



Brussels, 1.2.2022
SWD(2022) 25 final

COMMISSION STAFF WORKING DOCUMENT

ex-ante evaluation statement

Accompanying the document

**Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE
COUNCIL**

on providing macro-financial assistance to Ukraine

{COM(2022) 37 final}

Ex-ante evaluation statement

EU Macro-Financial Assistance to Ukraine

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1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1 Introduction

Ukraine has been developing a strong partnership with the European Union since 2014, going beyond mere bilateral cooperation to evolve towards gradual political association and economic integration. The EU-Ukraine Association Agreement, which entered into force on 1 September 2017 and includes a Deep and Comprehensive Free Trade Area (DCFTA), is the main tool for bringing Ukraine and the EU closer together. In addition to promoting deeper political ties, stronger economic links and the respect for common values, the Agreement has provided a solid framework for pursuing an ambitious reform agenda, focused on the fight against corruption, an independent judicial system, the rule of law, and a better business climate. The EU has shown continuous support for these reforms, which are crucial for attracting investments, boosting productivity and lifting the standards of living in the medium term. Among other support instruments, the EU has supported Ukraine through five consecutive Macro-Financial Assistance (MFA) operations that totalled EUR 5 billion of loans in the period 2015-2021.

However, notwithstanding the strategic long-term political orientation and commitment to implementing reforms, Ukraine continues to face significant challenges. The risks from the current geopolitical tensions and the security concerns at the border with Russia have been rising steadily since mid-November. They have weighed heavily on investors' confidence, as evidenced by a steady outflow of capital and drain on official foreign reserves. The weakening of the hryvnia, despite continued interventions by the National Bank of Ukraine (NBU) in support of the domestic currency, and the de facto loss of access to capital markets for the government increase the risks to the macroeconomic outlook of Ukraine significantly. Moreover, since the outbreak of the COVID-19 pandemic, more than 3.8 million contaminations resulted in almost 100,000 deaths. The return to economic growth in 2021 was slow, driven primarily by the retail and construction sectors, and the outlook is surrounded by considerable risks. Inflation accelerated and reached 10% at the end of 2021. The growing geopolitical tensions at its border with Russia have had considerable knock-on effects on confidence, in particular of foreign investors. The national currency has lost 9% of its value relative to the USD since mid-November 2021, despite interventions by the National Bank of Ukraine for about USD 1.6 billion during the same period, thereby drawing down the stock of official reserves by 5.5%.

In this context, the yields on the Ukrainian government Eurobonds increased to prohibitive levels in mid-January 2022. Private financing of the underlying balance-of-payments gap of Ukraine is thus no longer available at sustainable terms. Based on the latest projections by the International Monetary Fund in their first programme review, concluded on 8 November and approved on 22 November 2021, the lack of access to capital markets would imply a widening of the country's funding gap by the equivalent of, at least, USD 2.5 billion in 2022. Moreover, the escalating geopolitical tensions are having a detrimental effect on Ukraine's already precarious economic and

financial stability. Persistent security threats have already triggered a substantial outflow of capital. The negative impact on future investment, where Ukraine has been lagging behind regional peers already, further reduces the country's resilience to both economic and political shocks. Furthermore, the multiple threats that Ukraine currently is facing put a lot of pressure on state institutions to protect its citizens, which generates significant additional risks to the overall stability of the country and the broader society.

Against the backdrop of the loss of access to international capital markets due to the heightened geopolitical uncertainty and its impact on the economic situation in Ukraine, the Commission is submitting to the European Parliament and the Council a proposal to provide a new MFA of EUR 1.2 billion in the form of loans to foster stability in Ukraine.

The planned emergency MFA, put forward to provide swift support in a situation of acute crisis and to strengthen the resilience of the county, will have a duration of 12 months and include two disbursements. The release of the first tranche would occur swiftly after the approval of this proposal, upon entry into force of the Memorandum of Understanding (MoU) on specific structural policy measures, agreed between the European Commission on behalf of the EU and Ukraine. The disbursement of the second tranche would be linked to the continuous satisfactory implementation of both an IMF programme and the policy measures agreed in the MoU. The MoU underpinning this emergency macro-financial assistance operation is likely to focus on a limited number of feasible, short-term policy actions in the most urgent priority areas, such as strengthening economic resilience and stability, governance and rule of law, and energy. A subsequent, longer-term MFA could look beyond the immediate crisis and focus on a broader set of reform priorities. The implementation of the proposed operation is expected to go hand-in-hand with the support under budgetary operations financed by the Neighbourhood, Development and International Cooperation Instrument (NDICI – Global Europe). The announced additional allocation of EUR 120 million in NDICI – Global Europe grants will be important to further strengthen Ukraine's state-building and resilience efforts. Moreover, the EU will work closely with Ukraine to follow up on their request for a subsequent, regular MFA operation when the situation stabilises.

As further elaborated in this Commission Staff Working Document accompanying the proposal, the Commission considers, based also on the assessment of the political situation made by the European External Action Service, that the political and economic pre-conditions for the proposed MFA operation are satisfied.

1.2 Ukraine's macroeconomic situation

The return of Ukraine to economic growth in 2021 was rather slow. Following a less severe than expected recession of 4% only in 2020, Gross Domestic Product (GDP) contracted by 2.2% year-on-year in the first quarter of 2021. The second quarter rebound by 5.7% year-on-year was disappointing, given base effects with a corresponding severe contraction of 11.2% in the second quarter of 2020. Growth further decelerated to 2.7% year-on-year in the third quarter. The growth of the index of key sectors' output slowed down to 2.3% year-on-year in July and the index even

declined by 4.4% in September 2020. Following this soft patch, it subsequently expanded noticeably by more than 15% in the last months of 2021 compared to a year earlier. By end-November 2021, and relative to the same period of last year, early indicators suggest that industry (+1.3%) and construction (+0.3%) stagnated, while agriculture (+16.7%) and retail (+11.4%) recovered more assuredly. Yet, whether this moderate rebound sufficed to reach the pre-COVID-19 GDP level by the end of 2021 is yet to be seen.

After an initial deterioration during the recession, unemployment started to decrease in the second quarter of 2021. The unemployment rate reached 10.5% in the first quarter of 2021, which was still 1.9 percentage points above its level a year earlier. Yet, the return to economic growth had an immediate impact in the second quarter, when the unemployment rate declined already to 9.9%. It further declined to 9.7% in the third quarter. Nominal wages moderated their annual growth from almost 30% in April 2021 to 19% in November 2021, when the average monthly wage reached EUR 460. The annual growth of wages in real terms accelerated to almost 20% in April 2021, which is well above developments in 2018 (+12.6% by year-end) and in 2019 (+9.8%). By end-November 2021, annual growth in real wages moderated to 8%.

Taking into account the growing money supply and the accelerating inflation, the National Bank of Ukraine increased its key policy rate by 400 basis points to 10% between June 2021 and January 2022. The growth rate of the supply of money in the broad sense (aggregate M3) accelerated to 32.7% in November 2020, before slowing down to 13.5% in August 2021, thanks to the policy rate hikes. Although an increase in the precautionary demand for money might have played a role, money supply factors, and in particular additional loans to the government, have also been instrumental, as suggested by the price dynamics. Consumer and producer prices inflation reached 10.0% and 62.2% year-on-year in December 2021, respectively, up from 5% and 14.5% a year earlier, and compared to an inflation target of 4% to 6%.

After a lasting stabilisation of the exchange rate and of the level of international reserves, an abrupt decline in investors' confidence started to reverse the stabilisation trend in November 2021. Earlier in the year, the gross international reserves at the NBU had continued to grow and had reached more than USD 31.6 billion (more than 5 months of imports) in August 2021, also thanks to the allocation of additional Special Drawing Rights (SDRs) by the International Monetary Fund (IMF) for USD 2.73 billion. The improved confidence in the economy was also reflected in the higher amounts of net central bank purchases of foreign currency amid a context of domestic currency appreciation. However, the trend started reversing already in November 2021, when the NBU had to intervene in the foreign currency market by buying back hryvnia for the equivalent of USD 940 million. The cumulative support measures in the first three weeks of 2022 reached another USD 730 million. Thus, the stock of official foreign reserves of Ukraine declined by 5.5% in response to the changed investors' perception. Meanwhile, the domestic currency has depreciated by 8% relative to mid-November and has been exchanging at 28.3 hryvnias for 1 US dollar in mid-January 2022, up from 26.1 hryvnias for 1 US dollar in mid-November. In the current context of a gradual

global tightening of financing conditions, and as an emerging market, Ukraine is also exposed to additional fragility stemming from a re-assessment of global risks.

According to the central government's preliminary estimate, the 2021 public deficit stood at 3.1% of GDP in December, which is 2 percentage points better than initially planned. Public revenues increased by 24% year-on-year, which is 2.8 pps higher than planned, while public expenditure increased by 11% year-on-year, which is 1.5 pps less than planned. All of the expenditure increase reflects current spending, while public investment has stagnated. Based on data until end-August, the expenditure rise was particularly pronounced in healthcare (+32%), education (+26%) and state administration (+15%). Gross public debt reached 54.2% of GDP at the end of the second quarter of 2021, down from 60.8% at the end of 2020, largely reflecting a denominator effect.

International investors' perception of the sovereign risk remained volatile throughout 2021 and started worsening since mid-November, until Ukraine effectively lost access to international capital markets in January 2022. Against the backdrop of the protracted IMF first programme review, the yield on the EUR 1.25 billion Eurobond issued in January 2020 had deteriorated in the autumn of 2020 to almost 7% before stabilising below 5% in December 2020. Since then, it has increased again to 6.5% in November 2021 before reaching almost 10% on 18 January 2022. The yield on the USD-denominated Eurobond with remaining maturity of two years spiked to more than 20% on 19 January, before moderating slightly to 14.8% a few days later and compared to below 5% in early November 2021. This deterioration in the funding conditions implies that Ukraine no longer has access to international capital markets and cannot finance its external funding gap privately at sustainable rates.

Consistent with the resumption of economic growth, the significant 2020 current account surplus turned into a deficit in 2021. After a surplus of USD 5.3 billion in 2020, reflecting above all a strong demand compression as COVID struck, the current account registered a deficit of USD 830 million, or 0.5% of GDP, in January-August of last year. Exports and imports of goods rose by respectively 36% and 30% year-on-year, resulting in a merchandise trade deficit of USD 3 billion. The services balance, where exports and imports increased by respectively 12% and 21%, showed a surplus of USD 2.3 billion. Primary income turned into a significant deficit of USD 3 billion, as opposed to a surplus of USD 3.2 billion in January-August 2020, despite remittances surging by 18% to USD 8.9 billion. This development is driven by the significant widening in the deficit of the net investment income, in turn reflecting an improvement in the reinvested earnings by more than USD 5.2 billion relative to January-August 2020.

The stock of foreign direct investment recovered notably in the first half of 2021, with reinvested earnings being the primary driver. Fresh foreign equity stakes increased by less than USD 700 million in the first seven months of 2021. Yet, it is still encouraging that existing investors decided to re-invest their profits and incomes rather than repatriate them, for more than USD 4.7 billion. Portfolio investments also contributed towards a net capital inflow of USD 2.8 billion, though essentially due to investments into government debt. Other investments, mostly driven by the

hoarding of foreign cash and by trade credits abroad, contributed to a net capital outflow by USD 6.5 billion. Including the effect of all other factors, and in particular, the allocation of additional SDRs by the IMF amounting to USD 2.73 billion in August, official reserves increased by USD 917 million in Jan-Aug 2021, as opposed to USD 1.5 billion during the same period a year earlier. They declined significantly in September as the country faced a peak in external debt repayments. Because of delays with official support, Ukraine used USD 1 billion from the new SDR allocation to repay external obligations in September. Moreover, the official reserves have been declining since mid-November 2021 due to cumulative foreign exchange interventions in support of the domestic currency for about USD 1.7 billion.

Table 1: Ukraine – Selected macroeconomic indicators, 2017-2021

Ukraine	2017	2018	2019	2020	2021 latest	Dates
Nominal GDP, USD millions	112,202	130,844	154,136	155,495	168,315	H1 annualised
Nominal GDP per capita, USD	2,639	3,095	3,666	3,650	3,980	est 2021
Real GDP, % change	2.5	3.4	3.2	-4.0	2.7	Q3
Consumer price inflation, %, end of period	13.7	9.8	4.1	5.0	10.0	December
Consumer price inflation, %, average	14.4	11.0	7.9	2.7	7.7	September
Key monetary policy rate, %, end of period	14.5	18.0	13.5	6.0	10.0	January'22
Unemployment rate, LFS, %	9.5	8.8	8.2	10.1	9.7	Q3
General government balance, % of GDP	-1.4	-1.9	-2.2	-5.4	-3.1	December
Public expenditure, % of GDP	35.5	35.1	34.5	38.0	36.8	Q2
Gross Public debt, % of GDP	71.8	60.9	50.2	60.8	54.2	Q2
Current account balance, % of GDP	-2.2	-3.3	-2.7	3.6	-5.3	Q2
Official international reserves, USD billion	18.8	20.8	25.3	29.1	30.9	December
International reserves, months of imports	3.2	3.3	4.8	4.9	6.1	December
Gross external debt, % of GDP	102.9	87.7	79.0	80.8	74.4	Q2
Net foreign direct investment, % of GDP	3.3	3.4	3.4	-0.1	4.6	Q2

Source: National authorities, Commission staff.

1.3. IMF and other donor support

The IMF has been engaged in Ukraine with successive programmes since 2014, accompanied by EU MFA operations. Following a Stand-by Arrangement in 2014, the IMF approved a four-year Extended Fund Facility (EFF) programme of USD 17.5 billion for Ukraine in March 2015, out of which USD 8.4 billion were disbursed only. This programme was replaced in December 2018 by a Stand-by Arrangement (SBA) for a total of USD 3.9 billion, out of which USD 1.4 billion were disbursed. General political uncertainty and a divided parliament contributed to the poor track record with implementation of commitments. Following the 2019 parliamentary elections, the new government started negotiations on a new programme with the IMF.

On 7 December 2019, the IMF announced the conclusion of a staff-level agreement with the Ukrainian authorities on a new, three-year programme under the EFF for USD 5.5 billion. However, in 2020, the plans for a new EFF programme were superseded by an eighteen-month SBA that would allow for more policy flexibility in light of the COVID-19 crisis. Staff-level agreement on this new SBA for about USD 5 billion was reached on 21 May 2020. Policies under the new arrangement focus on four priorities: (i) mitigating the economic impact of the crisis,

including by supporting households and businesses; (ii) ensuring continued central bank independence and a flexible exchange rate; (iii) safeguarding financial stability while recovering the costs from bank resolutions; and (iv) moving forward with key governance and anti-corruption measures to preserve and deepen recent gains. Following the successful implementation by Ukraine of the attached prior actions, the IMF Executive Board approved the new SBA on 9 June 2020 and disbursed the equivalent of USD 2.1 billion on the same day.

Ukraine's engagement with the IMF under the new programme has been slow and uneven. While Ukraine met the two structural benchmarks for the period up to end-August 2020 on time, there has been a lack of progress and even some evidence of backtracking in relation to crucial reforms in the areas of rule of law, the fight against corruption and governance of state-owned enterprises. This delayed the official start of the first IMF review mission to mid-December 2020. The engagement with the IMF was revigorated in the summer of 2021. A physical visit by the Minister of Finance to Washington in mid-July provided a push to the reform implementation momentum, which was backed also by a strong effort from the Rada.

The Executive Board of the IMF validated the first programme review on 22 November 2021, which paved the way for the immediate disbursement of the equivalent of about USD 700 million. Simultaneously, the Board also approved the extension of the current Stand-By Arrangement until end-June 2022. Two more programme reviews are planned. If these disbursements take place, the outstanding amount of IMF loans to Ukraine would reach the binding upper limit of 450% of Ukraine's SDR quota in the IMF. This means that the IMF would not be able to provide any *net* funding to Ukraine beyond the current programme.

As regards support to Ukraine from the World Bank, the Bank's commitments to the country have totaled more than USD 14 billion in about 80 projects and programmes since Ukraine joined the World Bank in 1992. The portfolio of projects supports improvements in basic public services that directly benefit citizens, in areas such as water supply, sanitation, heating, power, energy efficiency, roads, social protection, education and healthcare, as well as private sector development.

Since the beginning of the pandemic, the World Bank has provided Ukraine with a total of USD 2.3 billion in budget support and investment projects. Ukraine received two Economic Recovery Development Policy Loans (DPLs), each of USD 350 million, in June 2020 and December 2021. The second loan complements additional financing of USD 150 million for the Emergency COVID-19 Response and Vaccination Project, approved on 10 December 2021. The DPLs support key reforms in Ukraine, notably i) fostering de-monopolization of the economy and strengthening the anti-corruption institutions; (ii) strengthening land and credit markets, including access to finance for small farmers; and (iii) bolstering the social safety net for the vulnerable elderly population to cushion the impact of the COVID-19 pandemic.

In turn, the EU has stepped up its assistance since the events of 2013/2014 and the security situation in and around Ukraine, underlining the importance it attaches to common fundamental values and respect for Ukrainian stability, sovereignty and territorial integrity.

The EU financial support *via* the programmes of the **2014–2020** Multi-annual Financial Framework provided EUR 1.565 billion bilateral financial and technical assistance under the European Neighbourhood Instrument (ENI) to support Ukraine's stabilisation and reform process in areas such as the fight against corruption, judicial and public sector reforms, economic and private sector development, energy reforms as well as support to civil society organisations. A specific allocation under ENI was also made to support the COVID-19 response in 2020 (a support package of more than EUR 190 million covering both the health crisis and socio-economic relief). In addition to ENI, Ukraine benefits from different cooperation projects at regional level in a wide range of fields, and of assistance under specific EU instruments, for instance the Instrument contributing to Stability and Peace (IcSP) or the Instrument for Democracy and Human Rights (EIDHR).

The new Multi-annual Financial Framework **2021-2027** will continue the bilateral assistance to Ukraine under the heading “Neighbourhood, Development and International Cooperation Instrument – Global Europe” (NDICI-Global Europe), which streamlines a number of previous financial instruments within one broad geographical and thematic instrument. The Multi-annual Indicative Programme for the seven years prioritizes the areas of economy, rule of law, climate resilience, digital transformation, support to civil society and response to conflict.

The Annual Action Plan **2021** financed under NDICI-Global Europe was adopted on 15 December 2021 for the total commitment of EUR 141 million to support border management, media democracy and fight against disinformation, and reform of the Public Administration. Moreover the Technical Cooperation Facility 2021 supports institutional and administrative capacities of the Ukrainian public authorities to implement reforms and commitments under the Association Agreement (and DCFTA) and EU agreements. The Commission has recently announced that (in conjunction with the emergency MFA) to strengthen Ukraine’s state-building and resilience efforts, another EUR 120 million will be allocated to Ukraine this year.¹

In addition to policy-based support, Ukraine also benefits from substantial project-based loans from the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB), among others.

As of end-November 2021, the cumulative EBRD investment since 1991 reached EUR 16 billion, with a private sector share of 48% in the portfolio. The current portfolio amounts to EUR 4.1 billion, out of which EUR 2.4 billion are actually realised, distributed across 203 projects. 56% of these investments are in the area of sustainable infrastructure, 32% in industry, commerce and agrobusiness, with the remaining 12% supporting financial institutions. Annual investment by the

¹ https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_545.

EBRD fluctuates between EUR 500 million and EUR 1 billion and involves an average of 30 projects.

The EIB has been active in Ukraine since 2007. It operates in the country in line with the European Neighbourhood Policy (ENP), the Eastern Partnership (EaP) and other EU bilateral agreements. Its operations make a particularly strong contribution to the labour market, preserving existing jobs and creating new opportunities. EIB operations focus on financing transport, small and medium-sized enterprises (SMEs), energy efficiency as well as municipal and social infrastructure. Since the start of its activities in Ukraine, the EIB has committed more than EUR 1.9 billion to support small and medium companies and EUR 3.6 billion to support the public sector. Lately, the EIB has been working actively to improve the absorption rate of its commitments, as actual disbursements are less than 30% of commitments.

1.4. External financing needs

In its November 2021 update of its projections of the balance of payments (BoP), general government finances and gross external financing requirements of Ukraine, the IMF estimates an overall financing gap of USD 2.6 billion for 2022. The underlying balance of payments gap that results from private international transactions is estimated at USD 3.6 billion. Given the high amount of accumulated official reserves, the IMF allows for a reduction in the stock of reserves throughout 2022 by USD 1 billion, which explains the difference between the underlying balance of payments gap and the estimated financing gap. As of November 2021, the IMF considered that this financing gap was fully funded with available official financing. In particular, the IMF itself would contribute USD 2.3 billion, with the remaining USD 0.3 billion coming from other international donors. At the time, the projections did not include any official contribution by the EU.

Table 2: Ukraine – Financing Gap in USD billion, 2020-2022

in USD billion	2020	2021	2022
Financing gap	3.4	2.8	2.6
Underlying BOP gap	-0.4	2.2	3.6
Official reserves accumulation	3.8	0.6	-1
Available official financing			
from the IMF	2.1	0.7	2.3
from the EU	1.2	0.7	0
from other institutions	0.1	1.4	0.3
Memo:			
Capital market access	4.6	1.8	2.5
Gross international reserves	29.1	29.7	28.7

Source: IMF projections.

However, the change in foreign investors' sentiment since November 2021 and the sell-off of domestic currency holdings question the validity of two critical assumptions. First, the loss of

market access, as evidenced by the hike of the Eurobond government yields to prohibitive levels in mid-January, implies that the assumed market funding of the government's funding needs for USD 2.5 billion will not materialize. Hence, the financing gap widens by this same amount, which is unfunded as of today. Second, should the loss of confidence by foreign investors persist, the contraction in the official foreign reserves would exceed the projected USD 1 billion reduction. Indeed, the National Bank of Ukraine has intervened already in the first three weeks of January 2022 for about USD 750 million. Should the trend persist, the reduction in the international reserves that had been projected to take place over the course of one year could instead take only one month to materialise. Without a notable improvement in the confidence of foreign investors and domestic currency holders, the financing gap could even widen by much more than USD 2.5 billion.

Assessing financing needs is surrounded by an unusual degree of uncertainty at the current juncture. From the point of view of government finances only, Ukraine faces a USD 2.5 billion of external debt redemptions in the course of 2022, with the largest one-time payment of USD 1 billion on 1 September (Eurobond maturity). The remaining redemptions are split relatively evenly throughout the year. The reserve liquidity available to the State Treasury is currently estimated at the equivalent of USD 2 billion, out of which 60% is in foreign currency. Without access to international capital markets, the government of Ukraine would have to rely primarily on the domestic banks to finance its deficit. This, however, could result in a further drain on the official reserves, thereby de facto widening the external financing gap beyond USD 2.5 billion. While the government could use the available liquidity reserve of USD 2 billion, a sizable impact on the stock of official reserves could potentially further weigh on international confidence. This emergency MFA responds to the new situation in the external financing gap of Ukraine and aims at stabilising both the level of official reserves and investors' sentiment.

The proposed MFA operation of EUR 1.2 billion would cover almost half of the USD 2.5 billion by which the external financing gap has widened as a result of the loss of access to international capital markets. The level of MFA support is justified by the exceptional crisis context in Ukraine. Moreover, it is in line with the conclusions of the ECOFIN Council of 8 October 2002², which specified that “[...] for candidate countries (countries which have signed Europe or Association Agreements with the EU) and European countries which are concerned by the Stabilization and Association process (countries which have signed, or are expected to sign, Stabilisation and Association Agreement), the maximum Community involvement may amount to as much as 60% of the country's residual financing needs over and above contributions from multilaterals.”

1.5. Structural reforms

Since the political transition in 2014, Ukraine embarked on an ambitious and wide-ranging reform programme. This programme has been supported by large-scale financial and technical assistance

² <https://data.consilium.europa.eu/doc/document/ST-12592-2002-INIT/en/pdf>.

provided by the EU and other multilateral and bilateral partners. Following the initial strong reform impulse, however, progress has become uneven, which impacted not only on the pace of economic recovery but also on the implementation of the financial support programmes for the country.³ The main obstacles to faster reform implementation were the complex domestic political environment, the lack of political will among some of the decision-makers to implement ambitious reforms in certain sectors, and the opposition by vested interests some of which continue to exert influence on policy-making in the country.

Despite these challenges, Ukraine managed to push through reforms in a variety of sectors. Here is an overview of the recent reform efforts, with a focus on those supported by the MFA operations that have been implemented over the last years.

Governance reforms resulted in the set-up of new **anti-corruption** institutions: the National Anti-Corruption Bureau (NABU), the National Agency for the Prevention of Corruption (NAPC), the Specialised Anti-Corruption Prosecutor Office (SAPO) and the High Anti-Corruption Court (HACC). After a difficult start, these institutions have started to prove their effectiveness: in the last two years, the HACC issued 45 decisions in cases investigated and prosecuted by NABU and SAPO respectively, 80% of which led to convictions for bribery, embezzlement of public funds, abuse of office and other corruption offenses⁴. The most recent legislative changes in this field aimed at strengthening the institutional independence of NABU and enhancing the credibility of the selection process of its head.

In spite of reform efforts since 2016, the current **judicial system** suffers from very low levels of public trust due to systemic corruption, low efficiency of the courts, poor management of resources and insufficient transparency. This is considered as a key impediment to investment and economic growth. The recently adopted laws address two key judicial self-governance bodies, namely the High Council of Judges (through integrity vetting) and the High Qualification Commission of Judges that pre-selects judges for Ukrainian courts. However, challenges remain, including in the Constitutional Court. The attestation of prosecutors at both regional and local levels has been recently carried out; however, some 2000 cases challenging the attestation are pending in various courts.

Important measures were launched in order to improve **corporate governance and transparency of state-owned companies and banks**. For instance, their supervisory boards have been granted appropriate powers and are required to have a majority of independent members, to be selected on a competitive and transparent basis. However, the adherence to the corporate governance framework has worsened.

³ This effect was evidenced by the non-disbursement of the final loan instalment from the MFA III operation (2015-18) and delays in IMF programme reviews.

⁴ IMF Staff report for the first review under the SBA, November 2021

The **energy sector** also witnessed comprehensive reforms, aimed at introducing the liberalised gas and electricity market model inspired by the EU Third Energy Package. Ukraine transposed the majority of the relevant EU gas and electricity-related sector acquis in 2015-17. This legislation provided, inter alia, for a stronger role of the market in the energy sector, for unbundling generation and supply from its transmission and distribution and for strengthening of the energy regulator. A number of issues hamper the functioning of and competition in the market. In view of the recent international energy price hikes, mounting debts and payment arrears in both gas and electricity sector are of particular concern. Secure and competitive provision of energy, which is of key importance for the resilience of the economy, remains a challenge.

In the area of **public finance management**, the track record is rather favourable. New laws adopted in 2018 improved the fiscal governance by introducing medium-term budgeting and by strengthening programme-based budgeting. The State Tax Service and Customs Service, created in 2018 and effectively reorganised in 2019 and early 2020, are now fully operational, even though the quarantine conditions have not allowed yet for an open and transparent selection of their senior management. More recent actions in this area included, inter alia, enhancing the VAT monitoring system based on risk management, developing the methodology of electronic tax audit and the use of new IT solutions in customs. To improve tax compliance, the authorities started the gradual deployment of electronic software tax registrars in 2020, to be fully adopted by all businesses by 2025. At the same time, the State Fiscal Service, considered as an old-style tax police with a disruptive effect on business, has been replaced by the recently established Bureau for Economic Security.

In the **social domain**, a reform of healthcare financing aims at improving its efficiency and quality of services, under the principle “the money follows the patient” A new institution, the National Health Service of Ukraine has been established, which concludes contracts with healthcare providers for the provision of healthcare services. Another central agency has been created to deal with centralised procurement of medicines. Other major actions in the social field concerned, inter alia, providing social benefits and integration measures for some 1.4 million of internally displaced persons following the Donbas war; and improved targeting of the Household Utility Subsidies.

While structural challenges need to be addressed, this emergency MFA operation will primarily focus on reforms that address the current crisis and are realistic within the operation’s one-year availability period. Focus areas may include economic resilience, governance and the rule of law, and energy sector. The detailed list of structural actions supported by the MFA will be agreed with the Ukrainian authorities after the adoption of the MFA decision.

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The objectives of the proposed MFA operation are to:

- i) Contribute to covering the external financing needs of Ukraine in the context of a sizeable external financing gap and the current lack of access to external capital markets due to a significant increase in geopolitical tensions and security concerns at the border with Russia.
- ii) Support structural reform efforts aimed at restoring external stability, improving overall macroeconomic management, strengthening economic governance and transparency, improving the conditions for sustainable growth and strengthening the resilience of the country.
- iii) Facilitate and encourage efforts by the Ukrainian authorities to implement measures identified under the EU-Ukraine Association Agreement and in the context of bilateral cooperation programmes (including capacity-building), support regulatory convergence and economic integration with the EU and strengthen the EU's economic policy dialogue with the authorities.

2.2 Monitoring indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- i) Progress with macroeconomic and financial stabilisation, notably by assessing the track record of implementation of the IMF-supported programme.
- ii) Progress with the implementation of structural reforms, notably the specific policy actions to be identified as conditions for disbursement of the assistance, which will be included in a Memorandum of Understanding to be negotiated between the Commission and the Ukrainian authorities.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1 Delivery mechanisms

The MFA operation under consideration is expected to cover part of the residual financing gap for the 2022-2024 period and would amount to a maximum of EUR 1.2 billion. The Commission proposes to provide the assistance in the form of medium-term loans. Given the proposed size of the operation, the Commission is considering releasing the assistance in two instalments. The first instalment will be released upon the signature and entry into force of the relevant documents (the Memorandum of Understanding and the Loan Facility Agreement) and will be conditional upon a satisfactory track record of implementation of the programme agreed between Ukraine and the IMF. The disbursement of the second instalment will be also conditional on a positive assessment of progress made with respect to a number of macroeconomic and structural adjustment measures.

MFA is an untied and undesignated macroeconomic support instrument, which helps the partner meet its external financing needs, and may contribute to alleviating budgetary financing needs. The funds would be paid to the Central Bank of the partner. Subject to provisions to be agreed in the Memorandum of Understanding, including a confirmation of residual budgetary financing

needs, the funds may be transferred to the Ministry of Finance of the partner as the final beneficiary.

3.2 Risk assessment

There are fiduciary, credit, policy and political risks related to the proposed MFA operation.

There is a risk that the MFA, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as the quality of management systems in the central bank and the ministry of finance, administrative procedures, control and oversight functions, the security of IT systems and the appropriateness of internal and external audit capabilities.

To mitigate the risks of fraudulent use, several measures will be taken. First, the Loan Agreement will comprise a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, the assistance will be paid to a dedicated account of the National Bank of Ukraine.

Moreover, in line with the requirements of the Financial Regulation, the Commission services have carried out an Operational Assessment of the financial and administrative circuits of Ukraine in order to ascertain that the procedures in place for the management of programme assistance, including MFA, provide adequate guarantees. The final report of the Operational Assessment, prepared by a consultancy company, was received in August 2018. The report concludes that the status of Ukraine's financial circuits and procedures is deemed favourable for a subsequent MFA operation. An update of the Operational Assessment has been prepared in June 2020. Developments in this area are closely monitored by the EU Delegation in Kyiv, also through the regular progress reports.

Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Anti-Fraud Office (OLAF), and the European Court of Auditors.

A second risk stems from the possibility that Ukraine will fail to service the financial liabilities towards the EU stemming from the proposed MFA loans (default or credit risk), which could be caused by a significant additional deterioration of the balance of payments and fiscal position of the country or/and by unforeseen events. This risk is mitigated, however, by the fact that the EU's MFA is one of several international donors supporting Ukraine, including the IMF. The loan is backed by the External Action Guarantee. The provisions to cover any financial liabilities arising from the loan will be held in the Common Provisioning Fund. The provisioning rate for the macro-financial assistance is set at 9% of the total amount of the loan.

Another key risk to the operation stems from the regional geopolitical situation, in particular potential escalation of tensions stemming from Russia and the lingering conflict in the eastern part

of the country, which acts as an important deterrent to private capital inflows and impacts negatively on the economic recovery. A worsening of the regional geopolitical situation could have a negative impact on Ukraine's macroeconomic stability, affecting the repayment of the proposed MFA. Diplomatic efforts for de-escalation conflict management and resolution continue, including with the support of the EU.

On the domestic front, the main risks stem from the complex political environment and the existence of strong vested interests against reforms. Various multifaceted attempts to destabilise Ukraine's internal political landscape cannot be excluded thereby limiting the political capital further. This could undermine a more broadbased reform implementation at the current juncture. In the current difficult political environment, Ukrainian authorities have requested further MFA, knowing that the disbursement of the second tranche will be conditional on the implementation of reforms to be agreed. This conditionality provides a tool to support reform-oriented forces in the country and in particular within the authorities (government and Parliament). Moreover, politically Ukraine remains highly committed to its comprehensive commitments under the Association Agreement with the EU, including in the part on the establishment of a Deep and Comprehensive Free Trade Area, which is also reflected in the government's action plan of April 2020. Having made a thorough assessment of the risks, the Commission services consider that there are sufficient grounds and guarantees to proceed with the proposed MFA to Ukraine.

The Commission services will maintain close contacts with the authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

4. ADDED VALUE OF EU INVOLVEMENT

The Union's financial support to Ukraine reflects the country's strategic importance to the EU in the context of the European Neighbourhood Policy. The MFA instrument is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EU package of assistance, it would contribute to supporting the European Union's objectives of economic stability and economic development in Ukraine. By supporting the authorities' efforts to establish a more stable macroeconomic framework and improve economic governance, the proposed assistance would help improve the effectiveness of other EU financial assistance to the country, including budgetary support operations.

The EU's MFA would also complement the standard EU aid packages mobilised under the NDICI-Global Europe. By supporting the adoption, by the Ukrainian authorities, of an appropriate framework for macroeconomic policy and structural reforms, the EU's MFA would enhance the added value and effectiveness of the EU's involvement through other financial instruments. The proposed MFA would increase substantially the EU's leverage on policy making in Ukraine, helping steer the country towards a reform trajectory that should restore macroeconomic stability, support resilience, address governance problems and boost potential growth in the longer run.

5. CHARACTERISTICS OF MACRO-FINANCIAL ASSISTANCE

5.1 Exceptional Character and Limited Time-frame

The MFA operation would be exceptional, aiming to support the restoration of a sustainable external finance situation, in the situation of increased geopolitical risk related to escalated tensions and threat of military invasion. It would run in parallel to the ongoing IMF Stand-By Agreement arrangement, the first review of which was adopted by the IMF Executive Board in November 2021. As usual, the MFA disbursements would be conditional upon successful implementation of the IMF programme and on meeting the political pre-condition. The disbursement of the first tranche could take place in the first half of 2022. The second disbursement is also conditional on the satisfactory implementation of policy measures, to be agreed with the EU and listed in the Memorandum of Understanding attached to the proposed MFA operation. The availability period of the MFA is one year from the entry into force of the Memorandum of Understanding. While in the short-term the country faces substantial external financing needs, the proposed MFA, the IMF programme and other donors' support is expected to produce a gradual strengthening of the external position and of the country's resilience to external shocks.

5.2 Political preconditions and EU-Ukraine relations

Countries that are covered by the ENP, like Ukraine, are eligible for MFA. A pre-condition for granting MFA is that the eligible country respects effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, and guarantees respect for human rights.

Political preconditions: The political preconditions for receiving MFA may be considered to be fulfilled in the case of Ukraine. 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. Ukraine is an open society, where elections are held freely and largely in line with international standards. Media freedom has improved, but further work is needed to strengthen the pluralistic media environment. Severe human rights violations take place in the areas not under the control of the Government, following the illegal annexation of the Crimean peninsula and the conflict in the east provoked by acts of aggression by the Russian armed forces since February 2014. Ukraine has made considerable progress in reforms of the judiciary and the fight against corruption, but continued efforts are needed to ensure full implementation and irreversibility of these reforms, as well as launching of further key reforms, in particular of the Constitutional Court. The EU remains fully committed to supporting Ukraine in its reform efforts together with other international donors. The envisaged financial assistance should help keep the current reform momentum to the extent that its effective disbursement will be conditional on continued progress with key reforms. In this context, the European External Action Service and the Commission stand ready to provide a further detailed assessment of the situation of democracy, human rights, rule of law and reform in Ukraine throughout the lifecycle of the proposed Macro-

Financial Assistance operation. Delivering on key anti-corruption and governance reforms will be indispensable if the Macro-Financial Assistance operation is to be successfully completed..⁵

EU-Ukraine relations: The EU and Ukraine have developed close political and economic relations over the years, leading to the signature of an Association Agreement, including a Deep and Comprehensive Free Trade Area (DCFTA), on 21 March and on 27 June 2014. The Association Agreement, which is the main tool for bringing Ukraine and the EU closer together, replaces earlier frameworks for cooperation. It promotes deeper political ties, stronger economic links and the respect for common values.

Parts of the Association Agreement have been provisionally applied since 1 November 2014. This has enhanced EU-Ukraine cooperation on human rights, fundamental freedoms and the rule of law, political dialogue and reforms, movement of persons. It has also strengthened cooperation in a number of sectors such as energy, environment and climate action, transport, financial services, public finances, agriculture, consumer protection and civil society. The provisions concerning the DCFTA have been provisionally applied since 1 January 2016, when the EU and Ukraine started to mutually open their markets for goods and services. The Association Agreement, including its trade part, entered into force on 1 September 2017, following the conclusion of the ratification process. On 11 June 2017, a visa free regime for short term stays in Europe for Ukrainian citizens holding biometric passports came into force.

The EU is Ukraine's first trading partner, accounting for 36% (in value terms) of Ukraine's total exports and 42% of imports in 2020. The EU share in Ukraine's trade has increased substantially over the recent years.

The EU is also an important source of assistance to the reform process in Ukraine. This includes EUR 5.6 billion in macro-financial assistance (out of which EUR 5 billion has been disbursed) in five consecutive programmes since 2014. This is the largest amount of MFA the EU has disbursed to any single partner country. The EU has also provided to Ukraine EUR 1.565 billion of grants for bilateral financial and technical assistance under the European Neighbourhood Instrument (ENI). In addition, the EIB has committed more than EUR 5 billion and the EBRD has signed project investment contracts for more than EUR 16 billion to support infrastructure development and private sector activity, among others (see also section 1.3).

5.3 Complementarity

The proposed MFA would complement the assistance provided by other multilateral and bilateral donors, including the IMF. Based on the information currently available, multilateral and bilateral donors other than the EU are expected to cover some 50% of the estimated external financing gap, ensuring reasonable burden-sharing. The EU's MFA would also complement the standard EU aid packages mobilised under the NDICI – Global Europe. By supporting the adoption of an

⁵ A more detailed assessment of the compliance with this criterion, provided by the European External Action Service (EEAS), is reproduced in the Annex of this Staff Working Document.

appropriate framework for macroeconomic policy and structural reforms by the Ukrainian authorities, the EU's MFA would enhance the added value and effectiveness of the EU's involvement through other financial instruments. The proposed MFA would increase substantially the EU's leverage on policy making in Ukraine, helping steer the country towards a sustained reform trajectory to restore macroeconomic stability, address governance problems and boost potential growth in the longer run and in a sustainable manner.

5.4 Conditionality

Disbursements under the proposed MFA operation would be conditional upon a satisfactory track record of implementation of the IMF programme. In addition, the Commission and the Ukrainian authorities would agree on a specific set of structural reform measures, to be defined in a Memorandum of Understanding. These reform measures would support the authorities' reform agenda and complement the programmes agreed with the IMF, the World Bank and other donors, as well as the policy programmes associated with the EU's budgetary support operations. They would be consistent with the main economic reform priorities agreed between the EU and Ukraine in the context of the Association Agreement, including its DCFTA, the Association Agenda and other strategic documents.

The Commission will seek a broad consensus with the Ukrainian authorities, so as to ensure their ownership and foster smooth implementation of the agreed conditionality. These policy conditions should address some of the fundamental weaknesses shown over the years by the Ukrainian economy and economic governance system. Possible areas of conditionality could, in principle, include economic resilience, governance and the rule of law, energy sector as outlined in detail in section 1.5 on structural reforms.

5.5 Financial Discipline

The proposed EUR 1.2 billion of MFA operation for Ukraine is foreseen to be disbursed in two equal tranches to be released in 2022 and 2023. The validity period of the programme is 12 months from the entry into force of the Memorandum of Understanding. The required provisioning, at a rate of 9% of the External Action Guarantee, will be programmed under the Neighbourhood, Development and International Cooperation Instrument (NDICI - Global Europe), for a total amount of EUR 108 million (budget line 14 02 01 70 "NDICI - Global Europe – Provisioning of the Common Provisioning Fund").

6. EVALUATION AND COST-EFFECTIVENESS

This assistance is of exceptional and macroeconomic nature and its evaluation will be undertaken in line with the standard Commission procedures.

6.1 Evaluation

Ex-post evaluations of MFA operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. An ex-post

evaluation of the proposed MFA to Ukraine will be launched within a period of two years after the availability period has expired. A provision for the ex-post evaluation is included in the proposed Decision for the assistance, and will also be included in the Memorandum of Understanding. Budget appropriations from the macro-financial assistance grant budget line will be used for this evaluation.

6.2 Achieving cost-effectiveness

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- i) Since the assistance would be leveraged by that provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the IMF and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.
- ii) Providing coordinated macroeconomic support to Ukraine on behalf of the EU countries, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.
- iii) The proposed assistance would be provided in the form of loans, the budgetary impact of which is limited.
- iv) Finally, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiary of the relevant measures (notably in the area of public financial management).

ANNEX

EUROPEAN EXTERNAL ACTION SERVICE



Head of Division

Eastern Partnership Bilateral

Brussels, 26 January 2022

EURCA EAST 2 (2022)

ASSESSMENT OF DEMOCRACY, HUMAN RIGHTS, RULE OF LAW AND REFORMS IN UKRAINE

Political preconditions: Countries which are covered by the ENP are eligible for MFA. A precondition for granting MFA should be that the eligible country respects effective democratic mechanisms, including a multi-party parliamentary system and the rule of law and guarantees respect for human rights.

Ukraine's Constitution envisages a parliamentary-presidential democracy which is based on the rule of law, division of powers, and guarantees for local self-government. The Constitution protects human dignity, equality, rights and freedoms such as freedom of media, speech, religion, association and assembly as well as broad social and economic rights. It also guarantees the free functioning of political parties. Cabinet of Ministers is accountable both to the Parliament and the President who holds important powers and who has also legislative initiative and veto rights.

Following a major political crisis in 2013-2014, Ukraine has embarked on an ambitious reform path, supported by its international partners. The reform agenda is rooted in the EU-Ukraine Association Agreement, including its Deep and Comprehensive Free Trade Area (AA/DCFTA), the Association Agenda and various Government strategies and action plans.

The AA/DCFTA was signed in 2014, has been partly provisionally applied since November 2014 (the DCFTA since January 2016), and entered into force on 1 September 2017. The constitutional, electoral and judicial reforms and preventing and combatting corruption are among its priorities for action.

Ukraine has pursued the implementation of structural reforms, generating positive trends in the governance, economic and social spheres despite the internal and growing external challenges, including the illegal annexation of the Crimean peninsula by Russia and the conflict in the east of the country provoked by Russia's destabilising actions. Ukraine has continued to advance measures to tackle corruption, but the sustainability of reforms remains a challenge and immediate actions need to be taken in order to ensure the full implementation and sustainability of these reforms.

Recent developments

Regular **presidential elections** were held in Ukraine over two rounds in March and April 2019. The International Election Observation Mission of the Organisation for Security and Cooperation in Europe's Office for Democratic Institutions and Human Rights (OSCE-ODIHR) assessed the two election rounds as "competitive and held with respect for fundamental freedoms". Voters had a broad choice and turned out in high numbers. President of Ukraine, Volodymyr Zelenskyy, called early **parliamentary elections** in July 2019, on which the International Election Observation Mission concluded that "fundamental rights and freedoms were overall respected and the campaign was competitive, despite numerous malpractices, particularly in the majoritarian races".

A new **Electoral Code** harmonising the rules for all types of elections, was adopted in December 2019. The Electoral Code introduces new election systems for parliamentary and local elections. It enfranchises internally displaced persons and other mobile groups of the population. It contains more progressive provisions on gender representation, and improves access to elections for persons with disabilities. In July 2020, shortly before the start of the electoral process, Parliament addressed some of the technical shortcomings, strengthened electoral justice and introduced new important changes to the electoral rules.

Nationwide local elections based on the new Electoral Code were held in October 2020. Elections were held neither in the illegally annexed Crimea and Sevastopol nor in the non-government-controlled areas in the east. In addition, elections were not held in 18 communities in the government-controlled part of Donbas.

The elections were competitive and were characterised overall positively by domestic and international observers, although various irregularities and legal shortcomings were recorded. COVID-19 posed an additional challenge to the organisation of the elections.

Work on amendments to the Electoral Code to implement previous international and domestic recommendations have continued within a working group in Parliament, which included also civil society experts.

Next parliamentary and presidential elections are expected in October 2023 and March 2024 respectively.

The Servant of the People Party (Sluha Narodu) enjoys the parliamentary majority with 242 out of the 450 seats of the Ukraine's unicameral Parliament (Verkhovna Rada). It is followed by Opposition Platform — For Life (44), European Solidarity (27), Batkivshchyna (25), and Holos (20), as well as two groups formed mainly by MPs elected in single-mandate districts, For the Future (21) and Dovira (20). There are currently 27 vacant seats. Strong vested interests are still represented in the Parliament, as well as among institutions and authorities.

Since 2014, Ukraine has been implementing a **decentralisation** reform at the basic (community) level. Overall, it has led to significant increases in tax revenues, notably in the voluntary amalgamated communities, increased trust among the population towards the local authorities and new opportunities for socio-economic development. Following completion of the administrative part of the decentralisation reform in 2020, work continues on the legislative framework aimed at ensuring effective local self-government, including constitutional amendments. The **public administration reform** is being implemented steadily, albeit in some areas at a slow pace. A new public administration reform strategy was adopted by the Government in line with the OECD and European public administration principles and merit-based recruitment to the civil-service was

restored. The long-awaited law on administrative procedure was adopted in autumn 2021. The President vetoed the law sending a few proposals to the text. The Parliament is expected to consider them and thus finalise the adoption of the law.

In terms of **media freedom**, Freedom House ranked Ukraine as "partly free country" in 2021. Reports by Freedom House and Reporters sans Frontières highlight that Ukraine's media environment has significantly improved since 2014, as ongoing reforms continue to strengthen the legislative environment for journalists and outlets, including a law on media ownership transparency and establishment of the Public Service Broadcasting Company, however several challenges remain. Although declining overall, instances of physical attacks against journalists have persisted, along with impunity for those who committed such crimes. More action is needed to loosen the oligarchs' tight grip on the media, encourage editorial independence and combat impunity for crimes of violence against journalists.

Freedom of media remains broadly respected but audio-visual media legislation approximating Ukrainian rules with EU law remains to be adopted, including as regards independence of media regulator, transparency of media ownership, equal market conditions and resilience to disinformation. A number of ambitious reforms have been initiated in Ukraine's **justice** sector, in particular the creation of a new Supreme Court which started operating in December 2017. In 2021, Ukraine has taken major steps towards a comprehensive reform of the judiciary. Two key laws aiming at reforming the High Council of Justice (HCJ) and re-launching of the High Qualifications Commission of Judges (HQCJ) were adopted and their implementation has started. However, significant challenges remain, including the urgent reform of the Constitutional Court (CCU). A draft law on the CCU reform is pending in Parliament, however it does not include key recommendations by the Venice Commission, notably the establishment of a transparent selection procedure for CCU judges which would lead to gradual renewal of the Court.

There has also been progress in the implementation of **anti-corruption** reforms. Ukraine has adopted a number of measures to limit the space for corruption in public procurement, administrative services, energy, banking and other sectors. Five dedicated **anti-corruption institutions** have been established and are operational since 2014, covering the entire chain from checking asset declarations, to investigations, seizure of assets, and criminal justice. These are the National Agency for Prevention of Corruption (NACP), the National Anti-corruption Bureau (NABU), the Specialised Anti-corruption Prosecutor's Office (SAPO), the High Anti-corruption Court (HACC), as well as the Asset Recovery and Management Agency (ARMA). With the creation of the High Anti-Corruption Court in 2019, the anti-corruption architecture in Ukraine is complete. An unprecedented transparent electronic asset declarations system requiring public officials and politicians to disclose information about their private assets was introduced, and the deterrent criminal sanctions for failing to report/report incorrectly were reinstated in summer 2021. Another significant step was taken in the reform of Ukraine's system for combating serious economic and financial crimes with the creation of the Bureau for Economic Security (BES). Further actions are needed to ensure completions, full implementation and sustainability of the reforms in the judiciary and anti-corruption area, including ensuring transparent and merit-based selection of key institutions. In this context, the selection of SAPO Head needs to be finalised and the winner of the competition appointed. NABU Head selection has been launched and independent experts by international donors nominated, however Cabinet of Ministers has yet to nominate their members to the selection commission.

Ukraine's state-owned enterprises (such as Naftogaz) and banks have continued to face challenges from vested interests and undue interference in their corporate governance, prompting engagement from partners including EU and US and the international financial institutions. Developments at the National Bank of Ukraine (NBU) have also sustained concerns over central bank independence and broader banking sector supervision, while full investigation of the large-scale fraud at Privatbank prior to its nationalisation, eventual prosecution and conviction of those responsible, along with the recovery of misappropriated funds, are still to be conducted.

A law on “**de-oligarchisation**” was signed by the President in autumn 2021, providing for a register of individuals designated as oligarchs by the National Security and Defence Council. Ukraine has asked for a Venice Commission (Venice Commission) opinion. The Venice Commission recommendations should be duly considered.

The long-awaited **reform of the Security Service of Ukraine** (SSU) remains outstanding.

Ukraine has a vibrant **civil society** that plays an active role in promoting, design and oversight of reforms, especially in the area of anti-corruption, judiciary, decentralisation, human rights, media, health and energy. However, some civil society actors have also denounced pressure on their activity, undermining their work and credibility.

The ongoing conflict in the east of the country and the illegal annexation of the Crimean peninsula by Russia continue to take a heavy toll on the human rights situation, resulting in grave violations of human rights and international humanitarian law. Referring to the impact of the ongoing conflict, Ukraine has notified of derogations from some of its obligations under the International Covenant on Civil and Political Rights and the European Convention of Human Rights. A mechanism of periodic independent review of these derogations has been established, but no review has been conducted.

As a result of the conflict, there are approximately 1.4 million internally displaced persons (IDPs), who continue to suffer from socio-economic difficulties and lack of access to certain political and social rights. Ukraine has taken several important steps to promote a more inclusive approach towards the conflict areas and people living in the non government controlled areas (NGCAs). However, further steps could be taken to improve the legislative and regulatory framework for the conflict-affected population, including residents in the NGCAs.

The National Human Rights Strategy, adopted in 2015, reached the end of its five year duration in 2020. In 2021, Ukraine adopted a new National Human Rights Strategy for 2021-2023, based on amendments to the previous strategy and its relevant Action Plan. Adequate resources and political will remain key to ensure their implementation.

The investigations into the killings at Maidan and the violent events in Odesa on 2 May 2014 have proceeded very slowly and culprits have still not been brought to justice. The Council of Europe's International Advisory Panel has identified a number of shortcomings in these investigations, which need to be addressed.

As regards the rights of persons belonging to ethnic, linguistic, religious and national minorities, Ukraine has taken some steps aiming to implement the recommendations of the Venice Commission. However, an overarching Law on national minorities remains to be adopted. Legislative changes still to be made include a ban on all forms of discrimination, including discrimination based on the grounds of sexual orientation and gender identity, as well as the development of the new Labour Code.

Despite progress, gender-based discrimination and domestic violence remain a challenge. The ratification of the Istanbul Convention remains pending.

As far as the promotion of international justice is concerned Ukraine is yet to deliver on its Association Agreement commitment to ratify and implement the Rome Statute of the International Criminal Court and its related instruments.

EU-Ukraine relations

After almost three years of provisional application of different parts of the AA/DCFTA, it entered into force on 1 September 2017. On 11 June 2017, a visa free regime for short term stays in Europe for Ukrainian citizens holding biometric passports came into force. The Fourth Report under the Visa Suspension Mechanism concluded that overall, Ukraine continues to fulfill the visa liberalisation benchmarks. However, further efforts are needed to address the issue of unfounded asylum applications as well as in the areas of the fight against corruption, money laundering and the prevention and fight against organised crime. Continued effective implementation of the AA/DCFTA provides a clear path for Ukraine's political association and economic integration with the EU. The EU-Ukraine relations, based on the Association Agreement, including its Deep and Comprehensive Free Trade Area, are discussed annually at the bilateral Summit, the Association Council and other relevant Committees. At the 23rd bilateral EU-Ukraine Summit (October 2021), the two sides reaffirmed their strong commitment to further strengthening the political association and economic integration of Ukraine with the European Union, including through continued close cooperation to strengthen the rule of law, advance reforms, foster sustainable economic growth, support the green and digital transitions and increase resilience.

Conclusions

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. Ukraine is an open society, where elections are held freely and largely in line with international standards. Media freedom has improved, but further work is needed to strengthen the pluralistic media environment. Severe human rights violations take place in the areas not under the control of the Government, following the illegal annexation of the Crimean peninsula and the conflict in the east provoked by acts of aggression by the Russian armed forces since February 2014. Ukraine has made considerable progress in reforms of the judiciary and the fight against corruption, but continued efforts are needed to ensure full implementation and irreversibility of these reforms, as well as launching of further key reforms, in particular of the Constitutional Court. The EU remains fully committed to supporting Ukraine in its reform efforts together with other international donors. The envisaged financial assistance should help keep the current reform momentum to the extent that its effective disbursement will be conditional on continued progress with key reforms. In this context, the European External Action Service and the Commission stand ready to provide a further detailed assessment of the situation of democracy, human rights, rule of law and reform in Ukraine throughout the lifecycle of the proposed Macro-Financial Assistance operation, whose political preconditions may be considered as being fulfilled. Delivering on key anti-corruption and governance reforms will be indispensable if the Macro-Financial Assistance operation is to be successfully completed.