Strategy For Ukraine 2005-2007

As approved by the Board of Directors on 17 May 2005

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

AIDS	**Auto Immune Deficiency Syndrome**
AML	**Anti Money Laundering**
BAS	**Business Advisory Service**
CEE	**Central and Eastern Europe**
CES	**Common Economic Space**
CIDA	**Canadian International Development Agency**
CPI	**Consumer Price Index**
CSF	**Chernobyl Shelter Fund**
EBRD	**European Bank for Reconstruction and Development**
ED	**Environment Department of the EBRD**
ESCO	**Energy Services Company**
EU	**European Union**
EUR	**Euro**
FAO	**Food and Agricultural Organisation of the United Nations**
FATF	**Financial Action Task Force of the OECD**
FDI	**Foreign Direct Investment**
FI	**Financial Institution**
FIG	**Financial and Industrial Group**
FUIB	**First Ukrainian International Bank**
GDP	**Gross Domestic Product**
G8	**Group of eight Nations (Canada, France, Germany, Italy, Japan, Russia, UK, US)**
HIV	**Human Immunodeficiency Virus**
IFC	**International Finance Corporation**
IFI	**International Financial Institution**
IMF	**International Monetary Fund**
INOGATE	**Interstate Oil and Gas Transport to Europe**
K2	**The second reactor at Khmelnitsky Nuclear Power Plant**
MIS	**Management Information System(s)**
MSE	**Micro or Small Enterprise**
NAK	**Ukraine Naftogaz**
NBU	**National Bank of Ukraine**
NPP	**Nuclear Power Plant**
NSA	**Nuclear Safety Account**
OECD	**Organisation for Economic Cooperation and Development**
OHS	**Occupational Health and Safety**
OSCE	**Organisation for Security and Cooperation in Europe**
PB	**Participating Bank**
PPP	**Purchasing Power Parity**
R4	**The fourth reactor at Rivne Nuclear Power Plant**
SBA	**IMF Stand By Agreement**
SIMEST	**Italian Financial Institution for the development and promotion of Italian business abroad**
SIP	**Shelter Implementation Plan**
SME	**Small or Medium sized Enterprise**
TAM	**Turnaround Management**
TC	**Technical Co-operation**
TFP	**Trade Facilitation Programme**
TNK	**Tyumen Oil Company**
UAH	**Ukrainian Hryvna**
UMC	**Ukrainian Mobile Communications**
UMLP	**Ukraine Micro Lending Programme**
UMTS	**Universal Mobile Telecommunications System**
USD	**United States Dollar**
VAT	**Value Added Tax**
WHR	**Warehouse Receipt**
WTO	**World Trade Organisation**

EXECUTIVE SUMMARY

Ukraine has come through a difficult political test and now stands at a critical juncture in its transition. The democratic election of President Viktor Yushchenko has re-affirmed Ukraine’s adherence to the principles of multiparty democracy and pluralism contained in Article 1 of the Agreement Establishing the Bank. The core institutions of democratic governance – transparent elections, an independent parliament, active civil society and the rule of law – were all strengthened as a result of the prolonged election process. The new government is preparing a programme to address Ukraine’s key transition challenges and to get closer to EU standards and values. The Bank is committed and well-positioned to assist the Ukrainian authorities in this respect.

The Ukrainian economy has grown strongly over the last Strategy period with GDP growth of 9.4 per cent in 2003 and over 12 per cent in 2004. The balance of payments has remained in surplus driven by strong demand for Ukrainian metals and machinery. For much of the period the National Bank of Ukraine (NBU) resisted the resulting upward pressure and maintained a stable exchange rate against the US dollar. This, in turn, contributed to a steady increase in foreign exchange reserves which peaked at over USD12 billion by mid-September 2004. Until the pre-election period in 2004, inflation was at moderate levels, public finances were also reasonably strong and with modest volume of borrowing on the euro markets, public sector debt fell steadily as a share of GDP. However, fiscal loosening in the pre-election period had a substantial negative effect on the fiscal deficit for both 2004 and 2005 and added to inflationary pressures.

Provided prompt policy action is taken to address the fiscal and inflationary pressures, there are good prospects for a further period of economic growth, albeit unlikely to be as strong as recorded in 2004. Indeed growth has already slowed during the early months of 2005, partly reflecting the impact of the political crisis, although these effects were thought to be modest. The demand for finance for expansion and modernisation is expected to remain strong over the forthcoming strategy period. However, FDI flows remain at modest levels and, although the banking sector has grown strongly, the weak capital base of many banks is likely to constrain the ability of the banks to meet these needs. Thus the challenge for the EBRD during the next strategy period is threefold – to continue to provide necessary finance, to contribute to ways to strengthen the banking system and to improve the investment climate to ensure growth can be sustained in future years.

Ukraine has made some progress in transition over the period of the last Strategy. This includes the introduction of tax reform, new civil and commercial codes as well as pension reform. The banking sector has grown rapidly, not only in terms of deposits and lending, but also with several new products, including mortgage lending. This has been accompanied by some strengthening of supervision and progress in dealing with money laundering. However, some key reform issues were not addressed and many challenges still remain. Whilst there has been some progress in privatisation, the process has been marred by a lack of transparency. Ukraine was ranked 122nd in Transparency International’s Corruption Perceptions Index in 2004, with only three of the Bank’s countries of operations ranked lower.

The most urgent transition challenges are to:

- improve the business environment and combat corruption by strengthening the judiciary, reinforcing the rule of law, reforming the state bureaucracy, simplifying the regulatory regime for business and completing tax reform;
- improve corporate governance with the introduction of a new joint stock company law that increases protection for minority investors;
- strengthen the financial sector and its competitiveness with a further improvement of the regulatory framework to encourage consolidation, strengthen the capital base and ensure transparency of ownership;
- implement further large-scale privatisation in a transparent and open manner and continue with restructuring, particularly in energy and telecommunications; and
- promote Ukraine's full integration into the world economy.

The new government is preparing a programme which is expected to address most if not if not all of the transition challenges listed above. The guiding principles, outlined in a Presidential Decree, are the need to improve the investment climate and to encourage investment by increasing the transparency of both the ownership and operation of business entities, reducing the tax and administrative burden, tackling corruption, developing the financial sector and making privatisation transparent and open to all interested parties. The new conditions provide an enhanced opportunity for the Bank to play a leading role in policy dialogue. Following the agreement with the EU in February 2005 to implement a three-year Action Plan, the government's next steps in integrating the country into the European and world economy are expected to include obtaining market economy status from the EU, and WTO membership. The Bank can play an important role in supporting the implementation of key elements of the Action Plan.

A major test for Ukraine in terms of credibility with the international community will be timely and successful implementation of the international nuclear safety measures and respective policies for its nuclear safety systems. Whilst the Bank has secured the necessary donor support, the government will need to ensure a supportive institutional environment, including resolution of the various political, legal, regulatory and administrative issues that have hindered the Chernobyl Shelter Implementation Plan.

For the forthcoming Strategy period, the Bank will pursue a strategy of assisting the development of the private sector while supporting much needed public infrastructure projects and enhancing sectoral reforms in the transport, energy and municipal sectors. In order to meet the growing demand, the Bank will seek to develop local currency financing instruments based on the approach used already in Bulgaria, Romania and Russia, subject to the appropriate legal and regulatory changes being made. What the Bank can achieve under the Strategy is contingent on progress in reform in the coming years: it is hoped that the new Government's strong intention for reform, its commitment to move closer to Europe and its willingness to work with IFIs will transform the environment in which the Strategy is expected to be implemented and enable the Bank to achieve much more than in earlier Strategy periods.

The proposed new strategy is ambitious with the objectives of significantly increasing the Bank's impact through the broadening of its clients and segments in which it operates, through the expansion of its available products and committed resources and finally through an enhanced mode of intervention in policy dialogue.

Consistent with this Strategy the Bank will directly support the new government's priorities. Given the main focus on the private sector development, the Bank will concentrate on:

- helping to improve the business climate and the competitiveness of private sector by:
  - encouraging and sharing risk with foreign direct investors and increase the investment in large local manufacturing, service, property and agribusiness projects;
  - providing more equity and debt with longer maturities, promoting syndications, and making smaller direct investments;
  - enhancing integrity and corporate governance in local private sector projects; and
  - supporting environmental and energy efficiency related projects.

- Strengthening the institutional capacity of the financial sector and increasing the level of finance for micro enterprises and SMEs by:
  - supporting consolidation in the banking sector by providing new equity finance, particularly in the context of mergers of domestic banks or market entry by foreign strategic investors;
  - providing specialised credit lines (micro and SME finance, mortgage, leasing, energy efficiency, warehouse receipts) and pre-privatisation and merger finance; and
  - working with more banks and starting to work with insurance companies and other non bank financial institutions.
- Supporting the restructuring and modernisation of Ukraine's road, railway, harbour and airport infrastructure, power and oil & gas sectors by:
  - Financing sovereign guaranteed projects that help promote transition goals such as greater commercialisation or more cost reflective pricing; and
  - promoting new non-sovereign guaranteed structures and providing pre-privatisation finance.

The ambitious reforms by the new government will require enhanced support from the donor community and the Bank will aim to identify the needs in a timely manner and work in very close coordination in order to optimise our mutual and convergent objectives.

1 THE BANK'S PORTFOLIO

1.1 OVERVIEW OVER BANK ACTIVITIES TO DATE

As of 31 March 2005, Ukraine was the Bank's 5th largest exposure (after Russia, Poland, Romania and Hungary), representing approximately 6.3% of the Bank's signed commitments. The Bank had invested in some 66 projects with a net cumulative business volume of EUR 1,687 million with equity representing 6.3% of this volume, private sector projects representing 67% of the net cumulative business volume and non sovereign operations representing 58% of this stock. In terms of the amount of Bank financing, some one third of the portfolio is in Agribusiness, with some 20% each in Financial Institutions, Energy and Infrastructure and the balance of 7% in General Industries. In terms of number of projects, the greatest number (23) is in Specialised Industries, Financial Institutions having fourteen and the other sectors each between eight and ten projects.

Table 1 - Net cumulative business volume by Industry (as of 31 March 2005)

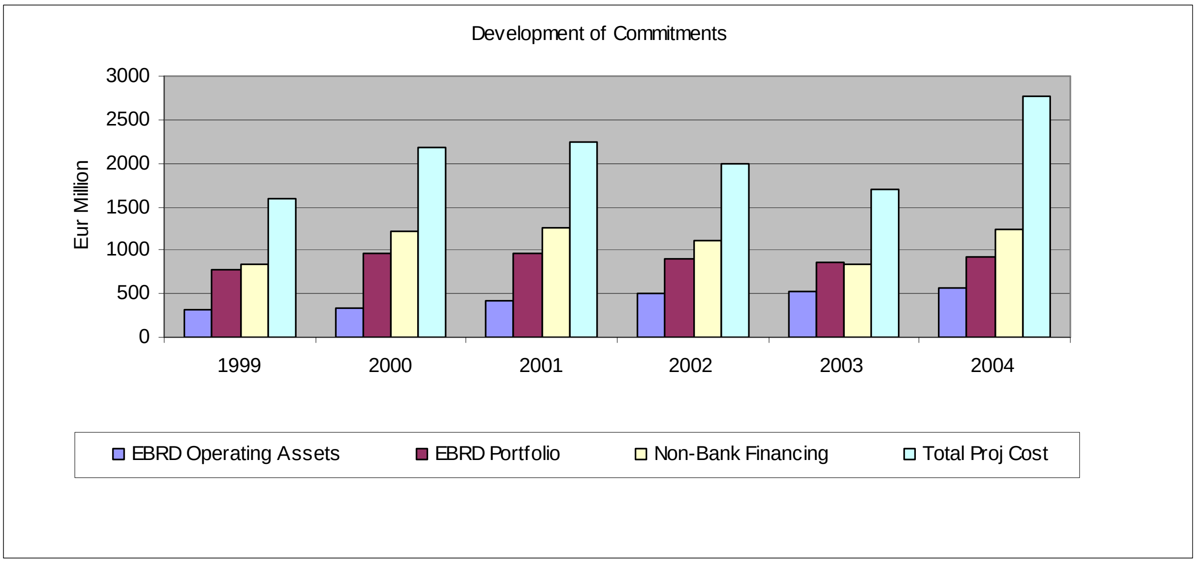
Sector	No of Projects[1]	EBRD finance (M EUR)	Portfolio share (%)	Total project cost (M EUR)
Corporates	**33.1**	**658**	**39%**	**1,547**
General Industry	10	112	7%	400
Specialised Industries	**23.1**	**546**	**33%**	**1,147**
Agribusiness	*19.4*	*461*		*945*
Property and Tourism	*1.2*	*25*		*88*
Telecoms, Informatics & Media	*2.6*	*60*		*114*
Energy	**8.1**	**269**	**16%**	**480**
Energy Efficiency	2.1	19		29
Natural Resources	3	76		197
Power and Energy Utilities	3	174		253
Financial Institutions	**14.7**	**402**	**24%**	**578**
Bank Equity	3.5	33		53
Bank Lending	7.5	307		330
Non-Banking Financial Institutions	0	0.0		0.0
Small Business Finance	0.1	13		43
Equity Funds	3.6	49		152
Infrastructure	**10.5**	**358**	**21%**	**577**
Municipal & Environmental Infrastructure	1.0	22		33
Transport	9.5	336		543
TOTAL	**66.5**	**1,687**	**100%**	**3,181**
of which debt		1,580	94%	
of which equity		107	6%	
of which private		1,134	67%	
of which state		553	33%	
of which direct		1,621	96%	
of which regional		66	4%	
of which non sovereign		974	58%	
of which sovereign		713	42%	

[1] The Bank allocates fractional counts to partially signed or partially cancelled stand alone operations.

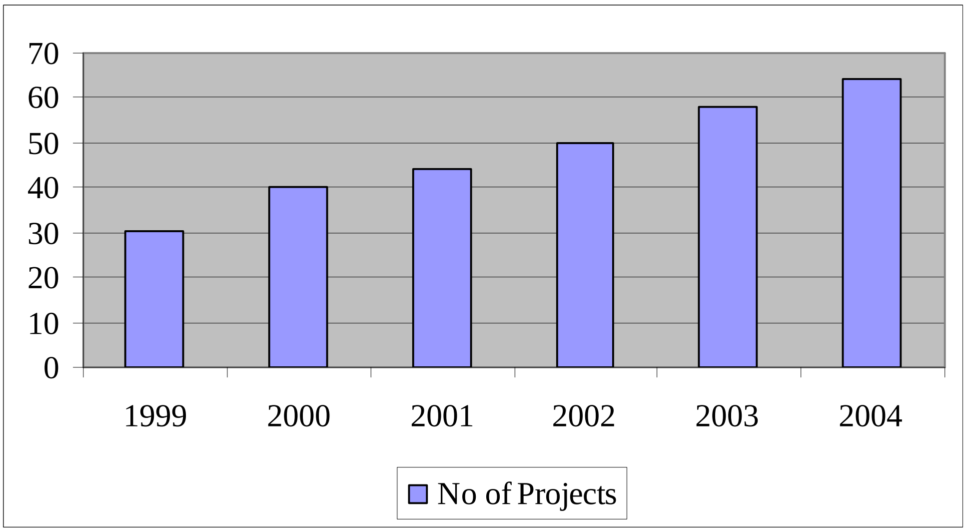
The graphs below shows the build-up of Bank commitments since 1999, showing the parallel build-up of the non-Bank funding mobilised for projects in Ukraine. Over the period of the last Country Strategy, the new annual commitments of the Bank, after a significant build-up in 2000-2001, decreased slightly but then increased again in 2004. The cumulative number of projects showed a steady increase with the highest year on year increase in 2000, then dropping in 2001 and steadily rising thereafter until 2004 when it dropped slightly. The percentage of operating assets in the Bank's portfolio has risen steadily from 45 % in 2001 to 61% at the end of 2004.

DEVELOPMENT OF COMMITMENTS, DISBURSEMENTS AND OTHER FUNDING MOBILISED[2]

By amount



By number of projects



2 Operating Assets: Loan and equity investments owned by EBRD, net of those written off, sometimes referred to as "disbursements outstanding". Net Disbursements are defined as Gross Disbursements less (i) total repayments, (ii) prepayments, (iii) sales of net disbursed loans and equity investments and (iv) write offs. Portfolio: Operating Assets plus undrawn com

1.2 IMPLEMENTATION OF PREVIOUS COUNTRY STRATEGY

Progress against the six elements of the September 2002 Strategy for Ukraine has been generally positive, though to varying extents. For the most part the elements were well chosen although the previous government's lack of political will for reform in the infrastructure sector, the limited numbers of transparent companies of sufficient size as well as low foreign investor interest in Ukraine before the 2004 elections limited progress in the private sector.

In respect of ***encouraging privatisation and commercialisation of major utilities*** the Bank has played a positive role through its chairmanship of the Energy Sector Task Force. Project conditionality has encouraged some further reform in the power industry and the transport sector though much remains to be achieved.

In respect of ***encouraging energy efficiency,*** Ukresco now has a significant portfolio of existing and potential projects; the Bank has financed the first private sector ESCO in Ukraine (Energy Alliance), and is systematically encouraging energy efficiency in its industrial clients.

As regards the development of the ***financial sector and financing for SMEs and MSEs,*** the Bank continued to finance MSEs and SMEs through the USD 88 million (EUR 80 million) sovereign SME II Credit Line and started to provide financing through local banks without sovereign guarantee. It has also provided credit lines to local banks for a variety of purposes including the first non-sovereign loan to finance SMEs, mortgages and WHR based lending. It has continued to expand the TFP and provided subordinated debt to help strengthen the capital base of Raiffeisenbank Ukraine. A new USD 200 million framework for SME/MSE lending direct through local banks was approved in December 2004. The new framework will be complimented by the technical assistance programmes for further institutional building of the local banks for micro and SME lending, which is supported by the EU through the TACIS National Programme for Ukraine for 2004, 2005 and 2006. The Bank has continued to build the capacity of the partner banks in micro enterprise finance, with more than 100,000 loans disbursed over the last Strategy period.

In respect of ***financing the private corporate sector***, three new projects were financed, reflecting the difficulty of finding suitable transactions, although the pipeline is healthy.

As regards the development of a ***WHR Programme,*** the Bank has contributed to the good progress in developing such a system over the last three years and is finalising three projects based on the provision of working capital financing against WHRs.

Finally, the Bank has continued to administer ***nuclear safety*** funds for Chernobyl NPP and in 2004 signed a loan for upgrading the nuclear safety systems at the K2 and R4 NPPs.

1.3 TRANSITION IMPACT OF THE BANK'S PORTFOLIO AND LESSONS LEARNED

1.3.1 Financial Performance

As at 31 December 2004, the portfolio stands at EUR 929.2 million with operating assets of EUR 569.6 million and non-performing assets of only 0.5 per cent of operating assets although the overall portfolio risk rating of 5.77 is higher than Bank's average of 5.42. Cumulatively the mobilisation ratio (external finance/EBRD finance) was 1.82. The pace of disbursements improved substantially over the last Strategy period, with 38.7% of undrawn commitments in the portfolio compared to 61% in 2002. The level of cancellations of public sector projects has also very substantially reduced and the percentage of operating assets has increased primarily reflecting much better co-ordination between the Bank and the Ukrainian Government through regular monitoring meetings agreed under a Memorandum of Understanding signed in 2003.

1.3.2. Mobilisation of Co-financing

The level of commercial co-financing, at 22% of Bank financing, is relatively low but is growing with some EUR 148 million raised from partner banks for 11 projects in 2003-04 compared to EUR 116 million for 5 projects in 2001-02. Cooperation with other IFIs, and donors has also been excellent, with EUR 20 million in donor funding in support of EBRD investments in the last three years with a focus on the financial and energy sectors.

1.3.3 Transition Impact

The Bank's transition impact in energy sector projects has lessened during the last Strategy period reflecting a weakening of reform commitment under the Yanukovich Government. The formation of the Energy Company of Ukraine may even have represented a reversal. However, earlier gains in terms of high levels of cash collection and privatisation of some of the distribution companies have been maintained and the Bank has continued to influence policy development though the Energy Sector Task Force. Project conditionalities in the K2R4 nuclear safety upgrade are designed to help the smooth functioning of the Wholesale Energy Market. In the rail sector, project conditionalities have stimulated the spin off of non core activities and in due course further spin offs, the development of competition and elimination of cross subsidies and in the road sector improved administration and management. Policy dialogue in the municipal sector has helped develop the framework for non sovereign guaranteed municipal borrowing as well as the first Bank project which has been approved and is currently under negotiation. The Bank has helped promote energy efficiency through Ukresco, the establishment of the first private sector energy efficiency company (Energy Alliance) and through direct work with industrial clients including a programme of energy audits for new clients.

The implementation of the Chernobyl "sarcophagus" and safety upgrade of the K2 and R4 NPPs will help improve standards of nuclear safety.

The Bank has had a strong transition impact in the banking sector through helping to improve the fundamental skills of private sector banks, strengthening the capital base of some banks, supporting through policy dialogue and with finance the development of the mortgage sector and WHR based lending as well as facilitating trade with an expanding TFP. An integral part of its role in financing SMEs and MSEs has been to develop and strengthen the capacity of the banks to make sound credit decisions, including the training of more than 1,000 loan officers throughout Ukraine. The development of ProCredit Bank has had a profound demonstration effect in transforming perceptions of micro lending with repayment rates of over 99%.

In the corporate sector the Bank has provided finance for the modernisation and expansion of four companies (in cardboard packaging, computer manufacture steel and glass containers), encouraging more widely through its involvement, higher standards of transparency and integrity as well as higher standards of management, greater efficiency and more customer focus. The Bank has also been active in the development of a WHR system and through syndication has helped demonstrate the benefits of this approach to other banks.

1.3.4 Lessons Learned

In the case of private sector projects critical lessons learned are the frequent need to work with local clients to address dual accounting and opaque corporate structures, patience whilst companies grow to a size at which they are suitable for direct Bank finance, encouraging potential clients to use consulting support where necessary to help prepare financeable business plans and focusing early on integrity issues which could rule out a particular candidate. Where such challenges can be overcome the transition impact can be particularly strong, sometimes starting several years before a project comes to fruition. Sponsor involvement is more likely to be sustainable in a difficult business climate if projects can be phased (where appropriate) and care is taken to analyse and address stakeholder interests at the outset. Greater care needs to be taken in identifying and addressing environmental and OHS risks.

In the financial sector, key lessons in respect of project development are the importance of early evaluation of the extent of related party lending, shareholder integrity and the existence of questionable tax minimisation schemes as these may preclude Bank financing. Lack of adequate professional skills can be overcome with targeted TC or a strategic investor.

In sovereign projects a key lesson is the need for regular co-ordination with the Government and to make sure that there is a strong champion for each project in the relevant industry Ministry. Six monthly project reviews with the Ministry of the Economy have played an important role in speeding up project preparation and implementation. It is also important to ensure that project conditionalities are realistic, within the powers of the entity to which they apply and not the subject of wider political considerations. Finally, an effective Project Implementation Unit, supported by consultants where necessary, is essential to timely implementation of projects and to securing necessary regulatory and other approvals.

1.4 PORTFOLIO RATIO

During the strategy period the percentage of finance for private sector projects increased from 69% to a maximum of 72%, reflecting the absence of signings of public sector projects during the first part of the period. However, the ratio has subsequently reduced and as of end of March 2005 stood at 61% private vs. 39% public as a result of the signing of substantial loans to Ukrainian State Railways, the Ukrainian Roads Authority and for the improvement to international standards of the safety systems at the nuclear power stations K2 and R4. The current project pipeline is substantial (about EUR 900 MM), with a balanced mix among public and private sectors, in line with the proposed operational priorities. The portfolio ratio is expected to stay stable (60/40 private/public) or increase slightly as the Bank is expecting an increase in the amount of private investment as a result of increased FDI in Ukraine.

2 OPERATIONAL ENVIRONMENT

2.1 THE GENERAL REFORM ENVIRONMENT

2.1.1 Political developments

The past Strategy period has been marked by political uncertainty and institutional instability. The Presidential election of end-2004 put significant stress on a fragile system in which democratic practices were not yet deeply encoded. Although Ukraine boasted a strong opposition and active civil society, political structures inadequately reflected the diversity of views in the electorate and decision-making was dominated increasingly by regional and business elites. The national media, mainly in the hands of the State and pro-Government oligarchs, betrayed a systematic bias in favour of the authorities and there were persistent accusations of censorship through so-called *temnyki* or information 'circulars' issued by the Presidential administration on what should be reported in the press. The opposition complained of constant harassment, which only increased in the run-up to the first round of the Presidential election in October 2004.

This underlying conflict – between the state and society and between the authorities and the opposition – continued to build over the past two years and came to a head in the Presidential election. Following two rounds of voting that the OSCE observation mission said fell short of a considerable number of OSCE commitments and Council of Europe and other European standards for democratic elections, the Central Election Commission rushed to announce a winner before all legal challenges had been heard. The extraordinary events that followed have helped put Ukraine on the path to stable democratic development.

Opposition supporters filled the streets and began a peaceful demonstration in favour of electoral transparency and fairness that lasted for several weeks. Their demands, for a repeat of the second round of the election under an amended Electoral Code, were ultimately met thanks to crucial support they received from the Rada and the Supreme Court. The OSCE reported that the conduct of the repeat election on 26 December 2004 "brought Ukraine substantially closer to meeting OSCE election commitments" and praised the comparatively balanced coverage by the national media, improved election administration, and a marked decline in the misuse of State resources.

Violent conflict was averted in Ukraine in 2004 in part due to the willingness of all sides to negotiate and make compromises for the good of the electorate. The main concession by the opposition was acceptance of a Constitutional reform proposal favoured by the outgoing administration that fundamentally alters the Ukrainian political system. The reforms shift power from the executive to the parliament and, within the executive, from the President to the Prime Minister. These measures, which go into effect between late 2005 and early 2006, move Ukraine further toward a European model of democracy. They will introduce necessary checks and balances into the system that have been absent under the 1996 Constitution, which concentrated power in the Presidency. They could help to ensure that Ukraine stays on the path of representative democracy and accountability, which in other countries has been strongly associated with success in market transition. On the other hand, the reforms will place an additional burden on the country's still weak political party system, which to date has been dominated by powerful economic clans and regional interests.

2.1.2 Regional Integration

Ukraine is the largest country by area wholly within Europe, with strong regional centres, particularly in the East. The Bank 's marketing effort seeks to identify projects in all parts of the country and infrastructure projects, particularly in transport and power (high voltage transmission), help improve links between the different parts of this large country.

Ukraine is also strategically located between Russia and the EU. President Yushchenko has made eventual EU membership for Ukraine one of his foremost priorities. A first step will be rapid implementation of the EU Action Plan, under the leadership of the Vice Prime Minister responsible for European Integration with the goal of making Ukraine "EU compatible". Ukraine has further set itself the goal of starting negotiations on associate membership in 2007. The EU has emphasised the overwhelming importance of full implementation of the Action Plan in advancing Ukraine's internal reforms and bringing it closer to the EU. The Action Plan notes that the possibility of a new enhanced agreement will be considered and its scope "*defined in the light of the fulfilment of the objectives of this Action Plan and of the overall evolution of EU-Ukraine relations*".

The Bank can play a significant role in supporting Action Plan implementation both because the Bank's transition goals match key components of the Plan, for example in respect of regulatory reform and improving the business climate, and because the Bank can engage in policy dialogue and provide finance for projects in energy, transport (including cross border links), private sector development, nuclear safety and environment. The Bank and the EIB have agreed that they will work jointly on infrastructure projects in order to ensure optimum efficiency of delivery. The Action Plan is also expected to increase the flow of FDI into Ukraine, particularly from the new EU member states, for which the Bank can provide finance.

At the same time, President Yushchenko has said that Russia is also an important strategic partner for Ukraine with already strong economic links between the two countries. Whilst full membership of the Common Economic Space (CES) is likely to be incompatible with EU membership, Ukraine may participate in certain elements of it such as the free trade area.

Although the level of FDI is still low, there is already increasing interest in Ukraine from Russian investors in many sectors, for example with recent acquisitions in telecommunications, agribusiness and electronics. Investment from the EU and North America is also growing but still primarily confined to the agribusiness sector. Ukrainian companies are also starting to look at investing abroad, for example in the steel industry. The Bank stands ready to provide finance for cross border investments among Ukraine and other countries of operation such as Poland and is well placed do so through its Resident Offices in relevant countries. 11 banks in Ukraine participate in the Trade Facilitation programme which helps finance Ukrainian eternal trade.

2.1.3 Social Conditions and Labour Issues

Ukraine's population continues to decline as a result of relatively low fertility rates and high mortality rates, accentuated by the outward migration of workers. Given that Ukraine is an aging society, this will reduce the workforce and increase the dependency ratio.

Whilst extreme poverty is low, the share of the population below a poverty line of UAH 2,423 per annum in 2002 (about USD450) was 25.6 per cent focused on rural areas and families with young children. The share is likely to have declined since then, reflecting strong growth, but is still thought to be in excess of 20 per cent. The government has addressed the issue of poverty mainly by increasing the minimum wage, reforming pensions and repaying wage and pension arrears. Strong economic growth has ensured rapidly increasing nominal and real wages overall, from an average of UAH 376 (USD70) per month at the end of 2002 to UAH 666 (USD126) by February 2005. In the run up to the presidential election in late 2004 the government more than doubled the minimum monthly pension from UAH 132 to UAH 284 (USD 25 to 53). Earlier in the year laws providing for the eventual introduction of a three-pillar pension system came into effect.

However the government has had less success in increasing employment. This partly reflects the slow rate of restructuring in industry and partly the lack of progress in reforming the social insurance tax which almost certainly restricts the growth of employment in the formal sector. By driving activity into the informal economy (estimated to be at least 33 per cent of the recorded economy) the overall tax and pension contribution base is restricted. Ukraine is an ILO member country and has ratified all eight core ILO conventions.

On most other social indicators Ukraine scores well with high literacy rates, a reasonable infrastructure network and reversal of the deterioration in some mortality ratios which occurred during the 1990s. However concerns remain over access to essential health facilities, especially for the poorest, and most seriously the rapid growth of tuberculosis and HIV/AIDS. The government has adopted a national programme to address these problems but is unlikely to reach the 2015 Millennium goal for preventing HIV/AIDS and tuberculosis.

2.1.4 Integrity issues

Although Ukraine was taken off the FATF "Black List" in 2004, integrity is perhaps the biggest challenge faced by the Bank in Ukraine. Integrity issues make it difficult for the Bank to work with financial industrial groups or FIGs (which were built up partly through non transparent privatisation of State assets and other questionable activities). However there are increasing signs that some FIGs are becoming more transparent. This may provide opportunities for the Bank to finance projects in highly selected cases where it is satisfied that the sponsors would be committed to international standards of accounting, to full transparency, to respect of corporate governance and to manage their businesses respecting the rule of law and a level playing field. The Bank will do so after careful consideration of the past business practices of the FIG and individuals behind it.

With smaller clients the issues relate to complex corporate structures and tax minimisation schemes, often motivated by the desire to limit the impact of an intrusive State and avoid unwanted attention from business predators. President Yushchenko has made tackling corruption one of his priorities. The Bank places a strong emphasis on ensuring transparency and integrity on all its projects and will continue to do to, focusing on projects with a strong demonstration effect.

2.1.5 Legal reform

Over the period of the last Strategy there has been a significant amount of new legislation of direct relevance to the Bank's work. This includes new Civil and Commercial Codes and new laws on money laundering, personal income tax, leasing, mortgages and pensions. Certain other new laws, such as the Financial Services Law, came into full force during the Strategy period. Nevertheless, there remain important gaps and inconsistencies in the law. In particular, there is a pressing need, which the new Government has recognised, for a new Joint Stock Company law that better protects the rights of minority shareholders. Other desirable changes would include amending the law on insurance to bring it into line with international standards and practice, amending the insolvency law (which ranked as one of the least compliant with international standards in the EBRD's countries of operations), removing inconsistencies between the Commercial and Civil Codes and between the Law on Mortgages and the Mortgage Finance Law and reforming the judiciary and related institutions.

2.2 PROGRESS IN TRANSITION AND THE ECONOMY'S RESPONSE

2.2.1 Macroeconomic conditions for Bank operations

The economy has grown very strongly over the last two years, with GDP increasing by 9.4 per cent in 2003 and by a little over 12 per cent in 2004. Domestic demand remained strong, fuelled by strong wage growth and higher investment spending and exports were boosted by favourable volume and price trends. High oil prices boosted demand from Russia for imports of machinery from Ukraine while strong demand for steel from China helped boost metal prices on world markets.

On the supply side, industrial output grew strongly across most sectors; agricultural output recovered in 2004 following the drought of 2003; and the boom in construction activity continued. Although Ukraine's GDP growth in 2003 and 2004 exceeded the CIS average (of around 7.5 per cent per annum), by the end of 2004 recorded activity was estimated to be only 57 per cent of the level recorded in 1989, indicating the potential that still exists.

The impact of the political crisis at the end of 2004 on output was modest, and mainly reflected the effects of the restrictions on foreign exchange introduced by the National Bank of Ukraine (NBU). Most of these were subsequently removed at the end of the year. Although there were concerns about the banking sector, the measures taken by the NBU were successful in maintaining liquidity in a number of banks which had been affected by a run on deposits at the height of the crisis.

Strong output growth has been accompanied by large current account surpluses, mainly the result of export growth, but also boosted by earnings from gas transit services as well as a rise in workers remittances. Foreign exchange reserves rose steadily and the National Bank of Ukraine (NBU) ensured exchange rate stability by maintaining a de facto peg to the US dollar until mid-2004 when it allowed a modest nominal appreciation. During the run-up to presidential elections, when uncertainty contributed to demand for hard currency, the NBU met the demand from reserves, allowing them to fall by USD 3 billion from mid-September to the end of 2004, although always remaining in excess of 3 months of imports. Gross reserves subsequently increased to USD 11.9 billion by end-March, boosted by higher capital flows. For most of the period, with the dollar weakening against the Euro, combined with Ukraine's lower inflation rate compared to Russia, the real effective exchange rate depreciated during the period, boosting competitiveness.

Until mid-2004 inflation remained at moderate levels; strong growth of the monetary aggregates was largely matched by the steady re-monetisation of the economy. However, inflationary pressures emerged in mid-2004. The immediate trigger was higher oil prices which resulted in producer prices rising to 24 per cent at end-year. The impact on the CPI was more moderate, but nevertheless inflation rose steadily during the second half of 2004, also boosted by the government's decision to increase spending on wages and pensions ahead of the presidential elections. As a result, CPI inflation was over 12 per cent at year-end, well in excess of the government's original end-year inflation target for 2004 (of between 5.8-6.3 per cent), and has remained at high levels in early 2005.

Concern over higher inflation prompted the NBU to introduce several measures from May 2004, including higher interest rates, to tighten monetary policy. However, the fact that the NBU continued its purchases of foreign exchange on the inter-bank market at least until mid-September, only part of which were sterilised, meant that the banking sector had ample liquidity to support the continued growth of credit. However, the growth of credit slowed at the end of the year.

For much of the Strategy period the implementation of fiscal policy was responsible and resulted in modest fiscal deficits. The impact of the reduction in income and corporate tax rates from the beginning of 2004 was more than offset by the effects of strong economic growth. However, the government increased spending from mid-2004, and in September raised the amount of the minimum pension. The latter required transfers from the budget to the pension fund and the overall impact was a sharp upward revision in the fiscal deficit for 2004 from the initial target of 1.2 per cent of GDP to an estimated 3.4 per cent. However, financing the spending increases was not a major issue in 2004 as privatisation receipts were well in excess of target.

The immediate growth prospects for the economy are favourable, provided prompt action is taken to reduce inflationary pressures.

It is, however, unlikely that such a favourable set of external conditions will occur during 2005/06. The impact of EU enlargement on Ukraine's exports is likely to be small; losses from the abolition of free trade arrangements with particular countries are likely to be broadly offset by a lowering of the average tariff level in others to the level of the EU Common External Tariff. Over the medium term Ukraine could benefit from more inward investment as a result of enlargement, reflecting its lower wage levels.

Action is, however, required on the policy front. The main issues are:-

- Fiscal adjustment is required if the recent commitments to increase spending on wages and pensions are to be met in future years, while maintaining the fiscal deficit at modest levels. The revised deficit target in the State budget for 2005 approved by the Rada in March was 1.6 per cent of GDP. However, given that the budget is based on optimistic revenue assumptions, it is probable that the consolidated fiscal deficit will be at least 3 per cent of GDP. Although the government hopes that much of the planned deficit will be met from privatisation receipts (of UAH 6.8 billion), further borrowing from both the domestic and the Eurobond markets is likely. However, the government is unlikely to have any difficulty in attracting the necessary funding.
- Policy needs to be tightened to contain and lower inflation. Although the NBU projects end-year inflation in 2005 at 8.5-9.5 per cent, there could still be upward pressure on inflation, partly because of the continued increase in producer prices.
- The recent decision by the authorities, to permit a nominal appreciation of the hryvnia against the US dollar, should help offset the potential inflationary pressures. The previous policy of maintaining a de facto peg to the US dollar risked accentuating inflationary pressures, especially as foreign exchange reserves could again increase as the current account is expected to remain in surplus (although declining over time).
- The growth of credit needs to be restrained, especially as the resulting growth of assets has exceeded the increase in banks' capital. The NBU has already introduced several measures, including higher reserve requirements, in an attempt to slow credit growth, but banks continue to meet the demand for credit through a combination of attracting additional deposits and borrowing. In these conditions there is a risk of some deterioration in overall credit quality.

Providing action is taken along these lines, GDP growth during the forthcoming strategy period is expected to be at least 6 per cent per year, accompanied by some moderation in inflation. However, given the investment needs, sustained growth over the medium-term will depend on further reforms to improve the business environment and attract higher investment from both domestic and external sources. The share of investment in GDP is close to 20 per cent and FDI flows have risen in recent years, providing the opportunity to import latest technology, crucial for a country, which remains very inefficient in its use of energy. However the levels of FDI remain very low and it should be of concern that despite several years of strong economic growth, there has been no significant surge in FDI.

2.2.2 Transition success and transition challenges

Progress in Transition

During the period of the current strategy, Ukraine has continued to make progress in certain areas of reform, although in many cases, such as tax and pension reform, work had commenced on these issues in earlier years. The 2002 strategy noted that if progress could be made with large scale privatisation, WTO accession, approval of the tax code, modernising infrastructure, strengthening the financial sector and successfully implementing anti-money laundering legislation, then these developments ought to contribute to an improvement in the business environment.

Both the government and the Rada were active on the legislative front during 2003, a year which saw the approval of several important pieces of legislation. However, progress slowed during 2004, partly because the government lost its overall majority in the Rada in the first half of the year, while the focus on the presidential elections dominated events during the second half.

Overall, progress in reform was slow, but among the main achievements were:-

- the introduction of lower tax rates for both corporate and income tax from the beginning of 2004 which should lead to some improvement in the business environment.
- The new civil and commercial codes, which also took effect from the beginning of 2004, provide a more market-friendly legal framework for business, although there are inconsistencies between the two codes.
- The NBU strengthened its supervisory regime, most notably with the formal introduction of a 10 per cent capital adequacy ratio from March 2004.
- Following the enactment and implementation of the anti-money laundering legislation in 2003, the OECD’s Financial Action Task Force removed Ukraine from their list of non co-operating countries in early 2004.
- In addition, progress has been maintained in one of the most important of the earlier reforms introduced in 2000 - the hardening of budgetary constraints, reflected in both the high level of cash collections among the main utilities as well as the continued growth in demand for cash and other services from the banking sector.

Key Remaining Challenges

Improve the business environment and combat corruption.

Despite the progress that has been made, most Ukrainian companies continue to perceive the business environment as very difficult. In its annual survey of the Business Environment in Ukraine, conducted in 2003, the IFC found that taxation, inspections and customs procedures remained the main obstacles. A World Bank Business Environment Study, published in October 2004, concluded there had been no overall improvement over the past two years. Despite some progress in areas such as price regulation and a reduced time tax (the proportion of time spent by managers in dealing with regulatory issues), companies remained very concerned over the implementation of VAT and some unintended consequences of the enactment of the Civil, Commercial and Customs Codes. These surveys indicate that not only should the new government aim to accelerate the reform agenda, but should also concentrate on the effective implementation of the reform legislation which has already been approved.

Perceptions of the business environment among Ukrainian enterprises in recent years have also been negatively affected by the purportedly close ties between state bodies and financial industrial groups (FIGs) and the high levels of *corruption* these ties engendered. The 2004 report from Transparency International largely confirms this, with a slight deterioration in Ukraine's score compared with 2003. The results of the 2004 Presidential election and the appointment of a new Government promises to bring significant change in the relationship between the state and private enterprises. Lasting improvement in the business environment and reductions in corruption will also require strengthening the judiciary, reinforcing the rule of law, and reforming the state bureaucracy. These are urgent institutional reforms that cannot be completed overnight, but the authorities must make a serious start at creating a stable set of rules for business and strengthening the bodies responsible for implementing them. The courts need greater political and financial independence; the General Prosecutors Office and the police need better incentives and resources to prevent, investigate and prosecute crimes; and the bureaucracy needs to be reduced, reorganised and re-staffed to eliminate sources of corruption. A third round of the EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS), to be completed in mid-2005, will provide fresh information on Ukrainian enterprises' perceptions of the business environment and problems of corruption. These findings could provide a useful tool for the Bank's policy dialogue with the Ukrainian authorities on improving both public and private sector governance.

Further reduction in the *regulatory burden* would help stimulate the growth of private businesses, especially SMEs. Whilst the number of SMEs has continued to grow it is estimated that they accounted for just 10 per cent of GDP and 19 percent of employment. (compared to 49 and 61 per cent in Poland and 34 and 44 per cent in the Czech Republic). Recent surveys show some progress in simplifying company registration procedures, following a new law on registration of legal entities which took effect in mid-2004. Although the number of procedures required remains relatively high, the time taken and overall cost is comparable with the regional average. There have also been improvements in certain areas, such as price regulation, but new problems have emerged in connection with land and construction permits a key concern for many businesses is the unpredictability of the regulations and the associated inspections, especially when one takes into account the wide regional variations. Thus greater consistency in the application of the regulations, as well as steps to remove unnecessary regulations, would lower the regulatory burden.

Although considerable progress was made in lowering the *tax rates* for both income and corporate tax from the beginning of 2004, progress on reforming VAT has been much slower. The main challenges are to lower the rate of VAT while abolishing exemptions, to improve the efficiency and administration of VAT and to resolve the long-standing problem of the late repayment of VAT arrears due to exporters. The abolition of exemptions has faced opposition in the Rada and VAT refund arrears remain a strong concern of business, emphasising the need for prompt action.

Improve corporate governance.

Although the new Civil and Commercial codes have improved the legal framework for property rights, the corporate governance framework falls short of the OECD principles and, as a result, investment in joint stock companies is adversely affected. The current law not only provides inadequate protection for minority shareholders but also allows any group of shareholders to block lawful decisions on technical grounds.

The State Securities Commission and the IFC have made a start by drawing up a voluntary set of governance principles, although only a few major corporates have adopted them to date. However the new government recognises that a new joint stock company law is an urgent priority. If this were to be harmonised with EU legislation, it could encourage more portfolio investment, thus contributing to the development of capital markets.

Strengthen and encourage greater competition in the financial sector.

The last few years have witnessed a rapid growth in the activity of the banking sector. Deposits grew from 12.5 per cent of GDP in 2001 to almost 30 per cent in 2004 and lending from 23.5 per cent in 2001 to 25.3 per cent in 2004. Although it is still relatively small, with total banking sector assets standing at some 38.8% of GDP and the gross customer loan portfolio standing at some 25.3% of GDP at the end of 2004, banks play an important role in financing local companies, given the undeveloped capital markets and limited FDI, and demand for credit is strong. Lending rates have fallen although they remain high and new products, such as leasing and mortgage financing, have been developed. Lending skills are improving but the risk assessment and monitoring of most of the banks is still weak. The growth of credit has also highlighted the need to strengthen the capital base of the banking sector which at the end of 2003 stood at only some 5.3% of GDP. This rapid credit growth carries with it risks and emphasis the need for continued institutional strengthening to maintain financial stability.

This includes continuing the move by the NBU to risk based supervision, the NBU assessing the impact of new products on the risk profile of banks, and reducing the volume of related party lending which is prevalent because of the involvement of FIGs in the banking sector. The early introduction of IAS accounting for corporates would provide a sounder basis for credit decisions. The capital adequacy ratio was raised to 10 per cent in March 2004, and the minimum regulatory capital requirement was also increased with the aim of making the banks more resilient should problems emerge, although a possible increase in the capital adequacy ratio to 12 per cent from the beginning of 2005 has been delayed owing to the impact of the political crisis on the sector. So far the banks have been able to find the capital required though some of this is of questionable quality. Increasing the capitalisation of the banking sector is therefore a priority and is most likely to be met in a number of ways including domestic mergers or greater foreign investment in the sector, to which the government and the NBU are open. Starting from 2004 banks have to be audited in accordance with International Auditing Standards.

It is hoped that the higher capital adequacy ratio and minimum capital requirements will lead to consolidation in the banking sector, which at the end of 2004 comprised some 160 banks, both through mergers of domestic banks and greater involvement of foreign strategic investors. The sector is already becoming increasingly concentrated with the top ten accounting for 55% of total assets, loans and capital. The proposed changes to the banking legislation that would allow branches of foreign banks to operate in Ukraine should help promote competition. Early approval of the draft legislation that the NBU is preparing on beneficial ownership is also important if the NBU is to control connected lending and to help remove potential obstacles to capital raising by the banks.

Implement further large-scale privatisation in a transparent and open manner and continue with restructuring, particularly in energy and telecommunications.

Effective privatisation of the remaining large-scale assets would contribute to higher investment and productivity growth, thus assisting with the restructuring of industry, much of which is still reliant on out-dated equipment and technology. In energy and telecommunications, this may need to be preceded by restructuring and the introduction of more effective and transparent regulation to pave the way for greater competition. In other sectors, such as transport, spinning off non core assets and corporatisation are the necessary first steps.

Although the Government met or exceeded is target for privatisation receipts in 2003 and 2004, privatisation has been carried out on an ad-hoc and non transparent basis as the Rada failed to approve the Government's privatisation programme for 2003-08. In many instances the terms of privatisations have clearly favoured some of the FIGs and there have been serious doubts as to whether the State has always received full value for the assets, the most notable case being the major steel company, Krivorizhstal. Overall the pace of privatisation has been slow, so that the State still retains a significant share of fixed assets in a number of major sectors including energy transport and distribution, mining, fishing and transport (especially rail transport). There is also the long-standing proposal for the government to sell a 43 per cent stake in Ukrtelecom. Furthermore, with the exception of some successful Russian investment, mainly in the oil refining and mobile telecoms sectors, Ukraine has failed to attract major strategic investors from the West.

The new government has a clear opportunity to send a signal to the investor community as to the type of management and nature of investment they would like to attract and of the importance of following transparent procedures. The government has already indicated its intention to prepare a new privatisation programme. However, the immediate need is for the government to clarify its position with respect to the review and possible re-nationalisation of past privatisations, currently involving Krivorizhstal and "a few dozen other companies", according to President Yushchenko. The issue has important implications both for the budget and for investor perceptions about Ukraine and is one on which there is also a need for greater clarity as to the criteria on which past privatisations will be assessed.

Promote Ukraine's full integration into the world economy.

Key priorities for Ukraine are accession to the WTO and the development of closer relations with the EU, especially as the new government has placed strong emphasis on implementing the Action Plan with the EU. Ukraine has further set itself the goal of starting negotiations on an association agreement in 2007. The EU has emphasised the overwhelming importance of full implementation of the Action Plan in advancing Ukraine's internal reforms and bringing it closer to the EU. The Action Plan notes that the possibility of a new enhanced agreement will be considered and its scope *"defined in the light of the fulfilment of the objectives of this Action Plan and of the overall evolution of EU-Ukraine relations"*.

In the case of the WTO, Ukraine still needs to reach agreement with the US and China and will need to make changes in respects of export taxes, reducing tax privileges and harmonising technical standards and certification procedures. The early recognition by the EU of Ukraine as a market economy would also strengthen the latter's ability to deal with international trade disputes in key areas such as trade in metals. Further progress with the EU depends on implementing the 3-year Action Plan which was endorsed by the EU Ukraine Cooperation Council in February 2005. In addition WTO accession could also assist any future negotiations on a trade agreement between Ukraine and the EU. Overall the prospects for stronger relations with the EU are favourable: not only is it one of the government's main objectives, but in February 2005 the EU-Ukraine Cooperation Council met to endorse the Action Plan.

For some time there have been concerns that the establishment of the CES, with Russia, Belarus and Kazakhstan, could complicate Ukraine's integration into Western markets. Given the new Government's strong ambitions in respect of the EU and President Yushchenko's view that Ukraine should not participate in the full aims of the CES, it now seems likely that Ukraine will limit its involvement to developments such as a free trade area that do not conflict with its broader goals.

Government Programme

Although the Government has not yet announced a detailed economic programme, President Yushchenko has instructed the Government to prepare within 3 months a programme to improve the investment climate and encourage investment that will address most if not all of the key transition challenges. Key components will be the introduction of a new joint stock company law, simplifying and reducing the burden of business regulation, tackling corruption, reforming tax and tax administration, reforming the bankruptcy law, making privatisations transparent and open to all interested parties, strengthening the capitalisation of the banks and developing the non bank financial sector. In due course, the government is expected to restart the large scale privatisation programme, but this is only likely to make progress once there is greater clarity over the review of past privatisations.

Key objectives of the government are for the European Union to accept Ukraine as a market economy, to implement the EU Action Plan as rapidly a possible, to enter the WTO and to secure closer relations with the European Union. The government's declared objective of EU membership has provided greater impetus to reform.

2.3 ACCESS TO CAPITAL AND INVESTMENT REQUIREMENTS

Over the last two years, domestic sources of funding for capital spending have been supplemented by both the growth in FDI and the return of the government to the Eurobond markets. These sources of longer-term funding will remain important during the forthcoming strategy period.

The share of public external debt to GDP fell to 20 per cent at end 2004 and Ukraine has had little difficulty in meeting its debt service obligations, which has contributed to sovereign ratings upgradings. Further upgrades are expected if the new government tackles fiscal and inflationary pressures. The strength of the external position has meant that the Government has not required large- scale funding from the IFIs. In any event the IMF was unable to complete its review in August 2004 of the (precautionary) SBA that had been agreed earlier in the year owing to concerns about fiscal policy and VAT arrears. The Yanukovitch Government's failure to meet some of the conditions in the energy and banking sectors of the World Bank's second Programmatic Adjustment Loan meant that no disbursements were made under this facility. The new government may well remove these obstacles.

There has also been a rapid growth in the amount of private external debt, estimated to have increased to over USD 6.7 billion by the end of 2004, so that total medium and longer term external debt was 31 per cent of GDP. The largest private sector companies have been able to access the Eurobond markets since 2003 and some banks have borrowed from Western banks, mainly to on-lend to clients to promote bilateral trade. Overall it is likely that external borrowing by the private sector will increase over the Strategy period, but it will be limited to those entities able to meet the necessary financial reporting requirements.

Borrowing from the domestic banks is also expected to grow but will be constrained by the NBU's desire to limit credit growth to avoid deterioration in asset quality. Maturities remain relatively short (typically 1-2 years), margins relatively high (8 per cent or more) and NBU rules encourage overcollateralisation (150 per cent or more). Much lending to SMEs is financed directly or indirectly by the Bank. The domestic banks do not provide mezzanine finance or equity. The domestic bond and stock markets are also growing but limited by the lack of an active secondary market. Critical to the development of these markets will be improved corporate governance.

The opportunity exists for Ukraine to substantially increase the amount of FDI it attracts. Although the flows have risen steadily – to an estimated USD1.7 billion in 2004, the overall stock (of some USD7.9 billion) remains well below the levels recorded in Central Europe. There is now greater realisation among investors of Ukraine's strong economic performance and its low wages in relation to its neighbours, while a large number of large-scale entities remain to be privatised. Whether this opportunity is realised depends very much on how transparently the new government implements the next phase of privatisation, how willing existing owners are to dilute their equity and how quickly the business environment improves.

3 STRATEGIC ORIENTATIONS

3.1 BANK'S PRIORITIES FOR THE STRATEGY PERIOD

The Bank expects to play a significant role over the Strategy period in helping the Government implement their economic reform programme. The new conditions provide an enhanced opportunity for the Bank to play a leading role in policy dialogue. What the Bank can achieve under the proposed Strategy is contingent on the progress in reform in the coming years: it is hoped that the new Government's strong intention for reform, its commitment to move closer to Europe and its willingness to work with IFIs will transform the environment in which the Strategy is expected to be implemented and enable the Bank to achieve much more than in earlier Strategy periods. As noted in section 2.2 above, this should address most if not all the key transition challenges faced by Ukraine. For the forthcoming Strategy period, the Bank will pursue a strategy of assisting the development of the private sector while supporting much needed public infrastructure projects and enhancing sectoral reforms in the transport, energy and municipal sectors and address in part the huge need to upgrade the infrastructure.

Given the main focus on the private sector development, the Bank will concentrate on:

- helping to improve the business climate and the competitiveness of the private sector by:
  - encouraging and sharing risk with foreign direct investors and investing in medium sized local manufacturing and agribusiness projects;
  - providing more equity and debt with longer maturities, promoting syndications, and making smaller direct investments;
  - enhancing integrity and corporate governance in local private sector projects; and
  - supporting environment and energy efficiency related projects.
- Strengthening the institutional capacity of the financial sector and increasing the level of finance for micro enterprises and SMEs by:
  - supporting consolidation in the banking sector by providing new equity finance, particularly in the context of mergers of domestic banks or market entry by foreign strategic investors;
  - providing specialised credit lines (micro and SME finance, mortgage, leasing, energy efficiency, warehouse receipts) and pre-privatisation and merger finance; and
  - working with more banks and starting to work with insurance companies and other non bank financial institutions.
- Supporting the restructuring and modernisation of Ukraine's road, railway, harbour and airport infrastructure, Power and Oil & Gas sectors by:
  - Financing sovereign guaranteed projects that help promote transition goals such as greater commercialisation or more cost reflective pricing; and

– promoting new non-sovereign guaranteed structures and providing pre-privatisation finance.

In order to meet the growing demand, the Bank will seek to develop local currency financing instruments based on the approach used already in Bulgaria, Romania and Russia.

3.2 SECTORAL CHALLENGES AND OPERATIONAL PRIORITIES

3.2.1 CORPORATES

3.2.1.1 Agribusiness

Transition goals

The Bank's key transition goals for the sector are to:

- support higher standards of integrity, transparency and corporate governance;
- complete the development of a fully functioning warehouse receipts (WHR) system;
- modernise agricultural processing and develop the wholesale and retail distribution of foodstuffs; and
- support the modernisation and development of locally owned companies in the agribusiness sector.

Operational focus

In pursuit of these goals, the main areas of operational focus will be:

- in the short term, to achieve better lending efficiency (and therefore, lower margins) to the agricultural sector by promoting of the warehouse receipts system. The Bank will attempt to increase lending to local and foreign-owned players against pledges of agricultural commodities and warehouse receipts (enhanced where appropriate by pledge of other assets). This can take the form of financing via or with the aid of local commercial banks under the Agricultural Commodities Financing Programme or other structures. To date, WHR have been used to finance clients in processing rather than primary agriculture, but the Bank will carefully examine in the coming years the possibilities of financing the primary agriculture against WHRs once the system is tested with the processing companies;
- in the short term, to continue the joint EBRD/FAO initiative to review of the Ukrainian edible oil sector with a view to implementing the necessary changes and improvements to make the sector more market oriented;
- in the short term, to focus on financing the downstream linkages in the food chain – the distribution and retailing of food and fast moving consumer goods;
- in the medium term, to increase efforts to work with local companies on viable projects;

- in the medium term, to examine the possibility to support local manufacturers of agricultural machinery or leasing arrangements with multinational players as Claas and Caterpillar; and
- in the medium term, to encourage greater Foreign Direct Investment whether thorough financing investments alongside foreign strategic investors or by helping the development of locally owned corporates in sectors that may attract foreign investment in due course.

The most advanced projects in preparation are in agricultural commodities trading and processing and in food and fast moving consumers goods retailing.

3.2.1.2 Manufacturing

Transition goals

The Bank's key transition goals are:

- to encourage and support higher standards of integrity, transparency and corporate governance;
- to modernize and improve the competitiveness and standard of efficiency of Ukrainian manufacturing facilities;
- to improve standards of management particularly in respect of financial management, marketing and distribution;
- to introduce to the market a wider range of financing instruments such as export and pre-export finance, mezzanine debt and private equity and potentially local currency financing;
- to encourage greater foreign direct investment whether thorough financing alongside foreign strategic investors or by helping the development of locally owned corporates in sectors that may attract foreign investment in due course; and
- to bring the environmental conditions and energy efficiency of Ukrainian manufacturing facilities up to international standards;

Operational focus

The Bank's short and medium term operational focus will be on seeking debt and equity transactions in amounts of EUR 6-8 million and above which support one or more of the above transition goals. Smaller transactions (4-6 MEUR) may exceptionally be financed directly by the Bank where they are particularly strong in respect of one or more of these goals or in their demonstration effect.

Over the Strategy period, the Bank will continue with its more structured approach to marketing designed to increase the flow of potential clients. This involves a thorough review of selected industry sectors and regions designed to identify clients whose size and business profile may make them candidates for Bank finance. The Bank now has the capacity to structure and execute General Industry transactions from the Kyiv RO. The Bank will seek to develop financing structures that meet the needs of potential clients using a wider variety of financial instruments with particular emphasis on private equity.

Given the importance of improving standards of corporate governance, transparency and integrity, the Bank will consider specific proposals from a FIG where it is satisfied that the sponsors would be committed to international standards of accounting, to full transparency, to respect of corporate governance and to manage their businesses respecting the rule of law and a level playing field. The Bank will do so after careful consideration of the past business practices of the FIG and individuals behind it.

3.2.1.3 Property and Tourism

Transition goals

Key transition goals in the Property and Tourism sector are to:

- increase the number of hotels of international standard, particularly in Kyiv and other major cities and resorts;
- privatise and upgrade State owned hotels;
- support the development of tourism related SMEs;
- promote the development of modern logistics and warehouse infrastructure; and
- increase the supply of office and retail premises of international standard in Kyiv and other major cities.

Operational focus

However, opportunities for the Bank in Ukraine's property sector remain limited due to absence of sponsors able or willing to meet Bank's transparency criteria. The Bank however plans to make an impact in those areas of the sector where high international business standards apply. The Bank will offer selective support to projects that promote better hotel, logistics/warehouse, office space and retail infrastructure in response to demand. The Bank will provide mainly senior debt or a combination of debt, mezzanine debt and equity supported by agreed exit. In respect of the specific transition goals, the key areas of medium term operational focus will be:

- in the ***hotel*** sector the Bank will play a role in meeting unfulfilled demand by continuing to support projects that introduce international standard hotel management and service levels. The Bank will pursue quality international city centre hotel opportunities, including mid range hotel developments in Kyiv, to promote better infrastructure in order to address growing demand from international business travellers. The Bank will also identify opportunities to support hotel chains in major Ukrainian cities outside Kyiv;
- the Bank will selectively support the privatisation of city (Odessa, Lviv) and resort (Crimea) hotels;
- the Bank may promote credit lines for smaller tourism projects as part of its effort to encourage SME development.

- The ***warehousing and logistics market*** will remain an important sub-sector for the next years. There is a significant potential for development, as most of the existing warehousing stock is inadequate for modern logistics management and proper storage. The evolution of local retailing is expected to contribute to growth in warehouse demand and development.

In the short and medium term:

- The Bank will selectively support projects that promote better ***office and retail*** infrastructure in response to proven demand. Factors constraining the development of suitable office and retail space include vague and inconsistent planning regulations and legal framework uncertainty, lack of transparency and scarcity of investment capital. Addressing these challenges will be critical in encouraging growth.

3.2.1.4 BUSINESS ADVISORY SERVICES (TAM/BAS)

The non-financial enterprise management and business support programmes of the TAM/BAS Team will assist in developing SMEs and larger local enterprises in all sectors and in particular will help to achieve the goals described above for Agribusiness, Manufacturing and Property & Tourism.

The EU has now committed EUR 0.5 million which will enable both Programmes to assist enterprises in selected industry sectors, thereby strengthening the pipelines for Bank and Bank-related financial instruments. As yet in the Ukraine, only one TAM project (Lutsk Konditer) has mobilised funding (€ 575,000) from an EBRD-related institution, but it is known directly that two others have been financed by other banks. A high proportion of the remaining 34 enterprises assisted by TAM in the Ukraine since 1997 must have received external finance as they are proving to be successful businesses.

Meanwhile, the Bank and Bank-related financial institutions are encouraged to utilise industry-specific TAM expertise to assist in the rapid initial assessment of relatively small companies which are of interest from the point of view of financial support, as a preliminary to due diligence for those selected for further investigation and negotiation. Similarly, TAM industry-specific expertise could be used post-investment to develop management, financial, production, and marketing functions in selected companies.

3.2.2 FINANCIAL SECTOR AND MICRO, SMALL AND MEDIUM ENTERPRISE FINANCE

3.2.2.1 Banking Sector

<u>Transition goals</u>

The key transition goal for the banking sector will be:

- To strengthen the banking sector by encouraging consolidation and strengthening the capital base of the banks sufficiently to enable them to meet the expected continuing strong growth in demand for credit. Tighter regulation is required to encourage mergers of weaker banks with stronger ones and create banks with real critical mass. Foreign investment should also be encouraged as a means of strengthening the capital base of the sector as well as increasing competition.

- To continue institution building - for the banks to continue to improve their lending skills, approach and services to clients to increase the range of products they offer and for the smaller banks to find niches in the market (eg SME finance, energy efficiency, mortgages, consumer credit) where they can differentiate themselves from their competitors.
- Depending on the strategy and the political will of the government, to play a role in preparing the privatisation of Ukreximbank through a pre-privatisation investment.

Specific challenges faced in realising these goals are:

- **Integrity and ownership.** Key issues are links between the banks and politicians, the integrity of their owners and the use of non transparent business practices. As yet the NBU does not have the power to enforce disclosure of the ultimate ownership of banks.
- **Related party lending.** A significant number of banks (Pryvat, UkrSib, FUIB, and other smaller banks) are part of industrial groups and have a substantial amount of related party lending. In some cases this is diminishing in percentage terms with the growth in business with non related parties.
- **Productivity**. Productivity in the banking sector is low with relatively high cost to income ratios.
- **Asset quality.** Provisioning levels in management accounts are often too low and are being constantly revised upwards by the auditors.
- **Capitalisation of banks.** Many banks are small and their low capitalisation constrains their development and intermediation capacity as well as increases the risks of dealing with such banks. Moreover banks currently use tax minimisation schemes, for example using captive insurance companies, as a legal but questionable means of increasing their capital base.
- **Lack of long term funding, especially in local currency.** This restricts the ability of the banks to provide longer term funding and exposes them to increasing risk of assets and liabilities maturity mismatch. Lack of long-term local currency funding increases the share of hard currency assets which can be financed by relatively cheaper and longer term hard currency deposits. The Bank may be able to play a role once it develops a local currency product.

Operational focus

Therefore the Bank will continue to support the development of the banking sector in the following ways:

- In the short term, provide tailored products to those banks that are professionally managed, are transparent, have clear ownership and are willing to change and improve their corporate governance to bring it to best standards. These products will include the new USD 200 million framework facility for SME and MSE lending (the latter UMLP II) as well as products such as mortgage finance, energy efficiency, leasing, and factoring coupled with support in developing the proper lending methodologies, training and know-how transfer;

- In the short and medium term, help strengthen the capital base of selected banks and support and facilitate consolidation of the banking sector by providing new equity or quasi equity capital both to banks that are wholly locally owned, particularly in the context of mergers to create entities with greater critical mass, or in the context of the entry into the Ukrainian market of foreign strategic investors. Equity and quasi-equity investments should be accompanied by substantial institution building assistance especially where the investees are wholly locally owned;
- In the short term, increase activity and volume of business done with the local banks under the Trade Facilitation Programme thus facilitating cooperation between local banks and the international banking community and increasing the use of documentary instruments by Ukrainian banks' customers in financing foreign trade;
- In the short term, support the development of Warehouse Receipts System to improve access to finance for the agricultural sector and use by banks of warehouse receipts as collateral for loans to agribusinesses by providing the necessary funding and participating in risk sharing (and providing technical know-how where necessary) based on local banks acceptance of WHR lending methodology;
- In the short term, introduce local partner banks to international banks and other investors for risk sharing and syndicated lending under different EBRD programmes; and
- In the medium term, participate, in coordination with the World Bank and IFC, in the discussions over the strategy for the state-owned banking institutions, including privatisation plans (e.g. UkrExim). The Bank could play a role in providing pre-privatisation finance once it is satisfied that there is a firm intention to privatise, that the bank's lending policy will be free from political influence and that the quality of management of the bank concerned is acceptable.

The most advanced projects in preparation are a number of tailored credit lines, mainly for SME, MSE and mortgage finance as well as a potential equity investment alongside a foreign strategic investor.

3.2.2.2 Microlending

The Ukraine Micro Lending Programme includes five local partner banks and ProCredit Bank and plans to include at least two more banks. Together with these banks a total of 180 MSE finance departments have been set up, which finance MSEs in 45 towns and cities. So far, banks participating in UMLP have disbursed from EBRD and other funding sources more than 141,770 loans for USD 781 million and at present they have 55,768 borrowers outstanding for almost USD 240 million. EBRD Funding accounts for EUR 31 million of this portfolio and the partners banks use their own funding and other IFI loans for the balance, demonstrating clearly the strong leverage (almost 8:1) of the Bank's monies. While the portfolio numbers show that strong institutional capacity for MSE lending has been built in the PBs and a wide range of MSEs are financed by them, the existing coverage and scope deserves broadening and deepening.

Transition goals

The UMLP II component of the new SME/MSE framework will continue the efforts of the previous sovereign SME II Credit line directed at improving the access of creditworthy MSEs/SMEs to sources of reliable finance and at strengthening the lending capacity and skills of selected banks. UMLP II will focus on (i) further regional expansion, (ii) systematic roll out to the agriculture sector, (iii) institution building in existing PBs (especially the training and management capacity for MSE lending operations, including areas such as internal audit and MIS), and (iv) further development of efficient and easily accessible financial products to MSEs, especially in rural areas and the agriculture sector.

Operational focus

Key areas of operational focus are:

- In the short term, to enable partner banks, which are already funding 50% of the MSE loan portfolio out of own funds, to keep pace with the growing demand for micro and small loans in Ukraine**;**
- in the short and medium term, to maintain the focus on first time borrowers (currently 80%), keep an average loan size around USD 5,000;
- in the medium term, to enable partner banks gradually to take over the management, training and control functions at head office level, while accelerating graduation of TC input at branch level;
- in the medium term, to expand operations into previously under-served regions of the country, reaching more remote and economically isolated areas. It is planned to set up another 100-150 MSE finance departments and train another 500 lending staff;
- in the medium term, to systematically roll out the existing pilot agricultural lending project by continued development of the appropriate lending technology, loan products, training programmes for specialist staff and implementation of appropriate monitoring and risk management tools;
- in the medium term, to build on the cooperation of existing partner banks, while selecting and building relationships with new partner banks.

TA provided by the Ukraine Micro Lending Programme will continue. However, the international (3) and local (20) consultants and advisors will further shift their input from loan officer training and setting up new branches/departments to training in-house consultants and trainers for the PBs, portfolio and risk management as well as strengthening the management function of the MSE operations in the PBs head offices. The UMLP audit team will focus on establishing competent MSE audit units in each PB to monitor the MSE loan portfolio and improve internal controls and risk management. In addition new partner banks will likely be included, enabling a wider skill transfer and eventually mainstreaming MSE finance throughout the banking sector.

3.2.2.3 Non Bank Financial Institutions

New laws were approved in 2003 setting the background for further structural reforms in the pension system (laws on State Pension System, Non-State Pension Funds) and improving leasing legislation (Financial Leasing Law). A new regulator for non-bank financial institutions (insurance companies, leasing companies, credit unions, non-state pension funds and others), the State Commission for the Regulation of Financial Services Markets, was also set up and started working in 2003 ending the era of no state regulation of most of the Non Bank Financial Institutions.

The commercial insurance market in Ukraine is extremely underdeveloped. Although there are some 350 insurance companies, some 87% of the premium income of non-life insurance companies is believed to be “sham” insurance related to tax avoidance schemes. 36 insurance companies had their licences withdrawn during the first year of operation of the State Commission for AML and other violations. Foreign investment in the sector is also very low with only three foreign insurance companies together taking 6% to 7% of the market. However, the insurance market is expected to grow rapidly in the coming years, stimulated by such factors as the introduction of compulsory car insurance, the increasing use of third party finance for which lenders will require the assets financed to be insured and rising incomes leading to rising demand for life insurance products.

Leasing in Ukraine is still in its initial development stage. The total volume of leasing operations is difficult to estimate but it is well below 1% of the GDP. While there are a few dozens leasing companies, only a handful of them provide leasing services on a sustainable basis. These are the companies that can secure the access to funding, and therefore majority of the leasing companies are either related to banks or large industrial companies. Agricultural equipment and car leasing are probably the most developed leasing sectors. The state-owned Ukragroleasing dominates the market for agricultural equipment financing, but depends on the government subsidies and is highly inefficient. Car and truck leasing sector has been developed mainly by western sponsors/producers. Due to ineffective legislation up until recently other types of leasing have not really been developed yet.

Private pension funds are still being licensed by the State Commission and only a handful have started to work so far.

<u>Transition goals</u>

The key transition goals in the non bank financial sector are:

- the development of “real” life and non life insurance companies that provide a range of products, operate with integrity in a transparent way and are professionally managed and a reduction in the number of “sham” insurance companies by aligning the taxation regime for insurance companies with other sectors or by reviewing the tax minimisation schemes in which a majority of local insurance companies are involved;
- the development of private sector pension fund managers with high standards of professionalism and integrity;

- in due course the development of capital markets as sources of investment capital;
- the development of the best existing leasing companies and new entrants into the market that provide finance for industrial and commercial equipment, vehicles and consumer products;
- amending various aspects of the law relating to non bank financial institutions, particularly in relation to insurance to bring the regulatory framework into line with international standards; and
- improving the level of professionalism and standard of regulation of non bank financial institutions.

Operational focus

The key areas of operational focus in the insurance sector in the short term and in the pension fund sectors in the medium term will be to provide new equity capital to the best local companies or to strategic investors who wish to enter the market. The number of cases where it will be feasible to invest in local companies without a strategic investor is likely to be limited and may require associated TC or the identification of experienced expatriate resources to strengthen the current management team. In the case of leasing companies, the main area of focus in the short and medium term, will be to provide secured debt but in selected cases, where the capital base of the company requires strengthening, this may be accompanied by the provision of new equity capital.

The most advanced projects in preparation are an investment in an insurance company and the provision of finance to a leasing company.

3.2.3 ENERGY

Transition goals

The key overall transition goals in the energy sector overall are:

In the short term:

- timely and successful implementation of the international nuclear safety measures and respective policies for nuclear safety systems; and
- resolution of the various political, legal, regulatory and administrative issues that have hindered the Chernobyl Shelter Implementation Plan;

in the short to medium term:

- increasing commercialization and transparency;
- strengthening independence of the regulator, NERC;
- reducing Ukraine’s energy intensity;
- providing for greater regional integration (e.g. possibly with UCTE for power), allowing greater efficiencies to be achieved overall; and
- gradually introducing market pricing, reducing cross subsidies of industry to households, moving closer to achieving cost recovery; while

in the medium to long term,

- introducing of competition wherever possible through introduction of appropriate market models.

3.2.3.1 Nuclear Safety and K2R4

Nuclear safety

CSF

In June 2004, the Cabinet of Ministers approved the conceptual design of the new safe confinement which will be built around the "sarcophagus" to insulate its radioactive inventory from the environment for 100 years, although the regulatory and approval delays remain a major risk in the construction phase. At the end of 2004 the Shelter Implementation Plan (SIP) has entered its final stage. The contracts for the main elements of the SIP are now either under implementation (stabilisation, monitoring system) or, as for the new safe confinement, at the procurement stage. The opening of tenders for the new safe confinement in November 2004 appears to confirm the competitive situation and high quality of proposals. Completion of this several hundred million Euro project is currently scheduled for 2008 to be confirmed through ongoing evaluations and contract award.

To date, the EU and 28 countries have pledged USD 735 million for the SIP. Additional contributions are required to meet projected cost and contingencies. The G8 and EU confirmed the commitment to the SIP in the 2004 Sea Island Summit and are currently leading a pledging effort. Their readiness to pledge some further USD 200 million, including the first contribution from the Russian Federation should be mirrored by a commitment of Ukraine also to contribute financially and through sustained attention to the SIP. The Bank has been engaged from the very beginning of the SIP in an almost permanent dialogue with the authorities of Ukraine and the donor governments and this engagement will need to continue. The institutional environment, including political, legal, regulatory and administrative issues aggravated by frequent changes of key counterparts, have caused delays in the past. Regular reporting to the President of Ukraine and periodic meetings involving the Chair of the Assembly and donor representatives have been instituted since mid-2002. This process has accelerated the solutions of many problems and will be needed in the future.

NSA

The NSA for Ukraine, although with total funding of some Euro 150 million substantially smaller than the CSF, has had an important mission, firstly to increase the safety of the operating nuclear reactor at Chernobyl up to the closure in 2000 and secondly, to provide funding for two major facilities supporting the decommissioning of Chernobyl – a spent fuel storage facility, and a facility to treat liquid radioactive waste. The first task – safety upgrades and a safe closure of the Chernobyl reactor - has been successfully completed

The second one, however, has run into serious difficulties caused by design problems and the business and regulatory environment in Ukraine. The Bank has pro-actively facilitated the necessary exchanges between contractors and Ukrainian parties in the ongoing disputes on technical and contractual issues. Finding a way forward, in a situation where many problems are outside the remit of the Bank as a fund administrator and the cost of design changes and delays exceed the currently available resources of the Fund, remains a big challenge.

<u>K2R4</u>

In 1995, the G8 and Ukraine signed a Memorandum of Understanding (MoU) related to the closure of the Chernobyl power plant. Included in this MoU was a commitment for the G8 to participate in financing related to the completion of Khmelnitsky 2 (K2) and Rivne 4 (R4) nuclear power units to internationally acceptable nuclear safety levels. In support of the MoU, in mid 2004, the Bank and *Euratom*, agreed a set of conditions to co-finance the post start-up component of the internationally agreed Modernisation Programme for the K2 and R4 nuclear power units.

Construction of the two units and implementation of the pre-start up component of the Modernisation Programme was completed by the Ukrainian State nuclear operator, Energoatom, in 2004. The implementation of the first phase of the post start-up component of the Modernisation Programme is due to take place during the first scheduled plant shutdown in 2005. The remainder of the programme is expected to be completed in the following two annual scheduled shutdowns.

Once the Modernisation Programme is fully implemented K2 and R4 will act as a benchmark for the ongoing upgrade of all nuclear power units in Ukraine. However, before the loan can become effective, the following conditions related to nuclear safety must be met:

- A positive assessment by independent international operators of Energoatom's level of compliance with the implementation of the pre start-up component of the Modernisation Programme.

- Establishment and first contribution to a decommissioning fund for all Ukrainian nuclear power units.

- Levels of nuclear insurance for all nuclear power plants must be increased and maintained.

Once the loan is effective, the borrower will be required to comply with the following nuclear safety related covenants:

- The implementation of the post start-up component of the Modernisation Programme must take place within the agreed time frame and according to the agreed specifications.

- Energoatom's tariff must be maintained at a level that ensures full cost recovery for all costs including contributions to the decommissioning fund, all costs associated with implementing a safety upgrade programme for all existing Ukrainian nuclear units and costs associated with radioactive waste management ands spent fuel treatment.

Western consultants will be engaged by Energoatom to support them to achieve all the intentions of the loan and the EBRD and Euratom will engage an independent monitoring consultant to closely monitor progress.

The K2R4 loans provide an opportunity for Ukraine to work together with the international community to achieve internationally recognised levels of nuclear safety at K2 and R4. Furthermore, the loan covenants require Ukraine to improve nuclear safety aspects such as decommissioning funds; nuclear insurance and safety upgrade programmes related to all existing units.

3.2.3.2 Energy Efficiency

Transition goals

Improving energy efficiency remains a key issue in Ukraine. Energy intensity in 2002 (calculated against GDP in PPP) is estimated to have been 0.62 – approximately 3 times higher than the EU 25 average. More recent increases in energy tariffs for business consumers are however providing stronger incentives to energy users to address efficiency. Anecdotal evidence suggests this is now much more of an issue for energy consumers, particularly in the industrial sector, than it has been in the past. A key challenge is the diverse nature of energy consumption across the main sectors, particularly in industry, and that many energy efficiency projects are relatively small (i.e. less than USD1 million).

The Bank's main transition goal will therefore be to continue to develop infrastructure for financing smaller energy efficiency projects and to encourage capacity building. This will entail not only providing the financial resources but also the technical expertise to identify and implement a wide range of energy efficiency investments, particularly in the industrial sector.

Operational focus

The main operational focus will be the following:

- ESCOs: in the short term, the Bank will continue to support the development of the ESCO market. The activities of the state-owned UkrEsco will be further expanded with a view to eventual privatisation when market conditions permit. Other private sector ESCOs will be supported on a case by case basis.
- Industrial Energy Efficiency: in the short term, the Bank will encourage all its clients to assess energy efficiency opportunities as part of any project with the Bank. TC resources will be made available for energy audits and energy management training and the Bank will consider to provide additional funding to finance energy efficiency projects wherever possible;
- SME financing mechanisms: in the short term, the Bank will work with institutions in the financial sector to develop and implement mechanisms to finance smaller energy efficiency projects, including use of technical assistance and grant co-financing where this is available;
- Carbon Credits: in the medium term, the Bank will seek to purchase carbon credits from clients in the framework of the TC Funds it manages (e.g. the

Netherlands EBRD Carbon Fund and, once set up, the Multilateral Carbon Credit Fund). To facilitate this, the Bank will work with the Ukrainian authorities to develop institutional capacity for approving the sale of carbon credits and will assist clients, particularly in the power sector, to identify and prepare carbon credit transactions.

The most advanced projects under preparation are the provision of a second loan to Ukresco and the development of a mechanism to finance SME energy efficiency and renewable energy projects through the local banks.

3.2.3.3 Power

Transition goals

In addition to the overall transition goals for the Energy sector, it is necessary in Ukraine to eliminate the excessive levels of debt in the sector left over from the period of low or misappropriated collections, promote diversity of supply and rationalize the function of the Energy Company of Ukraine.

Operational focus

The key areas of operational focus will be to:

- in the short term, continue the Bank's efforts as co-chair of the Energy Sector Task Force in order to promote the necessary structural and regulatory reforms consistent with the transition goals outlined above;
- in the short term, the Bank will focus on financing least cost solutions, including removing bottlenecks through new or upgraded transmission lines. New transmission lines can result in energy efficiency gains by allowing flow between regions that otherwise could not exchange power, reducing the need for new generation in one or both of these regions. In this regard, the Bank will support the expected effort by Ukraine to join UCTE and possibly the Energy Community of Southeast Europe, both of which will allow Ukraine to trade more energy with neighbours;
- in the medium term, encourage the government to restart the privatisation process and stand ready to provide finance to privatised companies in the sector. As and when the debt overhang is resolved and the privatisation process resumes, opportunities to finance projects in the sector are expected to grow quickly as a result;
- in the medium term, finance sovereign projects that are consistent with and facilitate policy initiatives and build on recent success in reforms to help ensure that they become irreversible. Financing of sovereign projects in the sector remains an important tool to replace old industrial technologies, reduce technical and commercial losses as well as to support the enforcement of financial discipline in the public sector and bring about reform in general;
- in the medium term, finance projects that would increase efficiency, or reduce emissions for a given amount of production. Due to utilisation of outdated and worn-out equipment as well as the extremely high energy intensity of

power plants, all projects in the energy sector considered by the Bank are associated with considerable environmental benefits.

- in the medium term, the Bank will continue to promote renewable projects as an alternative to fossil-based projects. The tariffs in Ukraine are presently too low to finance most renewable projects, but adjustments to energy policy will be sought in policy dialogue to introduce renewable related tariff structures to support such projects; and
- in the medium term, support private sector involvement in power distribution as well as generation, focusing on projects aimed at the improvement of efficiency in conversion, and distribution of energy and of the quality of energy services. Financing private projects will provide an important demonstration effect to catalyze further private investment. The Bank's presence in private transactions will help reduce political risk and encourage private investors to put more investment in the sector to improve its efficiency for better returns on equity.

The most advanced project under preparation is the Usatovo-Ajalyk High Voltage project for the construction of a new high voltage transmission line in the Odessa region.

3.2.3.4 Natural Resources: Oil, Gas and Mining

Transition goals

Ukraine's principal role in natural resources is for oil and gas transit to Europe from Russia (and to a limited extent Kazakhstan) and domestic processing and handling. Ukraine is a net importer of fuel supplying only 18% of current consumption from domestic sources. Upstream oil and gas resources are managed by the national oil and gas company Ukraine Naftogaz ("NAK") which also owns and operates the high pressure transit lines and the bulk of domestic low pressure distribution and strategic reserves. NAK's scope for investment is circumscribed by low regulated tariffs limiting revenues and substantial payment arrears (built in the mid 1990s) to Gazprom on which it relies. Russian involvement in the sector is substantial with large gas supply concessions granted to Gazprom, Russian oil majors controlling the two largest of Ukraine's four refineries and related filling stations (TNK – Linos and Lukoil – Odessa) and considerable influence in transit politics of Gazprom and Transneft (gas transit, reversal of Odessa-Brody). At the margins, small independent companies have sought various exploration and development concessions in Ukraine but have been largely undercapitalized and have not met with much success. Western majors have so far remained on the sidelines although a change of government policy and increased regulatory transparency could unlock substantial investment. However the Bank has supported two significant gas transit projects (respectively "Gas Transit" and "Gas Transit 2") improving transit efficiency and economics.

Mining remains at the periphery of Ukrainian resource policy, although the Eastern Ukraine is well endowed with coal deposits. The sector however suffers among other things from antiquated facilities and dangerous conditions, lack of consolidation, impenetrable governance and political sensitivity over employment. The World

Bank's early efforts to promote reform have been frustrated and their programme has been closed.

Against this backdrop, in addition to the overall transition goals for the Energy Sector, are to broaden Ukraine's transit role in terms of suppliers and destinations (eg the Odessa Brody pipeline).

<u>Operational focus</u>

The key areas of medium term operational focus will be:

- financing viable infrastructure projects that contribute towards one or more of the transition goals, although there are currently no such projects in the pipeline; and
- helping finance private sector investments and FDI in the sector, that do not rely on distortions in the market for their viability.

Substantial investment is required in all parts of the oil and gas sector to improve product quality, environmental health and safety, economic pricing, fair access and transparency. While the Bank has so far been unable to identify projects that would increase oil and gas production in Ukraine because of the weak resource endowment and the absence of suitable sponsors, the situation will be closely monitored and all mid and downstream including retail are considered as eligible and needful of investment.

The most advanced project under preparation is financing for a chain of petrol retailers that will help modernise the distribution of petrol in Ukraine.

3.2.4 INFRASTRUCTURE

3.2.4.1 Transport

<u>Transition goals</u>

Key transition goals in the transport sector are:

- Further tariff reform, restructuring and commercialization in the road and rail sectors;
- greater involvement of the private sector in port operations and state-owned shipping activities; and
- greater commercialisation and the further involvement of private capital in the aviation sector.

<u>Operational focus</u>

Despite the progress achieved to date, there is still a considerable need for investment in transport infrastructure to facilitate regional economic growth and integration. Subject to confirmation by the government, the key areas of operational focus will be:

- in the short term, to implement the existing priority projects already agreed between the Bank and Ukraine. These include further rehabilitation and if possible completion of the M06 Kiev-Chop highway, which is a key transit corridor linking Ukraine with Central and Western Europe the Bank will also seek to support upgrading of other major roads identified as a priority by the Government, which are part of the pan-European network, such as M05 Kiev-Odessa highway;
- In the short term, and subject to the availability of a sovereign guarantee, the Bank is willing to finance the modernisation of the port of Illichevsk and other Ukraine large sea ports;
- in the short term, the Bank will also seek to finance construction of port terminals on a private basis;
- in the short term, the Bank will seek to finance, where possible, renewal and upgrade of the railway rolling stock and possibly aircraft fleet through corporate or structured finance instruments;
- in the medium term, and subject to progress of the sector reform programme and the availability of sovereign guarantees, the Bank will also consider further projects to develop railway and harbour infrastructure;
- in addition, in the medium term, the Bank will seek to provide further support to the shipping industry and upgrading of selective shipyards. For state-owned activities in these sectors, the Bank's involvement will be conditional on a commitment to restructuring and commercialisation;
- in the medium term, where possible, the Bank will seek opportunities to participate in development of airport infrastructure alongside private partners and will investigate opportunities to support development of regional airlines;
- the Bank will seek to involve EIB in financing of its major transport infrastructure projects in Ukraine.

3.2.4.2 Municipal and Environmental Infrastructure

Transition goals

The Bank's fundamental transition goal in the Municipal Infrastructure sector is to strengthen the creditworthiness of local municipalities to enable them to access banking and capital markets, for the rehabilitation of municipal services. Intermediate goals in this respect are:

- to have an updated legal framework for local borrowing and mutual agreements between the Ministry of Finance and municipalities.
- to encourage more professional management of municipal services;
- to make tariffs for municipal services more cost reflective;
- to encourage financial transparency and greater accountability in the provision of municipal services; and
- to encourage greater private sector involvement in the provision of municipal services, where possible.

In 2001, with the adoption of new Budget Code, Ukraine has started institutional and regulatory reforms to support decentralised borrowing by municipalities and municipal utilities. Since then the Bank has been working actively with the Government and the World Bank to prepare a draft law on municipal borrowing. When adopted, this is expected to allow all credit worthy municipalities to borrow on domestic and international markets. Before the adoption of the new Budget Code, the Bank faced numerous serious problems in getting projects approved or implemented. According to Article 16 of the Budget Code municipalities with a population of more than 800,000 residents have the right to borrow externally. This provision allowed the Bank to renew its efforts in the sector.

Operational focus

Affordability constraints will remain an issue and the Bank will calibrate investment sizes, structures and tenors to ensure long term affordability. The Bank will seek sources of grant investment finance from donors where there is a higher proportion of poor people and where affordability constraints limit the amount of investment that can be financed on a commercial basis. The Bank will continue to incorporate the use of TC funds to ensure that institutional capacity building is achieved and the project achieves sustainable results. The institutional assistance will be aimed both at utility companies and local municipalities to address corporate governance, financial, operational and commercial capabilities.

- In the short term the main area of operational focus will be to sign and disburse the Board approved loan to Dnipropetrovsk Water and Wastewater Management Utility, to be guaranteed by the City of Dnipropetrovsk, for the modernisation of water and wastewater treatment in the City. The Bank will endeavour to take the final steps to complete the Zaporizhia water project started in 2001.

- In the medium term, the Bank will aim to strengthen its presence in the municipal sector by extending sub-sovereign loans to municipal companies and/or municipalities to structure projects in the municipal infrastructure sector and to develop and implement transactions including technical assistance and, where possible, investment co-financing. By directly providing investment financing to municipalities and, where applicable, regional utilities without a sovereign guarantee, the Bank will support decentralisation of financing responsibilities and will contribute to the enhancement of the creditworthiness of municipal borrowers, thereby developing their long-term capacity for financing capital improvements on a sustainable basis.

Although the Bank’s focus will be sub-sovereign, it will work closely with utilities to develop private sector involvement, where possible. In addition, it is also envisaged that, the Bank could consider sovereign or sovereign guaranteed financing for municipalities of a smaller size than it would be ready to finance directly. This will depend on the evolution of the government's approach to municipal financing and expenditure priorities and whether an approach can be developed that is consistent with the Bank's transition goals and sound banking principles. If it becomes possible in due course, the Bank will provide local currency financing to municipalities and municipal utilities, in order to match the currency of their cash flows better.

The Bank has started the preparation of a loan to the City of Donetsk to finance municipal district heating infrastructure and is in contact with the City of Kharkiv on the City's investment priorities in the municipal water supply sector

3.2.4.3 Telecommunications

Transition goals

The key transition goals in the telecommunications sector are:

- the establishment of an international standard legal/regulatory framework capable of supporting liberalisation and privatisation including a timetable for full liberalisation of the fixed line sector, tariff rebalancing, and the establishment of an independent regulator;
- the attraction of private investment for modernisation and expansion of the sector, which is characterized by low levels of penetration (now lower at 23% that mobile at 25%) and low levels of digitalisation (35%) including broadband access and data transmission products. This can be achieved through both full liberalisation of the market and privatisation of Ukrtelecom.;
- privatisation of Ukrtelecom, including the involvement of an experienced private sector operator. This may be accompanied by the enhancement of the liquidity of Ukrtelecom's stock which would play a significant role in the development of Ukrainian capital markets;
- supporting the further development of the Ukrainian mobile telephone companies (which now have more subscribers than Ukrtelecom) including the development of UMTS; and
- supporting the development of a diverse and vibrant media sector.

Operational focus

The key areas of medium term operational focus for the Bank in telecommunications will be:

- TC assistance for implementation of regulatory reform. In the past, the Bank has provided significant legal and TC assistance to the authorities in respect of sector reform. Provided the new government shows commitment to full implementation of all necessary sector reforms, the Bank stands ready to explore a resumption of its TC assistance programme in the sector.

- Subject to decisions about the timing, size and mode of Ukrtelecom's privatisation, the Bank could expect to play a role in preparing Ukrtelecom for privatisation (eg through a pre-privatisation investment and related regulatory TC) and subsequently financing its acquisition and/or taking an equity stake.

- In respect of investment, the Bank will seek to enhance the volume and tenor of financing to accelerate network development if needed, as well as supporting alternative domestic and international operators competing in this market. Development of internet access in both the retail and corporate segments will continue to be a priority given its importance for developing democracy and supporting SME access to worldwide networks.

- The Ukrainian mobile telephone market is dominated by two operators (UMC and Kyivstar) with a combined market share of close to 100%, each of which has raised finance in the commercial banking market. The Bank will look to provide additional financial support to these operators if needed, for example for building out UMTS and other advanced networks, whilst promoting the development of competitors in a fast growing market provided that they respect principles of transparency and corporate governance.

- Building on its experience in various countries in CEE and the CIS, the Bank will continue to examine opportunities to invest in television, including free to air, cable and satellite, as well as other media including radio, cinema and outdoor advertising ventures.

4 OTHER IFIS AND MULTILATERAL DONORS

4.1 IMF, THE WORLD BANK AND IFC

The Bank continues to co-operate closely with the other IFIs which are active in Ukraine, partly to ensure consistency in approach towards the Ukraine authorities in areas of mutual interest, for example reform of the energy sector and development of the financial sector, and also to ensure that where necessary programmes are complementary and do not overlap. Bank staff meet other IFIs in Kyiv, at donor forums and working groups initiated by the Bank or by the World Bank, or at meetings of the Energy Sector Task Force or similar bodies.

There is frequent contact with the World Bank on financial sector activities, especially mortgage-lending and regulation of non bank financial institutions and other areas where the Bank's selective institution-building orientation complements the World Bank's more systemic approach. There is significant complementarily between several of the IFC’s stand alone TA programmes, such as those relating to Corporate Governance and Leasing, and concrete investments by the Bank. With respect to the IMF the EBRD has maintained regular contact with the staff both in Washington and Kyiv.

4.1.1 The IMF

The precautionary one-year SBA agreed with the IMF in March 2004 has now expired and was in any event on-hold following the inability of the IMF to complete its mid-year review last August. The new government is likely to show more resolve in addressing the outstanding fiscal issues, such as the need for fiscal tightening, as well as meet some of the IMF concerns regarding the need for greater exchange rate flexibility. Further information on the current status of the IMF’s support for Ukraine will be included in the Strategy when received.

4.1.2 The World Bank

To date, the World Bank commitments to Ukraine total over US$4.0 billion for 30 operations. Of these, 13 had been completed as of December 31, 2003. Eight new projects are currently under preparation or awaiting effectiveness. The World Bank's current portfolio in Ukraine comprises eleven active investment projects, and two grants.

In the public sector, the Work Bank’s loans comprise the second Programmatic Adjustment Loan (PAL II), the State Tax Service Modernisation Programme and the Development of the State Statistics System for monitoring the social and economic transformation project. In Energy and Infrastructure, the World Bank is financing the Kyiv District Heating Improvement Project, the Kyiv Public Buildings Energy Efficiency Improvement Project and the Lviv Water and Wastewater Project. In the Social Sector, the World Bank is financing the Social Investment Fund and the TB and HIV/AIDS Epidemic Control Programme. The World Bank is also financing the Rural Land Titling and Cadastre Development Project, the Private Sector development Programme and a project to promote the use of electronic methods in the procurement of public sector goods and services. Through the Global Environment Fund, the World Bank is supporting the phasing out of ozone depleting substances and a biodiversity conservation project for the Azov / Black Sea Corridor.

4.1.3 IFC

As of March 1, 2005, IFC had invested $153 million in 15 projects in Ukraine. The investment program in Ukraine is currently expanding, focusing on investment opportunities in finance, agribusiness, construction materials, retail trade and services, transport equipment, and infrastructure. In the financial sector the IFC is focusing on leasing and housing finance.

In fiscal year 2004, IFC significantly expanded its investment program in Ukraine, investing $87 million in the agribusiness, financial and general manufacturing sectors. To support the agricultural sector, IFC invested $30 million in Myronivsky Khleboproduct, a leading domestic poultry producer, and $10 million in Sandora, number one producer of juices and nectarines in Ukraine. These projects support expansion and modernization of local companies, strengthen their corporate governance and create a significant number of new jobs, especially for Ukrainian farmers. IFC also supported the construction of two new home improvement retail stores Nova Liniya, which will boost local production and will directly employ 300 employees. IFC's increased activity reflects the improving investment climate in Ukraine, greater opportunities in a broad range of sectors, and stronger foreign investor interest.

IFC has been conducting an extensive advisory program in Ukraine since 1992. IFC has contributed to privatization of small businesses and unfinished construction sites and to land and mass privatization. Current donor-funded programs offer advice on corporate governance, leasing, development of the agribusiness sector, and seek to improve the business environment, and promote the growth of small and medium enterprises.

4.2 MULTILATERAL DONORS

4.2.1 European Union

The major areas of co-operation between the EU and the EBRD include environment, energy and SME finance support. EC assistance includes a major contribution (1/3 of total contributions) to the Chernobyl Shelter Fund managed by the EBRD. In addition, Euratom has provided a loan in the amount of 60.8 M€ to the post start-up of the nuclear safety and modernisation programme of the two nuclear power stations at Khmelnitsky and Rivne (K2/R4 project).

A Partnership and Co-operation agreement (PCA) between the EU and Ukraine was signed in 1994 and entered into force in 1998 for an initial 10 year period. A number of specific agreements are also in place in the fields of trade, science and technology, and nuclear energy.

During 2005 and 2006, the level of assistance provided to Ukraine through the TACIS National Programme will be increased to € 88 million in 2005 and € 100 million in 2006. This assistance will focus particularly on implementation of the European Neighbourhood Policy Action Plan, which was endorsed by the EU Ukraine Co-operation Council in February 2005. A further increase in EU funding for Ukraine is expected upon the introduction of the European Neighbourhood and Partnership Instrument (ENPI) in 2007. The EU has also decided to increase the level of support through the TACIS Programme for legislative approximation, including technical assistance to meet EU norms and standards, and to help Ukraine to pursue the reform process.

EU funded Neighbourhood Programmes are being prepared between Ukraine and neighbouring countries to address common challenges such as economic and social development of the border areas, environment and communicable diseases, illegal immigration and trafficking, efficient border management and people-to-people contacts. The indicative allocation of funding for Ukraine amounts to approximately €20 million (2004-2006).

4.2.2 European Investment Bank

Ukraine is also now eligible for European Investment Bank lending. The intention is to provide a significant amount to Ukraine from the EIB envelope made available for Russia, Ukraine, Moldova and Belarus. The Council Decision sets out that work shall be appropriately shared with the EBRD according to mutually agreed modalities and that projects shall be in the sectors of environment, transport, telecommunications and energy infrastructure.

4.2.3 United Nations

The United Nation’s Common Country Assessment for Ukraine, dated October 2004, identifies four areas of potential cooperation for UN agencies in Ukraine. Two of these, “institutional reform and capacity building for democratic governance” and “promoting inclusive prosperity” address aspects of transition challenges identified by the Bank. Under the first of these headings, the UN proposes measures to reform the judiciary, strengthen public institutions, public administration and the accountability of public officials, strengthen environmental governance and harmonise Ukrainian legislation with international norms. Under the second heading, the UN proposes measures to address unsatisfactory environmental conditions that affect the poor and to help reduce the shadow economy as well as other measures to reduce poverty. The remaining two headings are “improving vital health indicators”, primarily in relation to HIV/AIDS and sexual health more generally, tuberculosis, maternal health and child mortality; and “promoting human rights and gender equality”.

ANNEX 1 POLITICAL ASSESSMENT

Compliance with Article 1

Ukraine has come through a difficult political test and now stands at a critical juncture in its transition. The democratic election of President Viktor Yushchenko has re-affirmed Ukraine's adherence to the principles of multiparty democracy and pluralism contained in Article 1 of the Agreement Establishing the Bank. The core institutions of democratic governance – transparent elections, an independent parliament, active civil society and the rule of law – were all strengthened as a result of the prolonged election process.

Political Accountability

The extraordinary events of November and December 2004, in which controversy over the conduct and official results of the second round of the presidential election on 21 November provoked mass demonstrations across the country, were a turning point for political accountability in Ukraine. Elections are the key, though by no means the only, "accountability moments" in a democracy. The presidential elections of 2004 were a prime opportunity to hold accountable a leadership with a poor record of representing the diversity of views in the electorate and a government that had deepened the divisions between the state and the society.

Millions of Ukrainian citizens went to the polls on 21 November with that objective in mind. However, due to allegedly excessive interference in the conduct of the election by state agencies and the media in behalf of the incumbent authorities, as well as flaws in the counting procedures, the will of the electorate was in danger of being overridden. Although the results were being contested in several districts where irregularities were reported, the normal legal procedures for investigating allegations of misconduct were short-circuited and the Central Election Commission (CEC) rushed to announce the then-Prime Minister, Viktor Yanukovych, the winner. This was in spite of reports from independent domestic and international election observation missions that called into question the integrity of the voting.

For example, the Committee of Voters of Ukraine, a non-affiliated NGO with over 10 years experience monitoring election campaigns, concluded that "the runoff vote on 21 November was held with mass and systematic infringements of the election laws, human rights and international standards for fair elections. The results being announced by the Central Election Commission fail to reflect the will of the Ukrainian voters". Observers from the OSCE and Parliamentary Assemblies of the Council of Europe, the European Union and NATO similarly reported that the second round of the election "did not meet a considerable number of OSCE commitments…for democratic elections" and that "serious shortcomings" identified in the conduct of the first round of the election were not remedied. "Overall", they concluded, "State executive authorities and the Central Election Commission (CEC) displayed a lack of will to conduct a genuine democratic election process". This interpretation of the conduct of the election and its questionable results was also shared by the European Network of Election Monitoring Organisations (ENEMO), a group of civic organisations from 16 countries of the former Soviet Union and Eastern Europe, which deployed a team of 1,000 observers for the second round vote.

Believing that the election had been stolen, tens of thousands of demonstrators converged on Kiev's Independence Square (the "Maidan") where they set up tent camps and launched a peaceful campaign to overturn the results. Although tensions ran high at several points, violence did not break out and an orderly, legal process of reviewing the conduct of the election was finally begun in the Supreme Rada (as the parliament is known) and the Supreme Court. In a resolution issued on 27 November, the Rada declared the results of the second round of the presidential election invalid and expressed no-confidence in the Central Election Commission. On 1 December, representatives from both political camps along with the outgoing President Leonid Kuchma and international mediators from the EU, the OSCE, Poland and Lithuania reached agreement to amend the electoral law and adopt a package of Constitutional reforms that would re-allocate powers among the executive and legislative branches of government. On 5 December, the Supreme Court annulled the election results and called for a repeat vote in three weeks time. The Court's decision, which was not subject to appeal, was based on its finding that there had been widespread election fraud and that the CEC had acted unlawfully in declaring Mr Yanukovych the winner before the opposition's legal challenges had been given a fair hearing.

Viktor Yushchenko won the repeat election on 26 December with 52 per cent of the vote compared to 44 per cent for Mr Yanukovych. The Committee of Voters of Ukraine once again organised a large scale observation mission for the repeat election and found that there were very few violations, which were mainly of a technical nature that would not affect the outcome of the vote. According to the OSCE, which deployed its largest observation mission ever (1,370 observers from 44 countries), the conduct of the presidential election "brought Ukraine substantially closer to meeting OSCE election commitments and Council of Europe and other European standards". Campaign conditions were "markedly more equal" in the repeat election compared to the previous rounds, the OSCE observers said, and the main media provided voters with balanced coverage of the campaign. Although a legal challenge was presented by the losing camp, this proved unsuccessful and the results of the election were deemed legitimate by the majority of Ukrainian citizens and by the international community.

At the end of a prolonged and sometimes tense election process, political leaders were held accountable to the electorate due to the active civic engagement of Ukrainian citizens, the endorsement they received from the parliament and the legal ruling of the Supreme Court. This has further strengthened Ukraine's adherence to democratic practice and the rule of law. The agreement on Constitutional reforms, which helped to ease tensions, may also propel Ukraine forward on the path to democracy. The reforms shift power from the executive to the parliament and, within the executive, from the President to the Prime Minister. The measures go into effect between late 2005 and early 2006. They will introduce necessary checks and balances into the system that had been absent under the 1996 Constitution, which concentrated power in the Presidency. They could help to ensure that Ukraine stays on the path of representative democracy and accountability, which in other countries has been strongly associated with success in market transition. Parliamentary elections due in spring 2006 will provide the first test of the authorities' resolve to uphold democratic rules and standards under the new Constitutional rules. These include a change to a fully proportional representation system of voting, which will provide added incentives for party development.

Rule of Law

In accordance with its Constitution, in Ukraine "the principle of the rule of law is recognised and effective". The conduct of the Supreme Court during the political crisis of November/December 2004 demonstrated that a separation of powers can function as intended and that the rule of law can be observed. However, there are still numerous cases where the independence of the judiciary and effective limits on the power of the State have come under question. The newly-elected authorities recognise this and have identified measures needed to strengthen the rule of law and combat abuses by corrupt judges and officials.

Speaking to an audience of potential investors in New York in March 2005, the current Ukrainian Justice Minister, Roman Zvarych, allowed that "our courts are corrupt. Our judges cannot be trusted. This is the simple truth". Survey and anecdotal evidence supports this assessment. Similarly, administrative corruption and so-called "state capture" – which involves corruption at the highest levels, where the rules of the game are established – have reached some of the highest levels in the transition region according to the EBRD/World Bank Business Environment and Enterprise Performance Survey. According to Transparency International's Corruption Perceptions Index (CPI) for 2004, Ukraine ranks 122nd out of 146 countries surveyed, fifth from the bottom among transition countries. With a CPI of 2.2 out of a possible 10 (where 10 is least corrupt), Ukraine's score puts it in the category of countries with "rampant corruption" according to Transparency International.

It is necessary first of all to acknowledge and accept the scale of a problem before you reasonably expect to solve it, and the authorities in Ukraine appear ready to do this. In fact, their performance in office will be judged by the electorate largely on how effectively they can enforce the rule of law, bring down levels of corruption and dismantle the system of crony capitalism built up by their predecessors. The authorities have not thus far pursued an integrated, high profile anti-corruption programme. Such programmes in Ukraine (and elsewhere) have met with little success in the past. Instead, they are targeting areas where corruption has been a major problem – at the highest levels and the lower ones – and designing more discrete initiatives to tackle them. The rule of law/anti-corruption effort announced in the first few months of 2005 includes:

- Judicial reforms that will enhance transparency of judgements, facilitate dissemination of legal rulings, upgrade the technological capacity of the courts system and improve training and compensation for judges. There is also a need to tighten enforcement of judicial decisions, which will require better discipline in the executive branch as well as reforms of the bailiff system, law enforcement and the civil service.
- A strengthening of the Justice Ministry's authority to initiate disciplinary procedures against judges found to have engaged in corrupt activities.
- A revival of the "Clean Hands" campaign by the Justice Ministry, which will involve pledges by Government officials at all levels to work honestly and transparently, with monitoring and sanctioning mechanisms to encourage full participation. The Justice Ministry is also drafting a "Civil Service Code" that will enforce greater public disclosure by officials and narrow the space for conflicts of interest.

- The creation of a National Bureau of Investigation with a staff of 5,000 to fight corruption at the higher echelons of power. This has been endorsed by the Interior Ministry, the Prosecutor General's Office and the National Security and Defence Council.
- Changes in the organisation and functioning of the Interior Ministry, including simplification of procedures for the traffic police to cut down on bribery.
- A radical overhaul and clean-up of the customs service, including much more stringent controls over customs officials, the installation of web cameras at border points and more regular inspections by the Interior Ministry and Security Services.
- A plan to aggressively pursue civil service reform and "cut the army of bureaucrats" in the country while increasing wages.
- Plans for de-regulation and reducing red tape that will lessen the incentives for government bureaucrats to extract bribes from businesses and private citizens – this includes streamlining licensing and registration procedures, limiting inspections and establishing one-stop shops for new businesses.
- Finally, there are a range of other policy initiatives that have elements of corruption-fighting inherent in them: the abolition of tax privileges for selected firms; the improvement and transparency in the management of state-owned firms (especially monopolies); putting an end to transfer pricing schemes; and conducting a review of possible illegal conduct in past privatisations which gave rise to problems of state capture.

Civil and Human Rights

The Constitution guarantees protection of all basic rights and freedoms, and in large measure these are upheld. However, over the past two years rights groups have identified frequent violations in some spheres, notably media freedom.

Ukraine maintains a wide array of broadcast, electronic and print media, but a concentration of ownership by the State and a handful of business interests close the State, as well as documented cases of political interference in the independent media, restricted the diversity of views expressed there for most of the previous Strategy period. Internet usage continued to grow in the past two years, prompting the former State authorities to step up the monitoring of web-based publications and take legal control of the "ua" domain away from a private firm and transfer it to the Security Service (SBU). Up until the end of 2004, the authorities frequently interfered with news media by issuing so-called "temnyki" or circulars which dictated the nature and substance of news that could be reported. There were also cases of intimidation of journalists through the use of libel laws, license revocation and excessive investigation by health or fire/safety agencies. In 2004, the leading opposition internet publication, *Ukrains'ka Pravda*, was charged with libel by two people connected with the president's administration. They asked the court to seize the property and bank accounts of the owners while the case was being heard. Access to international broadcasts was curtailed in the same year, in the run-up to local and national elections, when the Radio Liberty service was taken off the air. These and other incidents resulted in Ukrainian media receiving a rating of "not free" in 2004 by the NGO Freedom House.

Since coming to office – partly with the help of independent media like Channel 5 which was broadcast on giant screens to protestors on Independence Square during the

Orange Revolution – the Yushchenko administration has pledged to create a competitive, fair market for media organisations (including opposition media) consistent with Council of Europe standards. The following steps have been taken in this sphere:

- The Presidential Secretariat has publicly stated that it will no longer produce “temnyki”.
- The Deputy Prime Minister for Humanitarian Issues, Mykola Tomenko, has announced plans to transform the state media into a public broadcasting corporation, on the model of the British BBC or PBS in the United States.
- The Ukrainian authorities have sought closer cooperation with the Council of Europe in the field of mass media, specifically requesting assistance in reforming the legal framework and improving the conditions for greater pluralism and independence of the mass media.
- President Yushchenko has promised to liberalise the distribution of TV and radio broadcasting licenses in Ukraine, which currently are concentrated in the hands of three powerful political clans, in order to create a truly competitive and diverse information space.
- Finally, President Yushchenko has pledged to vigorously pursue the investigation into the unresolved murder of Internet journalist Georgy Gongadze, whose headless body was found outside Kiev in 2000.

One area of human rights concern is discrimination against women in the recruitment and hiring processes. The Constitution prohibits discrimination on the basis of sex, race, religion and disability. These provisions, however, have not been effectively enforced. For instance, both Government and private business regularly specify the gender of employees in job advertisements. Moreover, discrimination against women and sexual harassment continues to be a common problem in the workplace. Although the Labour Code enshrines the principle of equal pay for equal work, the economic decline of the past decade has harmed women disproportionately. Women are much more likely to be made redundant than men.

A final area of some concern is trafficking in persons. According the US State Department Trafficking in Persons Report for 2004, “Ukraine is a source country for women and girls trafficked to Europe and the Middle East for the purpose of sexual exploitation, and for men trafficked to Europe and North America for forced labour. Ukraine is also a significant transit country for Asian and Moldovan victims trafficked to Western destinations. Ukraine has seen an increase in the trafficking of children, especially orphans, during the last year. The Government of Ukraine does not yet fully comply with minimum standards for the elimination of trafficking; however, it is making significant efforts to do so. Despite resource constraints, Ukraine continues to make progress in combating trafficking, demonstrated by a steady increase in prosecutions and convictions. But progress has lagged in implementing the Comprehensive Program for Combating Trafficking in Persons, coordinating with law enforcement officials of destination countries, and fighting government corruption. The Ukraine parliament should adopt amendments to the criminal code that will strengthen anti-trafficking legislation”.

NGO involvement in providing support services for victims of trafficking has been increasing, and Government cooperation with these NGOs has been steady. The current authorities have recently signalled their intention to crack down on cross-border smuggling and step up cooperation with their neighbours, particularly with Moldova as concerns contraband that crosses the territory of Transdnistria. This, combined with the programme to reduce corruption and strengthen law enforcement, could lead to an improvement in the country's record on elimination of trafficking.

External Relations

Since coming to power in January 2005, the Yushchenko administration has accelerated Ukraine's drive toward European integration, a longstanding goal. In his inaugural address, President Yushchenko stated unequivocally that "Ukraine's place is in the European Union". In a speech at the Council of Europe two days later he said that "the European choice of Ukraine has become a reality. And it is irreversible". Toward this end, a National Strategy for European Integration has been drawn up and will become a basic document for implementing Ukraine's "European Choice" policy. The general framework for the European Union's relations with Ukraine is the Partnership and Cooperation Agreement (PCA), which came into force in 1998 for an initial 10-year period. With the adoption of the European Neighbourhood Policy (ENP) in 2003, the EU has launched a process of formulating specific Action Plans with the neighbouring countries. The Action Plans are designed as instruments to implement aspects of the PCA on a more sharply defined timetable. The EU-Ukraine Action Plan, which has a three year time horizon, was negotiated in late 2004 and agreed on 21 February 2005. In addition to the implementation of the EU-Ukraine Action Plan, it has been agreed that the EU should further maximise its support in ten areas of cooperation on the basis of proposals which had been jointly made by the Commission and the Council secretariat.

Alongside their EU ambitions, the authorities in Ukraine have made clear their intention to join NATO in the nearest future. In Brussels on 22 February 2005, President Yushchenko supported Ukraine's integration with Euro-Atlantic institutions and membership in the NATO bloc. This represents a sharp reversal of the policy adopted by the previous government in their last year in office. While there is broad agreement in the society on the EU agenda, public opinion among Ukrainians regarding NATO membership is more divided.

Relations between Ukraine and the United States have improved dramatically since the recent election. A visit to the United States in April 2005, which included an address by President Yushchenko to a joint session of Congress, resulted in agreements on removing American trade restrictions with Ukraine under the Jackson-Vanik amendment, support for Ukraine's WTO accession bid and as easing of travel restrictions between the two countries. The US has also promised additional democracy assistance for Ukraine.

While improving relations with the West is a clear policy priority, the Ukrainian authorities are equally intent on maintaining friendly and mutually-rewarding ties with Russia, their largest trade partner. President Yushchenko and Prime Minister Tymoshenko have held constructive meetings with Russian President Vladimir Putin on matters of bilateral trade and security cooperation. President Yushchenko has also met with Russian business leaders in Kiev, where he assured them of the security of their property rights in Ukraine and guaranteed a level playing field for investment.

ANNEX 2 ECONOMIC DEVELOPMENTS AND PROSPECTS

Recent Economic Developments: The election of President Yushchenko and the appointment of a government committed to accelerating reform is the most significant development in Ukraine since independence in 1991. The new government has already provided a clear indication that EU accession, higher living standards for all, and improving the investment climate are its main priorities, to be achieved by faster and more consistent reforms

Nevertheless the Yanukovitch government achieved stronger than expected growth, not least in 2004 when a particularly favourable set of factors including stronger than expected demand from Russia, high prices for the major exports of metals and chemicals, and the continued growth of domestic demand resulted in GDP growth of 12 per cent – significantly higher than most initial estimates. On the supply side growth was broad based including from most industrial sectors, from agriculture following a good grain harvest and also from the continuing construction boom.

The positive contribution to growth from net trade meant that the external position remained very strong, reflected in large current account surpluses. In addition fiscal deficits remained low. However, NBU interventions in the foreign exchange market to ensure stability of the exchange rate resulted in continuing strong growth of the money supply. Although this was largely matched by the strong growth of demand for money, nevertheless inflation began to rise in 2004. The increase in inflation was because of higher food and oil prices in the first instance.

However, this broadly favourable scenario was seriously affected by the government's decision to ease fiscal policy in the second half of 2004 (which added to inflationary pressures) and then by the run on bank deposits in late 2004 when political uncertainty was at it height. Furthermore GDP growth slowed in early 2005 – to 5.4 per cent in the first three months of the year (yoy) as industrial output weakened, while inflation remained high (the CPI was 14.7 per cent in March (yoy) while the PPI remained over 20 per cent (yoy) in February).

Monetary and Exchange Rate Policy: Until April 2005, monetary policy was largely subservient to the policy of maintaining a de facto peg against the US dollar (at around HR5.3/US$). The policy was very successful initially as providing a clear nominal anchor against inflation. However, the inherent inflationary nature of such a policy with large external surpluses, limited scope for sterilisation and the uncertainty over the strength of growth of money demand, has long been a concern.

In the early months of 2005 the new government began discussions with the NBU over the future of monetary/exchange rate policy. This resulted in an initial nominal appreciation of the exchange rate of about 5 per cent against the US dollar, although it remains unclear at present whether this represents a move towards greater exchange rate flexibility, perhaps combined with a gradual move towards inflation targeting.

Greater exchange rate flexibility will almost certainly require the removal of some restrictions in the foreign exchange market. Some preliminary steps have already been taken, including the removal of the 2 per cent corridor around the official exchange rate, introduced by the NBU last October when it was required to defend the exchange rate. The NBU has also agreed to the removal of the 50 per cent surrender requirement of export receipts. Nevertheless the overall policy shift ought to give the NBU greater scope for controlling the growth of the money supply, even if it will require further work to assess the likely impact of interest changes on activity.

One important reason for permitting greater flexibility is the likelihood that the exchange rate will appreciate in real terms. Over the last couple of years the rate has fallen in real terms, mainly because of the sharp fall of the dollar against the Euro. The resulting undervalued exchange rate has provided a further boost to exports. Given the prospect of further external surpluses and higher capital inflows the exchange rate is likely to come under stronger upward pressures. Permitting some nominal appreciation appears the best way of dealing with these pressures. The impact on competitiveness is likely to be small in view of low wage levels.

Such a change of policy should have two broad impacts. Firstly it should contribute to lower inflation, assuming some fiscal tightening too, although the current rate of PPI inflation suggests that the decline in (CPI) inflation will be modest this year. Secondly external reserves are likely to grow, but less rapidly than before. Reserves had risen to some US$ 12.5 billion by mid-September 2004 before falling by US$ 3 billion in the final quarter on account of political uncertainty. Reserves have since recovered (to US$ 11.9 billion by end-March), well in excess of three months of imports of goods and services, and should increase further during the remainder of the year.

Fiscal Policy: The Yanukovitch government raised spending in mid-2004 and then more than doubled the basic minimum pension from September 2004, at an annual cost of some UAH 13 billion (over 3 per cent of GDP). These decisions transformed an original projection for the fiscal deficit of 0.9 pre cent of GDP for 2004 into an EBRD estimate of 3.4 per cent of GDP and resulted in a primary fiscal deficit of some 2.5 per cent of GDP. They also left the new government with a serious problem as to how to address these recurrent spending issues. Until then fiscal policy had been generally sound, with several years of low fiscal deficits and primary surpluses. The latter contributed to a steady decline in the ratio of public debt to GDP from 46 per cent in 2000 to 26 per cent in 2004.

There is, however, considerable uncertainty as to what the actual budget outcome was in 2004 (including the outstanding VAT arrears which are believed to be some HR7.5 billion). The IMF has estimated that the deficit was at least 4.5 per cent of GDP. However, on the published figures, with debt repayments estimated at some HR9 billion, financing requirements in 2004 were some UAH 20 billion, readily funded by higher than expected privatisation revenues and domestic and external borrowing.

The challenge in 2005 will be greater, partly because the government committed itself to implementing the pension increases, intends to meet its own campaign promises while tax revenues are unlikely to be as buoyant as in 2004. Towards the end of March the Rada approved the new government's state budget for 2005 with a deficit of just UAH 6.8 billion (1.6 per cent of GDP). This is to be achieved by valid and necessary measures including removing tax exemptions and increasing revenues as a result of improved management of state run enterprises. However, the budget is also based on optimistic revenue assumptions – an increase of about 30 per cent in total.

The latter includes a higher projection for GDP growth in 2005 of 8.2 per cent (compared with an original estimate of 6.5 per cent, the same as EBRD's current projection).

In the budget the total funding requirements for 2005 are UAH 15 billion (debt repayments and the fiscal deficit). This is to be met from privatisation revenues (UAH 6.8 billion), domestic borrowing (the limit has been raised from UAH 4 to little over 6 billion) with the balance from external sources, mainly from the World Bank. However, the state budget numbers exclude any deficit on the pension fund (which should be self-financing). By mid-March the pension fund was in deficit and this had been met from the budget and funded by borrowing from the domestic market. For 2005 as a whole the EBRD project the consolidated fiscal deficit at some 3 per cent of GDP, which would increase the financing gap by some UAH 8 billion (US$ 1.5 billion). The government has indicated that any shortfall in funding will be met by borrowing on the domestic market, although some further borrowing from external commercial sources may also be necessary. However, the government is unlikely to face any real problems in raising additional finance from the markets.

Nevertheless the episode indicates the importance of the need for more fundamental fiscal reform. Some steps have already been taken with the introduction of lower income and corporate tax rates as well as pension reform from the beginning of 2004. The new government is also likely to introduce a Tax Code, including a lower rate for VAT, reform the State Tax Authority and more generally ensure lower rates for duties, charges etc to reduce the scope for corruption and boost total revenues. But much more is required to improve the targeting of some expenditure programmes, both to lower expenditure and achieve the social objectives of these programmes.

External Sector: In 2005 Ukraine is likely to record its seventh successive annual current account surplus, equivalent to 5.3 per cent of GDP (after a surplus of 10.5 per cent in 2004). Although export growth is expected to slow, the trade account will remain in surplus, gas transit fees will ensure the traditional surplus on services while net transfers, mainly reflecting workers remittances, remain very strong. The capital account has been more volatile and was undoubtedly affected by large amounts of capital flight towards the end of last year. However the two underlying trends, which should continue this year, are the growth of borrowing by government, utilities and banks and the steady growth of FDI.

The stock of external debt is expected to increase from the estimated US$ 30.5 billion at the end of 2004. The fastest growing element of external debt has been medium-term borrowing by the private sector, amounting to US$6.7 billion by the end of 2004. This includes euro bond issues by a few entities on the back of the successful re-entry of the sovereign to the euro markets, as well as syndicated loans by some large banks. Further growth is expected this year, although it is likely to be limited to those entities able to meet the reporting requirements for such issues. Short-term debt amounts to US$ 10.4 billion. This comprises mainly trade credits, although last year was also boosted by the rescheduling of the US$ 1.4 billion of gas arrears of Naftogaz (to be met by foregoing some future gas transit fees).

Official medium/longer-term debt which was US$ 12.9 billion at the end of 2004, with most of the borrowing last year from two successful euro issues[3]. EBRD expect the government to borrow up to US$ 2 billion this year, mainly from the euro markets, part of which will be used to refinance some of the existing debt.

The sovereign is unlikely to have any difficulty meeting its external debt obligations. Despite higher debt levels, external debt ratios have fallen and the debt service ratio for official debt obligations remains well below 10 per cent. There are adequate sources of finance available and spreads on Ukraine bonds have steadily fallen over the last couple of years (with only a minor interruption in late 2004) from around 430bp in October 2003 to some 200bp now. This partly reflects the general improvement for all borrowers in emerging markets, but more specifically reflects the markets recognition of the improved prospects for Ukraine. This in turn is reflected in more favourable credit ratings. These include an upgrade by Fitch (from B+ to BB-) and an improved outlook from Moody's during the first quarter of 2005.

The markets perception of Ukraine's ability to meet its funding requirements would be improved if the government is successful in reaching a new agreement or an understanding with the IMF. The precautionary one-year SBA agreed with the IMF in March 2004 has now expired and was in any event on-hold following the inability of the IMF to complete its mid-year review last August. The new government is likely to show more resolve in addressing the outstanding fiscal issues, such as the need for fiscal tightening, as well as meet some of the IMF concerns regarding the need for greater exchange rate flexibility. Improved co-operation with the IMF would almost certainly provide some assurance to the markets. Such progress, as well as some other reforms, should also enable the World Bank to proceed with the US$ 175 million disbursement under its second PAL and also consider more lending under PAL 3.

mitments of the Bank.

[3] Ukraine issued US$ 1 billion 10-year Euro bonds in 2003 at 7.65%. In February 2004 it issued a US$ 600 million, 7-year Eurobond at 6.875%; in July it issued US$ 500 million, 5-year FRNs at

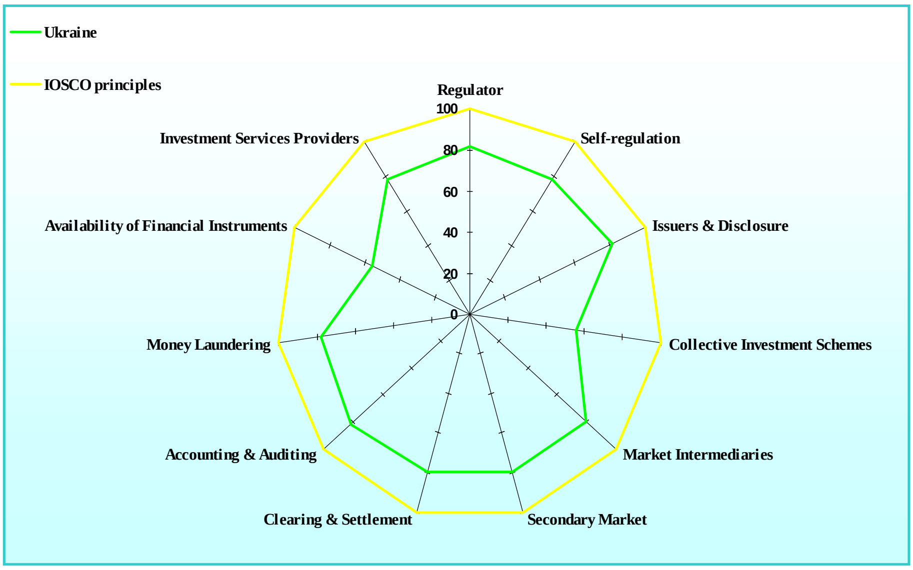
ANNEX 3 LEGAL TRANSITION

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Ukraine, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

The primary legislation governing the Ukrainian securities markets includes the Law "On Securities and Stock Exchange" (1991), the Law "On Companies" (1991), the Law "On the State Regulation of the Securities Market in Ukraine" (1996) and the Law "On the National Depository System and Specifics of Electronic Circulation of Securities in Ukraine" (1997). These laws have been amended several times since their adoption and are complemented by a myriad of regulations and resolutions issued by the State Commission on Securities and the Stock Market of Ukraine. This Commission, established in 1995, is the principal regulator of the Ukrainian securities market. According to the 2004 EBRD Securities Markets Legislation Assessment, Ukraine was rated as in "medium compliance" when benchmarked against International Organization of Securities Commissions (IOSCO) Principles (see chart below).

Quality of securities markets legislation –Ukraine (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

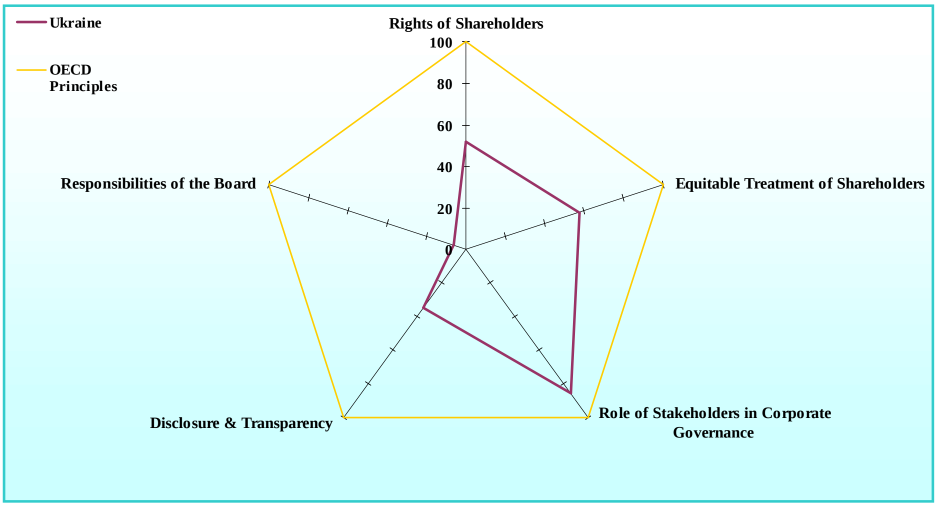
Notwithstanding substantial reforms implemented since the last EBRD strategy, room for improvement remains. In particular, the rules requiring segregation of assets by market intermediaries, the disclosure obligations of major shareholders in listed companies, and the framework for the monitoring of large exposure on the secondary market continue to be inadequate. Additionally, the authority of the regulator to collaborate and share information with foreign authorities should be improved.
Following its blacklisting by the Financial Action Task Force on Money Laundering (FATF)[4], Ukraine embarked upon a significant programme of reform addressing the FATF criticisms during 2002 and 2003. In particular, in June 2003, new anti-money laundering legislation entered into force and the legal framework is now deemed generally in line with the "*Forty Recommendations on Money Laundering*" and "*Eight Special Recommendations on Financing Terrorism*" issued by FATF. Following the enactment and implementation of these reforms, in February 2004, Ukraine was removed from the "*Non-Cooperative Countries and Territories*" list.

Company Law and Corporate Governance

The primary sources of law relating to corporate governance in Ukraine are the Law on Enterprises in Ukraine, the Law on Securities and the Stock Exchange and the Law on Business Associations. All these laws were enacted in 1991, as Ukraine gained its independence, and have been amended several times since then.

Five different corporate forms of legal entities may be established under Ukraine legislation: joint-stock companies ("JSC"), limited liability companies, additional liability companies, full liability companies and differentiated liability companies (similar to limited partnerships). There are two types of JSC: open and closed. An open JSC is established through a public offering and subscription of shares, whereas the shares of a closed JSC are distributed privately among the founding shareholders.

Quality of corporate governance legislation –Ukraine (2003)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2003 assessment

[4] The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. See www.fatf-gafi.org.

As evidenced by the 2003 EBRD Corporate Governance Sector Assessment, Ukrainian corporate governance legislation is measured as being in “very low compliance” with OECD principles (see chart above). In particular, disclosure rules concerning company information were found inadequate, the duties of a company’s board of directors were deemed unclear and the provisions concerning shareholders rights insufficient.

With the aim of improving the corporate framework, on 1 January 2004, the Civil Code and the Commercial Code entered into force, substantially amending the existing legal framework. Among the various reforms introduced, it is worth mentioning the possibility for a physical person to set up a JSC, the introduction of new rules concerning compulsory reduction of capital and the exclusive power of the general shareholders meeting to change the company charter and authorised capital. The latter provision seems to implicitly abrogate the previous authority of the management board and/or the supervisory board to decide on capital increases pursuant to the Law on Business Associations. This is a clear improvement of corporate governance rules. Furthermore, the introduction of the possibility for shareholders representing 10% of company capital to request an external audit on the company is another important improvement in minority shareholder protection.

Notwithstanding the positive impact that the above reforms may have, the beneficial effects may be hindered by problems related to law application. Sometimes the new provisions are conflicting with each other and a difficult interpretation exercise should be performed in order to understand which provision prevails. In view of the special nature of the new Commercial Code, it is arguable that in case of conflict, its provisions prevail over the new provisions introduced by the Civil Code and the existence of potentially conflicting interpretation could attract increased litigation.

Concessions

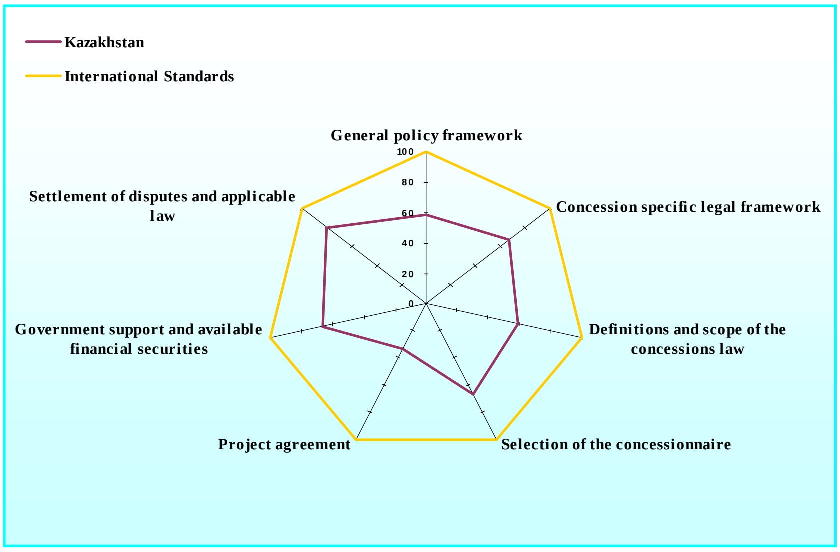
The Ukrainian Law “On Concessions” of 1999 (the “Concessions Law”) serves as a general framework law for concessions. In addition, the Economic Code of Ukraine of 2003 also contains provisions on concessions. The Concessions Law sets terms and procedures for the concession of state and communal property, including procedures for open public tendering. Provisions regulating project agreements provide relatively clear guidance on the main issues to be covered and remain sufficiently flexible to allow the parties freely to negotiate its terms.

While the Concessions Law constitutes a relatively solid legal basis for the development of Private Sector Participation (PSP) in infrastructure and utilities sectors, certain improvements, however, would be desirable. In particular, the Concessions Law is somewhat uneven inasmuch as that, while it clearly defines the scope of application, more detailed tender rules (i.e. incorporation of principles of transparency, non-discrimination, proportionality and efficiency, clear regulation of the pre-selection procedure and of review procedures) should be developed. Additionally, the identification and collaboration between different public entities involved should also be improved. There also is room for improvement in the Concessions Law as far as the lender’s position with respect to security and step-in rights is concerned, as these remain unregulated at this stage.

In addition to the Concessions Law, issues such as licensing, procurement, natural resources development and utility activities are governed by a set of special or sector-specific laws such as the Law "On Production Sharing Agreements", covering oil, gas and mining sectors. This is a fairly adequate law under which the state can grant mineral rights to a private investor by way of a negotiable contract rather than a licence. This law also helps facilitate private investment in the above-mentioned sectors by way of providing certain tax incentives and exemptions. In 1997, at the request of the Ukrainian authorities, the EBRD provided a commentary on this law.

The recent EBRD Concession Laws Assessment, undertaken to evaluate applicable regimes throughout the EBRD's 27 countries of operations, (the law on the books only, rather than how they work in practice), revealed that Ukrainian laws were in "medium compliance" with internationally accepted standards. As can be seen from the chart below, while general framework rules and rules covering settlement of disputes in concession-related arrangements, for instance, are regulated fairly extensively, most other areas, in particular, selection of a concessionaire, availability of financial instruments and state support need dramatic improvement in order to meet the requirements of a modern legal framework facilitating private sector participation. One more dimension that will inevitably require the attention of the authorities is policy framework, the absence of which makes any law, even an ideal one, extremely difficult to implement.

Quality of concession legislation – Ukraine (2004)

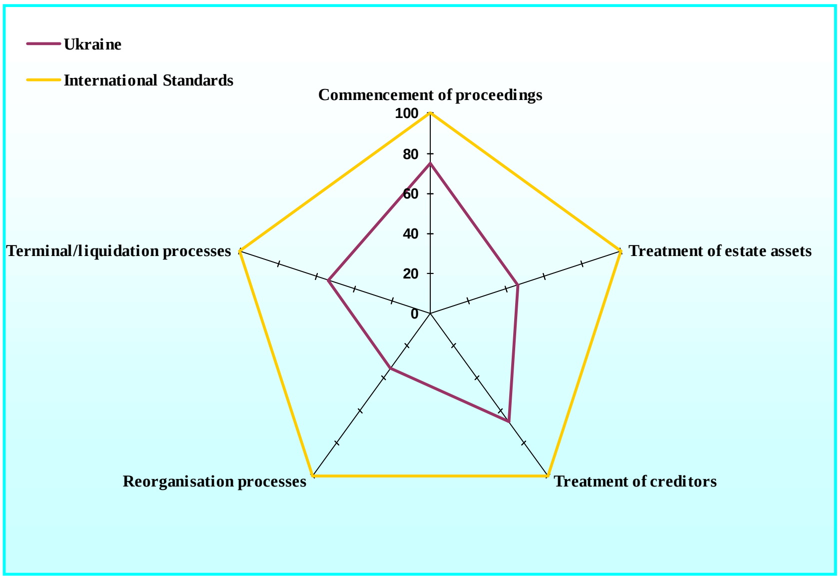


Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2004

Insolvency

Insolvency is governed by the Law on Restoring Debtor's Solvency & Declaring a Debtor Bankrupt (as amended) (the "Insolvency Law"). This law scored "very low compliance" when compared with international standards in the EBRD's 2003 Sector Assessment Survey.



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment Project, 2003/4

As the above chart reveals, this law is severely deficient in virtually all of the key areas of insolvency. Specifically, the Insolvency Law provides virtually no measurable reorganisation provisions. Under the few provisions that are included there is no requirement for independent assessment of the plan of reorganisation, very little involvement of the general body of creditors and no supervision of the plan's implementation. Given these limitations, it seems unlikely that an effective, efficient and transparent reorganisation could take place under this law. In addition, the law fails to provide for the timely delivery of property of the debtor to the bankruptcy administrator or for the effective avoidance of suspicious pre-bankruptcy transactions.

The above deficiencies could be classified as 'critical' or 'threshold' deficiencies in that they are imperative to the basic functioning of a proper insolvency law. In addition to these fundamental failings, the Insolvency Law has several other important shortcomings. In particular, the requirements for the commencement of bankruptcy proceedings are too complicated; there are inadequate requirements for the qualification of a bankruptcy administrator; there are no provisions for set-off; and, there are insufficient sanctions for failure to comply with the law.

Although the Insolvency Law does contain some positive elements, such as the requirement for a speedy hearing and determination of proceedings, it is unlikely that such provisions work well in practice.

The results of the EBRD 2004 Legal Indicator Survey, which measured the "effectiveness" (or how the laws work in practice) of insolvency regimes in the Bank's countries of operations, clearly show that the practical application of the Insolvency Law is likely to be expensive, fairly slow and unduly complex. All of these factors would militate against the speedy determination of proceedings provided for in the letter of the law. In addition, the results of the survey show that the predictability and competence of judges hearing bankruptcy cases is fairly unreliable.

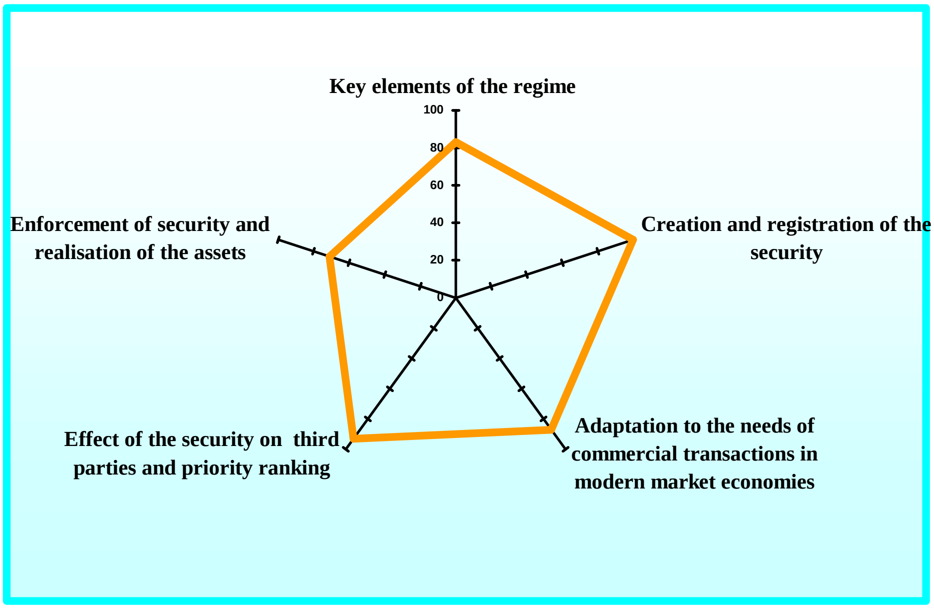
Secured Transactions

Recent years have seen Ukraine undertaking considerable reform in the field of secured transactions. The adoption of new Civil and Commercial Codes has been followed by reform of the provisions related to security over both movable and immovable property, together with extensive work on supporting institutions such as state registers. However, while these changes are encouraging, the framework remains confused and transitory. Consequently, it is difficult to present a definite assessment of the state of law at this juncture.

Security rights over movable assets in Ukraine are currently largely governed by the Law on Securing Creditor's Claims and Registration of Encumbrances 2003 (the "2003 Securing Creditor's Claims Law") and relevant provisions of the 2003 Civil Code. The Law on Pledges, 1992 (as amended), remains in force but is now of more limited relevance, applying in a somewhat unclear manner to matters not covered by the 2003 Securing Creditor's Claims Law. With respect to movable property, the 2003 Securing Creditor's Claims Law treats all encumbrances (e.g. pledges, leases) similarly and requires registration in the State Register of Encumbrances over Movable Property (effective August 2004) to be effective against third parties. All encumbrances entered into pre-existing register prior to 1 January 2004 were due to have been automatically transferred to the new Register.

The main weakness of the regime lies in the lack of flexibility in the description of the collateral and of the secured debt. Despite fairly liberal provisions in the law, the effectiveness of taking security over generally described assets, or fluctuating pools of assets, remains uncertain. Consequently, legal advisers are usually reluctant to advise such a course of action. Additionally, there remains much uncertainty with respect to taking and enforcing security over bank accounts. This weakness is reflected in the chart below, taken from a recent EBRD regional survey of secured transactions (2004).

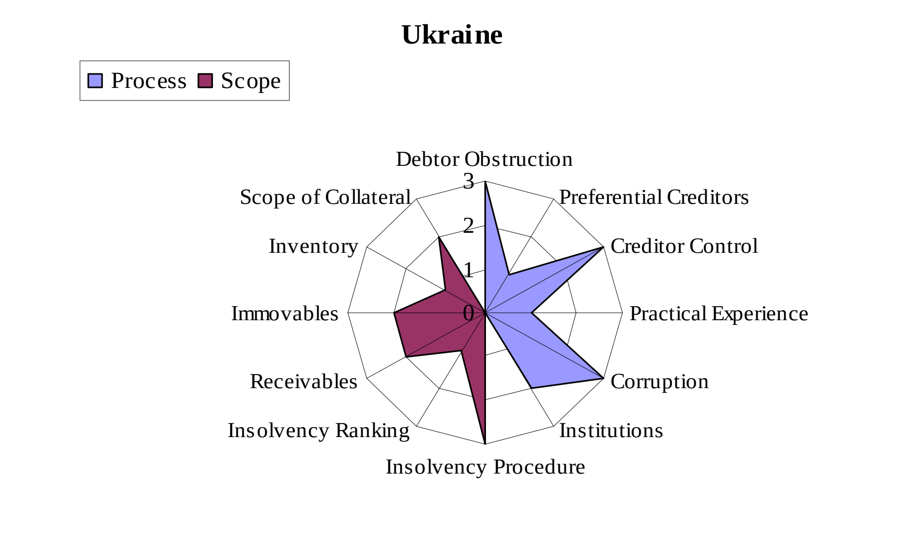
Legal and Practical Regime for Taking Security over Movable and Intangible Property Ukraine (2004)



Note: *Scoring on a scale from 1 to 100, where 100 represents the most advanced legal and practical regime.*

Source: *EBRD Regional Survey of Secured Transactions,* Another notable weakness is in the enforcement of security. While the 2003 Securing Creditor's Claims Law introduced new rules applicable to enforcement of security (including new modes of extra-judicial enforcement allowing transfer of ownership over the collateral to the creditor; sale of collateral directly by a creditor; assignment of pledged rights to the creditor; or, transfer of funds corresponding to the value of any cash or securities subject to a pledge), practitioners remain unconvinced of their effectiveness in implementation. Indeed, a 2003 EBRD survey on enforcement of a charge over movable assets (see chart below), has shown that enforcement problems stem to a large extent from the inability (or unwillingness) of the courts to proceed quickly and fairly, and from the ability of the debtor to deliberately obstruct the process. If these problems are not addressed, it is likely that out-of-court enforcement, ultimately relying on fair arbitration of disputes by courts, will have little effect.

Obstacles to charge enforcement process – Ukraine (2003)



Scoring on scale of 3 (problematic area) to 1 (not problematic)

Note: The fuller the web, the more serious the problems are in each of the respective categories.

"Process" factors measure the impact of specific incidences on the enforcement proceedings.

"Scope" factors relate to the ability of the system to deal with specific situations or items.

Source: EBRD Legal Indicator Survey, 2003

Security rights over immovable property (mortgages) are governed by the Law on Mortgage, 2003, together with relevant provisions of the Civil Code. A major unplanned change to the mortgage regime came from an apparent legislative drafting error in the new Law omitting specific provisions relating to enterprise mortgages, notwithstanding their deletion from the Law on Pledges. Although the new Civil Code that concomitantly entered into force authorises the mortgage of an enterprise complex, "enterprise complex" is now defined specifically as "immovable property", notwithstanding the fact that an enterprise mortgage also includes movables and other property rights. This has given rise to a number of practical issues in terms of notarisation, certification and registration of this type of agreement. Consequently, to avoid subsequent delays or problems, most law firms prefer to recommend classic mortgages and pledges over the immovable and movable assets of a borrower instead of the taking of enterprise mortgages. Apart from this issue, an important feature introduced by the new mortgage law is the possibility for the parties to agree in the mortgage agreement on a mutually beneficial disposal price for the mortgaged property (provided that it shall not be inferior to the market price for such type of property). On this basis, extra-judicial enforcement can take place, subject to all statutory restrictions.

The regime for registration of mortgages has been fundamentally changed in the last 2 years, with Art. 182 of the Civil Code (effective 1 January 2004) providing for mandatory registration of title, encumbrances and other interests in real estate. Prior to that time neither registry nor legal requirement to register encumbrances over real estate/land (such as mortgages) existed. Lenders could only require registration of certain restrictions over real estate mortgaged in their favour on the 1999 Unified State Register of Prohibitions on Alienation of Immovable Property. While failure to register would not affect validity of the mortgage itself, it would impact upon the opposability of the mortgage against third parties and priority ranking. Registration was temporarily to take place in the 1999 Unified State Register. The Law "On the State Registration of Corporeal Rights to Immovable Property and Limitations Thereon", of 1 July 2004 (the "Registration Law"), provided a new State Registry of Rights to Immovable Property and Limitations. The Registration Law effectively merges two separate temporary registry systems (***i.e.,*** the title registry and the mortgage registry) into a comprehensive cadastral system for registering rights to, and limitations on, immovable property, as well as unilateral and bilateral contracts regarding immovable property. This registry was to enter into operation on 1 January 2005 but it is currently unclear whether this has been the case.

Telecommunications

The telecommunications sector in Ukraine is currently governed by the Telecommunications Law of 2003 (the "2003 Telecom Law") and is formally regulated by a newly established National Commission for the Regulation of Communications (the "NCRC"). Provision for the establishment of the NCRC was included in the new 2003 Telecom Law and it was formally established on 1 January 2005. The NCRC's formal regulatory role includes responsibility for licensing and registration of operators, tariff regulation, interconnection, management of numbering resources and resolution of operator and consumer disputes. The 2003 Telecom Law dictates that the chair and members of the NCRC are appointed by, and report to, the President. Policymaking is carried out by the Central Communications Authority (also newly established), whose responsibilities will include formulating and implementing state telecommunications policy and developing standards.

Enactment of the 2003 Telecom Law has moved the sector legislative base towards alignment with European Union (EU) standards, aiming to create an open, non-discriminatory and transparent process for access to sector markets. The 2003 Telecom Law evidences this by listing a limited set of circumstances in which individual licenses are required to provide services, establishing that in all other cases notification and registration will suffice. Further EU reflective provisions include those providing for asymmetric regulation of dominant operators, granting rights of access and interconnection and requirements that tariffs of an operator may only be subject to regulation where the operator is providing universal services or is deemed dominant in the market-place.

While Ukraine's telecom sector is formally open to competition, competitive fixed line providers have yet to make any significant inroads in Ukrtelecom's (state-owned incumbent) dominance in the market-place. Despite the government's willingness to issue competitive licences in the recent past, the absence of meaningful regulatory controls have meant the fixed market remains, by and large, skewed in favour of Ukrtelecom. Although successive governments have sought to privatise Ukrtelecom, numerous obstacles have conspired to prevent its implementation. Political opposition to privatisation, a difficult investment climate, an uncertain regulatory environment, together with global conditions in the telecoms sector and the economy have been the main impediments. The new government has again postponed privatisation until 2006, ostensibly to afford an opportunity to restructure Ukrtelecom to make it more attractive to private investors.

Private sector led competitive provision of service is fundamental to the successful development of the telecom sector in Ukraine. Liberalisation and privatisation are key to the attraction of the necessary private investment. An independent regulator and a transparent, rule based, cost-oriented regulatory regime are essential for meaningful competition to take hold. These measures can do much to enhance investor confidence in Ukrainian telecoms markets. Despite recent changes in the legal framework, successive implementation failures have resulted in sector stagnation. While the 2003 Telecom Law incorporates many EU standards and provides a firm basis upon which a modern regulatory framework can be built, the government should ensure that this Law is made fully compliant with all the appropriate EU standards and a comprehensive programme of implementation of these standards is embarked upon immediately. In particular, the key ingredient for implementation of such standards is an independent and appropriately resourced telecom regulatory authority. While the 2003 Telecom Law makes provision for new sector regulator (i.e. the NCRC), it fails to provide the necessary independence guarantees for that organisation. The government should move to resolve any ambiguity in this respect immediately and re-constitute the NCRC as an independent agency accountable to parliament and responsible for implementation of all elements of the telecom regulatory framework. Additionally, the authorities should re-double efforts to finalise a coherent, attractive and transparent process and timetable for attracting private investment into Ukrtelecom, allowing the company access to the capital and expertise necessary to develop its network infrastructure and service portfolio, thus allowing it to fully participate in a competitive environment.

ANNEX 4 ENVIRONMENTAL DEVELOPMENTS

Part I

The Ukrainian environment, and particular its soil, water, forest, mineral resources remain to be in the state of emergency since the times of the totalitarian economic regime. This situation requires rigorous implementation of the national environmental policy with the emphasis on restoration of natural resources, rehabilitation of waters and legislative alignment of all the economic activities with this national environmental policy.

Ukraine aims to align its environmental management system with the European legislative and institutional bases, primarily through harmonisation of the national environmental policy in accordance with the Action Plan adopted in the framework of the European Neighbourhood Policy. The environment part of the Action Plan contains three main sections: environmental governance, prevention of deterioration of the environment (sector-specific legislation and programmes) and co-operation on environmental issues. In May 2003 Ukraine hosted the Fifth Pan-European Conference of the Ministers of Environment "Environment for Europe", which provided strong impetus to the country in regard to further improving its environmental management and protection system as well as raised public awareness of the key environmental concerns.

Strategic directions of the country's environmentally sustainable development are set out in the 2003-2015 Comprehensive Program on National Implementation of the Decisions of the World Summit on Sustainable Development (Johannesburg, 2002) approved by the National Commission on Sustainable Development under the Cabinet of Ministers in Ukraine. Corresponding implementation sub-Programs include, *inter alia*, such on the Ecological Rehabilitation of the Dnipro River Basin and Enhancement of Drinking Water Quality (by 2005); Protection and Rehabilitation of the Azov Sea and the Black Sea Environment (by 2010), On Ratification of the Kyoto Protocol to the United Nations Framework Convention on Climate Change (2003); on establishment of national environmental framework to halt the loss of biodiversity (2002-2010) and National Program "Forest of Ukraine" (2002-2015).

While the development of the environmental legislation framework in Ukraine has progressed, a comprehensive system of environmental management has not yet been adequately established. The issues of environmental enforcement, continuous improvement of environmental legislation in line with country's economic development, the current system of state environmental regulation, which is still over centralised and compartmentalised, remain central to the environmental challenges in Ukraine.

Another challenge lies in further incorporation of environmental considerations into the sectoral and corporate environmental management systems. Steps in this direction are exemplified by the sectoral development programs such as the National Energy Programme till 2030, which *inter alia* calls for further reduction of the air emissions, waste water discharges and waste generation from the power through introduction of the energy efficiency measures); National Programme for water resource use (2002), which provides *inter alia* for maintenance and protection of the river catchments basis, for implementation of the economic instruments for water resource conservation.

Further improvement of the environmental management system in Ukraine is also seen by the country in strengthening its economic underpinnings for the national environmental policy through establishing the National Environmental Fund and introduction of the “polluter pays principle” into the Ukrainian legislation. These steps should enable the country to master the market mechanisms of environmental management, including increased investment into resolution of environmental problems in the country. . It will also be essential to build up administrative capacity and implement regional cooperation activities that can have a transboundary environmental impact, such as water management in relation to the Black Sea Task Force and the EU Water Initiative, and implementation of measures reducing emissions (implementation of Kyoto protocol).

Part II

The Bank's environmental approach to Ukraine continues to reflect the country's environmental challenges and the Bank's project portfolio.

The recently signed K2R4 Post-start-up Safety and Modernisation Programme finances the post-start-up component of a safety and modernisation programme developed for unit 2 at Khmelnitsky (K2) and unit 4 at Rivne (R4). This programme consists of approximately 70 measures, aimed to further improve safety. The Chernobyl Shelter Implementation Project has entered a phase of implementation activities. The Bank continues to monitor compliance with relevant environmental, health and safety standards which apply to this project.

In the property development sector, environmental due diligence will address environmental, health and safety issues including life and fire safety issues in public buildings as well as adherence to national labour law and International Labour Organisation (ILO) conventions.

In the MEI sector, the Dnipropetrovsk Municipal Water and Wastewater project and the Zaporizhia Water Utility Development & Investment Programme aim to improve the water supply and wastewater sectors in the City of Dnipropetrovsk and the City of Zaporizhia respectively, through reducing pollution to the Dnipro River and subsequently the Black Sea, caused by the discharge of insufficiently treated sewage, by improving the quality of the drinking water and the reliability of the water supply system and reducing wastage of drinking water through demand-side management and leakage reduction. As a result of the implementation of these projects not only national, but also EU drinking water and effluent discharges standards will be achieved.).

In industry operations, the Bank will apply rigid standards as well as actively promote voluntary and market-based mechanisms for ensuring environmentally sound and sustainable raw material supply. This will be a particular focus in the Bank’s activities in sectors, which utilise significant amounts of natural resources, such as forests. A number of projects in the Bank’s current pipeline involve brownfield site development. In absence of adequate national regulatory framework, the Bank will adhere to international standards and best industry practice to ensure appropriate site assessments, remediation and/or containment measures will be undertaken.

In the heavy (iron & steel) industry, the Bank's project with Istil has brought the client's operations in compliance with EU Integrated Pollution Prevention and Control (IPPC). The worker health and safety program is now well defined and includes comprehensive training, monitoring and accident investigation procedures. Total air emissions have been reduced over the past three years by about half despite a significant increase in production. The second project with Istil will further improve energy efficiency and waste disposal practices when completed.

In the energy efficiency sector, Ukresco will promote energy efficiency through its demonstration impact in the highly energy inefficient Ukrainian industry. The Bank will continue to structure projects so they meet the Ukrainian and EU environmental standards and attempt to maximise environmental benefits.

In the shipping sector, the existing projects with Ukrichflot have brought the client's operations into compliance with the IMO, MARPOL and SOLAS regulations. The Bank will continue to adhere to similar approach for any future clients in the sector. The Bank will also cooperate with other international organisations, environmental activities of which are complementary to those of EBRD.

The Bank will continue to ensure implementation of its environmental procedures for intermediated financing through local banks, for small and micro loans, for residential mortgaging and for leasing as per the respective types of the FI operations in Ukraine. EBRD will conduct a new round of environmental due diligence training for its FIs in early 2005 to ensure adequate implementation of the Bank's environmental requirements. The Bank will continue to actively monitor environmental performance of its FI clients in Ukraine on the basis of annual environmental reports and designated monitoring trips. For example, ED staff member carried out environmental monitoring trip to Ukraine in late 2002, which included meetings the management of the EBRD's FIs in Ukraine and a number of site visits.

The Bank has a number of agribusiness projects in Ukraine each of which has undergone an environmental appraisal in accordance with the Bank's Environmental Procedures and commensurate to the environmental risks associated with the Project. Projects include, inter alia, breweries, malteries, edible oils, and the manufacture of glass containers. Typical due diligence includes independent environmental audits to assess current compliance issues, potential environmental liabilities and opportunities for environmental improvement, plus environmental analyses to assess impacts associated with expansions or new developments. The Bank will continue to apply this approach with a particular emphasis on compliance with European Union standards given Ukraine's extensive trade contact with the EU and the expectations placed upon Ukraine as a participant in the EU's European Neighbourhood Policy.

ANNEX 5 SELECTED ECONOMIC INDICATORS

	1999	2000	2001	2002	2003	2004	2005
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP[1]	-0.2	5.9	9.2	5.2	9.4	12.1	6.5
Private consumption	-2.2	2.3	9.0	9.0	12.1	12.5	na
Public consumption	-7.9	1.0	10.4	-6.7	14.8	13.0	na
Gross fixed capital formation	0.1	12.4	6.2	3.4	15.8	11.0	na
Exports of goods and services	-2.2	21.5	3.5	7.4	10.3	10.0	na
Imports of goods and services	-16.7	23.8	6.0	3.3	16.4	9.5	na
Industrial gross output	4.0	13.2	14.2	7.0	15.8	12.5	na
Agricultural gross output	-6.9	9.8	10.2	1.2	-11.0	19.1	na
Employment			*(Percentage change)*				
Labour force (end-year)	0.2	0.3	-0.1	0.5	0.3	na	na
Employment (end-year)	-2.5	-1.2	1.7	0.3	0.5	na	na
			(In per cent of labour force)				
Unemployment (end-year)	4.3	4.2	3.7	3.8	3.6	3.6	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	22.7	28.2	12.0	0.8	5.2	9.0	14.4
Consumer prices (end-year)	19.2	25.8	6.1	-0.6	8.2	12.3	12.1
Producer prices (annual average)	31.1	20.8	8.7	3.0	7.6	20.4	na
Producer prices (end-year)	15.7	20.6	0.9	5.7	11.1	24.1	na
Gross average monthly earnings in economy (annual average)	16.3	29.2	35.2	20.9	22.9	27.7	na
Government sector[2]			*(In per cent of GDP)*				
General government balance	-2.3	-1.1	-0.9	0.1	-0.7	-3.4	-3.0
General government expenditure	34.1	34.5	34.4	35.6	37.7	37.2	32.5
General government debt	51.0	45.9	36.9	33.5	29.3	25.9	24.0
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	40.7	45.3	43.2	42.3	46.9	32.8	32.3
Domestic credit (end-year)	30.5	23.1	18.7	28.9	39.6	22.8	22.3
			(In per cent of GDP)				
Broad money (M2, end-year)	16.6	18.5	22.1	28.5	35.8	36.3	40.3
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	45.0	27.0	12.5	7.0	7.0	9.0	na
Treasury bill rate (3-month maturity)	na	na	na	na	na	na	na
Deposit rate[3]	20.7	13.7	11.0	7.9	7.0	7.8	na
Lending rate[3]	55.0	41.5	32.3	25.4	17.9	17.4	na
			(Hryvnias per US dollar)				
Exchange rate (end-year)	5.2	5.4	5.3	5.3	5.3	5.3	5.3
Exchange rate (annual average)	4.1	5.4	5.4	5.3	5.3	5.3	5.3
External sector			*(In millions of US dollars)*				
Current account	1,658	1,481	1,402	3,173	2,891	6,804	4,100
Trade balance	244	779	198	710	-269	3,741	1,200
Merchandise exports	13,189	15,722	17,091	18,669	23,739	33,432	36,200
Merchandise imports	12,945	14,943	16,893	17,959	24,008	29,691	35,000
Foreign direct investment, net	489	594	769	698	1,411	1,700	1,900
Gross reserves, excluding gold (end-year)	1,046	1,353	2,955	4,241	6,731	9,302	13,300
External debt stock[4]	13,532	11,819	12,098	12,771	14,578	20,157	22,650
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	0.8	0.9	1.7	2.4	2.9	3.2	4.0
			(In per cent of exports of goods and services)				
Debt service[5]	15.9	10.4	8.7	5.7	6.3	4.8	4.9
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	50.1	49.3	49.0	48.7	48.4	48.4	48.4
GDP (in millions of hryvnias)	130,442	170,070	204,190	225,810	264,165	345,940	412,000
GDP per capita (in US dollar)	631	634	777	870	1,024	1,343	1,605
Share of industry in GDP (in per cent)	27.2	26.7	27.1	30.5	31.0	30.0	na
Share of agriculture in GDP (in per cent)	11.7	14.4	14.4	13.4	13.0	13.5	na
Current account/GDP (in per cent)	5.2	4.7	3.7	7.5	5.8	10.5	5.3
External debt - reserves (in US$ million)	12,486	10,466	9,143	8,530	7,847	10,855	9,350
External debt/GDP (in per cent)	42.8	37.8	31.8	30.1	29.4	31.0	29.2
External debt/exports of goods and services (in per cent)	79.3	60.5	57.4	54.7	50.4	50.7	53.0

1 Includes changes in inventories.

2 General government includes the state, municipalities and, from 1994, extra-budgetary funds.

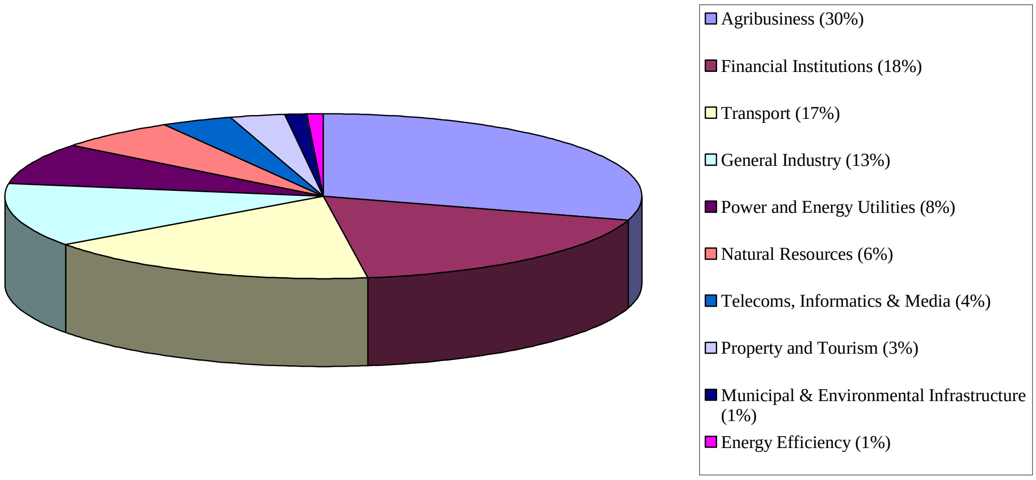
3 Weighted average over all maturities.

4 Public and publicly guaranteed debt and an estimate of the stock of private debt (in both cases medium and long-term debt only).

5 Refers to payments on official debt only.

ANNEX 6 SIGNED BANK PROJECTS AND PIPELINE

I Signed Bank Projects as of 31 March 2005 – By Total Project Value



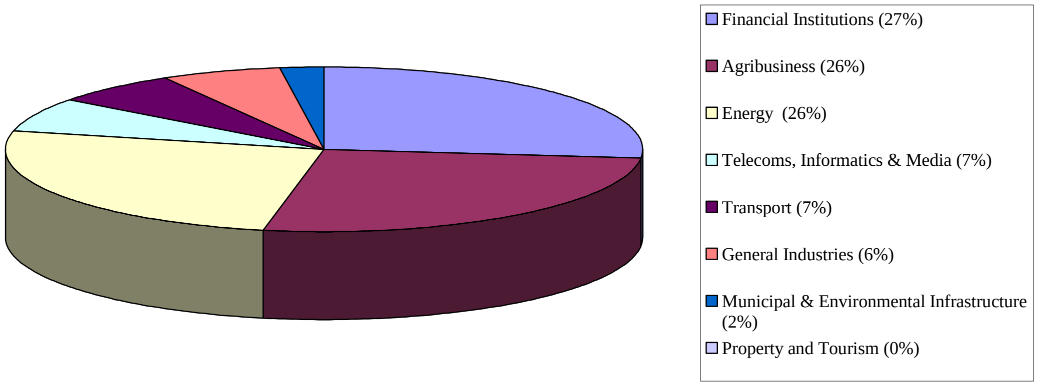
Operation Name	Sector	Signing Date	Total project Value	EBRD Finance	Debt	Equity	Operation Stage
Billa	Agribusiness	20/03/03	70.8	15.8	15.8	0.0	Disbursing
Cargill Industrial Complex	Agribusiness	30/06/99	68.2	37.5	37.5	0.0	Repaying
Cargill Ukraine: Warehouse Receipt Program	Agribusiness	03/12/01	11.5	11.5	11.5	0.0	Completed
Cargill Ukraine: WRP Harvest 2003	Agribusiness	06/06/03	11.5	11.5	11.5	0.0	Completed
Cargill Working Capital Facility	Agribusiness	17/06/04	11.5	11.5	11.5	0.0	Signed
Cerealia BCP	Agribusiness	29/06/00	7.5	2.1	2.1	0.0	Disbursing
Cereol Ukraine	Agribusiness	01/02/02	22.3	20.4	20.4	0.0	Repaying
Chumak	Agribusiness	30/06/04	15.3	11.5	11.5	0.0	Disbursing
DOEP (AMENDED)	Agribusiness	05/05/99	56.5	18.1	18.1	0.0	Completed
Dnipropetrovsk Oil Extraction Plant I(DOEP I)	Agribusiness	28/07/95	15.8	6.5	6.5	0.0	Completed
Dnipropetrovsk Oil Extraction Plant II (DOEPII)	Agribusiness	16/09/97	15.4	15.4	15.4	0.0	Completed
EFES - EBI	Agribusiness	15/04/02	1.4	0.5	0.5	0.0	Completed
Evrotek	Agribusiness	19/11/04	15.4	7.7	7.7	0.0	Signed
Integrated Agricultural Services and Processing	Agribusiness	15.05.95	23.6	8.1	5.8	2.3	Completed
JSC Gostomel Glass Factory	Agribusiness	27/01/04	13.1	4.2	4.2	0.0	Disbursing
Malteurop	Agribusiness	11/07/02	43.5	18.8	18.8	0.0	Disbursing
Nidera (Ukraine)	Agribusiness	01/04/03	3.1	3.1	3.1	0.0	Disbursing
OJSC Gostomel Glass Factory	Agribusiness	25/03/02	8.0	5.7	5.7	0.0	Repaying
OJSC Slavutich Brewery	Agribusiness	21/11/01	43.1	13.1	13.1	0.0	Repaying
Obolon Brewery	Agribusiness	10/12/97	48.4	23.0	23.0	0.0	Completed
Obolon Phase II	Agribusiness	08/12/04	7.7	7.7	7.7	0.0	Disbursing

Soufflet ACL 2004 Slavuta	Agribusiness	07/09/04	8.6	4.3	4.3	0.0	Disbursing
Soufflet Slavuta - Ukraine	Agribusiness	21/10/04	37.0	9.1	9.1	0.0	Signed
Svitoch Confectionery	Agribusiness	22/04/97	4.0	3.2	3.2	0.0	Completed
Toepfer Working Capital Revolving Facility	Agribusiness	14/06/02	92.3	36.9	36.9	0.0	Completed
Toepfer Working Capital Revolving Facility 2004	Agribusiness	09/06/04	149.9	92.3	92.3	0.0	Repaying
Toepfer Working Capital Revolving Facility/2003	Agribusiness	03/06/03	139.8	61.4	61.4	0.0	Completed
Sub-total			**945.2**	**460.8**	**458.5**	**2.3**	
Danfoss Debt Facility for Industrial Energy Projects	Energy Effieciency	20/12/02	0.3	0.1	0.1	0.0	Repaying
Energy Alliance	Energy Effieciency	19/02/04	7.7	3.8	3.8	0.0	Disbursing
Ukraine Energy Service Company - UkrEsco	Energy Effieciency	09/05/98	21.4	15.4	15.4	0.0	Repaying
Sub-total			**29.4**	**19.3**	**19.3**	**0.0**	
AIG New Europe Fund	FI	29/06/99	25.5	4.7	0.0	4.7	Repaying
Alliance ScanEast Fund	FI	01/04/94	9.6	3.3	0.0	3.3	Repaying
AVAL Mortgage Credit Line	FI	28/1004	7.7	7.7	7.7	0.0	Signed
BNP Dresdner Ukraine	FI	06/03/98	9.0	1.0	0.0	1.0	Completed
Baring Vostok Private Equity Fund	FI	13/12/00	4.1	1.8	0.0	1.8	Repaying
Baring Vostok Private Equity Fund III	FI	21/12/04	67.3	12.5	0.0	12.5	Signed
Black Sea Fund	FI	26/08/98	5.2	2.0	0.0	2.0	Repaying
Credit Facility to AVAL under Tranche 3 of Ukraine SME II	FI	19/12/03	11.5	11.5	11.5	0.0	Disbursing
FUIB Credit Facility	FI	11/08/95	10.0	10.0	10.0	0.0	Completed
Kiev International Bank	FI	18/08/95	5.0	1.8	0.0	1.8	Completed
Kiev International Bank	FI	21/10/99	0.8	0.8	0.0	0.8	Completed
PPF - Euroventures Ukraine - Internatl. Distrib. System Ltd	FI	20/12/00	2.1	2.1	0.0	2.1	Completed
PPF - Euroventures Ukraine - Anthousa Ltd (Furshet)	FI	26/06/02	2.5	2.3	0.0	2.3	Repaying
PPF - Euroventures Ukraine - Hudson Asset Management	FI	23/11/00	2.4	2.4	0.0	2.4	Disbursing
PPF - Euroventures Ukraine - Laona Investments (former Alba)	FI	30/07/02	2.5	2.1	0.0	2.1	Disbursing
PPF - Euroventures Ukraine - Orleander	FI	17/07/01	3.1	3.1	0.0	3.1	Disbursing
PPF - Euroventures Ukraine - P5 Communications	FI	15/11/00	1.1	1.1	0.0	1.1	Completed
PPF - Euroventures Ukraine: Abikelly Ltd	FI	18/03/05	1.7	1.7	0.0	1.7	Disbursing
PPF - Euroventures Ukraine: Sodelem Dev. (for. Milky Land)	FI	15/02/02	3.4	2.1	0.0	2.1	Disbursing
PPF - Euroventures Ukraine: Statinko Ltd.(former Frau Marta)	FI	30/04/04	1.9	1.9	0.0	1.9	Disbursing
Raiffeisen International	FI	20/10/04	10.0	5.0	0.0	5.0	Disbursing
Regional TFP: Aval bank (Gtees & cash disb)	FI	24/01/01	9.6	9.6	9.6	0.0	Signed
Regional TFP: First Ukrainian International Bank (FUIB)	FI	24/01/01	8.6	8.6	8.6	0.0	Disbursing
Regional TFP: Forum Bank	FI	24/01/01	5.4	5.4	5.4	0.0	Signed
Regional TFP: Hypovereinsbank Ukraine (G. & Pre-export)	FI	19/12/01	10.9	10.9	10.9	0.0	Disbursing
Regional TFP: Kreditprombank (Guarantee & Pre-export)	FI	20/10/04	6.0	6.0	6.0	0.0	Signed
Regional TFP: Kredyt Bank Ukraina (former WUCB)	FI	01/03/02	0.3	0.3	0.3	0.0	Disbursing
Regional TFP: Nadra bank	FI	24/01/01	0.3	0.3	0.3	0.0	Signed
Regional TFP: ProCredit Bank (formerly MFB)	FI	18/04/02	0.2	0.2	0.2	0.0	Signed
Regional TFP: Raiffeisenbank Ukraine	FI	22/10/02	2.8	2.8	2.8	0.0	Disbursing
Regional TFP: UkrSotsBank	FI	04/12/02	1.8	1.8	1.8	0.0	Signed
Subordinated Loan to Raiffesenbank Ukraine II	FI	23/06/03	3.8	3.8	3.8	0.0	Disbursing

US/EBRD SME - ProCredit Bank Ukraine (Formerly MFB)	FI	02/10/00	33.7	8.9	6.9	2.0	Repaying
US/EBRD SME - ProCredit Bank Ukraine - Cap Inc	FI	14/11/03	9.3	3.9	3.1	0.9	Disbursing
Ukraine Ent. Facility - First Ukrainian International Bank	FI	26/10/00	7.6	7.6	7.6	0.0	Repaying
Ukraine Ent. Facility - Hypovereinsbank Ukraine	FI	18/12/01	7.7	7.7	7.7	0.0	Repaying
Ukraine Ent. Facility - Raiffeisen Ukraine	FI	14/12/01	11.5	5.4	5.4	0.0	Repaying
Ukraine Fund	FI	25/03/93	9.2	2.9	0.0	2.9	Repaying
Ukraine Fund Capital Increase	FI	13/12/95	8.4	2.6	0.0	2.6	Disbursing
Ukraine Multi Bank Equity -Kredyt Bank Ukr (portage)	FI	17/09/99	23.6	19.8	19.8	0.0	Repaying
Ukraine Multi Bank Equity Finance - FUIB (Share Purchase)	FI	29/12/98	4.9	4.9	0.0	4.9	Disbursing
Ukraine SME Credit Line II	FI	08/05/98	71.7	67.9	67.9	0.0	Repaying
Ukraine SME Line of Credit	FI	16/12/94	93.2	93.2	93.2	0.0	Completed
Ukraine Subordinated Credit Facility to Raiffeisenbank	FI	23/12/99	7.7	5.4	5.4	0.0	Disbursing
Ukraine/Aval/2003/Warehouse Receipt Programme	FI	10/09/03	12.3	10.0	10.0	0.0	Completed
Ukraine/Aval/2004/Warehouse Recipt Programme	FI	09/09/04	23.1	15.4	15.4	0.0	Disbursing
Ukraine/Aval/Warehouse Receipt Programme	FI	13/11/02	7.7	7.7	7.7	0.0	Completed
Ukraine/UkrSotsBank/2003/Warehouse Receipt Programme	FI	15/12/03	7.7	7.7	7.7	0.0	Completed
Sub-total			**575.4**	**401.4**	**336.6**	**64.8**	
AD-Zarya	General Industries	05/02/98	43.1	12.8	0.0	12.8	Repaying
Bosch Service Franchisee Framework	General Industries	06/12/01	4.7	4.7	4.7	0.0	Repaying
Consumers Sklo Zorya	General Industries	17/04/03	17.0	11.3	11.3	0.0	Repaying
DIF - Ukram Industries	General Industries	17/07/01	2.1	2.1	0.0	2.1	Disbursing
ISTIL (Ukraine) II	General Industries	09/12/04	34.6	23.1	23.1	0.0	Disbursing
ISTIL-UKRAINE	General Industries	15/11/01	99.8	19.2	19.2	0.0	Completed
IVECO/Kraz Joint Venture	General Industries	08/11/95	37.5	10.6	10.6	0.0	Completed
Iveco Ukraine	General Industries	26/09/00	33.4	9.2	9.2	0.0	Completed
Kvazar-Micro Corporation BV (KMC)	General Industries	18/11/02	9.6	6.2	6.2	0.0	Repaying
Procter & Gamble Distribution	General Industries	30/12/98	83.6	1.6	1.6	0.0	Completed
Rubizhansky Cardboard and Packaging Mill	General Industries	26/11/03	34.1	10.8	10.8	0.0	Disbursing
Sub-total			**399.7**	**111.6**	**96.6**	**15.0**	
Zaporizhzhia - Water Utility Development & Investment Progr.	Municipal Infrastructure	21/05/99	33.5	21.5	21.5	0.0	Repaying
Sub-total			**33.5**	**21.5**	**21.5**	**0.0**	
Balkan Gas Transit II	Natural Resources	21/11/01	95.3	38.8	38.8	0.0	Repaying
Balkan Gastransit Project	Natural Resources	21/12/99	69.2	30.8	30.8	0.0	Repaying
Poltava Oil and Gas Project	Natural Resources	26/04/95	32.9	6.2	6.2	0.0	Completed
Sub-total			**197.4**	**75.8**	**75.8**	**0.0**	
K2R4 Post-start-up Safety and Modernisation Programme	Power & Energy	29/07/04	96.1	32.3	32.3	0.0	Signed
Starobeshevo Power Modernisation Project	Power & Energy	11/12/96	111.3	96.8	96.8	0.0	Repaying
Ukraine Fuel Purchase Loan Facility	Power & Energy	06/10/00	45.4	45.4	45.4	0.0	Completed
Sub-total			**252.8**	**174.4**	**174.4**	**0.0**	
Europolis II	Property	15/11/04	21.0	5.3	3.9	1.4	Disbursing
ORCO APARTHOTELS	Property	07/03/03	16.3	1.7	0.0	1.7	Disbursing
Radisson SAS Kyiv II	Property	01/12/98	50.5	18.1	9.8	8.3	Disbursing
Sub-total			**87.8**	**25.1**	**13.7**	**11.4**	

MBA Loan Project (guarantee)	Regional fund investment	06/03/95	0.4	0.1	0.1	0.0	Repaying
MBA Loan Project II (guarantee)	Regional fund investment	07/12/98	0.1	0.0	0.0	0.0	Completed
NIS Restructuring Facility	Regional fund investment	16/03/00	2.4	0.5	0.0	0.5	Repaying
Sub-total			**2.9**	**0.7**	**0.1**	**0.5**	
Eurovision - Ukraine	Telecom	14/12/93	0.8	0.8	0.8	0.0	Completed
Golden Telecom	Telecom	30/09/99	43.8	13.0	0.0	13.0	Disbursing
ITUR	Telecom	30/06/94	47.8	40.8	40.8	0.0	Completed
Ukrainian Wave (f.k.a L'viv Wireless)	Telecom	10/12/97	21.4	5.4	5.4	0.0	Completed
Sub-total			**113.8**	**60.0**	**47.0**	**13.0**	
Air Navigation System Upgrading	Transport	26/02/98	33.2	19.5	19.5	0.0	Repaying
Railway Development Project	Transport	06/12/99	73.1	39.9	39.9	0.0	Repaying
Rehabilitation of M06 H'way & Road Sector Financing Reform	Transport	11/12/00	100.0	75.0	75.0	0.0	Disbursing
State International Airport Borispol	Transport	22/12/93	11.4	3.9	3.9	0.0	Completed
Ukraine International Airlines	Transport	14/12/00	4.2	4.2	4.2	0.0	Disbursing
Ukraine Railways: Fast Passenger Trains Project	Transport	31/08/04	111.1	61.5	61.5	0.0	Signed
Ukraine Second Project "Kiev-Chop Road Rehabilitation"	Transport	28/02/05	138.0	100.0	100.0	0.0	Signed
Ukrrichflot	Transport	29/09/95	24.5	6.2	6.2	0.0	Completed
Ukrrichflot II	Transport	20/10/00	7.9	2.1	2.1	0.0	Completed
Ukrrichflot III	Transport	20/10/00	39.9	24.0	24.0	0.0	Repaying
Sub-total			**543.2**	**336.3**	**336.3**	**0.0**	
			3,181.0	**1,686.8**	**1,579.8**	**107.0**	

II Pipeline Stock as of 31 March 2005



Sector	Concept Clearance	Structure Review	Final Review	Board Approved	Current Pipeline Stock
General Industries	**49.4**	**0.0**	**0.0**	**7.5**	**56.9**
Specialised Industries	**166.8**	**0.0**	**0.0**	**138.4**	**305.2**
Agribusiness	105.3	0.0	0.0	138.4	243.7
Property and Tourism	0.0	0.0	0.0	0.0	0.0
Telecoms, Informatics & Media	61.5	0.0	0.0	0.0	61.5
Energy	**231.4**	**0.0**	**7.7**	**0.0**	**239.1**
Energy Efficiency	0.0	0.0	7.7	0.0	7.7
Natural Resources	25.4	0.0	0.0	0.0	25.4
Power and Energy Utilities	206.1	0.0	0.0	0.0	206.1
Financial Institutions	**22.4**	**0.0**	**173.0**	**54.5**	**249.8**
Bank Equity	5.4	0.0	0.0	0.0	5.4
Bank Lending	0.0	0.0	76.9	49.3	126.2
Non-Banking Financial Institutions	17.0	0.0	0.0	0.0	17.0
Small Business Finance	0.0	0.0	76.9	0.0	76.9
Equity Funds	0.0	0.0	19.2	5.2	24.4
Infrastructure	**30.8**	**0.0**	**0.0**	**50.8**	**81.5**
Municipal & Environmental Infrastructure	0.0	0.0	0.0	20.0	20.0
Transport	30.8	0.0	0.0	30.8	61.5
TOTAL	**500.8**	**0.0**	**180.7**	**251.1**	**932.6**
of which debt					878.4
of which equity					54.2
of which private					671.2
of which state					261.4
of which non sovereign					691.2
of which sovereign					241.4

ANNEX 7 BILATERAL ASSISTANCE

Austria

Under the IFC PEP (Private Enterprise Partnership Program) for Eastern Europe and Central Asia, Austria has supported the Vinnytsya Fruit Supply Chain Development Project in the Ukraine with a TA programme in the amount of USD 600.000. The Austrian strategic investment partner in this venture is Steirerobst. The project is being implemented and no further plans for future investments under the PEP program are yet known. As this is one of the two pilots under PEP the Austrian Government wants to evaluate its experience with PEP before considering other potential projects.

Canada

The key objective for CIDA's bilateral program of support to Ukraine is strengthening governance, including institutional capacity building of government and strengthening civil society. The program will be focussing on the following: public administration/public service reform, rule of law, and private sector enabling environment. CIDA assists in these areas by building capacity, providing knowledge and technology transfer, multi-level partnership (with business labour, government, academia and NGOs) and encouraging direct links between Canadian organizations and their Ukrainian partners, including leveraging the cultural ties of the Ukrainian Canadian community (approximately 1.1 million).

Projects are currently active in 10 sectors, with the greatest amount of expenditure occurring in government and civil society and private sector development (which includes agriculture). There are approximately 26 projects dispersed across Ukraine, although there is a concentration in Western Ukraine. Working in partnership with EBRD CIDA has concentrated on promoting small and medium sized enterprises and improvements in banking practices by improving access to credit for entrepreneurs and making the most reputable representatives of Ukraine's banking system more effective. CIDA has provided financial support and technical assistance to ProCredit Bank and the SME line of credit.

Canada was also active in supporting free and fair elections in Ukraine. As well as providing a strong contingent of election observers, the Democratic Institutions and Practices project ($1,250,000) supports local NGOs' activities such as increasing voter awareness and improving understanding of the electoral process; and, Building Democracy, ($2.5M) which aims to foster a greater understanding of, and enduring commitment to, the values of democratic governance, rule of law and civil society.

Germany

Germany is the third largest donor of bilateral and multilateral aid to Ukraine. Since the beginning of the 1990s, Germany has developed an intensive bilateral cooperation with Ukraine in order to support the strengthening of democracy, the rule of law and market economy reform. From 1993 to 2004, the Federal Government supported Ukraine with approx. 115 Mio € by its TRANSFORM programme. After TRANSFORM had expired in 2004 and following the change of government in 2005, this programme has been replaced by an intensified bilateral cooperation. Some of those measures are still in planning or being calibrated with the Ukrainian partners, but co-operation will certainly continue to encompass several measures and programmes in a broad range of activities:

Government and security: advice to governmental bodies, including continuation of the “German Advisory Group to the Ukrainian Government” and consulting for Ukrainian judicial bodies by the "International Foundation for Judicial Cooperation". Furthermore, measures for security and regional cooperation will be continued in 2005.

Economic and development cooperation: promotion of small and medium enterprises (in 2005 implementation of two programmes amounting to 14 Mio €; another bilateral agreement should be signed in 2005/06), environment, sustainable development and health, and financial cooperation.

Training and education: several training measures for representatives from the Ukrainian public and private sector, culture, education and science, promotion of independent mass media, political education for democracy and civil society, esp. through German political foundations.

Germany is furthermore supporting Ukraine as a significant contributor to EU-financed projects (German share: approx. 21%) and financial contributions to initiatives of the G8, e.g. the implementation of the Memorandum of Understanding on the Closure of Chernobyl Nuclear Power Plant.

Italy

Italian bilateral assistance to Ukraine began in 1992. For the period 2003-2004 the Italian Government provided TA for the amount of EUR 400,000. Within the Paris Club Agreement of 27 June 2002, the Ukrainian debt amounting to EUR 80 million was restructured. As of 31 December 2004, the total cumulative exposure of the Italian export credit agency, SACE, amounted to EUR 195 million. The Italian Government is furthermore supporting Ukraine with the establishment of a "Fund for Russian Federation and Ukraine" of EUR 70 million (March 2004). This is a revolving fund aimed at supporting the investments of Italian enterprises through equity participation by SIMEST. For the period 2005-2007, direct Italian Government support will focus on fostering internal stability, sound parliamentary institutions and an enhanced respect for human rights.

Japan

Japanese bilateral assistance to Ukraine began in 1992. Before the commencement of official development assistance (ODA) in 1997, this consisted mainly of: (1) nuclear safety (USD 64 million) and disaster relief assistance in response to the Chornobyl nuclear accident (c. USD 15.8 million of grants and domestic Japanese subsidies as well as dispatch of medical experts); (2) cooperation on the elimination of nuclear weapons (USD 19 million); and (3) loans and export credits totalling USD 200 million from the former Japan Ex-Im Bank. These were complemented by various forms of technical assistance. (Some of the above was implemented after 1997.)

As for ODA, the first yen loan, worth JPY 19.1 billion for the expansion of Kiev's Borispil Airport was pledged in October 2004. Cumulative grant aid consisting of general-type, cultural and grass-roots assistance, reached c. USD 10 million. Technical cooperation has been extended through training programmes held in Japan and Poland as well as by dispatching experts to Ukraine.

A bilateral technical and grant aid cooperation agreement was signed in June 2004 during the visit of Kostyantyn Hryshchenko, the then Ukrainian Foreign Minister to Japan.

Netherlands

The Netherlands provides support to Ukraine through the MATRA Programme. Within Matra there are 12 priority areas of which the most important in Ukraine are: *healthcare (27%), environment (15%), human rights/minorities (13%), publicity/media (11%)*. In total two-thirds of the budget is dedicated to these themes .
MATRA contributes particularly to projects for democratisation through strengthening 'civil society' (with a focus on NGOs) as well as local Administration. Two types of Matra programmes are applied in Ukraine:

- **MATRA - MPP** aims at institution building for Ukrainian organisations through "twinning" with Dutch organisations. NGO benefited strongly in Ukraine through MATRA, thereby strengthening the NGO landscape substantially.
- **Small Embassy Projects of MATRA** which are in 70% of the cases leading to bigger MPP-projects.

A total of more than EUR 16 million has been committed to Ukraine since 194, of which EUR 6 million was in the period 1994-2000 and EUR10 million subsequently, for a total of 48 projects.

Sweden

The overall strategic goal for Sweden's development cooperation is to contribute to poverty reduction in all its dimensions. Swedish support should be well integrated into the process of Ukraine's adjustment to European values and cooperation structures. During the period 2002 – 2004, in total EUR 22 million in technical assistance from Sweden has been allocated to six areas: common security, deepening democracy, economic change, social security, environment, and education and research. Sweden has provided EUR 5.2 million for the Lviv Water and Wastewater Project and EUR 1.7 million for the Energy Efficiency in Public Buildings Project.

Sida's proposal for strategy 2005 – 2008 in Ukraine was prepared during the political turbulence at the end of 2004 and finalized in January 2004. It is therefore consciously open-ended and puts its general thrust into supporting the structural reforms that the new government chooses to embark on. The proposed strategy is meant to make possible a mix of limited but quick responses to requests from the Ukrainian side, and participation in large, sectorwide, multidonor reform programs. Possible such areas are health and social sectors, where reform preparations have already started. Another area where experience from earlier Swedish engagement could well benefit future work is local self-governance and administrative reform.

Support to economic change should help develop market economy, investments in sustainable growth, and pro-poor growth. Continued engagement is therefore foreseen in agriculture and forestry, but also in anticorruption, business development, and support to Ukraine's accession to the WTO. The volume of Sweden's development cooperation with Ukraine is foreseen to double from around EUR 9 million to EUR 13- 17 million a year towards the end of the strategy period.

Switzerland

The Swiss Government's Economic Co-operation Programme (**seco**) has been active in Ukraine since 1994. The bulk of its assistance (a total amount of about CHF 40 millions) has been targeted at financing of the rehabilitation of basic infrastructure in priority sectors, namely health, energy, wastewater and nuclear safety. Technical assistance in the financial sector and private sector support were provided in a second priority. Credit guarantees for Swiss companies willing to export to Ukraine were also available.

For the future, **seco** will focus on strengthening the role of SME's; increased partnership with the private sector (with an emphasis on promoting transparent corporate governance); support for projects or programs which stimulate and support innovative approaches and have a high potential demonstration effect; co-operation and eventual co-financing options with multilateral or multi-national partners (where general policy issues or business conditions need to be addressed); projects that demonstrate substantial knowledge and experiences sharing and nuclear safety. During the priod 2005-2008 the Swiss Government will pay the remaining CHF1.5 million into the CSF.

Support for the development of SMEs will be provided by further capacity building in the banking and corporate sectors with a focus on the introduction of sound corporate governance practice, continued support to local financial institutions which finance SMEs and attract private sector resources including venture capital, active promotion of Ukraine's entry into the multilateral trading system, improving the efficiency and the effectiveness of the supply chain and at reducing the unit input costs for industry, more active role of the Swiss Organization for Facilitating Investments (SOFI), and possible support for the export of niche export markets for goods such as organic products.

United Kingdom

The UK's Department for International Development (DFID) plans to provide up to £6.5m per annum over the period 2005-2007 for development activities in the Ukraine. The focus will be on two key areas: 1) creating a strong and stable economy through the following projects: working in rural communities; working with Lviv, Donetsk and Luhansk Oblast authorities to create a better investment climate; supporting the development of the private sector and SMEs; and assisting the Ukrainian government in its plans for WTO accession; 2) creating an open and transparent society with an effective public administration at both regional and central level through the following projects: support for the World Bank Public Administration Reform programme; assisting the Oblast authorities in Lviv, Donetsk and Luhansk in their strategic and budget planning; and working with local communities in Lviv and Donetsk Oblasts. In addition DFID Ukraine will be supporting the World Bank’s Social Investment Fund and work in the HIV/AIDS field.

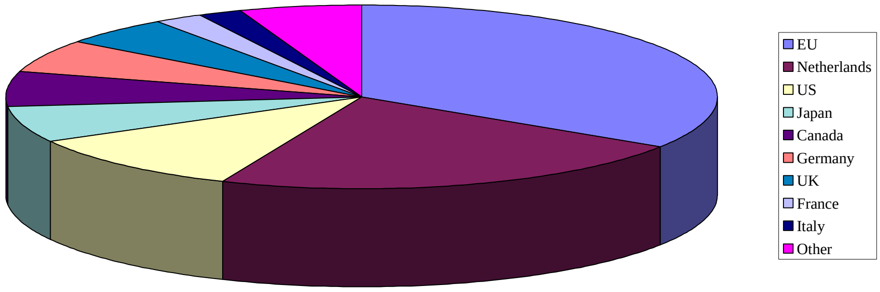
United States

Ukraine has been a primary recipient of US technical assistance, which since Ukraine's independence has totalled more than USD 3.3 billion. Total USA assistance planned for 2005 is about USD 111 million, of which approximately USD 79 million will be provided through the FREEDOM Support Act (FSA). US assistance to Ukraine is targeted to enhance regional security and nonproliferation goals, support market-based economic reform, strengthen democratic governance, rule of law and civil society and address urgent humanitarian needs.

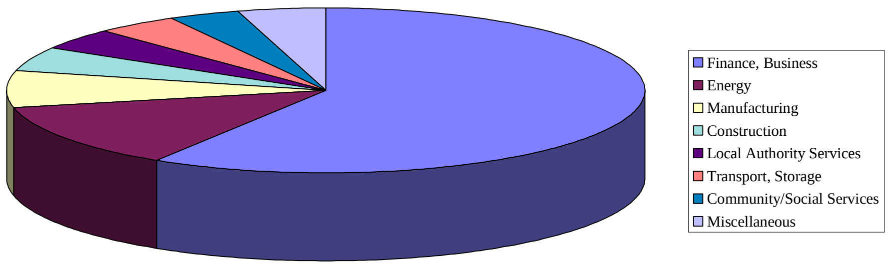
Programmes related to Economic Restructuring cover financial sector reform, budget reform, legal reform, finance for agriculture, the environment and SME development. Democracy and Governance programmes cover strengthening the electoral process, support for independent media, access to legal advice, development of civil society and NGOs and the development of municipal and local government. In the Health and Social Sector, programmes cover healthcare (HIV/AIDS, maternal and infant health services, and treatment of tuberculosis), pension reform, humanitarian aid and prevention of human trafficking.

ANNEX 8 TC PROJECTS LINKED TO BANK ACTIVITIES IN UKRAINE

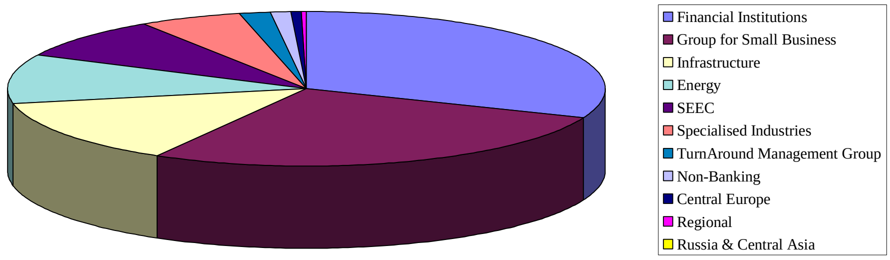
TC in Ukraine by Donor



TC in Ukraine by Industry Sector



TC in Ukraine by EBRD Team



TC in Ukraine – List of Commitments

Donor and Commitment Date	Commitment Name	Euro Committed	Euro Disbursed	Commit. Stage Name	Sector
AUS-1994-09-03	Kyiv (Borispol) Airport refurbishment - Cost Accounting and Management Information Systems	39,449	39,449	Closed	Transport, Storage
AUS-1995-01-01	Kyiv (Borispol) Airport refurbishment - Cost Accounting Phase II	57,769	57,769	Closed	Transport, Storage
AUS-2000-01-01	TurnAround Management Programme - Shvieya	42,264	42,264	Closed	Manufacturing
AUS-2001-08-04	TAM Programme - Kharkov Biscuit Factory	70,280	52,595	Disbursing	Manufacturing
AUS-2001-10-06	Ukraine Second Railway Project	48,811	48,811	Closed	Transport, Storage
AUS-2002-11-08	ToR for Geological Study for new double track Beskyd tunnel	10,000	10,000	Closed	Transport, Storage
BEL-1995-10-02	Transhipment centre study	28,826	28,826	Closed	Transport, Storage
BEL-1995-11-03	Crimea tourism and hotel study	45,550	45,550	Closed	Commerce, Tourism
BEL-1997-04-01	TurnAround Management Programme - Kispo	32,715	32,715	Closed	Manufacturing
CA3F-2004-02-01	Ukraine ANS: Assistance in Negotiations with Eurocontrol	11,958	11,958	Closed	Transport, Storage
CAN-1995-01-03	Power demand projection	170,543	170,543	Closed	Energy
CAN-1995-04-08	International audit for Akatsiya Textile Company	46,301	46,301	Closed	Manufacturing
CAN-1995-07-09	Trade facilitation programme	21,929	21,929	Closed	Finance, Business
CAN-1996-09-03	Municipal Utility Development and Investment Programme	282,665	282,665	Closed	Local Authority Services
CAN-1997-05-04F	Legal technical co-operation (framework contract)	36,906	36,906	Closed	Community/Social Services
CAN-2000-01-02F	Ukraine Post-privatisation Fund - pre- and post-investment advisory services	118,864	118,864	Closed	Finance, Business
CAN-2000-05-03	Ukraine Telecommunications Regulatory Development Project	158,050	158,050	Closed	Telecommunications
CAN-2000-10-08PS	Ukraine Microcredit Bank	738,484	738,484	Closed	Finance, Business
CAN-2001-01-01F	Ukraine SME II Technical Cooperation Project under CIDA	1,858,571	871,186	Disbursing	Finance, Business
CEI-1993-12-01	Kyiv to Western Border Highway feasibility study	784,844	784,844	Closed	Construction
CEI-1997-08-03	Air navigation system management information.	182,412	182,412	Closed	Transport, Storage
DEN-1996-04-02	Consulting services planning assignment	38,000	38,000	Closed	Energy
DEN-1998-04-03	TurnAround Management Programme - Yunost Kyiv Sewing	39,746	39,746	Closed	Manufacturing
DEN-1999-04-03	TurnAround Management Programme - MarKomProd JSC	68,780	68,780	Closed	Manufacturing
DEN-2001-05-05	Financial Advisory Assistance to the State Municipal Water and Wastewater Company, Vodokanal Zaporizhzhia	72,175	72,175	Closed	Local Authority Services
EC-1992-06-21	Privatisation Advisory Strategy - definition of strategy	930,000	930,000	Closed	Community/Social Services

EC-1992-06-22	Privatisation Advisory Programme - promotion of procedures	885,000	885,000	Closed	Community/Social Services
EC-1992-10-43	Fossil fuel power plant efficiency study	469,800	469,800	Closed	Energy
EC-1993-07-28	Edible oil processing project - feasibility study	123,209	123,209	Closed	Manufacturing
EC-1993-07-29	Project preparation unit	734,135	734,135	Closed	Agriculture, Forestry, Fishing
EC-1993-09-47	Fossil fuel power plant efficiency study (extension)	75,000	75,000	Closed	Energy
EC-1994-08-15	Kyiv (Borispol) airport refurbishment - airport regulatory framework	193,886	193,886	Closed	Transport, Storage
EC-1994-11-53	Air navigation systems upgrading project	250,000	250,000	Closed	Transport, Storage
EC-1994-12-66	Preparation of pilot power plant rehabilitation	190,354	190,354	Closed	Energy
EC-1994-12-67	Technical analysis of Ukrainian coal	149,990	149,990	Closed	Energy
ECT2000-2001-05-07	Rehabilitation of M06 Highway and Reform of Road Sector - Detailed Design, Tender Documents and Supervision of Works	1,496,009	1,496,009	Closed	Construction
ECT2000-2001-07-09	Ukraine Microlending Programme - Micro Credit Advisers	1,999,863	1,999,863	Closed	Finance, Business
ECT2000-2003-01-01	Ukraine Railways: Financial System Implementation	461,300	392,800	Disbursing	Transport, Storage
ECT2000-2003-01-02	Ukraine SME Credit Line II: Central Credit Advisor	400,000	321,982	Disbursing	Finance, Business
ECT2000-2003-08-02F	Ukraine Local Private Sector Framework	150,000	0	Committed	Non-classifiable Establishments
ECT96-97-01-36	Kyiv to western border highway improvement project	293,552	293,552	Closed	Construction
ECT96-97-05-53	SME line of credit - credit adviser to participating banks	189,074	189,074	Closed	Finance, Business
ECT96-97-05-54	Dnieproenergo twinning arrangement project	315,738	315,738	Closed	Energy
ECT97-97-05-13	SME line of credit - support Institution Building Programmes for Participating Banks (IBP) - Nadra Bank	421,131	421,131	Closed	Finance, Business
ECT97-97-05-14	SME line of credit - support Institution Building Programmes for Participating Banks (IBP) - Grant Bank	181,442	181,442	Closed	Finance, Business
ECT97-97-05-17	Zahidenergo twinning arrangement project	287,182	287,182	Closed	Energy
ECT97-97-06-20	Crimea independent power project	434,791	434,791	Closed	Energy
ECT97-97-08-27	Kyiv district heating rehabilitation	168,000	168,000	Closed	Energy
ECT97-97-09-28	Lviv district heating commercialisation study - evaluation of accounting and financial control systems	147,329	147,329	Closed	Energy
ECT97-97-10-31	Railways commercialisation project - preparation for project implementation	149,500	149,500	Closed	Transport, Storage
ECT97-97-10-32	Railways commercialisation project - development of five-year business plan	349,029	349,029	Closed	Transport, Storage
ECT97-97-10-33	Zaporozhzhia water utility development and investment project - institutional development assistance	488,024	488,024	Closed	Local Authority Services
ECT97-97-10-41	SME line of credit - support institution building programmes for participating banks - Energo Bank	277,848	277,848	Closed	Finance, Business

ECT97-98-08-65	Ukraine SME line of credit (I and II)	15,162	15,162	Closed	Finance, Business
ECT97-98-08-66	Ukraine SME line of credit (I and II)	41,445	41,445	Closed	Finance, Business
ECT98-98-08-23	Ukraine - SME line of credit - central credit adviser	351,667	351,667	Closed	Finance, Business
ECT99-2000-12-74	Zaporozhzhia Water Utility Development and Investment Programme - Phase II	479,808	479,808	Closed	Local Authority Services
ECT99-2001-02-80	SME Credit Line - Technical Co-operation	307,763	307,763	Closed	Finance, Business
ECT99-99-08-06	Ukraine railways - project implementation assistance	749,150	749,150	Closed	Manufacturing
EIPF-02-2003-08-05	Ukraine: Assistance in implementation of mortgage facilities with local banks	170,000	143,157	Disbursing	Finance, Business
EIPF01-2002-11-03	Preparation of Management contract in Kherson	128,963	128,963	Closed	Local Authority Services
EIPF01-2003-05-02	SME Credit Line II: International Commerce Bank - Design and Implementation of an Institution-Building Programme	399,671	385,891	Disbursing	Finance, Business
EIPF01-2003-08-03	Ukraine Microlending Programme 2003-2005 EUIPF2001 Extension	1,999,912	1,999,912	Closed	Finance, Business
EIPF01-2003-11-07	Ukraine SME II: Institutional Building Programme for KreditPromBank	399,740	50,000	Disbursing	Finance, Business
EIPF01-2004-08-03	UKRAINE: Kherson Municipal Utility Development Programme - IFRS Audit	47,100	0	Committed	CEALs,CoFinancing Lines & RVF's
EIPF01-2004-09-05	Ukraine Microlending Programme - Regional Expansion	2,250,000	202,769	Disbursing	Finance, Business
FIN-1999-02-01	TurnAround Management Programme - Dnipropetrovsk Furniture Plant	54,483	54,483	Closed	Manufacturing
FIN-1999-07-10	Turnaround Management Programme - Interfoam OOO	12,174	12,174	Closed	Manufacturing
FIN-1999-08-11	TurnAround Management Programme (TAM) - Sandora	10,589	10,589	Closed	Manufacturing
FIN-1999-11-14	TurnAround Management Programme (TAM) - Kherson pulp & paper combine JSC	83,368	83,368	Closed	Manufacturing
FIN-2000-07-03	Kyivenergo District Heating: Technical Due Diligence	46,597	46,597	Closed	Energy
FIN-2000-10-06F	TurnAround Management Programme (TAM) - TAM Team Country Coordinator (Ilkka Arvola)	76,100	30,451	Disbursing	Manufacturing
FIN-2001-07-06	Regional TAM Programme for 35 enterprises in CIS countries - Kharkov Biscuit Factory	15,220	9,207	Committed	Manufacturing
FIN-2004-02-02	Feasibility Study for a BAS Programme in Ukraine	25,000	17,903	Disbursing	Manufacturing
FRB-1993-07-08	Edible oilseed processing - identification and preparation	69,105	69,105	Closed	Manufacturing
FRB-1993-10-10	Kyiv vegetable market - restructuring project	31,150	31,150	Closed	Manufacturing
FRB-1995-04-04	Venture Capital Fund	36,413	36,413	Closed	Finance, Business
FRB-1996-04-01	Starobeshevo thermal power project - conceptual design and preparation of tender documents	291,874	291,874	Closed	Energy
FRB-1996-05-02	Financial restructuring of Bank Ukraina - twinning programme	431,005	431,005	Closed	Finance, Business

FRB-1997-03-02	SME line of credit - Aggio Bank	121,433	121,433	Closed	Finance, Business
FRB-1997-08-03	Shelter Implementation Plan - private participation strategy review	110,728	110,728	Closed	Energy
FRB-2000-06-02	Ukraine Telecommunications Regulatory Development Project	122,068	75,635	Disbursing	Telecommunications
FRB-2001-04-01	Ukraine Malt Sector Review	32,737	32,737	Closed	Manufacturing
GER-1993-08-07	Edible oilseed processing - identification and preparation	85,752	85,752	Closed	Manufacturing
GER-1994-09-09	Akatsiya textile company	37,232	37,232	Closed	Manufacturing
GER-1994-12-13	Power sector least cost development programme	233,001	233,001	Closed	Energy
GER-1995-04-03	Akatsiya market analysis	11,109	11,109	Closed	Manufacturing
GER-1999-04-01	TurnAround Management Programme - Shvieya	16,159	16,159	Closed	Manufacturing
GER-2001-09-01	Ukraine Microlending Programme (UMLP)	412,994	412,994	Closed	Finance, Business
GER2-2004-03-01	Project Preparation for Odessa High Voltage Grid Upgrade	70,000	7,000	Disbursing	Energy
GER2-2004-12-04	Project Preparation for Odessa HV Grid Upgrade - follow up assignment - prepararation of an Environment Impact Assessment	45,000	0	Committed	Energy
GERK-1996-01-01	Trade facilitation - credit training for four banks	167,448	167,448	Closed	Finance, Business
GERK-1996-07-07	Power plant component market survey	47,965	47,965	Closed	Energy
GERK-1998-05-03	Checkseal business plan	37,851	37,851	Closed	Manufacturing
GERK-1999-07-04	Turnaround Management Programme - Tiso JSC	12,843	12,843	Closed	Manufacturing
GERK-2000-11-09	Central Credit Advisor for Participating Banks - Ukraine SME Credit Line	190,003	190,003	Closed	Finance, Business
GERK-2001-02-01	Kharkiv Solid Waste Management - Landfill Engineering Support	262,107	262,107	Closed	Local Authority Services
GERK-2001-09-08	Ukraine Microlending Programme (UMLP)	1,587,006	1,587,006	Closed	Finance, Business
GERK-2002-01-01	Central Credit Adviser, Ukraine SME I / SME II Credit Lines	43,830	43,830	Closed	Finance, Business
GERK-2002-04-02	Central Credit Advisor, Ukraine SME II credit line	139,030	139,030	Closed	Finance, Business
GRE-1999-09-03	Turnaround Management Programme - Sandora	53,126	53,126	Closed	Manufacturing
GRE-2002-09-02F	Ukraine Local Private Sector Framework	100,000	32,734	Disbursing	Non-classifiable Establishments
HOL-1993-02-01	Ukraine natural gas transit project - technical preparation	175,096	175,096	Closed	Energy
HOL-1994-06-10	Odessa free ecomonic zones	158,874	158,874	Closed	Finance, Business
HOL-1995-03-02	Kyiv International Bank	298,126	298,126	Closed	Finance, Business
HOL-1995-06-07	Feasibility study for free economic zones	159,740	159,740	Closed	Community/Social Services
HOL-1996-03-04	Urban transport project preparation	136,469	136,469	Closed	Transport, Storage
HOL-1996-09-13	Municipal Utility Development and Investment Programme	249,988	249,988	Closed	Local Authority Services
HOL-1997-06-05	Stirol OAO restructuring - environmental audit	45,351	45,351	Closed	Manufacturing

HOL-1998-11-03	TurnAround Management Programme - Aerosweet	38,286	38,286	Closed	Manufacturing
HOL-1999-09-02	Turnaround Management Programme - Interfoam OOO	58,365	58,365	Closed	Manufacturing
HOL-2000-03-03F	Ukraine Post-privatisation Fund - Investment Advisory Services	426,350	426,350	Closed	Finance, Business
HOL-2000-05-06F	Ukraine PPF: Investment Advisory Services I - PricewaterhouseCoopers	234,926	234,926	Closed	Finance, Business
HOL-2000-05-07F	PPF - Euroventures Ukraine Fund PPF - Consultancy Services	728,643	551,737	Disbursing	Finance, Business
HOL-2001-11-10F	Eastern Ukraine PPF: Individual Contracts	131,134	131,134	Closed	Finance, Business
HOL-2003-01-01F	Euroventures Ukraine Fund PPF - Consultancy Services	305,866	67,333	Disbursing	Finance, Business
HOL-2004-01-01	Mid-Term Evaluation of Euroventure Ukraine PPF	20,955	20,955	Closed	Finance, Business
HOL-2004-06-06F	PPF - Euroventures Ukraine Fund PPF - Consultancy Services	215,074	0	Committed	Finance, Business
HOL-2004-11-08	Trade Finance Advisory Services to Ukraine banks	161,000	0	Committed	Finance, Business
HOL-95-11-13PS	Kyiv wholesale market feasibility study	185,421	185,421	Closed	Manufacturing
ICE-1998-04-01	Kyiv hotel service improvement training programme	63,469	63,469	Closed	Commerce, Tourism
IRL-1995-10-06	Telecommunications legislation and regulatory structure (a)	16,754	16,754	Closed	Telecommunications
IRL-1996-07-02	Trade facilitation programme and medium term facility	39,129	39,129	Closed	Finance, Business
IRL-2000-06-02	Ukraine Energy Service Company - Monitoring Assistance	23,550	23,550	Closed	Energy
ISR-1993-07-02	Edible oilseed processing project - identification and preparation	41,683	41,683	Closed	Manufacturing
ITA-1995-09-08	Kyiv wholesale market management technical assistance - short term expertise	49,584	49,584	Closed	Manufacturing
ITA-1999-03-02	Turnaround Management Programme - MarkKomProd JSC	15,197	15,197	Closed	Manufacturing
ITA-1999-03-03	Turnaround Management Programme - Dnipropetrovsk Furniture Plant	13,726	13,726	Closed	Manufacturing
ITA-1999-03-04	Turnaround Management Programme - Shvieya	12,901	12,901	Closed	Manufacturing
ITA-1999-06-11	Turnaround Management Programme - Odescabel JSC	72,202	72,202	Closed	Manufacturing
ITA-1999-07-10	Turnaround Management Programme - TISO JSC	15,220	15,220	Closed	Manufacturing
ITA-2001-06-07	TurnAround Management Programme (TAM) - Poltavakonditer	10,457	10,457	Closed	Manufacturing
ITA-2003-03-03	Ukraine Local Private Sector Framework Environmental Due Diligence	14,500	14,500	Closed	Non-classifiable Establishments
JAP-1992-05-17	Training programme for energy conservation / project finance	192,792	192,792	Closed	Energy
JAP-1992-12-31	Privatisation advisory programme - pilot privatisation transactions	914,973	914,973	Closed	Finance, Business
JAP-1993-02-05	Ukraine natural gas transit project - financial and institutional appraisal	170,000	170,000	Closed	Manufacturing

JAP-1994-10-37	Ukraine international airline - search for investor, audit and draft strategy	100,504	100,504	Closed	Finance, Business
JAP-1994-10-38	Procurement assistance for gas transmission	279,754	279,754	Closed	Energy
JAP-1995-10-29	Energy conservation financing scheme	483,096	483,096	Closed	Energy
JAP-1996-09-23	Municipal Utility Development and Investment Programme	193,510	193,510	Closed	Local Authority Services
JAP-1996-09-24	Municipal Utility Development and Investment Programme	120,309	120,309	Closed	Local Authority Services
JAP-1997-02-03	Mykolayiv alumina plant industrial strategy assessment and investment project identification	41,267	41,267	Closed	Manufacturing
JAP-1997-08-22	Municipal Utilities Development Programme	195,246	195,246	Closed	Local Authority Services
JAP-1997-10-32	TurnAround Management Programme - Motordetal Konotop	16,438	16,438	Closed	Manufacturing
JAP-1997-10-34	TurnAround Management Programme - Nord	49,643	49,643	Closed	Manufacturing
JAP-1997-11-39	TurnAround Management Programme - Aerosweet	9,886	9,886	Closed	Manufacturing
JAP-1998-01-04	TurnAround Management Programme - Kochevatski Kombinat	20,500	19,337	Disbursing	Manufacturing
JAP-1998-03-11	Centerenergo twinning project	315,726	315,726	Closed	Energy
JAP-1999-08-15	Investigation of schlamm and culm stocks	453,131	453,131	Closed	Energy
LUX-1994-10-02	SLAWEL (LUX-FWC)	28,318	28,318	Closed	Manufacturing
LUX-1995-05-01	SME line of credit (I) - Institution building	38,948	38,948	Closed	Finance, Business
LUX-2000-07-03	TurnAround Management Programme (TAM) - Tiso JSC	10,573	10,573	Closed	Manufacturing
NEUM-2004-12-01	Ukraine Microlending Programme - Regional Expansion ProCredit Bank	1,500,000	0	Committed	Finance, Business
NLPPF-2002-09-01	Ukraine Fund PPF - Fund Manager	3,425,000	2,712,277	Disbursing	Finance, Business
NLPPF-97-02-01	Ukraine Post-privatisation Fund - fund manager	3,902,510	3,902,510	Closed	Finance, Business
NORG-1994-02-01	Italy-Turkey-Ukraine-Russia (ITUR) - procurement advice	49,800	49,800	Closed	Telecommunications
NORG-1995-10-03	Telecommunications - legislation and regulatory structure (c)	24,133	24,133	Closed	Telecommunications
SPA-1992-12-01	Kyiv wholesale market - feasibility study	199,473	199,473	Closed	Manufacturing
SPA-1994-01-01	Edible oilseed processing project - feasibility study	95,645	95,645	Closed	Manufacturing
SPA-1996-09-01	Southern Ukraine (Odessa) Post-privatisation Fund - rapporteur	17,129	17,129	Closed	Finance, Business
SPA-2000-07-03	Ukraine Railways : Business Development for Spin-off Non-core Business Units	99,150	99,150	Closed	Transport, Storage
SWE-1995-11-05	Lviv district heat planning study	192,940	192,940	Closed	Energy
SWE-1996-05-02	Trade facilitation programme - medium-term facility	46,748	46,748	Closed	Finance, Business
SWE-1997-04-02	Lviv district heating feasibility study	184,635	184,635	Closed	Energy

SWI-1995-11-05	Power market development	10,908	10,908	Closed	Energy
SWI-2001-07-06	TurnAround Management Programme (TAM) - Poltavakonditer	68,412	68,412	Closed	Manufacturing
SWI-2001-10-09	Ukraine Post Privatisation Fund - Furshet - Industry Analysis	13,196	13,196	Closed	Finance, Business
SWI-2002-02-03	K2R4: Restatement of EA's 2001 financial accounts	55,000	55,000	Closed	Energy
SWI-2002-06-12	FAO Framework Agreement Review of Sunflower Oil Sector	28,060	28,060	Closed	Manufacturing
SWI-2003-06-02	Restatement of the Energoatom Financial Accounts for 2002 and Budget for 2003	55,000	55,000	Closed	Energy
SWI-2004-06-08	Restatement of the Energoatom Financial Account	55,000	55,000	Disbursing	Energy
TAI-1993-02-02	Workshop on relations among branches of democratic governments	29,399	29,399	Closed	Community/Social Services
TAI-1995-09-02	West Ukrainian Commercial Bank due diligence	50,139	50,139	Closed	Finance, Business
TAI-2001-08-04F	Gostomel Glass Factory - Strategic and Financial Audit	84,277	84,277	Closed	Manufacturing
TAI-2002-02-06	TurnAround Management Programme (TAM) - ZAT Zaporozhcrane	64,700	64,700	Closed	Manufacturing
TAI-2002-07-14	Strategic Review of Ukrainian Airline Industry	29,728	29,728	Closed	Transport, Storage
TAI-2004-01-01	Policy Options for the Ukrainian Sunflower Sector Round of discussions between Ukrainian sunflower growers and crushers	75,714	0	Committed	Manufacturing
TAI-2004-05-07	UMLP - PrivatBank Integrity Due Diligence	31,465	31,465	Closed	Finance, Business
TCS-1997-07-05	Obolon Brewery - environmental audit and analysis	18,091	18,091	Closed	Manufacturing
TCS-1998-04-03	Kyiv Hotel service improvement training programme	100,000	100,000	Closed	Commerce, Tourism
TCS-1998-05-04	Checkseal business plan	6,883	6,883	Closed	Manufacturing
TCS-1999-10-01	Ista Centre Commercial and Technical Assessment	9,096	9,096	Closed	Manufacturing
TCS-2000-09-03	Ista Legal Due Diligence	79,000	79,000	Closed	Manufacturing
TCS-2002-09-04	Ukraine SME-2 Line of Credit 2nd & 3rd Competition	72,739	72,739	Closed	Finance, Business
UK-1994-12-17PS	Power sector - financial analysis	126,769	126,769	Closed	Energy
UK-93-11-19PS	Chernobyl Unit Four - project preparation assistance	11,159	11,159	Closed	Energy
UKB-1994-05-02	Italy-Turkey-Ukraine-Russia (ITUR) international transmission system - legal advisory services	48,250	48,250	Closed	Telecommunications
UKB-1994-06-07	Ukrainian Bank for Development of Exports (UBEX)	45,154	45,154	Closed	Finance, Business
UKB-1995-03-04	Venture capital fund	11,643	11,643	Closed	Finance, Business
UKB-1995-04-05	Akatsiya partial environmental analysis and audit	14,533	14,533	Closed	Manufacturing
UKB-1995-05-09	Akatsiya external legal counsel	42,813	42,813	Closed	Manufacturing
UKB-1995-07-11	External legal counsel in connection with a trade finance programme	8,376	8,376	Closed	Finance, Business

UKB-1995-10-14	Telecommunications legislation and regulatory structure (b)	52,347	52,347	Closed	Telecommunications
UKB-1996-04-03	SME line of credit - project co-ordinator request - National Bank of Ukraine	193,934	193,934	Closed	Finance, Business
UKB-1996-06-05	Yuzhny oil terminal pre-feasibility study	105,905	105,905	Closed	Transport, Storage
UKB-1996-07-07	Equity investment in Bank Ukraina	77,107	77,107	Closed	Finance, Business
UKB-1996-07-08	Switch confectionery company - environmental due diligence	29,679	29,679	Closed	Manufacturing
UKB-1996-07-09	Svitoch confectionery company - external legal counsel - due diligence	84,248	84,248	Closed	Manufacturing
UKB-1996-08-10	Khmelnistky 2 / Rovno 4 project	366,247	366,247	Closed	Energy
UKB-1996-11-13	Restructuring of Svitoch in preparation for financing	149,183	149,183	Closed	Manufacturing
UKB-1997-03-09	Donbasenergo twinning arrangement programme	378,223	378,223	Closed	Energy
UKB-1997-05-11	Stirol OAO restructuring - energy efficiency study	46,987	46,987	Closed	Manufacturing
UKB-1997-06-13	TurnAround Management Programme - Kispo	8,054	8,054	Closed	Manufacturing
UKB-1997-07-14	Stirol OAO restructuring	170,226	170,226	Closed	Manufacturing
UKB-1997-08-16	Khmelnistky 2 / Rovno 4 completion project	369,271	369,271	Closed	Energy
UKB-1998-06-10	Ukrainian USC Business Plan	50,276	50,276	Closed	Construction
UKB-1998-11-25	TurnAround Management Programme - Korchevatski Kombinat	29,096	29,096	Closed	Manufacturing
UKB-1998-11-26	TurnAround Management Programme - Motordetal Konotop	30,017	30,017	Closed	Manufacturing
UKD-1999-04-05	K2R4 procurement and contracting due diligence support	89,252	89,252	Closed	Energy
UKD-1999-11-26	Ista Centre Business Plan	33,806	33,806	Closed	Manufacturing
UKD-2000-07-18	Ukraine Railways : Business Development for Spin-off Non-core Business Units	69,837	69,837	Closed	Transport, Storage
UKD-2000-08-22	Ukraine Fuel Purchase Loan Facility - Advisory Services	46,640	46,640	Closed	Energy
UKD-2000-10-24	Ista Centre Environmental Due Diligence	8,199	8,199	Closed	Manufacturing
UKD-2001-03-05	SME Business Project Competition	70,891	70,891	Closed	Finance, Business
UKD-2001-12-19	SME Business Project Competition	5,861	5,861	Closed	Finance, Business
UKD-2001-12-20	SME Business Project Competition	13,428	13,428	Closed	Finance, Business
UKD-2002-05-01	FAO Framework Agreement	7,771	7,771	Closed	Manufacturing
US06-2004-03-01PS	Ukraine Warehouse Receipt Programme - Implementation Assistance	690,239	235,753	Disbursing	Agriculture, Forestry, Fishing
USA-1998-06-03	Checkseal	4,532	4,532	Closed	Manufacturing
USA-1999-06-03	Ukraine Railways financial model documentation and training	55,928	55,928	Closed	Transport, Storage

USA-1999-12-05	Ista Centre Financial Modelling and Restatements	5,615	5,615	Closed	Manufacturing
USA-2000-06-05	Ecofridge	22,549	22,549	Closed	Manufacturing
USA-2002-03-01	Warehouse Receipt TC Framework	8,435	4,557	Committed	Agriculture, Forestry, Fishing
USA-2002-07-06	Warehouse Receipt TC Framework	14,771	0	Committed	Agriculture, Forestry, Fishing
USA-2002-11-08	Warehouse Receipt TC Framework	33,135	24,101	Disbursing	Agriculture, Forestry, Fishing
USA-2002-11-09	Warehouse Receipt TC Framework	32,401	21,554	Disbursing	Agriculture, Forestry, Fishing
USA-2002-12-10	Warehouse Receipt Credit Adviser	27,747	6,391	Disbursing	Agriculture, Forestry, Fishing
USAD-2000-06-01PS	Ukraine Micro Credit Advisors Programme	132,887	132,887	Closed	Finance, Business
USAD-2000-09-01PS	Ukraine Micro Credit Advisers Programme (continuation)	646,151	646,151	Closed	Finance, Business
USAD-2001-08-01PS	Ukraine Microlending Programme (' UMLP')	813,693	813,693	Closed	Finance, Business
USAD-2002-05-01PS	Ukraine Microlending Programme (' UMLP'), including MFB (C)	721,536	721,536	Closed	Finance, Business
USAD-2003-02-01PS	Ukraine Microlending Programme - Regional Expansion 2003-2005	564,544	564,544	Closed	Finance, Business
USAD-2003-04-01	Ukraine Microlending Programme (' UMLP')	19,658	19,658	Closed	Finance, Business
USAD-2004-09-01	Ukraine Microlending Programme - Regional Expansion ProCredit Bank	767,342	84,207	Disbursing	Finance, Business
USAD-96-10-02PS	SME line of credit - project management unit	70,879	70,879	Closed	Finance, Business
USAD-98-10-03PS	Micro credit advisors programme	900,445	900,445	Closed	Finance, Business
USAD-99-12-01PS	Ukraine SME II Micro Credit Advisors Programme	419,524	419,524	Closed	Finance, Business
USTD-1994-02-01	Italy-Turkey-Ukraine-Russia (ITUR) international transmission system - legal assistance	44,392	44,392	Closed	Telecommunications
USTD-1997-10-06	Khmelnistky 2 and Rovno 4 - safety analysis methodology review	127,828	127,828	Closed	Energy
	Country Total Euro Amount:	**57,025,983**	**48,680,622**		
	No of Commitments:	**239**			