

## **UPDATED RECOMMENDATIONS of the Economy and Energy Task Force (June 2020)**

In early June 2020 the Task Force updated its recommendations and submitted the update as testimony to four Congressional Committees – the House Committees on Appropriations, House Foreign Affairs and the Senate Committees on Appropriations, and Foreign Relations. The text of the testimony was in each case identical and the text is set out below.

### **CONGRESSIONAL COMMITTEE TESTIMONY:**

Thank you, Mr. Chairman, the Friends of Ukraine Network (FOUN) is a non-partisan coalition of former ambassadors, leading policy and international professionals.

FOUN is an outgrowth of the U.S.-Ukraine Foundation (USUF) and U.S. Department of States-sponsored U.S.-Ukraine Policy Dialogue programs of 2005 and 2011, that brought together government officials and on-government policy experts from both countries to discuss and make recommendations on numerous issues of mutual concern.

The Foundation has organized FOUN into several task forces. The FOUN National Security Task Force submitted testimony several weeks ago. The Democracy and Civil Society Task Force is reviewing and considering whether to update its original recommendations however its initial Priority Recommendations are contained in the attached Priority Recommendations for U.S. Assistance to Ukraine 2020.

In this statement The Economic & Energy Security Task Force supplements its original Priority Recommendations.

The Economic & Energy Security Task Force is focused on four areas that have major implications for Ukraine's economy: the general economic situation, the energy sector, humanitarian issues and the defense sector.

The respective area group chairs are Anders Åslund, Edward Chow, Dawn Calabria and David Rigsby. The overall task force chairman is Ambassador Roman Popadiuk.

Until the Covid-19 pandemic struck Ukraine in March, the general economic situation had improved considerably. Many of the changes were on the international level. Ukraine's economy has slowly broken its strong links to Russia. About one third of Ukraine's trade had been tied to Russia but 2019 saw China becoming Ukraine's biggest trading partner, with Russia now third after Poland. In addition, the European Union now accounts for a little over 40% of Ukraine's

exports and imports. This trade diversification is allowing Ukraine to slowly increase its foreign trade, loosen the hold of Russia and to integrate more closely with the West. However, the coronavirus has thrown Ukraine, as the rest of the world, into a renewed economic crisis. At the same time, Ukraine continues to struggle with issues of transparency and corruption which hamper business development. Added to these economic challenges is Russia's ongoing war against Ukraine and the most recent Russian aggression and activities in the Sea of Azov that have interfered with Ukraine's shipping and negatively impacted the economy. On the energy front, gas prices have been moved toward market prices, but there is still a long way to go as regards attracting foreign investment and developing domestic production. The task force is making a number of specific recommendations to move Ukraine forward on these fronts.

## **ECONOMIC**

- The Covid-19 pandemic has suddenly endangered the Ukrainian economic stabilization, and the international community needs once again to focus on macroeconomic support, but further structural reforms to promote higher economic growth in the future are also needed. Support the conclusion between the International Monetary Fund and Ukraine of a new 18-month Standby Agreement with \$5 billion of financing to maintain Ukraine's macroeconomic stability
- Promote generous international financing for Ukraine's economic development through the World Bank, the European Bank for Reconstruction and Development, the ExIm Bank and OPIC
- In view of the new challenges to macroeconomic stability, the United States should consider refinancing its loan guarantees for Ukraine to facilitate Ukraine's access to the international financial market
- Support with the assistance of USAID structural reforms to open up the Ukrainian market for both domestic and international competition
- Encourage reforms of the General Prosecutor's Office and the Security Service of Ukraine to ascertain securer property rights and investment
- Promote privatization of the many remaining state enterprises and continue the improvement of corporate governance of state-owned enterprises

## **ENERGY**

Ukraine's energy sector suffered from post-Soviet legacy of state control and state capture by private interests, overregulation and monopolization. The result is Ukraine has the lowest energy efficiency in Europe, damaging its economic competitiveness, and an energy sector that fails to fulfill ample production potential. If Ukraine is to modernize its energy economy and integrate economically with Europe, it has to fundamentally reform its energy systems by freeing market forces, promoting competition by privatizing state assets, eliminating market distortions such as price controls, establishing transparent and stable regulatory mechanisms, and prosecuting energy corruption and market abuse.

Structural reform starts necessarily with political will from Ukrainian leaders and unity of purpose among Ukrainian authorities. International donors can help with expert advice for comprehensive energy reform and by providing resources to build capacity in new institutions for implementation. Any energy assistance should be conditioned on the overhaul of the current system with Ukrainian authorities held accountable for the implementation of their own plan.

Among the critical areas that need attention are:

- The current crisis of imbalance in the electricity market, which has been evident since last autumn, with massive circular debt including to/by/among state agencies and potential state default on renewable energy tariff
- Truly independent and transparent regulatory bodies, including the National Commission for State Regulator in Energy and Utilities (NEURC) and Anti-Monopoly Commission, without interference in their daily workings by the government and parliament
- Stable tariff methodology that provides for full cost recovery and a reasonable return on investment, including for much needed modernization and resiliency of energy systems
- Removal of Public Service Obligation (PSO) in the electricity and gas markets, to be substituted by direct subsidies to targeted consumers
- Defining the role of state enterprises in the energy sector; whether they should be reorganized or broken up, whether some assets should be privatized, how should parastatal companies be governed
- De-monopolization of energy market, including by state companies
- Revival of the moribund oil refining sector, which necessarily means eliminating contraband petroleum products imported by special interests
- Policy on incentives to attract private capital, including foreign direct investment
- Fair tender procedures, equal access to geologic data, taxes and royalties in licensing system for energy extraction that meets international standards and business practice
- Policies on addressing opportunities and threats presented by the European Green Deal that will affect trade relations with Ukraine's largest export market

## HUMANITARIAN

Seven years of war in eastern Ukraine have taken a terrible toll. Over 13,000 lives have been lost and the injured number in the tens of thousands. Today, 3.4 million Ukrainians in the East are hard pressed to survive without international humanitarian assistance.

The arrival of the virus COVID 19 caused the shut-down of the country to slow the disease, taxing the medical system, disrupting public transportation, increasing unemployment and increasing the number of people in need of basic human needs. Only \$18 million has been donated for the UN coordinated response of nongovernmental local, international organizations, including \$6.4 million from the US. To reduce the suffering of the war affected population, the following the following steps are recommended:

1. The US should press for a total cease fire during the COVID 19 emergency to prevent further loss of life and damage to essential civilian infrastructure like hospitals and health facilities, water supply and treatment (essential for preventive hand washing). sanitation services, gas and electricity
2. US should work with the OECD, the UN and other governments to condemn and outlaw attacks on essential civilian life support systems: water, sanitation, gas and electric.
3. Because of the additional impact of COVID 19 on top of widespread displacement and grave levels of humanitarian need, the US should continue Ukraine's designation as a humanitarian disaster area and provide at least one-third of the recognized humanitarian need. High priority needs include food, cash and livelihood assistance, transport to improve gray zone access to essential goods and services; improved medical services, repair of essential utilities, and marking and clearance of unexploded ordnance and landmines.
4. The US with other donors should support improved public education about the virus by local government and civil society organizations and ensure the supply of needed equipment, hygiene materials and other supplies for hospitals and medical facilities so Ukrainians can be tested for the virus.
5. Ukraine's newly created Ministry for the Reintegration of Temporarily Occupied Territories and Internally Displaced People should be assisted by the US and other donors with technical and other support to expedite the Ministry's work in aiding these citizens to receive their legally entitled services, i.e. issuance of legal documents, birth certificates, internal passports, pension payments, medical care, payments for damaged property, etc. The Ministry should also work to restore the ability of Internally Displaced Persons to exercise their electoral rights in both local and national elections.
6. Food assistance should be expanded to reach the one million Ukrainians now at risk of hunger and illness in areas once the country's industrial heartland.
7. The new Ministry of Veterans Affairs, Temporarily Occupied Territories and Internally Displaced Persons should prioritize maintaining humanitarian aid to conflict affected populations and coordinate its efforts with local government, civil society and international humanitarian organizations.
8. Legal assistance for the 1.5 million displaced people must be streamlined and expanded to help them navigate Ukraine's complicated administrative and legal system to receive medical care, pensions and essential civil documentation, particularly birth certificates and internal passports.
9. With one of the world's largest concentrations of land mines and unexploded ordnance which hinders freedom of movement, commerce and agriculture Ukraine should be assisted to expand civilian mine risk education and accelerate the removal of mines and ordnance which have already taken the lives of 1000 civilians, including many children.

10. Continued attacks, shelling and insecurity along the 740 KM line of contact and the flight of personnel from damaged medical facilities has left thousands of families in the East without medical care or access to medications unless more mobile clinics are provided.
11. The recovery of injured veterans and 7000 civilians require the development of comprehensive medical, physical and psychological rehabilitation programs to ensure the full recovery, reintegration and wellbeing of wounded veterans and the 7000 civilian victims of the war.

## **DEFENSE**

Ukraine's defense and security segment of the national budget for 2020 is about 5.5% of GDP which is a 16% jump over the 2019 budget. The objectives of the Ukrainian Ministry of Defense remain focused on improving the reconstruction and development of infrastructure, the procurement, modernization and renovation of military assets and equipment and the acquisition of the necessary capabilities to comply with the criteria for NATO membership, which is a major focus.

One of the challenges Ukraine faces is that the defense economy is unevenly divided into state-owned and private defense entities. The state-owned entities in Ukroboronprom (UOP), a state holding group, consists of 137 enterprises, 21 of which are located in the occupied territories, 85 are financially unstable and eight are bankrupt.

The private sector is composed of more than 100 companies with a wide variety of specializations that provide about 60% of Ukraine's in-country sourced military requirements. Plans to rationalize UOP are on the verge of being implemented although the impact of this on the private defense sector is unknown. Some of the former entities may be fully privatized. The changes contemplated for UOP include reducing its regulatory role, which has had a detrimental impact on the private companies.

Overall, the defense sector needs greater transparency and a better procurement process as well as an in-depth analysis to determine the actual needs of Ukraine's front-line forces. Our recommendations are aimed at creating a more efficient defense structure that will be able to meet the military's battlefield requirements and help develop the private defense sector. Specific recommendations include:

- Initiatives to attract Western investment and partnering opportunities
- Reform of the regulatory environment which is complex, hide-bound, delay inducing, and export-revenue focused
- A better system to capture, analyze and prioritize data collected from combat and exercise operations
- Improved communications between military, private industry and UOP to deliver most essential capabilities to fighting forces fastest

- Incentives for the defense sector to focus on building its own capabilities to provide needed requirements
- Focusing United States assistance programs on meeting current requirements
- Consider expanding the role of the United States' Ukrainian security assistance funds to directly support the development of the private defense sector.
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