



EUROPEAN COMMISSION

## **MACRO-FINANCIAL ASSISTANCE TO UKRAINE: DISBURSEMENT OF THE FIRST INSTALMENT**

---

(Information Note to the European Parliament and to the Council)

## 1. Introduction

Following an official request from Ukraine,<sup>1</sup> on 9 March 2018 the Commission adopted a proposal for a Decision providing further MFA to Ukraine of up to EUR 1 billion in loans. The Decision was adopted by the European Parliament and the Council on 4 July 2018.<sup>2</sup>

The assistance, which is the fourth MFA operation in Ukraine since the onset of the crisis in 2014,<sup>3</sup> was originally meant to complement the previous IMF programme, a four-year (2015-2019) Extended Fund Facility (EFF) of around USD 17.5 billion (SDR), approved on 11 March 2015. The EFF programme is expected to be replaced by a 14-month Stand-By Arrangement (SBA) of USD 3.9 billion (SDR 2.8 billion), agreed at staff level on 19 October 2018. This SBA aims to support the Ukrainian government's reform programme and anchor sound economic policies in 2019 – a difficult year for the country both politically (due to presidential and parliamentary elections) and economically (mainly due to a peak in external debt repayments).

Following the positive opinion delivered by the Member State Committee on Macro-Financial Assistance on 6 September 2018 on the Memorandum of Understanding (MoU) relating to this MFA operation, the MoU and the Loan Facility Agreement (LFA) were signed on 14 September 2018 and ratified by the Ukrainian Parliament on 8 November 2018. The MoU and the LFA entered into force on 30 November 2018.

In accordance with the MoU, the assistance is to be provided in two instalments of EUR 500 million each. Aside from the general political pre-condition for MFA (respect for effective democratic mechanisms, including a multi-party parliamentary system, the rule of law and human rights), both instalments are conditional on a satisfactory track record under the IMF programme and on the fulfilment of a set of policy conditions, laid down in the MoU. Regarding the fulfilment of policy conditions, Commission staff visited Kyiv on 1-5 October 2018 for a review mission and has been in regular contact with the Ukrainian authorities since. On 27 November 2018, Ukraine submitted the compliance statement.

In accordance with the consultation and information requirements of the aforementioned MFA Decision, this note informs the European Parliament and the Council of the state of play of the MFA operation in Ukraine, in particular the disbursement of the first loan instalment of EUR 500 million. In line with the Joint Statement of the European Parliament, the Council and the Commission attached to the MFA Decision, the note will be made public. The note first describes recent macroeconomic developments in Ukraine (Section 2), and reviews the compliance with the political pre-condition for MFA (Section 3) and the progress of the IMF programme (Section 4). The note then provides background information on the fulfilment of policy conditions for the first instalment, contained in the MoU (Section 5), and an overall conclusion summarising the grounds for the disbursement of the first instalment to Ukraine (Section 6).

In view of the positive overall conclusion regarding Ukraine's compliance, on 30 November 2018 the Commission adopted a decision to release the first instalment to Ukraine and a

---

<sup>1</sup> Letter of 29 November 2017 from the Finance Minister Danyliuk to Vice-President Dombrovskis.

<sup>2</sup> Decision (EU) 2018/947 of the European Parliament and of the Council of 4 July 2018 providing further macro-financial assistance to Ukraine, OJ L 171 06.07.2018, p. 11.

<sup>3</sup> The previous three operations totalled EUR 3.4 billion, of which EUR 2.8 billion was disbursed: EUR 1.6 billion in 2014-2015 (under MFA I and II) and two tranches of EUR 600 million each in July 2015 and April 2017 (under MFA III).

decision to borrow the corresponding funds in capital markets. The disbursement is expected to take place in December 2018 or January 2019.

## **2. Recent macroeconomic developments**

### **REAL SECTOR**

Ukraine's economy has returned to growth after the deep recession in 2014-15 and accelerated in the first half of 2018. After 2.5% in 2017, real GDP growth picked up to 3.1% in the first and 3.8% in the second quarter of 2018, but in the third quarter it came in somewhat weaker (2.8% according to provisional data). Real GDP growth for the whole 2018 is now forecast at around 3.3%.

In terms of demand components, growth is mainly driven by strong investment activity (+17% in the first half of 2018) and private consumption (+6%). Investment is stimulated by the need to modernise production facilities, especially in export-oriented companies. Private consumption is rising due to increasing real wages, pensions and remittances. The contribution of foreign trade to real GDP growth remains negative.

The situation in the labour market has recently improved. The survey-based unemployment rate fell to 8.3% in the second quarter of 2018 from 9.1% a year before. Lower unemployment was driven by growing demand for labour from domestic companies (as indicated by an increasing number of vacancies) and by a contraction of labour supply related to labour migration to EU countries, in particular to Poland. Higher demand for labour and hikes of the minimum wage led to an increase in average nominal wages by 13% in real terms in August 2018 year-on-year.

### **MONETARY DEVELOPMENTS**

Annual consumer price inflation slowed down from 13.7% in December 2017 to 9.5% in October 2018, approaching the target range set by the Monetary Policy Guidelines (6.5%  $\pm$  2 pp). Disinflation was mainly due to contractionary monetary policy of the central bank, which raised its key interest rate by a cumulative 5.5 percentage points since October 2017 to 18% now. The central bank points to a number of factors which justify continuation of tight monetary policy despite moderating inflation, including risk of capital outflows from the emerging markets, high inflation expectations and the expected increases in administered prices (gas and heating tariffs).

Regarding the exchange rate, the hryvnia was broadly stable against the US dollar in 2017, with some seasonal volatility. In the first half of 2018, the hryvnia appreciated against the US dollar by 7% and then lost this gain in August, in relation to the situation of emerging market currencies on global financial markets. Currently, the hryvnia is some 2% stronger against the US dollar than at the beginning of the year.

Bank lending in hryvnia continued to increase: the stock of loans went up by 16% year-on-year at the end of September 2018. In particular, household credit surged by 26% year-on-year, while corporate lending growth was up 13%; hryvnia deposits increased in the same period by 12%. Ukraine's banking sector continues to struggle with a very high ratio of non-performing loans (54% at the end of September 2018). However, as part of a substantial improvement in the regulatory framework and quality of banking supervision over the last few years, banks have been forced to provision these non-performing loans at high levels and have therefore already largely realised the associated losses, in turn reducing the risks of systemic instability.

## **FISCAL DEVELOPMENTS**

Ukraine has made significant progress in the consolidation of its public finances in the past few years. The overall fiscal deficit (including the deficit of oil and gas company Naftogaz) was reduced from 10% of GDP in 2014 to 1.4% in 2017. The government's 2018 fiscal deficit target is UAH 80.6 billion (2.3% of GDP). In spite of faster increase in spending than in revenues in the first half of the year, the actual deficit is now expected to be somewhat lower than budgeted, mainly because the cost of debt service has been lower due to a slightly stronger-than-budgeted exchange rate, which reduces the local-currency cost of USD-denominated interest payments compared with the plan.<sup>4</sup>

Ukraine's public debt decreased from 81% of GDP at end-2016 to 64% of GDP at the end of August 2018, reflecting strong nominal GDP growth (denominator effect), only slight depreciation of the hryvnia vs. the US dollar (leading to a smaller-than-expected increase in the hryvnia value of dollar-denominated debt). However, part of the debt moderation in 2018 so far also relates to delays in external borrowing and are expected to be partly reversed before year-end in light of the recent Eurobond issue. Two thirds of Ukraine's public debt is denominated in foreign currency, half of which is extended on concessional terms by international financial institutions and bilateral partners, including the EU.

## **EXTERNAL SECTOR**

Ukraine's foreign trade balance saw a significant adjustment in the wake of the crisis in 2014-15, but is now widening again. In the first three quarters of 2018, imports, spurred by strong investment needs for modernisation of the economy and by consumer demand in light of rising incomes and remittances, increased by 16% year-on-year; exports increased by 10% in the same period. The resulting trade deficit exceeded USD 9 billion (against USD 6.4 billion in the same period of 2017). Imports are, in general, much more high-tech and of higher added value than exports, which are dominated by metallurgical and agricultural products. The widening of the trade deficit was counterbalanced by increasing remittances from Ukrainians working abroad, estimated at USD 8.5 billion in this period, while the balance of investment income was strongly negative (-USD 6.5 billion). Altogether, the current account deficit widened significantly, to USD 3.9 billion in the first nine months of 2018 (from USD 1.5 billion in the same period of 2017), and should be monitored as a (re-)emerging source of risk to the economy.

In terms of the financial account, net FDI decreased in the first three quarters of 2018 to USD 1.5 billion (from USD 2.2 billion in the same period of 2017) and remains low. As the World Bank has recently underlined,<sup>5</sup> significant reforms are needed to attract FDI in Ukraine, including strengthening the anticorruption architecture and the judiciary, but also further streamlining the regulatory environment, strengthening competition policy and enabling efficient financial intermediation.

The main current short-term challenge to the Ukrainian economy is repayment of public debt, especially of the part denominated in foreign currency. Ukraine needs to repay USD 3.5 billion of principal and interest (in foreign and domestic currency) in the fourth quarter of 2018 and another USD 7.7 billion in the first half of 2019. The redemptions of external debt

---

<sup>4</sup> The National Bank of Ukraine forecasts the budget deficit in 2018 at UAH 69.1 billion (around 2% of GDP).

<sup>5</sup> World Bank, Tapping Ukraine's trade potential, October 2018.

falling due in 2019 (USD 4.1 billion) are more than twice as high as in 2018 (USD 1.8 billion). The government plans to finance repayments by issuing Eurobonds on international markets (a successful issue took place in late October), by borrowing on the domestic market (which, however, has low liquidity) and by loans from international donors (IMF, EU, World Bank).

Ukraine's international reserves amounted to USD 18.1 billion in early November 2018, an equivalent of 3 months of imports. They decreased by 4% since the beginning of the year due to debt repayments and interventions of the central bank on the foreign exchange market. However, as the next disbursement from the IMF is expected in December, reserves will increase by the end of the year.

### 3. Political pre-condition

Pursuant to Article 2 of the MFA Decision, a *“pre-condition for granting the Union’s macro-financial assistance shall be that Ukraine respects effective democratic mechanisms – including a multi-party parliamentary system – and the rule of law, and guarantees respect for human rights”*. As confirmed by the European External Action Service, Ukraine’s constitution and legislation enshrine the principles of democratic pluralism and multi-party political system, the rule of law and respect of fundamental rights and freedoms.

Regarding **effective democratic mechanisms**, Ukraine is an open society, where elections are held freely and largely in line with international standards. The next presidential and parliamentary elections will take place, respectively, in March and October 2019. The new members of the Central Electoral Commission have been appointed after some of the mandates lapsed in 2014 and 2017. Media freedom has improved since 2014, but further work is needed to strengthen the pluralistic environment and to effectively investigate the attacks against journalists and civic activists.

Regarding **human rights**, Ukraine has continued the implementation of the 2015-2020 National Strategy and Action Plan on Human Rights, although at a slow pace, and a number of concerns persist. The most severe violations take place in the areas not under the control of the Ukrainian Government, following the illegal annexation of the Crimean peninsula and the conflict in the east provoked by Russia’s destabilising actions.

Regarding the **rule of law**, reforms in the area of the judiciary and the fight against corruption have advanced, albeit at a slower pace. Further actions are needed to ensure their completion, full implementation and sustainability, including with regard to the banking fraud. This concern is also being addressed by means of MFA policy conditionality in the area of good governance and the fight against corruption.

Following escalation of the security situation in the Azov Sea after an incident between Russian and Ukrainian naval vessels, Ukraine introduced martial law in 10 regions in the southern and eastern Ukraine on 26 November 2018, for 30 days as of 28 November until 27 December. As such, this does not create an obstacle for the implementation of the MFA programme, but the situation will be followed closely by the Commission and the European External Action Service.<sup>6</sup>

Overall, Ukraine can be considered to meet the political pre-condition for MFA.

---

<sup>6</sup> The IMF made the following statement on 26 November 2018: “We are following recent developments, including the imposition of martial law, and hope for the prompt de-escalation of the current situation. The IMF does not have any legal restriction to the continuation of cooperation with Ukraine in this situation.”

#### 4. Progress with the IMF programme

On 19 October 2018, the IMF announced<sup>7</sup> an agreement at staff level with Ukraine on a new 14-month Stand-By Arrangement (SBA), which would run to the end of 2019 and have a volume of USD 3.9 billion (SDR 2.8 billion). It would replace Ukraine's previous Extended Fund Facility (EFF) programme and provide an anchor for prudent economic policies during 2019, with presidential and parliamentary elections scheduled for, respectively, March and October of that year. The SBA will focus on continued fiscal consolidation and reducing inflation, as well as on reforms to strengthen tax administration, the financial sector and the energy sector.

Importantly, the SBA also builds on Ukraine's progress under the EFF programme, including a pension reform started in October 2017, an improved legal framework for privatisation (notably, by adopting the privatisation law in January 2018) and the adoption of legislation establishing the High Anti-Corruption Court in June and July 2018. Thus, the first disbursement under the new SBA essentially replaces the disbursement after the fourth review under the previous EFF.

The staff-level agreement includes the following actions to be implemented before the IMF Board discusses the staff proposal for the new SBA and approves the first disbursement under it:

- (a) Enactment of the **2019 budget** in line with programme parameters. In particular the IMF expects the scope of a planned **exit capital tax** – if introduced at all – to be limited (the tax should apply to SMEs only and be accompanied by the abolishment of a simplified turnover tax scheme for SMEs); and
- (b) Increase in **gas and heating tariffs**. The Ukrainian authorities have agreed with the IMF on a staged increase in gas prices for households by 23.5% as from 1 November 2018 and 15% in spring 2019. The government made a formal decision on the gas price increase on 19 October 2018. On the basis of the latter decision, the regulator now needs to take the technical steps to ensure that these gas price increases also translate into commensurate heating price increases (by district heating companies) as of 1 January 2019.

In addition, the IMF expected the President to sign the **legal amendments regarding the governance of state-owned banks** (the law on state-owned banks), which the President did on 31 October 2018.

On 23 November 2018 the Ukrainian Parliament adopted the 2019 budget. In a statement of 28 November 2018 the IMF announced that, based on a preliminary assessment, it considered the adopted budget satisfactory and expected all prior actions to be completed by 10 December; a meeting of the Executive Board to discuss the Stand-By Arrangement would be convened promptly after that.<sup>8</sup>

---

<sup>7</sup> <https://www.imf.org/en/News/Articles/2018/10/19/pr18392-imf-and-ukrainian-authorities-reach-staff-level-agreement-on-a-new-stand-by-arrangement>

<sup>8</sup> <https://www.imf.org/en/News/Articles/2018/11/28/pr18441-statement-by-the-imf-managing-director-on-her-telephone-call-with-the-president-of-ukraine?cid=em-COM-123-38029>

## 5. Fulfilment of policy conditions

The policy conditions contained in Annex I of the MoU aim to address key weaknesses of the Ukrainian economy. In line with the Joint Statement by the European Parliament, the Council and the Commission accompanying the aforementioned MFA Decision, a key focal point of the MoU is the strengthening of the governance, the administrative capacities and the institutional set-up in particular for the fight against corruption. Other policy conditions for the first instalment fall into the areas of public finance management (PFM), and sector reforms and state-owned enterprises (SOEs).

### PUBLIC FINANCE MANAGEMENT

***Action 1.*** *To improve the predictability of the tax environment for businesses, the Ministry of Finance of Ukraine will issue at least seven general tax consultations on the practical application of tax legislation in the third quarter of 2018. These general tax consultations will take the form of orders of the Ministry of Finance.*

In order to increase the quality and efficiency of the tax administration, in 2017 the Ministry of Finance started issuing clarifications (so-called general tax consultations on the practical application of tax legislation) on selected issues where there is a risk of inconsistent interpretation. This initiative has been well perceived by businesses, as it increases the predictability of the tax system and thereby contributes to further improvement of the business environment in Ukraine.

Tax clarifications, which take the form of orders of the Ministry of Finance, are drafted by the legal service of the Ministry of Finance. An advisory board that consists of representatives of the Ministry of Finance, the State Fiscal Service (Ukraine's tax and customs administration), as well as external experts and stakeholders, is then consulted on the draft orders, prior to their adoption by the Minister.

In the third quarter of 2018, the Ministry of Finance issued two orders, approving seven clarifications in total.<sup>9</sup> The first order of 6 July 2018 approves three clarifications relating to land taxation and the second order of 3 August 2018 four clarifications relating to the value-added tax. According to the Ministry of Finance, drafting and issuing of clarifications is a continuous process. On 14 November 2018, the Ministry of Finance issued a further order approving a clarification on the definition of a tax reporting period.

Assessment: the condition can be considered as met.

---

<sup>9</sup> The Ministry of Finance made the two orders publicly available on its website on 9 July and 7 August 2018: <https://www.minfin.gov.ua/news/view/normatyvnopravovi-akty-z-podatkovykh-konsultatsii?category=bjudzhet&subcategory=podatkovi-konsultatsii>.

## GOOD GOVERNANCE AND FIGHT AGAINST CORRUPTION

***Action 2.*** *To put in place an automated verification system for electronic asset declarations of persons authorised to perform functions of the state and local self-government and thereby detect and prevent corruption, the Ukrainian authorities will (a) ensure the upgrade of the verification module to enable logical and arithmetic control of electronic asset declarations, obtaining the necessary certificate of compliance for this module, take ownership of the module and put it into operational use, and (b) conclude the technical protocols on automatic data exchange between the verification module and relevant state registers and establish these connections.*

A compulsory electronic asset declaration system for public officials was introduced in Ukraine in 2016 with the aim to expose cases of illicit enrichment. So far, officials have submitted around 2.7 million asset declarations in three vintages (2016, 2017 and 2018). Given this large number, an IT-supported system is necessary to verify declarations in an effective way.

The automatic verification software (the verification module), which had been developed by a contractor of the United Nations Development Programme (UNDP), has been upgraded, in order to make the software compatible with the current state of the electronic declarations system. On 20 August 2018, the UNDP transferred the module to the NACP<sup>10</sup> and, on 24 September, the module received data security certification from the State Service of Special Communication and Information Protection.

In parallel, the NACP has developed technical protocols, to enable the automatic exchange of information with the relevant authorities (so-called register holders), in order to cross-check the data provided in asset declarations. On this basis, the NACP has established connections with 10 out of 16 state registers. Out of the remaining six registers, held by the Ministry of Justice, connections to three registers are being established and will be operational shortly. Connections to the remaining three registers will be established as soon as the Ukrainian Parliament adopts the necessary legislative changes that have already been submitted to it.

On 2 October 2018, an EU-mandated IT expert confirmed the facts that the verification module had been duly upgraded, certified and handed over to the NACP, and that connections to the currently accessible state registers had been established.

In terms of putting the verification module into operational use, the NACP has:

- (a) Uploaded all 2.7 million declarations into the verification module, carried out the internal consistency check of these declarations (including comparing the declarations submitted by the same public official in different years) and produced a list ranking these declarations according to the apparent risk of illicit enrichment; and
- (b) Started cross-checking the declarations against the information in other state registers, using the verification module. This cross-check is currently limited to the declarations risk-flagged based on the internal consistency check (outlined under (a) above; currently about 200,000) and the declarations of high-level officials that have to be fully audited on a mandatory basis. For this purpose, on 21 November 2018, the NACP made the necessary changes to its internal rules: the decision on the procedure

---

<sup>10</sup> <http://www.ua.undp.org/content/ukraine/en/home/presscenter/pressreleases/2018/undp-transfers-software-for-the-automatic-verification-of-e-decl.html>

for conducting control and detailed audit of declarations of 2 October 2017 (so-called Decision 56) and the decision on logical and arithmetic control rules.<sup>11</sup>

Assessment: the condition can be considered as met.

***Action 3.*** *To ensure effective verification of information on companies' beneficial ownership in the Unified State Register of Legal Entities, Individual Entrepreneurs and Public Associations, amend the company registration process so as to require – whenever a legal entity seeks to register or change its entry – additional information on beneficial ownership, notably (a) the type of beneficial ownership, (b) the percentage of each beneficial owner's interest, (c) a description of the ownership structure in case a legal entity is not directly and wholly owned by its members/shareholders, and (d) a reasoned explanation in case no beneficial owner can be stated.*

In 2017, Ukraine created a publicly available online database of beneficial owners of companies, the Unified State Register of Legal Entities, Individual Entrepreneurs and Public Associations, under the authority of the Ministry of Justice.

Given the lack of international examples of beneficial ownership verification mechanisms and of internationally agreed practices to exchange information on beneficial ownership, the Ukrainian authorities requested help from the EU on the appropriate legal and organisational development. This technical assistance, which was provided in the summer of 2018, resulted in a number of short-, medium- and long-term recommendations that would ensure effective verification of companies' beneficial ownership data. One of the short-term recommendations is reflected in the policy condition under consideration.

On 29 August 2018, the Ministry of Justice issued an order amending the registration forms to require the companies to provide more information on beneficial ownership, notably (a) the type of beneficial ownership, (b) the percentage of each beneficial owner's interest, (c) a description of the ownership structure in case a legal entity is not directly and wholly owned by its members/shareholders, and (d) a reasoned explanation in case no beneficial owner can be stated (for instance, in cases of dispersed ownership of listed companies). Since 24 September 2018, when the new forms came into effect, companies have had to provide additional information on their beneficial owners each time they request a change to their entry in the register, except in the case of liquidation. Previously, limited information on beneficial owners was only required when registering a new company.

According to the Ministry of Justice, the requirement for additional information will significantly reduce the number of cases where beneficial owners are not known (currently estimated at around 75%), given that – on average – companies request changes to their entry in the register around once a year.

In parallel, the Ministry of Justice is currently upgrading the software of the Unified State Register, which should improve access to beneficial ownership data from early 2019, including making it searchable. The Ministry also started providing explanatory information and training to registrars, in order to enhance the quality of beneficial ownership data over the medium term.

---

<sup>11</sup> Changes to the Decision 56 notably ensure that both the internal consistency check of declarations and their cross-check against the registers is part of the logical and arithmetic control, preceding the full audit of declarations by the NACP. Changes to the logical and arithmetic control rules ensure the appropriate risk coefficients for the internal consistency check.

Assessment: the condition can be considered as met.

**Action 4.** *In the draft 2019 budget to be submitted to the Parliament of Ukraine by 15 September 2018, the Ukrainian government will include an amount for the **High Anti-Corruption Court of Ukraine** that is appropriate for its effective and independent functioning. The Ukrainian authorities will also launch the processes of selection of members of the Public Council of International Experts and of judges of the High Anti-Corruption Court of Ukraine.*

The High Anti-Corruption Court (HACC) is widely seen as a missing element in the anti-corruption enforcement chain, given the relative weakness of Ukraine's judiciary<sup>12</sup> and the fact that few public officials have been convicted of corruption so far.

In June 2018, the Ukrainian Parliament adopted two laws relating to the HACC: (a) the law on the HACC, defining the functioning of the court, and (b) an implementation law on the establishment of the HACC, with the sole provision of setting up the HACC located in Kyiv. In July 2018, the Parliament also adopted the necessary legislative amendments to the transitional provisions, whereby appeals in the relevant cases already brought to the court system will be heard by the Appeal Chamber of the HACC rather than the general courts.

In terms of the progress of setting up the HACC, the 2019 budget adopted by the Parliament in the second reading in November foresees an adequate provision for the HACC of UAH 318 million (EUR 10.1 million), covering running costs (mainly salaries) and capital costs (e.g. IT equipment). The provision for the HACC for 2019 is comparable those for similar courts, such as the Constitutional Court, albeit with more prominent capital costs (reflecting one-off costs of setting up the HACC).

Moreover, the High Qualification Commission of Judges launched the selection processes for the members of the Public Council of International Experts (PCIE) and the judges of the HACC on, respectively, 31 July and 8 August 2018. Regarding the members of the PCIE, which has a crucial role in the selection of judges, the High Qualification Commission has received 12 proposals for candidates from the EU Delegation, which coordinates the efforts of the international community in this area. Having reviewed the proposals and interviewed the candidates, the High Qualification Commission appointed six members of the PCIE in early November.<sup>13</sup> Regarding the judges of the HACC, 343 applications for 39 posts have been received. The verification of the candidates' compliance with the requirements started after the members of the PCIE had been appointed.

Assessment: the condition can be considered as met.

---

<sup>12</sup> According to the World Bank Governance Indicators 2018, Ukraine scores 25 out of 100 (highest) with regards to the rule of law. This is worse than the average 35 score for lower middle income countries to which Ukraine belongs.

<sup>13</sup> <https://vkksu.gov.ua/ua/news/wkksu-uchwalila-sklad-gromadskoi-radi-miznarodnich-iekspiertiw/>

## SECTOR REFORMS AND STATE-OWNED ENTERPRISES

**Action 5.** *To improve corporate governance in state-owned enterprises (SOEs), the Ukrainian authorities will (a) select and nominate independent members of the supervisory board of Ukrenergo (electricity transmission operator), so that the supervisory board becomes operational in its new composition, and (b) launch the selection process for independent supervisory board members in at least three other large SOEs, assisted by professional executive search companies.*

Improving corporate governance of Ukrainian SOEs is a key tool for addressing shortcomings in this sector, notably the generally inefficient management that has contributed to the accumulation of significant contingent liabilities for the government, as well as corruption and political interference that undermines the level playing field for (other) businesses.

One of the main steps in improving corporate governance of SOEs in Ukraine has been the establishment of independent supervisory boards of Naftogaz (the national oil and gas company) and Ukrzaliznytsia (the state railway company). Moreover, recent changes in selection procedures – notably the involvement of professional executive search companies – are expected to improve the quality of shortlists of candidates for appointment.

In order to make further progress, on 3 October 2018 the Cabinet of Ministers of Ukraine appointed the supervisory board of Ukrenergo (Ukraine’s electricity transmission operator).<sup>14</sup> As required by the reformed corporate governance rules, the board consists of four independent and three owner (i.e. state) appointed members. In early November 2018, the contracts with the recently appointed board members were signed and the first meeting of the board took place, making the board operational in its new composition.

The Ukrainian authorities have also launched the selection of independent supervisory boards of three other big SOEs. In the case of UkrPoshta (the state postal company), the selection process is, in fact, complete: independent board members have been selected, and the full board (five independent members and two members representing the state) was appointed on 10 October 2018.<sup>15</sup> On the same day, the Cabinet of Ministers announced the call for applications for independent members of the supervisory board of the Ukrainian Sea Ports Authority (the company administering Ukraine’s sea ports).<sup>16</sup> In the case of Boryspil airport, the call for applications was announced on 20 November 2018.<sup>17</sup>

Assessment: the condition can be considered as met.

**Action 6.** *Pursuant to the government’s privatisation plan, put at least 200 small state-owned objects up for sale through electronic auction in the ProZorro.Sale system.*

<sup>14</sup> <https://www.kmu.gov.ua/en/news/uryad-pogodiv-kandidaturi-chleniv-naglyadovoyi-radi-ukrenergo>

<sup>15</sup> <https://ukrposhta.ua/en/uryad-pogodiv-sklad-naglyadovoï-radi-ukrposhti/>

<sup>16</sup> <https://www.kmu.gov.ua/en/events/ogoloshennya-pro-provedennya-vidboru-na-posadu-nezalezhnogo-chlena-naglyadovoyi-radi-dp-administraciya-morskih-portiv-ukrayini?=-print>

<sup>17</sup> <https://www.kmu.gov.ua/en/events/announcement-selection-position-independent-member-supervisory-board-state-enterprise-international-airport-boryspil>

Ukraine has significantly improved its legal framework for privatisation, also by adopting the necessary secondary legislation in June 2018, which has enabled the launch of sales of small companies and assets through an electronic platform – ProZorro.Sale. In the absence of successful large-scale privatisations so far, starting the sale of small state assets – such as shareholdings and buildings – is an important signal for investors of the intention of the state to reduce its influence over the economy and to attract additional financing.

According to the Ministry of Economic Development and Trade, 300 small state-owned objects had been put up for sale as of 1 October, of which 67 objects had been sold, with satisfactory results. While the revenue from sales remains small in absolute terms, the prices achieved (the total sale price of around UAH 75 million, or EUR 2.3 million) were on average almost double the starting price (around UAH 40 million).

The State Property Fund of Ukraine publicly reports the results of small privatisations, on a monthly basis.<sup>18</sup>

Assessment: the condition can be considered as met.

## **6. Conclusion**

Ukraine continues to fulfil the general political pre-condition for MFA (respect for effective democratic mechanisms, including a multi-party parliamentary system, the rule of law and human rights). Performance under the IMF programme can be considered as satisfactory, given the staff-level agreement between Ukraine and the IMF on 19 October 2018 and the progress that Ukraine has made since in implementing the prior actions (described in Section 4). Moreover, as described in detail in Section 5 of this note, Ukraine met all six policy conditions for the disbursement of the first instalment of MFA.

Against this background, the Commission adopted a decision on 30 November 2018 to release the first instalment to Ukraine and a decision to borrow the corresponding funds in capital markets. With this disbursement, the EU contributes to the economic stabilisation of Ukraine, while also affecting the country's social situation positively by providing much-needed financing that enables the government to execute its budget, including the timely payment of pensions and other social benefits.

---

<sup>18</sup> <http://www.spfu.gov.ua/ua/content/spf-privatization-objects-rezultati-prodazhu.html>