Japanese ODA Loan

Ex-Ante Evaluation (for Japanese ODA Loan)

1. Name of the Project

Country: Ukraine
Project: Economic Reform Development Policy Loan (Ⅱ)
Loan Agreement: December 4, 2015
Loan Amount: JPY 36,969 million
Borrower: Cabinet of Ministers of Ukraine

2. Background and Necessity of the Project

(1) Current State and Issues of Ukraine

From 2001 through 2008, the Ukrainian economy reached a high level of growth, averaging 7.0% real GDP growth. However, the country's growth slowed in the wake of the global financial crisis began in 2009, falling to just 0.2% in 2013. Furthermore, the subsequent deterioration and the prolonged conflict in southeastern Ukraine made Ukraine's economic situation worse to −6.8% real GDP growth in 2014. The International Monetary Fund (IMF) had forecast that Ukraine's GDP for 2015 would shrink by -11%, and the projection is likely to be revised downward.

Factors such as the retention of public utility charges, effective preservation of the fixed exchange rate system, a slump in domestic demand due to the economic recession and a fall in food prices had resulted in a lowering of the inflation rate to 0.5% by the end of 2013. However, inflation surged to 52.8% in August 2015 due to the country's switch to a floating exchange rate system and a rise in gas prices. In 2014, the ratio of Ukraine's current account balance to GDP widened to −4.7%, while the ratio of its budget deficit to GDP deteriorated to −4.5%.

As a percentage of GDP, Ukraine's public debt and external public debt continued on an upward trend in 2014, reaching 71.2% and 39.6%, respectively. The IMF expects the country's public debt to peak at 94.4% of GDP (56.8% of GDP for public external debt) and then begin to gradually fall. The IMF's Extended Fund Facility (EFF), which has been approved, is designed to bring the country's ratio of public debt to GDP below 71% by 2020.

Since a change of Government took place in February 2014, the Government of Ukraine has pressed ahead with a series of structural reforms to implement corrective actions that had been identified as being necessary some time ago, which are reform of the gas sector, the switch to a floating exchange rate system, the introduction of inflation targets and spending cuts. Under the leadership of the IMF and the World Bank, the international community has supported Ukraine's reform efforts since April 2014, but lingering instability in eastern Ukraine has caused a further deterioration of the country's economy. With foreign reserves of approximately US$ 12.8 billion as of the end of September 2015, which is equivalent to about 3.1 months of imports, Ukraine remains in a difficult position. In fact, IMF calculations indicate that Ukraine will face a financing gap totaling US$ 40.0 billion between 2015 and 2018. The key challenges that Ukraine will have to address in the short term is to restore its economy through financial support from donor countries and agreeing debt restructuring with private creditors. In the medium- to long-term, the country's key challenge will be to implement various reforms designed to establish a sound financial position for itself, including continual improvement of governance, the business environment and efficiency of public sector.

(2) Economic Reform in Ukraine and Priority of the Loan

In January 2015, the Government of Ukraine announced "Ukraine 2020," a medium-term strategy that will run until 2020. Agreed to by the Government of Ukraine, the World Bank and JICA, each policy action of the program (the Program) is in line with the reform items set out in the Ukraine 2020 strategy and will help Ukraine to implement and promote its development strategies.

(3) Japan and JICA's Support Policy and Operations in Ukraine

Japan's Country Assistance Policy for Ukraine (March 2013) was formulated based on the key policy of "Establishment of a Mutually Beneficial Economic Relation" and it includes "Industrial Promotion for Sustainable Economic Growth" as a priority area. The Loan is in line with two development initiatives under the priority area: 1) Building of Economic Infrastructure and Improvement of Energy Efficiency and the Environment; and 2) Improvement of the Investment Environment and Development of Human Resources. Japan has established the following three basic policies for supporting stabilization and national reform in Ukraine "Improvement of the Economic Situation", "Restoration of Democracy" and "Promotion of National Dialogue and Integration". The Loan is in line with the first of these policies "Improvement of the Economic Situation". Based on this policy, the Japanese government announced in March 2014 a support package for Ukraine of up to approximately JPY150.0 billion, and various assistance programs are currently underway. Furthermore, the Japanese government announced the additional financial support through the Loan in January 2015, with US$ 3 million.

The assistance that JICA has provided to Ukraine are as follows.

- Technical cooperation: Ukraine-Japan Center project (2006–2011)
  Democracy Restoration Support Package for Ukraine (2015)
- ODA loans: Boryspil International Airport Development Project (2005)
  Economic Reform Development Policy Loan (DPL1) (2014)

Bortnychi Sewage Treatment Plant Modernization Project (2015)

- Grant aid: Project for Improvement of Medical Equipment for Children's Hospitals (Phase 1: 2007; Phase 2: 2008)

(4) Other Donors' Activities

Under the leadership of the IMF and the World Bank, the international community has provided coordinated support for Ukraine's economic reform efforts. On February 12, 2015, the Executive Board of the IMF approved a 4-year EFF amounting to approximately US$ 17.5 billion, of which approximately US$ 6.7 billion had been provided to Ukraine by the end of August 2015.

In addition to the First Financial Sector Development Policy Loan (US$ 0.5 billion) and the Second Financial Sector Development Policy Loan (US$ 0.5 billion), the World Bank provided the First Economic Reform Development Policy Loan (World Bank's DPL1) (US$ 0.75 billion) co-financing with JICA in DPL1 and the Second Economic Reform Development Policy Loan (World Bank's DPL2) (US$ 0.5 billion) co-financing with JICA in the Loan.

The EU agreed Macro-Financial Assistance (MFA) amounting to €1.61 billion in May 2014, and approved financial assistance worth an additional € 1.8 billion in April 2015.

The US signed a US$ 1.0 billion loan guarantee for Ukraine in April 2014. In the following month (May 2014), the National Bank of Ukraine issued a US$ 1.0 billion 5-year sovereign bond. Furthermore, the US announced its plan to provide an extra US$ 2.0 billion in financial assistance (loan guarantee) in January 2015, and Ukraine issued US-backed bonds of US$ 1.0 billion in May 2015.

Other donors and their support activities include the following: Germany provided € 0.5 billion in the form of a loan guarantee; Canada provided a US$ 0.2 billion loan to promote financial sector reforms; and Norway provided approximately US$ 26.3 million through grant aid (co-financing with the World Bank's DPL 2).

(5) Necessity of the Project

The Loan aims to assist Ukraine in its efforts to rebuild its financial health and undertake various reforms by providing support for the implementation of the country's economic reform policies. The Loan is to be carried out under the framework of international assistance provided to the Government of Ukraine with the aim of realizing economic and national stabilization over the medium to long term and in line with Japan's Country Assistance Policy for Ukraine. In light of these points, it is highly necessary and relevant for JICA to support the implementation of the Loan after the completion of DPL1.

3. Project Description

(1) Project Objective(s)

The objectives of the Loan are to support the Government of Ukraine in implementing its economic reform measures related to the following three pillars: 1) promote good governance, transparency and accountability in the public sector; 2) strengthen the regulatory framework and reduce the costs of doing business; and 3) reform inefficient and inequitable utility subsidies while still protecting the poor. Through its support for these pillars, the Loan will help Ukraine to stabilize its economic situation, thereby contributing to sustainable economic growth.

(2) Project Site/Target Area

Throughout all of Ukraine.

(3) Project Components

The Loan aims to support the Government of Ukraine in implementing its economic reform policies in collaboration with the World Bank. The Program supports the reform pillars listed in the table below, all of which have been agreed upon by the Government of Ukraine, the World Bank and JICA. As the completion of all 10 of the policy actions related to the Program, the entire loan amount will be disbursed as a lump sum.

Pillars	
	Policy Actions
1) Promote good governance, transparency and accountability in the public sector	
	1: The Borrower has introduced rules for transparent appraisal and selection and predictable financing of public investments for purposes of improving its public investment management framework
	2: The Borrower has established a centralized external verification function for financial disclosures of publicly elected and senior public officials, and provided for disciplinary and administrative accountability for those officials who fail to comply with financial disclosure requirements or misrepresent financial information
	3: The Borrower has expanded the mandate of the Accounting Chamber of Ukraine to cover external audits of the Borrower's budget revenues
	4. The Borrower has improved transfer pricing legislation and practices in line with the OECD Guidelines for purposes of reducing tax avoidance
2) Strengthen the regulatory framework and reduce the costs of doing business	
	5: The Borrower has extended automatic VAT refund procedures and revised automatic refund eligibility criteria guidelines for purposes of improving VAT refund processing
	6: The Borrower established a deregulation framework, eased licensing and permit requirements, and harmonized food safety standards and procedures and technical regulations and conformity assessments with European Union requirements for purposes of improving the investment climate
	7: The Borrower has removed the possibility of counting land as bank capital
3) Reform inefficient and inequitable utility subsidies while protecting the poor	
	8: The Borrower: (a) has strengthened the independence of the national regulation of communal services by removing provisions that allow the Borrower's Cabinet of Ministers to develop a mechanism for setting utility tariffs below cost-recovery levels (b) has strengthened the independence of the national regulation of the energy sector.
	9: The Borrower's Cabinet of Ministers has approved the "Gas Sector Reform and Implementation Plan" to comprehensively restructure the gas sector, including gradual energy price increases (and accompanying social assistance measures); incentivizing domestic production through attracting more private and international investment to the sector; restructuring of Naftogaz and distribution companies; and

	improving governance of the sector through introduction of an accelerated gas and heat meters installation program.
	10: The Borrower has introduced income testing of the housing and utilities subsidies and reduced the amount of such housing and utilities privilege benefits, replaced universal child benefits with a guaranteed minimum income (GMI) supplement for children of age 0-3, and has reduced the amount of the universal child-birth grant benefit, all for purposes of improving the targeting of social assistance to the poor

(4) Estimated Project Cost (Loan Amount)

JPY 36,969 million

(5) Schedule

The start date for the delivery of financial assistance through the Loan is the date on which the loan agreement is signed. The policy actions are to be achieved by July 2015. The Loan will be completed when the full amount has been disbursed (scheduled for January 2016).

(6) Implementation Structure

1) Borrower: Cabinet of Ministers of Ukraine

2) Executing Agency: Ministry of Finance

3) Operation and maintenance system: N/A

(7) Environmental and Social Considerations/Poverty Reduction/Social Development

1) Environmental and Social Considerations

① Category: C

② Reason for Categorization:

The Loan is classified as category C under the JICA guidelines for environmental and social considerations (promulgated in April 2010) because it is likely to have a minimal adverse impact on the environment.

2) Promotion of Poverty Reduction: Poverty measures and poverty considerations

3) Promotion of Social Development: Program for the conducting of a needs assessment and analysis of gender mainstreaming (reasons for categorization: 1) a report compiled by the World Bank, which carries out the co-financing with JICA, states that the gender differentiated impacts and/or risks associated with the operation are limited; and 2) householder data broken down by gender will be collected under the monitoring presented in Policy Action 10)

(8) Collaboration with Other Donors

The Program is to be implemented through co-financing with the World Bank. The World Bank's Development Policy Loan (DPL) can be divided into two operations: DPL1, in which US$ 0.75 billion was disbursed in May 2014 (co-financing with JICA); and DPL2, in which US$ 0.5 billion was disbursed in August 2015.

(9) Other important issues

None

4. Target Outcomes

(1) Quantitative Effects

1) Performance Indicators (Operation and Effect Indicators)

Pillars / Indicator	Baseline[*1]	Target[*1]
1) Promote good governance, transparency and accountability in the public sector		
Share of competitive procurement selection by value	2013: 35%	2016: 55%
Share of new eligible public investment projects appraised and selected through the public investment management system	2013: 0%	2016: 100%
Share of financial disclosures subject to external verification	2013: 0%	2016: 100%
Coverage of external audit	FY2012: State revenues not included in external audit	FY2015: State revenues included in external audit
2) Strengthen the regulatory framework and reduce the costs of doing business		
Ratio of VAT refund claims older than 74 days to quarterly receipt of VAT refund claims	2013: 153%	2017: 20%
Number of permits	2013: 143	2017: 84
3) Reform inefficient and inequitable utility subsidies while still protecting the poor		
Naftogaz Financial Deficit	2013: US$ 3.3 billion	2016: US$ 1.0 billion
Number of families below the defined income threshold who benefit from the new targeted program	2014: 1.10 million	2016: 2.00 million
Share of means and income tested programs in overall social assistance spending	2012: 13%	2016: 20%

*1: Unless otherwise noted, both baseline and target values use figures current as of January 1 of the year following the year contained in parentheses.

*2: Changes have been made to part of the DPL1 policy matrix after consultations with Ukraine.

(2) Qualitative Effects

Improvement in fiscal situation, governance, business environment, efficiency of the public sector, etc.

(3) Internal Rate of Return

Not calculated

5. External Factors and Risk Control

In light of potential risks to the Loan, the political and economic situation, particularly in southeastern Ukraine, needs to be carefully observed.

6. Evaluation Results and Lessons Learned from Past Projects

(1) Lessons learned from similar past projects

The ex-post evaluation of the Emergency Budget Support Japanese ODA Loan provided to the Philippines (disbursed in March 2010) has taught JICA that, together with a precise understanding of the country's current state and issues and strong ownership, the steady implementation of various policies for tackling the economic crisis by the Government of the Philippines (including short-term demand stimulus measures and investment in infrastructure for the protection of the socially handicapped and medium- to long-term economic growth) played a key role in the country's economic recovery. This suggests that a precise understanding of issues and the implementation of measures under strong ownership are important for a project's success.

(2) Incorporating lessons learned into the Project

Given the Ukraine's political and economic difficulties, special attention was paid to the pillars in the discussions that were held in order to ensure that the Government of Ukraine would assume full ownership in implementing its policies. Specifically, before an agreement was reached, numerous discussions on the policy actions were held among the World Bank, JICA and the executing agency, the Ministry of Economic Development and Trade and the Ministry of Finance, together with the participation of the Ministry of Justice, the Ministry of Social Policy and other governmental agencies. In addition, given the possibility that public opposition could prove an obstacle to revising the existing subsidy system related to the gas price revisions, etc., programs offering special compensation to the poor were included.

7. Plan for Future Evaluation

(1) Indicators to be used

As outlined in 1) Operation and Effect Indicators, which appears under (1) Quantitative Effects in 4. Target Outcomes.

(2) Timing of the next evaluation

Three years after the completion of the disbursement.

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