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ABBREVIATIONS AND ACRONYMS

AGSECAL	Agricultural Sector Adjustment Loan
BIS	Bank for International Settlements
BRD	Bank Resolution Department
BSD	Bank Supervision Department
CAS	Country Assistance Strategy
CEE	Central and Eastern Europe
CIS	Confederation of Independent States
CPAR	Country Procurement Assessment Report
EBRD	European Bank for Reconstruction and Development
ECU	European Currency Unit
EDAL	Enterprise Development Adjustment Loan
EDF	Export Development Fund
EDP	Export Development Project
EU (TACIS)	European Union Program of Technical Assistance for Commonwealth of Independent States
EXIM	State Export-Import Bank of Ukraine
FIDL	Financial Institutions Development Loan
FSAL	Financial Sector Adjustment Loan
FSP	Financial Services Project
FSR	Financial Sector Review
FSU	Former Soviet Union
FTO	Foreign Trade Organization
GDP	Gross Domestic Product
GNP	Gross National Product
Gosbank	Former USSR State Bank
GOU	Government of Ukraine
IAS	International Accounting Standards
IBRD	International Bank For Reconstruction and Development
ICB	International Competitive Bidding
IMF	International Monetary Fund
JEXIM	Japanese Export-Import Bank
KBV	Karbovanets (Former Ukrainian Local Currency)
LIBOR	London Interbank Offered Rate
MOE	Ministry of Economy
MOF	Ministry of Finance
MOFER	Ministry of Foreign Economic Relations
MPP	Mass Privatization Program
MU	Monitoring Unit
NBU	National Bank of Ukraine
PMU	Project Management Unit
SBA	Stand-by Arrangement
SCL	Single Currency Loan
SMEs	Small and Medium-Size Enterprises
SPF	State Property Fund
SSCM	Securities and Stock Market Commission
STF	Systemic Transformation Facility (of the IMF)
UAH	Hrivnya (Ukrainian Local Currency)
UBPR	Unified Bank Performance Report
UCCI	Ukrainian Chamber of Commerce and Industry
USAID	United States Agency for International Development
USSR	Union of Soviet Socialist Republics

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MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

UKRAINE: Country Assistance Evaluation

Attached is the report *Ukraine: Country Assistance Evaluation* which evaluates the relevance, efficacy and efficiency of the Bank's assistance to the country since 1992. A draft of this evaluation was discussed by CODE on May 12, 1999 and a report of that discussion is attached as Attachment 1. This report is now being re-issued for the purpose of public disclosure.

Despite considerable natural resources, a well educated population and a relatively well developed infrastructure, economic and social development over the past eight years have not been good. Income per capita declined by over 40 percent from 1989 to 1997, real wages are about 35 percent of the levels at independence, and poverty has increased significantly. The Government has not been a committed and sustained reformer, as the political consensus necessary for deep structural reform has been absent.

The country assistance strategy was broadly relevant. Achievement of a degree of macroeconomic stability and eliminating hyperinflation has been a notable success, however the sustainability of this is uncertain. Some progress has been made in privatization and trade and price liberalization, but progress in creating a more dynamic agricultural sector, or in rationalization of the coal sector has been limited. Little or no progress has been made in reforming the country's social safety net systems or creating financial viability in the electricity and heavy industry sectors. Despite Bank efforts to generate a shared vision of the path to follow, the fundamental principles of a market economy are not yet accepted by a sufficient body of policymakers and civil servants to make far-reaching reform feasible.

The business environment needed for a dynamic, private sector driven market economy is generally absent. Excessive regulation, onerous tax systems, a non transparent legal system and ad hoc Government interventions inhibit investment and undermine the progress achieved through privatization or trade liberalization. Progress in reform of public administration and overcoming institutional weaknesses has been limited, and a range of vested interests have been able to thwart the liberalizing intent of many policy changes. Corruption has become pervasive, contributing to not only a considerable increase in transaction costs but pushing a large portion of the economy "underground" and out of the formal system, with detrimental fiscal repercussions.

A number of key lessons emerge from this CAE. First, where there is limited social consensus for reform, the scope for Bank assistance is constrained and efforts should be targeted toward the poorest groups or demonstration projects that can be scaled up once tangible success is observed. Second, future project design should seek to bring about a fundamental change in the role of public administration in the economy. Third, the Bank, in partnership with other donors, must focus more on public awareness of the causes of the country's economic difficulties and the nature of the needed reforms.

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Preface

This Country Assistance Evaluation (CAE) presents the findings of an OED team that visited Ukraine in September, 1998. The team held extensive discussions with government officials, representatives of the civil society and academic community, NGOs, other donors and the Bank staff in the Resident Mission. The valuable contribution and cooperation of all is gratefully acknowledged.

This CAE reports on the period from 1992 to 1998 of World Bank involvement with the Government of Ukraine and its economic transition and development efforts. Sixteen projects, a substantial economic and sector work program and an active policy dialogue that covered most aspects of economic life are reviewed. The report presents a synthesis of the evaluation findings describing a comprehensive and intense country assistance program. The bibliography lists over a hundred reports, books and journal articles, as well as voluminous operational documentation. All materials, including detailed working papers on each sector, are lodged in OED's Ukraine CAE files and are available on request.

The CAE's main conclusion is that the Bank's assistance to Ukraine has been only partially effective, and while the partnership forged with the government has helped to move the necessary transition reform agenda forward, little progress has been made in some key areas. Achieving a degree of macroeconomic stability and eliminating hyperinflation has been a notable success, although the sustainability of these advances is still somewhat uncertain. Good progress has been made in privatization, trade and price liberalization, and in strengthening the central bank. Partial progress has been achieved in reforming the country's crucial agricultural sector and focusing attention on restructuring the coal sector. Little progress has been achieved in reforming the country's social safety net systems and the health and education sectors, creating financial viability in the electricity sector, or dealing with the heavy industrial sector. Poverty has increased significantly. The business environment needed for a dynamic, private sector-driven market economy is generally absent. Progress in reforming public administration has been limited, and the onerous regulatory environment maintains the status quo of an interventionist public administration more akin to the Soviet system.

The lessons drawn from the CAE are presented at a general and a sector level. The aim has been to develop key issues and themes, culled from experience in Ukraine and elsewhere, that will assist the Bank to refine its country assistance strategy and strengthen its future assistance efforts.

Executive Summary

1. Ukraine has some of the best agricultural land in the world, a range of hydrocarbons and minerals and a relatively well developed infrastructure. Literacy is close to 100 percent, and the labor force is educated to the highest technical and scientific levels. But at independence Ukraine's apparent economic wealth had been built by the flawed investment decision-making under central planning. When the Soviet Union dissolved, the breakdown in the trade and payment systems was a massive shock to the Ukrainian economy. Developing a political consensus to manage both the immediate macroeconomic stabilization requirements and the transition reform agenda has been difficult. The first three years following independence in 1991 were characterized by sharp falls in output, hyperinflation, lax fiscal and monetary policies and little progress in structural reform.

2. Ukraine joined the World Bank in September 1992. At that time the Bank realized that there was limited scope for project activity until a credible government plan to deal with monetary stabilization could be developed. The lead role in achieving this was with the IMF. While the government had expressed an early commitment to move toward a market economy, only following the election of President Kuchma in mid-1994, was a minimal political consensus necessary to deal with macroeconomic stabilization attained. The Bank had previously undertaken a large ESW program to both establish what the reform agenda should be and to broaden the constituency of "reformers".

3. Development outcomes have not been good. Income per capita declined by over 40 percent from 1989 to 1997, and output in agriculture and industry has declined every year since independence. These economic difficulties have exacted a heavy toll on the population. Real wages are estimated to be about 35 percent of the level prevailing in 1990 and poverty has increased significantly. Limited progress has been made in reforming the social safety net system, and the country's pension system is in deep crisis. Public sector management has improved only marginally. The major achievement has been monetary stabilization and the eradication of hyperinflation. Progress has been made in price and trade liberalization, privatization and creating the basic financial sector infrastructure. But only limited progress has been made in restructuring the coal and electricity sectors and creating an enabling environment in the agriculture sector. The overall commercial environment has improved little, because of excessive regulation, onerous tax rates, non-transparent legal systems and impromptu government interventions. From a development outcome perspective the efficacy of the Bank's country assistance efforts has been unsatisfactory.

4. Recognizing the difficult political environment, the Bank's strategy was a graduated assistance program, increasing with the intensity of the perceived reform effort. Key "triggers" were strong efforts in price and trade liberalization, privatization and land reform. Because of the weak institutional and administrative capabilities, technical assistance featured strongly, especially in the initial stages of assistance strategy development. As the strategy was formed attention became increasingly focused on the agriculture, energy and financial sectors; poverty alleviation was to some extent subsumed in seeking to arrest and reverse the continuing decline in output. IBRD commitments during the period under review (1992-1998) amounted to US$ 2.8 billion, with the approval of 16 projects. Adjustment lending constituted 71 percent of

lending. Implementation has not proceeded smoothly. The disbursement ratio is one-third the Bank-wide average, despite a supervision intensity twice as high as the Bank-wide average.

5. By and large the Bank's country assistance strategy has been relevant. The "graduated response" approach was probably the best option, given the lack of full government commitment to reform across all sectors. However, the Bank has often overestimated the government's implementation capacity and the speed with which the economy would respond to changes in the incentive structure and policy environment. Gradually, the Bank has developed a better understanding of the political economy and governance issues in Ukraine; project preparation now explicitly includes discussion with a fuller diversity of political and public administrative groups. This is positive. But despite Bank efforts to create a shared vision of the path to follow, the principles of a market economy are not yet accepted by enough policymakers and civil servants.

6. Progress achieved in privatization, price liberalization and in strengthening the central bank is likely to be sustained. In all other areas, however, sustainability is far less certain. The fiscal situation remains fragile, key rationalizations in the heavy industry and coal sectors have yet to be done, the power sector has not reached financial viability, land title and registration systems face Parliamentary opposition and the social safety net requires urgent overhaul. In view of this, the overall assessment of the sustainability of the Bank's country assistance efforts is uncertain.

7. Progress in reforming public administration and overcoming institutional weaknesses has been limited. The general business environment is not transparent or supportive, and bureaucratic and administrative obstacles inhibit entrepreneurial activity. A fundamental reorientation of public administration philosophy and approach is still absent. Overall institutional development is therefore rated as modest.

8. A generic question emerging from the Bank's assistance experience in Ukraine is what can be done in a country with a limited social consensus for reform? In the absence of this consensus, the Bank should focus on technical assistance, ESW and lending targeted to deal with the poorest groups, or demonstration projects that can be scaled up once tangible success is observed.

1. Background

1.1 Since the collapse of the Kiev Rus state in the 12th and 13th centuries, Ukraine has found great difficulty in maintaining social and economic independence. From 1654, most of the country fell under the protectorate of Russia: the remaining part was controlled by Poland and subsequently Austria. In 1918 a Western Ukrainian Republic was founded, but this disappeared when the Treaty of the Formation of the USSR was signed in 1921. On 16 July, 1990 the *Verhovna Rada* (Parliament) of the then Ukrainian Soviet Socialist Republic approved the Declaration on Ukraine's State Sovereignty, marking the first steps toward reform of Ukraine's political and constitutional framework. Subsequent laws brought further amendments to the 1978 Constitution, including the annulment of the Communist Party's leading role, the suspension of state planning (24 October, 1990) and the institution of the Presidency (5 June, 1991). Following a referendum in which more than 90% of the population favored independence, Ukraine became independent on 24 August, 1991.

1.2 This political history of Ukraine is important for understanding the difficulties and complexities of transition to a market economy. The country's leadership faced the immense task of forging an independent nation state with its associated administrative, legal and social structures. Ukraine was embarking upon an entirely different economic path, and the political and civil society systems were in a state of flux. Liberal democratic traditions were in their formative stages, new political parties were each searching for a political platform, and civic institutions, each with a variety of agendas, were beginning to emerge. Over the past five years nearly twenty new trade unions have been started. Over 200 NGOs focusing on many areas of civic life have also been formed, and an explosion of new publications has taken place.

1.3 Achieving a speedy domestic consensus on the pace and direction of economic reform amongst the variety of groups in this large country (a population of 52 million) was not going to be easy. While the independence referendum indicated massive public support for Ukraine to chart its own course, this did not signal consensus on the economic path to be followed. For many citizens, the Soviet economic and social framework provided reassuring continuity and certainty, and for some, the need for urgent fundamental systemic reform was not apparent. This diversity of opinion exists against a background of domestic tension between Eastern and Western Ukraine and the Crimea. Defining the powers of the Presidency, the Parliament and local governments continues. In June 1995, the President and the Speaker of the Parliament signed a "power sharing" agreement defining the tasks of the executive and legislative branches of government. A new Constitution was adopted by the Parliament in June 26, 1996, following debate since mid-1992. There is now talk of further refinement and amendment.[1]

1.4 Ukraine is potentially a very wealthy country. The country boasts some of the best agricultural land in the world, has an enviable range of hydrocarbons and minerals, and has a relatively well developed infrastructure. Numeracy and literacy are close to 100 percent, and the labor force is well educated to the highest technical and scientific levels. The problem at independence was that this apparent economic wealth was built and driven by the flawed investment decision making of the USSR Gosplan. Under the USSR, Ukraine's internal pricing

[1] Many of the reforms reviewed in this evaluation have been undertaken by Presidential Decree or by using the emergency powers of the Presidency.

of inputs and outputs was artificially set, and highly distorted from world market-determined levels. Under the Gosplan, investment location decisions were made on political or strategic grounds, resulting in industry locations, structures and linkages that were not efficient economically.

1.5 The collapse of the Soviet Union and the end of Gosplan dissolved the institutional mechanisms that had coordinated economic activities between the various republics, and, with the breakdown of the normal payment and trade systems, this was a severe shock for the Ukrainian economy. Gosplan had encouraged widespread integration of Soviet industries, with parts and materials transported thousands of kilometers across republican borders for processing. In 1990 82.1 percent of Ukraine's total trade was with other republics of the USSR.[2] The disintegration of normal trading and firm level links was compounded by immediate adverse changes in the terms of trade. From January 1992 to mid-1993 the price of oil imported from Russia rose from 3 percent to 80 percent of the world market price, and the price of natural gas rose even higher. Given the high energy intensity of much of Ukraine's industry, and its inefficient use of this energy, this was a massive blow.

Initial Conditions And Constraints

1.6 The first year of independence was a sobering experience for the new Ukrainian government. Without strong central control over the economy, inter-enterprise and interstate trade and payment links crumbled. Because Ukraine was still part of the ruble zone, monetary policy followed by the Central Bank of Russia affected economic developments in Ukraine outside government control. Thus when Ukraine joined the World Bank in September 1992, the need for bold reform action to forestall further declines in output was clear.

1.7 *Macroeconomic Management and Monetary Stabilization:* With the sharp fall in demand from the FSU and the adverse terms of trade effects the economy suffered a major contraction. GDP fell by 11 percent in 1991 and by 15 percent in 1992. Inflation became a major destabilizing factor. Retail prices rose by over 90 percent in 1991 and by over 1500 percent in 1992. Although the causes of this were lax fiscal and monetary policies, this was also a reflection of the repressed inflation built up in 1989 and 1990 by excessive money creation. The government had little control over fiscal expenditures, and the budgetary deficit rose to 14 percent of GDP in 1991 and to 24 percent in 1992. The lack of fiscal discipline and monetary stabilization was inimical to a restoration of growth. This situation persisted until mid-1994.

1.8 *Institutional Arrangements and Legal Systems:* At independence, Ukraine, like other FSU countries, had a legal and regulatory framework and institutions ill suited to the needs of a market economy. Many basic laws and organizational entities simply did not exist; those which did were inherited from a centrally planned economy with strong centralized control. This fostered a system of bureaucratic as opposed to judicial law predicated on so-called "state interests". The notion of using law to set the basic rules of economic and social behavior, and regulating within this framework, was radical for policymakers and bureaucrats.[3] The inherited legal framework was excessive, and resulted in perverse incentives, a continual search for special dispensations and a fertile environment for corruption within the administrative and regulatory

2 Two other highly integrated areas, the European Union and Canada, had shares of inter-regional trade of 59.2 percent and 44.1 percent respectively.

3 For a discussion of the bureaucratic versus judicial law see Katarina Pistor (1996).

systems. Ukraine needed to enact the full range of basic laws necessary for a market economy; it also needed to develop a system that could enforce these laws, and a public administration that could formulate appropriate policies, monitor their implementation, and regulate where necessary.

1.9 *Health, Education and Social Protection:* Ukraine's economic and social system reflected the predominance of state employment. Although unemployment was negligible, generous temporary income support payments (unemployment insurance and severance payments) and active labor programs (job training, replacement) were provided. Social transfers represented about a quarter of labor income. Taxation had almost no distributive impact. Income taxes were low, but payroll taxes were high and were paid almost entirely by the employer. The pension system, based on the pay-as-you go principle, offered five types of pensions to over 14 million beneficiaries. Compared to other systems in the OECD, the Ukrainian system allowed a low retirement age, generous eligibility conditions and a high replacement ratio (the level of pension benefits compared with wage levels was relatively high). As a result, the pension system represented about 8 percent of GDP in 1989/90 compared with 2.9 percent in similar middle-income countries and 6.9 percent in upper middle-income countries. Some 40 percent of Ukrainians were entitled to one or more cash benefits at a budgetary cost, in 1990, of 25 percent of GDP.[4]

1.10 On the eve of independence, Ukraine's social indicators were below Western Europe's, but marginally above middle-income countries in other parts of the world. Its health conditions were on a par with Europe in the 1960s. Ukraine's education system was large and diverse. Coverage extended from preschool to university education. Enrollment rates at the post-secondary level compared favorably with other middle-income countries, the drop-out rate was negligible, and teacher qualifications were high.

1.11 The economic collapse in Ukraine following the break-up of the FSU led to a rapid decline in social conditions, and the pre-transition social safety net and support system came under intense stress. Attempts to maintain the real value of benefits, in the face of collapsing tax revenues, were a major cause of the government's budgetary crisis. State enterprises, which had provided extensive support to social programs, began reducing their support for child care, preschool programs, hospitals and clinics. Local governments were left with the responsibility to finance social services, without adequate fiscal autonomy or revenue-raising ability.

1.12 *Energy:* At independence the energy sector in Ukraine was in critical need of reform and restructuring. The economy was energy-intensive, with over half of the energy demand supplied from Russia at a fraction of the world market price. At independence, only 4 of 240 coal mines were operating profitably and the electricity and gas systems were not financially viable.[5] Tariffs needed to be raised, power generators and distributors needed to operate independently on commercial terms, and the coal sector required massive restructuring.

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4 Compared in 1989/90 to roughly 18 percent in the UK, 10 percent in the USA, and 16 percent in Chile.

5 Since then, a culture of non-payment has emerged and there is a lack of appreciation of the need for full cost recovery. Collections need to be pursued more vigorously, with discontinuation of supplies as one of the means to achieve this.

1.13 *Agriculture and Rural Development:* Ukraine has a rich agricultural potential, with conditions well suited to the production of grains, oil seeds, root crops and a wide variety of fruits and vegetables. Even discounting for the legacy of distorted input and output pricing from the Soviet period, Ukraine has a comparative advantage in a wide variety of crops. Yet despite this potential, Ukraine's agriculture has declined for at least the last two decades. Output grew at about 2 percent annually during the first half of the eighties, slowed to zero in the second half of the eighties, and between 1990 and 1993 declined to more than 20 percent below the 1986-1990 average. The poor performance of Ukraine's agricultural sector has been the cumulative result of a poor policy environment.

1.14 As part of its macroeconomic program, the government liberalized prices, including agricultural input prices, in late 1991 and throughout 1992. However, approximately 70 percent of the production of the state and collective farms, was still subject to the state order system at non-market prices. So, while agriculture output prices were kept below world market levels, input prices rose dramatically resulting in seriously deteriorating terms of trade for agriculture and large losses for farm enterprises. In 1992 government policy toward land reform envisaged that collective ownership would remain the dominant form of land ownership (75 percent), with private agriculture a supplementary component. Throughout 1991 and 1992, state farms were converted to collective farms, land shares were distributed to individuals, and voting in the management council was linked to the share holdings. These measures had little impact on the structure or behavior of farms. Reforms were needed in land ownership, farm organization, input and output market arrangements, and rural finance.

1.15 *Financial Sector Development:* The financial system was a counterpart of the Gosplan system of central planning. The financial systems had no independent decision making authority and loans were made solely to execute the plan. Interest rates served no allocative function. Loans were not made on an economic basis and there was no analysis by bank staff of the viability of the borrowers or their capacity to repay.

1.16 From 1990 to 1992 the government made limited progress in creating the legal and regulatory infrastructure necessary for an effective and efficient financial system. A banking act passed in 1991 imposed lenient standards (for example low minimum capital) for opening a bank; more than 100 private banks were being formed by the end of 1992. The bank supervision capabilities of the central bank were extremely limited. The large bad debt portfolio of the existing state-owned banks was growing, as the SOEs encountered increasing liquidity problems. The lack of monetary stability undermined the development of a sound financial intermediation system. At the time that Ukraine joined the World Bank, a number of key issues had to be addressed in the banking sector. First, was the need to revise banking laws and regulations to conform more closely to international standards and increase the capacity of the central bank to supervise them. Second, interest rates needed to be market determined. Third, continued lending to loss-making SOEs by the state-owned banks had to be curtailed, and a system to deal with the existing bad debt portfolio had to be devised.

1.17 *State Owned Enterprises, Corporate Governance and Privatization:* Ukraine has a large, diversified, heavy industrial sector accounting for over 45% of GDP in 1991. Defense accounted for about 25 percent of this. This heavy industry was highly monopolized, vertically integrated and inefficient. Managers reported to sector ministries in Moscow, but following the break-up of the FSU, corporate governance was vague, property rights lacked clarity and accountability was absent. A rapid privatization program, coupled with the creation of an appropriate commercial environment more suitable for private sector development was urgently needed.[6]

2. Evolution of the World Bank's Country Assistance Strategy

2.1 The World Bank's country assistance strategy became more refined and specific as the Bank's country knowledge expanded. As the policy dialogue proceeded and implementation experience accumulated, the Bank displayed a growing awareness of the dynamics of political, public bureaucracy and vested interests which collectively determined the pace and direction of transition reform. The first outline of reform priorities, and the possible areas of Bank support, were contained in the Country Economic Memorandum issued in June 1993. The Bank identified three areas requiring urgent attention — create a stable macroeconomic environment through fiscal and monetary control, initiate an early program of transfer of ownership, and create a viable social safety net to protect those made vulnerable by the transition process.

2.2 The Bank recognized the limited scope in the early stages of Ukraine's membership for active Bank project support. Accordingly, the Bank ceded the lead role to the IMF in developing a credible stabilization program. The government had expressed an early commitment to move toward a market economy, but noted that the necessary political consensus was still being developed. This concerned the Bank because a key focus of the early suggested reforms was price liberalization, particularly in agriculture, which would give clear signals for all producers to follow. Price liberalization would have involved highly unpopular adjustments to food and energy prices. The fluid political situation and the lack of a Parliamentary consensus on the creation of a legal framework consistent with the workings of a market economy added to the Bank's concern.

2.3 The Bank realized that the country's institutional capacity to design and implement essential reforms was limited and that technical assistance would be vital to establishing an initial platform to implement privatization, financial sector development and improved public sector management. Previous regulatory practices could be obstacles which would have to be overcome. A fundamental change in public administration philosophy would be needed to ensure that the spirit of the intended reforms was not thwarted by perverse public administration behavior.

2.4 The Board approved the first loan in May 1993, the Institution Building Project. This was to provide technical assistance in the three areas of privatization, financial sector development and establishment of a treasury system in the Ministry of Finance. Besides the direct institutional development expected from the technical assistance, this project would contribute to strengthening the constituency for reform within key state agencies and ministries.

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6 The Region notes that "spontaneous privatization" and asset stripping which were occurring as a result of the breakdown of the past administration systems, made a rapid privatization program essential.

2.5 The first comprehensive Bank Group country assistance strategy went to the Board in November, 1994. Throughout 1993 and a large part of 1994, the government's lack of commitment to market-oriented reforms, monetary stabilization and fiscal discipline constrained the Bank's assistance efforts and injected strong elements of caution into the country assistance strategy being developed. During this period the Bank realized that the weak institutional and technical capacities, together with the lack of an effective framework for decision-making, identified earlier as a major constraint were much more severe than had been thought. As a result the Bank focused on a "core" assistance program, that would produce benefits even without macroeconomic adjustment and a sustained comprehensive structural reform program. ESW was undertaken in agriculture, power and energy, the foreign trade regime, the financial sector, local government, the environment and social protection. This work contributed to another element of the Bank's country assistance strategy—coordinating and mobilizing support from the wider donor community. The "Ukraine Policy Notes" which spelled-out the major reforms required for a comprehensive reform program, were presented to the first international donor meeting on Ukraine held by the Bank in July 1994.

2.6 The first stand-alone Country Assistance Strategy was presented to the Board in June, 1996. The assistance program envisaged was a graduated one, increasing with the intensity of the reform effort. If the stabilization program remained on track, but the reform effort was weak, then only investment lending was proposed in education, urban transport and district heating and the environment. The key "triggers" for a more comprehensive assistance program were stronger efforts in liberalization, privatization and land reform, because these measures were critical for a resumption of growth and job creation.

2.7 All country strategies continually refer to the need to strengthen *public administration institutions and reform laws and legal procedures*. Nevertheless no comprehensive legal reform agenda was mapped-out by the World Bank although certain laws were identified as necessary to support the development of a market economy, (progress in this was sought under a variety of sector adjustment operations). A new civil code, a bankruptcy law, banking regulations, secured transactions, contracts and company law were all identified as crucial. Yet it was becoming increasingly apparent that excessive regulation, bureaucratic intervention and corruption were perverting the desired outcomes from the liberalization agenda. Revised laws were not addressing these problems, and the institutional development supported by the Bank had focused upon only a narrow part of public administration. The Bank in conjunction with the authorities, did attempt to create a more comprehensive legal reform agenda in the context of a legal reform project. Progress was thwarted by waning support from the Ministry of Justice, and elements have now been subsumed into a proposed larger TA project. By 1997 the country strategy was emphasizing deregulation, a more comprehensive approach to reforming the civil service, and bringing greater accountability into all regulatory agencies.

2.8 Early in 1993 the Bank produced two reports describing *social conditions and the system of social protection* in Ukraine. The strategy emerging from this analysis focused on three elements: reducing public spending in key areas; improving targeting of cash benefits to vulnerable groups, and improving the efficiency of social spending. Because it was recognized that even the best prepared safety net would fail without a sound macroeconomic environment the early poverty alleviation strategy was subordinated to rapid stabilization.

2.9 The Bank's *energy sector* strategy has been to bring about a more efficient system of resource exploitation, electricity generation, distribution and use, and financial sustainability to the country's gas distribution and district heating systems. This was to be achieved by competition in the wholesale electricity markets, by moving toward full cost recovery for all forms of energy use, by rehabilitation investments in the generation facilities and significant rationalization of the country's large coal sector. The coal sector represented a difficult transition problem because of the large workforce involved. The Bank proposed a "learning by doing approach" with an initial small pilot project from which a sector-wide approach to structural change in the coal sector would develop.

2.10 From the outset, the Bank's focus on the *financial sector* was upon the central bank and on creating the necessary prudential regulations, bank supervision and payment clearing systems. A Financial Sector Review completed in June 1995 provided the essential basis for the evolving Bank country assistance strategy in this sector. The hyperinflation of 1993 and 1994 dramatically reduced the size and importance of the banking sector as a system of financial intermediation. This diminution reduced the sense of urgency in bringing about fundamental reform in the financial sector.

2.11 The Bank placed a high priority on *privatization.* The assistance strategy was to enlist a wide constituency of privatization advocates in the country, and in conjunction with other donors, provide the necessary technical assistance to advise on methods. IFC in late 1991 demonstrated the feasibility of privatizing small-scale firms and assisting city level privatization programs. The Bank recognized that while privatization was a necessary condition for vigorous private sector development it was not a sufficient condition. Substantial changes in the environment for private sector development would be necessary, including regulatory reform, tax reform, legal reform and capital market development. But once macroeconomic stabilization was in progress, the Bank pressed forward with privatization, and decontrol of domestic and international trade; the Bank would deal with other liberalization issues later. Part of the reasoning for this strategic approach was that while the reforms were important, they would not be forthcoming until a constituency largely consisting of the new owners of privatized enterprises was developed.

Country Strategy Summary

2.12 Given the economic and political developments in Ukraine from 1991 to early 1994, the Bank's view was that little could be achieved until the macroeconomic situation was under control. In this the Bank deferred to the IMF. The obvious lack of broad political consensus as to the pace and nature of economic reform entailed a cautious, sequential approach in the country assistance strategy. In defining the details of the necessary changes, the Bank undertook a large ESW effort even when the lack of monetary stability precluded any lending. The Bank was prepared to support those areas where the authorities demonstrated a willingness and strong commitment to reform. Another vital element of the country strategy throughout the period was an educational campaign to garner domestic support for the transition reform agenda. This included a public awareness campaign with parliamentarians, the academic community and the media. A final key element was mobilizing other donor support for vitally needed reform, to present a single voice to the government in the continuing policy dialogue.

3. Strategy Implementation

3.1 Implementation of the Bank's country assistance strategy has not proceeded smoothly. The Bank adhered to its stated strategy of only moving forward in adjustment lending in an environment of macroeconomic and monetary stability and in sectors showing strong commitment by the government to reform. Yet too often this reform commitment wavered, or the pace of agreed change slowed. Even with the smaller less ambitious investment projects, implementation problems arose ranging from procurement, confusion over decision making authorities within the public administration and bureaucratic inertia.

3.2 The three pillars of Bank country assistance, lending, ESW and the policy dialogue, and resource mobilization and aid coordination, have all been present in the Bank's implementation program. Non-lending activities have been the driving force during the first years of Ukraine's transition (1992-94) for implementing the country assistance strategy despite a lack of macroeconomic stability and the authorities' unwillingness to proceed on sector reform. Thereafter, the reform agenda has been pursued through adjustment and investment lending. A fourth key element in country strategy implementation has been a significant market reform education and awareness program. The Resident Mission undertook a vigorous program of seminars, workshops and roundtable discussions with government officials, Parliamentarians, academics and others on both the need for reform, the nature and objectives of this reform and the benefits and outcomes likely to result from reform.

Lending

Amount and Allocation

3.3 IBRD commitments during the period under review amounted to US$ 2.82 billion following the approval of 16 projects. Disbursements totaled US$ 1.608 billion. Adjustment lending has constituted 71 percent of lending. This followed a conventional two tranche disbursement design: however, in September, 1998 this method of disbursement was changed for the most recently approved sector adjustment loans and the remaining tranches of some of the other adjustment operations in the ongoing portfolio. The current method pools the undisbursed amounts, and disburses monthly tranches subject to satisfactory performance of the macroeconomic program covered by the IMF's current EFF and the agreed sector reform agenda.[7]

3.4 Table 3.1 reveals the difficulties encountered in implementing the lending part of the country assistance strategy. For the 12 ongoing projects at the end of 1998, 3 were rated "at risk", 5 were rated as :"potentially at risk " and only 4 were considered "non risky", (see Annex 5). The disbursement ratio is one-third of the Bank-wide average, and significantly below the ECA region average. Yet the supervision intensity, as measured by staff time per project under supervision, is twice as high as the Bank-wide average and

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7 This innovative mode of disbursement was devised to deal with the difficult policy reform environment encountered in Ukraine. The operations included in this pooling arrangement are the Coal Sector Adjustment Loan, the Enterprise Development Adjustment Loan II, the second tranche of the Agriculture Sector Adjustment Loan and the Financial Sector Adjustment Loan. This pooling arrangement will cease on July 31, 1999.

fifty percent more than the ECA region average. Considerable efforts have been expended on projects which did not materialize. From FY93 to FY98, 4 projects were dropped from further processing. While this may not seem excessive compared to some other countries, the stage at which they were dropped is revealing. The average staff weeks (SWs) per dropped project was nearly three times the Bank-wide average , and nearly four times the ECA region average. Portfolio management has improved and become more proactive in the past eighteen months, with a consequent improvement in portfolio indicators.

Table 3.1: Ukraine: Portfolio Indicators: 1993-1998

	Disbursement Ratio (%)	Supervision Intensity (SY Per Project)	Number of Dropped Projects	Staff Weeks Per Dropped Projects
Bankwide	18.4	0.35	301	31.7
ECA region	15.2	0.43	44	28.4
Ukraine	6.5	0.66	4	86.2
Kazakhstan	12.8	0.47	1	24.7
Indonesia	20.3	0.33	8	25.0
Mexico	22.1	0.30	8	29.8
Romania	16.1	0.68	2	29.6
Hungary	17.7	0.26	4	31.2

Source: PBD

Table 3.2: Ukraine: Lending
(as at 01/31/99)

	Commitments	Disbursements	Cancellations
Total ($billion)	2.822	1.608	0.02
Adjustment %	71	90	-
By sector ($ million)			
Energy	947	260	-
Agriculture	332	310	-
PSD	680	420	-
FSD	300	100	-
Human Development	19	2	17
PSM	43	26	-
General	500	500	-

Note: PSD: Private Sector Development; FSD: Financial Sector Development; PSM: Public Sector Management ; General: represents a Rehabilitation Loan

Sector Distribution

3.5 *Institutional Development and Legal Reform:* Only a small part of the Bank's lending program directly covered institutional development and legal reform. However, technical assistance was provided to support certain public sector entities (treasury, tax inspectorate, the central bank and customs) and the Enterprise Development Adjustment Loan II (EDAL II) supports the introduction of satisfactory bankruptcy legislation and general deregulation of the business environment. A judicial reform loan was planned, but processing was stopped when interest faltered. A Public Administration Reform Adjustment Loan at an advanced stage of preparation seeks, significant reorganization of the Cabinet of Ministers and the functional responsibilities of the line Ministries. This forthcoming operation will also deepen the deregulation reform initiated under EDAL II. A related Public Resource Management Loan is also planned, focusing on budget and tax administration.[8]

3.6 *Education, Health and the System of Social Protection.* Within the Economic Rehabilitation Loan (ERL) budgetary support for the safety net was to be improved, together with improved targeting of the benefits to protect vulnerable groups. While the ERL was being implemented the Bank was preparing two social sector projects. In health, the Bank proposed a project to support some of the government's short-term efforts to alleviate major health problems, especially among women and children. The project was also to lay the foundations for more ambitious future health sector reforms. Agreement could not be reached with the government on priority components and the project was dropped in mid-1995. A similar fate befell preparations for the education project. The objective was to assist the GOU with initial improvements in the national education system by broadening the scope of its programs, and enhancing the quality and viability of learning materials while keeping within expenditure constraints. Preparatory work spanned three years but led nowhere because of wavering commitment from the Ministry of Education.

3.7 A social protection adjustment loan was also proposed which would address rationalizing and targeting social transfers. This did not get beyond being a proposal. Bank staff believe this happened because no single Ministry or agency was prepared to champion a social protection project, and because of the absence of inter-governmental coordination on social protection issues. The Bank also sought reform of the country's state pension systems. Opinions within the GOU were highly polarized. To achieve some momentum for pension reform, the Bank encouraged the GOU to establish an inter-governmental working group. This was done in early 1997. Given the desire to maintain some redistributive element, together with the need to place the system on a more sound fiscal and actuarial footing, the Bank proposed a multi-pillar approach to pension reform. Government proposals were rejected by the Bank as not going far enough. At mid-1997 this impasse had not been resolved but a dialogue has continued on this critically important reform agenda.

3.8 *Energy:* Bank lending initially focused on immediate rehabilitation and maintenance, reorienting the electricity distribution system, and developing and demonstrating methods for restructuring the coal sector. To date five operations have been approved with total commitments of $ 942 million. From mid-1994 the GOU sought to develop a competitive

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8 It should be noted that other significant donor support has been focussed on institutional development, which has supplemented the Bank's efforts.

national wholesale market for electricity, and restructuring of the electricity distribution systems proceeded throughout 1995 and 1996. This was supported by the Electricity Market Development Project (L 4098, $ 317 million, effective January 1997). Implementation has not proceeded smoothly and the GOU has not adhered to its stated policy intent of creating a transparent electricity market and viable payment clearing systems. The Government has continued to interfere with the rate setting processes.

3.9 The Coal Pilot Project (L 4016, $ 15.81 million, effective August 1996) sought to demonstrate that unviable mines could be closed in a socially and environmentally responsible manner. It also sought to develop mechanisms for divesting the mines' social assets, and providing employment assistance for redundant miners. The three targeted mines have been closed and just over half the loan has been disbursed. Scaling this approach up for a sector-wide program with the Coal Sector Adjustment Loan (L 4118, $ 300 million, effective December 1996) encountered obstacles. Cost containment measures were not implemented, employment reduction has been limited, and wage arrears have been an ongoing problem. The second tranche was not released as planned, and the tranching has subsequently been transformed into the monthly pooling arrangement currently in place for all the ongoing adjustment loans.[9]

3.10 *Agriculture and Rural Development:* The Bank's first project in this sector took a modest approach to policy reform. The Seed Development Project (L 3891, $ 32 million, effective July 1996) sought to ensure that seed laws conformed to international standards. Implementation progress has been slow. The major part of the Bank's assistance strategy for agriculture was contained in the Agricultural Sector Adjustment Loan (L 4103, $300 million). The key focus of the SECAL was to liberalize trade in agricultural inputs and outputs, eliminate the state order system and eliminate subsidies, improve the competitiveness of agro-business, and support land reform and transfer of ownership. Like all other projects in the portfolio, this Agriculture SECAL encountered considerable implementation problems, however the second tranche has now been disbursed.

3.11 *Financial Sector:* Two projects have been approved that focus exclusively upon developing Ukraine's financial sector -- the Export Development Project (L 4107, $ 70 million, effective August 1997) and the Financial Sector Adjustment Loan (L 4391, $ 300 million, effective September 1998). The Institution Building Loan and the First and Second Enterprise Development Loans (EDAL I and II) all contained elements supporting financial sector development. The Institution Building technical assistance project sought to introduce a modern payments system, a chart of accounts consistent with international standards, and technical assistance to two banks. The chart of accounts component has been fully implemented and considerable progress has been made in introducing a modern payments system. The Export Development Project provided a $60 million line of credit for firms in the export sector through the State Import-Export Bank and this loan is disbursing well. Technical assistance was provided to strengthen the operations of the implementing bank. The recently approved FSAL is the centerpiece of the Bank's project assistance for the financial sector and the main vehicle for effecting policy change. The focus has been on continued strengthening of the central bank, introduction of international standards of prudential regulation, and improved bank supervision.

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9 The Region notes that to date 44 mines have been closed or are in the process of closure, which represents a positive achievement by the authorities in a difficult policy context. The first, of the four smaller tranches resulting from adjustments to the previously planned second tranche, has also been disbursed reflecting continued progress in sector restructuring.

3.12 *Privatization and Private Sector Development:* The Bank has made four loans to Ukraine totaling over US$ 1.1 billion which directly or indirectly have supported privatization and private sector development. A component of the Institution Building Loan (Ln. 3614-UA) approved in FY92 was designed to provide technical assistance for privatization and economic reform. This was to include pilot privatization of five enterprises, assistance to the Anti-Monopoly Committee to break up monopoly enterprises and prevent anti-competitive practices, and a public information campaign to build support for privatization. With the launching of the Mass Privatization Program (MPP), it was decided to give responsibility for small-scale privatization (SSP) to the IFC (with funding from USAID) and refocus Bank assistance on helping the State Property Fund (SPF). The two succeeding operations were large, multi-tranche adjustment operations designed to help meet Ukraine's urgent need for balance of payment support as well as to support elements of the reform agenda. These operations contributed to economic liberalization and helped privatization move forward despite strong opposition.

3.13 Progress in privatization was initially slow. Only about a third of small enterprises had been privatized by the end of 1995, compared to a target of 90%. Against a goal of privatizing 8,000 medium and large enterprises by voucher auction, majority shares of only 1,233 medium large enterprises had been sold by March 1996. Deep political divisions over the issue of reform impeded the program. Donors responded at a high level to the slow progress of privatization. A joint letter was sent to the Prime Minister in mid-1995 identifying the obstacles to rapid privatization and outlining a plan to accelerate it. Implementation would be a condition of further assistance. The government agreed to work with the donors to implement the plan. As a result, the privatization program began to accelerate in the first half of 1996, and small scale and mass privatization is essentially complete. The new focus is now on the larger scale case-by-case privatization.

Economic and Sector Work

3.14 The intensity of economic and sector work (ESW) in Ukraine has been higher than Bank-wide averages, but in line with averages in the ECA region. In view of the need to build institutional knowledge of the transition economies and the need to map out appropriate reform agendas, this extra effort is readily understandable. The first full economic report released in 1993 provided the first comprehensive analytical framework , which in turn led to the first comprehensive policy framework which was tabled at the first informal donors meeting in July 1994. A key element of the Bank's strategy was to maintain an intensive policy dialogue, supported by appropriate ESW, even in an environment where low borrower commitments precluded lending. This aspect of the Bank's involvement with Ukraine was seen as essential to provide guidance for other members of the donor community in defining their assistance programs. The Resident Mission has strongly influenced this and has provided "policy notes" on a range of topics as and when requested by the GOU. Reports have been completed on all main sectors during 1993 to 1997, and thematic studies have been prepared on debt management, the trade regime, public investment and public expenditure management.

Table 3.3: Ukraine: Intensity of ESW (Average 1993-1998)

Country	ESW SYs	ESW SYs as % of total SYs classified under "Client Services
Bankwide	**494.40**	**19.31**
ECA region	**97.96**	**22.54**
Ukraine	**5.54**	**21.56**
Kazakhstan	3.18	20.52
Indonesia	17.44	22.08
Mexico	9.83	23.35
Romania	5.17	19.36
Hungary	3.25	19.82

* ESW SYs (Economic and Sector Work Staff Years) are yearly averages
Source: PBD

3.15 "Stand alone" ESW on *institutional development and legal reform* has not been done. However, much informal sector analysis has been undertaken in the context of project preparation for a legal reform loan (subsequently dropped) and the proposed Public Administration Reform Project. A Public Expenditure Review (FY 99) also included a review of public administration and the civil service. By contrast, the Bank has undertaken considerable ESW on the social sectors, with two reports in 1993, and two policy research working papers on pension reform and one on poverty and inequality in 1994 and 1996. A full Poverty Assessment was completed in June 1996; this was particularly important because it was based on the first household survey of income and expenditure. Strong ESW emphasis has been in the *energy sector*. Sector reviews have been completed on the overall sector, the coal and electricity sectors and on district heating and gas distribution. A comprehensive sector study outlining the reform agenda was completed for the *agriculture sector* in 1994; this provided the basis for the early operational strategy.

Aid Coordination

3.16 The Bank has been active in coordinating aid and cofinancing mobilization from the outset. The first formal Consultative Group Meeting for Ukraine was chaired by the Bank in March 1995. There has been exceptionally close coordination with other donors in the *energy sector* and in *privatization*. Cofinancing was sought from Canada and the Export-Import Bank of Japan in helping to fill balance of payments financing gaps. Cofinancing of investment projects has been arranged with EBRD, the European Union, the United States, the United Kingdom, the Netherlands and Switzerland. Close collaboration between the main donors has maintained the reform momentum in crucial areas. This was most noticeable in encouraging the authorities to proceed with the privatization program at a faster pace. The Bank has participated in meetings of the G-7 Nuclear Safety Working Group, and has co-chaired the panel on conventional power in the Ukraine/G-7 Joint Working Group. The financial recovery plan for the energy sector, jointly developed by the Government and the Bank, has become the centerpiece of donor assistance efforts in the sector. The Bank helped develop the strategic basis for the memorandum of understanding between Ukraine and the G-7.

4. Development Outcomes: Progress in the Transition to a Market Economy

4.1 Few countries have witnessed such a precipitous decline in economic and social conditions over the relatively short period covered by this review. Income per capita declined by over 40 percent from 1989 through 1997, and gross output has declined every year since independence.[10] Only the service sector has recorded some growth (in common with all transition economies) and now accounts for about 50 percent of recorded GDP, compared to about 30 percent at the beginning of the decade. The country experienced hyperinflation from 1992 through 1994: one positive development has been the capacity of the authorities to attain some monetary stabilization, bringing inflation down to an annual rate of 11 percent by the end of 1998. These economic difficulties have exacted a heavy toll on the work-force. Real wages are estimated to be about 35 percent of the level pertaining in 1990, and unemployment has increased from almost zero in 1990 to about 650,000 (2.9 percent of the work-force) in 1997.[11]

Table 4.1: Ukraine: Economic Outcome Indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998*
GDP growth (annual %)	-6.4	-8.4	-7.2	-14.2	-23.0	-12.2	-10.0	-3.2	-1.7
Industrial Output (% annual change)	n.a	-10.0	-17.0	-22.3	-24.8	-14.8	-9.5	-4.2	0.2
Agricultural Output (% annual change)	n.a	-17.4	-10.0	-5.5	-9.6	-4.4	-9.9	-1.0	-3.2
GDP Deflator (annual %)	15.8	95.5	1713.4	3388.6	954.4	415.8	64.1	16.0	11.0 (CPI,IMF)
Current Account (% GDP)	n.a	n.a	-3.1	-2.5	-3.4	-3.1	-2.7	-2.7	-1.5 (IMF)
External Debt (% GDP)	n.a	n.a	1.4	21.7	20.9	22.7	19.9	19.2	34.3 (8/31/98)
Overall Budget Balance (% GDP)	n.a	-13.8	-24.2	-28.1	-8.7	-8.2	-6.1	-5.2	-3.7

*Preliminary and World Bank estimates. Data taken from World Bank "Ukraine: Restoring Growth with Equity- A Participatory Country Economic Memorandum", April 1999.

4.2 This economic decline has caused living standards to deteriorate sharply and poverty to increase significantly. The Poverty Head Count increased from 2 percent in the late eighties to

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10 A significant unrecorded "black" economy in Ukraine is estimated to be as much as 50 percent of the recorded GDP, climbing from 12 percent in 1989. Comparable figures for other transition economies in 1995 are Russia, 41.6%, Kazakhstan, 34.3%, Poland 12.6% and Romania, 19.1%. Only Azerbaijan and Georgia are estimated to have higher levels of non-recorded economic activity.

11 Actual unemployment is believed to be higher than the official statistics. In mid-1998, a World Bank mission estimated unemployment at about 11 to 12%, and underemployment as much higher.

41 percent in 1994. Life expectancy has been falling for over a decade and infant mortality has been steadily rising. The maternal mortality rate is higher than similar middle-income countries. The birth rate has declined by over 30 percent in the last eight years (from 14.4 per 1000 people to 9.1) and population growth became negative in 1994, and declined by 1.59 percent in 1996.

4.3 Progress in improving public sector management has been limited. While the overall budget balance has improved compared to the uncontrolled fiscal situation in 1991 to 1993, some of this improvement may not be sustainable.[12] The government periodically accumulates large arrears in the payments for wages, pensions and other benefits. Also, the government periodically pays arrears of wages in the coal sector due to the political pressures exerted by the large number of miners. These arrears have reached as much as 4 percent of GDP.

4.4 Limited progress has been made in state pension reform, and the system is now in deep crisis. Real pensions have declined by 48 percent over the past five years, and arrears have been continually rising since mid-1995. In response, the government has compressed the maximum pension, and the link between contributions and pension benefits has been significantly loosened. From the point of view of individual workers the system is actuarially unfair: if present demographic and labor market trends continue, then the number of pensioners will exceed the number of contributors by 44 percent by 2030.

Structural Reforms and Sector Outcomes

4.5 The monetary stabilization and reduction in inflation allowed the successful introduction of a new national currency. In August 1996 the authorities announced the introduction of the **hryvnia** and the conversion commenced in September. Despite some early implementation difficulties, conversion to the new currency restored a measure of public confidence. Exchange rate determination has been largely set by the market since the end of 1994. The real exchange rate has appreciated on a trade-weighted basis by 52 percent from December 1994 to mid-1997 but the initial under-valuation of the currency was such that the domestic economy still remains competitive.

4.6 Price de-control has proceeded, and most enterprises are now free to determine prices. The trade regime is liberal. The trade-weighted average import tariff rate was about 8 percent in 1996, and no more than 1 percent of imports incurred tariffs higher than 30 percent. The average tariff rate on industrial goods was 4.1 percent, and that for agricultural products 15.6 percent.

4.7 *Institutional Development and Legal Reform:* Following independence, a central machinery of government was established that embodied some features of the previous Soviet system. Decision making was highly centralized, however, lines of accountability were unclear, and the institutional structure was cumbersome, making coordination difficult, delaying decision making and reducing transparency. Little has changed over the past seven years. In some respects public administration has become worse because of a gradual erosion in lines of authority, the changing political systems, and a lowering of morale in the civil service.

4.8 While there has been some institutional development, this has been mostly confined to improving the technical skills of certain parts of public administration such as the central bank,

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12 The Government approved an austere 1999 Budget, with an overall deficit of 1.7% of GDP, but it faced revenue shortfalls in the first quarter of the year.

and the tax administration, and the introduction of a treasury system. The basic structure remains unwieldy, resulting in a public administration that makes systemic reforms difficult to implement. More ominously, the plethora of agencies seems to have created a more onerous and arbitrary regulatory environment. The sharp decline in real civil service wages, together with a structure that dilutes accountability, has provided strong incentives for rent-seeking behavior and a dramatic increase in the number of petty regulations and inspections.

4.9 Survey work done in Ukraine and in other countries illustrates the magnitude of this problem. The average percent of senior private sector management time spent with government regulations/officials is 37 percent in Ukraine, 30 percent in Russia, 15 percent in Brazil, 12 percent in Pakistan and 7 percent in El Salvador.[13] Not surprisingly, this regulatory burden, coupled with the taxation regime and the need to make extra-legal payments, has forced a large part of the economy to operate in an unofficial and informal way. As Annex 2 indicates, Ukraine has a very large estimated share of unofficial economy, and its environment for private sector development compares unfavorably with other countries in the FSU or Eastern Europe.

4.10 Progress has been made in putting in place the laws necessary for a market-based economy. But many anomalies and omissions remain. Progress has been most extensive in banking and securities law. Basic facilitation laws such as bankruptcy and collateral laws and a uniform civil code have not fully emerged as yet. Many donors have been involved in this process which has created problems of consistency between laws enacted. Even with good laws, application and enforcement in Ukraine are highly deficient. Creation of an independent and efficient court system has proved elusive. EBRD in its Transition Report (1997) found that "Legal rules concerning pledge, bankruptcy and company law are limited in scope and may be subject to conflicting interpretations. Commercial legal rules are generally unclear and sometimes contradictory. There are few, if any, meaningful procedures in place in order to make commercial laws operational and enforceable". Using a indicator classification system, Ukraine ranks behind Russia, all of Eastern Europe and even smaller countries such as Georgia, Armenia and Kyrgystan.[14]

4.11 *Agriculture and Rural Development:* The performance of Ukrainian agriculture over the past seven years has been dismal. Production is barely half what it was at the beginning of the decade and continues to fall. Agriculture exports stagnate, input use is one fifth of former levels, and incomes in agriculture and the rural areas have fallen drastically. Yields in all products remain well below the levels achieved at the end of the Soviet period. The process of restructuring farms has hardly begun and the market for agricultural commodities and farm inputs continues to be dominated by the government with virtually no new investment in modernizing agro-industries. Yet despite the decline of production, the structure of agriculture in Ukraine has begun to change. Private sector production has grown relative to the state/communal sectors. While household plots accounted for only 14 percent and private farms 3 percent of the land under production, they together accounted for 58 percent of total production in 1997, compared to 30 percent in 1990.

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13 For a comprehensive discussion of the regulatory burden in Ukraine, see Kaufman, Daniel "*The Missing Pillar of a Growth Strategy for Ukraine: Institutional and Policy Reforms for Private Sector Development,*" Harvard Institute for International Development, Development Discussion Paper No. 603, September 1997.

14 European Bank for Reconstruction and Development, *Transition Report 1997: Enterprise Performance and Growth*, pp17-19, London, 1997.

4.12 The incentive structures for farmers and intermediate producers have not changed since 1990. While the international trade regime has been liberalized and the state order system formally terminated, there is still strong involvement of government and quasi-government agencies in procurement of agricultural commodities and farm inputs. State orders were formally phased-out in 1994, about two-thirds of agro-industries were privatized, and an active trading sector began to develop, all of which led many to believe that a market economy was developing in the country's agricultural sector. However, these developments were countered by concurrent efforts of the government to control input and output markets through quasi-government corporations.

4.13 Some progress has been made in land reform. About 80 percent of state farms had been converted to collectives by the end of 1997, and the number of farms on which land share certificates had been distributed has risen to about 8500. However the legal framework for land reform is weak, the Land Code needs to be amended to clarify land sales, and the lack of adequate mortgage law makes it difficult to obtain finance. Lease markets are developing. Overall however, there has been little change in the structure and behavior of the collective farming system, and the move to private commercial farming has been slow.

4.14 *The Energy Sector:* Progress in creating a financially viable and efficient power sector, as well as dealing with the deep-seated structural problems of the coal sector has been limited. The President's Decree No.244 on the "Market Transformation of the Power Sector in Ukraine" sought to unbundle the sector and develop a national wholesale market for electricity. Nevertheless, the government has continually intervened to stop tariff increases, or has not pursued collections of arrears from budgetary entities or large state-owned enterprises. All the generating plants have serious cash flow problems, which has led to postponed maintenance and modernization.

4.15 Of the country's 263 coal mines, three have been fully closed and a further forty-one are not producing although the workforces are still accumulating wages. Direct budgetary support for the coal sector amounted to about 4 percent of GDP in 1996, but this large amount understates the real financial unsustainability of the present system because arrears accumulate and a complex system of administered pricing and cross-subsidization continues. Little progress has been made in divesting the mines of social assets, and the lack of individual mine autonomy inhibits cost containment and efficiency improvements in potentially viable coal mines.

4.16 *Privatization and Private Sector Development:* Small-scale privatization is now almost complete with about 47,000 firms transferred to private ownership by mid-1998. The small-scale privatization program has not yet addressed the so-called "communal enterprises/cooperative properties," which are still operated as part of the system of local and regional government. Privatization of medium to large-scale firms through the mass privatization program has also proceeded well, with about 9000 firms privatized by the end of 1998. Progress with the large state enterprises has been much slower; about 186 firms were in various stages of privatization by the end of 1998.

4.17 Despite the progress made in privatization, the environment for private sector development still remains highly deficient, and in many cases the quality of corporate governance has not improved. The legal and regulatory framework is still fundamentally antagonistic to private business. Enterprises face severe regulatory problems, high taxes, cumbersome registration and licensing requirements, frequent inspections by regulatory agencies (often aimed at generating revenues for the regulators) and problems with the tax bureaucracy and the customs system. The Bank recognizes the severity of these problems and has given a high priority to overcoming them.

4.18 The tax system is complex, with high rates and frequently changing methods of tax calculation. Most of the tax collected from a firm is calculated on the total revenue base and the wage bill, not on income generated. Frequent inspections, and the practice of auditing all tax returns and the near certainty of being found in non-compliance, encourages widespread evasion. Current rules create multiple licensing barriers , and there is little uniformity in registering and licensing procedures. Local officials, state organs and ministries frequently create their own rules and requirements.

4.19 The voucher auctions of the mass privatization program have resulted in wide dispersion of shareholders. The government retained a 25 percent share of the privatized companies, but the State Property Fund does not have the staff to monitor these firms nor does the special agency created by the Government to monitor firm activity. Accounting and auditing standards are weak, so information flows to the shareholders are further reduced. This allows existing management of many of these firms to operate inefficiently or fraudulently. The vast majority of medium and large firms privatized retain the previous management. Both factors reduce the drive for profitable operation and encourage firm optimizing behavior contrary to long term, sustainable financial viability.

4.20 *Financial Sector Development:* Limited development of the banking sector has occurred, and its size and intermediation function relative to the economy has remained at the low levels induced by the hyper-inflation of 1993 and 1994. The government is still involved in directed credit, many private banks still engage in insider lending and other questionable practices, capital inadequacy still affects a large number of banks, and no progress has been made in reforming the Savings Bank. Some progress has been made, however, in developing the infrastructure necessary for longer term development of the sector, bank supervision has improved, and international accounting standards have been introduced in the Central Bank, and are being implemented in the commercial banks and an effective payment system is in place. In-depth examinations of the seven largest banks are underway, which could lead to a sound method of dealing with the non-performing part of the individual bank loan portfolios. A Securities Commission has been established and a government paper market is functioning.

5. The World Bank's Assistance Strategy: Overall Assessment

Relevance of the Overall Country Assistance Strategy

5.1 Throughout Ukraine's membership in the World Bank, the country assistance strategy has been dominated by the need to have monetary stability and fiscal control. The Bank set this as a paramount pre-condition for any lending support: for the first eighteen months of membership, the Bank ceded the leadership role in creating macroeconomic stability to the IMF and refrained from any lending. This strategic approach was relevant and consistent with the Bank's experience of structural reform worldwide. The Bank recognized that country knowledge was limited, requiring a comprehensive ESW program that would help to define the structural reform agenda and define specific project components. From 1992 to mid-1994 a broad ESW effort was undertaken. This strategy was relevant and the overall quality of the ESW the Bank undertook was good.

5.2 The Bank's country assistance strategy for Ukraine highlights the issues of selectivity and sequencing. The Bank has continually expressed a cautious, graduated approach to providing lending assistance. The principle behind the Bank's strategy was to support the government in these areas where it had shown demonstrated willingness to move forward on systemic reform. Three basics were considered vital from the beginning (aside from the creation of monetary stability and fiscal sustainability); a speedy move toward minimally distorted market prices through trade liberalization and the removal of administered prices; a rapid transfer of ownership of productive assets through privatization; and a viable social safety net. An early focus on these reforms was relevant. One consistent weakness, however, in the Bank's evolving country assistance strategy for Ukraine, has been an over-estimation of both the government's implementation capacity, even when fully committed, and the speed with which the economy could respond to changes in the incentive structure and policy environment.[15]

Development Outcome and Sector Evaluations

5.3 *Development outcomes* over the past six years have clearly been *unsatisfactory*. Living standards for most of the population have declined dramatically, and absolute poverty has increased rapidly since independence. The state benefit and welfare system has not been able to cope with this rise in poverty nor to ameliorate the negative impact of the country's economic transition.

5.4 *Institutional Development and Legal Reform:* From the beginning, the Bank recognized that institutional weaknesses in public administration and the need for a legal framework suitable for a market economy were vital elements of transition. Progress has been mixed. Key laws on bankruptcy, collateral security, a Civil Code and land ownership are still lacking. The structure and operation of the judicial system, as far as commercial transactions are concerned, remain deficient.

5.5 Yet it is not necessarily the absence of key laws and institutions that is the major disincentive to private investment, but confusing administrative rules and arbitrary enforcement, and the persistence of state administrative interventions. Bureaucratic and administrative obstacles to entrepreneurial activity have increased. The Bank's approach to strengthening certain parts of public administration (the Treasury, tax administration, and the social safety net) through targeted technical assistance has had limited success.[16] But a global public

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15 The Region correctly notes that a core element of the Bank's country assistance strategy was to try many areas of engagement with the authorities in order to ascertain where there was a demonstrated willingness to move forward. This approach would result in a number of abandoned efforts, even at some late stages in the project cycle. There is validity to this contention, however OED continues to believe that the Bank has been overly optimistic about the Government's implementation capacity and the speed with which the economy will respond to policy change.

16 The Region notes that key institutional development in Treasury and Tax administration does take time, and OED does accept that solid foundations have been laid in both areas. It is the intention of the Region to continue its efforts in these areas which should improve the institutional development impact in the medium term.

administration reform program, which would produce efficient functioning of the legal infrastructure has been lacking. Despite solid progress in strengthening the Central Bank and some sections of the Ministry of Finance, the overall *institutional development* impact of the Bank's efforts has been modest.

5.6 *Poverty Alleviation and Social Sector Development:* In evaluating the Bank's country assistance strategy to improve social protection and bring about reform in the social sectors, it is necessary to distinguish between outcome and Bank performance. The outcome has been disappointing and the lack of tangible progress in assisting the very poorest is apparent. The question is whether the Bank approached the issues in the correct way, and here the evidence is mixed. On the one hand, the Bank identified the issues as early as 1992/93, with two reports on the social sectors that detailed the analysis of the problems and solutions. On the other hand, the Bank did not develop an operationally coherent strategy for the social sectors which won the confidence of government officials and other stakeholders. The Bank's proposals were ill-adapted to the political and institutional environment. They gave inadequate emphasis to the need to build support for change , and especially institutional change, from the ground up. Instead the Bank worked with the line ministries without the benefit of inter-governmental working groups and without much contact with regional and sub-regional administrations.[17]

5.7 The Bank's Poverty Assessment (1996) provided a profile of poverty incidence in Ukraine, and formed a solid platform for targeting those most at risk. The report acknowledges that a resumption of growth will entail widening wage differentials, but it falls short in considering the differential effects of a return to growth on women and men or younger and older workers. There is gender and age discrimination in the Ukrainian labor market. However, the Bank's country assistance strategy is not explicit on addressing these inequalities, despite evidence from other countries of the FSU that key groups such as women and pensioners are more at risk of being caught in a perpetual poverty trap.

5.8 Despite considerable efforts, the Bank's performance in bringing about pervasive social reforms in Ukraine has been unsatisfactory. A combination of a lending approach that lacked institutional realism and flexibility, a country strategy with a weak commitment to assisting the most vulnerable, and a complex social and political situation, deprived the Bank's efforts of tangible impact.

5.9 *The Energy Sector*: The Bank's country assistance efforts in the energy sector have had limited success. The objectives of achieving a more market-oriented power sector that would be financially sustainable, and encouraging long overdue rationalizations in the coal sector, were highly relevant. The Bank's ESW had identified the issues and formed the foundation for the policy dialogue in energy. This dialogue however failed to adequately assess the commitment of the central government to address what are admittedly very difficult structural problems. The desire to create a wholesale market for electricity was appropriate, but too ambitious in the absence of a visible government commitment to enforce payment for electricity used by budgetary institutions and the larger SOEs. The Bank should not have proceeded with the Electricity Market

17 The Region has indicated its disagreement with this conclusion, pointing that experience in other sectors suggests that the extreme centralization of political power in Ukraine makes "bottom up" strategies difficult to implement.

Development Loan until it was satisfied that the government was implementing a far stronger program of generation cost recovery. The Coal Pilot Project created the opportunity for both the Bank and the government to develop concepts for more comprehensive rationalizations in the sector. But again the Bank overestimated the government's commitment to scale this up on a sector-wide basis, which led to implementation difficulties in the follow-up sector adjustment loan. The Bank and the other donors involved in the coal sector, have been too optimistic regarding what could be achieved in the short term.

5.10 *The Financial Sector*: The Bank's strategy of focusing on strengthening the central bank and developing the necessary regulatory infrastructure for a sound banking sector was relevant, and the methods used (policy dialogue, donor coordination and technical assistance) were effective. Although this has not been a speedy process, a sustained effort has created a firmer foundation for a more effective financial intermediation system. The timing of the recently approved Financial Sector Adjustment Loan was appropriate, and this has maintained the momentum for reform in the sector.

5.11 The Bank has supported development of the banking system through direct assistance to commercial banks through the Export Development Project. While this has been reasonably successful, this approach to Bank involvement and assistance must proceed with caution. The demonstration effects of this type of assistance can be limited, and the use of credit lines to provide financial resources to targeted beneficiaries can damage the financial system far more than it assists individual firms or enterprises. A number of Bank projects under preparation reveal a number of small directed credit lines, and despite the perceived needs for this credit it is not clear that this represents an optimal use of Bank resources.

5.12 *Agriculture and Rural Development*: The Bank faced a formidable challenge in seeking reform in the agricultural sector. Not only was this one of the sectors least amenable to reform; it is also central to the economy. The Bank initiated its involvement with sector work covering the agricultural sector in general, the marketing systems and land reform. This sector work was of high quality and created the foundations for both the policy dialogue and sector adjustment efforts. The main intent of the assistance strategy was to remove the state from the marketing of inputs and outputs, change the structure of land ownership, and de-monopolize agro-industry. The strategy was relevant, and important progress was made in the liberalization of trade and in land reform. Despite this, government commitment to limited state intervention has been weak, and a complex network of government (both central, regional and local) and quasi-private institutions has continued to reduce the returns to farming.

5.13 The Agricultural SECAL realized some important objectives, but did not achieve government consensus on the basic spirit of the reform program. As a result, the authorities have effectively obstructed the full realization of the reform agenda envisaged by the Bank. The overall incentive framework for agriculture and rural development has changed little. The Bank has been slow to realize that the existing marketing and pricing systems undermine the potential benefits from other areas of reform. Until this is remedied, progress on land titling, rural infrastructure, agricultural extension and agro-industry will be limited.

5.14 The Bank did not fully understand, or know how to deal with, the wide range of vested interests within relevant ministries in the central government, large government-controlled agrobusinesses and regional administrations, all of which desired to maintain the status quo or protect special preserves of influence and patronage. Any agricultural/rural development strategy for Ukraine will be seriously flawed if market pricing for inputs and outputs is not the first item on the agenda.

5.15 Land reform and farm restructuring are important, but will not bring forth the desired supply response if the current incentive and tax structures remain. There is also a need for post-privatization assistance for farms at the local level. According to both IFC and USAID, support for farm restructuring at the local level is very strong and exceeds IFC and USAID's ability to meet the demand. This suggests another area where the Bank's country assistance strategy could be refined. Supporting national programs may not be fully effective in the absence of a strong local constituency for reform and strong integration of the needs for emerging private farmers. The country assistance strategy, with its attendant policy dialogue, focused more at the central government level and while this was necessary it is now apparent that dialogue and mobilization of support at the Oblast and local levels is equally important. This may suggest a series of regional or more localized, integrated rural development operations designed to enlist a critical mass of support for intervention. This could be a positive demonstration widening the constituency for reform, and with a broader rural development focus could support other elements of the Bank's country strategy such as rationalization of the coal sector.

5.16 *Privatization and Private Sector Development:* The Bank was clearly instrumental in encouraging the government to proceed with a privatization program. While government commitment has not been invariably strong, the Bank, and other donors, have been consistent in their efforts to maintain or accelerate the momentum for widespread privatization. This focus of the Bank's strategy was highly relevant, and achievements have been good. Progress in small-scale privatization (with strong IFC involvement) has been impressive. The Bank's focus on other aspects of private sector development has not been as strong. However, the process of creating an enabling environment, through deregulation and improvements in tax and legal systems, is getting underway. To late 1996, the assistance strategy did not reflect the need for a comprehensive and vigorous liberalization and deregulation agenda. There have been step-by-step efforts to modify laws and procedures (bankruptcy and business registration). The Bank has worked closely with the IMF to have deregulation issues included in the Funds ongoing EFF program.

Sustainability of the Achievements

5.17 Progress achieved in privatization, price liberalization, central bank supervision, monetary management and prudential regulation is likely to be sustained. In all other areas, sustainability is far less certain. The fiscal situation remains fragile, key rationalizations in the coal and heavy industry sectors have yet to be done, the financial viability of the power sector has yet to be assured, land title and registration systems face considerable Parliamentary opposition, and social safety net systems require significant overhaul. Progress has been made in legal reform but it is still unclear whether the equally important institutional reform necessary to complement the legal reform will be made. The political situation remain fluid, and those opposed to market-oriented reform may gain in power. Given these deficiencies, the overall rating for the *sustainability* of the Bank's country assistance efforts is *uncertain*.

Conclusion

5.18 Setting in motion a reform momentum in Ukraine has been a difficult task for the Bank. Assessment of the issues and needs was comprehensive and correct; however, translating this into a workable reform program fully owned by all the stakeholders was not always successful. Success was enjoyed in certain areas (privatization, for example), but such isolated achievements have been undermined by lack of progress in other critical areas. Perverse public administration responses to policy change have negated much of the intended behavioral response expected to flow from key policy changes.

5.19 The government has not been a committed and sustained reformer, moving forward only with sustained encouragement from the entire donor community and often reversing policy reforms. Much time has been lost in the transition process, and from 1991 to mid-1994 the authorities were unable to create even the minimal consensus necessary to bring about monetary stabilization and avoid hyperinflation. Key areas of feasible reform were not pursued vigorously. Agriculture and social safety nets are two prime examples. Speedier liberalization in agriculture, together with foreign participation and investment, would have arrested or even reversed much of the decline in the sector. This would have had positive consequences for the budget, the balance of payments, and the rural poor. Improved targeting of safety net benefits would have produced a more equitable support system for the poorest groups. Had government paid earlier attention to public administration and public accountability, much of the onerous regulatory environment might not have emerged, and the large informal economy would have operated more openly.

5.20 Today the Bank has a more sophisticated understanding of the political economy and governance issues in Ukraine. Project preparation now explicitly requires discussion with a fuller diversity of political and public administrative groups including the Parliament. The Bank was correct in being cautious up to mid-1994 when it became apparent that a strong political consensus on the pace and direction of reform was absent. Following the election of President Kuchma and a seemingly strong commitment to reform, however, the Bank overestimated the capacity and willingness of the authorities to reform. This optimism was shared by the reformist groups in the country, and by most other donors.

5.21 By mid-1995 it was apparent that the necessary political will to follow-through on difficult reforms was wavering or deficient. The Bank underestimated the extent to which the existing public administrative structure would resist change. The objectives of the Coal SECAL were ambitious, as were those of the Agricultural SECAL, and much stronger pre-Board and first tranche actions were needed. The total lack of progress in the social sectors reflects failure to create a sense of partnership and trust, sufficient even to warrant movement on projects with relatively limited objectives.

6. Lessons for the Future

6.1 A generic question emerging from the Bank's assistance experience in Ukraine is what can be done in a country with a limited social consensus for reform? In the absence of this consensus, the Bank should focus on technical assistance, ESW and lending targeted to deal with the poorest groups, or demonstration projects that can be scaled up once tangible success is observed.

General Lessons

6.2 The following lessons emerge from the Bank's relatively short country assistance experience with Ukraine:

- The essence of the reform agenda in Ukraine is to reduce the role of government and public administration in the economy. A large number of politicians, policy makers and public administrators in Ukraine however, remain unconvinced. The Bank's future program should focus on nurturing policy reform and capacity development.

- Public cynicism about the transition reform agenda is high. Abstract notions of economic liberalization and the benefits that ensue ring hollow to anyone exposed to the decline in living standards over the past five years. The Bank should promote public education about the causes of the economic collapse, the nature of the needed reforms, their costs and their benefits. Corruption is widespread in Ukraine, and this not only impedes reform progress, but also leads to inappropriate resource allocation. The Bank must develop a comprehensive anti-corruption strategy which will involve wide segments of Ukranian society.

- Experience in Ukraine has shown that important reforms (such as trade and price liberalization) may not realize their intended supply response because of counter-activities by vested interests. Regular monitoring at firm and farm level may help identify the factors that prevent the hoped-for supply responses.

- The Bank must broaden the range of partners and stakeholders involved in project preparation. While this makes project preparation more cumbersome, experience in Ukraine has shown that it pays dividends during implementation and improves the chances for a successful outcome. Small pilot or demonstration projects funded by LILs should be used to unmask key policy bottlenecks and illustrate potential benefits, while APLs would provide a flexible lending vehicle where borrower commitment and capacity is assured.

Sector Lessons

6.3 *The Energy Sector.* Little can be achieved by Bank lending to the power and coal sectors until the authorities accept that the power sector needs to operate in an independent and commercial manner, and that closure of highly inefficient coal mines is unavoidable. The present institutional arrangements are working very slowly.

6.4 *The Agriculture Sector.* The strategy of seeking to reduce the influence of government in the sector should be maintained, but the development of locally based, integrated farm support projects designed to galvanize local communities should be pursued. Further sector adjustment type lending will achieve little if domestic vested interests continue to exert monopsonistic and monopolistic powers, or political interference.

6.5 *Private Sector Development.* The emphasis on privatization in Ukraine should shift towards larger industry, enterprise restructuring and public utilities. The emphasis on deregulation and improving the overall commercial environment is correct. This may help reduce the perception of arbitrariness and corruption, which have contributed to the slow pace of foreign investment.

6.6 *The Financial Sector.* Drift to a proliferation of directed credit project components should be avoided. Where directed credit is extended on a sector basis, commercial lending practices should be followed.

ANNEXES

Annex 1: General Economic Indicators

	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*Ave. 88-97*	*Ave. 92-97*
NATIONAL ACCOUNTS												
GDP growth (annual %)	2.6	3.9	-6.4	-8.4	-7.2	-14.2	-23.0	-12.2	-10.0	-3.2	-7.8	-11.6
GDP index (1988=100/factor cost)	100.0	103.9	97.3	89.1	82.7	70.9	54.6	47.9	43.2	41.8	n.a	n.a
GNP per capita growth (annual %)	2.1	3.4	-6.6	-8.6	-7.5	-16.2	-21.3	-12.1	-8.5	n.a	n.a	n.a
Private Consumption (%GDP)	n.a	n.a	50.6	50.6	46.3	48.2	48.7	55.2	58.0	61.7	n.a	53.0
Govt. Consumption (%GDP)	n.a	n.a	23.3	21.1	17.6	16.0	19.4	21.3	21.7	22.0	n.a	19.7
Gross Domestic Investment (%GDP)	n.a	n.a	27.3	26.2	34.1	36.1	35.1	26.6	22.7	18.3	n.a	28.8
Gross Domestic Savings (%GDP)	n.a	n.a	26.1	28.2	36.1	35.8	31.9	23.5	20.3	16.3	n.a	27.3
Industrial Output (% Annual Change)	n.a	n.a	n.a	-4.8	-6.4	-8.0	-27.3	-12.0	-5.1	-1.8	n.a	-10.1
Industry (%GDP)	47.7	45.1	45.6	45.8	43.5	29.9	39.0	34.6	31.0	34	39.6	35.3
Agricultural Output (% Annual Change)	n.a	n.a	n.a	-13.0	-8.3	1.5	-16.5	-3.6	-9.5	-1.9	n.a	-6.4
Agriculture (%GDP)	20.9	22.9	25.8	24.4	20.3	21.6	16.0	14.9	6.7	6.0	18.0	14.3
Services Output (% Annual Change)	n.a	n.a	n.a	-6.6	-3.7	13.0	-40.2	0	1.6	n.a	n.a	n.a
Services (% GDP)	31.4	32.1	28.6	26.1	28.8	41.5	36.7	42.8	48.4	n.a	n.a	n.a
Inflation, GDP Deflator (Annual %)	1.7	4.3	15.8	95.5	1713.4	3388.6	954.4	415.8	64.1	16.0	661.5	1082.9

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	Ave. 88-97	Ave. 92-97
EXTERNAL ACCOUNTS												
Current Account (%GDP)	n.a	n.a	n.a	n.a	-3.1	-2.5	-3.4	-3.1	-2.7	-2.7	n.a	-2.9
Resource Balance (% GDP)	n.a	n.a	-1.2	2.0	2.0	-0.3	-3.2	-3.1	-2.4	-3.1	n.a	-1.7
Exports (%annual change)	n.a	n.a	n.a	n.a	9.5	-14.7	-15.8	3.0	11.5	1.8	n.a	-2.4
Exports (% GDP)	n.a	n.a	27.5	26.1	24.0	25.9	35.4	47.1	45.0	41.0	n.a	36.4
Imports (% annual change)	n.a	n.a	n.a	n.a	-18.1	-20.7	-13.8	-2.2	12.7	4.1	n.a	-6.3
Imports (% GDP)	n.a	n.a	28.7	24.8	22.0	26.2	38.6	50.2	47.9	44.1	n.a.	38.2
Gross Reserves (weeks of Imports)	n.a	n.a	n.a	n.a	0.4	0.7	2.3	3.7	5.2	6.3	n.a	3.1
EXTERNAL DEBT AND FINANCIAL FLOWS												
External Debt (US$ bill)	n.a	n.a	n.a	n.a	0.55	3.71	5.44	8.22	9.34	9.00	n.a	n.a
Long Term Debt (US$ bill)	n.a	n.a	n.a	n.a	0.46	3.55	4.66	6.45	6.63	6.30	n.a	n.a
Bilateral Debt (US$ bill)	n.a	n.a	n.a	n.a	0	2.78	3.53	3.69	3.36	2.66	n.a	n.a
IBRD Debt (US$ bill)	n.a	n.a	n.a	n.a	0	0	0.10	0.49	0.86	1.39	n.a	n.a
IMF (use of credit) (US$ bill)	n.a	n.a	n.a	n.a	0	0	0.36	1.54	2.26	2.26	n.a	n.a
Private Debt (US$ bill)	n.a	n.a	n.a	n.a	0.36	0.62	0.85	2.06	1.97	1.80	n.a	n.a
											n.a	n.a
Total debt (% of GDP)	n.a	n.a	n.a	n.a	1.7	11.3	12.1	22.0	20.8	21.3	n.a	n.a
Total Debt Service (US$ mil)	n.a	n.a	n.a	n.a	11.5	202.3	300.2	1136.7	1254.0	1345.0	n.a	n.a
Total Debt Service (% XGNS)	n.a	n.a	n.a	n.a	0.1	1.27	2.04	6.92	6.16	6.8	n.a	n.a

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
FISCAL ACCOUNTS										
Budgetary Revenue (% GDP) o/w	Fiscal data prior to 1991			36.5	41.6	39.8	41.9	37.8	36.8	38.4
Taxes Income/Goods (% GDP)	Based on USSR system			22.2	23.7	23.9	27.6	21.6	19.2	22.8
Budgetary Expenditure (% GDP) o/w				46.0	51.2	46.9	50.4	42.5	39.9	44.0
Cons./Prod. Subsidies (% GDP)	Fiscal data prior to 1991			18.0	5.6	10.3	14.4	7.8	5.9	n.a
Pension Fund (% GDP)	Based on USSR system			9.7	8.8	8.0	7.5	7.6	8.7	9.1
Overall Budget Balance (% GDP)	Fiscal data prior to 1991			-13.8	-17.8	-11.8	-8.2	-4.8	-3.2	-5.6
Domestic Financing, net (% GDP)	Based on USSR system			13.8	17.8	11.8	8.1	5.6	3.4	5.3
External Financing, net (% GDP)				n.a	n.a	n.a	0.1	-0.9	1.0	0.3

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
SOCIAL INDICATORS										
Population Growth	0.44	0.49	0.23	0.21	0.29	0.05	-0.5	-0.75	-1.59	n.a
Birth Rate (per 1000 people)	14.4	13.3	12.7	12.1	11.4	10.7	10.0	9.6	9.1	n.a
Death Rate (per 1000 people)	11.6	11.6	12.1	12.9	13.4	14.2	14.7	15.4	15.2	n.a
Fertility Rate (births per women)	2.02	1.99	1.85	1.81	1.72.	1.55	1.50	1.4	1.3	n.a
Life Expectancy – females (years)	74.8	75.2	74.9	74.0	74.0	73.0	73.2	72.7	72.95	n.a
Life Expectancy – males (years)	66.4	66.1	65.6	64.0	64.0	63.0	62.8	61.8	62.3	n.a
Infant Mortality (per 100 live births)	n.a	13.0	12.9	13.9	14.0	14.9	14.3	14.4	14.3	n.a
Immunization, DPT (% children under 12 months)	78.0	79.0	79.0	82.0	83.0	90.0	94.0	n.a.	n.a	n.a
				-13.8	-17.8	-11.8	-8.2	-4.8	-3.2	-5.6
Unemployment (000's)	n.a.	n.a	n.a	7.0	70.5	83.9	82.2	126.9	351.1	637.1
Unemployment (%)	n.a	n.a	n.a	0	0.3	0.4	0.4	0.6	1.6	2.9
Real wages (index 1990=100)	n.a	n.a	100.0	92.6	833.6	36.8	33.5	36.9	35.0	34.2

Memo Item	late 80s	1993/4
*Poverty Head Count (% of population)	2.0	41.0

*based on a poverty line drawn at US$4.0 per day. The World Bank's Poverty Assessment (1996) used a poverty line of US$24 per month resulting in a headcount of 29.5% of households living in poverty.

Annex 2: Ukraine: The Unofficial Economy (1994)

	Unofficial Economy Share (% of Total)	Private Sector Development and Liberalization Index (0-100)	Bureaucratic Discretion Index (0-100)
Ukraine	46	13	46
Russia	40	32	43
Kazakhstan	34	22	35
Latvia	34	40	46
Czech Republic	18	60	65
Belarus	19	18	40
Bulgaria	29	49	49
Hungary	29	69	74
Poland	15	69	71
Overall Average FSU and Eastern Europe	32	37	45

Sources: Freedom House Indices of Civil/Political Liberalization; De Melo, M and Denizer Gelb; *"From Plan to Market: Patterns of Transition"*, World Bank Policy Research Working Paper 1564, Washington D.C. 1996 and Kaufmann, D and A.Kaliberda, *"Integrating the Unofficial Economy Into the Dynamics of Post Socialist Economies: A Framework of Analysis and Evidence,"* in Economic Transition in Russia and the New States of Eurasia, ed. B. Kaminski, Armonk, NY 1996. The range of the PSD and liberalization index is from O (anti-PSD) to 100 (maximum pro PSD). The bureaucratic discretion index has been standardized to range between 0 and 100 (maximum discretion) based on Freedom House annual indices.

Annex 3: Ukraine: Selected Agriculture Indicators

	Average 1985-90	*1997*	*% change*
FARM STRUCTURE ('000 ha)			
Collective/State Farms	39,246	33,826	-14
Private Plots	2,512	5,789	230
Private Farms	1	1,037	-
PRODUCTION (1996 UAH million)	***1990***	***1997***	
Public Sector	34,700	11,700	-66
Private Sector	14,500	16,400	11
	1985-90	***1997***	
Grain ('000 xxxxxx)	460,093	354,717	-23
Sugar Beets ('000 xxxx)	429,802	176,628	-59

Annex 4: Projections and Outcome

	1995	1996	1997	1998	1999
Actual GDP Growth (%)	-12.2	-10.0	-3.0	0	n.a
Projections:					
Rehab.Loan PR	-5.0	1.5	3.0	4.0	
CAS (mid 1996)		-2.0	3.5	8.0	7.0
CAS Progress Report (mid 1998)				0	3.0

Annex 5: World Bank Ongoing Project Ratings FY95-99

PROJECT DESCRIPTION				QAG RATING	SUPERVISION RATINGS	
Proj.ID	*Project Name*	*Commitment $m*	*Approval FY*	*At RiskRating*	*Latest DO Rating*	*Latest IP Rating*
9117	Agric. Seed Development.	32	95	Actual	U	U
44110	Coal Pilot	16	96	Potential	S	S
40564	Coal Secal	300	97	Actual	U	U
49502	EDAL II	300	99	Potential	S	S
44444	Electricity Market	317	97	Actual	U	U
35814	Enter. Dev. Adjust.	310	96	Potential	S	S
44851	Export Development	70	97	Non Risky	S	S
40560	Financial SECAL	300	99	Non Risky	S	S
38820	Hydropower Rehab.	114	95	Actual	U	NA
44832	Kiev District Heat	200	98	Non Risky	S	S
45940	Social Protect. Supp.	3	97	Potential	S	S
49174	Treasury Systems	16	98	Potential	S	S

Annex 6: Contextual Framework for Evaluation

In an assessment of the Bank's country assistance strategy, a necessary but methodologically difficult task is to analyze other possible scenarios. The range of counterfactual propositions is infinite, and the linkage between alternative scenarios and economic and social outcomes is not amenable to precise quantification. Nevertheless exploring a set of other possible reform experiences provides a firmer contextual framework for assessing Bank performance.

Cross Country Comparisons. In an internal ECA assessment of policy and institutional change undertaken in 1998, Ukraine ranked 24 out of 27 countries; only Belarus, Turkmenistan and Uzbekistan were considered worse in reform progress and achievement.[18] EBRD comparing transition progress across 25 countries of Eastern Europe and the FSU ranked Ukraine 20.[19] In assessing the overall legal environment surrounding commercial activities, EBRD also found that Ukraine's legal environment was deficient, with unclear rules and inconsistent enforcement. This was true for many other FSU countries, however, in Russia, Latvia, Lithuania, as well as all Eastern Europe, the legal environment was considered to be better. Both assessments suggest that from an overall reform perspective, Ukraine has not done well in dealing with transition, even compared to countries that started the transition process at the same time and face similar problems. What are the implications of this relatively poor policy performance?

Foreign direct investment. Given the assumption that foreign investment is attracted by profitable opportunities and a predictable commercial environment (accepting that there may be a trade-off between returns and unpredictability) Ukraine could have done better in attracting foreign investment. Between 1989 and 1996, Ukraine attracted US$ 1.3 billion (or $25 per capita), Russia US$ 5.8 billion ($40 per capita), Poland US$ 5.4 billion ($140 per capita), Kazakhstan US$ 3.1 billion ($187 per capita) and Bulgaria US$ 0.4 billion ($51 per capita). Clearly Ukraine has been under-achieving: just rising to the level of Russia would have brought a further US$ 0.8 billion, and to the level of Bulgaria a further US$ 1.3 billion. While foreign investment as a proportion of domestic investment may be relatively low, doubling the flows of foreign investment would have contributed significantly to both a restoration of growth and generation of employment.

The informal economy. Ukraine has one of the highest levels of informal or unofficial economic activity throughout Eastern Europe and the FSU. Estimates range from 40 to 60 percent of recorded GDP. This is indicative of the excessive regulatory burdens in the country and the non-transparency of business rules and taxation.

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[18] This assessment covers 20 items broadly grouped into macroeconomic management, policies for sustainable and equitable growth, policies for reducing inequalities and public sector management.

[19] The factors assessed encompass privatization, governance and restructuring, price liberalization, trade liberalization, competition policy, banking reform and capital market developments. This assessment was drawn from the EBRD, *Transition Report 1997*, London, October 1997.

Assuming that just 50 percent of the unofficial economy became official, then GDP would be higher by about 20 percent or about hryvnia 16 billion or over US$ 8 billion. While this "extra" economy exists in Ukraine, its exclusion from the official economy has profound implications for many other facets of the economy and for public sector management. Given the same tax revenue (including the Pension Fund) to GDP ratios pertaining in 1996, then this unofficial economy represents about hryvnia 6 billion in lost fiscal revenues. To put this in context, total budgetary arrears (wages, social insurance, pension payments) were hryvnia 3 billion at the end of 1996, and the overall budget deficit was hryvnia 2.6 billion. Capital/investment spending from the budget was hryvnia 1.1 billion. Whatever the causes for the large and growing unofficial economy, it is clear that too little attention has been given to a fundamental change in the overall commercial and business environment that this represents.

The Bank's Intervention. Since mid-1994 the Bank has disbursed US$ 1.3 billion. Outstanding public debt to official bilateral creditors at the end of 1997 was about US$ 5 billion, and to the IMF about SDR 1.8 billion. Private non-resident holdings of Treasury Bills amounted to US$ 1.65 billion. In foreign resource transfers the Bank accounted for about 13 percent over the period of this review, a significant amount. These Bank resources undoubtedly cushioned the external shocks experienced by Ukraine; their absence would have made balance of payments and fiscal management far more difficult. However the key part of the Bank's intervention is not the resource transfers, but the policy dialogue, underpinned by ESW, and the Bank coordination of donor efforts to effect change and policy reform. If the Bank had not been engaged, policy reform in certain key areas would have been much slower. Privatization in particular would not have proceeded as swiftly, and the progress achieved in trade and price liberalization might not have occurred. While much remains to be done in agriculture, what has been achieved has created a foundation for further reform, and Bank efforts in this sector have created results.

In other areas the value of the Bank's interventions has been more marginal and limited. If the Bank had not been involved in any of the social sectors, it is hard to imagine that the outcomes would have been worse and policy reform any slower. In the coal sector, while the pilot project and associated sector work contributed to some reform momentum, the number of closed mines (3) is very small relative to the need and it is clear that the sector has been only marginally affected by the Bank's involvement.

Had the Bank been more active in pursuing regulatory and tax reform in 1994 (something it is now doing under EDAL II and the proposed Private Sector Development APL operation) and in agriculture input and output market reform in 1995, there might have been an overall business environment more conducive to reform, and the extent of output decline might have been much less. This assumes that the authorities would have heeded the Bank's advice and been vigorous in its implementation.

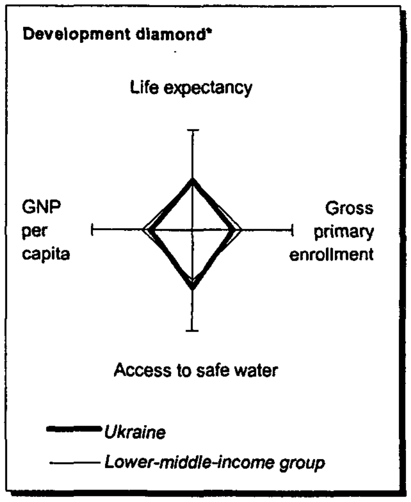
Expectations and Outcomes. The Bank has consistently been over-optimistic about the speed with which the economic decline in Ukraine could be arrested. The table in the Annexes provides some illustration. From 1995 to 1998, the Bank continued to display faith that positive growth was just around the corner, despite the obvious experience of a political economy environment not universally committed to a market-driven economy. It is not clear however whether this over-optimism affected the policy dialogue in a negative way, or encouraged the authorities to view reform less urgently. Nevertheless there is a potential to distort the realism of risk perceptions, to underestimate the complementarity and diversity of reform, and to assume that once one reform issue is resolved, it no longer needs to be monitored.

Annex 7

Ukraine at a glance

9/16/98

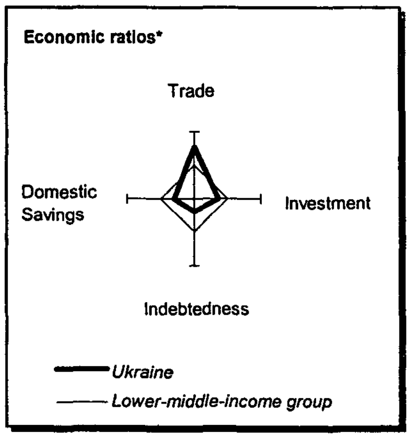
POVERTY and SOCIAL	Ukraine	Europe & Central Asia	Lower-middle-income
1997			
Population, mid-year *(millions)*	50.5	476	2,285
GNP per capita *(Atlas method, US$)*	1,040	2,320	1,230
GNP *(Atlas method, US$ billions)*	52.5	1,106	2,818
Average annual growth, 1991-97			
Population *(%)*	-0.5	0.2	1.2
Labor force *(%)*	-0.4	0.5	1.3
Most recent estimate (latest year available, 1991-97)			
Poverty *(% of population below national poverty line)*	32	..	..
Urban population *(% of total population)*	71	67	42
Life expectancy at birth *(years)*	68	69	69
Infant mortality *(per 1,000 live births)*	14	25	36
Child malnutrition *(% of children under 5)*	..	..	..
Access to safe water *(% of population)*	97	..	84
Illiteracy *(% of population age 15+)*	..	..	19
Gross primary enrollment *(% of school-age population)*	90	92	111
Male	..	..	116
Female	..	..	113



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

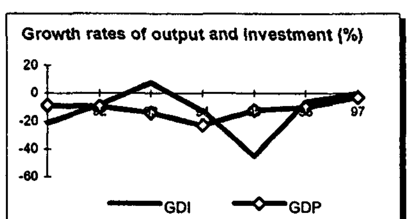
	1976	1986	1996	1997
GDP *(US$ billions)*	..	..	44.6	59.8
Gross domestic investment/GDP	..	..	22.7	20.1
Exports of goods and services/GDP	..	..	45.7	40.5
Gross domestic savings/GDP	..	..	20.1	16.3
Gross national savings/GDP	..	..	20.0	16.2
Current account balance/GDP	..	..	-2.7	-2.2
Interest payments/GDP	..	..	0.8	0.8
Total debt/GDP	..	..	21.0	18.0
Total debt service/exports	..	..	6.1	6.9
Present value of debt/GDP	..	..	19.5	..
Present value of debt/exports	..	..	42.5	..

	1976-86	1987-97	1996	1997	1998-02
(average annual growth)					
GDP	..	-10.2	-10.0	-3.2	4.4
GNP per capita	..	-9.6	-9.2	-2.4	4.4
Exports of goods and services	..	-2.7	-0.3	-6.0	..

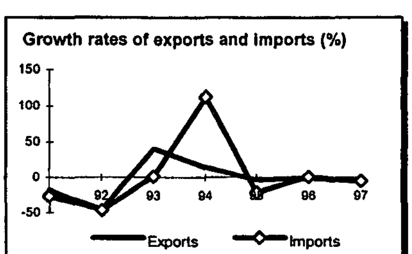


STRUCTURE of the ECONOMY

	1976	1986	1996	1997
(% of GDP)				
Agriculture	..	..	13.8	12.3
Industry	..	..	37.7	40.1
Manufacturing	..	..	6.7	6.0
Services	..	..	48.4	47.7
Private consumption	..	..	58.1	61.7
General government consumption	..	..	21.8	22.0
Imports of goods and services	..	..	48.2	44.3



	1976-86	1987-97	1996	1997
(average annual growth)				
Agriculture	..	-21.4	-22.1	-11.6
Industry	..	-16.4	-17.2	-14.5
Manufacturing	..	-15.9	-16.6	-17.2
Services	..	-8.6	4.3	12.1
Private consumption	..	-11.5	-10.3	..
General government consumption	..	-17.5	-10.9	4.4
Gross domestic investment	..	-14.8	-6.2	0.0
Imports of goods and services	..	-0.9	0.7	-5.2
Gross national product	..	-9.7	-9.9	-3.2



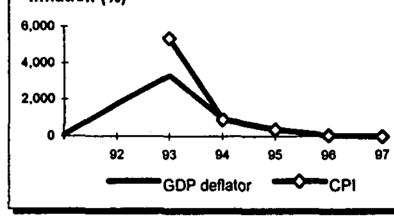
Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Ukraine

PRICES and GOVERNMENT FINANCE

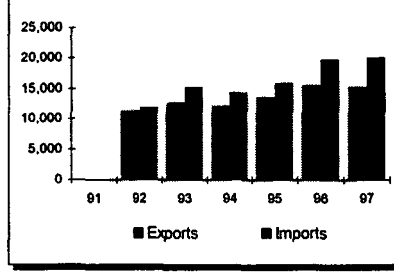
	1976	1986	1996	1997
Domestic prices				
(% change)				
Consumer prices	..	..	80.2	15.9
Implicit GDP deflator	..	..	66.2	17.2
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	36.7	38.4
Current budget balance	..	..	0.0	-6.9
Overall surplus/deficit	..	..	-4.4	-6.7



Inflation (%)

TRADE

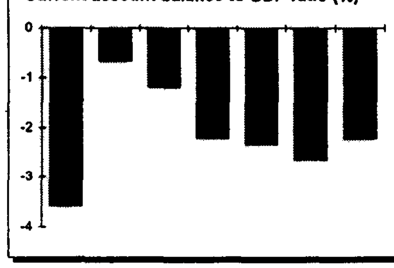
	1976	1986	1996	1997
(US$ millions)				
Total exports (fob)	..	..	15,547	15,287
Ferrous and non-precious metals	..	..	4,670	5,904
Mineral products	..	..	1,358	1,283
Manufactures	..	..	5,208	4,311
Total imports (cif)	..	..	19,843	20,114
Food	..	..	1,447	898
Fuel and energy	..	..	8,068	8,132
Capital goods	..	..	3,299	3,694
Export price index *(1995=100)*	..	..	102	99
Import price index *(1995=100)*	..	..	110	107
Terms of trade *(1995=100)*	..	..	92	92



Export and import levels (US$ millions)

BALANCE of PAYMENTS

	1976	1986	1996	1997
(US$ millions)				
Exports of goods and services	..	..	20,346	20,355
Imports of goods and services	..	..	21,468	21,891
Resource balance	..	..	-1,122	-1,536
Net income	..	..	-572	-644
Net current transfers	..	..	..	..
Current account balance	..	..	-1,185	-1,335
Financing items (net)	..	..	2,058	1,718
Changes in net reserves	..	..	-873	-383
Memo:				
Reserves including gold *(US$ millions)*	..	..	1,972	2,359
Conversion rate *(DEC, local/US$)*	..	..	1.8	1.5

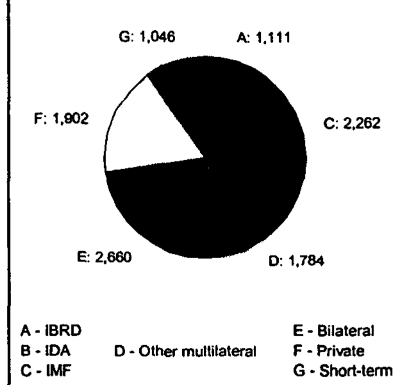


Current account balance to GDP ratio (%)

EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
(US$ millions)				
Total debt outstanding and disbursed	..	..	9,335	10,765
IBRD	..	..	859	1,111
IDA	..	..	0	0
Total debt service	..	.	1,254	1,410
IBRD	..	..	32	59
IDA	..	..	0	0
Composition of net resource flows				
Official grants	..	..	249	..
Official creditors	..	..	241	-93
Private creditors	..	..	45	-176
Foreign direct investment	..	..	526	581
Portfolio equity	..	..	0	..
World Bank program				
Commitments	..	..	1,260	73
Disbursements	..	..	406	306
Principal repayments	..	..	0	0
Net flows	..	..	406	306
Interest payments	..	..	32	59
Net transfers	..	..	374	247

Composition of total debt, 1997 (US$ millions)



Annex 8: ESW Reports, FY93-FY98

Report Title	*Economic or Sector Report*	*Date*	*Number*
Agriculture			
Ukraine – Food and agriculture sector review (Vol.1)	SR	6/30/94	11880
Agricultural trade and trade policy: a multi-country analysis - commodity trends in agriculture: production, gross margins, and trade: the experiences of Belarus, Moldova, and Ukraine – 1991-1994 (Vol.1)	SR	6/11/96	15960
Energy			
Ukraine – Power demand and supply options (Vol.1)	SR	5/6/93	11561
Ukraine – Energy sector review (Vol.1)	SR	7/1/93	11646
Ukraine – Coal industry restructuring sector report (Vol.1)	SR	3/4/96	15056
Environment			
Ukraine – Suggested priorities for environmental protection and natural resource management (2 Volumes)	SR	6/15/94	12238
Multi-Sector			
Ukraine – Country economic memorandum (2 Volumes)	CEM	6/2/93	10029
Poverty			
Ukraine – Poverty in Ukraine (Vol.1)	SR	6/27/96	15602
Public Sector Management			
Ukraine – Public investment review (Vol.1)	ER	5/30/97	16399
Ukraine – Public expenditure review: restructuring government expenditures (Vol.1)	PER	6/25/97	16112
Social			
Ukraine – Employment, social protection and social spending in the transition to a market economy (Vol.1)	ER	4/14/93	11176
Transport			
Ukraine – Transport sector review (3 Volumes)	SR	11/30/98	18636

Annex 9: Bank Managers (FY92-98)

YEAR	*VICE PRESIDENTS*	*COUNTRY DIRECTORS*
1992	Wilfried Thalwitz	Russell J. Cheetham
1993	Wilfried Thalwitz	Basil G. Kavalsky
1994	Wilfried Thalwitz	Basil G. Kavalsky
1995	Wilfried Thalwitz	Basil G. Kavalsky
1996	Johannes F. Linn	Basil G. Kavalsky
1997	Johannes F. Linn	Paul Siegelbaum
1998	Johannes F. Linn	Paul Siegelbaum

Attachment 1
CODE99-44

May 19, 1999

Report from CODE

Committee on Development Effectiveness

Ukraine: Country Assistance Review

The Committee met on May 12, 1999 to discuss the Ukraine Country Assistance Review (CODE99-37). The Committee thanked OED for a useful but sobering report and was pleased to note Government and Bank Management's general agreement with the findings of the report. It welcomed the proposed graduated assistance approach and the positive steps taken to promote participation and partnership. However members were concerned with Ukraine's poor performance, declining per capita income, and increasing poverty despite substantial aid from the Bank over the last several years.

The CAR found that progress had been made in the areas of macroeconomic stability, privatization and trade and price liberalization. However, limited progress had been made in increasing agricultural production or rationalizing electricity, coal and other heavy industries sectors. A key constraint has been the lack of government commitment to fundamental change in public administration, and the lack of a public consensus on reform. Overall development outcomes have been poor and longer-term sustainability of the Bank's program remains uncertain in the absence of commitment to and consensus for reform.

The key lessons from the CAR which will be reflected in the CAS include focusing Bank lending on the poor, implementing pilot projects in a supportive policy environment, and increasing public education and awareness of the need for reform.

Issues discussed included:

Lack of Social Consensus for Reform. The Committee was concerned by the lack of political will and in-country commitment to reform, as well as the limited development impact of the lending portfolio to date. Staff noted that the Bank had a tendency in Ukraine, and other countries in transition, to overestimate the government's implementation capacity, the speed with which actors responded to incentives and the pace of general economic reform. Nevertheless it was clear that in the absence of demonstrated government commitment to reform and more public awareness progress would continue to be slow.

The Political Economy of Transition. Committee members requested more information on the Bank's experience in and knowledge of the process of privatization in economies in rapid transition, including what kinds of investments bring about maximum impact in transition economies. Looking ahead, members also suggested that OED should assess the qualitative as well as quantitative dimensions of the privatization process.

Lessons Learned. Members requested more information on how the Country Team planned to avoid future unintended consequences of structural reform. Staff and the Director General responded that the possibility of perverse consequences would be lessened in the future based on Bank country experience-to-date, substantial investment in economic and sector work and more attention to policy reform requirements.

Informal Sector. The Committee noted the importance of the informal sector to generating growth, especially given the lack of consensus on reform and requested more details on its scope, and strategies to link it to the formal economy. This was especially important given the lack of demonstrated government commitment to reform, and the role that the private sector will have to assume in leading growth.

The Committee endorsed OED's recommendations for more lending to the social sectors and for targeted poverty interventions and less for adjustment, until Ukraine achieves consensus on its reform path. Public education around reform with a wide range of stakeholders will be key to promoting such consensus.

Jan Piercy
Chairperson, CODE

Distribution
Executive Directors and Alternates
President
Bank Group Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department heads, Bank, IFC and MIGA

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