsibilities enumerated in the new Parliamentary Election Law. While election monitoring capability itself is well developed, CSOs need to build stronger networks to monitor pre-electoral processes, disseminate information to the public, and mobilize public opinion.

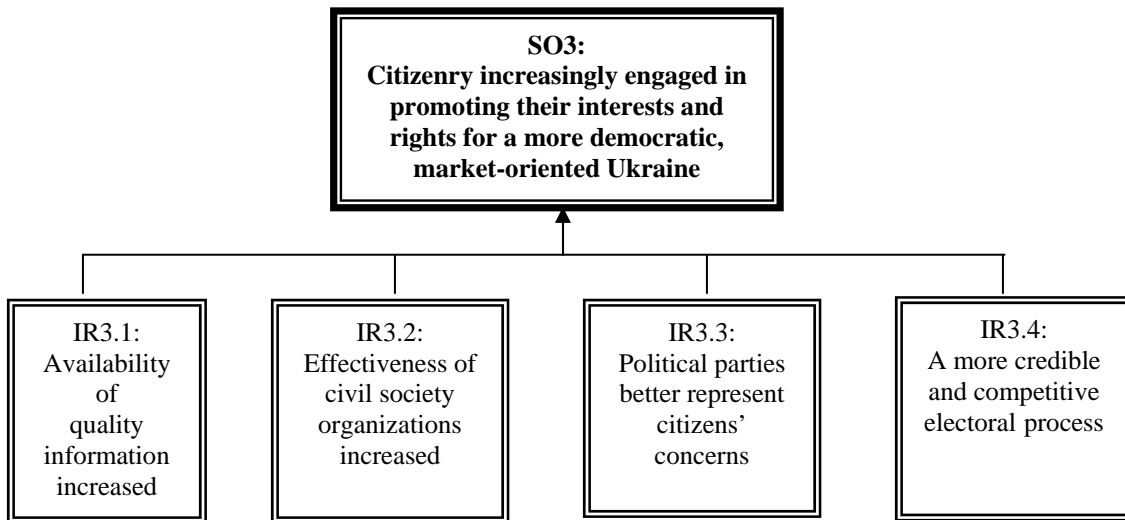
Over the past decade, USAID and other donors have improved the legal and regulatory environment for CSOs and the media. USAID's media and CSO partners have matured organizationally, resulting

in better advocacy, election monitoring, research, and social service delivery. Individual party activists and elected officials have applied lessons learned from USAID-sponsored events, improving their responsiveness to constituents and their ability to fulfill the responsibilities of their posts. As a result of USAID assistance, a nationwide coalition of domestic monitoring NGOs was created for the 2002 Parliamentary elections, and fielded 20,000 domestic election volunteer monitors.

II. Proposed Program

USAID identified the following causal linkages to help define support activities in civic participation. Tapping Ukraine's internal capacity to increase the flow of quality information is key to enabling Ukrainians to form better-informed opinions and determine more effective courses of action. However, information alone is insufficient. Therefore, the two key institutions through which citizens can best represent their concerns, civil society organizations and political parties, must also be strengthened. Finally, the ability of Ukrainians to better defend their rights and interests is fundamentally linked to the credibility, fairness, and competitiveness of the electoral process. These causal linkages are reflected in the results framework below.

USAID will measure results through the number of Ukrainians who are, through various venues, publicly defending their rights and holding government accountable. By the end of this strategy period, USAID and other donor efforts will help to: (1) increase the extent to which citizens believe that they can influence government responsiveness and adhere to the rule of law, and thus, (2) increase civic activism. At the SO level, results will be measured by the percentage of citizens who say that they have taken part in grassroots advocacy and the percentage of citizens who are members of civil society organizations and political parties [all data disaggregated by gender, region, and age].



Availability of quality information increased. USAID will increase the availability and quality of information by promoting freedom of speech and the production of outstanding news. Specifically, the Mission will emphasize activities to improve the protection of freedom of speech by supporting legal advocacy and defense of independent media, building on a successful pilot initiative over the past few years. The second area of emphasis will be financial viability, the lack of which currently stifles editorial board independence. Particular attention will be paid to learning to access and manage credit among other issues. Balancing these two longer term approaches, USAID/Kyiv will also support the production of outstanding news products and publication education while media outlets are still struggling to secure the political and financial space to do so themselves. Training

will be provided to media representatives (e.g. editors, journalists, etc.) and support given to an emerging public education NGO. USAID will partner with other organizations, especially the International Renaissance Foundation, in addressing the problem of improved information flow to the public.

As a result of this assistance, by FY 2007, most regions of Ukraine will have a broader array of news and information and more financially and editorially independent media outlets. The legal and regulatory framework for media will be more uniformly applied. Achievements will be monitored through the number of hours per week of quality news and information programming on targeted broadcast outlets and through the percentage of articles per publication by targeted print and internet outlets that meet quality standards.

Effectiveness of civil society organizations increased. During this strategy period, USAID will focus on coalition/constituency/membership-building, financial diversification, information-sharing and more sophisticated advocacy. Grant assistance will be specifically designed to enable CSOs, including but not limited to associations, think tanks and advocacy groups, to launch citizen defense/government accountability action plans and support legal advocacy and legal defense for freedom of association. Finally, to ensure that CSOs reflect the same values demanded from public servants, USAID will promote greater professionalism and ethics within the CSO community.

USAID's civil-society based anti-corruption project will develop and implement anti-corruption programs on both the local and national levels. At the local level, the program supports the development of local NGO coalitions which focus on citizen educational activities and increasing the transparency and accountability of local authorities. The project will also help implement anti-corruption educational campaigns, establish an NGO anti-corruption watchdog council, and promote research on anti-corruption issues and public attitudes.

By the end of the strategy period, partner CSOs will be strengthened in areas such as financial management, organizational capacity, advocacy, coalition-building and constituency and membership outreach. Progress for each CSO partner will be monitored on a CSO effectiveness index, which assesses growth in these areas.

Political parties better represent citizens' concerns. Because developments within political parties are so heavily shaped by external variables and unpredictable political events, it is difficult to foresee with any degree of certainty what the ultimate result of this assistance might be. However, by the end of the strategy period, several parties should have implemented more democratic internal management systems and their grassroots efforts should have resulted in at least some increase in public confidence in political parties. Party membership should remain at its current level or increase. Progress will be monitored using a political party index that examines the development of grassroots structures, internal democratic procedures, and responsiveness to constituents.

A more credible and competitive electoral process. Ukraine has demonstrated that it possesses the administrative capability to organize elections, while continued improvements to the election laws have helped to level the playing field. USAID will closely monitor the continued ability of the Government of Ukraine to administer already planned elections activities and will provide assistance in elections administration. Activities may include monitoring of the electoral process, distributing voter information, and monitoring results to both the public and key actors in the system, and building legal capacity to ensure that violations in the electoral process will be expeditiously

reviewed by the courts. All USAID-funded assistance will be offered and available on a completely nonpartisan basis.

These efforts should increase the competitiveness of the electoral process, thereby fostering greater public confidence in democracy. Progress will be measured by monitoring the percentage of citizens who believe the electoral process is credible.

III. Other Donor Support

A number of other donors support programs related to this strategic objective. USAID, on behalf of the U.S. Embassy and with the Political and Public Affairs sections, led donor coordination for elections assistance, including the organization of regular meetings to co-ordinate policy positions and donor funding. The British Embassy's Department for International Development (DFID), the Canadian Embassy, European Commission, French Embassy, German Embassy, International Renaissance Foundation (IRF), Netherlands Embassy, Organization for Security and Cooperation in Europe (OSCE), and Swedish Embassy all participate in this group and a similar one for coordination of media issues. In addition, USAID coordinates with the National Endowment for Democracy, the OSCE and the Charles Stuart Mott Foundation on elections. Similarly, there are regular meetings among donors working with civil society, including the IRF, TACIS, the British Council and DFID, the Canadian International Development Assistance (CIDA), the Netherlands Embassy, UNDP, UNICEF, the National Endowment for Democracy, the World Bank and the Charles Stuart Mott Foundation. Since USAID has the only significant political party programs in Ukraine, coordination in this sphere is on an as-needed basis.

SO 4: GOVERNMENT INSTITUTIONS ARE MORE EFFECTIVE, TRANSPARENT AND ACCOUNTABLE TO THE CITIZENS

Ten years after independence, Ukraine has a democratic constitution, significant reform legislation in place, self-governance in municipalities, and the framework for a more responsive judiciary. These results were not easily achieved.

Despite this progress, according to annual public opinion polls conducted by the International Federation of Electoral Systems (IFES) and ratings ascribed to Ukraine in the annual Freedom House report, Nations in Transition, Ukrainians have a consistently low level of confidence in most government institutions: Verkhovna Rada, Executive, Council of Ministers, Presidential Administration and Local Government. While they have consistently more confidence in the Supreme Court and the Constitutional Court, low confidence levels persist for local courts and public prosecutors. Nations in Transition rates Ukraine as making medium progress in governance, public administration and rule of law. The general public believes corruption is rampant and pervades all branches of government, all levels of government, and the private as well as public sectors.

A balance of power, horizontally and vertically, as provided for in Ukraine's constitution, is critical to maintaining stability in government and is especially important in assuring transparency and reducing corruption. Unfortunately, getting things done in Ukraine still depends on which individuals and/or institutions can exert the most power rather than on principles of rule of law. Currently, the executive branch has been able to dominate the government at all levels. There are frequent examples of the executive exerting influence and/or pressure on the Verkhovna Rada, meddling in judicial affairs, and interfering in local community matters. At the same time, in the last few years, there have been an increasing number of situations in which the legislature, judiciary and local governments have resisted this interference. New legislation may help consolidate the separation of powers.

I. Problem Analysis

A common theme runs through any analysis of governance in Ukraine and that is the need to change the culture of government institutions to one based on rule of law. Similarly, central and regional interference in local community matters extends the influence of the executive down to the local level. Ukraine's goal of a democratic government will be attained only when equally strong branches of government at all levels respect the rule of law and are accountable to the people.

The Verkhovna Rada plays a key role in helping Ukraine adopt the numerous legislative reforms required for Ukraine to make the transition to democracy and a market economy. In 2001, the Rada passed a series of significant laws, including: a new Criminal Code, a Law on Political Parties, a Budget Code that introduced formula-based intergovernmental fiscal transfers, a "Small" Judicial Reform Law, a new Parliamentary Election Law, a Land Code, and a new Civil and Customs Codes (although the latter were vetoed by the president for technical reasons). These reforms represent the cumulative effect of over seven years of USAID training and technical assistance to the Verkhovna Rada, the central government, "think tanks," and NGOs. Despite these accomplishments, numerous legal issues still require the attention of the Rada (e.g. administrative reform, a new tax code, a unified election code, etc.)

In spite of this recent record, the committee system in the Verkhovna Rada is still weak, the number of deputies who represent only special interests is significant, and limited professional staff

competency constrains the effective and efficient functioning of the Rada. The Rada has yet to fully exercise its lawful oversight role of the executive branch, thus inadvertently contributing to power imbalance. Of note is the need for the Rada to pass a Rule on Procedures, as required by law. Formalizing parliamentary procedures could help solidify the Verkhovna's legitimacy, facilitate its work, and increase its public accountability and transparency, in addition to limiting the ability of vested interests to control the entire legislature. Emerging efforts of the Rada to engage the public in policy deliberations are not yet broad and deep enough for the public to play a meaningful role in policy development and civic groups themselves are just learning how to reach out to their elected leaders.

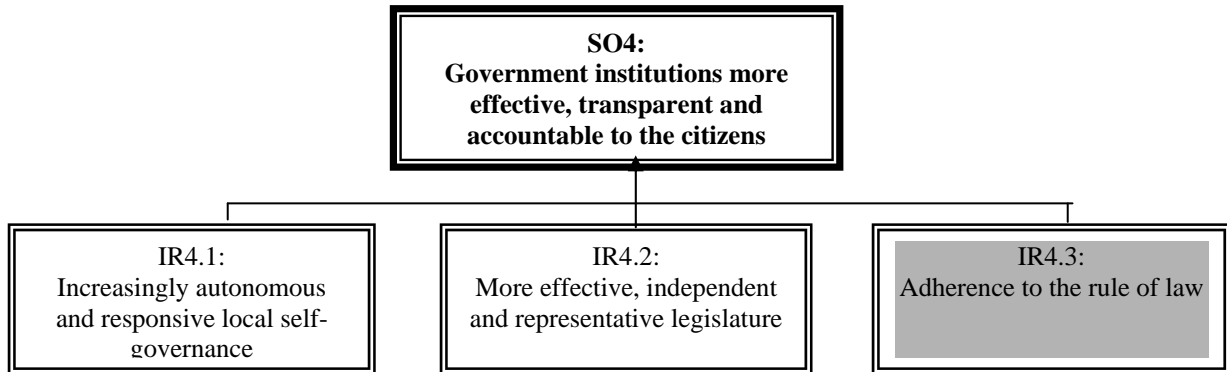
Compared to the executive and legislative branches of government, the judicial branch in Ukraine is even more underdeveloped. The enactment of the "Small" Judiciary Reform legislation in June 2001 and the passage of the Law on Judiciary in February 2002 are encouraging steps. These legislative actions have introduced a democratic foundation for further reform of the judiciary and increased independence from executive control.

Effectiveness, responsiveness, and accountability in the performance of most governmental functions are best achieved by assigning responsibility to the level of government closest to the people. Important services such as health, education, public transport, housing and communal services are all delivered at the local level. Ukrainian municipal governments are increasingly perceived as an independent level of government, accountable and responsible to the citizens, rather than to central authorities.

Despite the increased confidence the electorate has in local government, critical issues prevent elected city officials from being more responsive to their constituencies and improving communal services. Laws and regulations do not clearly delineate responsibilities between various tiers of government. Control over and sale of municipal property is not completely transparent. The lack of such measures as introduction of a property tax constrains municipal fiscal autonomy. Municipal government efforts to communicate with their communities and involve citizens and community groups in the decision-making process are still nascent. Finally, because the executive branch reaches down to this level through presidentially-appointed heads of subnational administrations (oblasts and raions), executive interference in local self-governance is not uncommon. Due partially to the fact that some mayors are reform-oriented and perceived to be creating a new power base that threatens central government, political and other pressures on elected mayors have led some to resign or resulted in their involuntary dismissal.

II. Proposed Program

Progress in democratic development in Ukraine requires a vibrant civil society interacting with strong democratic government organizations. Thus, SO 4, *government institutions are more effective, transparent, and accountable to the citizens*, is viewed as complementary to the Mission's civil society SO. The results framework below illustrates the hypothesis that improvement in the effectiveness, transparency and accountability of government institutions will depend on creating a system of governance that ensures independence of (albeit with productive cooperation between) the legislative, executive and judicial branches of power, while also promoting decentralization through the empowerment of local self-governance. By strengthening the Rada, the judiciary, and local self-government, USAID will continue to support the introduction of checks and balances on the executive branch.



Several critical assumptions are specific to this development hypothesis: current legislation governing elections will remain in place or improve; the Rada will have a pro-democracy majority; “small” judicial reform legislation or the Law on Judiciary will be enforced; the current level of administrative and fiscal decentralization will remain in place or deepen; and civil society and business will continue to mature and participate more actively in governance.

At the SO level, a “good governance index” will be used to evaluate the overall effectiveness of USAID’s interventions. The index will reflect expert opinion and public feedback on the degree of autonomy of government institutions and their responsiveness to the needs of their electorate.

Increasingly autonomous and responsive local self-governance. USAID will work with municipal governments to improve management of municipal services and assets, increase transparency of local government operations, and increase the administrative and financial independence of elected city officials.

Achievement of these results will be measured by two indicators: 1) the number of targeted cities with improved services, as measured by city government statistical reports and opinion polls of citizens and business persons; and 2) the status of specific legislative reforms related to local government autonomy and progress in their implementation as measured annually on a predetermined legislative scorecard.

More effective, independent and representative legislature. Changes in the composition of the Verkhovna Rada as a result of the March 2002 elections, created a progressive convocation which, offers unprecedented opportunities to promote legislative reform. USAID will help Ukraine develop a more effective and independent legislature through continued legislative reform and institutional capacity building in the Rada. First, USAID training and technical assistance will emphasize improving parliamentary procedures to strengthen the legislature, enhance its capacity to oversee the implementation of legislation and demand accountability of the executive. Second, USAID will support activities to increase transparency, responsiveness and public access to the Rada. This can expand citizen involvement in the legislative process and making the parliament a more representative institution. The current objective is to institutionalize nascent gains of past programs that began to improve public access. Finally, USAID will seek to facilitate the passage of key legislation to strengthen the legal framework for democratic institutions of governance.

Achievements will be tracked annually by means of an index that measures improved quality of the legislative process. An expert panel will conduct the rating and members of parliament will be surveyed regarding salient legislation, committee effectiveness in assessing and presenting draft legislation, drafting competence, political institutionalization of the parliament, increased efficiency and clarity of and adherence to parliamentary procedures, transparency of the legislative process, public accessibility, legislative-executive relations and oversight of the executive.

Adherence to the Rule of Law. Rule of law, the cornerstone of a democratic civil society, is a critical constraint to achieving progress under several Strategic Objectives outlined in this five year strategy for Ukraine. However, a comprehensive judicial reform program is currently not considered feasible because of a widely held perception that the Ukrainian government lacks the prerequisite political will to implement the comprehensive reforms envisioned. In addition to these perceived constraints on the part of the GOU, USAID is also constrained because resources are inadequate to support the broad approach to judicial reform that is required. For these reasons, the 'box' on USAID's strategic framework is shaded. This shading reflects USAID's assessment that although USAID recognizes the fundamental importance of Adherence to the Rule of Law to achieving its broader developmental objectives, it cannot launch even an adequate program in the current environment nor with available resources.

Since the two constraints identified above are not expected to change for the foreseeable future, in lieu of a major judicial reform initiative, provided resources are available and the opportunity presents itself, USAID would conduct judicial training on an issue-specific basis. This approach will serve two purposes: it will strengthen USAID's legal reforms in other sectors, such as commercial law or agriculture, while at the same time providing a concrete application and demonstration of the importance of judicial reform in areas of interest to the GOU. Hopefully, this would build a base of support for similar judicial reform initiatives in other sectors, and thus accelerate GOU interest in a broader judicial reform effort.

In addition to the potential focus on implementing key pieces of legislation, modest resources will also be allocated to increase public access to the legal system by continuing to support pro bono legal clinics and public advocacy centers. A complementary effort, working with a few local courts, will strive to increase the capacity of courts to adjudicate cases more efficiently, transparently, and judiciously through adoption of a new case flow management system. Finally, judicial independence will be fostered through support for nascent self-governing judicial associations.

If perceptions of GOU political will change and additional resources become available, USAID would be prepared to implement a more comprehensive rule of law program, including broader training of judges and support for Ukrainian NGOs which promote protection of civil rights.

III. Other Donor Support

A number of international donor organizations support democratic governance in Ukraine. The British DFID, the World Bank and the EBRD help strengthen local government. USAID regularly engages in information exchanges with these donors and coordination of training and technical assistance activities is frequent. USAID's technical assistance to the City of Lviv helped leverage a \$25 million World Bank loan for Lviv water infrastructure improvement. Similarly, USAID coordinated with the EBRD to improve the provision of municipal water services in eight cities. Two cities, Kherson and Mariupol, were selected by the EBRD for the first phase of the loan

program. Quarterly meetings of the donor municipal development working group are chaired by USAID, where an intensive information exchange takes place.

Donor coordination efforts are equally strong in providing assistance to the Parliament. Monthly donor meetings are held under USAID leadership. The British DFID and Canadian CIDA are training members of Parliament in drafting legislation. EU/TACIS and the Dutch are helping to harmonize legislation with that of the European Union. The World Bank is taking the lead on assistance in the administrative reform sphere.

On the judicial front, USAID coordinates with the Soros Foundation and the British DFID in supporting legal clinics at Ukrainian law schools. The Swiss Embassy is supporting a training center for judges in Kyiv.

SO5: IMPROVED SOCIAL CONDITIONS AND HEALTH STATUS

This Strategic Objective reflects an increased emphasis on addressing the social and health needs of vulnerable groups—women, street children, orphans, and others susceptible to exploitation, violence, discrimination and neglect.

I. Problem Analysis

For the average Ukrainian, the quality of life has declined since independence. An estimated 30 percent of the population now live below the poverty line and even families with two working parents have trouble adequately providing for their children. Personal and national income data for Ukraine are notoriously unreliable. Survey data show that about 60 percent of salary income from SMEs goes unreported, while estimates of the informal sector (or “black” economy) run from 40 to 60 percent of GDP. While official data placed unemployment at 4.2 percent in 2001, the International Labor Organization (ILO) estimates that the figure is probably closer to 12 percent. Of those officially registered as unemployed in 1999, some 70 percent were women. Many of the unemployed and underemployed engage in secondary employment in the informal economy to supplement their incomes.

The demographic and social indicators in the table below provide a stark picture of the current quality of life as compared to Poland and the United States. Ukraine’s gross national income is less than half that of Poland and less than a seventh that of the United States. Male life expectancy in Ukraine averages 10-15 years lower than male life expectancy in developed countries. Ukraine’s infant mortality rate of 11.9 /1000, although down from an estimated 15/1000 in 1995, is still more than 50 percent higher than that of the United States. The rate of tuberculosis infection and HIV/AIDS is rising and alcoholism and substance abuse are becoming increasingly common.

Country	Gross National Income	Male Life Expectancy	Infant Mortality Rate	% of Pop Living below Poverty
Ukraine	3,360	63	11.9	29.4
Poland	8,390	68	9.2	18.4
United States	25,440	74	7.1	16.9

While the long-term solution to improving the quality of life for Ukraine’s citizens is equitable economic growth, inefficiencies and deficiencies in the social, health and humanitarian assistance sectors inhibit the ability of these sectors to meet the immediate needs of the population.

Social sector

Social protection: Social protection encompasses social insurance funds, social assistance programs and social safety nets. Since independence, the government services that make up Ukraine’s social protection system have become increasingly under-funded and inefficient. Many services provided during the Soviet era have collapsed.

In 2001, up to 40 percent of the population received either social insurance or social assistance benefits. Fourteen million pensioners are supported by 23 million workers; four million poor families receive housing subsidies; 2.7 million jobless receive unemployment compensation; and 2.9 million families (with 4.3 million children under 18) receive family allowances.

In 1999, the GOU initiated the long process of reforming its public pension system. USAID has assisted the GOU in this process by providing support for developing a foundation for the establishment of a viable three-pillared pension system in Ukraine, including private retirement provisions. In addition, USAID helped develop a nationwide personified record-keeping system (which improved compliance rates by an estimated 5 percent) and draft legislation for pension reform.

Since 1995, USAID has also supported means-testing and better targeting of social assistance for housing and communal services. Seven hundred fifty-six local housing subsidy offices now operate throughout Ukraine, assisting an average of four million poor families annually.

While significant improvements in social protection have been realized, major challenges remain. Pensions continue to be woefully inadequate and unevenly distributed, and social safety net benefits are often not contingent on being poor. Given that Ukraine's demographic characteristics indicate that the number of pensioners will continue to increase, even if the age of retirement is raised, the public pension system is unsustainable. The fact that individuals are not required to make contributions to the system further undermines its financial viability. The centralized delivery of social assistance takes control and ownership away from local communities and leaves the central government playing a role that is both inappropriate and inefficient.

Labor: The labor market situation in Ukraine is very bleak. Aging and obsolete industries have employees on the books who draw little or no salary, who work in unsafe and unhealthy environments and who are "producing" with little benefit to either themselves or the economy.

Health sector

Improvements in Ukrainian's health status are beset by a series of constraints. First, there is a high degree of inefficiency in the existing health care system, which is in serious need of overarching reform. Large, inefficient public hospitals absorb a disproportionately high percentage of the GOU's health budget. A low proportion of qualified doctors' work at the primary health care level, while there is an oversupply of narrowly trained specialists. The overall system continues to focus on curative rather than preventive care. Second, Ukraine's Constitution guarantees free health care for all, which inhibits the growth and development of private sector health care. Third, little emphasis is placed on public health or on educating the public about lifestyle choices, including diet, smoking, alcohol consumption and exercise.

Over the past five years, USAID has focused on helping to reduce inefficiencies within the health care system. Modern primary health care is being strengthened by the establishment of a network of family medicine clinics, while a nationwide network of family planning centers is increasing the capacity of the health system to provide modern reproductive health services. These services contributed to a 50 percent reduction in the abortion rate. USAID-supported Women's Wellness Centers, neonatal resuscitation training centers and breast cancer screening interventions also contributed to improved health for thousands of families. USAID has screened approximately 100,000 children who were victims of the Chernobyl nuclear accident and addressed many of the psychological consequences of Chernobyl. Programs in HIV/AIDS have targeted intravenous drug users, homosexuals and commercial sex workers and financed development of a national information clearinghouse. USAID has also set up a pilot detection and treatment program for tuberculosis in the Donetsk oblast based on World Health Organization protocols.

Humanitarian sector

One consequence of Ukraine's difficult transition has been an increase in the number of people vulnerable to exploitation, violence, discrimination and neglect. While women are perhaps the largest single group, the number of youth at risk is also increasing. In addition, there are those who fall victim to natural and man-made disasters, as well as those who simply cannot succeed in the new economy and fall into a life of poverty and destitution.

Violence against women and girls is on the rise. Domestic violence is a widespread, but rarely reported, phenomenon. Amnesty International reported in March 2002, that 18 million women (68 percent of the population) are subject to domestic violence with 20 percent suffering it "as a rule" or "very often." Human trafficking also appears to be increasing. Women and children are trafficked both within Ukraine and across international borders. Often duped or coerced by friends and relatives, these victims find themselves forced to work -- through violence and intimidation -- in brothels, sweatshops or in private homes as domestic laborers. While the number of trafficked women and girls is difficult to determine due to its clandestine and criminal nature, the International Migration Organization estimates that 100,000 Ukrainian women have been transported across the border illegally since independence.

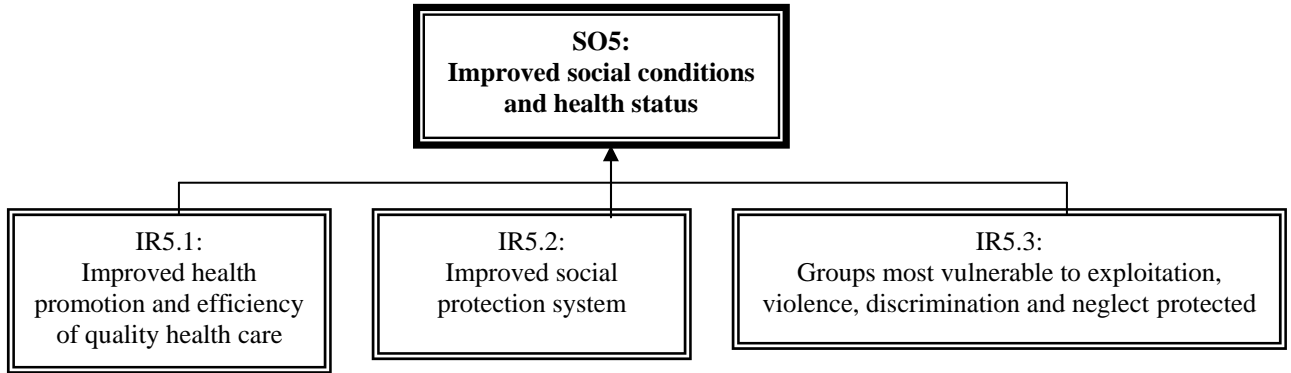
As a member of the working group on anti-trafficking, USAID cooperates with a number of national and international NGOs and international organizations to combat this problem. While several anti-trafficking/domestic violence programs have recently been initiated and greater coordination is taking place between national and international organizations, there is still a great need for victim support and prevention activities.

Unemployment, poverty, alcoholism and other social problems have contributed to growing numbers of street children, orphans and other youth at risk. In 1996, the EU estimated that there were 90,000 orphans in Ukraine, although 93 percent of these were "social" orphans, abandoned by their parents or placed in orphanages by court order. Only 7 percent of this estimate were "true" orphans. While no accurate surveys have been conducted, Ukrainian authorities estimate that there are some 50,000 to 60,000 children who live on the streets today. These young people sometimes become victims of human trafficking, but more often are forced into lives of crime and prostitution within Ukraine to survive. Lacking education and options, they are particularly vulnerable to HIV/AIDS and drug use.

Since 1994, USAID's disaster assistance has assisted victims of fifteen major natural and man-made disasters, including floods, mudslides and mine explosions. In addition, USAID has provided over \$128 million in humanitarian assistance since 1994, reaching over three million of Ukraine's most vulnerable. In this effort, USAID is providing capacity-building support to 20 local NGOs to enhance their management and administrative systems so that they can better deliver social services to the needy.

II. Proposed Program

Short- and long-term social and health conditions for all Ukrainians can only be improved by a combination of interventions. First, preventive measures are needed to reduce the risk and spread of communicable diseases. Second, critical structural problems in the social and health systems must be addressed for long-term sustainability. Finally, Ukrainians most at risk must be provided with basic protection and care. The SO5 results framework presents the three results that are *necessary and sufficient* for achievement of *improved social conditions and health status*.



Results at the SO level will be measured by the percent of the surveyed population applying knowledge and attitudes to change their practices, lifestyle and behavior. Each result is described in greater detail below.

Health promotion and efficiency of quality health care improved. USAID will continue to focus on reducing inefficiencies in the health care system, with an emphasis on reproductive health and the prevention of infectious diseases. In addition, USAID will support public awareness/education efforts to promote healthy lifestyles. Specifically, USAID will implement programs in reproductive health, family planning, maternal and infant care, HIV/AIDS and tuberculosis prevention and treatment, and screening for early disease detection. In addition, USAID will support public awareness campaigns emphasizing prevention and lifestyle choices related to smoking, alcohol consumption and responsible sexual behavior provide technical assistance to enhance management and financing mechanisms within the health care system, and support overall analysis and planning for health care policy development.

USAID's interventions in these areas are expected to result in greater utilization of primary health care, a population that is better able to make lifestyle choices and improvements in the mobilization, allocation and use of health care finance. Results will be measured by the percent of the population utilizing primary health care and maternal/infant mortality services in selected areas. In addition, the reduction in public health risks, such as HIV/AIDS and tuberculosis, will be measured.

Social protection system improved. USAID will continue to focus on pension reform between 2003-2005 by supporting the establishment of a supervisory and regulatory entity to manage pension investments, training pension fund staff, linking the information technology system to the Ukrainian tax collection system and continuing personification efforts nationwide. USAID will also explore the possibility of supporting the development of other private pension funds and health insurance. In the broader social protection area, USAID will: continue to support the adoption of means testing and targeting for social benefits, decentralization of social services and the establishment of "one stop" social service centers.

By the end of this strategy period, pension reforms will be complete and the administrative costs of social safety nets will be reduced. Indicators for measuring success include the percent of GOU social and health programs utilizing means testing and the existence of a private social insurance industry.

Groups most vulnerable to exploitation, violence, discrimination and neglect protected.

USAID will support limited interventions to improve the protection of vulnerable groups. In particular, USAID will target victims of domestic abuse and trafficking, disadvantaged youth and victims of natural and man-made disasters. Specifically, USAID will help local governments and NGOs to address the immediate needs of victims of recurring natural and man-made disasters; provide assistance to orphans and street children (to begin in 2004); and continue anti-trafficking programs.

USAID programs will directly assist vulnerable groups and strengthen local capacity to respond to and protect the most vulnerable groups. Progress will be measured by the number of NGOs working in these areas and by tracking domestic violence and human trafficking statistics.

III. Other Donor Support

The World Bank, EU, Canadians, Swiss, Germans, World Health Organization and several U.N. agencies all work in the health sector. Coordination with these donors takes place through international and regional meetings, annual health donor coordination meetings and selected working groups. USAID is the lead donor in the area of social protection, although the World Bank recently granted a \$50.2 million loan to finance a Social Investment Fund focused on improving living conditions of poor and vulnerable groups. The British and the EU also support social protection interventions. The Soros Foundation, EU, World Bank, Canadian and British Embassies are working in the area of education. A large and active working group, including the World Bank, OSCE, IOM, Dutch Embassy, UNICEF, U.S. Department of State and Ukrainian NGOs, meet regularly to coordinate anti-trafficking activities. The United Nations recently approved \$92 million for Ukraine efforts in combating HIV/AIDS. The World Bank has also approved \$50 million to support HIV/AIDS prevention initiatives.

SPECIAL OBJECTIVE: INCREASED ENVIRONMENTAL PROTECTION

USAID recognizes the important linkage between environment and development and the value that the GOU and people of Ukraine place upon environmental protection. Although resources for USAID environmental assistance are limited, USAID will design all its activities with careful consideration for their impact on Ukraine's environment and the conservation of biological diversity.

Background to the Special Objective

Since 1998, USAID has assisted Ukraine in developing environmental policy in two priority areas: global climate change and sustainable development. USAID technical assistance facilitated the re-establishment of the Inter-Ministerial Commission on Climate Change and the National Commission on Sustainable Development. The GOU decision to prepare for ratification of the Kyoto Protocol and the GOU approval of the Concept on Sustainable Development are measures of USAID results in this area. Nevertheless, policy reform activities are fraught with pitfalls. One of the greatest obstacles to policy reform in Ukraine is the constant political disruption of the policy development process brought about by frequent changes in leadership and government reorganization. The policy process is also subject to periodic standoffs between the Rada and the Government or to sudden removal of presidential support. Political obstacles are exacerbated by a lack of cooperation among government agencies and the relative weakness of the Ministry of Ecology and Natural Resources, especially the number and capability of staff working on environmental policy. For these reasons, and because declining resources limit the impact that USAID can have on national level programs related to Climate C and other environmental issues, USAID will end technical assistance for environmental policy reform in mid- 2003.

Although national-level activities are not within the manageable interest of USAID, the Mission evaluated the prospects for results from environmental action at the local level and found them to be more encouraging. Since 1998, USAID programs have demonstrated that small amounts of funds managed at the local level can achieve concrete results, including improving environmental management and energy efficiency at public and private facilities; reducing harmful greenhouse emissions; and increasing environmental awareness and public participation in decision-making. These local level environmental efforts directly complement other USAID programs and objectives at the local level. USAID assistance at the local level also has been successful in leveraging funds for environmental investment from authorities and industry. For these reasons, ongoing USAID environmental activities at the local level will continue through 2004.

These programs at the local level should, at least indirectly, improve national environmental strategies by institutionalizing procedures for public participation in environmental decision-making at the local level and increasing the availability of environmental information for management purposes.

Description of the Special Objective

Under the new strategy, USAID will support the Local Environmental Action Program (LEAP) through 2004, with a possible two-year extension. Already, the LEAP has been recognized by national authorities as a successful approach for Ukraine to meet its commitments under the United Nations Economic Commission for Europe Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (the Aarhus Convention). USAID will support community demonstration projects, the establishment of LEAP

centers of excellence, and the development of guidelines and training materials to assist communities in implementing LEAPs. As a result, the LEAP will assist Ukraine in institutionalizing procedures for public participation in environmental decision-making at the local level, in communicating and managing environmental risk, and in increasing public access to environmental services. The LEAP also is expected to achieve results in promoting energy efficiency, pollution prevention, and protection of nature and biological diversity.

USAID/Ukraine's principal activity in support of conservation of biological diversity and the sustainable management of natural resources is the Ukrainian Land and Resource Management Center (ULRMC). The goal of USAID assistance is to strengthen Ukrainian capacity to use remote sensing, geographic information systems (GIS), and internet technologies for effective public policy development and decision-making. The ULRMC applies remote sensing and GIS technologies in the: prevention, preparedness and response to human and man-made disasters (flooding, fires, hazardous accidents); development of policies for the sustainable use of natural resources (agriculture, forests, minerals, land and water resources); preservation of biological diversity and protected natural areas; and communication and management of environmental health risks (risk assessment, public health preventative interventions, environmental action plans, pollution registries). USAID assistance to ULRMC will end in 2004.

In the years following the closure of the LEAP and ULRMC programs, the Mission's focus on environmental protection will depend upon the availability of funds, the relative importance of environmental assistance to the GOU and the prospect that significant results are within the Mission's manageable interest. At the same time, activities under other strategic objectives will continue to support environmental protection, most notably in agriculture, energy and democracy.

In the agriculture sector, USAID will continue to assist Ukraine in the privatization of agriculture land, in removing subsidies, in the establishment of agriculture extension services, and in promoting safe use of agri-chemicals. The most significant environmental benefit of the land privatization and titling process in the near term is the exclusion from production of degraded and environmentally sensitive land. In the long term, privatization (and removal of subsidies) will allow the market to function more efficiently and encourage sustainable agricultural practices. Environmentally sound methods of cultivation and prudent application of agri-chemicals will protect soil and water supplies and minimize the negative environmental impact on surrounding habitat.

In the energy sector, USAID will continue to assist Ukraine to privatize energy distribution and generation companies, rationalize energy prices and improve collection of payments for energy consumption. Increases in energy prices and cash collections have done more to promote efficient energy production within enterprises, reduce overall demand for energy, reduce green house gas emissions and improve environmental management than any action yet taken by environmental regulators, including pollution fees and fines.

In democracy and governance, the Urban Water Rollout, the Community Partnership Program, and the Municipal Tariff Reform project will continue to contribute to the Mission's environmental objectives through 2003 by fostering efficiencies in water distribution and reductions in greenhouse gas emissions. In 2003, a new project will strengthen local economic development, including improvements to municipal infrastructure and services. Additionally, support for Environmental Public Advocacy Centers (EPACs) is expected to continue under the new strategy. EPACs provide legal support for court cases that challenge national and local authorities and industry to comply with regulations to protect Ukraine's environment and safeguard the public health. To date, the EPACs

have won more than 90 percent of the cases that have reached a judgment. Finally, the Mission's civil society strategic objective is expected to provide continued support to NGOs, including environmental groups. This support (and U.S. funding for the Regional Environmental Center/Kyiv) will strengthen the growth of the environmental roots of democracy in Ukraine.

SPECIAL OBJECTIVE: PROGRAM SUPPORT INITIATIVES

Under this strategy, USAID/Ukraine will continue to implement selected activities that support multiple objectives. These cross-cutting initiatives include the Kharkiv Partnership, PAUCI and participant training.

Kharkiv Partnership

In 1998, the United States Government and the Government of Ukraine established the Kharkiv Initiative to promote economic growth, job creation, and investment in the Kharkiv Oblast. The USAID Kharkiv Partnership Office was opened in FY 2000. In January 2001, the USG and the GOU refocused this program and formally re-established it as the Kharkiv Partnership in order to achieve more concrete results in four specific areas: 1) improvements in the investment climate; 2) development of business relationships; 3) encouragement of small business development; and 4) assistance for human and social development. The Kharkiv Partnership succeeded in creating opportunities for networking, sharing ideas, and establishing a common purpose with Oblast government personnel and elected officials, USAID partners and contractors, other USG agencies and other donors that work in the region. The Kharkiv Partnership can also serve as a model for other regional development activities in Ukraine that want to aggressively pursue their objectives for economic growth.

Under this strategy, the Kharkiv Partnership will continue to coordinate and increase the effectiveness of other USAID activities that are working within the oblast. These activities encompass all Mission strategic objectives. They presently include assistance with fiscal management, small farmer training, rural land titling, SME development, business and economic development-related study tours to the U.S., business development volunteer activities, business education, strengthening of civil society organizations, media development, rule of law and advocacy, local economic development, and health partnerships.

Additional USAID support for Kharkiv will focus on improving the economy at the local level and providing the tools necessary for the business community and public servants to continue with this task. Besides, it is expected that significant support will continue to be directed toward trade and investment, particularly through the Trade Development Authority (TDA), and the creation and growth of SMEs, areas in which the Kharkiv Partnership has already demonstrated success.

Due in part to the recent enactment of the budget code for Ukraine, local government should assume greater control over their revenues during this strategy period. Should this be true, the Kharkiv Partnership will enhance and expand its support to small cities and local governments within the oblast. This assistance will help accelerate economic growth and expand CSO participation and democracy in the region.

Although the anticipated budget for the Kharkiv Partnership is relatively small, it is anticipated that economic development fostered by the Partnership will enhance the image of Kharkiv Oblast as an attractive region for investors.

Poland – America – Ukraine Cooperation Initiative (PAUCI)

The Poland-America-Ukraine Cooperation Initiative was developed as a mechanism for facilitating economic development in Ukraine by fostering the growing relationship between Ukraine and Poland. Recognizing that Poland is an applicable model for Ukraine's economic and social transition, Polish-Ukrainian collaboration enabled by PAUCI allows Ukrainian NGOs, government ministries, local government officials and think tanks to implement lessons learned in Poland's development of market-economics, European choice, investment promotion and civil society advocacy. Small Ukrainian businesses cite that they are better able to adapt Polish advances in new technology, financing, capital investment and expansion than some technology and inputs available in the U.S. Similarly, PAUCI-funded partnerships have fostered an increased understanding among Ukrainians that civic identity and business/government/citizen partnerships helped bring about Poland's favorable investment climate in the mid-'90s.

The PAUCI program supports multiple strategic objectives through partnerships in small business development, local governance, macroeconomic policy, and most recently "Ukraine's Integration into European Structures", a key priority due to Poland's entry into the EU in 2004. In 2003-2004, the final year of PAUCI's five-year plan, the program will develop an information clearinghouse for Ukrainians and Poles on the issues of transition and cross-border development.

Participant Training

The participant training program provides leaders and professionals with the practical knowledge and technical skills needed to create policies, programs and institutions that support Ukraine's transition to democratic governance and a free market economy. Under this initiative, U.S.-based, third-country, and in-country short-term technical training opportunities are organized, with much targeted objectives, for public and private sector organizations.

Since 1993, this program has provided training for approximately 7,000 Ukrainians. Training participant data is stored and collated by USAID Strategic Objectives. Approximately 36 percent received training in support of economic reform, 15 percent in democratic reform, 39 percent in social reform and 10 percent in other categories.

During the course of this strategy, participant training activities will continue to support all strategic objectives. However, a new emphasis will be placed on the provision of follow-up services to trainees to ensure that training is applied.