

# Ukrainian municipalities: Accessing domestic and international financial resources for reconstruction efforts at the national level



## Authors

### **Mariia Lukyanova**

Ukraine National Coordinator

CEE Bankwatch Network, Center for Environmental Initiatives Ecoaction

[mariia.lukyanova@bankwatch.org](mailto:mariia.lukyanova@bankwatch.org)

### **Vladlena Martsynkevych**

Ukraine Reconstruction Officer

CEE Bankwatch Network

[vladlena@bankwatch.org](mailto:vladlena@bankwatch.org)

Prepared in cooperation with Ivan Shvets, Oleksii Stupnitsky, Ukrainian School of International and Innovation Entrepreneurship, Law and Communication. The findings of their research have also been published in the report: ‘Reconstruction of Ukraine: Financial Resources and Instruments for Restoration and Territorial Communities Development’, October 2023.



This report contains verbatim passages from the report: U-LEAD with Europe, [Coordination of Reconstruction and Recovery with the Regional Development Policy in Ukraine – Policy Paper](#), U-LEAD with Europe, 28, May 2023.

*This publication has been financed by the European Climate Foundation (ECF) and Swedish International Development Cooperation Agency (Sida). Responsibility for the content rests entirely with the creators. Sida and ECF do not necessarily share the expressed views and interpretations.*



# On the reconstruction front line:

## Ukrainian municipalities and the funding landscape

### Introduction of research series

Russia's war in Ukraine is having a devastating impact on the population and development of the country. Decentralisation reforms launched in 2014 have enabled Ukrainian communities<sup>1</sup> to remain resilient and promptly respond to the challenges of war. However, no community has been untouched.

While some have suffered huge loss of life and significant damage to infrastructure, others have had to provide internally displaced persons with housing and employment, or help businesses re-establish themselves after relocating from war zones and occupied territories. Because regions and communities are being impacted in different ways, this has led to an uneven allocation of resources among communities, leading to disparities in the level of support required for recovery, modernisation, and the effective liquidity and absorption of funds.

In our view, the primary responsibility of the government – in partnership with civil society and assisted by international organisations – is to establish clear and transparent mechanisms aimed at mobilising domestic resources, attracting international financial support, and fairly distributing aid to meet the reconstruction and development needs of Ukrainian municipalities.

In this report, we present and address the main problems in accessing funds for Ukraine's reconstruction at the following three levels:

At the **community level**, municipalities, local governments, volunteers and residents are responding to the challenges of war in different ways – by repairing damaged infrastructure, assisting internally displaced persons, providing basic services to the population, and supporting the army. While reconstruction needs at this level can be financed through various means like local budget revenues, assistance from twin cities, humanitarian funds, volunteer projects, and government support in the form of targeted grants and state-funded projects, there is an urgent need to increase funding.

This section explores avenues for financing municipal needs through extra-budgetary sources, including international financial institutions. Public participation is crucial for attracting additional funds beyond the local budget, such as through joint projects with non-governmental organisations, discussions on local development priorities, and project monitoring.

At the **national level**, recovery policy is formulated and implemented by state and regional bodies. This section identifies opportunities for utilising state funds and other forms of state support to meet the recovery needs of municipalities. The state bears responsibility for ensuring that funds provided by international partners are distributed fairly and transparently among municipalities to ensure their

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<sup>1</sup> From 2014 to 2020, the Ukrainian government implemented decentralisation reforms with the aim of enhancing regional development and local democracy. This resulted in the creation of 1470 communities or hromadas: 410 (28 per cent) of the city type, 433 (29 per cent) of the urban type, and 627 (43 per cent) of the rural type. The terms 'hromada', 'community', and 'municipality' are used interchangeably to refer to the distinct administrative and territorial units in Ukraine and the bodies that govern them.

recovery needs are met. It is our view that public participation in the tender committees tasked with reviewing reconstruction projects submitted by municipalities should be made mandatory and enshrined in law.

At the **international level**, support for Ukraine's reconstruction is being provided by international partners, financial institutions, and dedicated funds. This last section evaluates the availability of international financial support for municipalities.

This research series is divided into three publications, each dedicated to addressing the complexities of reconstruction funding at the level examined. All references to funds and civil society groups are for illustrative purposes and should not be interpreted as expressions of preference or exclusivity.



# Ukrainian municipalities: Accessing domestic and international financial resources for reconstruction efforts at the national level

## National recovery policy



Since 24 February 2022, Ukraine has demonstrated remarkable resilience and fortitude in the struggle for its statehood. To a large extent, this has occurred due to the decentralisation and operational response of the country's local self-governments, also known as hromadas. At the local level, decision makers have overseen the evacuation and accommodation of internally displaced persons, put in place the conditions necessary for businesses to relocate from war zones, and provided reliable support to the Armed Forces of Ukraine in their efforts to resist invaders on the front line.

Thanks to the efforts of national authorities and international partners, Ukraine has received significant support in the form of humanitarian and financial assistance, which has contributed to maintaining Ukraine's relative stability.

Ever since the first Ukrainian territories were liberated, it has become clear that the restoration of the infrastructure damaged in the missile attacks could not wait until the end of the war. In April 2022, the National Council for the Recovery of Ukraine from the Consequences of the War<sup>2</sup> was established to prepare for the country's post-war recovery and development up to 2032.

However, the first national recovery plans – presented in early July 2022 at the Ukraine Recovery Conference in Lugano<sup>3</sup> – lacked priorities, offered no holistic vision for the country's development, and made no provision for inclusive bottom-up participation. In June 2023, Ukraine's government was tasked with

<sup>2</sup> Office of the President of Ukraine, [Указ Президента України №266/2022 – Питання Національної ради з відновлення України від наслідків війни](#), Official Website of the President of Ukraine, 21 April 2022.

<sup>3</sup> Ukraine Recovery Conference, [Conference materials](#), Ukraine Recovery Conference, 4, 5 July 2022.

preparing a ‘Ukraine Plan’, a key component of the EU’s Ukraine Facility Regulation. While the EU guidelines seem more explicit, persistent issues remain, notably the lack of provisions in the plan for the organised and meaningful involvement of civil society and municipalities.

The Ukrainian government is currently developing a post-war national recovery policy. However, only a limited number of people at the highest levels have a clear understanding of what this policy requires. Additionally, many of the key stakeholders in the recovery process, including municipalities and businesses, are not familiar with the specifics of the policy and lack insight into the direction it may take. To bring more clarity to the structure and financing of the national recovery policy, this report will attempt to answer the following key questions:

- Who is responsible for developing the national recovery policy across different levels of public governance?
- What is the role of local government in the national recovery policy and how can it meaningfully participate in policy discussions and development?
- Where should municipalities obtain financing for reconstruction at the national level?
- What are the procedures for distributing state and international funding for reconstruction among frontline, support, backline, and liberated regions?
- How will the distribution and use of reconstruction funds be monitored and controlled?

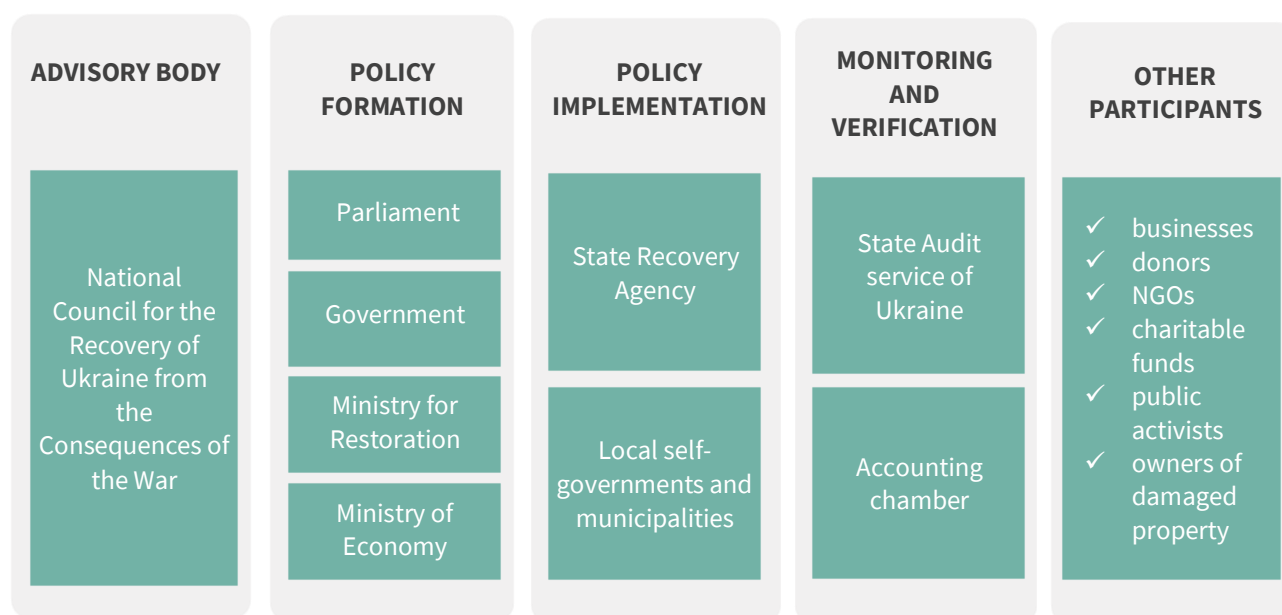
## National recovery policy: A review of the existing recovery legislation and regulatory framework

As of the end of 2023, the main players involved in the formation of the national recovery policy (Figure 1) are the Verkhovna Rada of Ukraine (Ukraine’s unicameral parliament) and the Cabinet of Ministers of Ukraine (the Government of Ukraine), which includes the Ministry for Communities, Territories and Infrastructure Development (also known as the Ministry for Restoration). According to Article 85 of the Constitution of Ukraine, the parliament is responsible for adopting relevant legislation and approving the state budget.<sup>4</sup> According to the Law on the Cabinet of Ministers of Ukraine, the government identifies reconstruction priorities and determines the allocation of funds for reconstruction activities.<sup>5</sup>

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<sup>4</sup> Verkhovna Rada of Ukraine, [The Constitution of Ukraine](#), Verkhovna Rada of Ukraine, 1 January 2020.

<sup>5</sup> Verkhovna Rada of Ukraine, [On the Cabinet of Ministers of Ukraine](#), Verkhovna Rada of Ukraine, 3 August 2023.



**Figure 1.** Architecture for formation of the national recovery policy.

The Ministry for Restoration is responsible for recovery and restoration, as laid out in a governmental resolution outlining the regulations that apply to the ministry.<sup>6</sup> Separately, the Ministry of Economy is involved in the development of the Ukraine Plan as part of the EU's Ukraine Facility, which seeks to align Ukraine's reconstruction with EU accession reforms covering the period 2024 to 2027. The powers of the Ministry of Economy in coordinating the preparation of the action plan are defined by the Cabinet of Ministers of Ukraine in Resolution No. 737.<sup>7</sup> This has been reflected in the Ministry of Economy receiving a significant increase in expenditure in the 2024 budget.<sup>8</sup> Meanwhile, allocations for the Ministry for Restoration and the State Agency for Reconstruction and Infrastructure Development of Ukraine (the State Recovery Agency for short) were reduced. This shift might have been caused by the Ministry of Economy's increased focus on the private capital and business aspects of the restoration, whereas most public projects are expected to seek support from international partners.

As outlined in Figure 1, the State Recovery Agency and local self-government bodies are responsible for implementing the national recovery policy. The State Recovery Agency oversees reconstruction projects at the national level, acting as an agent for individual local governments that are unable to fully implement projects on their own. With the assistance of the government and donors, local self-government bodies take the lead in initiating and, depending on capacity and funding, implementing reconstruction and restoration projects. The State Audit Service and the Accounting Chamber are tasked with overseeing the financial aspects of the recovery processes.

<sup>6</sup> Verkhovna Rada of Ukraine, [Про затвердження Положення про Міністерство розвитку громад, територій та інфраструктури України](#), Verkhovna Rada of Ukraine, 22 September 2023.

<sup>7</sup> Verkhovna Rada of Ukraine, [Про утворення Міжвідомчої робочої групи з питань підготовки плану заходів у рамках реалізації пропозиції Європейської Комісії щодо Регламенту Європейського Парламенту та Ради Європейського Союзу про створення Українського фонду](#), Verkhovna Rada of Ukraine, 14 July 2023.

<sup>8</sup> Verkhovna Rada of Ukraine, [Про Державний бюджет України на 2024 рік](#), Verkhovna Rada of Ukraine, 9 November 2023.

In April 2022, the National Council for the Recovery of Ukraine from the Consequences of the War was established by presidential decree. The Council, in addition to being involved in the formation of the national recovery policy, serves as an advisory body to the President of Ukraine. In principle, the Council is responsible for developing the post-war recovery plan for Ukraine, proposing essential priority reforms for the wartime and post-war periods, and establishing strategic initiatives and regulations for effective operation and recovery. Through its work, the Council is also expected to work with state and local bodies, civil society, and international organisations. Once proposals are agreed upon, they are then submitted to the President of Ukraine for approval.<sup>9</sup>

In reality, however, the Council is exclusively composed of officials from the government, its ministries, the president's office, and parliamentary committees. Representatives of civil society are not represented on the Council. With no information on the work of the Council currently available, it can only be assumed that the official website of the President of Ukraine will provide public information in due course.<sup>10</sup>

Communities as well as the representatives of state institutions are now faced with unprecedented challenges, including how to restore damaged infrastructure and accommodate the internally displaced. The speed and quality of these efforts will largely depend on how efficiently they are able to organise themselves.

The formation and implementation of the national recovery policy will rely on businesses operating in various sectors, such as architect and engineering firms as well as construction and design companies. As well as serving as contractors and implementers, these businesses have important roles to play in providing employment, recouping income for the state in the form of tax revenue, and engaging in public-private partnerships. Financing for the reconstruction is also expected to come from donors – via budget allocations or directly through various projects – as well as non-governmental organisations and charity funds that initiate local reconstruction and restoration projects. Ideally, non-governmental organisations and public activists should have a role in advising the committees and working groups tasked with monitoring reconstruction and recovery processes on the fair distribution of aid, so that it reaches the beneficiaries whose properties have been damaged.

It can be argued that the need for a coordinated national recovery policy dates to Russia's invasion of sovereign Ukrainian territory back in 2014. Despite actively pursuing reforms to advance European integration, the Ukrainian government's response to the temporary occupation of its territories was hampered by a lack of experience in responding to the challenges of war and the absence of any systemic cooperation between municipalities and international partners.

From a rational perspective, reconstruction and recovery policy should align with Ukraine's regional development policy. Following best practices in EU Member States, Ukraine's state regional policy should gradually embrace the principles and practices of the place-sensitive approach. As shown in Figure 2, the place-sensitive approach to regional development policy combines three basic principles:

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<sup>9</sup> Government Portal, '[About the National Council for the Recovery of Ukraine from the War](#)', *Government Portal*, 21 April 2022.

<sup>10</sup> Office of the President of Ukraine, [Указ Президента України №266/2022 – Питання Національної ради з відновлення України від наслідків війни](#), *Official Website of the President of Ukraine*, 21 April 2022.





**Figure 2.** *Basic principles of regional development policy.*<sup>11</sup>

The main principles of Ukraine's state regional policy are regulated by the Law of Ukraine 'On the Principles of State Regional Policy'. According to the law, the purpose of state regional development policy is 'to create conditions for the dynamic, balanced development of Ukraine and its regions, to ensure their social and economic unity, to raise the standard of living of the population, to create safe conditions, and to maintain state-guaranteed social standards for every citizen, regardless of their place of residence'.<sup>12</sup>

Amendments to the Law of Ukraine on the Principles of State Regional Policy introduced a more concise classification of functional types of territories that require different development support measures. These are restoration areas, regional growth poles, territories with specific development conditions, and sustainable development territories.<sup>13</sup>

- Restoration areas are microregions or territorial communities that have been impacted by conflict, temporary occupation, damage to critical infrastructure and the housing stock, or experienced a sharp decline in socio-economic development.
- Regional growth poles are microregions or territorial communities with geographical, demographic, and socio-economic indicators of development that compare favourably with other territories in the same region.
- Territories with specific development conditions are macroregions, microregions, or territorial communities with low levels of socio-economic development or natural, demographic, international, security, or other objective restrictions that limit development potential.
- Sustainable development territories are self-sufficient microregions or territorial communities with existing socio-economic potential, capable of developing in an economically, socially, and ecologically balanced way.

<sup>11</sup> U-LEAD with Europe, [Coordination of Reconstruction and Recovery with the Regional Development Policy in Ukraine – Policy Paper](#), U-LEAD with Europe, 28 May 2023.

<sup>12</sup> Verkhovna Rada of Ukraine, [Закон України – Про засади державної регіональної політики](#), Verkhovna Rada of Ukraine, last revised 1 January 2024.

<sup>13</sup> Verkhovna Rada of Ukraine, [Закон України – Про внесення змін до деяких законодавчих актів України щодо засад державної регіональної політики та політики відновлення регіонів і територій](#), Verkhovna Rada of Ukraine, 27 July 2022.

The classification indicators for these territories are determined by the Cabinet of Ministers of Ukraine. Resolution No. 731 of the Cabinet of Ministers of Ukraine<sup>14</sup> defines the procedure for determining restoration areas. According to the approved procedure, a municipality is classified as a restoration area if at least one of the following conditions is met:

- hostilities have occurred in the community territory;
- the community or a part of it has been temporarily occupied;
- critical infrastructure and housing stock have been destroyed due to shelling;
- the population has reduced by 15 per cent;
- unemployment has increased by 15 per cent;
- tax revenues for local budgets have reduced by 15 per cent;
- the proportion of internally displaced persons in the community is more than 10 per cent.

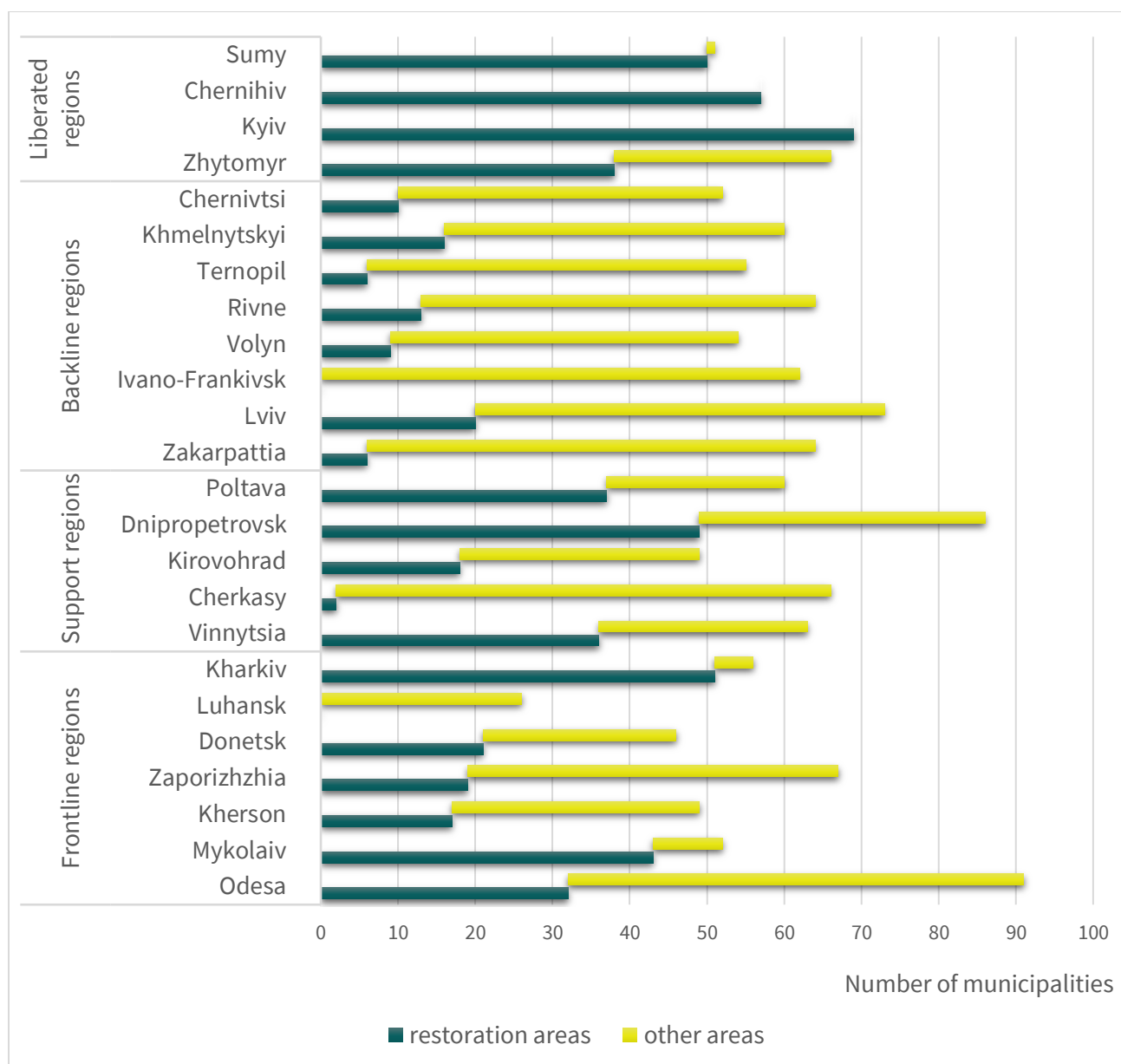
The Ministry for Restoration has created a committee responsible for evaluating whether certain municipalities are eligible for restoration based on the ministry's proposals. However, more than half of the committee are members of Ukraine's parliament. As such, this kind of evaluation can become highly politicised, opening the door for political interference and a 'hands-on' approach to managing municipalities. One way that the commission could resolve this issue is to involve representatives from specialised and public associations, including non-governmental organisations.

Based on the findings of this committee, the Ministry for Restoration has drafted a list of municipalities, including designated restoration areas (Figure 3). This proposed categorisation, reflecting the state of each region, was submitted to the Cabinet of Ministers for inclusion in the State Strategy for Regional Development of Ukraine covering the period from 2021 to 2027.<sup>15</sup> The proposed restoration areas populate a list that includes 619 municipalities in addition to the city of Kyiv, accounting for 42 per cent of all municipalities in the country.

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<sup>14</sup> Cabinet of Ministers of Ukraine, [Постанова Кабінету Міністрів України – Про затвердження порядків з питань відновлення та розвитку регіонів і територіальних громад](#), *Government Portal*, 18 July 2023.

<sup>15</sup> Ministry for Restoration, [‘Information announcement on the publication of the draft resolution of the Cabinet of Ministers of Ukraine “On Amendments to the State Strategy for Regional Development for 2021-2027 \(Annex 1\)”’](#), *Ministry for Restoration*, 5 December 2023.



**Figure 3.** Proposed categorisation of municipalities by region, including designated restoration areas.<sup>16</sup>

The crucial role of municipalities in the reconstruction process is now widely recognised by officials. However, certain issues still need to be addressed when it comes to adopting a decentralised approach to reconstruction, such as:

- (1) the inability of communities to determine quickly and objectively whether they belong to restoration areas due to challenges in collecting population statistics and the large numbers of internally displaced people;

<sup>16</sup> Decentralisation, [Communities list](#), Decentralisation, accessed 26 December 2023.

- (2) poor coordination between municipalities and departments at the central government level can impede recovery procedures among communities and significantly delay the decision-making process;
- (3) the risk of political influence and the application of unequal conditions to municipalities during the approval of funds for restoration areas; and
- (4) a shortage of qualified staff with relevant experience in drafting planning documents within municipalities.

In the eyes of community representatives, the primary responsibilities of the central authorities in the recovery efforts are to coordinate processes, develop state policies, implement regulatory acts, develop methodologies for community development, monitor the state register of damaged and destroyed property, accumulate resources, and procure funding to meet recovery needs.<sup>17</sup>

### Embracing a regional approach to the national recovery policy

During the implementation of the national recovery and regional development policies, the main focus should be on the regional level (oblasts). This is where state government bodies, including regional and district military–civilian administrations, and local self-government bodies, such as regional, district and local councils, most closely interact. The key to fulfilling the needs of citizens and promoting restoration and development lies in close cooperation and transparent interaction between state authorities and local self-government representatives. Regional military–civilian administrations should partner with municipalities to create regional development strategies, identify priority development and reconstruction projects for financing through the Ministry for Restoration, and contribute to the procurement and distribution of humanitarian aid. To prevent favouritism and promote equal opportunities, it is imperative that clear rules are established to ensure that all municipalities gain access to recovery aid.

At the regional level, heads of local councils and military–civilian administrations meet periodically to participate in joint national meetings of the Congress of Local and Regional Authorities.<sup>18</sup> Established by the President of Ukraine on 25 February 2021, the Congress consists of 1759 members, representing 1470 territorial communities and 49 regional bodies. The responsibilities of the Congress are to represent the interests of regions and communities, facilitate discussions among local authorities, interact with national and international organisations, organise public events to promote democracy, and prepare regular reports on the state of local and regional democracy.<sup>19</sup>

In addition to its important role in implementing local self-government reforms, the Congress is tasked with evaluating the implementation of the Association Agreement between Ukraine and the European Union at

<sup>17</sup> Agency for Legislative Initiatives, [What Is Happening With The State Policy of Community Recovery and Issues to Consider](#), Agency for Legislative Initiatives, 4 September 2023.

<sup>18</sup> The Congress of Local and Regional Authorities under the President of Ukraine is a consultative body established by Decree No. 73/2021 of the President of Ukraine of 25 February 2021, in accordance with the Regulation on the Congress of Local and Regional Authorities under the President of Ukraine, approved by Decree No. 89/2021 of the President of Ukraine of 4 March 2021.

<sup>19</sup> [Congress of Local and Regional Authorities Under the President of Ukraine](#), accessed 6 December 2023.

local and regional levels, preparing proposals to increase the effectiveness of the implementation of the agreement, and ensuring local self-government aligns with European standards.

Following amendments on 27 September 2022 (No. 1083) and 4 November 2022 (No. 1239) to the Resolution of the Cabinet of Ministers of Ukraine on the formation and implementation of local budgets during martial law, military–civilian administrations were granted the authority to exercise control over local budgets.<sup>20</sup> In our view, this is a concerning example of how decentralisation restrictions have been enforced at the regional level. While certain limitations under martial law are understandable, vague legislative provisions and limitations on self-government pose risks, including the potential usurpation of power, which runs counter to democratic values.

At the regional level, local authorities should take every opportunity to establish partnerships with civil society organisations. This can help to attract funds in the form of grants aimed at realising the strategic goals of local and regional development.

For example, on 12 December 2023, Ukraine's first immersive multifunctional hub opened its doors in Ternopil. Situated on the campus of the Western Ukrainian National University, this versatile space offers state-of-the-art virtual facilities and equipment for the benefit of students, scientists, medical professionals, wounded military personnel, and people with disabilities. The centre places special emphasis on providing higher education programmes that meet the needs of socially vulnerable groups.

The hub was developed by a Ukrainian non-governmental organisation called the Educational and Analytical Centre for Community Development with the support of Ternopil District Military–Civilian Administration, the Ministry of Digital Transformation of Ukraine, Cisco Systems, and the United Nations Development Programme in Ukraine.<sup>21</sup> The idea for the project came about following the adoption of the National Strategy for the Creation of a Barrier-free Space in Ukraine by 2030. The strategy envisions the establishment of a network of barrier-free centres providing equal access to innovative, digital and technological resources in education, science and leisure for the entire population of Ukraine.

A number of other international technical assistance projects further underlines the importance of regional decision-making. The PROSTO project,<sup>22</sup> a joint initiative by Sweden and Ukraine, aims to support ongoing decentralisation reform in Ukraine. Supported by the Swedish International Development Cooperation Agency (Sida), PROSTO is implemented by the Swedish Association of SALAR International AB, a company owned by the Swedish Association of Local Authorities and Regions. Since the war began, PROSTO has been actively monitoring the needs of liberated and frontline hromadas. For example, in July 2023, at a meeting of its international partners, PROSTO presented an interactive map highlighting the needs of hromadas in the Kherson oblast.<sup>23</sup>

<sup>20</sup> Verkhovna Rada of Ukraine, [Постанова Кабінету міністрів України "Деякі питання формування та виконання місцевих бюджетів у період воєнного стану"](#), Verkhovna Rada of Ukraine, 11 March 2022.

<sup>21</sup> Educational and Analytical Centre for Community Development, [У Тернополі відкрили імерсивний мультифункціональний хаб](#), Educational and Analytical Centre for Community Development, 12 December 2023.

<sup>22</sup> PROSTO – Support to Services Accessibility in Ukraine, [About Us, PROSTO – Support to Services Accessibility in Ukraine](#), accessed 6 December 2023.

<sup>23</sup> Decentralization Portal, [‘Interactive map of needs of Kherson oblast and analysis of monitoring of liberated hromadas of Ukraine were presented at the meeting of donors and international technical assistance projects’](#), Decentralization Portal, 18 July 2023.



On 1 December 2022, Ukraine's Cohesion & Regional Development Project (UCORD) was launched. The first phase of the project, covering the period from 1 December 2022 to 30 November 2023, aims to:<sup>24</sup>

- develop regional policy in Ukraine by supporting and strengthening regional development agencies in pilot oblasts;
- enhance the delivery of environmentally focused public services in the water supply, sanitation, and waste management sectors; and
- foster social cohesion through culture, dialogue and the creative industries.

## State-led recovery: Lessons learned from pre-war financial mechanisms

### Ukrainian funds for recovery and development

The Ukrainian government has appealed to international partners, investors, non-governmental organisations, businesses and citizens for financial assistance to help restore the stability of the Ukrainian economy and provide the country with the resources it needs to repel Russia's war. The proceeds from these donations are currently being distributed to meet specific needs, including supporting the Ukrainian army, providing humanitarian assistance to victims, rebuilding destroyed infrastructure, transforming the economy, restoring small and medium-sized enterprises, and servicing Ukraine's international financial obligations (Table 1).

Name of fund	Administrator	Description
<b>Small and Medium-sized Business Support Fund</b>	Ministry of Economy	The purpose of the fund is to provide financial support to small and medium-sized enterprises in the form of non-repayable grants. The procedure for using the account linked to the fund was approved by the Cabinet of Ministers on 12 October 2022. <sup>25</sup>
<b>Humanitarian Fund</b>	Ministry of Social Policy	The purpose of the fund is to provide humanitarian and other types of aid to the civilian population under martial law in Ukraine, particularly to victims of hostilities, internally displaced persons, and vulnerable groups in the most affected regions. The procedure for using the account linked to the fund was approved by the Cabinet of Ministers on 7 March 2022. <sup>26</sup>
<b>Armed Forces of Ukraine Support Fund</b>	National Bank of Ukraine	Since the full-scale war, a special account held by the National Bank of Ukraine has been credited with over UAH 31 billion (approximately EUR 785 million) to meet Ukraine's military and

<sup>24</sup> Decentralization Portal, [Ukraine's Cohesion & Regional Development Project](#), UCORD, *Decentralization Portal*, accessed 1 December 2023.

<sup>25</sup> Cabinet of Ministers of Ukraine, [Кабінет Міністрів України Постанова, від 12 жовтня 2022, р. № 1156](#).

Київ: [Деякі питання фінансування підтримки малого та середнього бізнесу](#), *Verkhovna Rada of Ukraine*, last revised 25 October 2023.

<sup>26</sup> Cabinet of Ministers of Ukraine, [Кабінет Міністрів України Постанова, від 7 березня 2022, р. № 220](#), Київ: [Питання надання гуманітарної та іншої допомоги цивільному населенню в умовах воєнного стану в Україні](#), *Verkhovna Rada of Ukraine*, last revised 10 March 2023.

		defence needs. <sup>27</sup> The National Bank of Ukraine website provides daily updates on the status and movement of funds in the account. <sup>28</sup>
<b>Economic Recovery and Transformation Fund</b>	Ministry of Economy	The account linked to the fund is used to provide non-repayable state grants for job creation and the development of enterprises involved in manufacturing and food processing. <sup>29</sup>
<b>Debt Management and Redemption Fund</b>	Ministry of Finance	The Ministry of Finance is responsible for deciding how the fund is distributed, giving due consideration to the funds available. <sup>30</sup>
<b>Destroyed Property and Infrastructure Restoration Fund</b>	Ministry for Restoration	The Ministry for Restoration and the Ministry of Digital Transformation have established an interdepartmental committee to review applications and create proposals for the distribution of resources to facilitate the restoration of damaged property and infrastructure. <sup>31</sup>

**Table 1.** Recovery funds established by Ukraine in response to Russia's armed aggression.<sup>32</sup>

The recovery funds outlined above, established during the full-scale invasion, have not been managed in an efficient, transparent, or accountable way. While very little is known about how these funds function in practice, identifying and analysing the weaknesses and strengths of the state funds established before the war can ensure that valuable lessons are learned.

## Pre-war financial mechanisms for funding reconstruction efforts

### State Fund for Regional Development

The main financial instrument for implementing state regional policy is the State Fund for Regional Development (SFRD). According to Article 241 of the Budget Code of Ukraine,<sup>33</sup> the SFRD is one of the sources used to finance regional development. We speculate that the government also has plans to use the SFRD to finance the restoration needs of municipalities.

<sup>27</sup> National Bank of Ukraine, [Special account for the needs of defense](#) National Bank of Ukraine, accessed 7 December 2023.

<sup>28</sup> National Bank of Ukraine, ["Стан та рух коштів на спецрахунку НБУ відкритому для підтримки ЗСУ та оборони України"](#), National Bank of Ukraine, accessed 7 December 2023.

<sup>29</sup> Cabinet of Ministers of Ukraine, [Кабінет Міністрів України Постанова, від 27 січня 2023, р. № 72. Київ: Деякі питання фінансування та надання грантів на створення або розвиток переробних підприємств](#), Verkhovna Rada of Ukraine, last revised 15 November 2023.

<sup>30</sup> Cabinet of Ministers of Ukraine, [Порядок використання коштів з рахунка "Фонд обслуговування та погашення державного боргу"](#), Ministry of Finance of Ukraine, 19 September 2023.

<sup>31</sup> Cabinet of Ministers of Ukraine, ["Постанова Кабінету Міністрів України «Деякі питання використання коштів з рахунка "Фонд відновлення зруйнованого майна та інфраструктури"»](#), Verkhovna Rada of Ukraine, 20 December 2022.

<sup>32</sup> Government Portal, [Фонди відновлення України](#), Government Portal, accessed 1 December 2023.

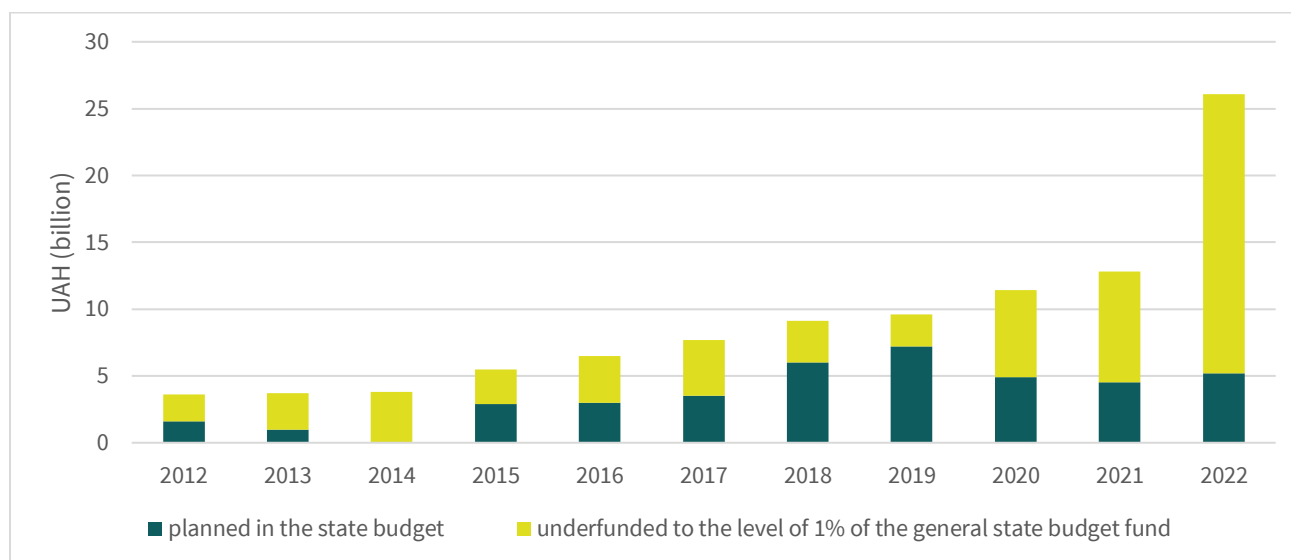
<sup>33</sup> Verkhovna Rada of Ukraine, [Бюджетний кодекс України](#), Verkhovna Rada of Ukraine, 19 November 2023.

The SFRD was established to ensure that a portion of funds from the state budget is invested in local projects. To be eligible, projects must not only meet the goals of the state's regional and local development strategies, but also contribute to job creation. Projects submitted for SFRD funding are evaluated based on how well they align with these strategies and whether they are likely to have a systemic long-term effect on local and regional development.<sup>34</sup>

The SFRD became part of the state budget following the approval of the budget programme by the Ministry for Restoration in December 2022.<sup>35</sup> The Budget Code states that the SFRD shall be credited with at least 1 per cent of the revenues from the general state budget fund for the year in question. In practice, however, the actual amount credited always falls short (Figure 4).



*In 2023, SFRD funds in the amount of UAH 2 billion were redirected to meet the needs of the Armed Forces of Ukraine.<sup>36</sup> However, based on a draft of the 2024 state budget, the SFRD has not been allocated any funding.<sup>37</sup>*



**Figure 4.** Funds from the state budget allocated to the SFRD in UAH billion.<sup>38-48</sup>

According to the Budget Code, the SFRD should receive 1 per cent of the general fund revenue of the state budget each year. This amount (1 per cent of the general fund revenue of the state budget) is represented by the columns, consisting of dark green and light green parts. Dark green indicates the amount actually planned in the state budget for the SFRD. Light green indicates the shortfall in funds needed to reach 1 per cent of the general fund revenue of the state budget, i.e. the underfunded part. In practice, the SFRD has never been fully financed.

<sup>34</sup> UNDP Ukraine, '[Development finance assessment: Ukraine.](#)' UNDP Ukraine, 12 August 2022.

<sup>35</sup> Government Portal, '[Government adopted a decision to optimize the system of central executive bodies](#)', Service of Minister of the Cabinet of Ministers of Ukraine, posted 2 December 2022.

<sup>36</sup> Verkhovna Rada of Ukraine, '[Про внесення змін до Закону України "Про Державний бюджет України на 2023 рік"](#)', Verkhovna Rada of Ukraine, 29 June 2023.

<sup>37</sup> Verkhovna Rada of Ukraine, '[Про Державний бюджет України на 2024 рік](#)', Verkhovna Rada of Ukraine, 9 November 2023.

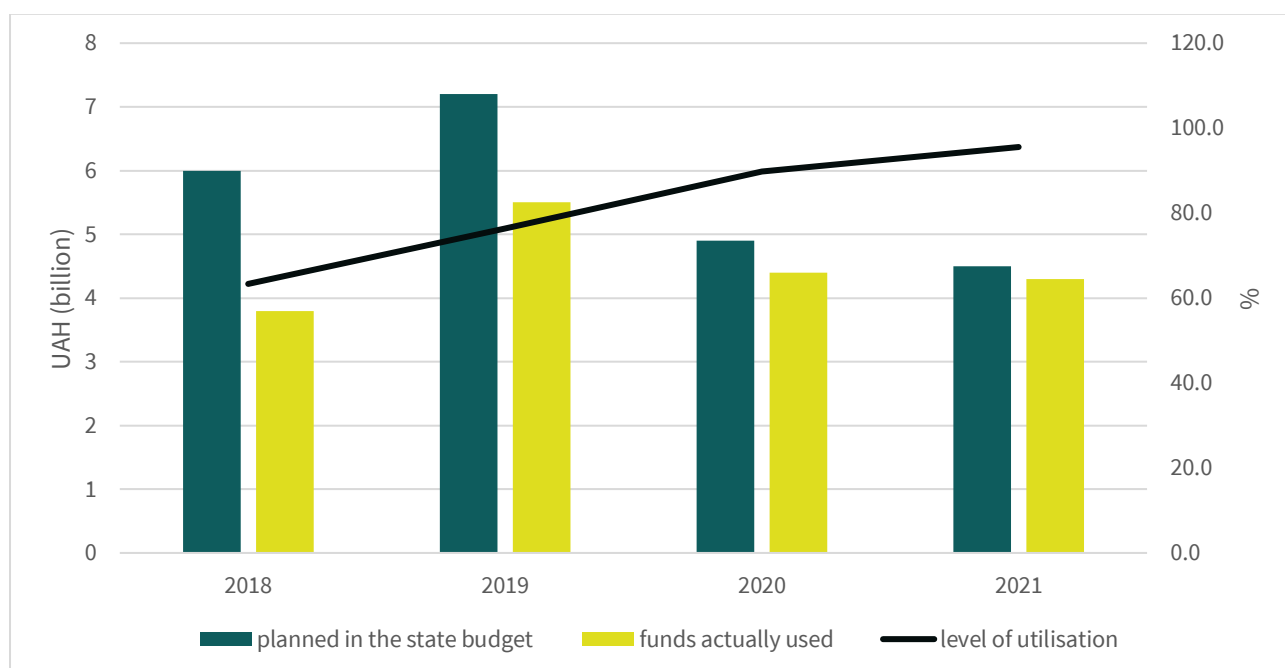
<sup>38</sup> Verkhovna Rada of Ukraine, '[Про Державний бюджет України на 2012 рік \(додаток 3\)](#)', Verkhovna Rada of Ukraine, 8 December 2012.

In order to receive funds from the SFRD, municipalities are encouraged to submit detailed project proposals, which are then evaluated by two separate committees:

- (1) a regional committee, of which at least one-third of its members must comprise representatives of public associations;<sup>39</sup> and
- (2) a committee handpicked by the Ministry of Regions, of which at least 50 per cent must comprise representatives of the parliamentary budget committee.<sup>40</sup>

On the one hand, the procedure for selecting SFRD projects is not sufficiently competitive. This increases the risk that the evaluation system in place could be exploited by politicians to influence communities or by high-level officials to lobby for projects located in communities in which they have a vested interest.<sup>41</sup>

On the other hand, the SFRD has proved a valuable tool for involving communities in activities connected with these projects. Moreover, financial decentralisation has provided project organisers with an opportunity to avail of funds in addition to the allocations available from local budgets (Figure 5).



**Figure 5.** Utilisation of SFRD funds between 2018 and 2021.<sup>42</sup>

While the planned annual budget for the SFRD decreased between 2018 and 2021, its relative utilisation (as a percentage of the budget) increased. Just 63 per cent of the budget was used in 2018, but almost 100 per cent was used in 2021.

<sup>39</sup> Verkhovna Rada of Ukraine, 'Про затвердження примірного Положення про регіональну комісію з оцінки та проведення попереднього конкурсного відбору інвестиційних програм і проектів регіонального розвитку, що можуть реалізовуватися за рахунок коштів державного фонду регіонального розвитку', Verkhovna Rada of Ukraine, 30 March 2016.

<sup>40</sup> Verkhovna Rada of Ukraine, 'Деякі питання державного фонду регіонального розвитку', Verkhovna Rada of Ukraine, 6 April 2021.

<sup>41</sup> Olexandr Hanushchyn, 'Поверніть громадам гроші', LB.ua, 18 September 2019.

<sup>42</sup> Open Budget, 'Державний веб-портал бюджету для громадян', Open Budget, 2023.



*According to independent research,<sup>43</sup> the SFRD is likely to be underfunded in the coming years and possibly until the war ends, reducing its ability to positively steer the country's recovery processes. The Ministry for Restoration, which currently manages the SFRD, has delivered a similar assessment.<sup>44</sup>*

To reform the fund, particularly the way in which projects are selected, the Ministry has taken a number of steps. It has proposed that citizens should be able to vote for their preferred projects through Diia, the government's online public services portal. In June 2023, the Ukrainian parliament adopted a draft law that would enable citizens to vote for regional development projects,<sup>45</sup> even though it has yet to take effect.

However, the merits of selecting projects based on a public vote are debatable for the following reasons:

- the average citizen does not have the expertise to comprehensively evaluate each project;
- not all citizens have access to digital voting, least of all the motivation to vote; and
- casting a vote online is not the same as public consultation and participation.

Although it is commendable that the Ministry has chosen not to wait until martial law ends before reforming the accessibility of the SFRD, engaging the public in a consultative role would be preferable. Additionally, there are a number of systemic problems with the way in which the fund is currently set up:<sup>46</sup>

- Most projects financed by the SFRD do not contain an investment component, limiting opportunities for business development, job creation, and increasing tax and local community revenues. Instead, the vast majority of projects tend to focus on the construction, reconstruction, and repair of public buildings such as preschools, schools, hospitals, and outpatient clinics. However, this money only goes so far. Typically, a municipality that avails of the SFRD to construct, for example, a gym or a cultural centre, will need to rely on other financial resources to finish the work and maintain the building.
- Local governments still have a low institutional capacity for preparing high-quality regional development project proposals that meet the criteria for absorbing all of the funds potentially available. There is an unmet need for municipalities to either improve the professional standing of their employees or engage external experts. To this end, international technical assistance projects can be utilised to improve project work among communities, including preparing project proposals for the SFRD.<sup>47</sup>

<sup>43</sup> Ступницький О. І., Швець І.Ю., [Відновлення України: фінансові ресурси і інструменти відбудови та розвитку територіальних громад](#), Навчально-науковий інститут міжнародних відносин Київського національного університету імені Тараса Шевченка, 11 October 2023.

<sup>44</sup> Centre for Economic Strategy, [Ukrainian state budget 2024. US uncertainty and funds for recovery needs](#), Facebook, accessed 13 October 2023.

<sup>45</sup> Ministry for Communities, Territories and Infrastructure Development of Ukraine, [SRDF in Diia: Parliament adopts draft law that enables citizens to choose regional development projects](#), Government Portal, accessed 29 June 2023.

<sup>46</sup> Benovska Liliya Yaroslavivna, [Проблеми фінансування проектів державним фондом регіонального розвитку](#), Institute of Regional Research, 7 January 2017.

<sup>47</sup> Vasyl Kashevskyi, [Підготовка проектів до державного фонду регіонального розвитку](#), Partnership for Local Economic Development and Democratic Governance, 2020.



- There is an acute lack of transparency with the formation and operation of project selection committees at regional and national levels. The large proportion of committee members in positions of influence, such as deputies and high-level officials, increases the risk for conflicts of interest. Deputies, for instance, could very well promote the interests of their own electoral district, businesses, sponsors, or political party, while officials could have a professional conflict of interest depending on their area of work.

Given the above concerns, there is a risk that the most pressing problems faced by citizens in the affected regions will be overlooked.

## Energy Efficiency Fund

The Energy Efficiency Fund (EEF)<sup>48</sup> is a state institution legally established by the Ukrainian government.<sup>49</sup> The main purpose of the EEF is to encourage businesses and communities to adopt energy efficiency initiatives by providing them with the incentives and tools they need to increase the energy efficiency of commercial and residential buildings in alignment with the National Energy Efficiency Action Plan. The EEF also aims to reduce carbon dioxide emissions in fulfilment of the Paris Agreement,<sup>50</sup> implement the *acquis communautaire* of the European Union and Treaty Establishing the Energy Community,<sup>51</sup> and ensure Ukraine's compliance with its international obligations in the area of energy efficiency.

By bringing Ukraine in line with European energy efficiency standards, the EEF is intended to reduce energy consumption and carbon dioxide emissions in the residential sector, thus mitigating their adverse impacts on the environment. For this purpose, multi-unit homeowner associations can avail of grants to help them carry out energy-efficient renovations that meet European best practices in thermal modernisation.

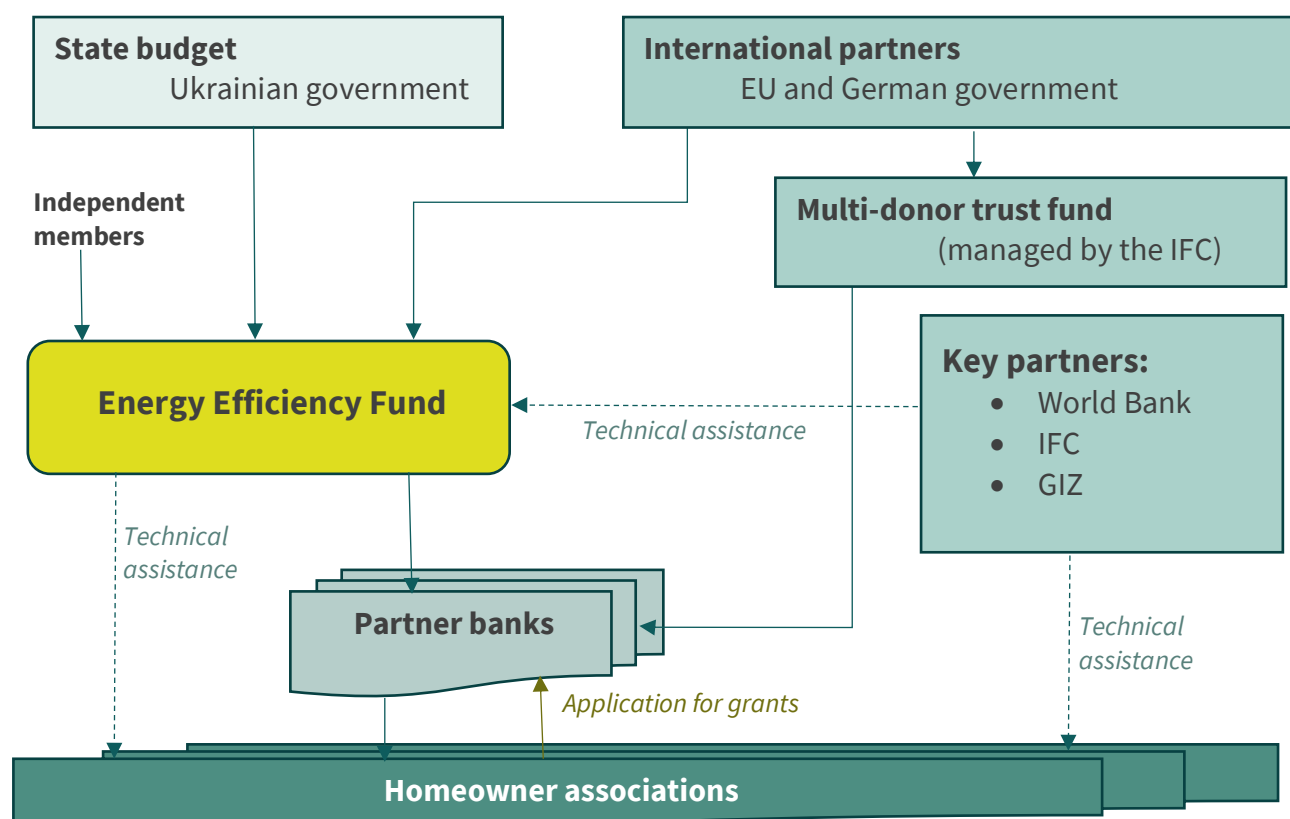
The EEF is funded by the Ukrainian state budget with support from the EU and the German government. The fund programme is implemented in cooperation with the International Finance Corporation (IFC), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, and the United Nations Development Programme in Ukraine (Figure 6).

<sup>48</sup> Energy Efficiency Fund, [About the Fund](#), *Energy Efficiency Fund*, accessed 1 December 2023.

<sup>49</sup> Verkhovna Rada of Ukraine, [Про Фонд енергоефективності](#), *Verkhovna Rada of Ukraine*, 3 August 2022.

<sup>50</sup> Verkhovna Rada of Ukraine, [Паризька угода](#), *Verkhovna Rada of Ukraine*, 14 July 2016.

<sup>51</sup> Verkhovna Rada of Ukraine, [Договір про заснування Енергетичного Співтовариства](#), *Verkhovna Rada of Ukraine*, 25 October 2005.



**Figure 6.** Organisational structure of the Energy Efficiency Fund.<sup>52</sup>



*In 2023, the EEF received no funding from the state budget, a trend that is expected to repeat in 2024.*

Despite a lack of funding from the state budget, the EEF continues to work with local self-government bodies, territorial communities and regional state administrations. According to 2022 data, 254 memorandums of cooperation with municipalities have already been signed.<sup>53</sup> However, communities mostly end up having to rely on their own resources and whatever funds they can access from local budgets.<sup>54</sup>

Together with a team of regional consultants from the IFC, the EEF is helping municipalities to develop or adapt support programmes to promote energy efficiency. One of the most successful is the EEF's Energodim programme, which reimburses apartment owners living in multi-unit homeowner associations with up to 70 per cent of the renovation costs involved in upgrading the energy efficiency of their homes.

Since the Energodim programme was launched in August 2019,<sup>55</sup> the EEF has received 898 applications, of which 818 have been approved. The total cost of the projects to date is around UAH 8.2 billion, with grants making up UAH 5.1 billion of the overall amount. Once completed, the projects are expected to result in

<sup>52</sup> Energy Efficiency Fund, [Partners](#), Energy Efficiency Fund, accessed 1 December 2023.

<sup>53</sup> Energy Efficiency Fund, [Digest of the Energy Efficiency Fund for September – October 2023](#), Energy Efficiency Fund, accessed 1 December 2023.

<sup>54</sup> Energy Efficiency Fund, [Карта місцевих програм підтримки ОСББ та підписаних меморандумів](#), Energy Efficiency Fund, 24 October 2023.

<sup>55</sup> Energy Efficiency Fund, [Програма Енергодім](#), Energy Efficiency Fund, accessed 1 December 2023.

energy savings of 437 million kilowatt-hours (kWh) per year. Based on 2022 figures, construction work has either been partially or fully completed on 162 projects. Of these, 150 were carried out during martial law.<sup>56</sup>

Despite its potential to have a considerable impact on energy efficiency in the residential sector, the EEF requires multi-unit homeowner associations to submit a large amount of paperwork to conclude contracts, a requirement stipulated by the main donors of the fund, particularly the German government.

Understandably, the war has prompted the EEF to expand in scope. In view of the large number of buildings damaged and destroyed as a result of the conflict, a new grant programme called VidnovyDIM was set up to support co-owners of multi-unit homeowner associations whose homes need to be repaired as a result of the damage.<sup>57</sup> The EU allocated EUR 5 million to support the pilot phase of the programme. Owners eligible for the scheme receive a non-repayable grant amounting to 100 per cent of their reconstruction costs. The money is deposited in two tranches: an initial 70 per cent once the application for the grant is approved, and the remaining 30 per cent once the works are completed and the final documents are received.

On 17 November 2022, the EEF's supervisory board approved the VidnovyDIM programme, and four days later the programme was officially launched. Thus far, <sup>56</sup> grant applications have been received from multi-unit homeowner associations in the regions of Kyiv, Zhytomyr, Sumy and Chernihiv. Based on the contracts already signed, the total cost of the projects amounts to roughly UAH 130.4 million, with the grant portion estimated at about UAH 127.7 million.<sup>58</sup>

One positive aspect of the EEF's work is its close interaction with municipalities and residents. Not only has energy efficiency increased within communities, but residents and municipal officials have become more proficient in writing applications and navigating the submission process. Additionally, the fact that the fund is co-financed encourages greater responsibility for ensuring that projects are implemented in a cohesive way.

## Revolving funds

A revolving fund<sup>59</sup> is a globally popular financial instrument that allows applicants to obtain funds for various projects. However, it has yet to take off in Ukraine.

Unlike financing sourced from local or state budgets, money from a revolving fund offers greater flexibility. It can be used across financial years to circumvent bureaucratic restrictions imposed by financing programmes. A revolving fund is designed to be self-replenishing, which means that funds are used for a specific purpose and then paid back. In this way, the fund is never depleted. For example, if a project financed by a revolving fund becomes profitable or manages to generate savings, these funds are then returned to the pot and used to finance other activities.

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<sup>56</sup> Energy Efficiency Fund, [Report on the Activities of the State Institution "Energy Efficiency Fund" for 2022](#), *Energy Efficiency Fund*, accessed 1 December 2023.

<sup>57</sup> VidnovyDIM, [The Vidnovydim Program](#), *VidnovyDIM*, accessed 1 December 2023.

<sup>58</sup> Energy Efficiency Fund, [Report on the Activities of the State Institution "Energy Efficiency Fund" for 2022](#), *Energy Efficiency Fund*, accessed 1 December 2023.

<sup>59</sup> EU4Energy, [Революверний фонд як інструмент успішного фінансування енергоефективних заходів місцевих громад](#), *EU4Energy*, accessed 10 January 2018.

A revolving fund can be set up by various entities, including local city councils, government agencies, multi-unit homeowner associations, cooperatives, and commercial organisations.

The revolving fund can be replenished from a variety of sources used simultaneously, including:

- funds raised by the local council through its budget, external donations and other fundraising initiatives;
- funds provided by financial institutions such as development banks, charitable foundations and international technical assistance projects;
- funds received from fund users in the form of user fees or individual contributions to finance the administrative work of the fund; or
- funds accumulated due to the successful implementation of cost-saving measures.

However, given the challenges of revitalising Ukraine's economy, it is extremely difficult for a revolving fund to sustain itself solely through repayments from its borrowers. Additionally, such an approach may not necessarily lead to lower interest rates than those offered by commercial banks. Therefore, it is advisable that municipalities allocate a specific amount from their local budgets each year to ensure the fund is always replenished. A revolving fund can be managed by a communal enterprise or institution, a non-governmental organisation, a bank, or a local government department.

The introduction of martial law in February 2022 restricted the opportunities for financing housing support programmes through community funding. These ventures are now categorised as third-tier 'other expenses'. As a result, community funding initiatives have been suspended in favour of funds allocated from the state budget.

Despite these challenges, a voluntary association called the Energy-Efficient Cities of Ukraine has created its own revolving fund. Even during the current period of martial law, their revolving fund has proved to be a reliable and robust financial instrument. Other municipalities seeking financing, such as for multi-unit homeowner associations that wish to apply for rebates under the Energodim scheme, would do well to follow their example.

The revolving fund is a potentially valuable instrument for municipalities looking to invest in energy-efficiency and recovery projects. We recommend that the Ministry for Restoration conduct its own in-depth analysis of the potential benefits of revolving funds with a view to promoting their use among municipalities on a wider scale.

### **Fund for the Liquidation of the Consequences of Armed Aggression**

The Fund for the Liquidation of the Consequences of Armed Aggression (FLCAA) is a fund within the state budget dedicated to meeting a significant portion of the country's reconstruction needs. These include the construction of public buildings and shelters, the reconstruction and repair of critical infrastructure, and the provision of housing for internally displaced persons and those who have lost their livelihoods as a result of the hostilities.

In 2023, the FLCAA was credited with funds seized from Russia in the amount of UAH 25.8 billion, as well as 50 per cent of the National Bank of Ukraine's profits, totalling UAH 35.9 billion.<sup>60</sup>



*The FLCAA's sources of funding from the state budget in 2024 have yet to be disclosed.<sup>61</sup> Instead of relying on budget allocations, the FLCAA is expected to become part of a special fund in 2024. Any unused funds left over from the FLCAA's budget in 2022 and 2023, along with confiscated Russian assets, will be used to top up the fund.*

The FLCAA is expected to continue to prioritise urgent reconstruction needs, such as restoring and maintaining energy and water supplies, financing reconstruction projects seeking assistance, and providing compensation for damaged housing through the eVidnovlennia (e-Recovery) programme.

In April 2023, the Ukrainian government, in response to recommendations submitted by a number of civil society organisations and experts, passed a resolution of the Cabinet of Ministers<sup>62</sup> approving amendments to the procedure for using FLCAA funds. These included defining a unified approach for determining priority restoration projects and simplifying requirements in order to make better use of the fund and expedite the disbursement of monies.

Based on the current plans, funds from the FLCAA will be directed to regions and territorial communities classified as recovery areas. In order to receive funding, projects must be included in the regional recovery and development plans, which are part of the general strategy for the recovery of regions. Local state and military administrations are responsible for developing these plans. However, a conflict arises in the Law on the Basics of State Regional Policy, which grants local councils the authority to independently formulate recovery and development plans. However, they face obstacles in obtaining financing from the FLCAA, because they must coordinate their actions with regional state and military administrations. Such an approach will undoubtedly create conflicts of interest and increase the risk of corruption, particularly given the expanded powers of regional state and military administrations.<sup>63</sup>

For the year 2024, the medium-term budget policy priorities include the reconstruction of war-torn regions and the restoration of critical infrastructure, social services, residential areas, and public facilities. In 2024, the FLCAA will be subsumed within the state budget as a special fund. The fund will be allocated for the following purposes: the restoration of damaged residential and public facilities; the construction of public buildings and protective structures for civil defence and military facilities; the construction of infrastructure facilities; engineering and technical measures to protect critical infrastructure; and compensation for destroyed or damaged residential buildings.

<sup>60</sup> Centre for Economic Strategy, '[Моніторинг стійкої повоєнної відбудови: настанови для України](#)', Centre for Economic Strategy, 6 October 2023.

<sup>61</sup> Verkhovna Rada of Ukraine, '[Про Державний бюджет України на 2024 рік](#)', Verkhovna Rada of Ukraine, 9 November 2023.

<sup>62</sup> Verkhovna Rada of Ukraine, '[Деякі питання використання коштів фонду ліквідації наслідків збройної агресії](#)', Verkhovna Rada of Ukraine, 28 September 2023.

<sup>63</sup> Ступницький О. І., Швець І.Ю., '[Відновлення України: фінансові ресурси і інструменти відбудови та розвитку територіальних громад](#)', Навчально-науковий інститут міжнародних відносин Київського національного університету імені Тараса Шевченка, 11 October 2023.



Since 2024, it is planned to modify the procedures for making decisions on the allocation of funds from this fund (Article 28 of the law).<sup>64</sup> From now on, every such decision must be made by the Cabinet of Ministers of Ukraine in agreement with the Budget Committee of the Verkhovna Rada.

The budget allocations of the FLCAA amounted to UAH 35.5 billion in 2023, and for 2024 their exact amount is unknown, as they will be distributed between the Budget Reserve Fund (UAH 44.8 billion) and subventions for the restoration of local budgets (UAH 9.4 billion). In addition, international aid for the reconstruction of Ukraine under certain programmes will be credited to this fund.

Some experts<sup>65</sup> have expressed concerns regarding the manual distribution of funds for the reconstruction of critical infrastructure from the reserve fund. They suggest that this process is not as effective as the current practices of the FLCAA. The latter has developed transparent project selection procedures to ensure that the funds are allocated in the most appropriate manner.

In response to this criticism, the authorities have begun working on a permanent national recovery fund, would receive financial support from the state budget's reserve fund. For this purpose, a draft law is being prepared on amendments to Article 24 of the Budget Code, which should ensure the harmonisation of various sources of financing the reconstruction of Ukraine in one fund and the use of the best practices for financing priority projects.<sup>66</sup>

Representing one of its more innovative projects, the Ministry for Restoration, in partnership with public organisations and donors, has developed the Digital Restoration Ecosystem for Accountable Management (DREAM), a state platform that serves as a single pipeline for all reconstruction projects.<sup>67</sup> It enables communities to create projects, present them to international partners to attract financial resources, and manage the construction process. The DREAM platform promotes transparency and integrity in Ukraine's recovery. It enables anyone to monitor reconstruction projects, fostering trust between the government, citizens, businesses, and financial institutions. The platform works on the principle of 'everyone sees everything', allowing international partners and the public to monitor the entire project cycle.

## State Fund for Decarbonisation and Energy-Efficient Transformation

The State Fund for Decarbonisation and Energy-Efficient Transformation (SFDEET) is expected to become a reliable, legally protected source of funds for implementing energy efficiency programmes, reducing carbon dioxide emissions and supporting alternative energy sources. The fund is also expected to adopt the 'polluter pays' principle, as laid out in EU Regulation 2018/1999 on the Governance of the Energy Union and Climate Action. To this end, funds generated from the Ukraine government's carbon tax will be used for energy efficiency purposes.

The main objectives of the SFDEET are to support government programmes that promote energy efficiency, alternative energy sources and decarbonisation, attract international loans and grants for the

<sup>64</sup> Verkhovna Rada of Ukraine, '[Про Державний бюджет України на 2024 рік](#)', *Verkhovna Rada of Ukraine*, 9 November 2023.

<sup>65</sup> Тетяна Богдан, '[Бюджет-2024: яких змін очікувати?](#)', LB.UA, 6 October 2023.

<sup>66</sup> Тетяна Богдан, '[Бюджет-2024: яких змін очікувати?](#)', LB.UA, 6 October 2023.

<sup>67</sup> DREAM, '[DREAM. Digital Restoration Ecosystem for Accountable Management](#)', *DREAM*, accessed 1 December 2023.

implementation of investment projects, and ensure international investments and financial liabilities are repaid in a timely manner.<sup>68</sup>



*In 2024, the SFDEET will receive financing from the state budget in the amount of UAH 759 200.<sup>69</sup>*

## Summary

The funds outlined above have considerable potential to steer the reconstruction of Ukraine along a sustainable and green course. However, ensuring transparency and accountability in how these funds are used is crucial. This will help avoid the risks of political influence and manipulation during the selection of projects.

## Other sources of financing

### Public-private partnership

The war has caused unprecedented damage to Ukraine's infrastructure. In theory, public-private partnerships can serve as a useful strategy for financing Ukraine's reconstruction needs.

Public-private partnerships in Ukraine is a system of relations between public and private partners that combines the funding, expertise, and infrastructure resources of both parties. By extension, this means that all of the possible risks, responsibilities, and rewards are shared. In terms of the current situation in Ukraine, this type of partnership would ideally be realised on a long-term basis with the aim of reconstructing or restoring damaged infrastructure that attracts future investment.

In other parts of the world, public-private partnership projects have been successfully implemented by both economically developed countries and developing nations facing the challenge of rebuilding their national economies under adverse conditions. Their collective experience proves that infrastructure investments can be injected with private capital over the short term, providing rapid economic growth even in cases where the level of state investment is not significant.<sup>70,71</sup>

The successful development of public-private partnerships as a mechanism to attract private investment in domains that are strategically important for the state is only possible if a balance of interests is established between state and private investors.

Currently, public-private partnerships are being promoted by a wide range of institutions, including bilateral donor agencies, United Nations agencies, and multilateral development banks. The World Bank Group continues to be at the forefront of advocating for the wider use of private finance in development. Their rationale is that public-private partnerships can help to overcome the challenges involved in

<sup>68</sup> State Agency on Energy Efficiency and Energy Saving of Ukraine, [President signs law establishing State Fund for Decarbonisation and Energy Efficient Transformation](#), *Government Portal*, accessed 3 May 2023.

<sup>69</sup> Verkhovna Rada of Ukraine, ['Про Державний бюджет України на 2024 рік'](#), *Verkhovna Rada of Ukraine*, 9 November 2023.

<sup>70</sup> Ministry for Restoration of Ukraine, [Public-private partnership in Ukraine](#), *Ministry for Restoration of Ukraine*, accessed 30 November 2023.

<sup>71</sup> CEE Bankwatch Network, [Case Studies](#), *CEE Bankwatch Network*, accessed 30 November 2023.

financing, implementing and delivering infrastructure and public services. This argument is based on the assumption that the private sector brings additional finance, and that private companies are inherently more efficient than the public sector in delivering high-quality public services.

However, experience from abroad points to the risks of pursuing this approach. The truth is that public–private partnerships have been poorly implemented in countries all over the world, from Spain to Nepal, negatively affecting local populations, hindering their fundamental human rights, and obstructing the fight against inequality and the climate crisis. The most common problem associated with public–private partnerships is the prioritisation of financial interests over the provision of infrastructure and public services, which casts doubt on their ability to deliver results that benefit society.<sup>72</sup>

Public–private partnerships also come at a high cost for the public purse and citizens, posing an excessive level of risk for the public sector and democratic governance. In Ukrainian municipalities, public–private partnerships are more the exception than the rule. According to central and local executive bodies in Ukraine, as of 1 January 2023, a total of 193 public–private partnership contracts had been signed. Of these, 18 contracts had been completed, comprising nine concession agreements, five joint-venture agreements, and four other types of agreement. However, 162 contracts had not been completed. Of these, 116 had not been implemented at all, 46 had either expired or been scrapped, and 13 had been suspended as a result of the war. The implementation of public–private partnerships is most prevalent in Lviv and the Zakarpattia region.<sup>73</sup>

In 2021, the Ministry of Economy published four public–private partnership manuals intended to help relevant parties navigate the complex process of establishing public–private partnerships in Ukraine.<sup>74</sup>

Public–private partnerships offer potential benefits, but require a balanced approach. It is imperative to establish legislation that ensures public–private partnership projects take social responsibility for the impacts of their activities and comply with environmental safety measures. It is also essential to safeguard against the possibility of state assets or municipal property being seized, and to prevent officials from transferring their economic liabilities and risks to business ventures.

### Energy-as-a-service provided by energy service companies

Energy-as-a-service (EaaS) is an innovative solution for financing energy-efficient projects. The energy-as-a-service model is based on outsourcing the delivery of energy-efficient services to private investors known as energy service companies (ESCOs). The measures these companies implement are paid for solely through the savings achieved as a result of reduced utility and energy costs.

The energy-as-a-service solution is also a way of reducing the burden on public finances, since private capital can be leveraged to fund energy-efficient projects in public sector buildings such as preschools,

<sup>72</sup> European Network on Debt and Development, [History RePPeated II – Why Public-Private Partnerships are not the solution](#), *European Network on Debt and Development*, 5–6, 1 December 2022.

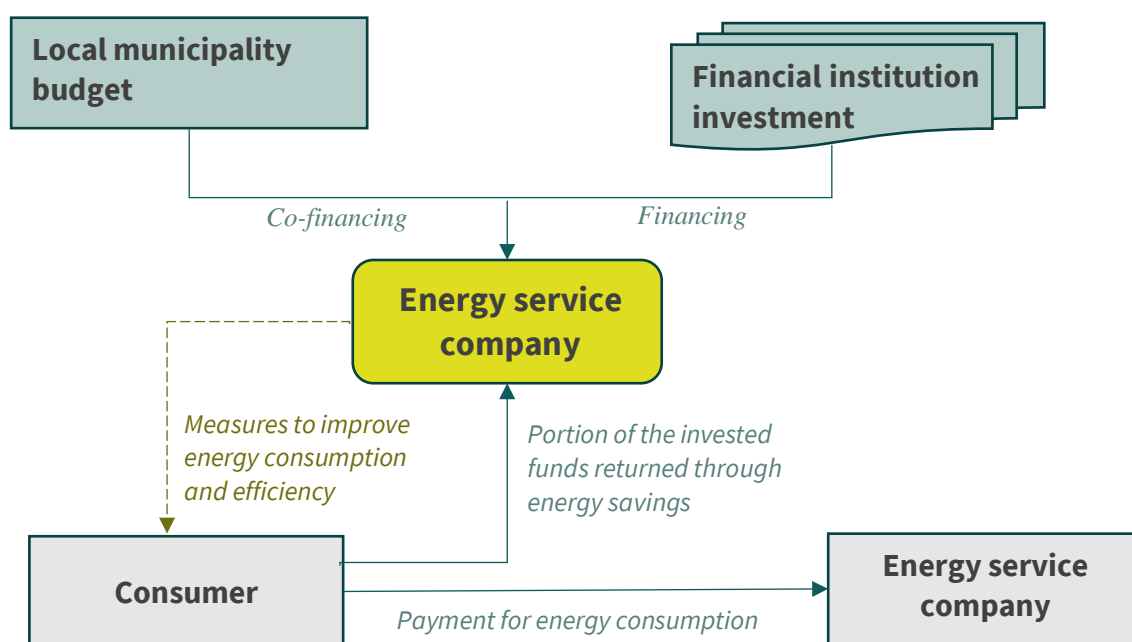
<sup>73</sup> Ministry of Economy of Ukraine, [Monitoring Of PPP Implementation In Ukraine](#), *Ministry of Economy of Ukraine*, 26 January 2023.

<sup>74</sup> Ministry of Economy of Ukraine, [Introduction to the Handbook on Public-Private Partnerships](#), *Ministry of Economy of Ukraine*, 21 July 2021.

schools, hospitals and universities. It also allows energy consumers to implement energy-saving measures without making any investments of their own, creating a win-win for all stakeholders.

This mechanism is open to all types of energy consumers, including households, homeowner associations, enterprises, state-financed organisations, and local authorities. The relationship between the energy consumer and the energy service company is governed by an energy service contract. The energy service company uses its own funds to carry out energy efficiency improvements, and the consumer repays the investments made by the company with a specified profit during the term of the contract. The savings in energy consumption make it possible for the consumer to pay back the investment within the agreed time frame.

In Ukraine, municipalities can hire energy service companies to deliver energy-efficient services through Prozorro, the country's online procurement platform. This procurement process follows an open tender procedure, where all eligible energy service companies can compete regardless of the proposed cost. Unlike traditional procurement where the lowest price wins, energy-as-a-service contracts are awarded to the energy service company offering the highest energy-as-a-service contract value, factoring in the greatest potential for energy savings over the lifetime of the project.<sup>75</sup>



**Figure 7.** The energy-as-a-service model.<sup>76</sup>

However, there are risks for municipalities seeking to hire energy-as-a-service providers. These include potential technical faults associated with the operation of the equipment installed or the work performed, errors in calculating estimated savings, or potential issues with the competence, qualifications or license of the energy service company contracted to deliver the services. Municipalities must also be aware that the

<sup>75</sup> State Agency for Energy Efficiency and Energy Saving of Ukraine, [Eneprocepic](#), State Agency for Energy Efficiency and Energy Saving of Ukraine, 8 March 2024.

<sup>76</sup> Energy Community, [The mechanisms of financing energy efficiency projects in Ukraine](#), 24, Energy Community, March 2017.

economic effects of implementing the energy-efficient measures will only kick in after the contract expires, given that the funds saved are initially recouped by the energy service company as payment for the services provided.

### Affordable lending programme

In February 2020, the Ukrainian government established an affordable lending programme to support business development, offering loans at subsidised interest rates of 5, 7 and 9 per cent. On 14 March 2023, the Cabinet of Ministers passed Resolution No. 229,77 which granted eligibility to the municipal sector to avail of financing under the affordable lending programme. Up until this point, only small private enterprises had been eligible for loans, excluding municipal institutions such as hospitals and other public facilities. However, the new resolution allows these institutions to apply for loans and provides communities with greater opportunities to avail of low-interest loans for energy-efficient measures.

Ukrainian banks offer a straightforward mechanism for submitting loan applications. The programme is available to all municipal enterprises and communities in Ukraine, giving them much needed access to funds for green development. The increased scope of the programme represents a significant breakthrough in addressing the urgent issues of communities, helping them to become more capable and sustainable.

### Conclusions

Amidst the challenges of war, Ukraine's national reconstruction policy is taking shape in a distinctly chaotic manner. This poses a risk that the legal frameworks underpinning the policy will be undermined by conflicting regulations. For example, laws such as the one requiring SFRD projects to be put to a public vote have been passed, only to remain unenforced.

Currently, the government's centralised approach to decision-making and the allocation of resources is creating a gap between reconstruction efforts and the communities directly affected. This is further complicated by the reduced funding allocated to the Ministry for Restoration and the State Agency for Reconstruction in the draft state budget for 2024, which is all the more surprising given that both state bodies were specifically established to steer Ukraine's reconstruction policy. Competition between the Ministry for Restoration and the Ministry of Economy, especially on the allocation of state budget resources, has added to the overall confusion.

The Law on the Principles of State Regional Policy has introduced four new territory classifications: restoration areas, regional growth poles, territories with specific development conditions, and sustainable development territories. Efforts are now underway to identify communities that qualify as restoration areas. These designated communities will be prioritised for restoration project funding.

While other territories can potentially seek state funding through mechanisms like the SFRD and the EEF, Ukraine is struggling to establish cohesive procedures for utilising state funds. This includes defining how they are formed, financed and implemented. Denying these well-functioning funds a place in the state

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<sup>77</sup> Verkhovna Rada of Ukraine, [Про внесення змін до деяких постанов Кабінету Міністрів України щодо надання фінансової державної підтримки суб'єктам підприємництва](#), Verkhovna Rada of Ukraine, 14 March 2023.



budget can be partly explained by the politicisation of the SFRD and the red tape associated with the EEF. However, the complete absence of an expenditure line for the FLCAA is baffling.

Ukraine's medium-term budget priorities for 2024 focus on reconstruction efforts in war-torn regions. This includes the restoration of critical infrastructure, social services, residential areas, and public facilities. However, there are some notable changes to how the reconstruction will be funded in 2024. The FLCAA will now be managed as a special fund within the state budget. In addition, the government has begun preparations for establishing another fund, tentatively called the National Reconstruction Fund, which will serve as a permanent source of financial aid supported by the state budget's reserve fund.

Overall, amendments to the Budget Code have been positive for the municipal sector, as they enable village and town councils to attract credit resources and gain access to the state's affordable lending programme.

## Recommendations

1. To be effective, Ukraine's national recovery policy must be guided by the core principles of state regional policy. In particular, it should:
  - differentiate between regions based on similarities and divergences in their economic, social and resource structure, as well as key development constraints;
  - coordinate efforts using top-down and bottom-up approaches to identify regional potential that informs the design of project and policy initiatives; and
  - adopt an integrated multidimensional approach to development interventions in the regions, as opposed to relying on poorly coordinated sectoral approaches.
2. The formation of a balanced and systematic legal framework for addressing recovery and restoration issues requires expert domestic and international support. Every effort should be made to ensure the risk of politicisation is minimised. **Existing laws and by-laws should be unified to eliminate contradictions.**
3. **The government should clearly define one ministry responsible for reconstruction, give it the authority to formulate policy, and support it with adequate resources from the state budget.**
4. National authorities should improve communication and participation between the central executive power and community representatives in the context of preparing strategies and providing methodological resources.
5. There are certain risks to replacing the concept of public participation with the concept of digitalisation. Alive communication with citizens will have a greater cumulative effect on the positive perception and further implementation of the recovery policy. It is advisable to qualitatively develop public participation procedures for the DREAM to ensure they are efficient and fit for purpose.
6. The government should proactively support measures that provide municipalities with improved access to financial resources to fund their reconstruction efforts. Simply proclaiming communities as the leaders of the reconstruction process is nothing but lip service. There is an unmet need to

develop and adopt a clear strategy for the recovery of Ukraine. A proliferation of funds that are not subject to transparent and equitable state budget financing should be avoided at all costs.

7. The procedure adopted by the SFRD for selecting winning projects needs to be reformed. To ensure greater transparency and fairness in project selection, tender committees should consist of experts and representatives of civil society as well as international partners. To avoid any potential bias from committee members, especially officials and deputies with ties to specific communities, it is worth considering coding and depersonalising projects before submitting them for consideration to the tender committee.
8. Currently, the EEF relies heavily on the financial capacity of international partners and the enthusiasm of municipalities. The introduction of the VidnovyDIM programme is a good example of how the EEF has adapted to meet the reconstruction needs of municipalities. To incentivise communities even more, municipal projects under the EEF should be co-financed from the state budget.
9. Revolving funds are promising financial instruments for supporting energy efficiency and recovery projects in municipalities. The Ministry for Restoration, in close participation with experts and technical support partners, should develop a detailed methodology for using revolving funds and promote it among communities.
10. The process of establishing public–private partnerships is a complex one that demands proper legislative regulation to make sure it promotes sustainable and inclusive development. The risks of losing state or municipal property during the formation of these partnerships must be minimised. Additionally, economic risks should not be transferred to businesses, as this could create an imbalance that may hinder the success of these partnerships.