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A New Pact for Ukraine: How to Make EU Aid Work

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Ukraine badly needs external aid from Western donors, but the money should be spent well. Past experience offers five indispensable lessons. In response to these, the EU needs to ensure sound public finance management and avoid mis-management; give priority to building governance structures over freeing up spending; and create a high-level advisory mission, to focus first on the rule of law and democracy, and then on long-term economic transition reforms. With the EU's financial capacities seriously limited, the bloc must at least ensure that the quality of support is high.

An international donor conference is in the air, and the EU is working on an aid package which can be deployed in a medium and long term in cooperation with various other financial institutions in Ukraine. Even more important than quantity is the question of quality. The situation in Ukraine is not so exceptional that past lessons are irrelevant. The results of a major research project carried out by PISM, involving 20 targeted interviews with the EU delegation and Ukrainian officials, independent experts and civil society organisations (CSOs) from June to September 2013 (and mirrored by similar investigations in four other Eastern Partnership countries) provide the necessary lessons.

EU Lessons Learnt from Budget Support in Ukraine. Since 2007, the EU has made direct transfers to the state budget to be spent on reforms under jointly-agreed conditions. Around 60% of all EU bilateral aid in the years 2007-2013 was to be spent this way. Six agreements were signed in the sectors of energy, energy efficiency, trade facilitation, environment, transport and border management (a second deal in the energy field is also in the pipeline) for the overall sum of €389 million. And yet, Ukraine has received payments of not more than one third of this amount (€111.14 million) due to limits on transfers imposed by the European Commission since 2011. The main reason for this was the significant deterioration in public procurement law and budgetary transparency, meaning the formal prerequisite of sound public finance management (PFM) was not fulfilled. Five lessons can be drawn:

Lesson 1: The real prerequisite is the existence of a reformist government. EU budget support has brought very limited results. Evidently it helped Ukraine's approximation to EU standards (making budget support more efficient than practice-sharing tools), but it did not ensure the implementation of the required legislation. The Ukrainian administration felt very much at ease drafting strategies and adopting legislation on paper (it fulfills 60–70% of the indicators), but actual implementation lagged behind. The major reason has been a lack of political will at a higher level to push for comprehensive reforms. The strict hierarchy within ministries hinders the implementation process, as, without a directive from the political level, nothing happens.

Lesson 2: The capacity building of governance structure must be supported. Implementation will also be ineffective in a system characterised by a high level of corruption, inefficient management (responsibility to the line manager not to the state interest, and a fear of taking decisions), a lack of administrative units capable of delivering cost-benefit analysis of the reforms, frequent turnover of top-level managerial positions, and weak inter-ministerial coordination. But most troublesome, Ukraine still lacks an efficient mechanism for the coordination of international aid. The institutions responsible for the management of EU funds, the Ministry of Economic Development and Trade, and the Ministry of Finance, have limited monitoring competencies over other ministries. State funds, through which international aid is transferred and distributed to ministries, lack transparency.

Lesson 3: The EU conditions must be relevant. The EU side is also to blame. The annual volume of budget support constitutes only a small part of the Ukrainian budget (around 0.1%). This is not enough to trigger massive reforms, and the EU's demanding agenda has thus required significant national funding. Whilst Ukrainian officials estimated that the cost of the national energy strategy could reach €100 billion, the EU budgeted just €145 million for energy and energy efficiency reforms. More worryingly, conditionality was applied inconsistently. The conditions either covered too many areas, proved too ambitious, or were simply formulated ambiguously. Some legislation required in the environmental sector would have been hard to adopt in the EU Member States themselves. Thus there was inexperience on both sides.

Lesson 4: Advice given should be relevant. Technical assistance (TA), meaning EU experts advising Ukrainian officials, underpinned budgetary support. But, due to lengthy bureaucratic procedures, the missions were launched around one year after the start of the operation. In some sectors, EU experts lacked ability in terms of drafting country-specific recommendations. The other problem is the use of the TA to shift expert duties that should be carried out by local officials to the EU (i.e., drafting monitoring reports, which should be delivered by the national administration). Thus TA actually limits efforts to build the analytical capacities of the administration. The logical response was for the EU to hire experts for the reform negotiation phase, and to frontload assistance during the whole budget support cycle period. In order to make analysis more relevant to Ukraine's situation, more local experts should also have been contracted.

Lesson 5: Popular support for reforms must be gained. Budget-support operations remain opaque, and therefore have undermined social approval for reform. In most cases the representatives of even EU-supported CSOs have limited access to information. The EU has thus found it hard to catch the attention of the media or society, as its aid is too abstract for most people. Only in the transport programme did a public campaign on road safety highlight the value of Ukraine approximation to EU standards. EU communication activities should have translated details about conditionality into a reader-friendly language, highlighted through regular press releases. The results of reform should have been communicated through campaigns, in close cooperation with the Ukrainian government, and the EU should have financed watchdogs to monitor reform implementation, in particular PFM, as well as inviting CSOs to participate in joint committees monitoring EU aid.

Speed not Haste. In trying to implement these lessons, the EU faces tension between, on the one hand, the need to provide immediate funding for Ukraine's economy, and, on the other, the requirement to ensure the long-term effectiveness of conditionality. If sound governance structures are not in place before funding arrives, the money will simply be wasted. There is also a risk that any "shock therapy" demanded by donors could lead to social disapproval and increase political instability. The medium-term financial limits of both sides (up to 2016 at least) give an additional reason to focus on the long-term perspective. After all, it will take time to mobilise foreign aid; following internal crises in Georgia and Moldova it took several years to get the financing to the recipients, even after political declarations had been made.

All this means that the finances should be entrusted to Ukrainians on condition that the new government implements previous commitments to the transparency of PFM and public procurement rules. A kind of reverse conditionality should also apply, with donors ratcheting up their long-term commitments in return for reforms related to building the rule of law and the democratic foundations of the country (for example, an independent judiciary and reform of the constitution). And the EU and other donors should empower Ukraine's new government to decide on the medium and long-term pace of the reforms, limiting themselves to an advisory role.

The EU can ensure that this approach is not undermined by other international donors by setting up a high-level advisory mission (based on experiences across the border in Moldova) involving EU and other internationally-experienced experts (for example, from the United States,) so as to set the tone. The EU can also ensure that its long-term agenda trumps those of other international players by positioning itself as lead coordinator for financial support. It has some good coordination practices to follow from Georgia, where, in the case of regional development reform, it was cooperating with the European Bank for Reconstruction and Development and its own Member State, Germany.

In all this, Poland should ensure the relevant changes in the EU's current aid scheme are implemented in the near future by being involved in the discussion on the European package in Ukraine at the technical level. In addition, as a Member State which is relatively proficient in using EU funds, it might offer the active engagement of its experts in technical assistance missions and a potential high advisory mission in Ukraine.