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MEDIUM-TERM MANAGEMENT OF GREEN BUDGET: THE CASE OF UKRAINE

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Keywords: Ukraine, Eastern Europe, Caucasus and Central Asia (EECCA), budget systems, medium-term budgeting, medium-term expenditure frameworks, direct budget support, environmental management, environmental public expenditure management, environmental investment programmes, development cooperation.

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ABSTRACT

The purpose of this study is to examine the medium-term budget planning process in Ukraine and the extent to which this approach is used within the environmental sector. It aims to assist the Ukrainian government to integrate environmental programmes more effectively into overall programming, financial planning and budgeting practices which could result into more adequate and predictable allocations to the environment sector. The study also seeks to analyse the implications of the progressive shift in aid modalities towards sectoral and general budget support.

This report was prepared within the framework of the OECD Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe, Caucasus and Central Asia. The report also builds upon work that started within the OECD Task Team on Governance and Capacity Development for Natural Resource and Environmental Management, a joint Task Team of the OECD Development Assistance and Environmental Policy Committees. In addition, the report contributes to the debate on Green Growth, demonstrating the need for more adequate and well-costed environmental budgets, in the context of medium-term expenditure frameworks, as a means of promoting structural changes as part of the transition to green economy.

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RÉSUMÉ

Cette étude décrit le processus de planification budgétaire à moyen terme en Ukraine et examine dans quelle mesure cette approche est appliquée dans le secteur de l'environnement. L'objectif est d'aider le gouvernement ukrainien à intégrer plus efficacement les programmes environnementaux dans les pratiques générales de programmation, de planification financière et de budgétisation, de façon que les dotations au secteur de l'environnement soient plus adéquates et plus prévisibles. L'étude s'efforce aussi d'analyser les implications de l'évolution progressive des modalités de l'aide vers un soutien budgétaire sectoriel et général.

Ce rapport a été établi dans le cadre du groupe d'étude de l'OCDE chargé de la mise en œuvre du programme d'action environnementale pour l'Europe centrale et orientale, le Caucase et l'Asie centrale. Il s'appuie également sur les travaux engagés dans l'équipe de projet conjointe du Comité d'aide au développement et du Comité des politiques d'environnement de l'OCDE sur la gouvernance et le renforcement des capacités au service de la gestion des ressources naturelles et de l'environnement. En outre, le rapport contribue au débat sur la croissance verte, car il démontre la nécessité d'établir des budgets environnementaux plus appropriés, avec une évaluation correcte des coûts, et s'inscrivant dans des cadres de dépenses à moyen terme, aux fins de promouvoir des réformes structurelles pour la transition à l'économie verte.

Classification JEL : E61, H61, O13, O19, O52, P28, Q01, Q56, Q57

Mots clés : Ukraine, Europe orientale, Caucase et Asie centrale (EOCAC), systèmes budgétaires, budgétisation à moyen terme, cadres de dépenses à moyen terme, soutien budgétaire direct, gestion environnementale, gestion des dépenses publiques environnementales, programmes d'investissements environnementaux, coopération pour le développement.

FOREWORD

Structural reforms to overcome the current economic and financial crisis often foresee an increase of "green budgets", *i.e.* public funds dedicated to environmental programmes. Relatively large environmental investments are planned in several OECD countries: for instance, Canada will invest 1.3%, Australia 0.8%, the United States 0.7% and France 0.5% of the GDP. While non-OECD countries may invest less in environmental projects and not aim to shift to green growth in the short to medium-term perspective, they are nevertheless likely to boost spending on environmental programmes in the context of climate change.

Are governments well equipped to undertake robust investment planning and avoid wasting green budgets? The promotion of bold public finance reforms over the previous two decades, especially the adoption of medium-term expenditure frameworks (MTEFs), has enabled many of them to cope with such tasks. MTEFs are particularly relevant for environmental programmes because of their intrinsic medium to long-term nature.

Though much later than in OECD countries, the MTEF approach is gaining ground in Eastern Europe, Caucasus and Central Asia (EECCA). In most cases, environmental authorities of EECCA countries have not been at the forefront of MTEF adoption, and their capacity to use MTEF is at an early stage of development. The need to develop such capacity is becoming highly relevant in the aid-dependent countries of the region as donors are shifting from project-specific mechanisms for delivering aid to general budget support.

In this context, the current report gives an overview of the medium-term budget planning in Ukraine and the extent to which this approach is used within the environmental sector. The report identifies the strengths and weaknesses of the existing country system and proposes recommendations for its improvement. From a regional perspective, its development supports intergovernmental cooperation that aims at diffusing good international practices. The report also contributes to the debate on Green Growth, demonstrating the need for more adequate and well-costed environmental budgets, in the context of medium-term expenditure frameworks, as a means of promoting structural changes as part of the transition to green economy.

The report was prepared within the framework of the Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe, Caucasus and Central Asia (EAP Task Force), whose secretariat is located in the OECD's Environment Directorate. In addition, the report builds upon work started within the OECD Task Team on Governance and Capacity Development for Natural Resource and Environmental Management, a joint Task Team of the OECD Development Assistance and Environmental Policy Committees.

The report was drafted by Nelly Petkova with inputs from Rafal Stanek and Alexey Sudakov (SST-Consult, Poland) and was reviewed by Eugene Mazur, Angela Bularga, and Brendan Gillespie. Carla Bertuzzi helped with verifying statistical data. Shukhrat Ziyaviddinov provided administrative support to the project. Natalia Chumachenko translated the report into Russian and Irina Massovets edited the Russian version. A substantial role in project implementation was played by Mykola Pylypchuk from the Ministry of Environmental Protection of Ukraine. The preparation of this report was financially supported by the United Kingdom's Department for International Development. All these contributions are gratefully acknowledged.

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LIST OF ABBREVIATIONS

Bn	Billion
CoM	Council of Ministers of Ukraine
DFID	UK Department for International Development
EAP TF	Task Force for the Implementation of Environmental Action Programme for Central and Eastern Europe
EBRD	European Bank for Reconstruction and Development
ENPI	European Neighbourhood Policy Initiative
GDP	Gross Domestic Product
GEF	Global Environmental Facility
IMF	International Monetary Fund
MEP	Ministry of Environmental Protection of Ukraine
Mln	Million
MTEF	Medium-term expenditure management
n.d.	No data
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
O&M	Operating and maintenance (costs)
OSCE	Organisation for Security and Cooperation in Europe
STP	State Targeted Programme
UAH	Ukrainian gryvnia (local currency)
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
USA	United States of America
USD	US Dollar
VAT	Value-added tax

Exchange rates

In the conversion of financial data presented in this report, the following annual average exchange rates were/may be used:

Table 1. Exchange rates, Hryvnia/USD and Euro (yearly average)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Hryvnia/USD	5.44	5.37	5.33	5.33	5.32	5.12	5.05	5.05	5.27	7.79
Hryvnia/Euro	5.03	4.81	5.03	6.02	6.61	6.39	6.34	6.91	7.72	10.82

Source: EBRD, IMF, OECD.

EXECUTIVE SUMMARY

Between 2000 and 2008, Ukraine enjoyed a period of rapid growth when the GDP increased annually by an average of 7.5% placing it among the most vibrant economies in Europe. At the end of 2008, Ukraine was hit hard by the global financial crisis. Against the background of a significant economic downturn that required immediate mobilisation of massive public funds, the Ukrainian government pursued much needed reforms of public finance. Most importantly, this included further advancement of medium-term budgeting approaches that are crucial for proper management of both domestic resources and international aid.

In this context, the report reviews the pace and achievements in the adoption of medium-term budgetary planning and management in Ukraine and the extent to which the environmental sector is integrated into this process. The study also seeks to examine the implications for the environmental sector of the progressive shift in aid modalities towards sector support and general budget support. Overall, the study sought to help the Ministry of Environmental Protection of Ukraine (MEP) to improve programming, financial planning and budgeting practices, thus increasing its chances to obtain adequate financing for environmental protection activities.

It has to be noted that current problems with environmental finance are significant in Ukraine. Domestic support to the environment sector (in constant terms) has been decreasing over the past few years. Environmentally-related official development assistance has also been low. This situation was further aggravated by the financial crisis: at the end of 2008, the MEP budget was cut by more than 30% compared to the budget commitment at the beginning of that year. At the same time, the World Bank has calculated that Ukraine's investment needs in environmental protection over a period of ten years (2006-2015) may amount to some USD 1.5-3 billion annually (excluding investments in energy and water supply and sanitation projects), which may translate into almost 2% of the GDP.

Medium-term expenditure frameworks – a new instrument for effective budget management

In broad terms, a medium-term expenditure framework (MTEF) seeks to structure the budget around programmes that are defined in line with objectives and linked to specific outcomes, thus aiming to integrate policy, activity planning and annual budgets. MTEF introduction is traditionally associated with increased discretion over budget management. Besides the improved allocation of resources to strategic priorities between and within policy areas, the benefits of implementing an MTEF include:

- Improved macro-economic balance, which is achieved through the consolidation of all revenue sources within one consistent and realistic framework;
- Increased predictability of funding which can help line ministries plan ahead and ensure that programmes be sustained;
- Enhanced fiscal discipline by providing line ministries with a hard budget constraint;
- Increased accountability for results with the aim of improving incentives for the efficient and effective use of public funds.

Implementing an MTEF needs strong political commitment to put in place and sustain necessary reforms. The financial crisis can be an opportunity to launch such reforms.

Major findings: Environmental programmes benefit marginally from public finance reforms

A full-fledged, whole-of-government, medium-term expenditure framework does not exist in Ukraine. However, there are a number of elements which, in principle, belong to the MTEF approach that have already been put in place. These include, among others, programme-based budgeting and performance budgeting. The Ukrainian government has already made some attempts to prepare projections of major macro-economic and fiscal targets on a three-year basis, but until now these have not been consistently used to inform the annual budget. In addition, government revenue sources have been largely consolidated. Control and oversight over public expenditure has increased. Through the so-called “State Targeted Programmes” (STPs), the government has also made an attempt to better link policies and annual budgets.

More recently, the government took supplementary measures to strengthen the medium-term element of budget management. At the end of 2009, the Ministry of Finance required the line ministries to prepare, for the first time, 3-year programme expenditure estimates to be attached to the annual budget. With support from donors, the development of a pilot MTEF for the agricultural sector was launched. All these measures show that the MTEF use is maturing.

The Ministry of Environmental Protection has been fully integrated into all these processes. However, until now, the MEP has not particularly benefited from the reforms and has not succeeded in obtaining adequate financing for environmental programmes. While it should be recognised that the budget process and resource allocation decisions are in large part of political nature, with or without an MTEF, the relatively low capacity of the MEP to prepare, cost and implement economically-sound multi-year STPs may well have been one of the reasons for a low and decreasing budget support for the environment.

The challenges related to the environmental STPs are very much rooted in their cross-sectoral nature, and the large number of actors involved in the design and implementation of these programmes. The lack of coordination of, and clear responsibilities for, STP financing seriously undermines programme implementation. In addition, the duplication of programmes, their launching without sufficient financing, and the lack of proper control by the MEP of the spending at the local level all result in the wasteful use of public resources. In this context, the problem lies not in the spending levels but in the quality of funds spent, expressed through the limited results achieved with these resources.

Environmental STPs are rarely based on robust financial and economic analysis, thus their credibility is weak. These programmes lack clear and measurable environmental targets, performance indicators (particularly for the investment part) and are not consistent across the years of programme implementation. Often, they consider only the capital costs of investments and disregard operating and maintenance costs. This costing approach produces a misleading picture of public expenditure needs. Financial strategies, market studies or feasibility studies are rarely prepared. All these make it difficult for the Ministries of Economy and Finance to assess the soundness of proposed environmental programmes.

This situation is further aggravated by the lack of sufficient capacity of the MEP to appraise and select projects to be funded through the MEP budget. As a result, it is not evident if the most environmental and cost-effective projects are supported by the Ministry. The lack of capacity to effectively monitor and evaluate projects and subsequent programmes often results not only in a waste of public resources, but in further degradation of environmental conditions.

Because of numerous flaws, the environmental STPs have largely failed to serve the purpose of informing the annual budget of the long term budget implications. STPs are mostly used as a legal basis for justifying public expenditure.

The change in donors' approach to delivering aid and the shift from project financing to direct budget support also calls for improved medium-term financial planning. The EU sector budget support, earmarked for the environment, which is currently being negotiated, provides the MEP with an opportunity to gain experience with this instrument that can be useful in future competitions for donor resources allocated through the budget.

Recommendations: Seize new opportunities to achieve an adequate level of qualitative spending

The recommendations that have emerged from this study address medium term budgeting in general and its application in the environmental sector, in particular. For convenience and clarity, they are split into three groups according to the target audience: recommendations to the government, to the Ministry of Environmental Protection, and to donors. These recommendations could be used as a basis for policy dialogue that would involve various stakeholders concerned with public environmental financing in Ukraine.

- Recommendations to ***the government***:

  – Before adopting full-fledged medium-term budget planning, introduce a medium-term *framework* to forecast budget revenues and expenditures (a forecasting MTEF), based on state-of-the-art econometric models. Such a framework should clearly and transparently reflect the level of the government's financial commitments;

  – Develop and endorse a government-wide methodology for preparing medium-term programmes in line with international good practices;

  – Introduce clear rules and procedures for mid-term reviews of the programmes and possible ways for adjusting them;

  – Introduce clear lines of responsibility for all actors involved in the implementation of the programmes, including responsibility for funding;

  – Select a few initial programmes as pilots in selected ministries;

  – Gradually expand every year the "bottom-up" programming exercise by adding a few additional programmes, and correct the performance measurement and monitoring framework, based on experience;

  – Initiate a series of outreach events to explain to frontline staff, line ministries and, possibly, the legislature, the concepts of a programmatic MTEF. Use this opportunity to revisit the foundations of the programme and result-orientation approaches to budgeting currently in use in Ukraine.

- Recommendations to ***the Ministry of Environmental Protection***:

  – Improve programme design in line with good international practices. This should include, among others, translating a programme's objectives into realistic and measurable environmental targets and performance indicators, introducing rigorous and binding project eligibility, appraisal and selection criteria for financing of investment projects;

  – Make consistent use of financial analytical tools (sector financial strategies, market studies, expenditure reviews, project feasibility studies) when preparing a programme. Base the programme cost estimates on the findings of these tools;

– Introduce and maintain regular monitoring and evaluation of (particularly investment) projects implemented with support from the MEP (technical, financial, and environmental performance). Conduct and maintain regular evaluation reviews (every 2-3 years) of overall progress with programme's implementation;

– Ensure training and capacity development of MEP staff with regard to programme design and project cycle management (economic, financial, engineering skills);

– Develop and maintain a database of all donor programmes and projects. These should be made public and easy access to this information should be ensured (*e.g.* through the MEP web-site).

- Recommendations to ***donors***:

  – Provide precise and timely information on the amounts and timing of aid that goes to Ukraine. When this is environmentally-related aid, duly inform both the Ministry of Finance/Economy and the MEP. This is particularly important when the aid is not channelled through national level institutions;

  – Align priorities with national priorities as well as with country systems (*e.g.* reporting and evaluation processes, procurement rules) that are in use in Ukraine.

Improving the programming and project appraisal and selection can be achieved independently from an MTEF process as they are part and parcel of sound public expenditure management. Improving the expenditure management practices of the MEP in line with good international standards can only help the Ministry become more transparent, visible and credible for the government and the public at large. This is an opportunity that, if seized by the MEP, could translate into access to more adequate resources for environmental management.

The Ministries of Economy and Finance have a key role to play in setting the rules and procedures for preparing, monitoring and evaluating the STPs as well as for the use of budget funds. The government and the legislature need to create further demand for good practices in public expenditure management, including in the environmental sector, should the country choose to improve its public finance system and bring it closer to international standards.

CHAPTER 1. INTRODUCTION

1.1 Objectives of the study and audience

This study aims to assist the Ministry of Environment Protection in its efforts to improve the programming, financial planning and budgeting practices within the environmental sector thus increasing its chances to attract more adequate resources for environmental action. A key objective of the study was to analyse how the adoption of medium-term budgetary planning in Ukraine has impacted the environmental sector, including in light of changing donor aid modalities.

More specifically, the study responds to the following questions:

- Is there a unified "whole-of-government" approach that encompasses all sectors?
- Is a "top-down" hard budget constraint provided to line ministries? Does this budget constraint ensure macroeconomic sustainability by limiting overall levels of spending over the medium-term?
- Do strategic priorities drive budget preparation? Are they revisited during this process?
- Is the "bottom-up" costing of policies and programmes supported by expenditure reviews and other studies?
- Has a single political process been put in place to reconcile the bottom-up and top-down components of the resource allocation decisions?
- Does a strong and clear link between MTEF projections and the annual budget exist?
- Are accountability rules relying on monitoring and evaluation of results (i.e. outputs and outcomes) rather than on financial inputs?
- Has the government developed a set of clear and robust procedures, rules and criteria for identifying and selecting projects that will be financed from medium-term programmes?

This "checklist", developed on the basis of international benchmarks, provided an overall analytical framework that was further elaborated during the review, particularly as concerns the specifics of the environmental sector.

The report may be of interest to various audiences. First of all, it is addressed to managers and experts from the Ministry of Environmental Protection who need to be aware of the basics that underpin a modern budgetary system in order to be able to effectively communicate with the Ministry of Finance and Economy. At the same time, the report aims to inform staff from the Ministry of Finance and Ministry of Economy, as well as other government and parliamentary officials about challenges faced by the environmental sectors. Another target group are donors who, despite moving to direct budget support, would like to ensure that the environment sector is not marginalised in the process of budget allocation. On the whole, the report may be used as a basis for discussion and consensus-building within the government on future reforms in the public environmental expenditure management system in Ukraine.

1.2 Review methodology

The study was implemented in close co-operation with the MEP and involved three stages: preparatory activities, review and drafting mission, and preparation of the final report. A comprehensive set of background documents concerning, and relevant to, the medium-term financial and annual budgetary planning, including in the environmental sector, were examined by the review team. During the appraisal mission, the team met with stakeholders from various ministries all concerned with or directly involved in shaping the country's budgetary and environmental policy. Also interviews were held with representatives of international organisations and financing institutions active in Ukraine.

The analysis mostly covers the experience of the Ministry of Environmental Protection; other ministries and agencies with responsibilities for environmental management are not included in the study. Where available data and information on other relevant institutions easily existed, these have been included in the analysis as well.

The study analyses in principle the expenditure management practices related to medium-term financial and budgetary planning and execution. It only briefly touches on issues related to the fiscal framework of the budget. The reason for this choice is that the main audience of the report, the MEP, has little responsibility for fiscal planning and forming of the budget. Even the planning of pollution charges and fines, which are set by the MEP, is a main responsibility of the Ministry of Finance. While this is an important issue, it should be a subject of a separate analysis.

The cut-off date for most of the financial data used and analysed in the report is end of 2008; more recent data were used when available.

1.3 Report structure

The logic of the study is the following: the analysis moves from a more general MTEF theory to studying the extent to which medium-term budgeting exists in Ukraine. The analysis then continues with an evaluation of how medium-term budget planning is practically done in the environmental sector and what impact changing donor practices have on planning public environmental expenditure.

The structure of the report follows this logic. ***Chapter 2*** briefly introduces the main premises and types of MTEFs. It also provides the major benchmarks against which the medium-term budgetary practices in Ukraine are assessed. ***Chapter 3*** looks into issues related to recent reforms in the budget policies in Ukraine and analyses different approaches to budgeting employed by the government. ***Chapter 4*** discusses one of the main tools for medium-term financial planning, the State Targeted Programmes (STPs) and the link between the cost estimates produced by this tool and the annual budget. ***Chapter 5*** addresses the specifics of the financial planning of public environmental expenditure within the medium-term perspective and the experience of the Ministry of Environmental Protection in this regard. ***Chapter 6*** briefly discusses issues related to donor support in Ukraine and specifically aid provided to the environment sector. This is also done in the context of changing donor aid architecture and the gradual shift from project financing to more general budget support.

The report finishes with a summary of the major findings that emerge from the analysis and suggests a number of recommendations for improving medium-term budgetary practices at the government level in general and in the environmental sector in particular. It also offers some thoughts on how donors can help in this regard.

CHAPTER 2. GENERAL OVERVIEW OF MEDIUM-TERM BUDGETING

The need to address the three main objectives of public expenditure management – fiscal discipline, strategic resource allocation and operational efficiency – calls for a strong link between policy and budgeting and for a planning perspective beyond the immediate future. Although in almost all countries government budgets are approved on an annual basis, to be formulated well, they must take into account events outside the annual budget cycle, such as the macroeconomic realities, the expected revenues, the longer term costs of programmes, etc. This chapter briefly introduces the MTEF-based budgeting that was developed to make public spending more effective. It identifies a set of benchmarks against which budgetary practices in Ukraine are discussed and assessed in the subsequent chapters of this review.

2.1 Benefits of medium-term expenditure planning versus annual planning

Environmental programmes, often requiring at least a medium-term implementation horizon, remain chronically underfunded and do not achieve their objectives partly because of budget planning that is limited to an annual cycle. This approach has been criticised on numerous grounds, including the following:

- ***Short-sightedness*** **–** because only the next year's expenditure are reviewed;
- ***Overspending*** – because huge disbursements in future years are hidden;
- ***Conservatism*** – because incremental changes do not open up large future policy vistas;
- ***Parochialism*** – because programmes tend to be viewed in isolation rather than in comparison to their future costs in relation to expected revenue;
- ***Departmental orientation*** (rather than programme or output orientation) – because budgets are prepared by and for administrative units rather than on the basis of the government's objectives, programmes and activities.

The Medium Term Expenditure Framework (MTEF) approach, developed by the World Bank, has been promoted as a means of remedying some of these deficiencies as well as providing the missing link between government policy decisions and multi-year financial planning and budgeting. Generally, MTEFs are designed to help achieve:

- Better macro-economic balance, especially fiscal discipline;
- Better inter- and intra-sectoral resource allocation;
- Greater budgetary predictability for line ministries;
- More efficient use of public money and service delivery at least cost;
- Greater credibility of budgetary decision-making (political restraint in future promises);
- Greater accountability for outcomes through a more legitimate decision-making process.

2.2 Definition and main premises for a medium-term expenditure framework

At its heart, the MTEF approach seeks to link expenditure allocations to government policy priorities using a medium-term perspective (i.e. three to five year time horizon) to the budget planning process. Commonly viewed as a set of broad principles for sound budgeting, the MTEF-based budgeting is implemented in different ways in different institutional settings. This "institutional sensitivity" is crucial for a successful use of MTEFs.

Defined in more technical terms[1], an MTEF consists of

(i) a ***top-down allocation*** of the budget envelope;

(ii) a ***bottom-up estimation*** of the current and medium-term costs of existing and new policies, and

(iii) a process of ***matching costs with available resources*** in the context of the annual budget cycle.

In its most advanced form, an MTEF implies that the annual budget is structured around broad programmes which are defined in line with policy objectives and specific outcomes. Annual budgetary negotiations focus on new policies while costs of on-going programmes are updated only on technical grounds. The update is based on the multi-year estimates prepared the previous years. These and other core elements of an MTEF methodology are described in Box 1.

The credibility of this system lies in the government's capacity to estimate resources available for the public sector over several years, usually within a multi-year macroeconomic and fiscal policy framework. The development of sound macroeconomic and fiscal forecasts is crucial. Most governments identify, at a minimum, pessimistic and optimistic scenarios.

Being optimistic, which serves primarily a political purpose, is likely to lead to excessive spending relative to likely revenues, as well as higher deficits and debt. Good practices show that comparing government estimates to estimates prepared by economic researchers from private sector institutions or non-governmental organisations (and using consumer confidence surveys) usually provides a more realistic picture.

While the estimation and modelling process is mostly a technocratic exercise, there are a number of strategic and political decisions that depend on government choices which will shape the economy and thus the strength of the fiscal base of the country. Some of these include what structure of the economy will be supported by the government, the level of debt that will be incurred by the government or guaranteed by it and the overall taxation policy.

[1] World Bank (1998).

Box 1. Internationally-recognised benchmarks for an effective MTEF

- A **unified "whole-of-government" approach** that encompasses all sectors. In order to ensure a genuinely strategic resource allocation, the MTEF cannot be partial in coverage. Sectoral access to external funds may undermine this mechanism, principally because of the resource fragmentation and inefficiencies created by earmarked donor funding. Direct budget support is designed to help avoid such negative impacts.
- A **"top-down" hard budget constraint** consistent with macroeconomic sustainability that limits spending levels over the medium-term. This should involve credible, realistic resource projections that are based on explicit and carefully considered macroeconomic assumptions. Mechanisms should exist to relieve administrative or political pressures for overoptimistic forecasts. The budget constraint should ideally be backed by political commitment from the executive and legislative branches and set in coordination with the various levels of government involved in the conduct of fiscal policy.
- A "**top-down" set of strategic policy priorities** that, together with the hard budget constraint, drive and are reviewed during the strategic phase of budget preparation. Decisions made during this phase will guide the detailed preparation of budget and MTEF estimates.
- "**Bottom-up" forward estimates** of the costs of existing policies as well as new programmes and activities over the medium-term supported by expenditure reviews. To have credible and robust estimates, the institution coordinating the MTEF process provides adequate guidance to the line ministries on the preparation of programme/policy estimates (including, among others, various assumptions needed for calculating the programme estimates, such as GDP growth, inflation rate, demographic changes, discount rates to be used, etc.).
- A single **nationally owned political process at the centre of government** that reconciles the bottom-up and top-down components, forcing policy priorities to be established within the overall resource constraint through resource allocation decisions. This includes the reallocation of resources from one sector to another (on the basis of transparent rules) as well as the allocation of any additional money or "fiscal space[2]" that arises for new policy initiatives.
- A **strong and clear link between MTEF projections and the annual budget process**, so that multi-annual targets (duly updated for changes in the macroeconomic situation) set in the previous years form the basis upon which the budget is prepared. Ideally, there should be no distinction between the MTEF and the budget process: they should be one and the same thing.
- A **focus on results** (i.e. outputs and outcomes) rather than on financial inputs. This implies that sector managers are given a more predictable flow of resources coupled with more discretion over detailed budget management. This is done on the basis that they have an informational advantage as to how best to spend public money. At the same time, they are held accountable for delivery of results. In contrast with "line item" approach, structuring the budget around programmes introduces an element of allocations contestability from year to year whereby sectors are not "entitled" anymore to their previous year's allocation plus some small additional increment.
- The **development of clear and robust procedures, rules and criteria** for identifying and selecting projects that will be financed from the respective programme is essential to ensuring the cost-effectiveness of such programmes.

Source: OECD (2009), Introduction to Medium-Term Expenditure Frameworks: Briefing Note.

2 The term "fiscal space" is most commonly understood as the "room in a government's budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy". Such space is needed in order for governments to increase spending on national priority areas. An MTEF approach can help to clearly identify the available fiscal space thereby allowing policy priorities to be financed in a predictable manner. Fiscal space can be created by phasing out of existing expenditures or through growth in total available resources, either in the form of additional revenue or aid inflows. Aid is less likely to be a source of genuine fiscal space than revenue because it is inherently unpredictable. The concept of fiscal space is often accompanied by the argument that the additional spending should be focused on areas that boost growth, thereby increasing future fiscal revenues and hence wholly or partially paying for itself. Source: Heller, P. (2005).

2.3 Types of MTEFs

The MTEF cycle can either be rolling or periodical:

- ***Rolling frameworks*** are drawn up during budget preparation every year or every two years. Year 1 in the previous year's framework becomes the basis for the budget and a new year 3 is added (in case of 3-year frameworks). Thus, an MTEF cycle in a rolling framework will necessarily overlap with the previous and subsequent cycles by one or two years by design.

- By contrast, a ***periodical framework*** has cycles that run in sequence one after another. Specifically, a periodical MTEF is drawn up at the beginning of the period to which it applies and stays effective until that period has elapsed.

Both rolling and periodical frameworks may be revised in the middle of their lifetime. The time span of an MTEF may run for two, three, four, or five years, including the upcoming fiscal year. The most commonly used period is three years.

In general, there are four major types of medium-term budgeting[3], including:

1. Traditional fixed-term planning;

2. Forecasting the economic composition of expenditure[4];

3. Forecasting the functional composition of expenditure[5];

4. Programmatic MTEF.

The ***traditional planning approach*** typically identifies in advance all major programmes and their funding over a fixed period of time - usually 5 years. What comes to mind are the typical command five year plans of the former Soviet Union economy. Experience shows that many of these plans were both economically and technically very well designed and impressive, internally consistent and complete in every detail except for the institutional context as to who will implement them, how, when and with what resources and under what incentives. These plans were close in spirit to MTEF as they aimed to integrate the investment and operating and maintenance (O&M) costs. But the main problem was that the expenditure plans were not normally prepared under a revenue constraint. As such, they remained academic exercises only and would rarely get implemented as they were financially unrealistic and thus not credible.

Where they still exist, these top-down fixed plans could effectively be turned into a rolling continuous exercise. Still an important missing element in fixed-term planning is the distinction between on-going and new programmes which is the genuinely new element of the MTEF approach.

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3 Schiavo-Campo, S. (2008).

4 The economic composition of expenditure implies that government financial operations are structured according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments: and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.

5 The functional composition of expenditure implies that government activities and expenditures are structured according to their purpose, for instance: policing, defence, education, health, transportation, environmental protection. The United Nations standard functional classification, used in the preparation of national accounts and government Financial Statistics, distinguishes 14 major groups, 61 groups and 127 sub-groups.

Forecasting the economic composition of expenditure implies top-down rolling projections of aggregate expenditure for economic categories. ***Forecasting the functional composition of expenditure*** is similar to the previous one, in the sense that is it implies top-down rolling projections of aggregate expenditure for economic categories but for each ministry and spending agency (for more information on budget classification systems, see Annex B). In both cases the expenditure thus projected are constrained by revenue forecasts based on medium-term estimates of various taxes and other revenues sources.

The forecasting MTEFs do not distinguish on-going from new programmes in the budget and rarely define performance indicators to monitor and evaluate programme implementation. They are important for fiscal sustainability and expenditure control, but do not, in themselves, improve resource allocation and expenditure efficiency. The purpose of a forecasting MTEF is to give an indication to budget entities of future resource availability and to send signals to private sector actors of future policy changes (e.g. in taxation policy) and guide their business decisions.

The last type of medium-term planning is the ***programmatic medium-term expenditure framework***. Being the most advanced form of MTEF application, it implies that the MTEF is prepared and presented around programmes. This, however, does not preclude identifying expenditure by economic or functional categories but the starting point is the programmes that budgetary institutions should implement. The main characteristics of programmatic MTEFs are that they: (i) are revenue-constrained and prepared within top-down expenditure ceilings provided by the ministry of finance or the respective government office that takes care of the MTEF process; (ii) distinguish on-going and new programmes and more importantly define fiscal space for new programmes; and (iii) use performance indicators to monitor and evaluate programmes.

With its broad definition, MTEF is often used to refer to various approaches to linking policy, planning and budgeting. On the one hand, the term may be used to simply refer to a forecasting MTEF, while on the other hand it may refer to a programmatic MTEF. One important point to make is that MTEF is a ***framework*** and not a fixed multi-year budget. Whether of the forecasting or programmatic variety, an MTEF serves to provide the medium-term perspective that is necessary for preparing a good annual budget - and should be discussed with and endorsed by the legislature - but must not be confused with a medium-term ***budget***.

This flexible nature of the MTEFs implies that the only hard expenditure ceilings are those for the current year of the MTEF, which constitute the start of a sound budget preparation process. At the same time, the sector ceilings for the outyears should not merely be loose and casual indications either, to be readily ignored when the annual budget process comes around again. If so, the line ministries and agencies would gain no added predictability from an MTEF, and the programmatic aspect of the exercise would be futile. The challenge is to design procedures and mechanisms that allow line ministries and spending agencies to plan on the basis of a reasonable assumption of availability of financial resources, while preserving the government's flexibility to adjust to policy changes. This, in effect, gives greater confidence to ministries with strong expenditure programmes while weakening the negotiating position of ministries with a weak programmatic basis.

Experience shows that not all technical elements are in place at the start of an MTEF process, but making progress towards establishing them is a critical part of an MTEF development. While setting the medium-term fiscal targets and sector expenditure ceilings is usually a responsibility of the ministries of finance and/or economy, estimating the costs of future policies, sector strategies and programmes lies with line ministries. This is the ***entry point*** for the sectoral ministries in the MTEF process and depending on the quality of the financing strategies and programmes prepared by these ministries, the programme cost estimates could be effectively used as a basis for annual budget negotiations and further allocations, as done in a number of OECD countries.

2.4 Enabling conditions for successful MTEF implementation

Implementing properly an MTEF is not an easy process. It is a learning-by-doing exercise that takes time and needs the concerted efforts of the entire public administration sector.

The MTEF model that is the most widespread today is largely based on the approach designed by Australia, a leader among OECD countries in reforms to control expenditure growth. Australia is the first country to have introduced the foreword estimates approach to strengthen the link between government policy and expenditure programmes and improve the affordability of policies by combining projection methods with institutional arrangements to enforce the outcomes. As the Australian mechanism has worked well, many other OECD countries followed the suit and introduced the forward estimate approach to their annual budgeting in one form or other.

It is worth noting that the MTEF model can work well only when certain pre-conditions are in place. One of the problems with MTEF is that often it has been pushed on countries without much understanding or sense of ownership. Most importantly, the MTEF needs a high level political support for and commitment to the reforms and a champion in the government to guide and supervise the process. If there is no real demand for medium-term budgeting, the reform will remain on paper only and will be a waste of public resources.

Other important pre-conditions include:

- political discipline and accountability of a well-organised public service;
- interested and supportive legislature;
- the availability of a large pool of highly competent government economists, accountants, econometricians, sector specialists in both the ministry of finance and line ministries;
- capacity to enforce a hard budget constraint;
- availability of reliable data on a timely basis;
- a sufficient degree of flexibility given to line ministries and budget managers in both personnel and internal financial resource allocation;
- a diversified economy that provides a basis for predictable government revenue not dependent on external sources.

Also the success of the budget reform process depends on the budgetary basics such as budget structure, scope and classification, accounting, evaluation and auditing. Unless these basics are well established, introducing MTEF may not generate anticipated benefits due to a generally weak public expenditure management environment[6].

Finally, it is important to tailor and define the MTEF approach in a manner suitable to the capacities and constraints of the country. With the right and realistic sequencing of measures, MTEF can help significantly improve the control of allocative efficiency and use efficiency of government's financial resources.

6 Prof. Allen Schick (1998).

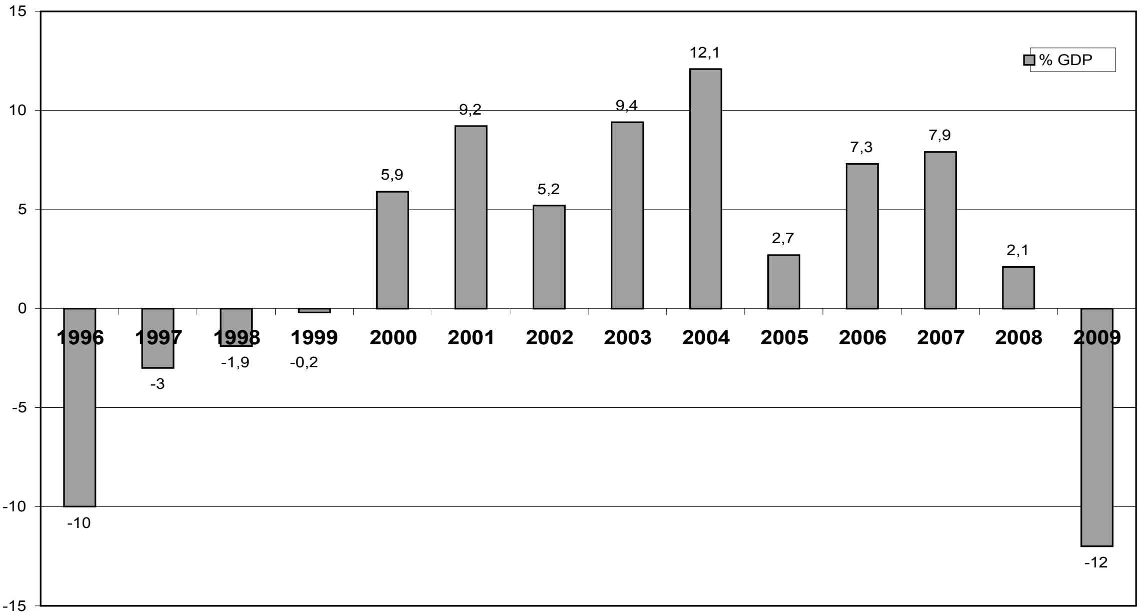
CHAPTER 3. BUDGET STRUCTURE AND APPROACHES TO BUDGETING IN UKRAINE

Despite political and economic challenges facing Ukraine over the years, consecutive Ukrainian governments have managed to implement a set of crucial reforms in the public finance sector that have brought significant improvements in the legal, regulatory and institutional framework for budget management. The 2008 financial and economic crisis revealed remaining structural weaknesses in the budget system and the need for its further strengthening, should the budget deliver the social benefits expected from it. This chapter looks into issues related to the past and most recent reforms of the national budget policies in Ukraine. In order to facilitate the understanding of the country's financial health, the evolution of macroeconomic indicators is discussed from the outset of the chapter.

3.1 Macroeconomic situation and the state of the budget in Ukraine

Since independence, the first positive economic growth was recorded in 2000 and this trend continued until 2008. The major macroeconomic indicators for Ukraine, just before the global financial and economic crisis, show a rather positive picture. According to the World Bank[7], Ukraine's economy ranked 44th in the world with a total nominal GDP of USD 180,355 mln in 2008. Apart from 2005 and 2008, when real GDP growth was respectively 2.7 and 2.1 percent, the average annual growth rate was about 7.5 percent for the period 2000-2008 (see Figure 2 below).

Figure 1. Real GDP growth rate in Ukraine, percent (1996-2009)



Source: World Bank data.

[7] The World Bank Development Indicators Database, July 2009.

The budget revenues, as a share of GDP between 2006 and 2008, were about 32% which is a par with the OECD countries while the budget expenditures in this period were slightly higher - about 32% on average, which translates into a budget deficit of about 1% on average (see Table 2). This is a low budget deficit and it points to a rather balanced budget which was one of the major macroeconomic objectives of the government.

Table 2. Government revenue and expenditure, 2006-2008, billion UAH

	2006	2007	2008
Revenues	171.8	219.9	297.9
Expenditures	175.5	227.6	312.0
Surplus /deficit	-3.7	-7.7	-14.1
GDP	544.1	720.7	949.9
Budget revenues as % of GDP	31.6%	30.5%	31.4%
Budget expenditures as % of GDP	32.3%	31.6%	32.8%
Budget surplus /deficit as % of GDP	-0.7%	-1.1%	-1.5%

Source: 2008 Statistical Yearbook.

At the same time, the public government debt grew steadily between 2005 and 2009 (see Table 3). It is necessary to note the significant increase in government guarantees (more than two-fold) in 2008 for externally-contracted government debt. This sharp increase is related to the financial crisis and reflects the decreased level of confidence in the ability of the Ukrainian economy to repay the debt.

Table 3. Public debt, 2005-2009, billion USD

	2005	2006	2007	2008	2009
Government debt	12.50	13.09	14.12	16.97	19.43
Internal	3.80	3.29	3.53	5.80	6.89
External	8.70	9.80	10.59	11.17	12.54
Guarantees	2.97	2.86	3.46	7.63	9.26
Internal	-	-	0.20	0.26	1.31
External	2.97	2.86	3.26	7.37	7.95
Total	15.47	15.95	17.58	24.60	28.69

Source: Ministry of Finance, as of 30 June 2009.

Note: The “-“ means that the amount is negligible.

Since 2004, the Ukrainian government has followed a pro-cyclical fiscal policy[8], which was partially attributed to short election cycles in the country. Generous social spending allowed for raising living standards. As a result of this positive economic growth, the country joined the group of high-spending economies of Western and Central Europe, disregarding its much lower level of income per capita, when compared to those countries. Loose fiscal policy is partially responsible for the economic difficulties the country is currently facing as the population's growing purchasing power amid limited domestic supply of consumer goods was increasingly satisfied via imports.

When the financial and economic crisis hit Ukraine at the end of 2008, the banking system was lacking liquidity and the public finance system did not have sufficient reserves to honour its domestic and external debt commitments. The government had to negotiate support from the IMF.

8 A pro-cyclical fiscal policy implies that spending goes up (taxes go down) in booms and spending goes down (taxes go up) in recessions.

The IMF loan granted under the stand-by agreement with Ukraine was conditional on the implementation of a comprehensive economic programme aimed at ensuring fiscal consolidation, structural reform and support for the financial system. Confidence in Ukraine could be further boosted, if the IMF's Board approves (which is expected in May 2010) the last tranche of the USD 16.4 bn loan granted to Ukraine in 2009. The first tranche of USD 4.5 bn helped to stabilise Ukraine's troubled banking sector, but the disbursement of further instalments had been frozen as a result of political bickering and concerns over fiscal prudence.

The World Bank forecast that the economy of Ukraine will slowly recover beginning with a 1 percent real GDP increase in 2010. As one of the world‘s leading steel, grain and chemical exporters, Ukraine's fortunes are heavily dependent on international commodity demand. In addition, the deficit of the state budget for 2010 is expected to significantly increase to more than 4-5% (from about 1% in the pre-crisis period), as stated by the Ministry of Finance. All these need to be carefully accounted for in preparing the new 2010 budget. In early 2010, however, the 2010 state budget was still not approved by the parliament which points to significant fiscal and budgetary challenges facing the newly-elected Ukrainian government.

3.2 Recent reforms in the public finance system

The public finance reforms which started in the early 2000 encompass a broad range of changes both on the revenue and the expenditure side of the budget. The reforms range from consolidating revenue sources, including extra-budgetary funds, to establishing a new modern Budget Code to creating new institutions for managing different aspects of the budget.

On the revenue side, the Ukrainian government took a number of measures to strengthen the generation and collection of public revenue. The barter and other non-monetary transactions (including environmental pollution charge offsets) and tax privileges for different sectors were largely eliminated after 2005 and since then all revenue has been collected exclusively in cash. Also marked improvement was achieved in fighting value-added tax (VAT) frauds and reduction of VAT arrears. In addition, the uncontrolled financing of the government deficit by the Central Bank of Ukraine has been abolished. In the environment sector, for example, the State Tax Inspection was made responsible for collecting the revenue from environmental pollution charges (until then collected by environmental inspectors) which resulted in a significant increase in the revenue generated from these charges[9].

These reforms were preceded by consolidating most extra-budgetary funds that had riddled the Ukrainian finance system for years into the regular budget. In 1999, a Presidential decree transformed the extra-budgetary accounts which belonged to different government ministries and agencies into budgetary "special funds" and included them into the regular budget. Since then, the special funds have undergone the same public and parliamentary scrutiny as the rest of the budget which has significantly improved the transparency of budget expenditure control.

The new Budget Code, first approved in 2001 and since then revised several times, introduced a number of modern concepts and approaches to budgeting. The most important ones are related to the introduction of programme and result-oriented or performance-based budgeting. These approaches require that all budgetary entities should present their expenditure in a programme format.

Programme budgeting and a new programme budget classification for the central government was introduced in 2002, and in 2003 the system was tested at a local level in selected local governments. In addition, the government legislated State Targeted Programmes (STPs) as a step towards introducing multi-year financial planning of public expenditure and linking them to annual budgets.

9 For more information, see OECD (2006b).

The Ukrainian government has made attempts to prepare medium-term macro-economic and subsequent fiscal projections. In this context, in 2004, the government issued a key document "The Adoption of Budgetary Indicator Forecasts for the Years 2006-2008 and in the Long-Term Perspective". In subsequent years, forecasts for the years 2007-2009, 2009-2010 and 2010-2012 were developed. In retrospect, those projections were not realistic. The 2008 economic and financial crisis in Ukraine led to a thorough revision of the figures for GDP growth, budget revenues and expenditures, and inflation.

At the same time, on the institutional side, in 2004, a Treasury Single Account was opened to collect and channel all state revenue and expenditure through it and a State Treasury was created to control all budget revenue generation. A year later, in 2005, the Supreme Chamber of Audit was created with the main purpose of strengthening the control of the expenditure of budgetary entities. Thus, the new Budget Code and the institutional arrangements for its implementation have laid the foundations of a more progressive and transparent system for managing the public finances.

3.3 Structure and classification of the annual budget

The annual general government budget of Ukraine consists of two main parts: the consolidated budget and a social insurance fund (see Figure 3). The consolidated budget is further divided between the state budget (or the central budget) and the local budgets. Both the state and the local budgets are additionally subdivided between a "general fund" and a "special fund". The general fund is basically allocated for covering the costs of administration and management of the respective ministry or agency while the special fund is predominantly used for financing investments.

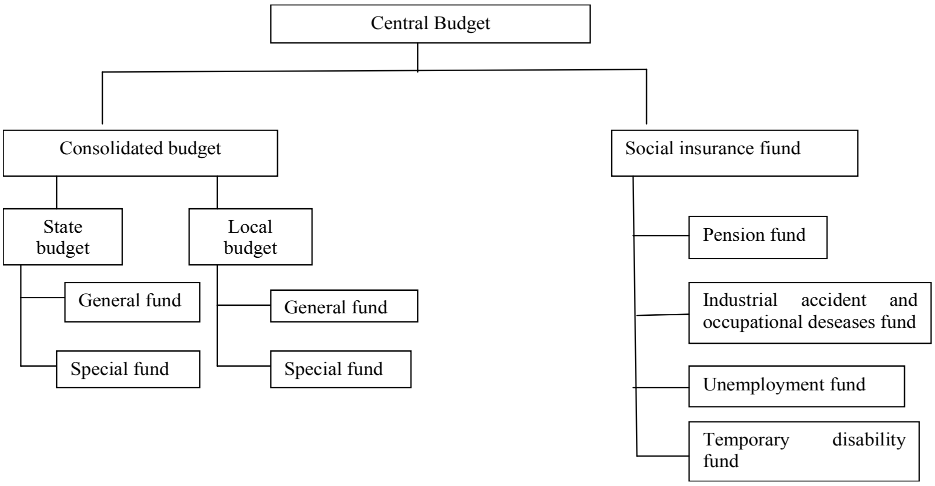
In addition, the Social Insurance Fund consists of four extra-budgetary funds, namely:

- the Pension Fund (which is the biggest one),
- the Industrial Accident and Occupational Diseases Fund,
- the Unemployment Fund and
- the Temporary Disability Fund.

The creation of the special fund was an important step in budget consolidation. The main rationale behind this reform was to pull together a variety of extra-budgetary sources and subject them to the same rules of control that budgetary sources undergo. Before the introduction of the special fund, sector ministries were frequently against the integration of extra-budgetary funds, arguing that without those dedicated funds they would be unable to fulfil their investment programmes.

As a consequence, the establishment of the special fund stipulated that the expenditures within this fund are to be financed by specially earmarked revenue sources. In the case of the Ministry of Environmental Protection (MEP) in Ukraine, the special fund includes the revenue generated from pollution charges and fines. In addition, it is the special fund that finances investment expenditure in the sector. Overall, this consolidation brought more transparency to the budget (for example, the Special Fund has been fully integrated into the Single Treasury Account of the Treasury of Ukraine).

Figure 2. Structure of the consolidated budget of Ukraine



Traditionally, the allocation of budget expenditure in Ukraine is done on the basis of economic and functional classifications. More recently, programme classification of expenditure was added to the budget. Budget programme classification is a major issue and often poses challenges to successfully integrating it with existing economic and functional classifications. In this context, Ukraine has dealt with this challenge rather well.

An example from the environmental sector can help shed some light on how this is implemented. Each budget programme is assigned its own code that identifies it. For example, the code of the MEP budget programme on *the Establishment of a National Environmental Network* is 2401260. A budget programme code consists of several parts. The first part (the first three digits of the code) indicates the main institution managing the funds (240 - MEP), while the second part (the fourth digit) indicates the unit within the organisational structure of the main manager responsible for the budget programme implementation. Where the implementing institution is a department of the Ministry itself, the fourth digit is "1". The third part of the code (the fifth and sixth digits) indicates the type of budget programme implemented by the manager. Where the programme is related to the funding of administration, this is signified by "01"; other programmes are denoted by "02" and so on. The fourth part of the code (the seventh digit) indicates the economic purpose of the budget programme. Currently, this is "0" as the process has not been finalised yet. Thus, the coding system has been designed with the idea of communicating, in a simple but coherent way, maximum basic information on each programme by also integrating the information conveyed by the economic and functional classifications of the expenditure.

3.4 New approaches to budgeting

Soon after the adoption of the new Budget Code in 2001, Ukraine introduced two new approaches to the traditional way of budgeting, namely: the programme-based and, the linked to it, performance-based budgeting.

Programme budgeting is the practice of grouping different kinds of budgetary expenditure into separate programmes so that every type of expenditure can be linked directly to one or another programme. Programme-based budgeting implies that expenditures are presented in the form of programmes in the annual budget. Unlike traditional practices of formulating budgets that usually focus on inputs of the public sector production function and frequently pay little attention to the nature of the outputs that are produced, programme-based budgeting reverses the process focusing first on outputs and outcomes and only then asking what is the adequate level of resources needed to produce these outputs. In this sense, programme-budgeting is concerned with achieving results and suggests the use of performance indicators to measure the attainment of the programme's objectives. In this context, programme and performance-based budgeting are closely linked in spirit.

Programme budgeting in Ukraine was operationalised through the 2002 Framework for the Implementation of the Performance and Result-Oriented Method in the Budgeting Process. The main rationale for introducing performance-based budgeting was to ensure a direct relationship between the allocation of budgetary funds and the results achieved with these funds. In addition, this approach was meant to make budget documents and, hence, the budgetary process more policy-oriented by presenting information on intended and achieved policy objectives, policy measures or instruments.

The Framework also introduced the requirement for budget entities to prepare passports of budgetary programmes. The budget programmes passports were further operationalised through the Regulation on Budget Programme Passports, adopted in December 2002. This regulation sets out the rules and procedures for preparing and submitting such passports to the legislature for approval. The regulation, which has undergone constant modifications and amendments, most recently in August 2008, also provides the budget programme passport template, the quarterly (annual) report template and the template for the plan of activities related to the implementation of the budget programme.

The passport is the programme profile that contains information on the programme, including objectives, performance indicators (in terms of quantity, quality, and costs of products and services (outputs) produced by the government unit or government services in order to achieve the objectives), legal grounds for its implementation, implementing institutions and other programme parameters according to which a financial and performance audit of the programme will have to be conducted, as stipulated in the Budget Code. The preparation of these passports is obligatory, as the Treasury does not authorise payments for any spending unit that has not prepared its programme passport within one month of the enactment of the budget. The budget passport provides information on the programme for the current budget as well as indicative costs of the programme for the next year budget. Programme passports have to be updated annually.

In terms of monitoring and evaluation of annual programme implementation, the Budget Code sets the general procedures for financial control, audit and assessment of the effectiveness of the use of budget resources. The State Treasury sets the specific reporting rules for budgetary entities. In case of violations of the Budget Code and commensurate with the degree of the violation (e.g. unauthorised use of budget funds, spending such funds for purposes other than those provided for under budget appropriations), these can result in civil, disciplinary, administrative or criminal penalties of relevant officials in consistency with the procedures established by the laws of Ukraine.

The Budget Code also requires that these programmes should be subject to both internal and external control. External audits of the effectiveness of budget programmes implementation and the use of programme budget funds are conducted by the Supreme Chamber of Audit. Reports from these audits are submitted to the Parliament together with the other relevant documentation (statistical and accounting documents) for information.

3.5 Analysis of the budgeting practices

Despite numerous political and economic challenges over the years, Ukraine has managed to introduce significant reforms in its public finance system. The 2001 Budget Code largely managed to consolidate the public finances, introduced a number of modern concepts and approaches, such as programme-based and performance-based budgeting and created the necessary institutions to manage and control the fiscal and expenditure side of the budget.

While medium-term budgeting is only rudimentary and largely remains at the stage of expert discussions, academic papers and political declarations, some basic elements of this approach have already been introduced. The government has made attempts to produce three-year macroeconomic forecasts which in principle may be used as input to the fiscal three-year projections. In general, these medium-term forecasts are for illustrative purposes only and are not integrated into the annual budget process. Often, between the first and the third reading of the draft law on the budget, it is a usual practice that the parliament would change significantly the fiscal indicators. Therefore, the quality of these projections is rather questionable, as also evidenced by the figures produced just before the 2008 crisis. When the crisis hit, even making such projections was (temporarily) suspended. Such macroeconomic forecasts do not allow the preparation of credible fiscal projections and the imposition of a top-down hard budget constraint that can guide overall levels of spending over the medium-term. Although there are budget expenditure limits (imposed both on capital and recurrent expenditure levels), these are provided for one year only; indicative multi-year sector ceilings do not exist.

Programme and performance-based budgeting can be seen as elements of medium-term expenditure frameworks but they can also exist without a medium-term perspective to the budget, even if this is only an imperfect solution, as is the case of Ukraine. One important issue that affects the quality of programme budgeting is the division of the budget between a general and special fund. This division is a *de facto* split of the recurrent and capital expenditure in the budget. While consolidating the extra-budgetary funds in a "special" budgetary fund is a commendable measure, keeping the two budgets separate is not in line with good international practices. Estimating the costs of investment programmes separately from their O&M costs provides a misleading picture of the future public funds needed for the adequate maintenance of the capital assets. This budget structure also goes against the rationale of the programme-based approach of grouping all relevant costs together. With further improvements in the budgeting process, there will be less need for such a split and the government may wish to consider the possible integration of the two sides of the budget.

Performance-based budgeting (and the related budget programme passports) is another important measure that lays the basis for introducing proper medium-term budgeting practices in Ukraine. In a certain way, by providing information on the costs of the respective budget programme over a period of two years, budget passports introduced a rudimentary two-year budget planning horizon. The problem is that the cost estimates and performance indicators even for one year ahead of the current budget are poor and unreliable and do not serve as a reference for the next year's budget. As will be discussed further, both cost estimates and performance indicators drastically change from one year to another which lends little credibility to this exercise.

This is also evidenced by the analysis of the draft 2010 state budget, prepared by Ukrainian Institute for Budgetary and Socio-Economic Research[10]. This review notes that while ministries and government agencies do prepare programme budgets, including performance indicators, there is practically no political demand for such information either by the government or by the parliament. This leads to a situation where the budget debate focuses on fiscal indicators only while the effectiveness of the budget expenditures of the previous years and the need for their continuation are never examined when adopting the annual budget. There is no distinction between new and on-going programmes in the budget discussions, either. As a result, the budget programmes have become a mere formality and the budget discussions in the parliament tend to be more over budget shares than over competing policies and priorities.

The relevant question then becomes if there is real demand for this work, by the parliament, by politicians, by regular ministries' staff, by society as a whole. While at first sight, it may seem like these are mostly cosmetic changes, maybe also implemented under pressure from donors and IFIs as a pre-condition for accessing external funds, it should be recognised that implementing programme and performance-based budgeting is a notoriously difficult exercise. It takes time for the government machinery to internalise these changes and to learn how to do the work well and efficiently. And then, the uncertain political environment and the frequent changes of governments have additionally undermined the process and have discouraged adequate follow-up on reforms.

10 Institute for Budgetary and Socio-Economic Research (2010).

This frustrating experience, however, need not necessarily impede progress. All the more so that a number of civil society organisations and circles within the government are aware of the need for changes in the budgeting process and they require adequate actions from the government and more than just superficial changes in the laws. The Supreme Chamber of Audit is particularly open about the abuses and inconsistencies encountered in the regular budget preparation and execution process. They regularly publish reports and inform the Parliament about irregularities. It seems, however, that it is at this particular stage that the process is brought to a halt. It also seems that within the government, there is greater recognition of needed budgetary reforms among senior officials than with the political leadership.

The public finance system in Ukraine has been reformed gradually through incremental changes. These improvements have been often imposed, as will be discussed in the next chapters, on budgetary institutions which have not had sufficient capacity to absorb such changes and internalise them in their routine work practices. These new methods require a change in the mindset of bureaucrats. This approach has led to a kind of paradox where a modern budgeting structure has been built on a foundation that is still largely rooted in past working models. In this context, while the current financial and economic crisis is a serious challenge for Ukraine it can also be used as an opportunity by the government to further reform the public finance system and strengthen its public institutions.

Altogether, Ukraine has declared its willingness to further reform its budgetary system in line with good international practices. The Budget Code is undergoing revision to facilitate a move towards medium-term budget planning. Most recently, the Ministry of Finance has issued a letter to all spending ministries to prepare and submit expenditure estimates for the next 3 years. An important next step will be to ensure that these estimates are well costed and actually used as input in the annual budget preparation process for the respective year.

Though Ukraine does not yet formally have a proper, whole-of-government, MTEF, some key components do already exist or are being put in place. The programme structure of the annual budget that has already been instituted lays an important basis for future improvements[11]. All this should provide a conductive environment for future MTEF elaboration.

[11] A simple template for introducing a programmatic MTEF is provided in Annex D.

CHAPTER 4. USE OF STATE TARGETED PROGRAMMES

As discussed earlier, multi-year budget planning in Ukraine has remained rudimentary for many years and has mostly had a declarative character. And yet, there have been attempts to link policy, medium-term financial plans and annual budgets. The State Targeted Programmes (STPs) were thought to provide this link even if not explicitly regulated in the existing legislation. This chapter looks at the major challenges with the design and implementation of STPs. It also seeks to clarify why STPs have largely failed to provide the expected link between policies and budgets.

4.1 Legal basis for the use of STPs

The STPs are not the only tool for multi-year planning in Ukraine. There is a whole lot of other planning documents prepared by the Government which include among others: national or regional economic and social development strategies, medium-term socio-economic development forecasts, sectoral strategies. Unlike other strategic documents, STPs provide more detail in terms of individual programme measures and cost estimates.

The legal basis for the STPs is provided by the 2001 Budget Code and the Act on State Targeted Programmes adopted by the Parliament in 2004. STPs existed before 2001 but the process of their preparation and adoption was rather messy. In order to strengthen the control over STPs, the 2004 Act introduced a number of changes in the procedures of the preparation, submission, approval and implementation of national targeted programmes.

The 2004 Act was operationalised through the Regulation on the Procedure for the Development and Implementation of State Targeted Programmes. Subsequently, in 2007, the Ministry of Economy issued a Regulation on Registering State Targeted Programmes, and in September 2008, an additional Regulation on Changes in the Procedure for Registering State Targeted Programmes was issued. An STP registered with the Ministry implies that it is fully compliant with the legislation in force and is closely monitored by the Ministry.

4.2 STPs - design and preparation

State targeted programmes are broadly defined sector specific, medium to long term, programmes[12]. They are usually approved either by the Parliament (in case of programmes of strategic importance) or the Cabinet of Ministers. STPs include both investment measures and non-investment activities aimed at solving a particular economic, social or environmental problem at a national, regional or sectoral level. Because of their national character, they can often span several sectors and be financed from the budgets of several ministries or agencies.

These programmes specify completion deadlines, implementing institutions and identify the resources required for programme implementation as well as the sources of financing. The main funding sources include: the state budget (both at a central and local level), enterprises' own resources, international grants and loans, donations from physical persons. STPs can be initiated by the Cabinet of Ministers, central government bodies, the National Bank of Ukraine, the National Academy of Sciences, the Supreme Council of the Republic of Crimea, provincial authorities and the administrations of the cities of Kyiv and Sevastopol.

[12] Annex C presents an example of a STP passport template.

Between 2001 and 2006, STPs started mushrooming, their number grew steadily and by the end of 2006, the total number of programmes exceeded 300. Due to their large number and related difficulties with implementation, in 2007, the State Targeted Programmes Department of the Ministry of Economy launched a major evaluation of the existing STPs. As a result of this analysis, only 21 programmes were identified as fully compliant with the Act on STPs and the Regulation on the Procedure for the Development and Implementation of STPs. By the end of 2009, there were 40 targeted programmes registered with the Ministry of Economy, which is the main coordinating body for STPs.

By the end of 2008, the total number of STPs was reduced from 300 down to 140. This is a positive trend, since a smaller number of STPs are easier to monitor and control. At the end of 2008, due to the financial crisis, the approval of new STPs was suspended.

Procedure for the development of state targeted programmes

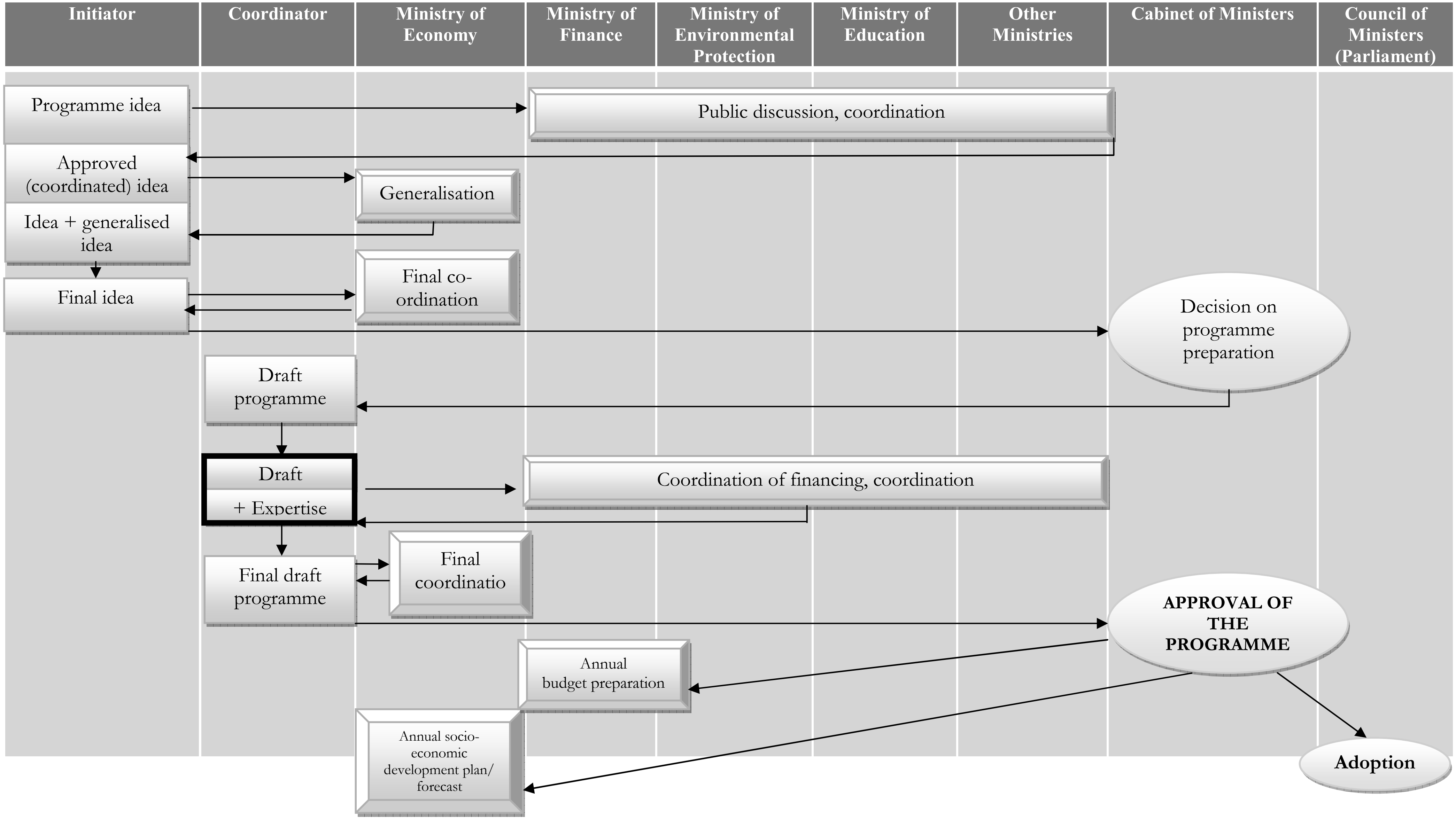
The procedure for the STPs development is divided into several stages. In the beginning, the project initiator prepares a draft programme idea. The idea should include a detailed analysis of the causes of the problem that will be solved through the programme and respective expected results; describe the optimum variant for solving the problem; and suggest major financial and technical performance indicators which can be used to monitor and evaluate the programme progress and implementation. The programme idea needs then to be consulted with the Ministry of Finance in the first place as well as with other relevant ministries and central government bodies. Each ministry prepares an opinion on the programme. In case of positive opinions, the project initiator submits the idea to the Ministry of Economy which in turn submits it to the Cabinet of Ministers. If the Cabinet approves the idea, it appoints an institution to develop a draft programme based on this idea.

Once the draft programme is prepared and after consultations with relevant ministries, the institution responsible for the draft programme submits it again to the Ministry of Economy and the Cabinet of Ministers. If the programme is approved, the Cabinet issues a resolution on adopting the programme. Subsequently, the Ministry of Economy includes the programme in the National Economic and Social Development Programme, and the Ministry of Finance takes the programme into account while preparing the draft budget for the next year. In the case of STPs of strategic significance, and after being approved by the Cabinet, such programmes are transferred to the Parliament for adoption.

Supervising STP implementation is a responsibility of the Ministry of Economy. The main institution implementing the programme is responsible for preparing annual reports on progress with STP implementation. As part of the reporting process, the implementing institution is also required to submit information on the individual projects supported through the programme. The Ministry of Economy evaluates the effectiveness of STP implementation and submits their analyses to the Cabinet of Ministers. However, the Act on STPs does not explicitly require the government to present this information to the Parliament.

The procedure for adoption of a state targeted programme is schematically presented in Figure 4.

Table 4. Procedure for STP adoption



4.3 Analysis of the design and implementation of state targeted programmes

In spite of the declarative character of many of the legal documents concerning multi-year financial planning of public expenditure in general and STPs in particular, there has been a general willingness on the part of the Ukrainian government to reform the system of public finances and bring multi-year financial planning closer to international standards. Conceptually, using STPs as a major tool for translating national strategies and policies into annual public expenditure in a comprehensive and holistic manner was the right step in the right direction. The STP design is rational and contains the main elements that such programmes need to have in place, including coordination mechanisms, mechanisms for the identification of measures to be financed through the programme, costing requirements, funding sources, programme implementers and programme completion deadlines. Also the STPs legislation has been gradually improving. STPs are now coded and registered and therefore better monitored.

At the same time, there is a general recognition at different levels of the government that regardless all efforts these programmes have largely failed to achieve their goals. There are a number of reasons for these poor results. These reasons are related both to the design and actual implementation of the STPs as well as the capacity of the main actors involved in preparing and implementing such programmes.

Problems related to the STP design

Whereas the main programming elements are in place, STPs are not designed in line with good international practices. Box 2 lists the set of elements that should be present in a well-designed public expenditure, particularly investment, programme. Given that STPs usually contain an investment component, these criteria apply to them as well.

Apart from clearly identified completion deadlines and sources of financing, most of the other programmatic elements are either not reflected in the STPs or are only poorly considered. As will be discussed in more detail in the chapter on financial planning in the environmental sector, the objectives and priority measures of these programmes are often defined in very general terms that do not allow proper control and supervision. Eligible project types and beneficiaries or financing terms and co-financing requirements are not identified either. Specific targets and indicators for their monitoring and evaluation are largely missing or poorly spelled out.

Even though the STPs are usually costed, including the individual investment measures identified in the programme, these cost estimates are largely unrealistic. The initial cost estimates, often prepared in a quick way and based mostly on experts' estimates, are rarely adjusted for changes in major economic and market parameters. There are no cost revision mechanisms built into the programme design. In principle, such adjustment can be done while preparing the annual budget requests based on these programmes. In reality, this is rarely done due to, as will be discussed further, the poor links and the lack of consistency between the STPs and the annual budgets.

More importantly, the investment measures identified in the programmes are simply long lists of non-prioritised investment (ideas) collected from different stakeholders. Given the lack of reliable data and information, particularly at a local level where these projects are implemented, the quality and realism of the costing of the individual investments are also questionable. Besides, when an investment project identified in the programme receives financing 5-10 years after the programme was adopted, it is very likely that its major parameters will have changed by the time of its implementation and neither the project concept nor its cost will be realistic any more.

In addition, STPs are not supported by detailed financing strategies or market studies to identify demand for a specific programme and to the check real interest of the industry, businesses or municipalities to contribute to different programmes by using their own resources. Cost-benefit or cost-effectiveness analyses are not applied in comparing and calculating the costs of the programmes.

More importantly, these estimates usually take into account investment costs only while O&M costs are for the most part disregarded, another reason that undermines the realism and robustness of programme cost estimates.

Box 2. Essential elements of the expenditure (investment) programme

At a minimum, each public expenditure programme should have:

- Clearly defined objectives and priorities - these objectives should be specific, measurable, realistic and time-bound and priorities should be few and unambiguous;
- Clearly defined timeframe of the programme;
- Specified cost estimates of achieving the objectives;
- Specified sources of financing;
- Specified eligible project types;
- Specified eligible beneficiaries;
- Clearly defined terms of financing, including among others, financial instruments (eligible form of subsidy), co-financing requirements, maximum/minimum level of support;
- Well-documented principles, rules, and operating procedures for project cycle management;
- Clearly-defined and robust criteria for appraisal, selection, and financing of investment projects;
- Clearly-defined procurement rules;
- Selection of the best institutional arrangement to manage the expenditure programme, equipped with sufficient resources to meet its objectives, qualified staff and instruments to implement the programme;
- Performance indicators for the institution managing the expenditure programme.

Source: OECD (2007b).

While a number of the above programme elements (e.g. criteria for appraisal, selection and financing of individual projects) could, in principle, be designed at a later stage by the agency responsible for the programme, experience from the environment sector shows that these, when specified, are not consistently used during programme implementation.

In addition, while the financing sources are usually identified in the programme, there is no clear division of responsibility as to who will pay for what and how much for the different measures. Some of the funding sources are identified on paper only and never materialise. This lack of clarity with regard to funding commitments often results in significant underfunding of the programmes. More generally, the deficiencies in the STP design translate into a poor implementation rate of these programmes which in turn undermines the achievement of their objectives.

Problems related to STP implementation

The main issues related to STP implementation that will be discussed in this section include: duplication across different programmes and programme measures, lack of adequate and predictable financing for STPs, poor links between the STPs and the annual budget.

Duplication across programmes

Despite the significant reduction in the amount of STPs over the past couple of years their number still remains very high. This problem is further aggravated by the overlapping of measures identified in different programmes. An example from the transport sector can help illustrate this point.

Table 5. Overlap between measures under different STPs in the transport sector

State Targeted Programme concerning the development of transport and roads for the years 2000 - 2004 (No. 101)	Other transport programmes
Measure No.3 Ukraine as a transit country 3.12. Repair of the network of international transit roads crossing the territory of Ukraine 3.13 Construction of the Lviv-Krakovec expressway within a concession framework	*Programme No. 197* Comprehensive programme: Ukraine as a transit country
Measure No.4.5 Implementation of the works stipulated in the Programme for the Development and Operation of a National Network of International Transport Corridors	*Programme No. 51* National Programme for the Development and Operation of a National Network of International Transport Corridors in the years 1999 - 2001
Measure No. 6.6 Development and implementation of measures concerning the safe operation of waterways and sluices	*Programme No. 151* State programme for enhancing the navigation safety system in the years 2002 -2006
Measure No. 7.4 Implementation of a long-term programme for the refurbishment of aircraft belonging to state-owned enterprises (civil aviation)	*Programme No. 152* State programme for the development of air transport until 2010
Measure No.6.9 Development and enhancement of the general civil and military system for controlling air traffic	*Programme No. 237* Programme for the development of the state system for the use of Ukrainian airspace from 2002 to 2006
Measure No.7.7 Implementation of a project aimed at the upgrade of the Ukrainian air navigation system	

Source: Heyets, V. (2008).

As the information in Table 4 shows, there are numerous examples of almost direct duplications of measures under different transport programmes. This overlapping actually translates directly into increased, but unjustified, funding needs. Analysis of the financing required to implement the targeted programmes in the sector shows that between 2000 to 2004 almost UAH 19 bn from the central budget and UAH 20 bn from other sources were required for the implementation of these programmes. The funding required for the work related to the National State Targeted Programme concerning the development of transport and roads for the years 2000 - 2004 amounted to almost UAH 10.2 bn from the central budget and UAH 1.9 bn from other sources. Because of overlaps between the state targeted programme and the other transport programmes, our estimates show that the overall value of all transport programmes was overstated by around 100%.

In other cases, ministries would try to compensate their shortages of resources for regular administrative tasks (usually financed directly from the general fund of the budget) by including such tasks in various STPs hoping that their administrative costs will be financed through this channel. When looking at the Ministry of Culture State Culture Development Programme (No. 18), for example, it can be observed that, in its content and scope, the programme largely resembles primary ministry's administrative responsibilities. While such a situation is legally unacceptable[13], the legitimate question is who, why and on what grounds adopted programmes in such a form.

Duplication of measures across different programmes and inflating costs is seen as a guarantee by ministries to obtain at least some resources in case of financial cuts. The expectation is that this overlap will not be immediately noticed. In this way, scarce public funds are dispersed among almost 140 targeted programmes, many of which mutually overlap. In addition, this practice shows once again that the costing of programmes is not realistic and cost-effectiveness is hardly a concern in preparing programmes. This approach to programme preparation undermines the credibility of the STPs and the institutions that manage them.

It seems that most actors involved in the process are aware of this problem. In 2007, in addition to the Ministry of Economy evaluation, the Supreme Chamber of Audit conducted a comprehensive performance audit of the state targeted programmes (the audit report was published in 2008). The audit concerned the effectiveness of the use of budget funds within the STPs framework and the compliance of the decisions made by programme managers with Ukrainian legislation. The main conclusion of the audit was that more than 70% of the budget funds allocated to the implementation of such programmes was spent ineffectively. The report also notes that the targeted programmes funded by the state over a period of several years largely failed to achieve their objectives.

This massive failure points to problems not only with the costing and preparation of targeted problems but it also shows loopholes in the control system. There are obvious problems with the approval, reporting and monitoring of the programmes. It is a failure not only of the individual ministries that manage the programmes, but of the whole government and the legislature as well. This failure may be even further magnified if the spending from other sources that contributed to the funding of the programmes was audited. It is unlikely that the situation with these other funds will be much more different. It should be underlined, however, that while the monitoring and evaluation capacity of the main supervising institutions has been strengthened over the past several years, real changes as a result of improved monitoring still remain to be seen.

In conclusion, the system of STPs as it currently exists does not deliver well. It needs a major overhaul. The government, and particularly the Ministry of Economy, understand that there is a need for unified methodology and clear guidelines for the individual ministries and approving bodies on how these programmes should be prepared and evaluated. Until this is done, the STPs will remain a rather poor financial planning tool.

Lack of adequate and predictable financing for STPs

The above issues largely explain the other major problem related to the STPs implementation, namely the lack of adequate financing for these programmes. As Table 5 shows, in the period between 2003 and 2006, not all STPs received the required financing from the budget on a regular basis. This applies both to funds from the state and local government budgets. On the other hand, between 2003 and 2006, the number of new programmes steadily increased. For example, in 2006, the number of STPs was estimated at about 300, of which only 218, i.e. 68% were funded (for comparison, in 2003, this ratio was much higher - 84%).

13 This practice was one of the reasons why so many STPs were identified in the Ministry of Economy evaluation as non compliant with the relevant legislation.

Table 6. Number of programmes actually funded from the central budget*

Programmes	Number of programmes funded from the central budget**			
	2003	2004	2005	2006
Social policy	14	17	19	25
Social programmes	41	51	52	60
Population safety (including environmental safety programmes)	22	30	34	35
Economic and scientific programmes	27	39	61	65
Ensuring conditions for further social and economic growth	6	6	7	7
Improving the quality of government administration	1	1	4	7
Activities in foreign markets	4	4	6	11
Total	115	148	183	210

Notes:* Since actual data are not available, only the (estimated) number of programmes funded from the central budget is included.

** The table includes information only on the number of programmes actually funded from the budget, while the overall number of programmes is much higher - e.g. in 2006, it was around 300.

The problem of inadequate financing of STPs is further confirmed by the data contained in Tables 6, 7 and 8 below. As can be seen from Table 6 and 8, in 2003 - 2005, on average, only about 43% of the expenditure planned under the STPs obtained financing from the budget (respectively, these shares were 43% in 2003, 47% in 2004 and 40% in 2005), in subsequent years, the funding ratio remained more or less at the same level, as far as can be judged from the partial data coverage. The lack of data on the planned STPs expenditure for the period 2006 - 2009 also hints at the problem of the availability of reliable programmes cost breakdowns in the medium term. This data analysis indicates a significant mismatch between programmes costs and the actual expenditure. Due to the presence of such a large gap, many measures that were planned as part of the STPs did not get implemented.

Tables 6-8 also show that the process of downward adjusting of the “appetites” of the institutions managing targeted programmes to the real capacity of the budget has been underway for almost seven years (2003–2009). In 2003, almost 41% of budget revenues were “requested” from the budget for targeted programmes (which represents 39% of all budget expenditure), while actually only around 18% were received from the budget (or 17% of all expenditure); in 2004, only 37%, and in 2009 - 20% of budget revenue were “requested”. Obviously, while on the one hand budget revenue increase every year, on the other hand the expenditure planned for targeted programmes decrease every year. This analysis also shows that due to the lack of sufficient financing, the proliferation of new programmes has led to a steady decrease of average budget funding per programme. This has contributed to the dissipation of budget funds and has had an adverse impact on programme implementation.

This is particularly true for the investment component of STPs. Where the amount of funds allocated to state targeted programmes is insufficient, individual projects have to be adjusted and the deadlines for their implementation shifted. In addition, such projects do not have any guarantee that funding will be necessarily available in the next budget cycle, for this reason, projects may stay uncompleted for years, in the meantime built assets would deteriorate, more funds would be needed to restore losses, project design changes, programme implementation is delayed and programme objectives remain unachieved.

The practice of launching investment projects without having secured their full financing is common and is perceived as a guarantee that the project will be eventually funded. While this mechanism usually works, even if it takes a long time for such projects to be completed, the main problem remains - the costs of such projects usually increase with time which results in more drain on the budget. As such, the existence of STPs in Ukraine has not brought particular budget funding predictability for these programmes.

Table 7. Changes in funding of state targeted programmes, billion UAH

		2003	2004	2005	2006	2007	2008	2009
Programme assumptions	General Fund	19.48	20.02	23.14	n.d.	n.d.	n.d.	28.36
	Special Fund	2.17	4.20	5.05	n.d.	n.d.	n.d.	19.44
	Total	**21.65**	**24.22**	**28.19**	**n.d.**	**n.d.**	**n.d.**	**47.80**
Actual amount	General Fund	8.40	9.39	9.36	14.36	8.75	20.47	n.d.
	Special Fund	0.94	1.97	2.04	3.37	14.96	17.39	n.d.
	Total	**9.34**	**11.36**	**11.40**	**17.73**	**23.71**	**37.86**	**n.d.**
Actual vs planned		43%	47%	40%	n.d.	n.d.	n.d.	n.d.

Note: n.d. – No data

Source: Own estimates based on Heyets, V. (2008) for the period 2003 – 2005, 2006 – 2009 – based on data contained in the respective annual Budget Law.

Table 8. Central budget in Ukraine, 2003–2009*, billion UAH

	2003	2004	2005	2006	2007	2008	2009
Budget revenues	53.27	65.22	106.13	127.51	157.28	231.93	238.93
General	42.23	51.41	83.51	97.26	125.44	180.78	183.70
Special	11.04	13.81	22.62	30.25	31.84	51.15	55.23
Budget expenditure*	55.91	72.22	117.40	140.20	174.63	253.22	267.37
General	43.74	58.57	94.15	109.49	142.77	200.12	193.33
Special	12.17	13.65	23.25	30.71	31.86	53.10	74.04

* Pursuant to the Law on the Budget for the respective year. Source: Own estimates based on Heyets, V. (2008) for the period 2003 – 2005, 2006 – 2009 – based on data contained in the respective annual Budget Law.

Table 9. Percentage share of targeted programme funding in overall budget revenue and expenditure

	2003	2004	2005	2006	2007	2008	2009
Total planned programme expenditure, mln UAH	21.65	24.22	28.19	n.d.	n.d.	n.d.	47.79
Share of planned expenditure in budget revenues	40.63%	37.14%	26.56%	n.d.	n.d.	n.d.	20.00%
Share of planned expenditure in budget expenditure	38.72%	33.54%	24.01%	n.d.	n.d.	n.d.	17.88%
Actual budget expenditure on programmes, mln UAH	9.34	11.36	11.40	17.73	23.71	37.86	n.d.
Share of actual expenditure in budget revenues	17.53%	17.41%	10.74%	13.90%	15.07%	16.32%	n.d.
Share of actual expenditure in budget expenditure	16.71%	15.72%	9.71%	12.65%	13.58%	14.95%	n.d.
Actual/planned programme expenditure	43.14%	46.88%	40.43%	n.d.	n.d.	n.d.	n.d.

Source: Own estimates based on Heyets, V. (2008) for the period 2003 – 2005, 2006 – 2009 – based on data contained in the respective annual Budget Law.

Predictability of funding is especially important for investment projects, and it is necessary to have in place budgetary provisions appropriate to a multi-year expenditure commitment. Especially prudent is a rule by which funds for new investments projects are released only when the entire project is "mature", i.e. ready for launch, with all the required approvals, full financing assured, and implementation modalities in place. While this provision has been criticised by some as old-fashioned, and by others as cumbersome, it can be very useful to protect against premature funding of investment projects that are not fully ready for implementation, and thus constitutes sensible insurance against the risk of missing to implement a good project. Delaying a good investment opportunity may be "old-fashioned", but is, in general, far less costly than wasting resources by rushing its implementation.

Links between STPs and the annual budget

As discussed already, one of the major sources of financing of STPs is the state budget (both at central and local levels). Usually, the costs of STPs are broken down by year over the lifetime of the programme. Ideally, these yearly costs can be used directly as an input to the budget proposals put forward by the respective programme managers when the annual budget proposals are prepared.

In reality however, the process works differently. First, ministries or programme managers are constrained by the top-down ceilings assigned to them by the Ministry of Finance at the beginning of the budget preparation process. Second, these programme costs are not realistic and programme managers do not readily use them. The main purpose of STPs in this case is to serve as a legal justification to request budget funds. They are not used as a proper analytical and financial planning tool. Third, experience shows that the programme manager usually deliberately understates costs in the first or second year of implementing a new programme, while in subsequent years its financial needs usually increase.

The rationale is that implementing institutions understand that once a programme receives support from the budget, the programme funding will be continued anyway because the government will feel forced to finance it in subsequent years, even if 100% of the resources are not available. This situation points to the fact that even if programme costs are broken down by years their financial implications for the annual budget are not carefully checked and understood when STPs are adopted. There is no mechanism in the public expenditure management system that can ensure realistic and effective links between the STPs and the annual budget, such as for example, a commitment allocation setting the limit to commitment during the fiscal year with carryover of unused commitments.

Many of the described practices of planning, implementing and budgeting medium-term programmes are logical from the point of view of the programme managers. They represent a kind of "survival" strategy for the budget institutions which allow them to continue functioning at a minimum level of resources. However, from the point of view of taxpayers and society as a whole, they represent a mere deadweight of lost social and economic opportunities.

All the above challenges and problems are often related to the institutional capacity of individual actors involved in the preparation and implementation of STPs as well as decision-makers in the government responsible for setting the STP rules and overseeing STP implementation. This issue will be discussed in more detail in the next chapter in relation to capacities in the environmental sector.

CHAPTER 5. SPECIFICS OF THE ENVIRONMENTAL SECTOR

It can be expected that the procedure for medium-term financial planning and the use of budget funds at the Ministry of Environmental Protection (MEP) will not be substantially different from the general procedures and rules that apply to all budgetary entities in Ukraine. The MEP faces similar challenges that other ministries encounter in competing for funds from the budget for implementing their programmes. However, in a certain way, the environmental sector is somewhat different from most other sectors particularly in that it is strongly cross-sectoral in nature.

This cross-sectoral nature of environmental and natural resources management raises a number of issues that are less prominent in other parts of the government administration. These issues include, among others:

1. ***Coordination*** is critical for success. Often, most of the heavy public environmental investments are done in other ministries and agencies. For this reason, the way environment sector strategies are developed must take into account the need for a strong cooperative approach.

2. ***Targets and accountabilities*** are harder to define as many actors contribute to a given output or environmental outcome. Indicators often lack hard, quantifiable targets for performance measurement.

3. ***Accurate costing*** of environmental programmes can be hampered by the many actors involved, as well as by the long-term nature of some environmental programmes and the lack of reliable data. For this reason, the results from environmental, particularly investment, programmes and projects will rarely, if ever, be seen within the framework of the annual budget.

4. ***Environment is often not a policy priority***. Social sector spending is the focus of national policies. In addition, at times of budget deficit or financial crisis, the environment sector is often among the first ones to suffer budget cuts.

This chapter addresses the particular challenges facing the financial planning of public environmental expenditure within the medium-term perspective and its links to the annual budget. The discussion opens with an analysis of environmental budget expenditure levels in Ukraine as an indication of the actual position of the Ministry of Environmental Protection in the budget negations process.

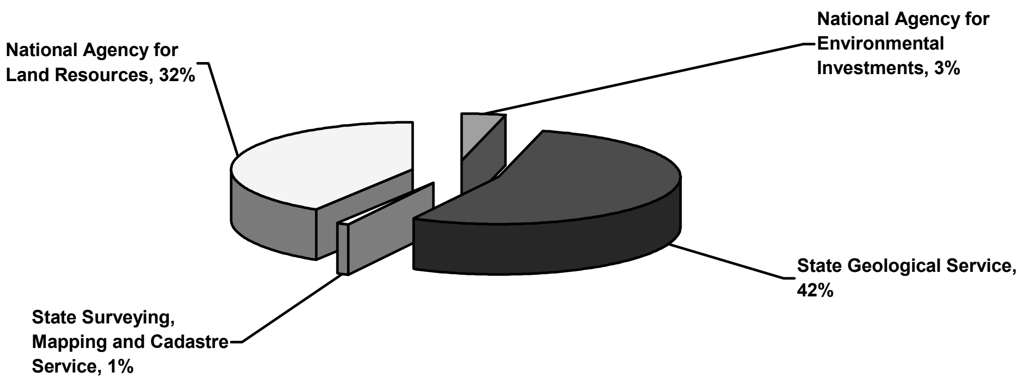
5.1 Trends in domestic environmental expenditure

The analysis of the MEP budget shows that its budget resources are split across 5 major services: the administration of the Ministry, the National Environmental Investment Agency, the State Geological Service, the State Surveying, Mapping and Cadastre Service and the National Agency for Land Resources (the former Committee for Land Resources until 2007).

In general, there was an increase of the budget funds allocated to the MEP, in current prices, in 2009 compared to 2007 and a decrease compared to 2008. As Table 9 below shows, in 2009, the MEP budget increased by 7% compared to the 2007 budget. In real terms, however, taking into account the 2007 and 2008 inflation of 16.6% and about 22%, respectively, there was a significant decrease of the budget resources allocated the MEP in this period. It is interesting to note that in 2008 - 2009, on average, two-thirds of the Ministry's budget is provided by the Special Fund, the former extra-budgetary National Environmental Protection Fund, currently integrated into the budget. Its resources actually come from the revenue generated from environmental pollution charges and fines (for air, water, waste pollution) and earmarked for environmental protection activities.

Also, as can be seen from Fig. 5, in 2009, the allocation of MEP budget resources across its subordinate agencies shows that the State Geological Service receives the largest part of the resources allocated to the MEP - more than 40%, followed by the National Agency for Land Resources with 32% of all resources, and 22% used to cover general MEP administration costs. In a way, these numbers reveal the real priorities of the MEP in 2009.

Figure 3. Allocation of MEP budget across subordinate MEP agencies, 2009, in shares of total budget



In addition, there are a few other observations that can be made when analysing the MEP budget over the period 2007 – 2009. These include:

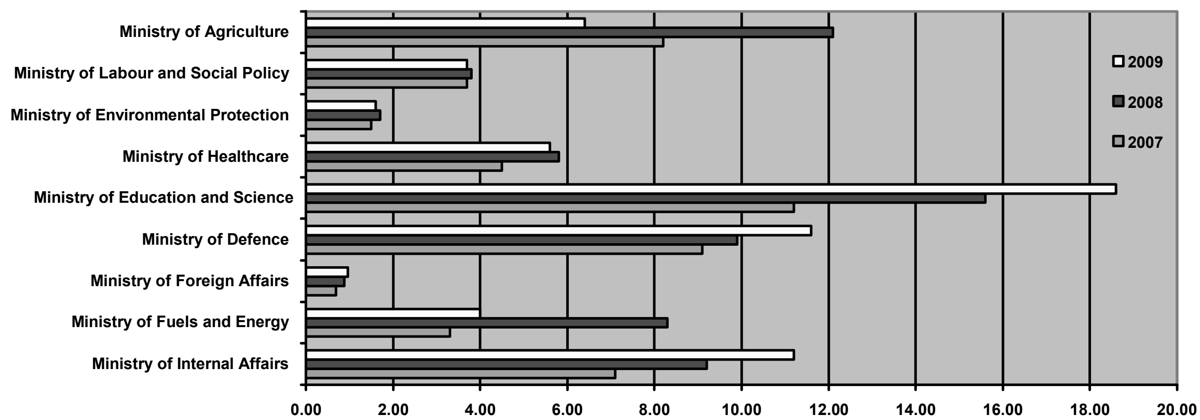
- First, it seems that the most important environmental problem in Ukraine and for the government is the development of the resource base, including the drilling of deep wells, as this is what the largest share of budget resources is spent on (e.g. about 40% in 2008 and 2009). Given the energy problems Ukraine has been experiencing recently, it is obvious why the Government places such an important focus on this strategic activity. Similarly, significant earmarked resources (more than 30% of the 2009 resources assigned to the Agency for Land Resources) are allocated to finance the issuing of state certificates concerning ownership title to agricultural land. Looking at these priority areas for the MEP budget, one cannot but raise the legitimate question: are there not more important environmental problems in Ukraine that need solving first and are there not other institutions in the country which are in a better position to finance such kind of expenditure?

- Second, the earmarked resources of the Special Fund are used so thinly, almost across all budget programmes, that it can hardly be seen how they can make any difference on any programme. Most importantly, more than 20% are used to cover purely administrative costs which makes it difficult to assess the effectiveness or efficiency of these resources. According to good public finance practices, earmarking can be justified only when used to cover priority investment costs and not general administration expenditure.

- Third, experience shows that the existence of earmarked funds in the budget of a ministry (the Special Fund in this case) often leads to a decrease of regular budget resources (in this case from the General Fund). The more the Special Fund revenues grow, the more the General Fund may decrease. As long as this situation persists, the MEP can hardly expect that the Ministry of Finance and the government as a whole will pay sufficient attention to the environment and allocate adequate resources from the general budget. More importantly though, the fact that the MEP is entitled to this revenue by law, without really competing for it, reduces the incentives for the Ministry's staff to prepare solid and convincing programmes and allocate the resources in a cost-effective and efficient manner.

In the context of overall budget funding for different sectors over the period 2007 - 2009, and as shown in Fig. 6 below, the MEP budget was consistently the lowest compared to other ministries' budgets. The only ministry that would get less than the MEP on an annual basis is the Ministry of Foreign Affairs which has no investment responsibilities. Given that the budget usually reflects the relative bargaining power and importance of each sector, this picture may be indicative of the position of the environment and the MEP on the government agenda.

Figure 4. MEP budget compared to other ministries' budgets, billion UAH



Source: Ministry of Finance of Ukraine.

In addition, the financial crisis of 2008 brought even more challenges to the budgetary situation in Ukraine, in general. The rate of the implementation of the consolidated budget expenditures in 2008, according to the functional classification (see Figure 7) shows two important issues: first, none of the sectors obtained the level of resources as planned in the budget and second, of all major sectors, the environmental sector suffered the largest cuts in its budget. At the end of the budget year, the MEP received less than 70% of the budgeted resources approved by the legislature at the beginning of the budget year. This must have had serious repercussions for MEP programmes implementation.

These low resources allocated for environmental protection compared to other sectors shows that the environment is not a priority for the government, other sectors, such as education, health and even defence would receive higher budget support. At the same time, it should be noted that some of the costliest investments are environmentally-related investments. Environmental investments in Ukraine, as a share of total fixed capital formation, have been consistently declining over the last five years, from 2% in 2004 to 1.3% in 2008[14].

[14] CIS STAT (2009).

Table 10. MEP Budget, 2007-2009*, thousand UAH

Name of annual budget programme	General fund	Special fund	TOTAL 2009	General fund	Special fund	TOTAL 2008	General fund	Special fund	TOTAL 2007
Ministry of Environmental Protection TOTAL	557 491	1 050 863	1 608 354	684 803	1 047 620	1 732 423	501 260	995 936	1 497 196
MEP Administration, of which:	224 872	132 006	356 878	217 004	294 720	511 724	175 454	294 384	469 838
General environmental protection management	28 459	7 543	36 002	33 686	6 864	40 550	36 431	5 982	42 413
Regional level environmental protection management and control	125 847	28 719	154 566	141 522	24 277	165 799	105 355	15 060	120 415
Applied science and scientific and technical work, work under state targeted programmes and public procurement within the framework of environmental protection, financial support for academic staff training	2 703		2 703	2 932		2 932	5 885		5 885
Enhancing skills and training related to environmental protection	6 858	10 270	17 128	782	741	1 523	544	611	1 155
Work related to protecting nature reserves, the maintenance of animal and plant cadastres, Red Book	61 005	5 474	66 479	38 082	4 685	42 767	26 795	3 809	30 604
Support for measurements and sample analysis during inspections by the Organisation for the Prohibition of Chemical Weapons			-			-	175		175
Natural environment monitoring and ensuring state control with respect to compliance with environmental legislation standards		25 000	25 000		97 459	97 459		65 400	65 400
Waste treatment		3 000	3 000		30 000	30 000		45 390	45 390
International collaboration with respect to environmental protection, promoting the development and dissemination of environmental information and education		4 000	4 000		6 273	6 273		7 550	7 550
Waste-related work, including work related to hazardous waste		25 000	25 000		69 206	69 206		60 782	60 782
Establishment of a national environmental network		15 000	15 000		20 000	20 000		30 800	30 800
Improvement of air quality		6 000	6 000		25 215	25 215		8 000	8 000
Analytical support for the monitoring of scientific projects related to environmental safety			-			-	269		269
Financial support for environmental activities, including credit enhancement (support for payment of interest rates provided to enterprises which take commercial loans for environmental projects)		2 000	2 000		10 000	10 000		30 000	30 000

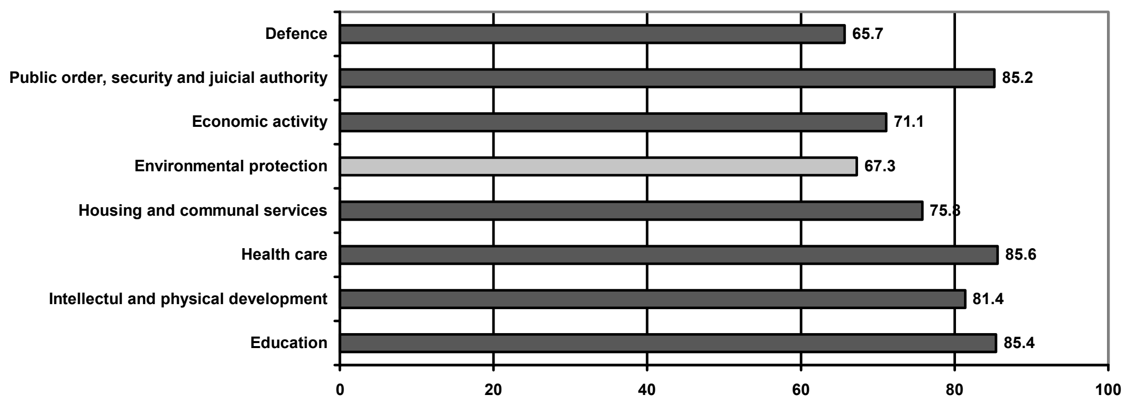
Name of annual budget programme	General fund	Special fund	TOTAL 2009	General fund	Special fund	TOTAL 2008	General fund	Special fund	TOTAL 2007
Restructuring and liquidation of mining and chemical enterprises and the implementation of urgent environmental projects at their sites			-			-		21 000	21 000
National Agency for Environmental Investments	5 462	50 000	55 462	8 439		8 439			
Environmental investment administration and management	5 462		5 462	8 439		8 439			
Implementation of projects related to reducing carbon dioxide emissions		50 000	50 000			-			
State Geological Service		668 182	668 182	5 500	672 900	678 400	5 500	616 600	622 100
Development of the resource base, including the drilling of deep wells		668 182	668 182		672 900	672 900		616 600	616 600
- of which the development of new open-pit mines as well as new offshore carbohydrate fields			-			-		72 000	72 000
Geological and environmental research and work				5 500		5 500	5 500		5 500
State Surveying, Mapping and Cadastre Service	8 095		8 095	35 050		35 050	25 050		25 050
National surveying and mapping work	3 020		3 020	11 900		11 900	11 900		11 900
Demarcation and delimitation of the state border	5 075		5 075	23 150		23 150	13 150		13 150
National Agency for Land Resources (Committee for Land Resources until 2007)	319 062	200 675	519 737	418 810	80 000	498 810	295 256	84 952	380 208
Land resource administration and management	307 660	45 000	352 660	336 476	30 000	366 476	232 284	25 000	257 284
Enhancing Committee staff skills and qualifications	137		137	195		195	195		195
Land reform measures	7 289		7 289	69 635		69 635	49 023	10 000	59 023
Preservation, reclamation and rational use of land resources	470		470	9 500		9 500	9 500		9 500
Issuing state certificates concerning ownership title to agricultural land	3 506	155 675	159 181	3 004	50 000	53 004	4 254	49 952	54 206

* The data in this Table refer only to the funding of the Ministry of Environmental Protection.

Source: Ministry of Environmental Protection of Ukraine.

The World Bank[15] has calculated that Ukraine's potential investment needs in environmental protection over a period of 10 years (2006-2015), taking into account Ukraine's EU legal approximation and industrial rehabilitation, amount to an estimated USD 15 - 30 bn which is not a trivial amount. On an annual basis, this translates into USD 1.5 - 3 bn. The World Bank estimates exclude investments in energy and water supply and sanitation which are envisaged to be undertaken by other government agencies. Even if we assume that these investments will not be a sole responsibility of the MEP and that other players will participate (other ministries, local budgets, even private sector participants), the MEP will have a key funding role in this process. Which leads us to the next question: How does the MEP plan its expenditure in the medium term and on an annual basis?

Figure 5. Rate of implementation of the consolidated budget expenditures in 2008 according to the budget functional classification



Source: Ministry of Finance of Ukraine.

5.2 Strategic financial planning in the environmental sector in Ukraine

There are a number of strategic documents related to environmental protection that serve as a legal basis for the MEP in planning its expenditure in the medium term and on an annual basis. These are prepared by the MEP alone or in cooperation with other line ministries and agencies with responsibilities for environmental management. The Act on the Main State Policy Directions Concerning Environmental Protection, the Use of Natural Resources and Ensuring Environmental Safety, adopted in 1998, has generally provided the strategic background for the national environmental policy. However, in order to reflect the political and economic changes of the past 10 years, a new strategic document is under preparation - the National Environmental Policy Strategy until 2020. Among other things, this strategy will account for economic globalisation as well as the 2008 financial and economic crisis. It will also take into account Ukraine's entry into the World Trade Organisation and Ukraine's numerous international commitments related to environmental protection.

Within the framework of developing the Strategy, in 2007, the MEP started drafting the National Environmental Policy Framework also in collaboration with other ministries. In addition, specific annual priorities for individual ministries are set out through the annual Programme of Government Activities. The major 2008 MEP priorities[16] included in this programme are:

- The introduction of environmental protection standards at levels similar to relevant European standards;

15 World Bank (2007b).

16 Adopted through the Cabinet of Ministers Regulation No. 366-r of 22 February 2008.

- The establishment of an environmental network of protected areas;
- Drafting of legal regulations aimed at ensuring the effective implementation of the Kyoto Protocol as well as encouraging large enterprises to reduce carbon emissions and securing budget receipts;
- Improvement of the use of natural resources;
- The protection of agricultural land, forest and water resources and preventing their illegal use;
- Work related to establishing the legal framework for land transactions;
- The improvement of the waste management system and adjusting it to European standards.

Strategic documents are also drafted by other ministries and organisations whose economic activities have impact on the environment. For example, Ukraine's Energy Strategy until 2030, adopted by the Cabinet of Ministers in 2006, includes a chapter devoted to the "contamination of the natural environment". Where a section devoted to environmental protection is included in a strategic document drafted by another ministry, the law requires that the respective ministry or agency should consult all relevant central level entities, including the MEP. In this manner, the MEP has a chance to review all policy and strategic documents with relevance to environmental protection prepared by the government. As can be expected, these are strategic documents and they do not contain costed policies or programmes, their objective is to provide the strategic directions of the national policy in the area of environmental protection. These strategies are further translated into concrete actions through the STPs and the annual budget programmes.

5.3 Preparation and costing of environmental STPs

As described earlier, a state targeted programme is the entire comprehensive framework of inter-related projects and measures aimed at solving major issues related to the development of the state, individual industries or local government units in different sectors. This implies that the programme will consist of policy and legislative initiatives, research and development, capacity building as well as investment components.

Targeted programmes are funded from the central budget and other financing sources. The programme is required to specify the deadline for implementation, the implementing institutions and required funds. STPs may be implemented and funded by various ministries and agencies. In preparing the programmes, stakeholders other than the concerned ministries, rarely take part in the discussions on programme development. As of the end of 2008, the MEP was involved in implementing 14 STPs. The list of all STPs, financed through the MEP budget, is included in Annex E.

As can be seen from the List, a number of ministries and agencies are involved in implementing and funding STPs jointly with the MEP. These include, among others: the Ministry of Agriculture, Ministry of Health, Ministry of Regional Development and Construction, Ministry for Extraordinary Situations, Ministry of Transport, Ministry of Culture and Tourism, Ministry of Labour and Social Policy, Ministry of Education, Ministry for Family and Youth, State Tax Administration, States Customs Service, States Border Service, Ukrainian Academy of Agricultural Sciences.

The responsibilities for implementing the programmes are split across numerous agencies at the national and local level, however, without a clear mandate for implementing the work or ensuring a stable flow of resources. This results in programme activities which are sporadically financed and in difficulties with monitoring the implementation process effectively.

All these STPs are rather comprehensive, attempting to solve a certain problem in a holistic manner, which is a rational approach, including through preparing relevant legislation, designing new policy instruments and mechanisms (e.g. improving environmental standards in line with EU directives, introducing taxes), financing research and development, and supporting investments. However, there is no clear sequence or prioritisation in implementing these measures. This situation encourages rather *ad hoc* financing decisions.

Market studies which can help identify potentially good projects are not carried out. Other modern tools, such as cost-benefit analysis, are not applied in preparing an economically-sound justification for the need for a programme. Even worse, STPs are adopted without even having an indicative financial envelope for the full period of the programme. Thus, the overall financial envelopes of the STPs are not realistic from the outset.

While there are legal requirements that STPs should be supported by more detailed sector financing strategies, this has rarely been done in the environment sector. The only time a detailed financing strategy was prepared, with the participation of the MEP and the Ministry of Housing Economy, was in 2003 with support by Denmark. The strategy aimed at balancing the costs and financing of different strategic choices for the sector. Unfortunately, the results of the strategy were not translated into clear policy targets for the sector.

To prepare credible programme, there is a need not only for clear objectives but for clear targets as well. The environmental STPs, reviewed for this analysis, do not have clearly identified environmental targets that have to be achieved by the time the programme is completed. Most often targets or indicators for investments are defined in terms of outputs (a unit of measure, such as, thousands of cubic metres of daily capacity of a wastewater treatment plant, kilometres of dike fortifications, etc.) but never in terms of actual pollution loads reduced.

The Institute of Environmental Economics which is part of the MEP is often involved in the preparation and development of environmental STPs. Despite the potential of the Institute and the support it provides to the MEP, the programmes are rarely well-costed. The costs of the non-investment measures are rarely calculated in relation to actual measures envisaged, they are rather calculated as a share of the total estimated investment cost of the programme. When translated into annual expenditure, historical data are usually adjusted using the inflation rate, or the predicted USD exchange rate for the coming year, or on the basis of the expected general salary increase.

As for the investment costs, the STPs usually exhibit long lists of potential investment measures. The projects included in a programme are not properly analysed, either financially or economically appraised, so it is not clear if all these measures are even environmentally effective. The programme investment costs are estimated on the basis of ministry experts' own calculations, using standard unit costs of different types of works and services. Typically, when a new programme is launched, ministry specialists prepare the cost estimates and they have to check market conditions by sending requests for information on prices of certain works and services. Sampling (when initial data are poor and not readily available, which is often the case in Ukraine), or cost-effectiveness analysis are not used.

Given the many actors involved in environmental STPs, it is not clear how these other actors have done their costing parts and if all parameters and assumptions are consistent across the various agencies. One major issue in this context is the choice of discount rates in the evaluation of programmes and policies. Different ministries may use different rates and environmental costs and benefits, where identified, may be discounted differently which may result in significant differences in expected results. The need for a harmonised methodology for preparing environmental programmes is obvious.

In principle, cost estimates should be supported by projects' feasibility studies. This is rarely done though. In addition, environmental STPs usually do not consider O&M costs as these are seen as a responsibility either of local governments (for water supply and wastewater treatment projects as well as solid waste projects) or (state-owned) companies (mostly projects related to air pollution). As such, investment and O&M costs are calculated separately and the MEP, or the government as a whole, for that matter, is not aware of the long-term O&M cost implications for the consolidated budget.

Cost-effectiveness of identified investment projects either at a programme level or at the point of financing these projects is not considered. Cost-effectiveness, which is a major criterion in public finance, is usually misunderstood as calculating the unit investment cost of a project. However, calculating cost-effectiveness requires the estimation of investment expenditure, operating and maintenance costs, and the environmental effect. The cost-effectiveness indicator is the ratio of costs to environmental effects. The lower this cost, the better, as less public money is spent on purchasing the unit of environmental effect. If the environmental effect is not specified in the programme/project, the cost-effectiveness ratio cannot be meaningfully determined.

In costing investment programmes, the objective should be to quantify the overall implications of public investment on future years' budgets and reduce the risk of wastage of valuable assets for lack of sufficient operations and maintenance expenditure. This is a very practical challenge. However, at a minimum, the MEP needs to:

- Collect standard costs from national and international experience, and technical manuals. Although this information is generally available, this is a substantial exercise, which requires structuring the information clearly, and arrangements for updating it at least annually;

- Decide on the time period over which the recurrent costs are to be estimated (a minimum of five years after project completion);

- Deciding on the cost elements to be considered - primarily for labour; durable goods (especially expensive equipment) and materials; fuel and other supplies; and maintenance of buildings and other physical facilities;

- Include in the terms of references for the feasibility studies of projects, the requirement to estimate future recurrent costs, on a standard format;

- Limit detailed recurrent cost estimation to large projects; for smaller projects, approximate calculations should be sufficient. For large projects, examine alternative variants of project design that have different combinations of initial investment and future recurrent costs.

It must be emphasised that such estimation affects the expenditure side only. However, public investment also adds to the economy's productive capacity and thus to the tax base and government revenue. If the choice of projects is appropriate, and their design, execution and financing sound, the resulting indirect increase in government revenue should more than compensate for the associated public resources spent on such programmes, debt service, depreciation and operations and maintenance needs - which is the ground rule of public investment.

This is a powerful argument which may not always be well understood, including in the Ministry of Finance and Ministry of Economy. If well designed and well implemented, environmental programmes and projects can become a strong driver of green economic growth and help increase country's competitiveness. But it seems that the MEP lacks the capacity to effectively communicate this argument across the government.

These poorly prepared and costed programmes are often the reason why the Ministry of Finance, the Cabinet of Ministers and the Parliament do not allocate adequate financing for environmental programmes. There is a need for a solid economic justification to make environmental investments understandable to these key actors. At the same time, the Ministry of Finance may not necessarily sufficiently well understand the nature of environmental investments and the potential benefits these can bring to the economy as a whole. Coupled with the poor capacity of the MEP to defend its proposals, the end result is chronic underfunding of programmes. This situation shows a need for targeted capacity-building of key stakeholders, including the Ministry of Finance and Economy staff, in issues related to environmental finance.

In general, the STPs implemented by the MEP provide useful information. However, they are mostly used to justify, in legal terms, budget spending but they do not serve as an analytical and financial planning tool the can inform the budget process meaningfully.

5.4 Challenges with implementing multi-year environmental STPs

Some of the main challenges facing the MEP with implementing STPs can be illustrated through a couple of examples. The first one, the Azov and Black Sea programme, was designed with the objective of preventing the increase in anthropogenic pressure on the natural environment of the Sea of Azov and the Black Sea, by providing support for environmentally-safe types of activities within the region of the two seas, the preservation and restoration of the biological diversity of marine resources and creating favourable conditions for settlement, recreation and leisure.

The responsibility for the implementation of this programme is shared among the MEP, the Ministry for Extraordinary Situations, the Ministry of Healthcare, Agriculture, Transport, Finance, Economy, Culture and Tourism, the Supreme Council of the Republic of Crimea and other regional authority bodies. The MEP has had the main coordinating role in this programme.

Programme funding comes from the central budget, the budget of the Republic of Crimea, relevant local general and special funds, other financing sources including funds of legal persons (enterprises' own resources and retained earnings). External funding sources envisage international organisation grants and donations from benefactors. The programme is divided into two stages: stage one (2000 - 2005) and stage two (2006 - 2010). Initially, programme cost estimates were prepared for the first stage only, the cost estimates for the second stage of the programme were developed only in the early 2008.

The main activities, envisaged to be financed under this programme, during stage one, include, among others:

- protection and restoration of the environment of the Sea of Azov and the Black Sea;
- monitoring and assessment of marine pollution;
- reinforcing the marine and riparian coast;
- development of legal acts ensuring programme implementation.

The second stage envisaged the creation of a Fund whose resources will be spent on:

- extending the tax base related to the use of natural resources;
- enhancing the pricing policy of municipal water services and improving the investment climate;
- setting environmental standards and pollution charges;
- supporting the development of camp sites, fishing, transport services and other types of business activities.

At the end of the first stage of the programme, in 2007, the Supreme Chamber of Audit conducted a performance review of the programme. The main conclusion of the audit was that the assumptions and activities identified in the programme do not correspond to the priorities of the government economic and social policy. The significant number of actors involved in programme implementation and the lack of coordinated action among them resulted in a low level of financing made available to the programme.

The analysis shows that during the first implementation stage (2000 - 2005), neither the investment nor the non-investment activities were properly implemented. On the investment side, only around 45% of the funds planned were actually allocated, whereas by the end of 2006, only 3 out of 21 planned environmental infrastructure facilities were commissioned. Funds from the central budget were allocated only when there were critical situations caused by the anthropogenic impact or natural disasters. In addition, and as a result of the failure of the MEP to properly oversee the works under the programme, between 2001 and 2005, local government authorities often used the funds, allocated to them under this programme for the construction of environmental infrastructure facilities, for other purposes. The MEP could not control either the expenditure which were supposed to be made by the enterprises.

As a result of this lack of coordination, poor monitoring and financing, the alarming development of the destructive processes in these regions continued. Over 150 hectares of coastline, which is valuable from the point of view of leisure and recreation, are irretrievably lost each year. During the last 30 years, the length of the coastline, threatened by degradation, has increased two- to five-fold. Biological sea stocks are catastrophically falling, the contamination and ecological hazard levels are rising, disease incidence in this region remains extremely high [17].

The MEP also failed to implement those programme activities that did not require major investment expenditure. The MEP could not even prepare in time the activity and financial plans for the second phase of the programme, 2006 - 2010. Even as late as the beginning of 2008, concrete plans for works and funding under this phase were still missing.

A report issued by the Supreme Chamber of Audit on this programme pointed out to ineffective organisational arrangements and failure to implement planned works. As a result of this analysis, in 2008, the Cabinet of Ministers asked the MEP to develop a new national programme for the protection and restoration of the environment of the Sea of Azov and the Black Sea. Thus, one programme, only poorly implemented, was to be replaced by another one. The new programme simply repeated the previous one, with no new analysis and no attempt to conduct proper financial analysis.

Another example is provided by the State Scientific and Technical Programme for the Development of Topographic and Surveying Activities and the National Mapping System. The programme implementation period is 2003 - 2010. Its main objective is to enhance the topographic and surveying systems in Ukraine as well as prepare maps through the establishment of a modern infrastructure for the production and distribution of geospatial data, the development of required production capacity and the stimulation of science and applied research.

The programme was envisaged to be implemented in two stages: 2003 - 2005 and 2006 - 2010. The programme funding has been estimated at about UAH 451 million of which UAH 301 million from the central budget, and UAH 151 million from other sources. The details of the funding (committed and actual annual levels) are shown in Table 10.

[17] Ministry of Environmental Protection of Ukraine, GEF, UNDP (2007).

Table 11. Breakdown of committed and actual funding by sources for the State Scientific and Technical Programme for Developing Topographic and Surveying Activities

Years	Total committed, mln UAH	Of which from central budget, mln UAH	Of which from other sources	% of real work funded from central budget	% of real funding from other sources
2003	30	21	10	0%	0.1%
2004	40	30	10	3.01%	0%
2005	51	35	16	52.2%	0%
2006	60	40	20	no data	no data
2007	60	40	20	65.2%	no data
2008	65	45	20	80.5%	no data
2009	70	45	25	43.4%	no data
2010	75	45	30	--	--

Source: Ministry of Environmental Protection of Ukraine.

As can be seen from Table 10, the actual annual funding levels of the programme are rather discouraging. Not only the funding from the central budget is low (around 30% on average of committed financing) but information and data on funding from other sources are practically missing. Thus, the actual implementation rate of the programme in reality is even lower.

This programme is actually being implemented jointly with several other agencies (e.g. the Ministry of Education, State Surveying Service). The problem is that even if information on the financial commitments and actual funding of the individual agencies exists, it is very difficult to obtain such information. When the programme is presented for approval to the Council of Ministers or the Parliament, the funding sources are specified in terms of central budget, local budget, other. Such a structure is not transparent and does not help understand the responsibilities of the individual partners on the programme.

5.5 Links between environmental STPs and the annual budget

There is a link between the STPs and the annual budget. However, due to poor initial data and poor cost estimates, these annual cost estimates, as identified in the STPs, do not provide a solid and robust basis for the annual budgets. In addition, for programmes which are financed over several years from the budget, both estimates and performance indicators would drastically change from one year to another which lends little credibility to this exercise.

What follows below is a description of how individual environmental projects identified in a given STP find their way into the annual budget. The focus of this discussion is on investment projects.

In general, investment projects are financed through the Special Fund of the annual budget. It is not easy to establish a direct link between the MEP STPs and the annual budget programmes as identified in Table 9 above. Obviously, the annual programmes are defined in a way which allows some flexibility with regard to the inclusion of an STP under one or another annual budget programme.

Each year and for each budget programme, the MEP prepares budget passport which contains a description of the programme and organises a call for project proposals from different stakeholders, including legal persons and central executive authority units. Legal persons submit applications through the MEP territorial units in the location where the project is going to be implemented. The territorial unit is obliged to review the application and issue an environmental opinion within the specified deadline before transferring the project to the Ministry. As such, the work of the MEP territorial units constitutes the first stage of identifying projects for financing from the MEP budget.

Central executive authority units may submit applications directly to the MEP. In this case, the environmental opinion is issued by the relevant department of the Ministry. In case of a positive opinion, the respective manager appraises or rather analyses the project applications for compliance with legal requirements. If the project meets required criteria, it is accepted, if not - it is rejected without possibilities for subsequent re-submission in the same budget year.

Once the list of possible projects for financing is compiled by each programme manager, a Working Group is established to review the projects. The structure and composition of the Working Group are approved by a regulation issued by the Minister of Environment on an annual basis. On the basis of the documents received (project proposals and approximate amounts of resources that will be made available by other programmes), the Working Group makes a selection of the projects to be financed from the Special Fund of the Ministry. The draft list of projects is then submitted to the Minister for approval.

However, the decisions on financing individual projects are not particularly transparent. There are no clear criteria for assessing environmental or cost-effectiveness of submitted projects or selection criteria for that matter. The most glaring problem is that project proponents are required to provide information on environmental effects (mostly in a descriptive form) only if a project is expected to be completed in the year when support from the MEP is requested. As such, a project may keep getting financing from the MEP for years before it becomes clear if this project is environmentally effective or not.

After the work plan is accepted by the Minister, the respective budget managers prepare a budget request and submit it to the Ministry of Finance. Following the adoption of the central budget for the subsequent year, the budget programme managers jointly with the Working Group introduce final amendments to the list of projects and re-submit it to the Minister for final acceptance. Once this process is completed, the respective budget programme managers notify the concerned government units, MEP territorial units and other organisations that their projects have been accepted for financing.

As beneficiaries receive funding on an annual basis, they have to re-apply every year to the MEP. It may happen, however, that a beneficiary does not receive support each consecutive year. It may also happen that the MEP budget is reduced in the middle of the budget year, as a result, many projects financed in this year's budget, have to be adjusted which creates problems for project owners with their contractors' contracts. On the other hand, due to difficulties with the project application and approval process (because of the involvement of a lot of different levels and people), many projects are financed at the very last moment of the budget year and money is often spent in a rush and inefficiently.

In principle, the ultimate selection and approval of all annul budget investment programmes (including those of the MEP), after consultations with the Ministry of Finance, lie with the Cabinet of Ministers, which may have even less relevant evidence to make well-informed judgements.

5.6 Institutional capacity to prepare and implement multi-year programmes

In general, the MEP capacity to plan, prepare and implement multi-year programmes is generally low. More specifically, there is a lack of capacity to gather information and data that underpin the analytical and financial basis of programmes, to conduct economic and financial analysis, to design rules, procedures and criteria for identifying, appraising and selecting cost-effective projects for financing, to monitor and evaluate projects.

This overall low capacity may be a function of the low remuneration of the ministry staff compared with other more powerful ministries in the administration and subsequent high turn-over of personnel. In addition, the relatively low pay results in hiring staff with lower skills; those with strong professional capacities would soon leave the ministry to find better financial offers in the private sector or in other government offices.

The MEP has little capacity to design programmes in line with international good practices. There is a general perception that when new environmental STPs are prepared they often repeat previous programmes. There is little new information and analysis in the new programme of how initial conditions have changed, the same activities are carried out from one year to another. In addition, programmes are overambitious and lack realistic costing. Financial strategies, market studies or feasibility studies are rarely prepared. The programmes lack clear and measurable environmental targets, performance indicators (particularly for the investment part) are not consistent across the years of programme implementation. Eligible beneficiaries and eligible projects are not specified anywhere explicitly. Co-financing requirements are not set either. Only investment data are collected, O&M costs are not considered. While programmes are consulted with other agencies within the government, there is rarely a broader debate with concerned stakeholders on the need and objectives of the programmes.

Project appraisal is particularly weak at the MEP. The appraisal and selection criteria are rather basic. No proper appraisal (financial, environmental and cost-effectiveness analysis) and ranking of projects is carried out. Project applications are mostly checked for conformity with current legislation. Evaluated projects are not ranked in any order of importance, hence there are no rules for determining which projects should be financed first with the limited resources.

There is no capacity in the Ministry to verify the information and data provided by project applicants. This prevents the Ministry from evaluating the capacity of project owners to operate and maintain the project in the future and achieve the objectives of the project for which they have obtained support from the MEP. As a result, it is not evident that the most environmental and cost-effective projects are supported by the Ministry. Thus, the MEP misses an opportunity to encourage the development of project preparation capacity in the country. In addition, due to the lack of clear rules, procedures and criteria, the final project selection is altogether highly discretionary and mostly left to the Cabinet of Ministers, which would have even less information on the projects to make well-informed judgements.

The MEP lacks capacity to effectively monitor and evaluate projects implemented with the Ministry's support. Even worse, the MEP does not collect information on achieved results of the projects it supports. Such information is not available from other institutions involved in programme implementation, either. Therefore, the role of performance indicators identified in the programme is not clear. There does not seem to be a real need or demand for such indicators. All this makes monitoring and evaluation of the overall programme implementation extremely difficult.

It is recognised by the authorities that the present processes for investment planning and implementation are complicated and not well co-ordinated with the budget process. Separate planning of capital expenditure and related current expenditure (for maintenance and operations) has led to negative consequences, such as uncompleted construction projects, prolongation of construction terms, and high operating costs of completed projects. It is important that proper investment planning is entirely integrated in the regular budget process of the line ministry that is responsible for the relevant policy sector.

The lack of capacity to coordinate and monitor programme implementation coupled with the lack of a clear division of funding responsibilities across various actors participating in a programme often result in further degradation of environmental conditions and health problems for the population. This inertia and lack of action usually lead to even higher future costs for the taxpayer and public purse.

This general lack of capacity to plan and implement public environmental expenditure over the medium term as well as the fragmentation of implementation responsibilities, and related accountability, may well be some of the main reasons for the overall low and inadequate funding of environmental programmes, declining environmental budgets and significant budget cuts at times of crisis.

CHAPTER 6. DONOR SUPPORT FOR THE ENVIRONMENT IN UKRAINE

This chapter briefly discusses issues related to donor support in Ukraine and specifically aid provided to the environment sector as well as links between donor aid and the annual budget. This is also done in the context of changing donor aid architecture and the gradual shift from project financing to more general budget support.

6.1 General budget support

For many years, official development assistance (and the influence of technical assistance) has been significant in aid-receiving countries, particularly in the environmental sector. Donor-assisted projects have often been "off-budget" and therefore not subject to the same discipline as activities funded through the national budget. Such projects often have different reporting, contracting and procurement standards, all of which tie up human resources, duplicating government's own systems. This is now being addressed through new aid modalities under the Paris harmonisation agenda.

General budget support is one of the aid instruments seen as a possible fix of some of the above problems. This instrument has been around for a long time but its use intensified during the last decade and particularly after the adoption, in 2005, of the Paris Declaration on Aid Effectiveness which called, among others, for better alignment of donor aid with partner countries' national priorities, harmonisation of donor requirements and an increased use of partner countries' financial systems in managing aid.

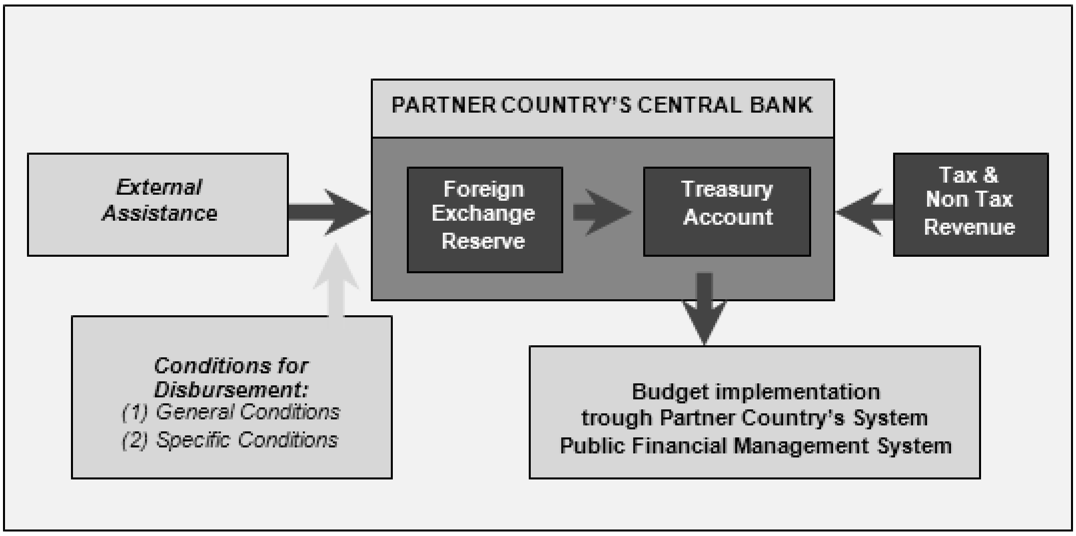
General budget support is defined as a method of financing a partner country's budget through a transfer of resources from an external financing agency to the national treasury of a partner country. These financial resources form part of the partner country's global resources, and are consequently used in accordance with its public financial management system. Budget support in this context involves three key elements. First, the transfer of foreign exchange from a donor to the partner country's central bank takes place. Second, the central bank credits the country's national treasury with an equivalent amount of local currency. Finally, transfers to the central bank are made only after agreed conditions for payment are met. Once the transfer is made, these resources are used, along with other government resources, in accordance with the partner government's public financial management systems. Figure 8 provides a visual representation of this aid instrument.

A broad distinction might be made between general budget support and sector budget support. In the case of general budget support, the dialogue between donors and partner governments focuses on overall policy and budget priorities, whereas for sector budget support the focus is on sector-specific concerns[18]. More specifically, there are three main variants of budget support:

- ***Sector Budget Support*** – budget support notionally earmarked to a particular sector, sub-sector or programme within the sector.
- ***General Budget Support*** – budget support that is notionally earmarked for poverty reduction measures as a whole, but not to individual sectors.
- ***Full General Budget Support*** – this is completely unearmarked.

[18] OECD (2006a).

Figure 6. Transfer of financial flows under general budget support



Source: ec.europa.eu.

The MTEF framework provides another incentive for donors to further align reporting and evaluation processes with the aid-receiving country's systems. Within the MTEF context, general budget support becomes therefore "on-budget". As such, donors can contribute to further strengthening the overall discipline of the expenditure management practices of aid-receiving governments.

6.2 Donor support to Ukraine

A large number of donors provide assistance to Ukraine totalling roughly two percent of GDP per year[19]. The largest assistance providers are the EU, EBRD, World Bank, Japan, and the United States. The aid is provided mostly as project funding, for both investments and technical assistance. Only recently, and in light of the changing aid modalities, has aid started being provided in the form of direct budget support. First, the World Bank provided budget support through its development policy lending facility, currently (starting in 2009) the EU, the UNDP and the OSCE are providing sector budget support. Part of the EU aid is being allocated to support the environment but discussions are still on-going.

When reflected in the annual budget, donor aid (basically multilateral) is shown as official transfers. It is further broken down between support from international organisations and EU support. Individual donors support is not included in the budget. In 2009, the level of donor support revealed in the budget amounted to UAH 838 040 thousand. Part of this, UAH 175 880 thousand, is identified as support coming (mostly) from the UNDP and the OSCE while the amount of UAH 662 160 thousand was identified as EU support (see Table 11 below). EU support is used almost exclusively for investment purposes, UNDP/OSCE support is allocated predominantly for technical assistance.

19 World Bank (2007b).

Table 12. Donor support in the 2009 budget, 1000 UAH

Budget code	Title	Total	General fund	Special fund
40000000	Official transfers	838 040	120 440	717 600
42000000	From international organisations	838 040	120 440	717 600
42010000	From UNDP, OSCE secretariat or other regional organisations to support Ukrainian presence in international (military) operations	175 880	120 440	55 440
42030000	EU support	662 160	0	662 160

Source: Ministry of Finance of Ukraine.

In Ukraine, execution/management of donor-financed activities (other than budget support) typically follow special procedures that are different from the country's regular public finance management system, e.g., banking arrangements, payments, procurement, accounting, financial reporting, and auditing. Technical assistance and in-kind assistance are typically managed or executed by the donor agency concerned and operate fully outside the country's public finance management system, e.g., the donor agency manages the procurement, contract management, and payments. Activities funded through cash assistance are typically executed or managed by the recipient entities, although even in these cases some functions are executed by the donor agencies, e.g., direct payments to contractors.

A major concern of the government is that donors often come up with their own proposals for projects that they are willing and interested to support. To help focus donors' attention on the country's priorities, the Ministry of Economy has prepared a draft Cabinet of Ministers Decree on the Strategic Priorities and Objectives of Attracting Foreign Aid to Ukraine for 2009 - 2012, which is currently being discussed in the government. The draft Strategy identifies 6 major priorities for donor support. One of them is raising the level of environmental, nuclear and radioactive safety. There is a specific sub-section in the Strategy on sustainable environmental management and natural environmental safety as well.

In addition, there are a number of donors specifically engaged in supporting public financial management reforms in Ukraine across a range of areas, including the institutionalising of a full-fledged medium-term expenditure framework. The two most important donors are the World Bank and the EU.

A significant component of the World Bank-funded Public Finance Modernisation Project is linked to medium-term budgeting. This aims at changing the legal status of the budget to facilitate performance budgeting and the introduction of sector MTEFs. There is also a World Bank Trust Fund which has a component linked to MTEF. Similarly, the EU-funded "Support to the Ministry of Finance of Ukraine in the Fields of Public Debt Management and Budgetary Forecasting" focuses, among others, on building models for improved forecasting of budgetary indicators which are part and parcel of a well-functioning MTEF.

In addition, the Ukrainian government with support by the EU, has launched the preparation of a sector MTEF. The Ministry of Agricultural Policy has been selected as a pilot sector to test this approach. One of the main objectives of the project is to help the Ministry develop credible and well-prioritised medium-term expenditure plans and programmes which may stand higher chances of obtaining financing from the general budget support pool made available by donors. Similar exercises are being launched in the health and in housing sectors as well.

All these initiatives show a clear trend in Ukraine towards moving to a more detailed MTEF as well as the willingness of donors to support such actions. Not surprisingly, these measures are closely linked to the new modalities in aid delivery. While the shift to general budget support is not yet so obvious, it is slowly but surely taking place.

6.3 Donor support for the environment sector in Ukraine

Ukraine receives support for environmental activities from a number of bilateral and multilateral donors both in the form of technical assistance and as support for investments. Multilateral donors include: the EU, the UNDP, UNESCO, the World Bank, and individual donors, such as Sweden, Canada, USA, the Netherlands. However, the majority of the projects do not go through the national budget or even through the Ministry of Environmental Protection but are directly disbursed to the local level.

Despite the efforts of the project team to obtain information on individual donor support that goes to the environment sector, the Ministry of Environmental Protection did not provide any data. This most likely implies that the Ministry has limited overview of the donor aid flows to the country or that coordination in the Ministry is poor. For this reason, we focus the discussion mostly on support provided by multilateral donors.

The **UNDP** is the main donor that provides support to the government of Ukraine for sustainable development and environmental policy implementation. The UNDP support focuses on:

- Environmental policy implementation at the national level;
- Climate change, renewable energy sources and energy efficiency;
- Nature management and biodiversity protection.

By the end of 2007, total UNDP assistance for Ukraine for environmental protection was approximately USD 6 000 000. Ukraine is also a member of 3 regional UNDP projects on the Dnipro and Danube rivers and the Black Sea. The overall project totals around USD 26 mln.

Information on UNDP-supported projects in the environment sector implemented at a national level in Ukraine is presented in Table 12 below.

Table 13. UNDP financing of selected environmental projects in 2005-2009, 1000 USD *

Name	Total	2005	2006	2007	2008	2009
Biodiversity of the Carpathian Region	24	11	13	-	-	-
Assessment of national capacity in environmental management	186	49	120	17	-	-
Dnipro Basin Environment Programme - Phase A	483	393	85	-	-	-
Dnipro Basin Environment Programme - Phase B	886	-	191	467	228	-
Energy Efficiency in Ukraine's Education Sector	309	-	38	164	107	-
Consolidation of the Polissya Ecological Corridor	286	-	92	194	-	-
Rivne central heating efficiency programme	234	234	-	-		
Energy sector reform and support for wind energy production	158	-	72	86	-	-
Energy efficiency lighting in communal buildings	100	-	-	-	-	100
Nature protection system support	954	-	-	-	264	690
Sustainable development programme of the Lugansk Region	963	-	322	72	108	461
Removing barriers to greenhouse gas emissions mitigation	2 965		106	593	354	1 912

* Data provided as of 1 April 2009.

Source: UNDP.

The **European Union** is the largest donor in Ukraine. It provides support for the environmental sector, in both investments and technical assistance, through its main instruments, including the European Neighbourhood Policy Initiative (ENPI) (the East Regional Action Programme and the Twinning Programme) that came to replace the various co-operation TACIS programmes (for the Eastern European countries) that existed before 2007 (e.g. TACIS Regional Action Programme, TACIS Cross-Border Cooperation Programme).

As of the end of 2009, the main areas of regional cooperation in the environmental sector supported by the EU through the ENPI and in which Ukraine participated[20], include:

- Civil Protection;
- Co-investment funding in the field of water and sanitation;
- Forest Law Enforcement and Governance;
- Support to Kyoto Protocol Implementation;
- Water governance in Western EECCA.

Under "Co-investment funding in the field of water and sanitation", the EU has allocated Euro 3 mln to support the Mykolaiv Municipal Water Project (co-funded with the European Investment Bank). In addition, several other projects were planned to be launched in 2009. One of these projects is particularly targeted at the Ministry of Environmental Protection and is envisaged to provide support for the implementation of the Law on Environmental Audit (Service contact in the amount of Euro 1.10 mln).

As part of the national programme for Ukraine, the EU is currently supporting two projects targeted at the environment and the sustainable management of natural resources. These two projects include: Support to Ukraine to Implement the Espoo and Aarhus Conventions (Euro 144,400) and Support to Ukraine to Implement the Danube and Ramsar Conventions (Euro 196,700). Support under both projects focuses on environmental policy and administrative management.

The **World Bank** Country Partnership Strategy for Ukraine outlines the priorities for the Bank Group's engagement through lending and investments, analytical and advisory services, and technical assistance in the country over the period 2008 - 2011. The strategy proposes a lending range of USD 2-6 bn over four years, with annual lending levels subject to progress in structural reforms, macroeconomic stability and improvements in the implementation of existing World Bank loans.

In addition, the World Bank offers different possibilities for the provision of grants. The World Bank Critical Ecosystem Partnership Fund provides support for overcoming conservation challenges (in particular, management of protected areas and coordination of actions in the biodiversity corridors; training; planning in the area of boundary territories). Grants recipients include a mix of nongovernmental organisations, community groups and private sector entities of various sizes.

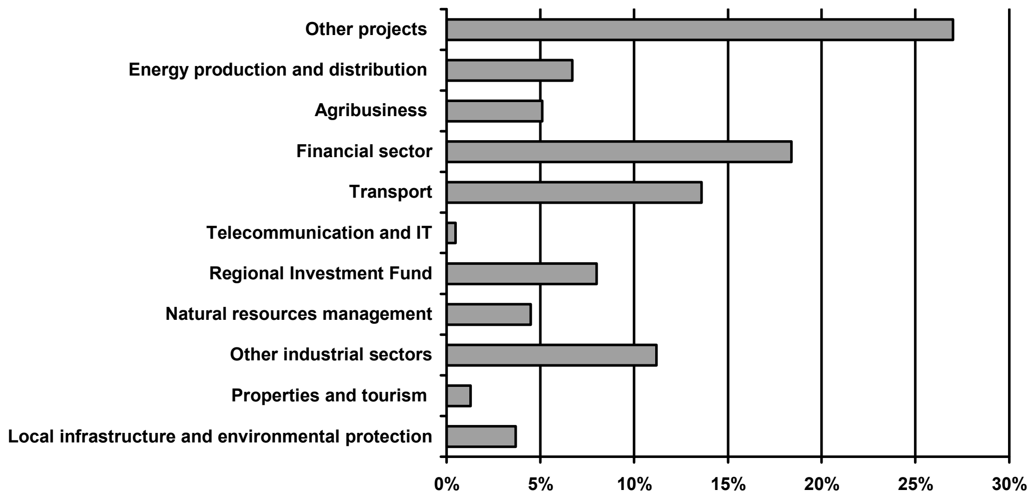
[20] EuropeAid (2010).

Table 14. World Bank involvement by sectors in 2009, million Euro

Sector	Amount, mln Euro	Share in total support
Local infrastructure and environmental protection	162.8	3.7%
Properties and tourism	59.0	1.3%
Other industrial sectors	497.8	11.2%
Natural resources management	201.2	4.5%
Regional Investment Fund	355.1	8.0%
Telecommunication and IT	22.0	0.5%
Transport	605.5	13.6%
Financial sector	817.1	18.4%
Agribusiness	224.9	5.1%
Energy production and distribution	295.8	6.7%
Other projects	202.0	27.0%

Source: World Bank.

Figure 7. World Bank support for sectors as a share of total support, 2009, %



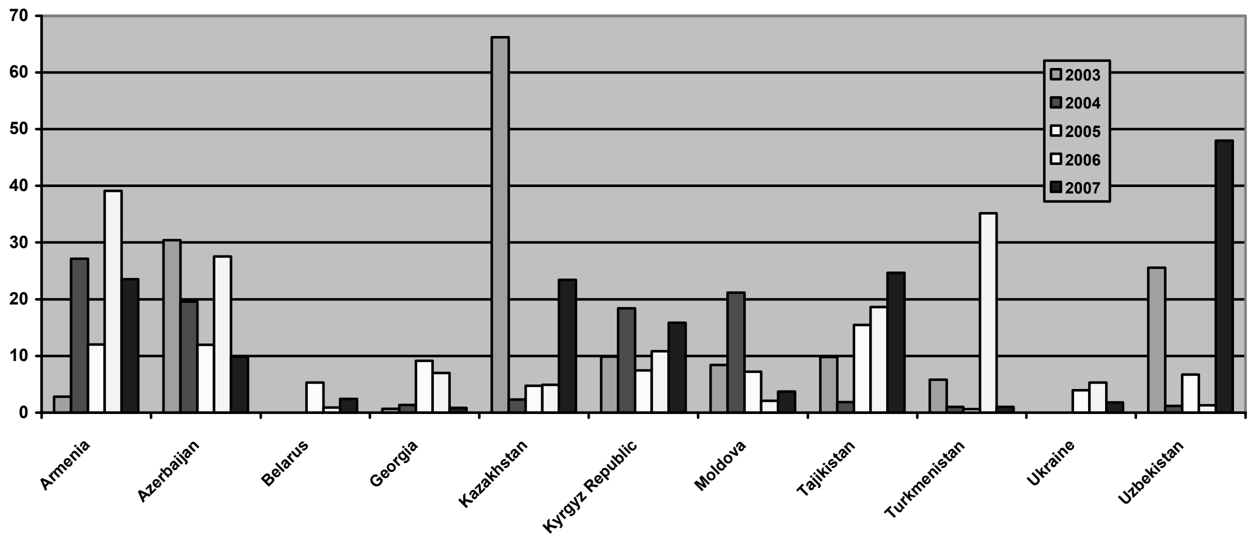
Source: World Bank.

As can be seen in Table 13 and Figure 9, in 2009, the World Bank support for the environment sector as a share of its total support in Ukraine was a little bit less than 4%. Bank support for natural resources management represented 4.5% of its total support for Ukraine. The financial and transport sectors got the lion's share of the support - with 18.4% and 13.6%, respectively.

Most recently, the **EU** has launched a significant support scheme for the environment in Ukraine. The resources will be provided as sector budget support for the environment, mostly for wastewater treatment projects, over a 3-year period, and will be managed by the Ministry of Environmental Protection. At the moment, the EU is ready to commit Euro 30 mln for this work. Sweden is also involved and is going to provide technical support for improvements in related legislation and for feasibility studies. The negations between the sides, which were delayed for a while by the political turbulences in the country, have resumed and are expected to be finalised soon. One of the main conditions for initiating the scheme was the finalisation of the new Environmental Strategy of Ukraine which has to serve as a basis for the disbursement of the EU support.

As the data obtained from the OECD-Donor Assistance Committee database show, environmentally-related official development assistance (ODA) that goes to Ukraine in the period 2003 - 2007 is rather low. On average, it is about 2% of the total ODA to the country. It is also low compared to the environmentally-related ODA that goes to the other countries in the EECCA region.

Figure 8. Environmentally-related ODA as a share of total ODA in EECCA countries, percentage



Source: OECD (2007c).

6.4 Analysis of donor support in Ukraine

As the above analysis shows, Ukraine is less dependent on foreign assistance financing than many other countries. Most of the aid, however, is still project-based and donors still prefer to use their own procedures for managing, implementing, monitoring and reporting on projects that they support.

This situation is slowly changing. Sector budget support starts being brought into play more consistently. It is clear that progress with obtaining more direct budget support depends both on the government's improvement of its public finance management systems and on donors working together and assisting the government to move forward in using improved country systems. Recent changes to the procurement law in Ukraine will likely inhibit greater use of Ukrainian procurement procedures for the immediate future.

At the same time, donors need clear directives as to where the country's priorities lie that they can support. The draft Strategy for attracting donor support provides an opportunity to present the government's vision for the future development of Ukraine. However, the priority areas, as identified in the draft document, are rather general and encompass pretty much every policy area that the government works on. The same holds true for the measures included under environmental and natural resource management. Altogether, the document resembles an all-inclusive shopping list. The draft does not provide either indicative cost estimates for any of the areas identified. As such, it offers little sense of priority and can hardly be seen as a guiding document for future donor support.

One of the major problems related to aid flows in Ukraine is the lack of precise and reliable data on these flows. Thus, it is difficult to draw any conclusions on volatility of donor support and its impact on Ukrainian budget formulation or execution. As Table 11 shows, the support of only very few donors is reflected in the budget. Cash funding to the government and public sector entities are typically included in the annual budget and reported in budget execution reports. However, technical assistance and in-kind assistance are not. Information flows from donors on planned and actual flows are still rather weak.

This situation is also evidenced by the state of affairs in the Ministry of Environmental Protection. The lack of access to information on donor support to the sector at a Ministry's level speaks of itself. This unwillingness of the Ministry to provide information may reflect the poor knowledge of the environmental administration of the real situation in the country. The lack of such knowledge may additionally undermine the effectiveness of the implementation of the budget and related targeted environmental programmes. Many of the STPs envisage support from international grants but the Ministry would not even know if local governments have had access to such support.

Altogether, the environmental sector receives very little donor support in Ukraine. This situation may change for better or for worse if and when donors switch to a more consistent use of general budget support. To a certain extent, this aid instrument introduces a level playing field where sectoral ministries and agencies will have to compete for access to donor funds, instead of negotiating them separately on their own.

The EU sector budget support, earmarked for the environment, is certainly an opportunity for the Ministry of Environmental Protection to gain experience with this instrument that can be useful in future competitions. It is important, however, that donors do not limit their requirements to the preparation of policy documents only as a proof of a given ministry's capacity to manage their resources. Donors may make use of this instrument to require and support real improvements in the capacity of Ministry's staff with designing, managing and implementing medium term programmes and investment projects in line with good international practices. This could help the Ministry get better chances in the future to obtain more adequate resources through the regular budget process.

On the other hand, the fact that Ukraine does not heavily depend on external support may be seen as positive factor for implementing an MTEF. This low dependence helps the government to plan better its expenditure without being constrained by negotiations with donors and donors' administrative conditionalities.

CHAPTER 7. FINDINGS AND RECOMMENDATIONS

7.1 Major findings

A full-fledged, whole-of-government, medium-term expenditure framework does not exist in Ukraine. However, there are a number of elements which, in principle, belong to the MTEF concept that have already been put in place. These include, among others, programme-based budgeting and performance budgeting. In addition, the Ukrainian government has already made some attempts to prepare projections of major macro-economic and fiscal targets on a three year basis but until now these have not been consistently used to inform the annual budget.

Ukraine has also introduced some tools, such as the State Targeted Programmes (STPs), which have been designed with the aim of providing a link between the national strategies and policies and the annual budgets. Unfortunately, these programmes, as currently designed and implemented, are riddled by a number of problems. In the environment sector, in particular, some of the major challenges include: unrealistic costing estimates, due, among others, to the fact that only investment costs are considered, lack of appropriate target and performance indicators, lack of capacity to appraise and select investment projects for financing, as well as monitor and evaluate the achievement of projects' and programmes' objectives and results.

Overall, these programmes are not designed in line with good international practices. The link between these programmes and the annual budget is rather poor. While the STPs do contain some useful information, they do not serve the purpose of informing the budget of future medium-term costs. To make an effective use of STPs as a possible input to the annual budget, there is a need to significantly improve their design and strengthen the MEP institutional capacity to implement them.

The change in donors' approach to delivering aid and the gradual shift from project financing to direct budget support also calls for changing budgeting practices and improved medium-term financial planning. Donors have a key role to play in transferring knowledge and supporting the implementation of good public expenditure management practices, including in the environment sector. Many of the donor countries have faced similar problems and have struggled with large budget deficits for years before starting to effectively implement MTEFs.

MTEFs *per se* are not a panacea for solving budget problems. International experience shows that introducing, and more importantly, institutionalising an MTEF, is a long and difficult process which requires high level political support and commitment. An MTEF should be tailored to the needs and capacities of the government administration. Given Ukraine's administrative capacity and particularly its experience with programme and performance-based budgeting, albeit riddled by numerous problems, starting with individual MTEF elements, gaining experience with their application and gradually moving to a full-fledged programmatic MTEF, may actually well be the right sequence of steps.

Before moving to a proper programmatic MTEF, it could be useful to strengthen government's capacity to do more realistic forecasting. Doing a "forecasting MTEF", which implies forecasting the functional and economic composition of expenditure contrasted with the revenue forecasts based on estimates of various taxes and other revenues sources, could be a first step towards implementing a full-fledged MTEF. The purpose of a forecasting MTEF is to give an indication of future resource availability for different ministries but it, alone, cannot significantly improve resource allocation and expenditure efficiency nor can it help strengthen the annual budget process. This can be achieved by the programmatic MTEF.

Given the most recent developments in the government, including the Ministry of Finance's letter to line ministries requiring them to prepare, for the first time, 3-year programme expenditure estimates to be attached to the annual budget, as well as launching a pilot MTEF in the agricultural sector (as well as similar work in the health and in housing sectors) and the support provided by certain donors for MTEF work, shows that the MTEF concept is maturing and the time has come for the Ukrainian government to undertake more concrete steps.

These recent attempts towards introducing a medium-term perspective to the budget may well have been a result from the recent financial crisis and the need to better plan and finance public expenditure. Thus, the crisis has provided a window of opportunity for the government to start introducing further reforms in the public finance system in the country, including preparing the ground for an MTEF launch. In doing so, however, the government needs to get ready to spare time and resources, as this will be a long process. In addition, to sustain the reforms, there is a need for a firm political commitment to and support for the changes as well as for a champion in the government that will guide and oversee the process.

7.2 Recommendations

In conclusion, the system of programming, planning and budgeting in the environment sector, as it currently exists, does not deliver and needs significant reforming. Below is a summary of the major recommendations that have emerged from the overall analysis. For convenience, these recommendations are addressed, on the one hand, to the government as a whole, and on the other, to the Ministry of Environmental Protection. There is a short set of recommendations addressed to donors as well.

These suggestions could be used as a basis for a policy dialogue on needed reforms among all stakeholders directly involved in or concerned with public environmental financing in Ukraine.

Recommendations to the government

- Before launching a full-fledged programmatic MTEF, consider introducing a medium-term *framework* (not budget) for budget revenues and expenditures (a forecasting MTEF), based on state-of-the-art econometric models as well as stable government commitments to provide, among others, entitlements to the citizens. This could help the government gain additional experience before gradually moving to a programmatic MTEF.

- Elaborate, in consultation with line ministries, a clear general definition of "programme," "sub-programme," and "activity" applicable to the entire government and define criteria to distinguish between on-going expenditure programmes (under current policies) and new expenditure programmes (under new policies when fiscal space is available).

- Develop a practical methodology for preparing medium-term programmes in line with international good practices and calculating the approximate cost of such programmes. Require from the line ministries to justify programmes with solid market studies and sector financing strategies (where appropriate, e.g. with large investment programmes). Introduce clear rules and procedures for mid-term reviews of the programmes and possible ways for adjusting them. This will help harmonise the programmatic approach across the government and ensure a more cost-effective use of scarce public resources.

- Select a few initial programmes as pilots in selected ministries. Gradually expand every year the "bottom-up" programming exercise by adding a few additional programmes, and correct the performance measurement and monitoring framework, based on experience.

- Simultaneously, initiate a series of outreach events to explain to frontline staff, line ministries and - possibly - the legislature the concepts of a programmatic MTEF. Use this opportunity, to revisit the foundations of the programme and result-orientation approaches to budgeting, currently in use in Ukraine. This will help gain support for the reforms from within the government.

- Integrate the investment and recurrent parts of the budget and make sector ministries responsible for both. This will help make the line ministries aware of the full cost of the programmes they propose.

- Improve coordination between ministries and introduce clear lines of responsibilities for all actors involved in the implementation of a given programme, including responsibilities for funding. This will help increase the accountability of different actors for achieving programmes' results and make the whole process more transparent.

Recommendations to the Ministry of Environmental Protection

- Before launching a new programme, involve all relevant stakeholders in a policy dialogue on the contents and financial needs of the programme. Apart from government agencies, these could include municipalities, business and industry associations, NGOs. This will help ensure broader public support for the programme.

- Review the existing environmental STPs, rationalise the activities included in them, adjust the programmes to the new economic and market developments, clean up duplications across programmes. This will help streamline budget resources and avoid wasteful spending as well as create fiscal space for new environmental expenditure.

- Improve programme design in line with good international practices. This should include, among others, translating a programme objectives into realistic and measurable environmental targets and performance indicators for monitoring the programme, preparing more realistic programme cost estimates, clearly identifying potential beneficiaries and types of projects that will be financed through the programme as well as clearly defined terms of financing and co-financing requirements. This will make the MEP programmes more transparent and visible within the government and the donor community which may potentially result in higher and more adequate budget allocations for the sector.

- Make consistent use of financial analytical tools when preparing a programme (sector financial strategies, market studies, expenditure reviews, project feasibility studies). Base the programme cost estimates on the findings of these analytical tools. Show clear links between environmental programmes and the country's economic growth and competitiveness strategies. This will make costing more realistic and more credible to the Ministry of Finance and the programmes more understandable to the government as whole.

- Introduce a clear sequence for implementing a programme's non-investment activities. For the investment component of the programme, which contains a list of projects, introduce a clear sense of priority as to which projects should be financed first when financing is made available. This will help minimise *ad hoc* financing decisions.

- Introduce rigorous and binding project eligibility, appraisal and selection criteria for financing of investment projects and streamline the project cycle process. Make cost-effectiveness (achieving environmental results at minimum costs) a prominent selection criterion. Require O&M costs and environmental objectives to be specified by project proponents every time they apply for support from the MEP. This can help make the process of selection of projects for financing more transparent and ensure that public funds are spent in a cost-effective manner.

- Introduce and maintain regular monitoring and evaluation of projects implemented with support from the MEP (technical, financial, and environmental performance).

- Conduct and maintain regular evaluation reviews (every 2-3 years) of overall progress with programme's implementation. Make reports from such reviews public. This can help the MEP learn lessons on how to improve future programmes and avoid future (costly) mistakes.

- Ensure training and capacity development of ministry's staff with regard to programme design and project cycle management (economic, financial, engineering skills). This, among others, can help the MEP staff get better prepared to more effectively confront potential future MTEF challenges.

- With regard to donors' support, develop and maintain a database of all environmental donor programmes and projects (including at a regional level). Make this information publicly available and ensure easy access to such data.

Recommendations to donors

- Provide precise and timely information on the amounts and timing of aid that goes to Ukraine. When this is environmentally-related aid, duly inform both the Ministry of Finance/Economy and the MEP. This is particularly important when the aid is not channelled through national level institutions.

- Align priorities with national priorities as well as with the county system processes (e.g. reporting and evaluation processes, procurement rules) that are in use in Ukraine. This will help reduce duplication of efforts and resources.

- Use the opportunity of providing direct budget support to further support the strengthening of public expenditure management practices in the environment sector in line with international standards.

Donors could be instrumental in building capacity in the sector by supporting, among others, the development and costing of environmental programmes, or the preparation of relevant analytical studies and methodologies. Providing support for strengthening the data information system, as a basis of robust financial planning and budgeting in Ukraine, is also important. Such support can help the MEP more successfully compete for public resources within the context of the annual budget process.

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Cabinet of Ministers Decree No. 106 of 31 January 2007 on the Development and Performance of State Targeted Programmes

Cabinet of Ministers Decree No. 504-r of 4 October 2006 on Enhancing the Forecasting System and Programme Documents with Regard to the Socio-Economic Development of Ukraine

Cabinet of Ministers Decree No. 1202 of 12 September 2004 on Forecasting Budget Indicators for 2006-2008 and in the Long Term Perspective

Cabinet of Ministers Decree No. 538-r of 14 September 2002 on Using the Task-Objective Method in the Budget Process

Law on Forecasting and Development of Socio-Economic Development Programmes in Ukraine (2000)

Law on State Targeted Programmes (2004 and further amendments)

Ministry of Economy Decree No. 180 of 23 May 2008 on the State Targeted Programmes Codes

Ministry of Finance Decree No. 1098 of 29 December 2002 on the Preparation of Passports for Budget Programmes

Socio-Economy Development Strategy for Ukraine 2004-2015, Ministry of Economy of Ukraine, Institute for Strategic Research, Institute for Economic Forecasting of the Ukrainian Academy of Science and the Statistical Office of Ukraine, Kiyv.

The Strategic Priorities and Objectives for Attracting Foreign Aid to Ukraine for 2009 – 2012 (unofficial translation), Cabinet of Ministers

List of national and sector specific programmes (of the Ministry of Environmental Protection), state targeted programmes and other government programmes reviewed

National Programme for the Development of the Dnipro River and the Improvement of Drinking Water Quality

National Programme on Environmental Monitoring

Programme for the Comprehensive Development of the Ukrainian Danube River Region for 2004-2010

Programme for a Comprehensive Flood-Control Protection of the Tisa River Basin for 2006-2015

Programme for the Discontinuation of the Production of Ozone-Depleting Substances for 2004-2030

Programme for Solid Waste Disposal

State Targeted Programme for Establishing the State Ecological Network for the Period 2000-2015

State Targeted Programme for the Development of the Mineral and Raw Material Base of Ukraine by 2010

State Targeted Programme for the Modernisation and Restructuring of the State Border until 2015

State Targeted Programme for the Protection of the Azov and Black Seas

State Targeted Programme for the Socio-Economic Development of Crimea until 2017

State Technical and Scientific Programme for the Development of Topography and Geodesy and the State Map System for 2003-2010

ANNEXES

Annex A: Socio-economic indicators for Ukraine

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP (USD mln)	31,262	38,009	42,393	50,133	64,883	86,142	107,753	142,719	180,355	..
GDP (% change, real terms)	5.9	9.2	5.2	9.4	12.1	2.7	7.3	7.9	2.1	*-14.0*
GDP per capita, PPPs (current international dollars)	3,170	3,630	3,940	4,450	5,160	5,520	6,130	6,840	7,210	..
Population, total (million)	49.18	48.68	48.20	47.81	47.45	47.11	46.79	46.51	46.26	..
Population, urban (% of total)	67.1	67.24	67.38	67.52	67.66	67.8	67.86	67.92	67.98	..
Consumer price inflation (average, %)	28.2	11.96	0.76	5.18	9.05	13.57	9.06	12.84	25.23	*15.89*
Unemployment (end-year, % of labour force)	11.6	10.9	9.6	9.1	8.6	7.2	6.8	6.4	6.4	..
Current account balance (USD million)	1481	1402	3174	2891	6909	2531	-1617	-5272	-12763	*-900.0*
Current account (% of GDP)	4.7	3.7	7.5	5.8	10.7	2.9	-1.5	-3.7	-7.1	*-0.8*
Trade balance (USD million)	779	198	710	518	3,741	-1,135	-5,194	-10,572	-16,091	*-3,500*
Gross capital formation (% of GDP)	19.7	19.7	19.2	20.6	22.6	22.0	24.6	27.6	27.2	
External debt (% of GDP)*	37.81	31.79	51.10	47.5	47.3	46.0	50.6	57.6	56.4	..
External debt (% exports of goods and services)	60.54	57.37	54.69	82.2	77.2	89.3	108.5	128.4	118.7	..
Foreign direct investment, net inflows (% of GDP)	1.9	2.1	1.6	2.8	2.6	9.1	5.2	6.9	6.1	..
Aid (% of GNI)	..	..	..	..	..	0.48	0.46	0.30	0.35	

Notes: 2009 data are EBRD estimates.µ

* Until end-2002, medium and long-term external debt only. From 2003 onwards, the series also includes short-term external debt. (EBRD)

Source: EBRD, *Transition Report* 2009; IMF, *International Financial Statistics* April 2010 (CD-ROM); WB, *World dataBank, April* 2010.

Annex B: Budget classification systems

Line item classification: Structures expenditure by object according to the categories used for administrative control, for instance: salaries, travel allowances, telephone, and office materials.

Functional classification: Structures government activities and expenditures according to their purpose, for instance: policing, defense, education, health, transportation and communication. The United Nations standard functional classification, used in the preparation of national accounts and government Financial Statistics distinguishes 14 major groups, 61 groups and 127 sub-groups.

Economic classification: Structures government financial operations according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments: and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.

Administrative classification: Structures expenditure by the institution responsible for the management of funds. The structure of administrative classification will vary from country to country, as will the number and administrative level of the budget holder.

Programme classification: Structures expenditures according to programmes, considered as a set of activities undertaken to meet the same objectives. The programme classification may correspond to a disaggregation of the administrative classification or may cross administrative units.

Territorial classification: Structures revenues and expenditure by the geographical area of impact of the financial operation.

Source: Based on Schiavo–Campo and Tommasi (1999).

Annex C: Example of a targeted programme passport template in Ukraine

PASSPORT

____

(Name of the State Targeted Programme)

1. Programme framework adopted by Regulation of the Ukrainian Cabinet of Ministers of ____ ____________ 20__ No.________.
2. Programme adopted:
- Act of____ ___________ 20__ No.________,
- Regulation of the Ukrainian Cabinet of Ministers of _____ No.__
3. State contracting authority (coordinator) _____________
4. Contracting authorities __________________________________
5. Programme manager_______________________________________
(position)
6. Programme implementing institutions_____________________________
____
____
7. Delivery date _________________________
8. Forecast expenditure and financing sources

Financing sources	**Total cost**	**Years**				
		20_	20_	20_	20_	20_
Central budget						
Local government budget						
Other sources						
Total						

Programme manager _____________________ _____________________
(signature) (name and surname)

Deliverables

____

(Name of the State Targeted Programme)

Project name	**Project indicator name**	**Indicator unit**	**Indicator value**					
			Total	Years				
				20_	20_	20_	20_	20_
	economic							
	social							
	environmental							
	other							

Annex D: A simple template for introducing a programmatic MTEF[21]

MINISTRY OF……….

EXPENDITURE PROGRAMME: ……. [22]

I. **Results framework** (Fill in **only** as relevant and applicable**)**

	Baseline (Year t)	***Year t+1***	***Year t+2 …***	***Year t+n***
A. Outcome (s) (Purposes of the programme; sometimes called "impact")				
B. Output (s) (A few clear, relevant, monitorable indicators of goods or services produced, *normally* quantitative.)				
C. Process indicators (If relevant: normally qualitative but clear and precise in any case)				
D. Programme cost				
E. Number of beneficiaries: (if applicable)				

II. Monitoring mechanism *("what is happening?")*

A. Who (designated ministry official responsible for the monitoring):

B. With whom:

1. In the same ministry:

2. Other government agency:

3. Civil society/user groups:

C. How and When (e.g., sample of activities, spot inspections, opinion survey, periodicity of monitoring, etc.):

E. With what (estimated cost of monitoring, additional to normal expenditure) [23]

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21 Borrowed from Schiavo-Campo, S. (2008).

22 Define as clearly as possible - *everything* flows from the clarity of definition of the expenditure programme. The programme cost and number of beneficiaries can be approximately estimated, with the estimates improved each year on the basis of experience.

III. Evaluation *(Why did what happened happen?)*

(Brief, simple and focused on the main causes for the results. Evaluation is intended to serve mainly as a basis for internal reflection and dialogue with the ministry of finance. Mechanical links with the budget are to be avoided.)

A. Internal factors contributing positively to results:

1. Institutional (rules, incentives…)

2. Informational (data availability/reliability, ease of transmission…)

3. Resources (personnel skills/motivation, financial, local cooperation...)

B. Internal factors contributing negatively to results:

1. Institutional (rules, incentives…)

2. Informational (data availability/reliability, ease of transmission…)

3. Resources (personnel skills/motivation, financial, local cooperation...)

C. Positive or negative external factors

1. External to the programme

2. External to the ministry

3. External to the government

IV. Follow up

A. Actions envisaged to strengthen positive factors and/or address negative factors:

B. Estimated cost of above actions:

C. Anticipated benefits (either in terms of savings or of expansion of programme services or of service quality. Describe in words if it is not realistic to quantify.)

D. Lessons learned (particularly in terms of improving the performance indicators, or the monitoring mechanism, or expanding the results framework of additional programmes).

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[23] Because monitoring should be a normal responsibility of any ministry, it does not justify additional budget or staff - and the monitoring staff should generally be designated from among the existing staff of the ministry. However, during the start-up period, the additional operations and maintenance costs directly associated with the monitoring may justify an additional temporary provision by the ministry of finance. After the initial start-up period, as programme efficiency increases as a result of the stronger performance orientation, the resulting savings should render the monitoring mechanism self-financing and produce additional savings and/or an expansion of services.

Annex E: List of STPs entirely or partially funded through the MEP budget, thousand UAH

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
037		**Programme for the Environmental Restoration of the Dnieper River Basin and Improving Drinking Water Quality**		**400.0**	**5,847.1**	**1,000.0**	**14,795.3**	**0.0**	**12,705.7**
		Resolution of the Supreme Council of 27 February 1997, No. 123/97-BP Programme implementation period: 1997–2010							
MEP	2401230	Waste treatment		0.0	4,641.1	0.0	12,468.8	0.0	10,205.7
MEP	2401250	Controlling municipal and hazardous waste and chemicals		0.0	1,206.0	0.0	2,326.5	0.0	2,500.0
Committee for Land Resources, MEP	2408040	Preservation, reclamation and ensuring the rational use of land resources		400.0	0.0	1,000.0	0.0	0.0	0.0
102		**Programme for the Establishment of a National Environmental Network**		**4,832.1**	**1,209.0**	**5,765.7**	**6,701.2**	**17,864.0**	**4,485.0**
		Act of 21 December 2000, No. 1989-III Programme implementation period: 2000–2015							
State Forestry Committee	1901080	Preservation of nature reserves		628.8	0.0	628.8	0.0	628.8	0.0
MEP	2401040	Applied science and scientific and technical work, work under state targeted programmes and public procurement within the framework of environmental protection, financial support for academic staff training		117.2	0.0	326.1	0.0	326.1	0.0
MEP	2401260	Establishment of a national environmental network		0.0	1,209.0	0.0	5,651.2	0.0	3,285.0
Ukrainian Academy of Agricultural Sciences	6591100	Preservation of the “Ascania-Nova” reserve together with its ecosystem		4,086.1	0.0	4,810.8	1,050.0	16,909.1	1,200.0

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
116		**Programme on the Integration of Ukraine with the European Union**		**800.7**	**75.0**	**375.0**	**0.0**	**375.0**	**0.0**
		Regulation of the President of Ukraine of 14 September 2000, No. 1072 Programme implementation period: 2000–2007							
Ministry of Culture and Tourism	1801170	Organisation of cultural and artistic events, support for regional cultural initiatives and amateur art		98.0	0.0	0.0	0.0	0.0	0.0
MEP	2401240	International collaboration with respect to environmental protection, promoting the development and dissemination of environmental information and education		0.0	75.0	0.0	0.0	0.0	0.0
Ministry of Labour and Social Policy	2501010	Management of labour and social policy		45.2	0.0	0.0	0.0	0.0	0.0
Ministry for Extraordinary Situations	3201010	Extraordinary situations management, protecting the population from the effects of the Chernobyl incident		127.9	0.0	375.0	0.0	375.0	0.0
Ministry for Family and Youth	3401070	Organisation of events related to state policy concerning youth, women and family		395.4	0.0	0.0	0.0	0.0	0.0
State Tax Administration	3507600	Modernisation of tax services		134.2	0.0	0.0	0.0	0.0	0.0
126		**Programme for the Protection and Restoration of the Environment of the Sea of Azov and the Black Sea**		**200.0**	**28,644.9**	**412.0**	**2,000.0**	**190.0**	**3,419.8**
		Act of 22 March 2001, No. 2333-III Programme implementation period: 2001–2010							
MEP	2401040	Applied science and scientific and technical work, work under state targeted programmes and public procurement within the framework of environmental protection, financial support for academic staff training		0.0	0.0	112.0	0.0	190.0	0.0
MEP	2401230	Waste treatment		0.0	11,666.9	0.0	2,000.0	0.0	3,419.8

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
MEP	2401240	International collaboration with respect to environmental protection, promoting the development and dissemination of environmental information and education		0.0	80.0	0.0	0.0	0.0	0.0
MEP	2401250	Waste-related work, including work related to hazardous chemical waste		0.0	16,898.0	0.0	0.0	0.0	0.0
Committee for Land Resources, MEP	2408040	Preservation, reclamation and rational use of land resources		200.0	0.0	300.0	0.0	0.0	0.0
178		**Programme for Comprehensive Flood Control of the Tisa River Basin, 2006–2015**		**442,3**	**70,900.0**	**530.0**	**80,900.0**	**140,303.3**	**73,200.0**
		Decision of the CoM of 24 October 2001, No. 1388 (amended in February 2006, No. 130) Programme implementation period: 2002–2015							
Committee for Land Resources, MEP	2408040	Preservation, reclamation and rational use of land resources		200.0	0.0	300.0	0.0	1,000.0	0.0
Hydrometeorological Service, Ministry for Extraordinary Situations	3207030	Development of structures and methods of hydrometeorological observations on rivers and lakes		70.0	0.0	60.0	0.0	65.0	0.0
State Committee for Water Resources	5001060	Implementation of the state monitoring of surface waters, water cadastre, passporting, water resource management		172.3	0.0	170.0	0.0	202.3	0.0
State Committee for Water Resources	5001080	Comprehensive flood control of the Tisa River basin		0.0	70,900.0	0.0	80,900.0	139,036.0	73,200.0
255		**Scientific and Technical Programme for the Development of Topographic and Surveying Activities and the National Mapping System, 2003–2010**		**26,095.2**	**0.0**	**36,250.0**	**0.0**	**19,568.9**	**0.0**
		Regulation of the CoM of 16 January 2003, No. 37 Programme implementation period: 2003–2010							

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
Ministry of Education	2201060	Scientific and technical work under targeted programmes and public procurement		0.0	0.0	0.0	0.0	68.9	0.0
MEP	2401040	Applied science and scientific and technical work, work under state targeted programmes and public procurement within the framework of environmental protection, financial support for academic staff training		1,045.2	0.0	1,200.0	0.0	1,200.0	0.0
State Surveying Service, MEP	2405020	National surveying and mapping work		11,900.0	0.0	11,900.0	0.0	18,300.0	0.0
State Surveying Service, MEP	2405030	Demarcation and delimitation of the state border		13,150.0	0.0	23,150.0	0.0	0.0	0.0
271		**Comprehensive National Programme for the Implementation of the Millennium Development Goals for the Years 2003–2015 Proposed during the Global UN Conference**		**0.0**	**0.0**	**0.0**	**70.0**	**0.0**	**150.0**
		Regulation of the CoM of 26 April 2003, No. 634 Programme implementation period: 2003–2015							
MEP	2401240	International collaboration with respect to environmental protection, promoting the development and dissemination of environmental information and education		0.0	0.0	0.0	70.0	0.0	150.0
301		**Programme for the Discontinuation of Production and Use of Substances that Deplete the Ozone Layer, 2004–2030**		**50.0**	**2,346.5**	**90.0**	**0.0**	**60.0**	**0.0**
		Regulation of the CoM of 4 March 2004, No. 256 Programme implementation period: 2004–2030							
MEP	2401190	Natural environment monitoring and ensuring state control with respect to compliance with the standards identified in the environmental legislation		0.0	369.0	0.0	0.0	0.0	0.0
MEP	2401250	Waste-related work, including work related to hazardous chemical waste		0.0	1,977.5	0.0	0.0	0.0	0.0

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
Ministry for Extraordinary Situations	3201340	Applied research and scientific and technical work with respect to civil defence and fire protection		50.0	0.0	90.0	0.0	60.0	0.0
302		**Programme for the Disposal of Solid Household Waste**		**185.0**	**0.0**	**190.0**	**0.0**	**50.0**	**30.0**
		Regulation of the CoM of 4 March 2004, No. 265 Programme implementation period: 2005–2011							
MEP	2401250	Waste-related work, including work related to hazardous chemical waste		0.0	0.0	0.0	0.0	0.0	30.0
Ministry of Regional Development and Construction	2701030	Scientific and technical and applied work with respect to projects under targeted programmes concerning the establishment and development of municipal economy		185.0	0.0	190.0	0.0	50.0	0.0
308		**Programme for the Comprehensive Development of the Ukrainian Territories around the Danube Estuary, 2004–2010**		**46,944.8**	**0.0**	**65,061.0**	**0.0**	**63,405.0**	**0.0**
		Regulation of the CoM of 31 March 2004, No. 428 Programme implementation period: 2004–2010							
Ministry of Education	2201060	Scientific and technical work under targeted programmes and public procurement		0.0	0.0	300.0	0.0	200.0	0.0
Committee for Land Resources, MEP	2408040	Preservation, reclamation and rational use of land resources		100.0	0.0	150.0	0.0	150.0	0.0
Ministry of Regional Development and Construction	2751090			442.0	0.0	860.0	0.0	0.0	0.0
Ministry of Transport	3103030	Support for ensuring the proper condition of sluices and internal waterways and the construction of a dam within the framework of the Danube-Black Sea Canal project		46,342.8	0.0	63,700.0	0.0	63,000.0	0.0

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
Ministry for Extraordinary Situations	3207030	Development of structures and methods of hydrometeorological observations on rivers and lakes		60.0	0.0	51.0	0.0	55.0	0.0
388		**State Programme for the Development of the Ukrainian Mineral and Resource Base until 2010**		**0.0**	**582,732.0**	**0.0**	**672,900.0**	**0.0**	**684,957.9**
		Act of 22 February 2006, No. 3458-IV Programme implementation period: 2007–2010							
State Geological Service, MEP	2404020	Development of the resource base, including the drilling of deep wells		0.0	582,732.0	0.0	672,900.0	0.0	684,957.9
410		**Programme for the Reconstruction and Upgrade of the State Border until 2015**		**0.0**	**0.0**	**139,112.8**	**15,691.0**	**693,025.0**	**14,339.0**
		Regulation of the CoM of 13 June 2007, No. 831 Programme implementation period: 2007–2015							
MEP	2401190	Natural environment monitoring and ensuring state control with respect to compliance with the standards of environmental legislation		0.0	0.0	0.0	15,691.0	0.0	14,339.0
Surveying and Cadastre Service, MEP	2405030	Demarcation and delimitation of the state border		0.0	0.0	0.0	0.0	23,150.0	0.0
Committee for Land Resources, MEP	2408030	Land reform		0.0	0.0	1,000.0	0.0	1,000.0	0.0
State Customs Service	3506010	Customs service direction and management		0.0	0.0	0.0	0.0	110,900.0	0.0
State Customs Service	3506020	Extension and upgrade of customs facilities		0.0	0.0	66,612.8	0.0	503,500.0	0.0
State Border Service	5341100	Reconstruction and upgrade of the state border		0.0	0.0	71,500.0	0.0	54,475.0	0.0
420		**Programme for the Social and Economic Development of Crimea until 2017**		**0.0**	**0.0**	**3,335.4**	**0.0**	**3,000.0**	**0.0**
		Resolution of the CoM of 30 August 2007, No. 1067 Programme implementation period: 2007–2017							

Programme No. / Financing unit	STP code	STP name	Programme approved when and by whom	2007		2008		2009 (projected)	
				General Fund	Special Fund	General Fund	Special Fund	General Fund	Special Fund
State Committee for Land Resources, MEP	2408030	Land reform		0.0	0.0	2,826.0	0.0	2,300.0	0.0
State Committee for Land Resources, MEP	2408040	Preservation, reclamation and rational use of land resources		0.0	0.0	509.4	0.0	700.0	0.0
422		**National Environmental Monitoring Programme**		**0.0**	**0.0**	**110.0**	**8,000.0**	**2,520.0**	**10,055.0**
		Regulation of the CoM of 5 December 2007, No. 1376 Programme implementation period: 2008–2012							
MEP	2401190	Natural environment monitoring and ensuring state control with respect to compliance with the standards of environmental legislation		0.0	0.0	0.0	8,000.0	0.0	10,055.0
State Committee for Land Resources, MEP	2408030	Land reform		0.0	0.0	110.0	0.0	120.0	0.0
Ministry of Agriculture	2801320	Research and experimental work related to agriculture		0.0	0.0	0.0	0.0	2,400.0	0.0
Total				**159,900.2**	**1,383,509.0**	**504,463.8**	**1,602,115.0**	**1,880,722.4**	**1,606,684.8**
of which from the MEP budget				***27,112.4***	***620,854.5***	***42,883.5***	***719,107.5***	***48,436.1***	***728,942.4***

Annex F: List of people interviewed

Ministry of Environmental Protection
Mykola Pilipchuk, Head, Environmental Economics Department
Svitlana Nigorodova, Adviser to the Minister
Taras Trotskiy, Director, International Relations Department

Ministry of Economy
Anatolyi Maksjuta, First Deputy Minister of Economy
Mikhail Garmash, Head, Department for International Technical Assistance and Cooperation with International Financial Organisations

Ministry of Finance
Olga Zvarych, Director, Revenues Department

World Bank Resident Office
Pablo Saavedra, World Bank Resident Officer
Alexey Balabushko, Economist in the ECSPE (Europe and Central Asia Region) Sector
Alexei Slenzak, Environmental Officer

IMF Resident Office
Max Alier, Resident Representative

EU Delegation in Kiyv
Olexander Klitko, Environmental Officer

UNDP-GEF Dnipro Basin Environment Programme
Lubomyr Markevych, Project Manager