

**SPECIAL STUDY**

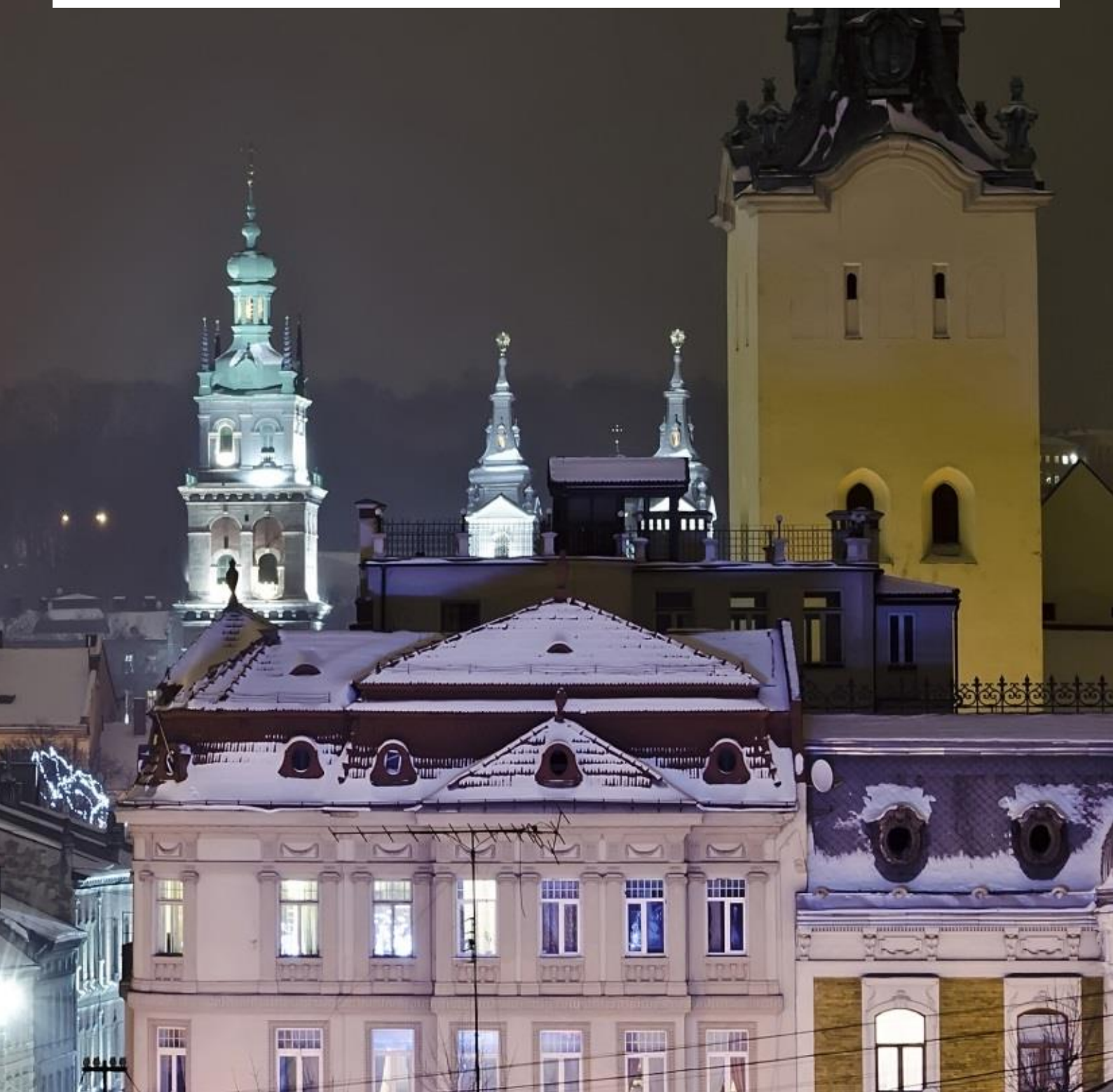
# **The EBRD's experience with policy dialogue in Ukraine Case study - city of Lviv**

April 2014

EBRD EVALUATION DEPARTMENT



**European Bank**  
for Reconstruction and Development



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## Abbreviations

ACC	Anticorruption Action Centre
AUC	Association of Ukrainian Cities
BAS	Business Advisory Services
GPA	WTO Agreement on Government Procurement
E2C2	Energy Efficiency and Climate Change Team
E5P	The Eastern Europe Energy Efficiency and Environmental Partnership
EECU	Association of Energy Efficient Cities of Ukraine
EGP	Enterprise Growth Programme
EIB	European Investment Bank
EU	European Union
GDP	Gross Domestic Product
GVA	Gross Value Added
FEG	Foundation for Effective Governance
HDI	Human Development Index
IBSER	Institute of Budget and Socio-Economic Research
IFC	International Finance Corporation
IFI	International Financial Institution
KfW	Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute)
LAD	LvivAvtoDor
LET	LvivElectroTrans
LTE	LvivTeploEnerg
MEI	Municipal and Environmental Infrastructure Team
MEDT	Ministry of Economic Development and Trade
NCRCS	National Commission on Regulation of Communal Services
NEFCO	The Nordic Environment Finance Corporation
NUTS	Nomenclature of territorial units for statistics
TC	Technical Cooperation
SBS	Small Business Support Programme
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprises
USAID	US Agency for International Development

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## Executive summary

In 2013 the Evaluation department (EvD), at the request of Board members and the President, conducted a study of the European Bank for Reconstruction and Development's (EBRD's) experience with policy dialogue in Ukraine. An early decision was taken to adopt a case study approach as the core evaluation methodology for the needed "rich picture" of qualitative information. Early consultations with EBRD policy actors identified ten possible cases of which five were selected using criteria to ensure their relevance to the Ukrainian context and other countries in which the EBRD invests. Some of these criteria included whether there was an international dimension beyond the interests of the EBRD and Ukraine, volume of operations, and degree of outcome success so far.

Unlike the other four sector based cases, this case study is multi-sector with a geographic focus (the City of Lviv) and is directed at understanding the nature and role of policy dialogue at the sub-national level; and to explore how policy problems encountered at the regional level can lead to national level policy dialogue. It was based on a range of interviews with officials in the city of Lviv, representatives of clients from private and public sectors, EBRD colleagues working at the Kiev Resident Office and London Headquarters, representatives of non-governmental organisations and business associations.

The case study produced several key findings:

- Working at the municipal level is not simple given the primacy of national level regulations and legislation, which limit the exercise of authority at the regional level, and a rigid and highly centralised system of control – however, even in centralised country like Ukraine, progress is possible in larger cities that have higher financial capacity and relative freedom of action;
- Working at the regional and municipal levels where leaders are committed to positive change is important as it not only contributes to the success of investment operations, but it also acts as a powerful demonstration to other municipalities, including those that currently do not have pro-reform leadership;
- Working at the regional level can also be a useful entry point to influence national policies. Having relatively powerful allies in different regions and municipalities of Ukraine can add to the EBRD's national policy dialogue efforts;
- By engaging directly with the cities, the EBRD enhances their capacity in many areas including; strategic thinking and the selection of rational tactics for achieving their objectives; project implementation; and introduction to international standards, particularly in procurement;
- Even if city strategic documents are not explicitly used by the EBRD and other international finance institutions (IFIs) as direct reference points upon which to base their decisions for investing in specific sectors, they should ensure that their investment programmes visibly deliver against the city's strategic objectives and that the TC assistance is also targeted at achieving those;
- Various EBRD teams are involved in Lviv – Municipal and Environmental Infrastructure (MEI), Small Business Support (SBS), Transport, Property and Energy Efficiency – while each team is working effectively, there is little evidence of a joined up approach;
- There is near universal support outside of the EBRD that the Bank could and should do more by promoting the cases of successful municipal partnerships across the country, demonstrating the effects of introducing transparent and fair procedures and mechanisms in planning and delivering municipal services and in other areas – a failure to adopt this broader view of its role

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could strengthen the view already held by a few that the EBRD is largely self-serving entity dedicated to developing its own business;

- Further thinking on how to capitalise on the network of like-minded city leaders who are committed to improving municipal services and the quality of life at a local level might be useful for the EBRD's future strategy of engagement in Ukraine.

## The policy problems, results chain and timetable


### Challenges – the policy problems to be addressed 2008 to 2013

This evaluation identified several policy problems in the city of Lviv between 2008 and 2013 that had potential to be addressed by policy dialogue:





- Lviv's inability to implement vital investment projects to enhance its infrastructure and open new opportunities for economic growth and local revenues. This situation was caused in part by rigid budget regulations on borrowing (including from IFIs), an inadequate and over centralised regulatory environment and lack of availability of commercial loans;
- Dependence of the city's leadership on central level decision makers in the areas that are crucial for the growth of the city;
- Inefficient use of available financial resources through inadequate contracting and procurement procedures, audit and control over execution;
- City council and municipal companies lacking capacity to establish market-based regulations and relationships between the individual clients and providers of municipal services (in transport, heat, water/wastewater treatment and solid waste management), and between provider companies and the municipality as sole shareholder;
- Inefficient road infrastructure; a rundown public transport network; inadequate provision of heat energy to Lviv residents; dilapidated central parts of the city with high energy consumption levels and excessive traffic flows that are often inconsistent with UNESCO World Heritage status of the central part of Lviv;
- Inadequate support infrastructure for developing small and medium sized companies that currently provide 52 per cent of jobs in the city, especially in information technology and tourism.

### What happened?

#### Conception, planning and strategy




Deciding to engage	Engagement with the city of Lviv was initiated at the request of the city leadership following attendance by the Mayor of Lviv at an investment forum organised by the EBRD held in London in February 2008, but unfortunately an initial cooperation agreement reportedly signed between the City of Lviv and the EBRD could not be provided to the evaluation team – an unfortunate apparent loss of documentary evidence. Given this, it was not possible to independently check the clarity of the EBRD's reasons for engaging. However, it is clear that pending changes to the Budget Code, the EBRD could not do business at the municipal level.	 <sup>1</sup> (Responding to demand, quality of local leadership very important)
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1 The various elements of the policy process as reflected in the each case study are characterised as follows:

	=	not or only weakly demonstrated
	=	mixed performance
	=	possible good practice
	=	possible best practice

The word "possible" is used as practice should be guided by the context so the practices should not automatically be considered good and replicated without thinking about the context.



	<p>Engaging at the regional level was in line with the EBRD's strategy in Ukraine and transition objectives related to strengthening fiscal decentralisation in Ukraine and improving creditworthiness of municipalities and publicly-owned utility companies to access long-term financing to rehabilitate and improve infrastructure and municipal services. This does provide a strategic dimension to the decision to engage at the municipal level.</p> <p>The quality of political leadership in the city was an important consideration in deciding to respond to the request.</p> <p>For Small Business Services (SBS) the decision was made based on the EBRD's Ukraine strategy and evidence of higher degree of private sector initiative in Western Ukraine.</p>	
Identifying the problem	<p>A very thorough analysis of city's challenges and opportunities for collaboration was reportedly performed by EBRD staff and external consultants. No trace of documentation relating to this could be found by the evaluation, suggesting issues with record keeping in the area of policy dialogue and more generally about the archiving of consultants' reports.</p> <p>Based on the analysis, an initial cooperation agreement was signed by the City of Lviv and the EBRD, which as noted above, cannot be located. The city has its own clear vision and strategic priorities identified in its strategy though this was not directly used by the EBRD for formulating the problems its policy dialogue was to address.</p>	 (Existence of good analytical underpinning to understand the problem and its causes is essential to ensure evidence-based and customised policy advice)
Selecting and validating the policy message(s)	<p>There was no explicit process for validating the policy messages, which is unfortunate as some see the EBRD's pursuit of change to the Budget Code with its provisions being applicable only to IFIs as being self-serving.</p> <p>The amendment to the Budget Code allowing cities to borrow from IFIs brought with it the need to provide knowledge and skills to allow city and municipal enterprise officials to understand and comply with EBRD requirements and practices, above all in the area of procurement, financial management and audit. This part of the policy agenda was largely automatically selected as being a necessary part of working with the EBRD.</p> <p>At a more technical level, the policy messages were reportedly based on recommendations by EBRD consultants who presented a detailed report on the city's challenges and possible solutions.</p> <p>National level policy dialogue in specific sectors particularly relevant for municipal sector engagement (infrastructure, district heating and inter-governmental budget relations) was performed jointly with key Government agencies, other IFIs and donors working in the municipal area.</p>	 (Policy solutions also based on good analysis)
Clarity on results	<p>Specific results targeted by policy dialogue associated with large infrastructure projects include:</p> <ul style="list-style-type: none"> <li>– new partnership relations between municipal authorities and publicly-owned utility companies, including clearly defined contracts for provision of municipal services;</li> <li>– new transparent financial management and procurement procedures;</li> <li>– improved strategic planning and management of utility companies;</li> <li>– concrete changes to legislation and the institutional framework at the national level to enable strengthening fiscal decentralisation and tariff regulation;</li> <li>– streamlining regulations and permits in the municipal infrastructure sector that enhances potential for profitability of municipal utility companies.</li> </ul> <p>However, expected results were not explicitly built on a theory of change ("if we take this policy action we expect this to happen") and nor were they specified in terms of outputs, outcomes and impacts to facilitate monitoring, reporting, evaluation and learning.</p>	 (Clarity on expected results from policy dialogue is important but these should be formulated within a theory of change plausibly likely to address problems and their underlying causes)



Strategy and tactics	<p>There is no documentary or other visible evidence on how the strategy and tactics for policy dialogue were decided upon. There was a perception that it was fairly self-evident to those involved and, given a committed leadership, maybe it was. However, the evidence is that a broader approach engaging more intensively, and with a wider range of stakeholders could have produced even better results and more quickly.</p>	<p>👉👉 (Spending some time deciding on an appropriate strategy and tactics in light of the specific context is important)</p>
	<p>There was no overall strategy for engagement in the city of Lviv and decisions were taken on the basis of specific needs and objectives of individual investment operations, or at least by the team concerned following an implicit or explicit sector or sub-sector strategy (it being explicit in the case of district heating where an integrated approach exists).</p>	<p>👉 (Where multiple teams are working in a municipality there is merit in the Bank having a more “joined up” approach)</p>
	<p>The EBRD does not have a practice of spatial engagement strategies. However, there is clearly potential for differentiating strategy for policy dialogue at the central from that at the regional or municipal level.</p>	<p>👉 (Having multi-sector engagement at the municipal level does call for consideration of a differentiated approach, particularly in terms of policy dialogue where a totally different context exists)</p>
	<p>In pursuing dialogue at the municipal level, the EBRD could have used the city’s strategic documents in a more articulated way to provide greater coherence to its operations and to more visibly help the city realise its strategy.</p>	<p>👉 (Where the municipality has a robust strategy that is actually using, the EBRD should more demonstrably align its strategy with that of the city to strengthen the city’s ability to lead its development and to provide a basis for joint monitoring of progress)</p>
<b>Carrying out the dialogue</b>		
Main inputs provided by the EBRD	<ul style="list-style-type: none"> <li>– Investment projects in the public sector (3), private sector (1+) and special small and medium enterprise (SME) support package;</li> <li>– TC funding for: feasibility studies, individual corporate investment projects, IFRS audits that are aimed at enhancing corporate management standards, financial and procurement procedures, human resources and leadership, preparation and implementation of modern public service contracts;</li> <li>– Stand-alone TC project supporting the national regulator in municipal services sector (jointly with the World Bank), including regulations and models of relationships with municipal service providers;</li> <li>– Policy dialogue with various actors at national level leading to changes to the Budget Code in part stipulating rights of Ukrainian municipalities to borrow money from IFIs; and to changes in the institutional and regulatory environment for municipal services delivery;</li> <li>– Energy efficiency TC associated with a multi-project aimed at producing a demonstration effect from a green commercial building that could be widely disseminated across Ukraine;</li> <li>– Support in the framework of Small Business Services (SBS) programme, including policy dialogue with city council officials aimed at improving local SME policy and regulatory</li> </ul>	<p>👉👉 (A sufficiency of resources but these could be better “joined up”)</p>

environment and enhancing opportunities of local SMEs to play a greater role in the local economy.

Actors and roles	<p>Among key stakeholders who are engaged in the process of policy dialogue at regional/ municipal level are the MEI team led by its director and the E2C2, Property and Tourism and Small Business Services (SBS) teams. The country director is playing crucial role at decisive stages of the process. The role of the EBRD's procurement department is crucial in municipal operations as there is a great deal of learning and change happening in this area – it has proved to be an excellent entry point for other reforms. On national level, policy dialogue on Budget Code changes and national regulator support is led by the MEI team, country director with inputs from OCE and other headquarters teams as necessary.</p> <p>The EBRD's role in this case (using the typology developed by this evaluation) is mostly as a credible and trusted adviser, influencer and advocate. Consultants are used extensively for both for pre-project activities and associated with the loans TC projects.</p> <p>At the municipal level the principal actors with whom the EBRD engages are the Mayor (decision maker), council (decision maker/adviser), municipal officials (adviser/analyst), chief executive officers and senior managers of municipal authorities (lower level decision makers/advisers to Mayor/council, Association of Energy Efficient Cities of Ukraine and Institute of City (as expert/ advocate)</p> <p>At the central level, the EBRD has engaged with the Ministry of Finance, parliament, cabinet ministers, the Ministry of Regions, the Presidential Administration (as decision makers), a local think tank (as expert/analyst), AUC (as influencer/interested party), National Commission on Regulation of Communal Services (as decision maker/expert).</p>	<p>👉</p> <p>(All key stakeholders included, clear roles though the EBRD could be more joined up in its approach)</p>
Selected actions	<p>Investment forum held in London</p> <p>Conduct of analysis of the city's development to identify and prioritise problems, their causes, possible solutions, strategy and tactics to achieve anticipated results (although the document could not be provided to the evaluation team).</p>	<p>👍👍</p> <p>(Shared point of reference and evidence base)</p>
	<p>Regular communication between the city mayor and MEI Director which contributes to co-operation, mutual understanding and trust. City leadership often facilitated dialogue with the municipal companies.</p>	<p>👍👍</p> <p>(Building relationships and trust)</p>
	<p>Signing of a general cooperation agreement with the City of Lviv, framework agreements with individual municipal enterprises, while the City Council and LvivAvtoDor sign a public services contract (although the general cooperation agreement could not be found).</p>	<p>👍</p> <p>(Putting it in writing to establish clear commitment and avoid misunderstandings)</p>
	<p>City of Lviv approves the Sustainable Energy Action Plan and Development Strategy 2025</p>	<p>👍👍</p> <p>(Helping deliver on locally-owned strategies and action plans strengthens the EBRD's hand)</p>
	<p>Site visits to other countries</p>	<p>👍👍</p> <p>(Helping decision-makers understand what success looks like and how to achieve it – selling the solution)</p>
	<p>Establishment of regional Small Business Services (SBS) office in Lviv (forthcoming) with two permanent staff members</p>	<p>👍</p> <p>(Working closely with clients)</p>
	<p>Integrated approach for reform of district heating approved by the EBRD's Board</p>	<p>👍👍</p> <p>(Moving from a short to a longer-term)</p>

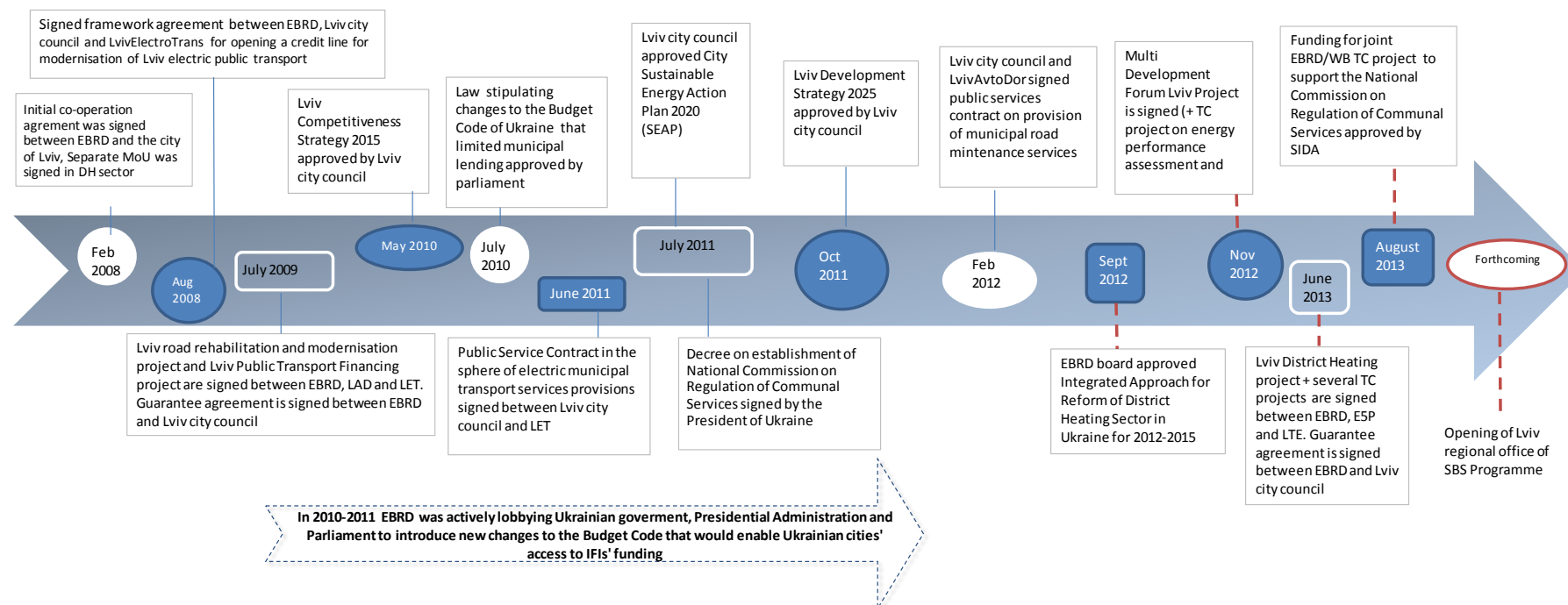
		perspective of policy dialogue and a more coherent and joined approach though for a single sector only)
	Progressive signing of investment projects and provision of support to implementation, particularly in procurement.	👍👍 (Ability to reward reforms in a very tangible way and to support implementation)
	Successful lobbying of central government, the President's Administration and parliament in support of changes to the Budget Code and in favour of establishing a National Commission on Regulation of Communal Services both of which were strongly supported at the municipal level	👍👍 (Shared interest with municipal authorities strengthens the case for reform)
Coordinating	The City of Lviv case study illustrates coordinated efforts of IFIs/donors that are working at sub-national level produces benefits. The EBRD, which has concentrated investments in Lviv's various municipal infrastructure projects, can benefit from strong commitment of the city leadership, which leads donor coordination activities. At the same time, donors are providing TC support complementary to investment projects (such as via E5P). At the national level there are close relations with the World Bank, European Investment Bank, International Finance Corporation and others, including joint implementation of a TC project for the National Regulator of Communal Services.	👍👍 (Effective division of labour among various IFIs and good use of international financial instruments)
Flexibility and reaction to events	The municipality expressed the view that compared to other IFIs, the EBRD demonstrates a good ability to adjust resources to changing needs and to react to emerging opportunities. However municipal counterparts highlighted the need for even more flexibility in matters where delays and change of plans are taking place due to problems with national level legislation, regulations and institutions. They asked for more support to local officials being harassed as a result of enforcing EBRD rules and regulations.	👍👎 (Adjusting pace, strategy and tactics in light of changes in the context)
<b>Results achieved</b>		
Outputs and outcomes	<u>Outputs</u> <ul style="list-style-type: none"> <li>– Improved municipal infrastructure (roads, public transport, and particularly heating);</li> <li>– New corporate structures and management standards for three municipal companies that provide core services (LAD, LvivElectroTrans – LET, and LvivTeploEnerg - LTE)</li> <li>– New public services contracts signed between city council and LAD and LET and to be signed with LTE;</li> <li>– New high standards in public contracting, procurement, delivery and audit that resulted in significant financial saving and improved delivery of results;</li> <li>– Simplified regional and some national regulations that enable implementation of projects funded with IFI loans;</li> <li>– 61 SMEs, including 18 consulting companies, benefited from Small Business Services programme;</li> <li>– Historical part of the city preserved as UNECSO World Heritage and revitalised via major sustainable commercial property project that will benefit to overall city's energy efficiency objectives through improved quality of buildings and transport flows.</li> </ul>	
	<u>Outcomes</u> <ul style="list-style-type: none"> <li>– City leadership, high- and mid-level managers of the city council and communal enterprises generally applying international standards of contracting, procurement, audit, stakeholder relationships;</li> <li>– Municipal leadership and officials planning and delivering</li> </ul>	

	<p>municipal services on the basis of free market regulations; communal companies operating in a free market manner;</p> <ul style="list-style-type: none"> <li>– Public service contracts widely adopted following transparent procedures and used for managing, evaluating execution, dialogue between city council and companies as for necessary changes and additional actions (and funding) needed for delivery of the contracts;</li> <li>– Local consulting market providing a wider range of services to SMEs in response to greater demand for such services by companies that are familiar with European standards of doing business;</li> <li>– SMEs operating with improved standards of corporate management, and increased competitiveness and profitability;</li> <li>– Investment operations in commercial property sector will result in first internationally certified commercial property in Ukraine (energy efficiency and sustainability certification) with high potential for further replication.</li> </ul>	
Supporting policy adoption and implementation	<p>In the examples for this case study, the EBRD is performing a combination of “proactive” and “reactive” policy dialogue. “Proactive” measures are aimed at initiating new practices and regulations that enable transparent and accountable procurement; strategic planning and financial management at municipal level; and modernisation of municipal services that meet the real demands of local community. “Reactive” dialogue (sometimes referred to as “troubleshooting”) is needed when significant problems arise during implementation. Sometimes the solution requires changes in national or municipal regulations, thus the policy dialogue becomes more proactive.</p> <p>There was a widespread view that having new policy adopted is less than half the battle – IFI engagement needs to continue to support policy implementation, a process which may involve capacity building, provision of assistance to develop secondary or enabling legislation, fine tuning the policy in light of experience, and helping protect the policy against capture or reversal. Having decided to engage, the EBRD should be prepared to remain engaged over the medium to long term.</p>	<p>👉 (Support is needed for policy implementation and policy adoption)</p>
Evidence of learning	<p>There is some evidence that the EBRD has incorporated lessons from experience in the process of policy dialogue at the municipal level. There is little visible evidence of learning as the knowledge mostly remains in people’s minds.</p> <p>However, as similar projects in other Ukrainian cities were launched earlier there is a great potential for further learning aimed at refining the planning process of investment and TC operations at the municipal level. Learning occurs among cities through participation in groups such as the Association of Ukrainian Cities and the Association of Energy Efficient Cities of Ukraine but the EBRD does not contribute to this.</p> <p>Within the city of Lviv there is an ongoing exchange of ideas and experiences among municipal utilities companies who are keen to learn the experience of colleagues who are more advanced in implementation of the similar projects.</p> <p>However, knowledge is poorly documented and shared and so has limited use as it is not available for wider replication. The opportunity exists for the EBRD to play a greater role in documenting knowledge and to support its dissemination.</p>	<p>👉 (Learning by adapting as you go is key for success in policy dialogue while documenting that learning and supporting its dissemination add considerable value)</p>
<b>Reviewing, monitoring, reporting and evaluation</b>		
Reviewing	<p>Monitoring and reviewing progress of policy dialogue takes place within sectors but in an informal and ad hoc manner with no independent views sought.</p> <p>There appears to be little if any cross-departmental or whole of city review, with or without the participation of the city itself, which would be highly desirable.</p> <p>While this light approach may be efficient for a particular case, the absence of documentation means the experience only resides in the</p>	<p>👉 (The absence of a formal and documented process of monitoring and review of policy dialogue greatly lessens the ability to</p>

	<p>minds of the immediate participants who may not even recognise the experience as knowledge worth preserving or sharing.</p>	<p>change strategy and tactics in a timely fashion and it precludes effective learning)</p>
Monitoring	<p>There is no monitoring (or reporting) on the basis of outputs, outcomes or impacts linked by a theory of change.</p> <p>There is no or very limited use of selected indicators to track progress as part of strategic management.</p>	<p>🔍</p> <p>(Structured monitoring of progress pays big dividends in terms of improved management of the policy process and enhanced ability to tell the story of progress and challenges)</p>
	<p>The monitoring that does take place is at the individual sector level – there is no joined up monitoring effort among EBRD sector teams and the city – the city does carry out regular monitoring of the implementation of its strategic plan, including through the conduct of regular surveys.</p>	<p>🔍</p> <p>(Working at the municipal level provides a tight geographic boundary which lends itself to a more joined-up approach by the EBRD, both among its teams and with the city)</p>
	<p>Monitoring and review of progress could usefully capture the knowledge and experience of those not directly involved. This independent input may be able to suggest alternative and ultimately more successful ways of going about the policy dialogue. As EBRD staff and consultants generally do not have in-depth knowledge of the political economy, this type of independent input may be particularly valuable, particularly at the municipal level where the EBRD does not maintain a permanent presence.</p>	<p>🔍</p> <p>(Detailed knowledge of the political economy dimension greatly enhances the success of policy dialogue)</p>
Reporting	<p>The EBRD does not have a formal mechanism for reporting on policy dialogue activities since it is not recognised as a results area in its own right even though ultimately its outputs and outcomes may be the principal contributor to transition impact.</p> <p>While the absence of reporting does result in less burden it also is directly responsible for the reality that the work lacks visibility and so also lacks reward and recognition for those involved in it.</p> <p>The absence of reporting also means that a potential source of learning is not captured and that the work is not subject to constructive scrutiny.</p> <p>There is no effort to bring the experience of the various sector teams together to capture the combined experience at the municipal level.</p>	<p>🔍</p> <p>(Reporting on policy dialogue work adds value in several ways)</p>
	<p>There are some successful examples of reporting and telling the story of experiences to the wider network of stakeholders. Lviv city leaders are especially good in performing this task through different networks and associations they are members of. They can demonstrate real effect from partnership projects with the EBRD and other IFIs which is of interest to other city leaders and creates interest in new investments in the future.</p>	<p>👤</p> <p>(Telling the story of policy dialogue is the most effective reporting mechanism for learning purposes)</p>
	<p>However given the scale of the EBRD's municipal infrastructure operations (existing and in the pipeline) there is a space for improving Bank's use and management of knowledge and skills generated through implementation of existing projects (even those at inception phase). It should be used for raising awareness and setting the level of engagement for potential clients in other municipalities.</p>	<p>🔍</p> <p>(Unmet potential for the EBRD to be a leader and advocate in the sectors in which it works, drawing on its own rich experience that has been documented)</p>

Evaluation	<p>No policy dialogue initiative studied by the evaluation made any provision for independent evaluation or external review. Given the complexity of most policy dialogue initiatives, their frequently long duration and the issue of “tunnel vision” that can develop through close involvement of a long period, periodic evaluation can add significant value, especially to provide learning for future initiatives.</p>	<p>🔗</p> <p>(Independent evaluation of policy dialogue initiatives should be built in)</p>
<b>Resourcing and rewards</b>		
Sufficiency of resources and skills available	<p>The quantity of human and financial resources for performing effective policy dialogue at the municipal level are adequate.</p> <p>The availability of donor funding to cover TC, especially through schemes such as E5P and the Neighbourhood Investment Fund, is contributing to success.</p> <p>Given the scale of challenges municipal stakeholders face and the need for “reactive” micro-level dialogue, or dialogue which is aimed at pre-empting the problems in the future, the accessibility of in-country staff to public sector clients could be improved. There are even some voices that strongly recommend having EBRD Resident Offices in the cities with the greatest concentration of investment and TC operations. The feasibility of such recommendations is unlikely.</p> <p>This evaluation strongly holds to the view that considerable value would be added by having skills in political economy available as the fundamental problems are not technical, they are political, and these are often hidden from view but addressing taking them into account is critical to success – to do so needs political awareness and understanding of the local context and how changes in this context can be exploited or should lead to changes in strategy.</p>	<p>🔗🔗</p> <p>(Quantity of resources generally adequate, accessibility could be improved, skills in political economy are needed)</p>
Incentives and rewards	<p>This evaluation considers that it is difficult if not impossible to provide a direct monetary reward for policy dialogue and in any case, it would be undesirable to provide such rewards even if it were possible because of the perverse incentives this would set up. Therefore, rewards will need to be largely soft (such as through praise and public recognition) and the motivation of staff will need to be intrinsic rather than extrinsic.</p>	<p>🔗</p> <p>(More soft rewards to those involved in policy dialogue is needed to enhance motivation)</p>

## Timeline of key events





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## 1. Introduction

The Lviv regional case was produced for this evaluation study to look beyond the national level of engagement and provide perspective on the intensity and effectiveness of policy dialogue the EBRD has with the authorities and other counterparts at regional and municipal levels. This lens of analysis is important for understanding the dynamics of relationships between the centre and regions of Ukraine and among various power elites of Ukraine. Since gaining its independence, Ukraine has been ruled by a range of competing economic groups with strong geographical identities. In different times different governments have been under influence of Dnipropetrovsk group, Lviv group, Kharkiv, Odessa or currently Donetsk group though never before has one power elite (Donetsk) so pervasively dominated the political landscape of the country.<sup>2</sup> This adds to the challenges of balanced and impartial approach to public administration, division of resources and strengthening the capacity of regions. For example, political and civil service appointments at the high and middle levels are currently largely based on a criteria of personal loyalty, regional affiliation and belonging to certain “family” or group and not on the criteria of merit.

The EBRD's operations in Ukraine have a clear sector structure and there is no differentiated spatial pattern in the planning and implementing of investment operations, TC and policy dialogue. All operations are being managed from the Kiev EBRD Resident Office as currently there are no Resident Offices in other cities of Ukraine.<sup>3</sup> It should be noted that the EBRD is one of the few IFIs which provides sub-sovereign guaranteed lending in Ukraine and its portfolio of municipal projects is growing steadily.<sup>4</sup>

Given the importance of political economy and the role of power elites and personalities in the process of change and reform implementation, analysis of the nature and a range of engagements the EBRD has with the municipal and regional authorities, and their role in achieving visible change at the regional level is useful. The chances for achieving success – long-term and visible – are potentially higher in the localities with responsive and responsible leadership where it is possible to use resources in a more concentrated way. Progress achieved along with the process that led to it could be used as a role model in similar environments in which the EBRD invests. Also, strong and supportive partners at regional and municipal levels across different regions of Ukraine where the EBRD has public sector operations can help to build a network of knowledge and experience, practice and new standards that are needed for bringing about successful national-level reforms.

The City of Lviv is an interesting case as it represents a locality with a relatively large concentration of EBRD operations and projects by other IFIs and donors which is one of the locomotives of growth and development in Ukraine. It is one of the most dynamically developing cities with a well-articulated strategy for growth and social wellbeing, extensive links with IFIs and donor organisations, active local (mid-size) business community.

The EBRD has a diversified portfolio of investment operations in the city, both in private and public sectors, and a soon to be opened Regional Office for the SBS programme whose activities primarily focus on enhancing the capacity of micro and small businesses, and supporting their growth into medium and

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<sup>2</sup> This case report was completed before the power crisis and change of President in February 2014

<sup>3</sup> As of December 2013, SBS Programme in Ukraine is about to launch its first regional office in Lviv with office premises and small team recruited locally. Previously EBRD had regional office in the city of Dnipropetrovsk which was operational from 2007 to 2010.

<sup>4</sup> Among other IFIs that provide loans with municipal guarantee are NEFCO and KfW. EIB and World Bank provide loans on the basis of sovereign guarantee.

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potentially large companies. The EBRD has a very good reputation in the city and is well known for its support to large-scale infrastructure projects.

This case study is based on a range of interviews with officials in the city of Lviv, representatives of clients from private and public sectors, EBRD colleagues working at the Kiev Resident Office and London Headquarters, representatives of non-governmental organisations and business associations.

## **2. Context of the dialogue**

In order to analyse the nature of policy dialogue performed by EBRD at the regional/municipal levels it is important to understand the context in which it is being performed. In particular it is crucial to consider:

- (i) Institutional and governance system of Ukraine, limited decentralisation of power and autonomy of local self-governments
- (ii) Specifics of the socio-economic development of the city of Lviv and its position in the geopolitical landscape of Ukraine;
- (iii) The power relationships at the local level; and
- (iv) The EBRD's approach to engagement with the regional and municipal counterparts and the scale of present operations.

### **2.1 Institutional and governance system of Ukraine**

Ukraine is one of the largest countries of Europe (second by territory and fifth by population) and the diversity of its regions is significant. Historical, religious, cultural and social lines of division are creating a patchwork space that currently lacks coherence and a uniting idea. There is no long-term vision for the development of Ukraine as a unified space and an integrated community of different identities. Acknowledging this gap in the national transformational processes is important. Many experts highlight that ongoing divergence of Ukrainian space and deepening misunderstanding of the role of different territories play in the national economy, social sphere and culture is potentially very dangerous for the state of Ukraine and its future integrity.

While having a diversity of regions, Ukraine is a unitary and quite centralised state (see Annex 1 for some data on its territorial-administrative arrangement).<sup>5</sup> There are laws that stipulate considerable powers and responsibilities of local and regional authorities (Laws on Local Self-Government and on Local State Administrations). However, in practice the implementation of these laws is very limited due to scarcity of financial resources and deep-seated reluctance of central government to let regions become more autonomous. As Ukrainian space is very diverse and the co-operative links among regions are weak, any appeal to give regions and cities more authority is treated as a potential threat to the integrity of the state, thus in practice it is almost never implemented.<sup>6</sup> Most of the policies, standards, regulations and requirements, which form the backbone of the investment climate, are being determined in Kiev with very little influence from regional and local authorities.

On the other hand, a challenging fiscal climate, especially since the crisis began in 2008, means that many services, even the most vital, are not being financed adequately. Fiscal centralisation leads to

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5 With one exception of Autonomous Republic of Crimea which has a special status.

6 The trend was especially aggravated after the Orange Revolution and an attempt to create South Eastern Ukrainian Autonomous Republic – an initiative supported by several regions in this part of Ukraine that were unhappy with the results of presidential elections and growth of national democratic movement in 2004-05

passiveness and dependence of regional elites and a lack of stimuli for active economic measures that would increase investment, employment and revenues in the region. Most of the financial gains of such policies would stay on the accounts of central government. These factors should be taken into account while developing the technique of engagement, designing and delivering investment projects at municipal or regional level.

Despite the high degree of centralisation, local leaders and politicians have an influence. Cities of oblast significance have comparatively significant power and resources to mobilise for the benefit of the community.<sup>7</sup> Active, astute and persistent leaders directly accountable to the local community (mayor and local councils are elected every 5 years) are keen to engage in dialogue with the central government. They are showing by example how cities, their infrastructure, business, climate, education and cultural appeal could change for the better thanks to effective relationships with the community, business and governments at different tiers.

There are two factors that are particularly significant for determining the positions of local and regional stakeholders and their willingness to engage in the dialogue with international organisations:

- Fiscal centralisation;
- Fluidity of regional elites.

### 2.1.1 *Fiscal centralisation*

About 15.7 per cent of Ukrainian GDP (2012) is distributed via local budgets and their share in the consolidated budget of Ukraine is equal to 20 per cent (2011) down from 41 per cent in 2009. About ¾ of all local spending is “transit” – funding for delegated authorities – and local authorities have no say in it. The total amount of revenues into general (current spending) and special (capital spending) funds of the local budgets in 2012 was equal UAH 225 billion (about €22.5 billion) of which UAH 125 billion were transfers from central budget.

The total amount of local development budgets that could be spent on capital investments in 2012 was equal to UAH 14 billion (€1.4. billion) which is 14 per cent of total own revenues. It is worth noting that there are 14,000 local budgets in Ukraine and this number includes oblast, rayon cities and village budgets. A quarter of all local spending is being made through oblast budgets and 46 per cent - through the budgets of large cities. This demonstrates the crucial role of large cities in the system of fiscal redistribution and their financial capacities.

The share of local authorities in overall capital spending in Ukraine is marginal at 3.2 per cent while the share of central government is only slightly higher at 6.3 per cent (2012). A majority of capital investments are being made by the private sector – domestic and foreign. In the situation of a near total lack of capital funding, local authorities are looking for alternative sources of funding, mostly borrowing via issue of municipal bonds, loans from IFIs and sometimes commercial banks. IFIs are among the major investors in the municipal sector of Ukraine (including in the areas of transport, infrastructure, heat, water, waste management and energy efficiency measures).

A snapshot of local budgets is presented in Annex 1 of this case study. It demonstrates that Ukrainian cities and regions lack financial stability and predictability – they mostly cannot afford large scale multi-year investment projects that are needed for renovating infrastructure. Thus funds provided by IFIs and

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<sup>7</sup> Cities of oblast significance: large cities with special status that make them directly subordinate to the national government rather than the regional (oblast) state administration

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international donor organisations on attractive financial terms and conditions, and along with technical support and advice are crucial sources of funding for large capital investment projects. Many cities are keen to collaborate with the EBRD, the World Bank, NEFCO or others, though not all of them are prepared to adopt strict international standards and procedures.

It is also worth noting that administrative procedures prohibit Ukrainian local and regional authorities from holding their money in commercial or state banks (though municipal companies have no such limitations). Local and regional authorities must make all their deposits and transactions via the State Treasury. This means that their financial operations are dependent on the decision of the centrally governed authority, which often does not process payment authorisations issued by local and regional authorities even if they have credit.

In 2013, Ukrainian local and regional authorities were still experiencing severe problems with making payments from their Treasury accounts. They, along with their associations, were protesting against Treasury's unlawful freeze of payments from their accounts (with the exception of salaries and social benefits). The freeze on making payments is due to the severe deficit of state budget and the fact that national government is using funds from local and regional authorities' accounts to fund its own needs, rather than the needs and obligations of the local and regional authorities. In many instances they have to cover urgent payments by taking short-term loans that increases burden on their already stretched budgets.

Regional offices of the State Treasury and Tax, Duties Ministry, permit and licensing authorities are usually dependent on the decisions made in Kiev. Recently, cities lost their authority to approve master plans and tariffs for communal services (with some exceptions, see below). To resolve specific issues related to taxation, regulations, permits or licences the EBRD often needs to talk to Kiev authorities rather than regional offices. This substantiates the model of having only one EBRD office in Ukraine as very few issues are being dealt with outside Kiev.

### *2.1.2 Fluidity of regional political elites*

Frequent changes of regional governors and heads of various regional authorities is a reality in Ukraine. While the mayor is an elected position and every five years residents have a right to cast their vote for the mayor and local councillors, heads of oblast and rayon state administrations are Presidential appointees. Their performance is often judged not so much on the basis of socio-economic performance, but by their ability to provide "good" outcomes for the ruling party in local and national elections, or by providing enough support to "favourite" companies and exerting enough pressure on "unfriendly" competitors or companies whose owners have different political views or an independent economic position.

The current mayor of Lviv was elected in 2006 and re-elected in 2010 – this is his last term in the office as he is precluded by law from standing for a third time. In the same period, Lviv oblast state administration has seen seven governors with the last one being appointed as recently as November 2013. Change at the top often leads to the change of the deputy governors and heads of key departments. This creates additional difficulties for the city authorities, the private sector and international organisations in collaborating with regional authorities who are responsible for budget expenditure, as a new team requires time to "come up to speed" and thus important decisions are often delayed while this happens.

The challenge for the Lviv region is that often senior regional appointees are people from outside the region with little knowledge of the local situation and weak connections in the region. This is due to the fact that the Lviv region is in opposition to the current President and his ruling Party of Regions, like many other western and central Ukrainian regions. Finding loyal senior state officials inside the region is difficult

so key positions are often filled by parachuting people in. Also, over the last three years there has been a steady trend of filling important positions at central, regional and local levels with people from one particular region of Ukraine (Donetsk oblast) or representatives of two to three political and economic groups of influence close to the political leadership.

While engaging with the heads of regional/local administrations and regional offices of national agencies it is important to bear in mind their dependence on the President and Government of Ukraine and their almost non-existent accountability to the local population. Elected regional and local councils delegate all executive functions to the regional and local administrations.

### 2.1.3 *City of Lviv and its position in Ukrainian socio-economic space*

The City of Lviv is the seventh largest city of Ukraine with the population of 750,000 (plus a further 200,000 in its greater metropolitan region). Its central part has a status of UNESCO World Heritage site which attracts many tourists from Ukraine and abroad.<sup>8</sup> It was one of four Ukrainian cities that hosted Euro-2012 (European football cup final), which provided an opportunity for significant investment in the city's transport infrastructure and hospitality sector, and which boosted tourist flows. Consequently, tourism and its associated infrastructure/services are becoming the driving force behind the city's economy. According to various estimates, between 700,000 to 1 million tourists visit Lviv each year.

The tourist cluster, along with those of business services and IT, were selected as priority areas for development in the Lviv Competitiveness Strategy 2015. The city is also implementing a comprehensive Development Strategy till 2025.

Lviv is the capital of the Lviv oblast (region) which has a total population of 2.73 million people. It is situated on the border with Poland and thus greatly benefits from being a neighbouring region to the EU. In particular, it affects the development of transport infrastructure, trade, movement of people, tourism and education. Being on the border means that the Lviv region and city is one of the largest recipients of EU Cross-border Co-operation Neighbourhood Instrument funding. The funding is aimed at enhancing economic, social, humanitarian and environmental cohesion of the territories across the EU borders. There are both challenges and benefits of a border location, which are primarily related to security, illegal economic activities, human trafficking and higher rates of migration, especially among professionals. Apart from the Cross-border Cooperation funds, Lviv was traditionally recipient of many TC projects.

It is difficult to present a comparative assessment of Lviv with other large cities of Ukraine due to limitations of Ukrainian statistics. It should be noted that city leaders are keen on benchmarking Lviv development to that of other comparable European cities. A separate benchmarking exercise is included in the implementation plan of the city strategy, albeit using a limited number of compatible indicators, ratings and survey results.

The Lviv municipal economy, heavily dependent on industrial enterprises (especially in the mechanical engineering and metalwork sectors) in Soviet times, is nowadays largely a service-based economy where services account for 75 per cent of all output by non-financial companies. The most significant sectors are retail and wholesale trade (49 per cent of total sales of goods and services and 13 per cent of total jobs (2010); and transport, telecom and education. In the manufacturing sector dominant areas include the food and drinks processing industry (38 per cent of total manufacturing); electronic/optical equipment production (12 per cent); and transport machinery (8 per cent).

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8 See <http://whc.unesco.org/en/list/865>

Lviv has one of the most vibrant SME sectors and there few large-scale enterprises compared to the national average. However, large enterprises are responsible for 48 per cent of jobs, medium enterprises account for 28 per cent and small enterprises provide 24 per cent (2010). Around a third of the region's trade goes through the city of Lviv.

Lviv has 22 higher education institutions and two of those (Lviv Politechnics and Ivan Franko University) are consistently ranking in the top-10 Ukrainian higher education institutions. These two universities are key to providing resources for the highly prioritised information technology sector which is expected to lead future income and employment growth.

EECU was established in 2007 by four cities (Lviv, Kamianets-Podilsky, Berdiansk and Slavutych) and today it unites 34 cities across all regions of Ukraine. It presents itself as an executive club of city leaders that are committed to energy efficiency and climate change objectives. Each city has to demonstrate progress in developing and implementing an energy management strategy and non-performing members can have their membership revoked. The main goal of the network is to persuade city leaders and residents to think about energy use from a broader perspective and to take an approach more congruent with the principles of efficiency and sustainability.

#### **Box 1 Association of Energy Efficient Cities of Ukraine (EECU)**

In 2007, Lviv was one of the first cities in Ukraine that developed and introduced an Energy Management Strategy, municipal energy management system, energy database for 600 municipal buildings, and positions of energy manager who are responsible for monitoring and analysing the city's energy flows and the ways in which energy use could be optimised. It was also one of the founding members of the Association of Energy Efficient Cities of Ukraine (see Box 1) headquartered in Lviv. Many initiatives in public and private sector, also those in collaboration with IFIs and international donor organisations, are being implemented in line with the priorities of the city energy strategy.

A more detailed portrait of the city with some illustrations is in Annex 2 of this case study report.

## **2.2 Power relationships at the local level**

The coherence of views and willingness to co-operate across the political spectrum are features that are important for local politics and politicians striving to deliver on promises to the local community. The City of Lviv and its surrounding region is one of the most politically active and outspoken regions of Ukraine with very strong notions about state building, nation building and democratic values. The Lviv region is often referred to as "Ukrainian Piedmont", a cradle of Ukrainian nationalistic movement that led to country's independence in 1992. It is thus important to acknowledge the very strong political messages and attitudes of local political elites that while being very pro-European and anti-Soviet are often in dissonance with the directions of thought at the national level and in other regions of the country.

The local political landscape consists of many political parties and personalities who attract the support of economic groups and some strata of population. The current mayor and city council are in opposition to each other. The periods of fierce battles are being followed by bursts of constructive collaboration when it is important to reach compromise to respond to the needs and preferences of the voters.

A majority of the city council is controlled by the nationalistic Party Svoboda (Freedom) whose popularity grew significantly on the ruins of Orange Revolution and segmentation of pro-democratic liberal political forces. Its party programme is a mixture of extreme right socio-political and ethical values and leftist economic agenda that is largely pro-state and anti-foreign capital. The mayor, Mr Sadovyy, who was not a member of a political party until recently,<sup>9</sup> supports liberal economic values and the rather conservative societal and family values of Western Ukraine. Over almost a decade of being mayor he proved to be a very flexible and co-operative manager who could find a common language with Western investors and donors, Kyiv decision makers, Lviv regional bureaucrats and businessmen, and Eastern Ukrainian oligarchs. Support from the electorate also continued due to his commitment to preparation for the Euro-2012 tournament in Lviv and the implementation of large socially significant infrastructure projects (including those funded by the EBRD).

Despite some serious mistakes and unaffordable ambitions (like a proposal to host the Winter Olympic Games 2022 in the Ukrainian Carpathian mountains/Lviv), he is by far the most effective mayor Lviv has seen and has the potential to become a national political candidate. As Party Svoboda increases its presence in other regions of Ukraine, the outcomes of political dialogue and achievements of joint decisions by the city council and mayor could provide a good insight into the process of reaching compromises in a highly politicised local environment that could contribute to long-term economic competitiveness and welfare. Of course, if the mayor does enter the national political arena he could become an important interlocutor for the EBRD – perhaps this provides another rationale for engagement at the local level.

## 2.3 Engaging with the regional/municipal counterparts

Policy dialogue at the regional or municipal level in Ukraine is not demonstrably strategic in nature as there is no framework agreement between the EBRD and the city of Lviv on the priorities of collaboration, expected outcomes, impacts and timeframes. Dialogue is being performed in specific spheres with various stakeholders in the mayor's office, city council, regional state administration, regional offices of regulatory agencies, by primarily the MEI and E2C2 teams according to a perceived need and opportunity. However, it would be unfair to say that there are no guiding principles, as the mayor and city council seem to be very interested in collaboration with the EBRD (and other IFIs, donors) and is being proactive in suggesting the areas where EBRD investments could contribute the most to the city's development. It is a two-way avenue where the EBRD is adjusting the city's ideas and suggestions to its own strategy and priorities in the country that are rooted in the potential for significant transition impact and competitive profit margin. This somewhat opportunistic approach may in fact be the most sensible one to adopt.

The city council and mayor's office are the first point of contact for any initiatives in the public sector while private sector initiatives are usually being implemented with the engagement of relevant regulatory agencies and the business community, and engagement with the city government is happening if need arises and mainly with the departments which are responsible for economic development, investments and support to entrepreneurs.

Table 1 contains key EBRD investment projects in the city of Lviv.<sup>10</sup> In a separate Table 2, a number of SBS operations is listed (for 2012-2013) as an illustration of small and medium sized enterprise support activities in the city and surrounding region (Lviv oblast).

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<sup>9</sup> In December 2012 he became a leader of newly created political party Samopomich (Self-help) that is eponymous to the NGO Samopomich established by Andriy Sadovyy in Lviv in 2004.

<sup>10</sup> Galnaftogaz deals are not included.



Table 1 EBRD projects in the city of Lviv

Signing Date	Project	Company	EBRD loan in EUR m	Grant in EUR m	Total cost, EUR m (estimate)	TC associated	TC budget	Scope of project
16 Jul 2009 <sup>a11</sup>	Lviv Road Rehabilitation and Modernisation Project	Lvivavtodor	26		48.7	Technical and environment scoping and review of tram investments and road rehabilitation	€73,270	Rehabilitation of tram tracks, streets, underlying utilities. Implementation of traffic management systems. Renewal of tram infrastructure, depots modernisation, etc.
						IFRS audit of LET's and LvivAvtodor financial statements	€96,000	
						Public Transport Regulatory Improvement for the city	€540,500	
	Lviv Public Transport Financing Project	LvivElectro-Trans Public Transport Company (LET)	12			Procurement, Implementation Support and Contract Supervision (600000 for LET, 585000 for LvivAvtodor)	€1,185,000	
						Corporate Development Support Programme for LET	€350,000	
						Credit enhancement Programme for the City	€299,500	
						Traffic Management Development and Design support for Lvivavtodor	€225,000	
13 Jun 2013	Lviv District Heating	Lvivteplo-energo	20	10	33	Feasibility study	€300,950	Finance a priority investment programme aimed at improving energy efficiency, reducing energy losses, gas and electricity consumption and improving quality of heat and hot water supply services
						IFRS audit	€25,000	
						Project implementation Support	€600,000	
						Corporate Development Support Programme	€275,000	
15 Nov 2012	Multi Development Forum Lviv	Multi Veste Ukraine 3 ZAT LLC	22.1		92.2	Energy Performance Assessment and capacity building	5€9,850	Development of an international-quality shopping mall

<sup>a11</sup> Lviv Road Rehabilitation and Modernisation Project and Lviv Public Transport Financing Project are part of a combined operation in the city of Lviv

**Table 2 The EBRD's SBS projects in the city of Lviv and its region**

Year	BAS project	Company	Sector	EBRD contribution (EUR)	Client contribution (EUR)
2013	Quality Management	Complex Business Process Management LLC	Electrical/Electronics/IT	4,725	1,575
2013	Quality Management	Domen-Druk Ltd	Paper	3,937.5	3,937.5
2013	Information Communication Technology	Paper and board company PJSC	Paper	6,207.5	8,506.5
2013	Information Communication Technology	Hotel Astoria LLC	Travel/Tourism	7,666.88	3,049.12
2013	Quality Management	Private Joint Stock Company "Drohobysky Khlibokombinat"	Food & Beverages	6,732	5,508
2013	Quality Management	Golden Quail LLC	Food & Beverages	6,364.26	2,121.44
2013	Energy/Resource Efficiency	TOR Enterprise	Glass/Rubber/Plastic	7,980	2,660
2013	Quality Management	LIZO Ltd.	Electrical/Electronics/IT	5,118.75	1,706.25
2013	Information Communication Technology	Nazariy Yaroslavovych Zinko Private Entrepreneur	Wholesale/Retail Distribution	5,197.5	1,732.5
2012	Information Communication Technology	Dyvosvit Ltd	Wholesale/Retail Distribution	7,627.5	9852.5
2012	Organisation	Market Universal LTD LLC	Wholesale/Retail Distribution	6,078	8,509.2
2012	Information Communication Technology	Vasyl Kushpir Private Entrepreneur	Metals/Machinery/Equipment	2,074.67	691,55
2012	Quality Management	Kachkynovych Roman Private Entrepreneur	Food & Beverages	9,891	3,297
2012	Information Communication Technology	BiSH Company Ltd	Health	3,025.5	1,372.5
2012	Organisation	O.R.K.-service LLC	Food & Beverages	10,000	7,900
2012	Information Communication Technology	Medical Center Intersono PE	Health	7,000	12,192.72
2012	Quality Management	Architectural Workshop Renesans PE	Construction/Engineering	4,455	3,645
2012	Information Communication Technology	Astra JV Ltd	Transport	1,522	2,130.8
2012	Quality Management	Firm Aspekt Ltd	Construction/Engineering	9,296.25	3,098.75
2012	Quality Management	Legal Company HD Partners LLC	Consulting	5,400	1,800
2012	Quality Management	Confectionary YARYCH LLC	Food & Beverages	1,375	1,625
2012	Information Communication Technology	Rikota PE	Health	5,647.5	2,742.5
2012	Quality Management	Paper and board company PJSC	Paper	3,792.5	3,792.5
2012	Organisation	Ukrenergo Ltd	Wholesale/Retail Distribution	10,000	6,800
2012	Organisation	Industrial & Trading Company NAK Ltd	Metals/Machinery/Equipment	10,000	10,000
2012	Information Communication Technology	HLIB-TRADE Ltd	Food & Beverages	10,000	16,477.66

### 3. Policy process

A detailed timeline of the policy dialogue in the city of Lviv is presented in Annex 3 of this study.

It would be fair to say that policy dialogue at regional or municipal level is mostly of a “tactical” rather than a “strategic” nature. It is mostly aimed at unlocking opportunities for investing in focused areas, creating a beneficial local investment climate, and building capacity of local public officials and specialists working in publicly owned companies. The EBRD is not engaging in the stream of work related to formulating and implementing the Strategy of City of Lviv – other international donor organisations are doing this. However the Bank is closely involved in implementation of specific priorities of the strategy and along with other IFIs and donors is contributing to growth of the city’s economy and wellbeing of its population.

#### Box 2 Example of troubleshooting policy dialogue in the city of Lviv

It took six months for the EBRD and Lviv counterparts (LvivElectroTrans and city council/mayor) to persuade the Ministry of Finance to change the regulation which prohibited the company to use cash for paying its share of capital in the loan. Meanwhile the client suffered as it was paying interest while not having access to EBRD funding.

One of the EBRD interviewees working in the area of municipal infrastructure sector highlighted the difference between strategic “proactive” and tactical “troubleshooting” (or “reactive”) policy dialogue. The latter is currently especially needed in Ukraine. While engagement at the highest level leading to legal, institutional and regulatory changes is essential, it rarely produces results in the short term, and it is often not appropriate for addressing smaller scale urgent issues which emerge while preparing or implementing a specific investment project. Then “troubleshooting” dialogue is more appropriate and consists of fast reactions to emerging problems of the clients and consultants, which require solution either at regional or municipal level or at the national level.

Unlike many cities in Ukraine, Lviv has a clear and up to date strategy document. EBRD counterparts did not specifically acknowledge the significance of this document for EBRD operations. However, potentially at least, working in a city with a clear vision for the future and instruments for mobilising joint public-private-community initiatives could lead to better results than having similar investment operations and TC activities in the cities that do not have clear strategic approach to the development.

The strategic element of municipal policy dialogue is related to:

- the legal changes that enabled lending with a municipal guarantee; and,
- ongoing work (jointly with the World Bank) in the framework of stand-alone TC projects aimed at:
  - building the capacity of the national regulator responsible for setting and monitoring the tariffs for communal services in Ukraine,
  - ensuring full cost-recovery; and,
  - building effective contractual relations between municipalities and communal companies that are providing services to cities’ population).

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Once issues are resolved at national level with the means of “strategic” policy dialogue, the process of “tactical” dialogue at regional/municipal levels could be continued to integrate new changes into the local regulatory and institutional environment.

### **3.1 Conception, planning and strategy**

Policy dialogue between the EBRD and Lviv city authorities became a reality when Andriy Sadovyy became mayor of the city and the trajectory of city development took a new turn towards enhancing its competitiveness and the wellbeing of population. Dialogue became more intensive and structured after the EBRD adopted its new Ukraine strategy 2011-2014 where the priorities were engagement with the municipalities and launching a package of projects aimed at improving the performance of utility companies at municipal level. In particular, the objective is to “support commercialisation of municipal utilities through projects with large demonstration effects or energy efficiency gains”.<sup>12</sup>

At the same time as the implementation of the EBRD strategy, there was a desire from the side of the city leadership to engage in improving performance of utility companies. As it was pointed during one of the interviews, formal dialogue on the priority areas for EBRD investments in the city was launched between the mayor and EBRD officials at the investment forum organised by the EBRD in London in February 2008. A number of areas for potential collaboration were identified which were then verified by the consultants hired by the EBRD. After their thorough assessment of the potential investment opportunities, including a site visit to Lviv, specific priorities were identified and the work on preparing concrete projects started. In 2009, terms of reference for two projects in road infrastructure and public transport were finalised. The Government of Ukraine was informed about the process at all stages and was supportive of the collaboration between Lviv and the EBRD.

It is unclear from our research whether any preliminary consultations were held with the city leadership regarding establishment of the first regional office of the SBS programme in Lviv. This decision is overwhelmingly welcomed by the city and by local business community (networks and individual companies) as a new opportunity for strengthening SME sector of the city and improving the performance and competitiveness of local businesses.

In the area of municipal infrastructure and environment, the EBRD was heavily involved in policy dialogue prior to launching the projects. This was due to the fact that prior to the adoption by the Verkhovna Rada (Parliament) of fundamental changes to the Budget Code in July 2010, cities were practically barred from borrowing as the criteria for getting municipal guarantee loans were very strict and difficult to fulfil. The Budget Code stipulated that only cities with a population above 500,000 people could borrow and the total amount of debt could not exceed 100 per cent (200 per cent for the capital city of Kiev) of average annual development budget revenues forecasted for the next two years after the respective budget year. Given great variation of revenues into the development budgets of local councils, this threshold in fact prohibited borrowing, including from IFIs.

The EBRD, jointly with other IFIs and donor organisations, engaged in intensive consultations with the Government of Ukraine and Parliament to amend the Budget Code and make lending to municipalities possible. For more details please refer to the next chapter on carrying out policy dialogue.

Another sphere of policy dialogue at the national level that enables investment operations with the municipalities is engagement with the recently created National Communal Services Market Regulation Commission (which was formerly part of NERC) which is now responsible for the regulation of tariffs for

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heating, water and wastewater services at the municipal level.<sup>13</sup> In a way, creation of a national Regulator started an important strand of dialogue at the national level which previously was not possible as individual cities were responsible for setting their own tariffs. This body became major partner in implementing Integrated Approach to Reform in the Ukrainian District Heating Sector 2012-2015 approved by the EBRD Board in 2011.

## **3.2 Carrying out policy dialogue**

Here we should distinguish policy dialogue at the central and regional/municipal levels.

### **3.2.1 National level policy dialogue**

Jointly with city councils, the Association of Ukrainian Cities, think tanks and expert communities, the Bank presented a strong case for opening up the municipal lending market and allowing cities to get much needed investments for capital spending and improving vital infrastructure. This is especially crucial in the situation when budget resources are scarce and are available mostly only for current expenditures.

After an intensive information campaign and facts-based arguments, the Parliament adopted new changes to the Budget Code in July 2011 as a result of which many Ukrainian cities (with a population 300,000 and above) can borrow from IFIs and the threshold for borrowing was raised to 200 per cent of revenues to the development budget (400 per cent for Kiev). There is a caveat in this progress as borrowing is permitted only from IFIs so the question of them pursuing self-interest is a valid one. However, after consultations with the representatives of Government of Ukraine, municipality, other IFIs and the EBRD's client banks it became clear that currently commercial banks in Ukraine are not willing to provide municipal lending. Also, the government has legitimate concerns regarding the ability of some commercial banks to lend responsibly to municipalities. The evaluation concluded it makes sense to prepare the way with IFI lending to build the capacity of municipalities to handle commercial borrowing. The EBRD's client banks saw the changes to the Budget Code in a positive light as preparing the way for their involvement in the future when risk appetite returns.

Launching and maintaining policy dialogue in this sphere was an EBRD initiative and it was performed without any additional TC funding or external consultants. The initiative was led by Kiev Resident Office staff with regular interventions from high-level visits by staff members from Headquarters, and via the medium of official letters that underlined main challenges for collaboration between the Bank and Ukrainian clients.

Special attention was paid to building relationships with high and mid-level officials at key government agencies such as the Ministry of Finance, Cabinet of Ministers and the Parliament. Despite a centralisation of power at the top and a hierarchical system of governance, it proved important to engage mid-level public officials and experts with in-depth knowledge of the Ukrainian public finance system who could help find realistic and pragmatic solutions. Having these counterparts on board helped the process for formulating changes and acquiring parliamentary approval of the new Budget Code. The outcome was positive and likely sustainable.

While policy dialogue in the area of municipal lending was proactive, the dialogue with the Ukrainian Government on the reform of regulations and tariff setting for municipal services (including heat and

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<sup>13</sup> The Commission's authority does not spread to smaller cities and towns. Freedom of tariff setting belongs to the cities/towns with the energy consumption below 20 GKal and those that are not getting energy from Oblast Energy companies as the latter are regulated at national level. In reality it means that smaller towns having freedom of setting their own tariffs for energy and heating often have higher tariffs.

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water) was more “reactive” and followed the institutional and regulatory changes that were initiated by government. With the creation of a national regulator responsible for tariffs of communal services, the EBRD and other IFIs gained a counterpart for engagement to bring about across-the-board changes for tariff setting in communal services (or at least across the most of cities and towns of the country). Establishing good relations with the Regulator and joint identification of the areas that needed urgent assistance and advice led to development of a terms of reference for a TC project that is funded by Sweden to be launched at the end of 2013. Specific to this dialogue is that it is a joint action by the EBRD and World Bank as both have large interests in the area. Despite using different financial instruments (municipal guarantee loans to individual cities versus sovereign guarantee loan for framework agreements), both banks have the same challenges in the regulatory and tariff sphere that makes municipal sector a difficult environment for investors. The World Bank is leading the TC project implementation while the EBRD is continuously engaged in the process. This is a good illustration of IFIs working together – an important element of persuading the government to take concrete steps in the area of municipal services reform.

### 3.2.2 *Regional level policy dialogue*

Whilst the Lviv city council (including its executive committee and mayoral office) is not a direct recipient of TC associated with the implementation of the loans it is a key contributor to and guarantor of the loans. The city council is deeply involved in the relationships between the EBRD and the municipal enterprises. It appoints the heads of all communal enterprises that are recipients of EBRD loans and is a signatory of the public service contract on service delivery. Developing the city council's capacity is therefore a crucial factor of success. It was highlighted by the city's leadership and managers that the experience of working with the EBRD, the World Bank and other IFIs towards building transparent procurement procedures based on best European practices is unique and extremely useful. The city is working on replicating this in other spheres where its own money is being spent on goods or services – an excellent example of demonstration leading to replication.

The city council is a crucial partner for the EBRD that often performs the role of mediator between the EBRD and the public company client when problems arise and it provides a full range of “services” – from providing explanations and information to interpreting during the meetings. Companies that work with the EBRD for a longer period of time are better communicators and are quicker to grasp new demands and standards while those only beginning the collaboration are often unhappy about the “overzealous intrusion” and “lack of trust in our abilities.” Reluctance to adopt EBRD procurement procedures can be significant (see Annex 2) at the beginning but is getting lower as the time goes by and the benefits become obvious. Also use of English language for all official documentation was mentioned as a difficult issue for many regulatory officials involved in overseeing EBRD projects in Lviv.

It was acknowledged that regional offices of the regulatory bodies are often tough to convince about the necessity of a specific action or financial transaction in the framework of municipal investment projects. Some interviewees suggested that more attention should be given to developing the capacity of officials working in the key agencies in order to enhance their understanding of the distinctive nature of investment projects funded by IFIs and why they are so different in many respects from investment projects funded by state/municipal budgets. Others believe that it would be an ineffective use of resources as there are many and diverse agencies involved and it is unfeasible to provide tailored training and briefings to all of them. Another view was that it is better to invest in the relationships and capacity of the officials at central offices of regulatory agencies who in fact should facilitate implementation of IFI projects across all Ukraine regardless their location, without in-depth involvement of local staff.

The latter suggestion advocates for a more rational use of resources and distancing from local political turf wars. It is also in tune with the general trends of centralisation of power in Ukraine (including for example recent transfer of responsibility for approving city master plans and regulating tariffs for communal services). However, it is against an internationally recognised trend of decentralisation of powers and bringing decisions on service delivery closer to consumers. It is also not quite congruent with the recommendations of other international organisations and donors which are advocating for de-concentration of powers from Kiev to regions and for a greater role for local and regional self-governments.

While carrying out policy dialogue it is important to understand the complexity of the institutional set-up and key stakeholders engaged at the national and regional tiers. Table 3 lists all the counterparts that are directly and sometimes indirectly influencing the policy dialogue in this case. Figure 1 illustrates the relationships between key counterparts for the EBRD's Lviv operations.

**Table 3 Stakeholders in Lviv municipal operations**

Government of Ukraine	Regional and Municipal Government	Public and private sector clients	IFIs/donors
<b>Ministry of Finance</b> (key decision maker in budget sphere, authorises cities' lending and determines budget transfers, including investment subventions) <b>Ministry of Economic Development and Trade</b> (responsible for state regional policy which is aimed at improving the competitiveness of Ukrainian regions and cities; for managing Regional Development Fund) <b>Ministry of Regional Development, Construction and Housing</b> (responsible for regulating housing and communal services) <b>Ministry of Taxes and Duties</b> (administering taxes and duties) <b>National Communal Services Market Regulation Commission</b> (national regulator in district heating and the water sector) <b>State Treasury</b> (bank for municipalities which holds all their accounts and makes necessary transfers to third parties) <b>Verkhovna Rada</b> (approving new laws and amending existing ones) and <b>individual MPs</b> <b>Other regulatory agencies</b>	Lviv city council and its executive committee (strategic role and execution) Lviv mayor (strategic role and daily management of city affairs) Lviv oblast state administration (strategic role for entire region, significant financial flows through oblast budget)  Lviv oblast council (strategic and control roles but no executive functions) Regional offices of national agencies and ministries in Lviv (Treasury, Tax, Audit, etc)	Lvivavtodor (road infrastructure) Lvivelectrotrans (electric public transport) Lvivteploenergo (district heating) Multi Veste Ukraine (green commercial building) Clients and consultants of SBS programme  <b>Non-governmental actors</b>  Association of Energy Efficient Cities of Ukraine Association of Ukrainian Cities IBSER (Institute of Budget and Socio-Economic research) Others	EBRD (MEI and other teams) WB (Framework agreements on improving performance of communal heating and water companies) + joint implementation of TC project with the National Regulator (funded through SIDA) IFC (active in some areas of municipal management like EE, waste management and e-tickets for public transport in Lviv) NEFCO (municipal lending, including to city of Lviv for EE projects) KfW (municipal lending, including to city of Lviv) EU and its TC projects (incl. Covenant of Mayors support project, Project "Technical Assistance Support for Ukrainian Municipalities" implemented by EBRD)



The diagram illustrates the EBRD's role in the Lviv region, showing its interactions with the Public Sector and the Private Sector. A vertical dashed line separates the two sectors.

**Public Sector (Left):**

- EBRD** (Central blue oval) interacts with:
  - GoU: MinFin, MEDT, MinRegio, Communal Services Regulator** (Blue box)
  - Parliament** (Blue box)
  - President** (Blue box)
  - Regional offices of tax and regulatory authorities** (Blue box)
  - Lviv OSA, Lviv oblast council** (Blue box)
  - City mayor, city council, executive committee (Guarantor)** (Blue box)
  - LvivTeploEnerg** (Blue box)
  - LvivAvtoDor** (Blue box)
  - LvivElectroTrans** (Blue box)
- Other IFIs/donors** (Orange oval) are connected to the Public Sector by an orange arrow.

**Private Sector (Right):**

- EBRD** (Central blue oval) interacts with:
  - SBS Regional Office** (Green oval)
  - Fls, local association** (Green box)
  - SMEs** (Green box)
  - Multi Project** (Green box)
  - District heating project** (Green box)
  - Lviv Transport** (Green box)

**Inter-Sectoral Interactions:**

- Green arrows show EBRD's role in the Private Sector, including projects like **District heating project**, **Lviv Transport**, **Fls, local association**, **SMEs**, and **Multi Project**.
- Green arrows also show EBRD's role in the Public Sector, including projects like **LvivTeploEnerg**, **LvivAvtoDor**, and **LvivElectroTrans**.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **District heating project**.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivTeploEnerg** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivAvtoDor** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivElectroTrans** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **District heating project**.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivTeploEnerg** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivAvtoDor** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivElectroTrans** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **District heating project**.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivTeploEnerg** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivAvtoDor** box.
- A green arrow points from the **City mayor, city council, executive committee (Guarantor)** to the **LvivElectroTrans** box.

- LvivAvtoDor (LAD) was first company in the city of Lviv that received EBRD loan so they are pioneers in many respects and other companies can learn from their mistakes. At the same time LvivTeploEnergo (LTE), as a relatively new EBRD client still, is keen to learn from the experience of other district heating companies which received earlier EBRD loans earlier (such as Ternopil, Zhytomyr) rather than from its Lviv peer company with greater experience .
- There are many reasons for the delay in implementation of a loan and one of the most significant is the need for total corporate reform of the clients, a process that is often quite political and protracted. In general, the EBRD is very conscious of Ukrainian political realities and is keen on following a step-by-step process. However a bit more familiarity with the political processes at central and municipal levels and how they clash would be useful for identifying realistic deadlines and conditions for obtaining funding. This would make the planning stage more practical and expectations more realistic.
- The EBRD is playing a crucial role in helping to introduce new practices and standards, though they are often met with suspicion by Ukrainian controlling authorities who lack the knowledge and secondary legislation that would recognise the distinctive nature of IFI-funded investment projects and their difference from publicly-funded projects.
- The EBRD and its consultants are providing great support to LAD and the city council, both with the implementation and arguing with/protecting them from controlling authorities that filed several criminal investigations against the leadership of LAD accusing them of misuse of funds (based on the facts of using different procedures required by EBRD standards).

A number of EBRD teams are collaborating with the city authorities or regional offices of government agencies in Lviv: from MEI and E2C2 to Property and SBS teams. There is a certain degree of joined-up

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approach to addressing the challenges of Lviv and conducting dialogue with the city leadership. In many cases energy efficiency and sustainability is the key reference point that unites the policy dialogue agenda with the city, along with the general business climate agenda. Having these topics as a backbone for collaborative initiatives and policy dialogue is positive, also bearing in mind that Lviv was one of the first cities in Ukraine that adopted an energy management strategy and action plan and is active participant and in many cases leader of the Association of Energy Efficient Cities of Ukraine.

The EBRD has organised a number of events in Lviv on energy efficiency, also using demonstrations from some of its SBS clients. Several business interviewees stressed the effectiveness of collaboration with the city authorities in the area of energy efficiency.

The MEI team is a key EBRD team for large municipal infrastructure projects and handling most of direct relationships with the mayor and city council, while the Property team is working with mid-level officials and specialised agencies on the project of first green building standard commercial property in Ukraine. There is also intensive engagement between the SBS team and city council officials working in the economic development department.

Potentially, the SBS programme presents an ideal platform for natural progression of small businesses of Lviv to medium and then large companies. As noted during interviews with both consultants and recipients of SBS support, many Business Advisory Services (BAS) clients become clients of the Enterprise Growth Programme (EGP) and later receive loans in the framework of EBRD agreements with commercial banks on supporting SME (and other IFIs, like NEFCO). With the city of Lviv's substantial mid-sized sector, the SBS programme could potentially be a source of clients for manufacturing and services, telecommunications, property & tourism or other banking teams. This might be in line with the emerging thinking for the next strategic period of EBRD activities in the country, where a greater focus will be on localisation of engagement with potential clients and access to mid-sized regional businesses. Building relationships with regional umbrella platforms, such as regional office of European Business Association, business clubs, business schools and informal gatherings of local CEOs, and regional banks, might be desirable.

During interviews with the counterparts in Lviv a number of points were raised with regard to the implementation of policy dialogue:

- All EBRD clients in the public sector and the EBRD itself have major problems with Ukrainian regulatory and controlling authorities that have their own vision of procurement and compliance rules and are hard to persuade that European standards and procurement rules are the only that could be used for all EBRD loans. Lots of time and effort is spent at all political levels to change this situation.
- Regulatory and legislative imperfections impact on the speed of loan disbursement and increase the cost of money spent. The EBRD constantly emphasises this point at meetings with Ukrainian authorities, including regular meetings with MEDT regarding the progress in disbursement and use of EBRD loans by Ukrainian clients in public sector, and yet in many cases these are the main reasons for delayed implementation. The EBRD is trying to help clients to overcome long delays on case-by-case basis.
- TC is being provided jointly with the World Bank to the national tariff regulator that should have capacity to develop and enforce a single methodology for tariff setting. International models and experience will be used extensively.

- Willing individual companies can achieve significant success in modernising their business standards and production techniques. Companies that receive support from the BAS programme often become clients of the Enterprise Growth Programme and later receive loans (via local partner banks). At the same time the BAS brand does help to expand opportunities for consulting businesses as their reliability and client trust is growing.
- More work needs to be done on developing secondary legislation as currently its absence creates a vacuum in the regulatory environment and causes trouble for clients in public sector.
- Working with the EBRD and the World Bank is a very good experience for the municipal government and its communal enterprises, not only for enhancing city infrastructure and improving the quality of services to the population but also for promoting internal changes and reforms based on new principles of public administration.
- The Department of Housing and Infrastructure is the direct partner of three big communal companies and signs public service contracts with them. These agreements incorporate some of the provisions of loan agreements with the EBRD, especially in the part of financial coefficients. The department's staff engaged in preparation and monitoring of public service contracts is becoming more competent and confident in this new sphere and prospects for further improvements in city council and its executive committee are good.

### 3.4 Reviewing, reporting and evaluation

Most of the projects that are currently active in the city of Lviv are either recently launched or where funding was only relatively recently released and are too new for reviews and progress reports. However some of them (road rehabilitation and public transport loans) are more advanced and went through an extensive inception phase of corporate restructuring, tariff changes and setting-up new contractual relationships between the municipality and companies.

There are lots of lessons that are extremely informative given Ukrainian political and economic realities, realities of local mentality and social culture. These should be analysed and used for enhancing the learning curve of the EBRD and other IFIs in terms of engaging with the municipal actors and investing in modernisation of the city. It is not only the financial result and transition effect that should be analysed – it is also the political economy, and changing dynamics of relationships between different actors at municipal and national level that needs to be understood and then taken into account while preparing future projects in the sectors.

Understanding those factors will allow revision of the standard approach to investment projects (especially with public sector clients) or consideration of changes to the approach in delivering TC and engaging in policy dialogue. This could overcome some of the complications, soften others or equip consultants' teams and EBRD staff with the knowledge and skills that are necessary for achieving progress in politically difficult situations.

Evaluations and assessments of the impact of SBS programme on the development of local SMEs in Lviv could be linked with the ex-ante evaluation of the potential for finding clients for the mainstream banking operations. This is especially true for growing companies that are keen to get more substantial sums directly from the EBRD where long-term financing through commercial banks is not available. Lviv could become a pilot for performing such joined-up assessments of SBS and banking teams that on the one

hand could improve demonstrability of SBS outcomes and on the other help to identify concrete clients for future business operations.

### 3.5 Resourcing

In the course of this evaluation a large number of stakeholders, including clients, highlighted the high level of expertise and professionalism of EBRD staff who are leading in policy dialogue, delivering specific investment or TC operations. They noted more efficient business processes at the EBRD compared to other IFIs/donors. The Kyiv Resident Office staff members are actively engaged in daily operations and in on-going policy dialogue with municipal and central government counterparts, while Headquarters is leading in important decision-making and high-level policy dialogue.

EBRD interviewees noted that currently there is an adequate amount of human and other resources dedicated to policy dialogue in the sector. However there were some remarks related to the efficiency of communication and 'distance' to the EBRD office in Kyiv. Quite a few Lviv counterparts noted that having a regional office in Lviv would help existing operations and improve overall communication between the clients in Lviv region and the Bank. Existing clients were not always happy with the length of time it takes between asking the question and receiving a reply from EBRD colleagues, which in their opinion slows down to the implementation process.

On the other hand, EBRD interviewees noted that opening regional office does not make sense since its small scale would not be able to accommodate diverse on-site expertise with decision-making authority, required to realise efficiency gains for such a broad range of projects that are being implemented in Lviv and neighbouring regions (a regional office would have to cover several *oblasts* of Ukraine). As one EBRD staff member noted, "It does not make sense to open a regional office as decisions would not be taken by the office but by individuals based either in London or Kiev".

At the same time, there is a sense of bringing EBRD services closer to the local businesses through the imminent opening of a first regional office of the SBS programme in Lviv. This signals a new approach by the Bank towards engagement with Ukrainian micro, small and medium-sized companies, which is outlined in both EBRD SBS Strategy and in Ukraine country strategy 2011-2014. Having two permanent staff members based in Lviv will help to expand engagement with the dynamic SME sector of Lviv and could lead to generation of a project pipeline for mainstream banking teams.

External consultants are used extensively for delivering TC projects associated with specific transactions in both private and public sectors. They are instrumental in preparing highly technical and specialised documents and delivering technical advice in the process of policy dialogue at mid-level. It is possible to access some of their reports and recommendations at the web-site of the Lviv city council. Most of Lviv counterparts highlighted the professionalism and effectiveness of consultant teams at the same time noting some of their limitations (need to get approval from the EBRD about any modifications to the terms of reference, inability to react quickly to the constantly changing local environment). However there were some instances of negative experience of collaboration with consultants hired by the EBRD. These led to highly heated debates that in the end had to be resolved at the highest level (between the city mayor and a Managing Director from the EBRD).

Extensive use of external consultants has negative impact on institutional memory of the Bank in specific areas. The quality of consultant output is sometimes not adequate and breadth of insight overshadows its depth.

Several recommendations were made by Lviv stakeholders to improve the use of EBRD resources in the future:

- Opening a regional office in Lviv with delegated authority in order to speed up the decision-making process;
- Investing more in organising specialised information events for local businesses interested in collaborating with the EBRD but who know very little about the standards, procedures and opportunities; also organising events for existing clients presenting international models and experiences that are most relevant for the reforms of municipal services and economy
- Allowing more flexibility in implementing investment operations that are taking a long time to 'hatch'. For example in the project with LET, the client identified specific needs for upgrading the infrastructure in 2009 when the terms of reference were being finalised. Currently, the realities of city development require a different focus of resources but it appears to be difficult to shift it due to EBRD approval norms and requirements (and long delays in obtaining first tranche of funding).
- Opportunities for twinning projects with foreign communal companies of the same profile would be desirable for a more hands-on practical learning of international experience.
- An overall recommendation was to allow greater flexibility in the dialogue that would factor in the political cycle and political issues related to the reform of municipal economy and services.
- Restructuring of a publicly-owned company (including redundancies), approval of tariff increase, adoption of new law by the Parliament or regulation by Ministry of Finance requires a lot of time which can be expensive if the client has to pay interest. On the other hand some interviewees recommended that the EBRD take a more active part in leveraging the influence over decision making by municipal and central government – for example, by demanding more radical changes in the banking sector, legislation and regulatory sphere.
- The EBRD should shift more resources to policy dialogue aimed at preparing and enacting secondary legislation and regulations that are crucial for bringing about real change in the specific sector.

## 4. Conclusions

The case of the City of Lviv demonstrates that the EBRD can achieve high quality outcomes at the regional level when the local environment is conducive to change with local leadership that has a clear vision for the future and specific priorities for action. Even in a centralised country where most decisions are taken by central government and most of financial flows are distributed centrally, big cities can achieve a relatively high degree of autonomy if the political will for change in the local economy and wellbeing of its residents are present. Local self-governments that have their own executive bodies and direct support from the local population can become effective partners in implementing high-impact projects that could become models for further replication across the country and in other countries where conditions are similar to Ukraine.

However, it is necessary to remain realistic about the extent of the potential for development that can be achieved by local initiatives only. If the general investment climate in Ukraine remains as bad as it currently is, and if political instability persists, then businesses will continue to pursue 'conservative' strategies with minimum investment and expansion (as noted by some business interviewees).

The investment outlook for the private sector is less certain than for the public sector. According to representatives of local businesses and their associations, very few businessmen, even in such dynamic

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city as Lviv, are currently investing in long-term projects and even fewer use credit for this. Politically motivated hostile business practices and a general lack of respect for private property are posing huge risks for expanding a business beyond certain 'safe' margins. For tapping into the potential of the private sector in Ukraine, the EBRD needs to pay more attention to policy dialogue at the central level with regard to improving overall business climate, deregulation, creating strong safeguards for private property and respect of law, reforming the banking sector and empowering regional and local authorities. Local authorities can then implement their own economic development policy based on the endogenous potential and comparative advantages of a specific city or region.

The EBRD has a very strong brand in the region which could serve as a great asset for further expansion of operations. Success of its current investment operations and the outcomes of policy dialogue and TC projects contribute to long-needed changes in the municipal infrastructure, services, energy efficiency and SME development. The experience with operations in Lviv (and EBRD operations in other cities) and engagement with the city leadership could be used as a basis for building relationships with other cities of Ukraine and formulating a portfolio of investments and TC that are most relevant to the challenges faced by Ukrainian municipalities.

## Annex 1: Spatial aspects of socio-economic transformations in Ukraine

### 1. Spatial disparities

Ukraine is a unitary state with three tiers of territorial government: regional (oblast), sub-regional (rayon and city) and local (gromada). Ukrainian oblasts by size are similar to NUTS-2 level in the European Union, rayons – to NUTS-3/NUTS-4 and gromadas – to NUTS-5 (Table 4).

Table 4 Territorial organisation of Ukraine

	Regional tier	Sub-regional tier	Local tier
	24 oblasts + AR Crimea + 2 cities of state significance	490 rayons + 171 cities of oblast significance	Circa 30,000 communes
Number of units			
Average area (square km)	22,360	975	20
Average number of population (thousand)	1,863	81	1.7

There is no self-sufficient and economically viable self-government at any territorial tier of administration. Only the Autonomous Republic of Crimea has special status and relative independence in political, economic and social development policies. Also the cities of Kiev and Sevastopol are governed by separate laws given distinctive nature of their status (capital city and formerly 'closed city' with strong presence of foreign military forces respectively), governance and institutional framework.

Ukrainian oblasts (regions) have an elected council without an executive body. Executive authority is delegated to the oblast state administrations, which is a regional representative of Central Government and the Presidential Administration. Heads of administrations, governors, are appointed by the President and are key decision makers who are directly subordinate to the central government and President and are not directly accountable to the regional population. The same situation exists at the rayon level. The basic territorial units of Ukraine – gromadas – have local councils and no administrations but they are very numerous and small, with limited income and little opportunity to perform any independent policy or provide services to the local population effectively.

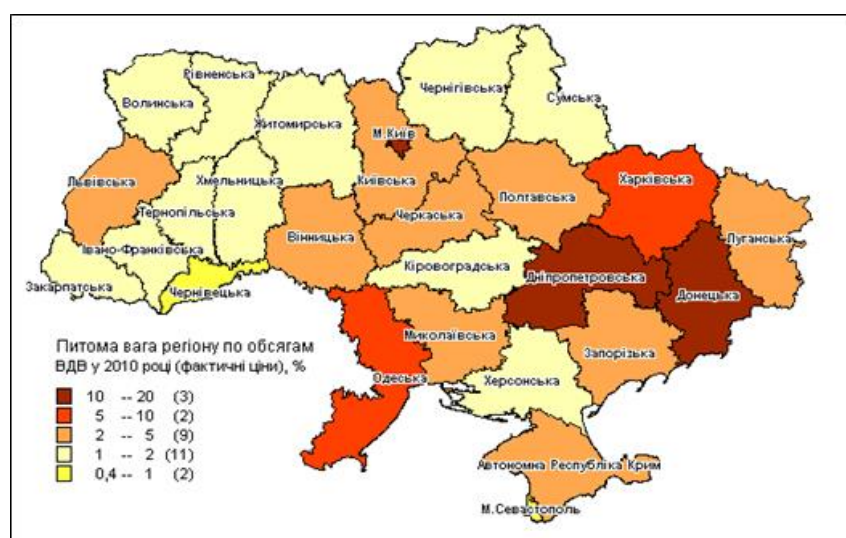
The overall administrative system in Ukraine is centralised with very few authorities and powers granted to the regional and local self-governments. However larger cities with the population 100,000 and above have relatively greater autonomy from surrounding regions and central government; they generally have a relatively sound financial base and are governed by mayors and local councils that are directly accountable to local community. Real self-government exists in 171 cities of *oblast* significance (equal to *oblast* status). They have elected mayors and elected councils with their own executive bodies responsible for a wide range of functions related to social and economic development of the cities.

Ukraine has a great deal of spatial disparities. Industrialised regions of Eastern and Southern Ukraine contribute more to Ukraine's GDP, and international trade, have higher levels of salary and less unemployment. Despite this, they have very negative human development indicators – including high levels of mortality, health problems, crime levels, alcohol and drug abuse, lower educational attainment and environmental hazards. Donetsk oblast – the industrial stronghold of Ukraine – might provide 20 per



cent of GDP and export in goods (Box 3), but it are trailing behind all other regions in the Ukrainian Human Development Index (HDI) regional ratings.<sup>14</sup>

**Box 3 Map of regional shares in Gross Value Added, 2010 (per cent)**



Source: Ministry of Economic Development and Trade, 2013

Explanations: Map illustrates distribution of Gross Value Added (GVA) among 27 regions of Ukraine in 2010 – the higher the percentage the darker the background colour. The regions are grouped in five categories according to their share in national GVA. The capital city of Kiev and industrial centres of Donetsk and Dnipropetrovsk regions contribute the highest shares while Chernivtsy region and city of Sevastopol contribute less than one per cent in total GVA each.

Regions in the western and central part of the country have less economic power but a higher quality of life and higher levels of private initiative and entrepreneurship. Table 5 provides some examples of gaps in socio-economic development of the most and least developed regions of Ukraine. The “capital city effect” is quite strong in Ukraine, particularly in areas such as investments, research and development, income, and trade where the differences between Kiev and the rest are extreme. However, disparities in core indicators, such as GDP, employment, salaries are comparable to those of some European countries of the similar size.

**Table 5 Ratio between minimum and maximum regional values of some socio-economic indicators**

Indicator	2012
Gross Regional Product per capita	6*
Disposable income per capita	3.1
FDI per capita (cumulative)	159**
Capital investments	30.3
Patents issued	111*
Export of goods per capita	33

\* 2011; \*\* 2013

Source: State Statistics Service of Ukraine, Ministry of Economic Development and Trade

<sup>14</sup> Methodology used by Ukrainian researchers – authors of Ukrainian regional HDI index – is based on UN methodology but is quite different from it using a much wider range of indicators and sub-indices. No data is available after 2010

## 2. Fiscal decentralisation

In 2001, the Ukrainian Parliament approved a Budget Code that brought dramatic changes to the fiscal policy and it signalled limited fiscal decentralisation. It made the budget management process much more transparent and predictable. The reform of intergovernmental finances resulted in a separation of transfers between the budgets of *rayons* and cities of oblast significance. Allocations started to go directly from the state budget to more than 680 local budgets using a formula-based approach with objective per head norms.

Since 2001, many amendments were made to the Budget Code that made the process of fiscal planning and distribution less objective and financial flows to cities and regions less predictable. Recent changes to the Code in 2011-2012 in fact made it a brand new document that despite strong calls for fiscal decentralisation in reality limits the ability of local authorities and cities in particular to use locally generated incomes for truly developmental goals.

Overestimates for local revenues leave local budgets short of money for covering even the most basic expenditures such as salaries and heating bills for public sector institutions. Investment subventions – one of the key sources of funding for capital projects in the region – are unpredictable and are determined on an annual basis using non-transparent criteria and priorities. It is quite possible that in a given year more than 50 per cent of the total amount will be allocated to a single region while the next year it may receive none. This precludes regions and cities from planning large scale projects that require several years to implement and significantly increases the risks of non-payments and consecutive penalty payments that local authorities face after breaching their obligations towards suppliers and contractors.

**Table 6 Share of state and local budgets in the total amount of capital investments in Ukraine, 2006-2013**

Source	2006	2007	2008	2009	2010	2011	2012	2013*
State budget funding, million UAH	9,605	15,077	15,403	8,361	10,952	18,394	16,531	876
State budget funding, % of total	6.5	6.8	5.7	4.3	5.8	7.1	6.3	1.7
Local budgets funding, million UAH	6,732	9,370	12,498	5,914	6,367	8,801	8,308	1,062
Local budgets funding, % of total	4.5	4.2	4.6	3.1	3.4	3.4	3.2	2.0

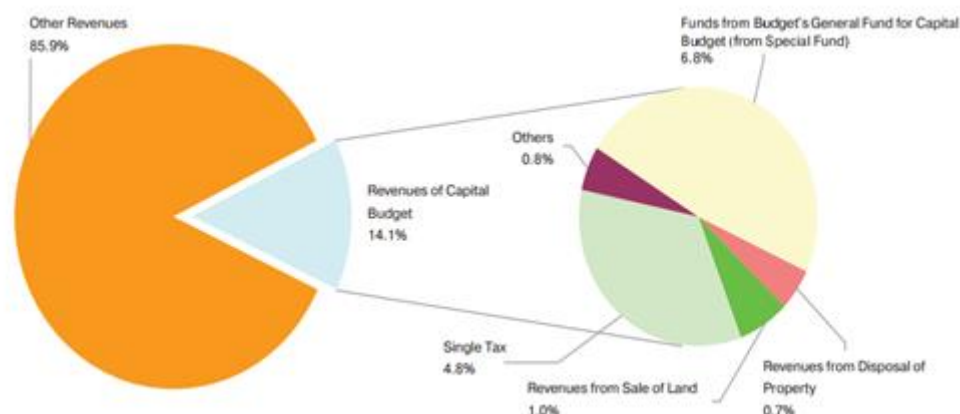
\*January-March 2013

Source: State Statistics Committee, 2013

Also, a significant share of all expenditures made by local authorities is for delegated authorities – functions and responsibilities of the state rather than local self-government. There are numerous examples when state budget does not cover the entire amount of those expenditures due to a chronic deficit of the state budget and local leaders are left with the challenge of finding money to cover the costs of things like fuel for emergency services vehicles or electricity bills. It leaves them with even less money for much needed investment projects or activities that will generate more economic growth, jobs and revenues to local coffers.

The total amount of local budget is split between two funds; (1) a general fund that is financing current spending and (2) special fund that is mainly financing capital investments. Local development budgets are playing a marginal role as only about 14 per cent of all revenues are going into the development (Figure 2). Almost 50 per cent of all development revenues are coming from the general budget fund while a single tax from small entrepreneurs accounts for another third of it. The total amount of all local development budgets in 2013 is estimated at the level of 7 billion UAH (around €630 million).

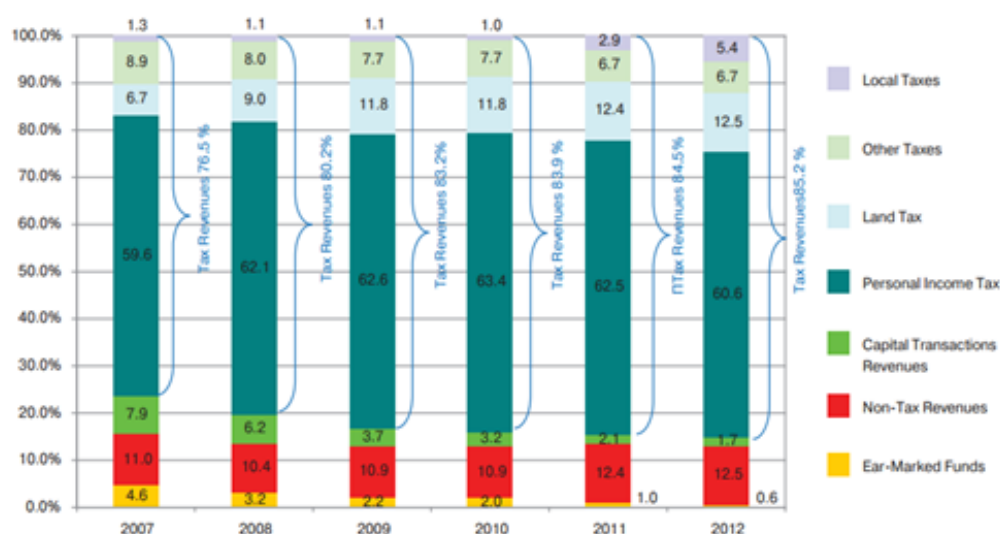
Figure 2 Share of local development budget revenues in the total amount of local budget revenues 2012



Source: IBSER based on Ministry of Finance data, 2013

Figure 3 below illustrates the structure of local budget revenues over the last five years – two thirds of this amount is generated by personal income tax. Land tax and non-tax revenues are other two major sources of revenues. It should be noted that after significant changes to the Tax Code in 2010 the number of local taxes which constitute the basis for local revenues was cut from ten to five.

Figure 3 Composition of local budgets' revenues, 2007-2012



Source: IBSER based on Ministry of Finance data, 2013

Another significant factor that aggravates the difficult financial situation of regions and cities is administrative – all accounts of local authorities are kept in one place – State Treasury – which is also running all accounts for the state budget. Since the beginning of 2013, there is a negative trend of withholding transfers to local authorities and from local authorities to their contractors. According to statistics, about UAH 25 billion (€2.25 billion) in payments are frozen by Treasury which means many cities are defaulting on their obligations and facing hefty charges for infringement of contractual obligations. Money is not released from cities' accounts. Experts agree that this is the result of plugging holes in the state budget by using the money belonging to local authorities.

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In general, the regions and cities of Ukraine lack financial stability and predictability. There is an acute deficit of funding even for current expenditures and most regions and cities cannot afford large scale multiannual investment projects that are needed for renovating dilapidated infrastructure and so creating conditions for dynamic economic growth. In this situation, funding from IFIs and international donor organisations (such as the EU or USAID), attractive financial terms and conditions and technical support and advice are crucial sources of funding for large capital investment projects. Many cities are keen to collaborate with the EBRD, the World Bank, NEFCO or others. However, not all of them are ready to accept the strict standards and demands of IFIs.

## Annex 2: City of Lviv

### 1. Key facts

Population – 760,000 people (2013)	Distance to capital city of Kiev – 479 kilometers
Seventh largest city of Ukraine	Distance to the Polish border (nearest checkpoint) – 76 kilometers
UNESCO World Heritage Site (central part)	Number of tourists – 700,000-1 million a year (estimates)
S&P rating – CCC+ (September 2013)	Number of higher educational institutions – 21
Average salary – US\$ 345 (Ukraine average)	Number of students – 117,000 people
FDI per capita – US\$ 761 (Ukraine average)	
Level of unemployment – 8.6 per cent	

### 2. Governance system

Lviv is governed by a directly elected mayor, the 90 city council members and its executive committee employing about 1300 people. Lviv is divided into six *rayons* (districts) each with its own council and executive body.

The current mayor, Andriy Sadovyy was elected to the office in 2004 and re-elected in 2010. It is his last term in the office which is due to end in 2014. He does not belong to any political party. A majority of the city council is currently controlled by the nationalistic Party Svoboda (Freedom) which is in opposition to the ruling Party of Regions and to the mayor in many aspects related to city development.

In the last several years, Lviv city council approved several strategic documents that are currently being implemented. They largely determine the priorities of the city leadership's policies:

- Lviv Development Strategy 2025
- Lviv Competitiveness Strategy 2015
- Sustainable Energy Action Plan 2020

Lviv is one of very few Ukrainian cities that has its own municipally-owned think tank, the City Institute. The City Institute provides the mayor's office and council with analytical and expert support, helps to develop and implement strategic documents, coordinate their implementation, and (innovatively) actively monitor and report on progress. It is a partner in many projects funded by international donor organisations and IFIs.

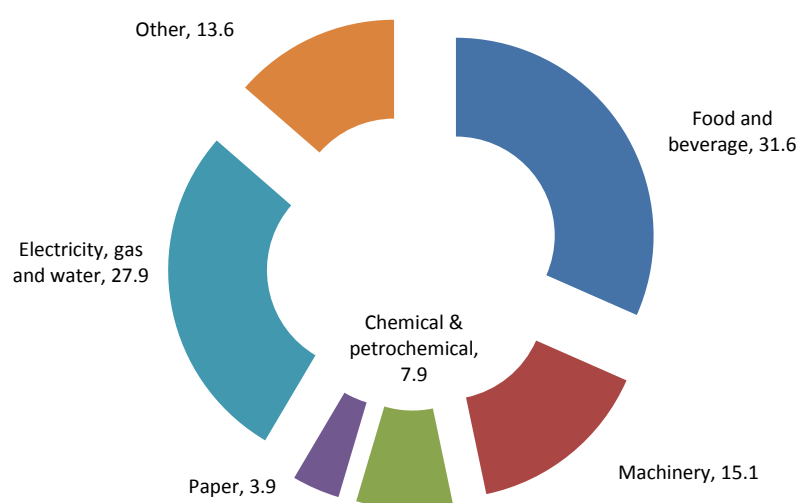
Lviv is a founding member of Association of Energy Efficient Cities of Ukraine, which has its headquarters in the city. Lviv is one of the leaders in implementing energy management measures aimed at increasing sustainability of the city space and economy to reduce energy costs that weigh on the municipal budget. According to the Sustainable Energy Action Plan, by 2020 Lviv has a target of reducing its energy consumption by 24 per cent and volume of CO<sub>2</sub> emission by 21 per cent.

### 3. Economy and finance

As in most of the larger cities of Ukraine, services dominate the economy of Lviv. The total volume of sales in the service sector reached about €757 million in 2012. Major sectors of the economy include trade, transport services, education, information technology, industry and tourism. Industrial output is dominated by the food and beverage industry and mechanical engineering. Lviv is one of largest information technology centres of Ukraine and has second largest number of IT engineers after Kiev, many of whom are working on outsourcing projects for large foreign companies. In 2009 KPMG included Lviv in top-30 world cities with potential of developing the IT industry.

Lviv has about 220 large and medium sized industrial enterprises. The total volume of sales of industrial products in 2012 reached about €1.16 billion. Figure 3 shows the sale of industrial goods by sector.

Figure 4 Sale of industrial goods by sector in Lviv, 2012 (per cent)



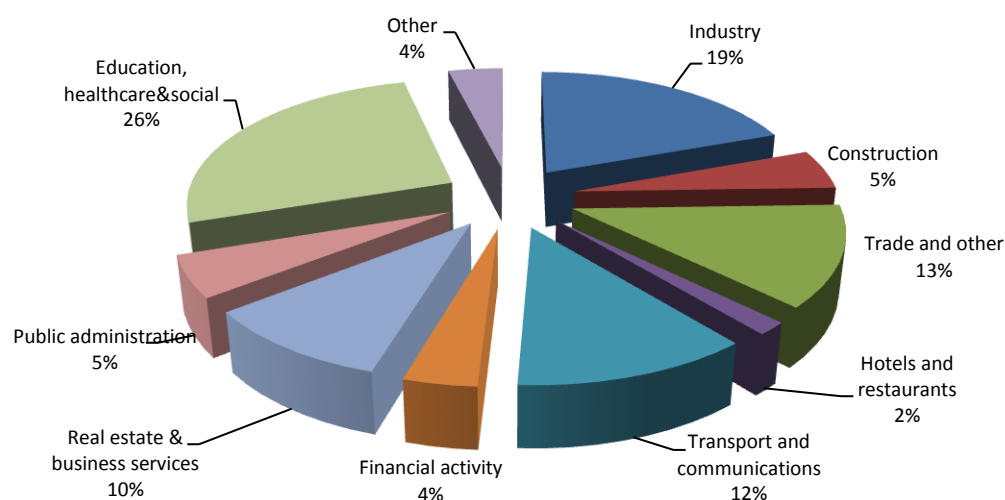
Source: Lviv regional statistics office, 2013

The top ten Lviv companies by revenues in 2010 included two food and beverage companies, three trade companies, one pharmaceutical, one light bulb producer and one transport producer.

In terms of job creation, industry is less prominent. Graph 2 illustrates the structure of employment in the city of Lviv where almost a third of all jobs are created in public services (health, education, social protection, public administration), a quarter in industry and construction and the rest in various service industries. Interestingly, hotels and restaurants, the bedrock of the Lviv's tourism sector that is one of 2 priorities in the City Competitiveness Strategy, provide less than 2% of all jobs in the city<sup>15</sup>. The total number of jobs in the city of Lviv in 2012 was 314,000 which is 12% less than in 2008 (see Figure 4)

<sup>15</sup> Based on 2009 statistics which is rather dated but no recent figures could be found in official statistics sources.

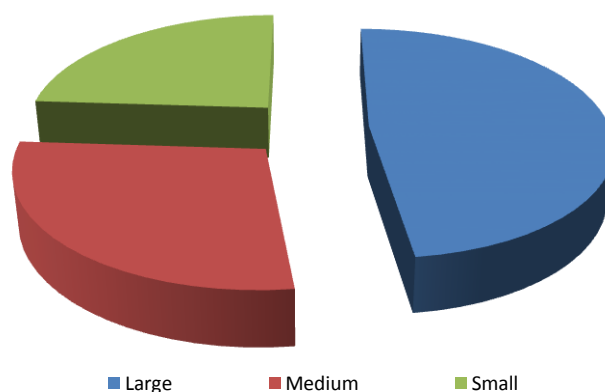
**Figure 5 Employment by sector in Lviv, 2009**



Source: Lviv regional statistics office

Large companies remain the largest employers (48 per cent) while small ones provide 24 per cent of all jobs (Figure 6). In 2012 there were 9.1 thousand SMEs in the city of Lviv which is 120 per 10,000 of population comparing to national average level of 70 SME per 10,000.

**Figure 6 Structure of employment by size of company, 2009**

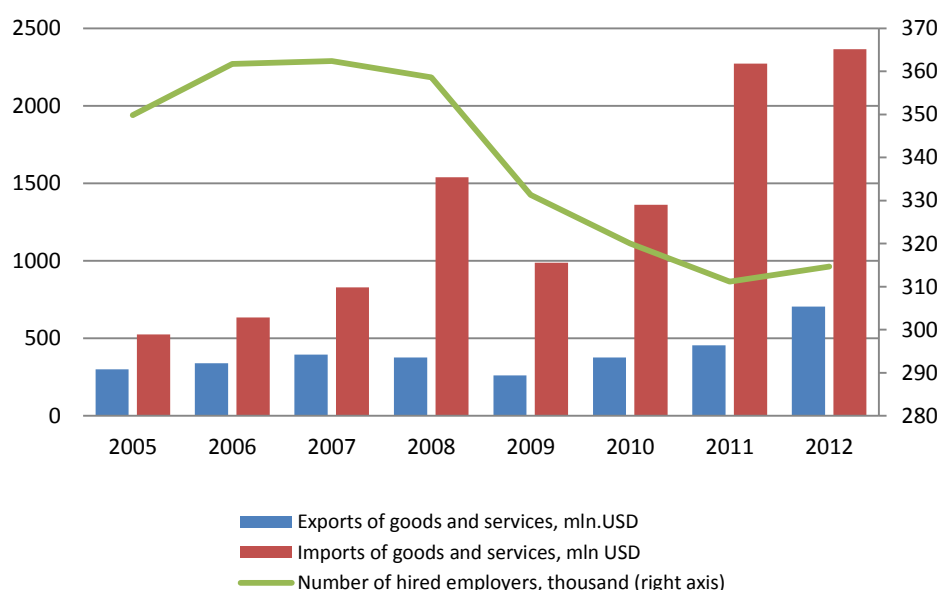


Source: Lviv regional statistics office

In 2012, the level of export of goods and services reached 705 million USD comparing to 377 million in 2010 while import of goods and services was 2.36 billion USA in 2011 comparing to 1,36 in 2010. The share of export to EU countries reached 41.3% and for import, 43.3%. The dynamics of foreign trade along with the job dynamics are shown in Graph 4.



Figure 7 Dynamics of foreign trade and jobs, 2005-2012



Source: Lviv regional statistics office

By the end of 2012, Lviv attracted cumulative volume of US\$1.1 billion of foreign direct investments which is US\$761 per capita, a level significantly lower than in cities of neighbouring Poland, Hungary or Slovakia. Almost 80 per cent of foreign direct investment comes from three countries – Cyprus, Poland and Austria.

The Lviv region's Gross Regional Product per capita in 2011 was US\$2,570 which is almost 30 per cent less than national average (US\$3,580 per capita). There is no data of GRP at the level of cities.

For 2013, revenues to city budget are planned at the level of UAH 2.84 billion (circa €256 million) from which UAH 483 million (circa €43.5 million) are revenues of the special fund (development budget). See Figures 8 and 9 for the sources of revenues. Expenditures in 2013 are planned at the level of UAH 2,356 billion of which UAH 733 million are transfers from state and oblast budgets.

Figure 8 Source of revenues for the general Lviv city budget, 2013 (estimates)

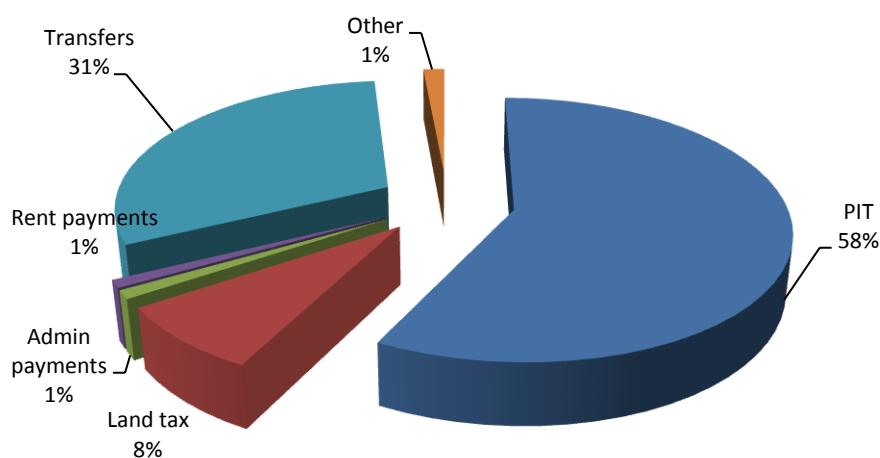
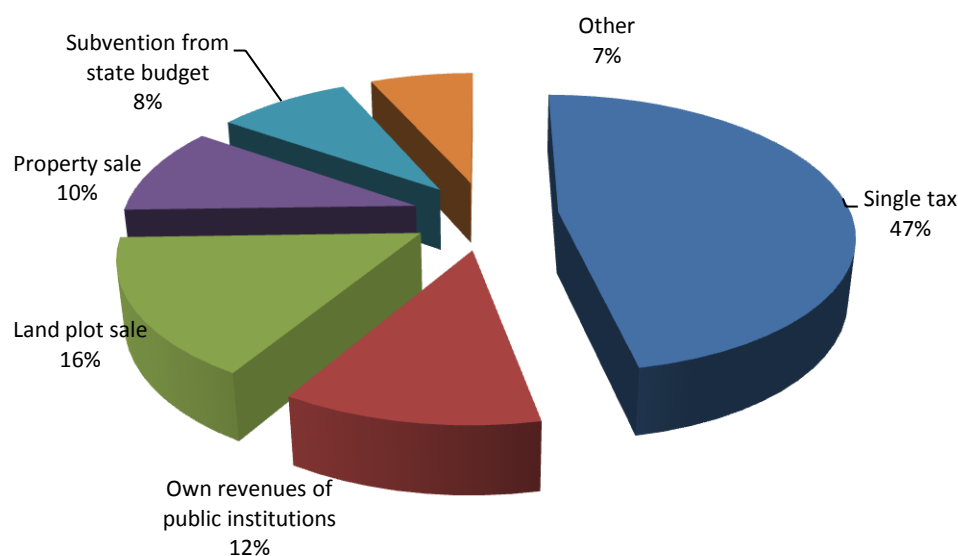


Figure 9 Source of revenue for the Special Fund of Lviv city budget, 2013 (estimates)



## 4. Public procurement

Public procurement remains one of the most challenging areas for Ukraine in general and its regions and municipalities in particular. Due to non-transparent and uncompetitive procedures, state and local budgets are losing a significant share of their resources which otherwise could be directed at important activities requiring investments.

For the EBRD, public procurement legislation (PPL) is one of the focus areas for TC and policy dialogue performed by the Legal Transition Team. Specifically the EBRD is providing substantial and on-going support to change PPL and regulations that would bring Ukraine closer to its obligations as a member of the WTO Agreement on Government Procurement (GPA). Ukraine applied for GPA membership in 2011 and since then the EBRD is providing substantial support (advice, training, capacity building) in guiding Ukrainian counterparts, in particular Ministry of Economic Development and Trade, through the application process, also using its own experience of procurement which is fully congruent with GPA rules and standards.

Despite this work and the adoption and enforcement of a new Public Procurement Law in 2010 the amendments that followed made the public procurement sector less transparent and more susceptible to corrupt practices. In particular a range of exemptions were brought into force (according to the Anticorruption Action Centre (ACC) – 34 in total) that allow most public agencies, central and local government bodies, publicly owned and municipal enterprises to organise tenders with one participant. In the first half of 2012 almost four per cent of all public procurement was made via tenders with one participant (up from 22 per cent in 2011)<sup>16</sup>. Also public sector organisations and state owned companies are not obliged to disclose the information about the tenders which means that the area is completely closed for public oversight and control.

<sup>16</sup> Report by Accounting Chamber of Ukraine, October 2012, available (in Ukrainian) at <http://nashigroshi.org/2013/05/13/17-pokraschen-tenderiv-chasiv-yanukovycha/>

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This non-transparency precludes foreign companies to participate in the tenders, as the rules are not clear and complaints/enforcement procedures are confusing and ineffective. According to Accounting Chamber of Ukraine in 2011 only 0.44 per cent of public goods and services were purchased from foreign companies (and 0.22 per cent in the first six months of 2012).

Municipal companies – clients of the EBRD – have to use EBRD procurement rules and standards that often lead to prolonged disputes with the Ministries of Finance, Tax and Duties, Economic Development and Trade, Anti-monopoly Committee and local controlling authorities. The case of Lviv city demonstrates that despite some significant legal changes at the national level and on-going capacity building work with the GoU municipalities suffer from lack of understanding and support by the GoU while implementing investment projects funded from IFI loans.

In Lviv criminal cases were launched against the managers of municipal companies, EBRD clients, who are accused of misuse and mismanagement of loans received from the EBRD and other IFIs. This is primarily caused by the lack of understanding of the *modus operandi* of such loans. Often, Ukrainian state agencies insist on using local regulations, especially for small scale tenders, which the EBRD consistently rejects. The case of Lviv demonstrates that by using EBRD procedures that guarantee a high quality of works and services at competitive price offered by companies from different countries it is possible to achieve significant positive outcomes for the city's economy and residents. It is good to see that city leadership, despite significant regulatory challenges, is acknowledging these positive effects and is keen to use EBRD standards in its own procurement procedures while using municipal budget funds.

### Annex 3: Timeline of policy dialogue in the city of Lviv

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
February	Lviv mayor Andriy Sadovyy took part in the investment forum in London organised by the EBRD where he discussed a number of challenges faced by city of Lviv and the need of capital investments for upgrading its infrastructure and unlocking economic potential. Collaboration with IFIs is one of the best opportunities for getting much needed capital investments into city's infrastructure projects.	Mayor of Lviv Andriy Sadovyy as decision maker, city council/mayor office officials as advisers	Director or MD as decision maker, MEI team at Resident Office and Headquarters as expert and advocate		Initial co-operation agreement between the EBRD and the city of Lviv was reached and consultants hired to perform the review of the possible areas for EBRD engagement in the city of Lviv.	Consultants' report outlining the potential areas of collaboration with the city of Lviv. A separate Memorandum of understanding was signed between the city council and the EBRD identifying 19 potential areas for collaboration in district heating sector.	Proposals were used for drafting terms of reference for three projects - road rehabilitation, public transport upgrade and district heating.
2008 August	In the process of preparation to Euro-2012 tournament city of Lviv required substantial investments in transport and hospitality infrastructure and was looking for diversified sources of funding. IFIs were among most attractive options due to favourable financial conditions and technical support package. Private investors were less interested in long-term high-cost infrastructure projects with communal enterprises.	Mayor of Lviv Andriy Sadovyy as decision maker who represents city as a guarantor of the loans; CEO of LET as interested party	Jean Patrick Marquet, Director, MEI as decision maker, MEI team members (HQ and RO) as expert and advocate		The EBRD, Lviv city council and LvivElectroTrans signed framework agreement for opening the credit line for the total amount of up to UAH 30 million (US\$ 6 million) for modernisation of Lviv electric public transport and enabling LET to become a profitable municipal enterprise	Framework agreement stipulating further steps for preparing the credit agreement between the EBRD and LET.	Creating a regulatory environment for further practical actions enabling a large investment project in the public transport sector of Lviv. Despite that the project did not deliver results before summer 2012 (in time for Euro-2012 tournament) it is currently being implemented with significant positive effects for the entire city transport network.

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes	
2009	July	After initial consultations it was agreed that Lviv transport and road infrastructure requires urgent investments and the EBRD agreed to finance two major projects that would substantially enhance the city's transport infrastructure, accessibility, and quality of services provided by communal enterprises that are receiving a package of TC assistance attached to the loan. EBRD Clients - LvivAvtoDor (LAD) and LvivElectroTrans (LET) went through major corporate restructuring. A number of political decisions by the city council had to be taken, including in the area of tariff setting, in order to enable the release of the tranches. However it still took 3 years for the first tranche to be disbursed.	Mayor of Lviv Andriy Sadovyy as decision maker who represents city as a guarantor of the loans; CEOs of LAT and LET – as interested parties	Jean Patrick Marquet, Director, MEI as decision maker, MEI team members (Headquarters and Resident Office) as expert and advocate	EU – as decision maker (TC provision)	Lviv road rehabilitation and modernisation project (€26 million) and  Lviv Public Transport Financing project (€12 million) are signed between the EBRD and clients (LAD and LET). At the same time guarantee agreement is signed between the EBRD and Lviv city council.	Two large investment projects with associated TC projects for the total amount of €2.8 million are being implemented involving both communal companies and the city council.	Significantly reformed corporate structures and management procedures at LET and LAD, including both strategic and operational aspects of their activities. Significantly enhanced capacity of both LET/LAD and city council officials to build partnership relationships, design and negotiate public sector contracts, manage and monitor their execution
2010	May	The leaders of Lviv were looking for new ways to spur economic growth, incomes and tax revenues, which required concentration on several key priorities that could contribute to those objectives. The strategy for the city's economic development was identified as a much-needed instrument for streamlining the efforts and resources that would bring maximum gains for Lviv's finances, jobs and productivity in the mid-term perspective.	Lviv City council, Lviv mayor Andriy Sadovyy as decision makers, Institute of City (Lviv) as expert and advocate, city residents as unorganised public	Foundation for Effective Governance (FEG), Monitor Group as expert, advocate, interested party	Lviv city council approved the Lviv Competitiveness Strategy 2015. It was developed by city leadership with the involvement of city community groups. Expertise and analytical support was provided by international consulting company Monitor Group and local municipal-owned think-tank Institute of City was used as a main platform for strategy preparation. This work was funded by Foundation of Effective Governance (established by Renat Akhmetov)	The Lviv Competitiveness Strategy 2015 identified two priority sectors (clusters) for development:  i) tourism; ii) business services (including the IT sector).	The strategy and its further operationalization, including creation of institutional mechanisms that bring together city authorities and private sector were effective steps in mobilising local economic resources and creating a much needed beneficial climate for start-up companies and growing small companies into mid- and large-scale ones. Lviv is using its strategy very aggressively as an economic planning and image document. Most policy decisions related to the city's economy are made on the basis of priorities and operational tasks of the Competitiveness Strategy. The clear vision for future development and tactics for reaching agreement with all key interested parties are essential elements of city's success.	

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
July	The escalating financial crisis and spiralling national and municipal debts required the Government to make some radical changes to the legal and regulatory framework	Parliament, Ministry of Finance, Cabinet Minister as decision makers			Parliament approved the Law that stipulated changes to the Budget Code of Ukraine in the part that regulates the municipal lending using sovereign and municipal guarantees. It led to substantial limitations of cities' abilities to borrow money.	Amendments to the Budget Code (Law of Ukraine from 8 July 2010) that in reality barred Ukrainian municipalities from taking loans (both from commercial banks and IFIs).	By setting very strict criteria for lending (loans could not exceed 100 per cent of incomes into development budget of the city, or 200 per cent in Kiev) The government of Ukraine in reality created barriers on the way of cities to obtain credits from IFIs or commercial banks for vital investment projects aimed at improving dilapidated municipal infrastructure. Several IFIs, including the EBRD that had already developed a pipeline of municipal projects were forced to freeze their lending programs for large cities due to legal restrictions for municipal/sovereign guarantee loans to municipalities.
all year  2010-2011	Changes to the Budget Code led to complete freeze in the MEI sector of EBRD operations in Ukraine, and the World Bank, EIB and other IFIs. Legal changes were needed in order to open the access to IFIs funding for Ukrainian municipalities that were strapped for cash due to severe economic crisis.	Ministry of Finance (MinFin), Cabinet of Ministers (CabMin), parliament, presidential administration as decision makers, city mayors, AUC as influencers, interested parties, local think tanks (IBSER) - experts/analysts	MEI team (Headquarters and Resident Office), in particular Mark Magaletsky, Senior Banker, Head of Energy and Infrastructure as expert, advocate, influencer, interested party	The World Bank, other IFIs, USAID, the EU as advocate, interested party	The EBRD played an active role in lobbying the Ukrainian government, presidential administration and parliament to revert Budget Code amendments so that Ukrainian cities could tap into Bank's investments, and investments of other IFIs.	Draft Law on amendments to the Budget Code that would allow cities to borrow money externally.	Building a wider coalition in the process of lobbying activities, including with mid-level officials at Ministry of Finance, Cabinet Ministers, members of parliament, officials at the presidential administration, city mayors, their association (AUC) - helped to raise the profile of the problem and to prepare a realistic proposal that fits into the reality of Ukrainian legislative, governance and institutional set-up. A joint approach with other IFIs and donors and use of analytics prepared by local think tanks such IBSER) contributed to building the robust and comprehensive case for changing the legislation.

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
June	After corporate reforms and management changes LET needed a new framework for partnership relationships with the municipality. An effective and detailed public service contract was required for long-term planning of LET activities and investments in particular. It was a condition of the EBRD loan agreement with LET and loan guarantee agreement with the city council.	Lviv city council as decision maker, LET as interested party	EBRD MEI team as advocate, influencer	Louis Berger as expert/analyst	Louis Berger published a final version of public service contract on providing municipal electric transport services to be signed by the Lviv city council and LET	A public service contract in the sphere of electric municipal transport services provision was signed between the Lviv city council and LET.	Clear contractual relations between the municipality as the main client and LET as a main service provider will create a basis for partnership relationships that are aimed at providing high-quality services to Lviv residents. Contracts will enable effective management and development of LET as one of the key municipal companies that requires full cost recovery for its services. This will assist them to become more effective and sustainable in the long-term.
2011 July	City leadership determined energy inefficiency as one of the major factors affecting inefficient use of municipal resources. A lot of energy goes wasted through dilapidated infrastructure, buildings, inefficient generation, transportation and use of energy. Lviv became one of four founding members of Association of Energy Efficient Cities of Ukraine (2007). It was second city in the country that approved Energy Management Strategy (2007). The document required an action plan and implementation that would bring in the best available international experience to the Ukrainian / Lviv realities.	Lviv City council, Lviv mayor Andriy Sadovyy as decision makers, Association of Energy Efficient Cities of Ukraine as expert, advocate		Covenant of Mayors - expert, advocate, EU (TC provider) as advocate	Lviv city council approved City Sustainable Energy Action Plan 2020 (SEAP). Lviv is the first Ukrainian city that developed, approved and is implementing SEAP.	SEAP 2020 developed according to the standards of Covenant of Mayors	As with the Competitiveness Strategy SEAP became a living document with tasks and activities encapsulated in the city's energy policy decisions. Both public and private sectors are engaged in various measures aimed at cutting down energy consumption and GHG emission. The wider public is being engaged as well through wider public relations campaigns and educational measures. The city council established a separate unit that is staffed with qualified energy managers who are responsible for the implementation of the Action Plan. All EBRD operations in the city with an EE component are contributing towards achieving the goal of the SEAP - reducing CO2 emission by 21 per cent by 2020.



		Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
2011	July	The Budget Code amendment that came into force at the beginning of 2011 in fact barred all Ukrainian cities from lending, including from IFIs, thus freezing and postponing many crucial investment projects aimed at modernisation of municipal infrastructure.	Parliament, Ministry of Finance, Cabinet Ministers as decision makers, AUC as influencer, think tanks (such as IBSER) as expert, advocate,	MEI team (Headquarters and Resident Office), in particular Mark Magaletsky, Senior Banker, Head of Energy and Infrastructure as expert, advocate, influencer, interested party	The World Bank as expert, advocate, influencer, interested party	New amendments to the Budget Code are approved by parliament which allows municipalities with the population above 300 thousand people to get municipal guarantee loans from IFIs with the coefficient of two (four for Kiev) - loan amount to the amount of development budget revenues forecasted for the next two years (average).	Amendments to the Budget Code (Law of Ukraine No 3614-17 from 7 July 2011) that enabled municipal guarantee loans from IFIs	New legal framework opened opportunities for many Ukrainian cities to (re)launch investment projects in the municipal infrastructure sphere, including vital projects in the sectors of district heating, water / waste water, solid waste management and public transport. IFIs that over years developed a pipeline of investment projects have been able to open their credit lines for Ukrainian municipal clients using municipal guarantee associated with less national level red-tape and greater degree of flexibility. Cities will have an opportunity to attract more investors after completion of these fundamental infrastructure projects. There is potential for opening the municipal lending market for private sector banks, that are currently not investing in the sector due to high risks and long-term substantial commitments in over-regulated sectors.
	July	A decentralised system of communal tariff setting (in particular for district heating and water/waste water services) was creating many complications for the development of municipal services sector in Ukraine. Multiple local political turf battles and populist actions barred serious investments in the sector that badly needs substantial upgrade of fundamental infrastructure and management culture. Establishment of the national regulator was perceived as a way out of this deadlock, allowing more control over standards and methodologies for tariff setting that would reflect real needs of the sector and full recovery prices for energy, heat and water supply.	President of Ukraine, Parliament, Ministry of Regional Development, Construction and Communal Services (MinRegio) as decision makers			President of Ukraine signed a Decree on establishment of a National Commission on Regulation of Communal Services (NCRCS - Decree No 743/2011 from 8 July 2011). This became possible as a result of amendments to the Law of Ukraine on Heat Supply approved in 2010. It led to transfer of authority to regulate tariffs for heat and water supply from municipalities to the central level regulator (for DH companies with boiler capacity over 20 Gcal/h)	The National Commission on Regulation of Communal Services (NCRCS) was established as an independent national regulator of heat and water tariffs	A single national level regulator (for middle and large cities and settlements that receive energy from oblast energy companies) provides an opportunity for systemic change in the sector of communal services, building capacity and expertise, developing a unified approach and methodology for tariff determination, setting, establishing parameters for full cost recovery, technical appraisal of capacity needs. It became a natural partner for IFIs and donors that are working in the municipal sector, in particular the EBRD, the World Bank, the EIB, the EC, USAID, the NIB and others. Centralisation of regulatory function potentially can bring much needed reform in tariff setting, if NCRCS manages to establish itself as truly independent regulator. However this decision goes against the widespread trend of decentralisation that is strong across most of developed and emerging economies and which is being strongly advocated in other spheres of regional / local economic development by international donor organisations and IFIs working in Ukraine.

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
October	Fragmented and incoherent strategic planning documents in the city of Lviv were not contributing to city development and were ignored by decision makers. A single strategy, that includes all spheres of city life, including education, healthcare, transport, culture, tourism, and is supported by city residents was required.	Lviv City council, Lviv mayor Andriy Sadovyy as decision makers, Institute of City (Lviv) as expert and advocate			Lviv city council approved the Lviv Development Strategy 2025 that outlines three key priorities for complex development of the city: (1) High quality of life for residents and attractive place for tourists; (2) Beneficial business environment; (3) Supporting and protecting traditions and historical legacy.	A complex Strategy of Lviv Development till 2025	A strategic framework for a complex city development, including social, human and physical spheres was approved and further encapsulated in the main local regulatory acts and policies aimed at growing city's economy and enhancing the quality of life of its residents.
February 2012	The city road and street management system in Lviv was based on centralised and demand-driven policies with multiple service providers, an unclear compensation system, and inefficient contracting, tendering and auditing functions. According to loan agreement between the EBRD and LAD and a credit guarantee agreement between City and the EBRD a new public service contract had to be prepared, signed and enacted to transform LAD into strong and professional service provider, based on the needs and priorities formulated by main client, the city council.	Lviv city council as decision maker, LAD as interested party			The city council and LAD signed a public services contract on provision of road and streets maintenance services which made LAD the sole managing company for all city roads and streets.	The public service contract stipulates clear terms and conditions for provision of road and street maintenance services by LAD to the city of Lviv, making the company the single responsible agent.	A new municipal road and street management system has been designed and is being implemented.

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
2012 September	The EBRD developed a pipeline of investment projects in Ukraine's district heating sector with various municipal partners across Ukraine (ten projects for the total amount of €150 million and €58 million E5P grants). It however lacked a strategic approach to the reform of the sector, including legislative, regulatory, institutional and professional capacity challenges. Such reform can be addressed in the framework of a stand-alone TC or national level policy dialogue, including collaborative initiatives with other IFIs and donors.		The EBRD board as decision maker, MEI and OCE teams as expert / analyst	E5P board (grant provision) as decision maker, interested party, advocate	The EBRD board approved Integrated Approach for Reform of District Heating Sector in Ukraine for 2012-2015	A strategic framework document outlining the directions and pace of transformations in Ukraine's district heating sector includes investment projects in concrete municipalities across Ukraine, TC and policy dialogue components.	The Bank has now a coherent approach to developing the district heating sector in Ukraine that puts specific investment projects in the perspective of a wider transformational processes being led by Ukrainian government with the support from IFIs and international donor organisations. Externally an integrated approach document helps to streamline various messages under one overarching objective. Internally it brings more focus on the effects of various investment operations when they are being implemented in a coherent manner and linked to TC or policy dialogue activities. Such linked initiatives are often launched jointly with other IFIs/donors with the national level regulator and high-level authorities. A combination of EBRD loans with E5P grants for district heating sector projects could become a good model for hybrid financial instruments aimed at reforming investment-intensive over-regulated sector
November	Lviv is a major tourist destination in Ukraine with the centre having UNESCO World Heritage status. However it has significant deficit of shopping malls in its central part. A large-scale development project that follows the best standards and practices of green building will contribute to meeting Lviv's SEAP's targets (see above) and result in the first sustainably built and managed commercial property in Ukraine with high demonstration effect.	Lviv city council as decision maker (indirectly)	EBRD Board, Property Director as decision maker, Property and E2C2 teams at Headquarters and Resident Office as expert and advocate	Multi Corporation as an interested party	Multi Development Forum Lviv Project (€22.1 million) is signed along with TC project on energy performance assessment and capacity building (€60,000)	The city of Lviv will have the first green building certified commercial property in the central part of the city with substantially improved traffic management, parking capacity and reconstructed surrounding residential properties with enhanced and energy efficient parameters.	Lviv will strengthen its position as a major tourist destination in Eastern Europe that can offer a shopping experience to the existing mix of historical and cultural activities. If successfully implemented the multi shopping mall will become first green commercial building in Ukraine that could attract more international and domestic developers with high quality projects. The project contributes towards city's SEAP aimed at considerable reduction in energy waste and GHG emission through use of energy efficient and sustainable practices in private and public sectors of city economy.

	Context (policy problems/opportunities and proposed policy solutions)	Ukraine actors (positions and roles)	EBRD actors (positions and roles)	Other actors (positions and roles)	Inputs and Actions	Outputs	Outcomes
June	District heating, being one of the most challenging areas of city infrastructure and crucial service provided by municipality was picked as an area for EBRD investment. It is in line with the priorities of the EBRD's Integrated Approach for Ukraine's district heating sector for 2012-2015 and with the Lviv Development Strategy and SEAP. The EBRD's client, LTE will be going through major corporate restructuring and a number of political decisions by city council will have to be made in order to enable the release of the tranches.	Mayor of Lviv Andriy Sadovyy as decision maker that represents city as a guarantor of the loans; CEO of LTE as interested party	Jean Patrick Marquet, Director, MEI - decision maker, MEI team (Headquarters and Resident Office) - expert and advocate	Andres Lund, Head of E5P as decision maker (grant for combined financial package), the EU as decision maker (TC provision)	Lviv District Heating project (€20 million loan + €10 million E5P Grant) along with several TC projects is signed between EBRD, E5P and LTE. At the same time guarantee agreement is signed between the EBRD and Lviv city council.	Large district heating investment project that includes loan and grant components (the largest E5P grant provided to Ukrainian municipality so far) with associated TC projects for the total amount of €1.3 million are being implemented involving both communal company and the city council.	A significantly reformed corporate structure and reformed management procedures at LTE, including both strategic and operational aspects of their activities. The capacity of both LTE and city council officials to build partnership relationships, to design and negotiate public sector contract, manage and monitor its execution has also being enhanced. In the long-term LTE's improved technical base and higher resource efficiency will contribute towards providing high-quality competitive services and savings for the city budget.
August	The newly established NCRCS requires significant resources and technical advice for preparing necessary methodological and regulatory documents that would enable calculation and setting full-cost recovery tariffs for heat and water. Its specialists need analytical and expert support while preparing important legislation and regulatory acts, also while building partnership relationships with municipal utilities companies. A TC project is necessary for achieving all these goals.	NCRCS as decision maker, expert, municipal utilities companies (including LTE) as interested parties	The EBRD MEI team as advocate, interested party	SIDA (TC funding) as decision maker, the World Bank as interested party, expert, advocate	Funding for joint TC project of the EBRD/ the World Bank to support the National Commission on Regulation of Communal Services (NCRCS) was approved by SIDA	A TC project that is aimed at strengthening the capacity of newly established Commission to independently regulate the tariff setting for communal services (such as heating and water) with the total budget of €1.5 million to be managed by the World Bank in close co-ordination with the EBRD.	A stronger and more professional national regulator will play a crucial role in the reform of district heating and water sectors of municipal economy. It will be instrumental in developing primary and secondary legislation in the sector, methodologies and instructions for the municipal utility companies that would lead to setting full cost recovery tariffs, control, monitoring and enforcement instruments over execution of national guidelines in the sector. It is a natural counterpart for the EBRD in the process of implementing Bank's integrated approach for Ukraine's district heating sector.
Forthcoming	Lviv has one of the most dynamic SME sectors in Ukraine and has considerable potential to enhancing its role in income generation and job creation. With the critical mass of SBS activities in the city and the receptiveness of city leadership to the advice and new practices in business sphere it is possible to increase the effect of the EBRD's SBS activities through localising its presence in the city in particular and the western region of Ukraine in general.		The EBRD board as decision maker, SBS team (Headquarters and Resident Office) as expert/analyst, advocate (external and internal)		Opening of Lviv regional office of SBS Programme that will manage BAS/Enterprise Growth Programme projects across several western Ukrainian regions.	The first regional office of SBS programme in Ukraine is due to be opened by the end of 2013 with three permanent staff members.	The regionalisation of SBS programme will contribute towards achieving a goal of a wider outreach of Bank's MSME support activities. It will also support the emerging approach to the EBRD business strategy in Ukraine that is considering generating more direct investment projects with medium-sized private sector clients located across the country. Localised presence of the EBRD will contribute towards mobilising regional business networks for accessing potential clients in Western regions of Ukraine.