Document of

The World Bank

FOR OFFICIAL USE ONLY

Report No: PGD321

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF EUR 300 MILLION
(US$349.5 MILLION EQUIVALENT)

TO

UKRAINE

FOR THE

SECOND ECONOMIC RECOVERY DEVELOPMENT POLICY LOAN

NOVEMBER 21, 2021

Macroeconomics, Trade And Investment Global Practice
Europe And Central Asia Region

UKRAINE

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of October 31, 2021)

Currency Unit: Ukrainian Hryvnia (UAH)

US$1.00 = UAH 26.32

ABBREVIATIONS AND ACRONYMS

CA	Current Account	MTEF	Medium-Term Expenditure Framework
CPF	Country Partnership Framework	NABU	National Anti-Corruption Bureau
DPL	Development Policy Lending	NACP	National Agency for Corruption Prevention
DSA	Debt Sustainability Analysis	NBFI	Non-Bank Financial Institutions
ECA	Europe and Central Asia	NBU	National Bank of Ukraine
EU	European Union	NDC	Nationally Determined Contribution
EBRD	European Bank for Reconstruction and Development	NPL	Non-Performing Loans
FDI	Foreign Direct Investment	MOF	Ministry of Finance
FX	Foreign Exchange	PCG	Partial Credit Guarantee
GDP	Gross Domestic Product	SAPO	Special Anti-Corruption Prosecutor Office
GRID	Green, Inclusive and Resilient Development	SDR	Special Drawing Rights
HACC	High Anti-Corruption Court	SCD	Systematic Country Diagnostic
IBRD	International Bank for Reconstruction and Development	SOB	State-owned Banks
IFC	International Finance Corporation	SOE	State-owned Enterprises
IMF	International Monetary Fund	WB	World Bank
LDP	Letter of Development Policy	WBG	World Bank Group

Regional Vice President:	Anna Bjerde
Country Director:	Arup Banerji
Regional Director:	Lalita M. Moorty
Practice Manager:	Jasmin Chakeri
Task Team Leaders:	Karlis Smits, Tehmina Shaukat Khan

UKRAINE

SECOND ECONOMIC RECOVERY DEVELOPMENT POLICY LOAN

TABLE OF CONTENTS

The Loan was prepared by an IBRD team consisting of Klaus W. Deininger, Tom Bundervoet, Johanna Jaeger, Yevhen Hrebeniuk, Irina Babich, Natalia Konovalenko, Oleksiy Sluchinskyy, Caryn Bredenkamp, Baher El-Hifnawi, Dejan Ostojic, David Bernstein, Laura Pop, Larysa Khaletska, Anastasia Golovach, Sergiy Zorya, Maryna Sidarenka, Sasa Eichberger, Warren Paul Mayes, Madhavi Pillai, Maya Abi Karam, Oksana Rakovych, Karlis Smits and Tehmina Shaukat Khan. The team benefited from guidance from Jasmin Chakeri (Practice Manager, EECM2), Lalita M. Moorty (Regional Director, EECDR), Arup Banerji (Country Director, ECCEE). The peer reviewers were Ruslan Piontkivsky, Wael Zakout, and Alexander Pankov.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P177931	Yes	2nd in a series of 2

Proposed Development Objective(s)

The proposed program development objectives are to: (i) foster de-monopolization and anticorruption institutions; (ii) strengthen land and credit markets; and (iii) bolster the social safety net.

Organizations

Borrower:	UKRAINE
Implementing Agency:	MINISTRY OF FINANCE

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**349.50**

DETAILS

International Bank for Reconstruction and Development (IBRD)	349.50

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results

Indicator Name	Baseline	Target
Results Indicator #1: The share of gas transit revenues flowing in a transparent manner from Naftogaz to the new independent Gas TSO, based on the tariff set by the NEURC.	Baseline (2019): 0 percent	Target (2022): 100 percent
Results Indicator #2: Number of port concession projects signed with private investment mobilized through project financing by lenders.	Baseline (2019): 0	Target (2021): 2
Results Indicator #3: Number of voyages by ships (including cargo) on Dnipro River increases by about 20 percent.	Baseline (2019): 11,938	Target (2021): 14,300
Results Indicator #4: Number of full verifications of high-risk declarations selected using prioritization criteria, assigned automatically to staff, and implemented using an improved methodology.	Baseline (2019): 0	Target (2022): 1,500
Results Indicator #5: Area of agricultural land previously under moratorium sold/purchased by eligible individuals.	Baseline (2019): 0 hectares	Target (2022): 150,000 hectares
Results Indicator #6: Loans are issued to small farmers and backed by Partial Credit Guarantee (PCG) facility.	Baseline (2019): No	Target (2022): Yes
Results Indicator #7: Gross Pre-2020 NPL Portfolio of State-Owned Banks.	Baseline (2019): UAH 397 billion	Target (2021): Under UAH 300 billion
Results Indicator #8: NBU and NSSMC adopt action plan on reshuffling supervisory regimes for insurance, credit unions, pension funds, and other NBFIs.	Baseline (2019): No	Target (2021): Yes
Results Indicator #9: Pension benefits increase in line with the indexation formula within the first half of each calendar year, allowing adequate support for pensioners, of which at least 65 percent are women.	Baseline (2019): No	Target (2022): Yes

IBRD PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY LOAN TO UKRAINE

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed Second Economic Recovery Development Policy Loan (DPL) supports reforms to ease impediments to Ukraine's long-term growth, against the backdrop of the COVID-19 pandemic.** The operation, for EUR 300 million (US$349.5 million equivalent), is the second in a series of two. Aimed at easing key impediments to investment, productivity, and growth,[1] the use of a programmatic series accommodates the considerable additional technical assistance and dialogue needed on critical pending actions related to: (i) the transparent and inclusive functioning of land markets when they eventually opened; and (ii) financing for small and medium farmers to access the land market, and to support policies to cushion the impact of the COVID-19 shock on the poor. The first DPL (DPL-1), for US$ 350 million, was approved by the World Bank's Board of Executive Directors in June 2020 in recognition of the passage of landmark agricultural land reforms (albeit with complementary land-related legislation still pending), as well as the historic unbundling of the gas sector and further progress on banking and anticorruption reforms. However, DPL-1 was declared effective only in June 2021. The delay was necessary to allow authorities to adequately address the Constitutional Court decision that affected the fulfillment of the key anticorruption prior action in DPL-1. The delay, in turn, provided an opportunity to strengthen and to deepen the reforms under DPL-2, including actions to foster de-monopolization and to weaken powerful vested interests – a root cause of Ukraine's inability to achieve and sustain inclusive economic growth. The key focus of this operation is to support the remaining actions necessary to realize one of the most transformative reforms Ukraine has undertaken – the historic opening of the land market on July 1, 2021. This reform is providing an opportunity to unlock a major source of growth, to increase living standards by allowing landowners to get a fair return on their most valuable asset, and given Ukraine's position as a major commodities exporter, to strengthen food security globally.

2. **Even before the COVID-19 shock, Ukraine faced structurally weak growth and high levels of economic vulnerability; the pandemic has further compounded these challenges**. Macro-financial reforms adopted after the 2014/15 crisis have served Ukraine well, anchoring macro stability during the COVID-19 shock. Still, even before the pandemic struck, GDP struggled to grow by more than 3 percent per year on average between 2016-19 due to low levels of domestic savings and fixed investment, an anti-competitive environment, and weak institutions and rule of law. Economic vulnerability, although improved since 2015, remained high, with one in five people living below the national poverty line.[2] With the onset of COVID-19, the economy shrank by 4 percent in 2020. Real household disposable incomes withstood the shock remarkably well, growing by 2.6 percent due to COVID-19 support measures including higher minimum wages, pension top-ups and targeted social protection responses. Income growth however did not translate into declining poverty rates, suggesting that the poorest Ukrainians bore the brunt of the pandemic's economic fallout. A slow recovery in labor markets since 2017 was upended, with the unemployment rate reaching 10.5 percent in Q1 2021. The pandemic's health impact on Ukraine has also been among the worst in the Europe and Central Asia (ECA) region,[3]

[1] These impediments were identified in the World Bank (2019) *Ukraine Growth Study: Faster, Lasting and Kinder*; and World Bank (2021) *Systematic Country Diagnostic Update: Pathways to Resilience, Sustainability and Inclusion.*

[2] Measured by the actual Subsistence Minimum. This amounted to UAH3,661 per adult per month in 2019, which translates to US$14.5 per day in 2011 Purchasing Power Parities (PPP). In 2015, one in two people lived below the poverty line.

[3] There have been some 3.4 million reported COVID-19 cases and estimated 82,000 deaths as of November 15, 2021.

and the country is currently experiencing a third wave. The fiscal response to the crisis, together with the GDP contraction, contributed to a general government budget deficit of 6 percent in 2020 (versus a pre-pandemic projection of 2.1 percent); public and publicly guaranteed debt ratios that had been declining since 2017 reversed course and rose to 60.8 percent in 2020 –10 percentage points higher than in 2019.

3. **The Government has sought to advance structural reforms to deliver higher, sustainable, and inclusive growth over the medium term, while mitigating the impacts of the COVID-19 shock.** President Zelenskyy's government set ambitious, aspirational goals laid out in the 2019-24 Action Program including 5-7 percent annual GDP growth over five years; lifting foreign direct investment (FDI); the development of infrastructure; the creation of 1 million new jobs; and significant poverty reduction. Key priorities included, among others, establishing land markets, de-monopolization and strengthening institutions of anticorruption and rule of law. Reform progress slowed during 2020, with the Government pivoting towards COVID-19 relief for households and firms. However, as a nascent recovery has taken hold, progress was made during 2021 on policy and institutional reforms, including: opening of land markets and adoption of land safeguard legislation; initiation of long-awaited judicial reforms; and passage of legislation strengthening the institutional independence of the National Anti-Corruption Bureau (NABU, a key anticorruption agency). With Ukraine facing significant environmental[4] and climate change challenges (related to vulnerability to both physical impacts of climate change, and mitigation potential given its carbon intensive economy) that impose an additional burden on growth and health, the Government also affirmed its commitment to the European Green Deal and updated its Nationally Determined Contribution (NDC) in 2021.

4. **The proposed operation is structured around three pillars aimed at supporting the Government in building a stronger, inclusive recovery, while protecting the vulnerable from the effects of the COVID-19 shock.** It is aligned with the World Bank Group's (WBG) COVID-19 Crisis Response Approach Paper, the current County Partnership Framework (CPF) (Report # 114516-UA discussed at the Board on June 20, 2017) and is consistent with the WBG framework for Green, Resilient, and Inclusive Development (GRID). In particular:

- ***Pillar 1 fosters de-monopolization and anticorruption institutions***. Reforms supported clarify the regulatory framework for the extensive, but under-utilized, inland waterways in Ukraine that are dominated by a single, private sector player. By providing non-discriminatory access to inland waterways to both local and foreign vessels, supported measures promote competition and facilitate much-needed private investment to modernize and expand river transport with potentially significant growth, productivity, and environmental/climate spillovers. The reforms facilitate the logistics infrastructure for agricultural exports and greater connectivity to the EU; they build on actions supported in DPL-1 aimed at attracting private investment in critical infrastructure through the reform of the legal framework for concessions.

- ***Pillar 2 strengthens land and credit markets.*** The establishment of the partial credit guarantee fund is an essential reform that is needed to ensure rapid provision of loans to small and medium sized farmers on affordable terms, thus supporting an inclusive recovery, especially for smaller

[4] The WHO ranks health/mortality impacts related to air pollution in Ukraine as among the worst in the ECA region.

credit-constrained producers that have long been under-served by the financial sector. Increased transparency in transactions, streamlined land transfer procedures, and strengthened land governance are fundamental reforms needed to support the transparent and efficient functioning of land markets, and to strengthen security of land tenure and incentives for productivity-enhancing investments in higher value-added agriculture. By preventing monopolization in land markets and addressing major sources of weak governance in land management and land-related corruption, measures supported under Pillar 2 also contribute to Pillar 1. Specifically, given that the effectiveness of public institutions charged with prevention of corruption and theft of public wealth continue to be undermined by vested interests, this pillar supports important safeguards to fair and transparent opening of the land market to ensure that Ukraine's unique natural resource agriculture land benefits all of its citizens, not just a select few.

- ***Pillar 3 bolsters the social safety net.*** During 2020, as part of crisis response measures, the Government scaled up overall social spending as part of efforts to strengthen the broader social safety net through two World Bank additional financing projects.[5] Households headed by a pensioner account for half the poor; the elderly are a particularly vulnerable group following the COVID-19 shocks due to significant health and income impacts. With pensions a key source of income for elderly households, measures in DPL-2 build on DPL-1 to increase pension benefits during the COVID crisis, by supporting the adoption of rules-based, transparent indexation of pension benefits.

5. **Coordinated support from development partners has been critical in advancing reforms supported by this DPL series, helping to sustain momentum in critical areas and preserving gains in others.** This proposed DPL-2 builds on actions supported in DPL-1 as well as longer-running reforms in land, credit markets, anticorruption and pensions supported in the 2018 Development Policy Financing operation that sought to address the structural underpinnings of the weak growth recovery and fiscal vulnerabilities. The adoption of the landmark land turnover law in 2020 (supported by DPL-1) paved the way for the opening of the agricultural land market on July 1, 2021, a development which few saw as possible as late as 2017. The adoption of complementary safeguard legislation, although critical to ensure efficient and transparent functioning of land markets, has taken longer than expected and required the support of a coordinated coalition of reformers in government, civil society, and international development partners to sustain momentum. This coalition has also helped advance reforms in other key areas (inland waterways) and safeguarded anticorruption reforms, most recently in early 2021 when it helped the authorities to restore the legal underpinnings of the asset declaration and verification system after several important legal acts (supported under prior actions of DPL-1) were found unconstitutional by the Constitutional Court in October 2020. Financing and technical support from the World Bank, in close coordination with the International Monetary Fund (IMF), the European Union (EU), the United States (US) Treasury, United States Agency for International Development (USAID), the United Kingdom (UK), Japan International Cooperation Agency (JICA), Swedish International Development Agency (SIDA) and other bilateral partners, has been central to these efforts.

[5] These include the US$150 million *Ukraine - Social Safety Nets Modernization Project: Additional Financing* in April 2020, which included US$ 50m for temporary social assistance support, followed by a *Second Additional Financing for COVID-19 Response under the Social Safety Nets Modernization Project* in December 2020 to strengthen Ukraine's Guaranteed Minimum Income Program (GMI) to prevent around 1 million Ukrainians from falling into poverty due to the COVID-19 pandemic.

6. **The macroeconomic policy framework is adequate for the proposed operation.** Monetary policy has remained consistent and prudent, with the National Bank of Ukraine (NBU) proactively tightening policy in response to rising inflation during 2021. Legislation adopted in October 2021, moreover, will further strengthen the independence and governance of the NBU. The economy has also shown greater resilience to the COVID-19 outbreak (a 7.8 percent contraction was initially anticipated in 2020), benefiting from macro-fiscal and banking reforms implemented since the 2014/15 crisis. The recently adopted medium-term budget declaration for 2022-24 sets out a path for gradual fiscal consolidation, and will reduce inflationary, and current account (CA) and financing pressures. Banking buffers are adequate, and system liquidity high. Ukraine has maintained market access throughout, with spreads tightening some 170 basis points over the past year. Favorable terms of trade and resilient remittances, averaging US$ 3 billion per quarter, have helped keep the CA close to balance. Reserves, already ample at nearly US$29.7 billion (3.9 months of imports) as of November 2021, have been supplemented by US$2.7 billion IMF SDR allocation. Finally, the staff-level agreement reached in October 2021 between the IMF and Ukraine on the first review of the 2020 Stand-By Arrangement (SBA) program is supportive of the external financing environment and an additional anchor for prudent macroeconomic policy.

7. **Still, the DPL series remains exposed to significant risks, highlighting the importance of sustained dialogue and engagement by IFIs and other stakeholders.** At 20.5 percent in mid-November 2021, Ukraine's rate of fully vaccinated population is among the lowest in the ECA region, which could affect the near-term economic recovery. Ukraine's reliance on external financing, and large debt service payments coming due leave it vulnerable to global financing and economic conditions. Additional macroeconomic risks come from growing medium-term fiscal spending pressures, reemerging quasi-fiscal deficits in the energy sector and contingent liabilities in the road sector. Political and governance risks are high due to still strong influence of vested interests, and unfinished reforms of anticorruption institutions, while further progress on judicial reform is critical to anchoring rule of law. A few key laws including ones supported by DPL-1 (e.g., the land turnover law) and other important laws (e.g., on Households Deposit Guarantee System) have been appealed to the Constitutional Court, and though deliberations are not currently under way, future Constitutional Court rulings could reverse reforms in these or other important areas. Despite reform, corporate governance at state-owned enterprises (SOEs) and banks (SOBs) needs to be further strengthened to reduce macro-fiscal risks, especially in the energy sector. SOEs and SOBs continue to be exposed to undue political influence, non-competitive practices in the selection of key management positions, and ineffective control and accountability mechanisms. The recent change of Naftogaz's management, and possible further changes in supervisory boards of the other SOEs and SOBs, may create uncertainty among investors and development partners. The emergence of significant quasi-fiscal deficits in the gas sector (relating to efforts to cushion households from a sizable global energy price shock), [6] which have been partially funded by a one-off transfer of resources from the independent Gas TSO to Naftogaz,[7] are indicative of structural challenges related to rules-based, transparent and predictable financing of public service obligations. These are

[6] In the previous heating season, the average utility bill amounted to over 23 percent of income for households in the bottom 40 percent of the income distribution; at current prices, the utility bill would account for the lion's share of household income.

[7] Following the unbundling of Naftogaz and establishment of certified GTSO, revenues for transit of Russian gas through Ukraine have been collected by GTSO in accordance with the new Gas Transit Agreement with Gazprom signed on December 30, 2019. Notwithstanding the repayment of transit revenues to Naftogaz in October (to cover the costs of higher priced gas imports during an unprecedented global energy price shock), the flow of transit revenues to GTSO was transparent in 2020 and 2021.

being addressed through ongoing dialogue, technical assistance and coordination with the World Bank, the IMF and other international partners. More generally, sustained engagement, monitoring and dialogue by a coalition of government reformers, development partners, and civil society has played a key role in mitigating potential economic, political and governance risks in the past and will continue to remain important.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

8. **Ukraine's economy has shown greater resilience to the COVID-19 outbreak than initially anticipated, benefiting from past macro-fiscal reforms**. Ukraine entered the COVID-19 crisis with sufficient buffers due to the prudent macroeconomic policy mix in 2019 and reforms implemented following the 2014-15 crisis. A 7.8 percent GDP decline was anticipated in the DPL-1 framework, with the economy contracting by (an albeit still sizable) 4 percent in 2020. However, a gradual labor market recovery since 2017 was halted, with employment declining by over a million between Q12020- Q12021, and the unemployment rate hitting 10.5 percent in Q1 2021—higher than in the 2014/15 crisis. Economic vulnerability, already significant before the pandemic, marginally inched up in 2020 with 23.2 percent of people living below the national poverty line.[8] Activity began to rebound towards the end of 2020, but the recovery quickly lost momentum in H1 2021, with the economy slipping back into a mild recession, [9] in part due to a second wave of infections and reintroduction of quarantine restrictions. More recent incoming high-frequency retail and industrial production indicators point to strengthening domestic demand while the unemployment rate inched down to 9.9 percent in Q2. Adaptive quarantines were extended till end 2021, amid a third surge in infections beginning September.

9. **COVID-response measures adopted by the Government have been somewhat effective in cushioning the poor from the shock, but also contributed to inflation pressures**. Inflation accelerated from 2.6 percent in October 2020 to 10.9 percent in October 2021, more than double the inflation target of 5 percent. Base effects, food inflation, and utilities adjustments have been major drivers but expansionary wage policies, notably a 25.5 percent increase in minimum wages (as part of COVID-19 relief measures) also played a role, reflected in rising core inflation and inflation expectations. Despite a change in leadership of NBU in June 2020, which led to concerns about the continued independence of the central bank in fighting inflation, monetary policy has remained prudent. The central bank proactively tightened policy rates (by 250 basis points since March 2021, although with the policy rate currently standing at 8.5 percent, real rates are still negative). The termination of anti-crisis monetary tools in October 2021 by the NBU, and mild appreciation of the Hryvnia should also tighten monetary conditions somewhat.

10. **Fiscal revenues have performed better than anticipated, but medium-term spending pressures are increasing, and fiscal space remains limited**. Trade and income tax revenues outperformed in 2020 and H1 2021, helped by favorable terms of trade and rising wages. On the expenditure side, almost 2

[8] Measured by the Actual Subsistence Minimum. This amounted to UAH3,661 per adult per month in 2019, which translates to US$14.5 per day in 2011 Purchasing Power Parities (PPP). In 2015, one in two people lived below the poverty line.
[9] GDP contracted for two successive quarters, but due to base effects related to the COVID-19 contraction in 2020, expanded by 5.7 percent on a year-on-year basis in Q2.

percent of GDP of COVID-19 related expenditures (including medical procurement, higher wages to health workers, and pension top-ups) were added to the budget in 2020, with the general government fiscal deficit amounting to 6.0 percent of GDP (versus a pre-pandemic projection of 2.1 percent). In 2021, with the added fiscal burden from fixed household gas tariffs (amidst steep increases in international gas prices), the deficit is expected to remain elevated at 5 percent. The composition of public expenditure remains suboptimal related to high levels of current expenditure: due to past increases in minimum wages, public wages cost over 10 percent of GDP, while categorical social benefits introduced during the COVID crisis have pushed social expenditures above 16 percent of GDP, increasing budget rigidities. In late October, the Parliament approved the first reading of the draft 2022 Budget which targets a deficit of 3.5 percent, with 70 percent financed through domestic debt issuance.

Table 1: Key Economic Indicators

	2017	2018	2019	2020	2021p	2022p	2023p	2024p
Nominal GDP, UAH *billion*	2,981	3,560	3,977	4,192	5,067	5,599	6,086	6,621
GDP per capita, US$	2,644	2,967	3,655	3,702	4,308	4,937	5,367	5,839
Unemployment Rate (ILO defn), *percent*	9.5	8.8	8.2	9.5	8.8	8.5	8.2	8.2
Real GDP, *percent change*	2.4	3.5	3.2	-4.0	3.4	3.2	3.5	3.8
Consumption, *percent change*	8.4	7.1	5.3	0.5	4.2	3.4	2.9	2.2
Investment, *percent change*	16.1	16.6	11.7	-24.4	9.7	8.1	7.7	9.6
Exports, *percent change*	3.9	-1.4	7.3	-5.6	3.4	2.0	4.4	5.0
Imports, *percent change*	12.9	2.8	5.7	-9.5	7.6	5.7	4.8	4.1
Monetary and External								
GDP deflator, *percent change*	22.1	15.4	8.2	9.8	17.5	7.3	5.2	5.0
CPI (eop), *percent change*	13.7	9.8	4.1	5.0	9.5	6.0	5.0	4.0
Current Account Balance, *percent GDP*	-3.1	-5.1	-2.7	3.4	0.8	0.0	-0.6	-1.2
Exports of G&S, *percent GDP*	48.1	47.3	41.3	39.0	39.6	37.5	36.9	36.3
Imports of G&S, *percent GDP*	55.9	56.3	49.4	40.6	41.7	40.8	40.5	40.2
Foreign Direct Investment, *percent GDP*	3.3	3.6	3.4	-0.1	0.6	1.0	1.3	1.6
External Debt, *percent GDP*	103.0	91.6	79.1	80.8	69.1	63.2	57.4	52.1
Fiscal								
Revenues, *percent GDP*	38.4	40.0	39.7	41.0	41.0	40.6	40.7	40.3
Expenditures, *percent GDP*	41.6	42.0	41.8	47.0	45.0	45.1	43.2	42.5
GG Fiscal Balance, *percent GDP*	-2.2	-2.0	-2.1	-6.0	-4.0	-3.5	-2.5	-2.2
GG Fiscal Bal. incl energy sector, *percent GDP*	-2.2	-2.0	-2.1	-6.0	-5.0	-4.5	-2.5	-2.2
PPG debt (eop), *percent GDP*	71.8	60.9	50.2	60.9	53.6	53.4	52.7	50.5

Source: Ministry of Finance, National Bank of Ukraine, State Statistical Service of Ukraine, and World Bank staff estimates (which rely on average annual exchange rates to calculate key indicators).

11. **Ukraine successfully retained access to market financing despite volatility in global financial conditions; however, this is more costly than financing that was available through IFIs**. Fiscal financing needs were estimated at a sizable 14 percent of GDP for 2021 on account of large debt amortizations including Eurobond redemptions during the year. Although Ukraine has not received the full volume of IFI financing originally anticipated for 2020 and 2021, it has benefited from the supplemental IMF SDR allocation (US$2.7 billion). It covered large repayment needs by drawing on FX buffers and tapping

(relatively costly) external commercial borrowing several times (including US$2 billion in Eurobond issuances in 2021) despite a delay in completing the first review of the IMF program and a spike in geopolitical risks in Spring 2021. Domestic borrowings have helped to cover the remainder while approximately US$1.4 billion of the SDR allocation was also drawn on in September 2021 to cover a Eurobond repayment.

Table 2: Key Fiscal Indicators, percent of GDP

	2017	2018	2019	2020	2021p	2022p	2023p	2024p
Revenues	**39.3**	**40.0**	**39.7**	**41.0**	**41.0**	**40.6**	**40.7**	**40.3**
Tax revenues	**34.2**	**34.6**	**34.4**	**35.3**	**35.7**	**35.6**	**35.7**	**35.8**
Personal Income tax	6.2	6.5	7.0	7.2	7.4	7.3	7.4	7.4
Corporate profit tax	2.5	3.0	3.0	2.9	3.0	3.3	3.4	3.5
Payroll tax	6.2	6.9	7.1	7.3	7.6	7.7	7.7	7.8
Property tax	1.0	0.9	1.0	0.9	0.9	1.0	1.1	1.1
VAT	10.5	10.5	9.6	9.8	9.9	9.9	10.0	10.0
Excise tax	4.1	3.7	3.5	3.8	3.7	3.4	3.4	3.3
Taxes on international trade	0.8	0.8	1.0	0.7	0.8	0.8	0.7	0.7
Other taxes	2.9	2.4	2.3	2.6	2.4	2.2	2.0	2.0
Non-tax revenues	4.2	5.4	5.3	5.7	**5.3**	**5.0**	**5.0**	**4.5**
Expenditures	**41.5**	**42.0**	**41.8**	**47.0**	**45.0**	**45.1**	**43.2**	**42.5**
Current expenditures	38.1	37.8	37.7	42.9	41.0	41.1	38.2	37.0
Wages and compensation	10.6	11.0	11.0	11.0	10.5	11.0	10.8	10.5
Goods and services	6.7	6.7	7.1	9.4	8.2	7.0	6.2	6.0
Interest payments	3.7	3.3	3.2	3.0	3.5	3.8	3.6	3.3
Subsidies to corporations	1.5	1.5	1.2	3.3	2.3	3.0	1.5	1.5
Social benefits	15.5	15.2	15.3	16.2	16.5	16.3	16.1	15.7
Pensions	9.8	10.1	10.7	11.9	12.0	12.0	11.9	11.5
Unemployment, disability and accident insurance	0.8	0.9	1.0	1.1	1.2	1.2	1.2	1.2
Social programs	4.9	4.2	3.6	3.2	3.3	3.1	3.0	3.0
Other expenditures	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Capital expenditures	3.3	4.1	4.1	4.1	4.0	4.0	5.0	5.5
Primary Balance	1.6	1.3	1.1	-3.2	-0.5	-0.7	1.1	1.1
Gen. Govt Balance	-2.2	-2.0	-2.1	-6.0	-4.0	-4.5	-2.5	-2.2
Gen. Govt Bal. incl. Naftogaz	**-2.3**	**-2.0**	**-2.1**	**-6.0**	**-4.0**	**-4.5**	**-2.5**	**-2.2**
Bonds to cover arrears to private sector	0.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0
Bank Recap & DGF	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gen. Govnt Balance incl. arrears and recap. needs	**-5.2**	**-2.0**	**-2.1**	**-6.0**	**-5.0**	**-4.5**	**-2.5**	**-2.2**

Source: Ministry of Finance, National Bank of Ukraine, World Bank staff estimates.

12. Improvements in the terms of trade and a CA surplus have reduced external financing needs (Table 4). Favorable terms of trade, coupled with import compression (related to the economic contraction due to the pandemic), contributed to a CA surplus of 3.4 percent of GDP in 2020. The CA[10] remained positive in the first half of the year, due to strong services net exports, which helped offset significant payments of reinvested incomes and dividends; meanwhile higher global commodity prices contributed to 30 percent YoY growth in merchandise exports in H1 2021 that helped to offset the 27-percent recovery in imports. Remittances have also remained relatively resilient, reflected in a large surplus on the secondary incomes balance that reached US$3.4 billion in the first 9 months of the year, while FX reserves, already ample at nearly US$29.7 billion (about 3.9 months of imports), were further supplemented by the US$2.7 billion IMF SDR allocation in August 2021.

[10] On a 12-month rolling basis.

13. **Financial and banking sector stability has been maintained during the COVID-19 shock; although NPLs are still high, they have begun to decline**. Due to strengthened supervision and regulatory frameworks, all banks undergo related party diagnostics and are now continuously monitored for related lending, as well as subjected to annual asset quality reviews, with large banks subject to annual stress tests. Regulatory capital adequacy ratios remained high during the COVID shock and amounted to 22 percent in July 2021 (prudential minimum: 10 percent) with liquid asset ratios at 70 percent. A high share of legacy non-performing loans (NPLs) mostly held by state-owned banks (SOBs) impedes efficient financial intermediation to the private sector. However, after years of slow progress, recent regulatory reforms on NPL write-offs and the possibility to restructure debts with partial write-offs by SOBs (supported by DPL-1) has enabled a reduction in NPL ratios to 36.3 percent at end-July 2021 (from 48 percent a year earlier and relative to a peak of 58 percent in 2017). However, the government's tapping of liquidity in the domestic banking sector to meet its financing needs in recent years constrains credit flow to the private sector with a potential crowding out effect. Currently holdings of government securities represent close to 42 percent of net assets of SOBs in H1 2021, albeit slightly down from 48 percent at end-2020.

Table 3: Estimated Fiscal Financing Needs and Funding Sources in 2021-2022

	2021		2022	
	USDbn	% GDP	USDbn	% GDP
Fiscal financing needs				
Fiscal deficit (incl. arrears)	**9.1**	**5.0**	**9.3**	**4.5**
Debt repayments	**16.2**	**8.9**	**15.2**	**7.3**
UAH repayments	7.8	4.3	9.4	4.5
FX domestic repayments	4.6	2.6	3.1	1.5
FX external repayments	3.8	2.1	2.7	1.3
IMF from the budget	0.4	0.2	0.5	0.2
EU bilateral	0.2	0.1	0.2	0.1
Eurobonds	2.7	1.5	1.9	0.9
Other	0.6	0.3	0.1	0.0
Total financing needs	**25.3**	**14.0**	**24.5**	**11.8**
Sources of funding				
External funding	**7.3**	**4.0**	**7.2**	**3.5**
IMF to the budget	2.7	1.5	1.5	0.7
EU MFA	0.7	0.4	0.7	0.3
WB	0.7	0.4	0.5	0.2
Eurobonds and other commercial loans	3.1	1.7	4.5	2.2
Domestic funding	**18.2**	**10.0**	**17.5**	**8.4**
Bond financing (incl. PF borrowings)	16.1	8.9	17.2	8.3
Use of carryover funds	2.1	1.2	0.3	0.1
Total funding	**25.4**	**14.0**	**24.7**	**11.9**
MoF balance at the year end	*0.2*	*0.1*	*0.2*	*0.1*

Source: Ministry of Finance, National Bank of Ukraine, World Bank staff estimates. IMF disbursements in 2021 include drawdowns from SDRs allocated in August 2021, with approximately US$1.4bn of the SDR allocation utilized in September 2021.

14. **Ukraine has made progress on several important reform areas during 2021.** Amendments to

the banking law were passed that improve corporate governance in banks, strengthen capital structure and introduce capital buffers of banks bringing it in compliance with EU directives, introduce new models of consolidated banking supervision, enhance internal control and risk management systems, and strengthen licensing and de-licensing framework for banks and provide additional legal protections against reversal of regulator's decision to resolve banks. In line with reforms supported in DPL-1, authorities continued to strengthen supervision and regulations for the non-bank financial institutions (NBFI) and cleaning up the NBFI sector. Significant progress was made on several other important legislative initiatives, including one strengthening independence and governance at the NBU, which passed in October. A bill on restructuring of the Deposit Guarantee Fund debt to the Ministry of Finance and bringing Oshchadbank, one of the four systemically important SOBs, into deposit insurance scheme is awaiting a final vote in Parliament. Judicial reform, which was long overdue and critical for anchoring confidence in rule of law, was finally begun, with the adoption of two laws reforming judicial management bodies, laying the ground for comprehensive judicial reforms. Legislation adopted in October significantly strengthens the governance and independence of NABU; the law brings the regulations governing the NABU into line with the Ukrainian Constitution, defines NABU's status as an executive body and empowers the Cabinet of Ministers to appoint the NABU director while establishing strong guarantees of institutional independence.

15. **Even so, progress in other areas has been uneven.** Recent changes in the management of Naftogaz are indicative of pending challenges to corporate governance reforms at SOEs. The unbundling of Naftogaz and the gas Transmission System Operator (TSO) in January 2020 was a major reform achievement supported by DPL-1. However, following the severe global energy shock, in which European gas prices rose four-fold between May and October 2021, the government has sought to protect households. In order to finance the burden on Naftogaz, it opted in early October to transfer a portion of transit revenues from the TSO. Although sub-optimal, mitigating factors include the fact that the measures are: (i) temporary in nature; (ii) respond to an acute shock that households would have found difficult to bear, and which the Housing and Utility Subsidy (the main transfer program that helps mitigate energy affordability for poor households) would require adjustments in design and eligibility criteria to offset the impact on vulnerable households; (iii) being supported by additional technical assistance by international partners (including the World Bank) to address structural challenges in the energy sector related to financing of public service obligations, greater competition in the energy sector and hedging instruments.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

16. **Ukraine's economic recovery in 2021 is expected to be mild, given the slow pace of vaccine rollout, and weak growth in the first half of the year.** The GDP growth projection of 3.4 percent for 2021 is underpinned by positive base effects in agriculture and relative to last year's economic contraction. Agricultural output was a key drag during 2020, mainly due to poor weather conditions; a record harvest is anticipated in 2021/22,[11] which should support farm exports and partially offset the drag from a third surge in COVID infections in September that weighs on consumer spending. The DPL-1 framework had anticipated a relatively modest contraction in investment, and for economic growth in

[11] Per Ministry of Agriculture estimates, Ukraine is expected to harvest a record 80.3 million tons of grain this year, up from 65 million tons in 2020.

2022-23 to be underpinned by subsequent recovery in investment and net exports. The revised framework takes into account the 24 percent decline in investment in 2020 (versus the 5.7 percent drop initially projected), that drags on the economy's supply capacity.

17. **A slow recovery is anticipated over the medium term; this is conditioned on sustaining structural reforms that bolster investment, increased COVID-19 vaccine rollout and support capital deepening.** In addition to the reforms supported in this operation (land and credit markets, anticorruption, transport, de-monopolization and concession projects), the baseline assumes sustained reforms to roll back the footprint of the state in the economy (through privatization of SOEs and return of SOBs into private ownership) that enable a greater role for market forces in the economy; completion of financial and banking sector reforms that increase the flow of financing to firms; and improvements to corporate governance and judicial reforms that increase trust in rule of law and a level playing field, and thus help to improve investor confidence and support a gradual increase in FDI. Growth is expected to remain close to potential, at about 3.2 percent in 2022 (in part as tailwinds from improvements in Ukraine's terms of trade begin to fade, as harvests normalize and as monetary policy remains tight) before gradually rising to 3.8 percent in 2024 as reforms bear results, declining NPL ratios support a recovery in bank lending to firms, prudent macro-financial policies are adhered to, and the vaccine rollout accelerates. With the output gap nearly closed, and core inflation and inflation expectations elevated, monetary policy is expected to tighten further. This, coupled with a fading of base effects and supply shocks, is expected to help inflation gradually moderate towards the target rate in the second half of 2022.

18. **While external liquidity buffers remain sufficient, a significant share of fiscal financing needs will be met through external sources.** Fiscal financing needs are estimated at 14 percent of GDP in 2021 and 11.8 percent in 2022 (Table 3). The general government deficit is expected to remain elevated, in part because of quasi-deficits in the energy sector, while debt amortization is significant at about US$15-16 billion in 2021 and 2022, in part due to large external debt redemptions on Eurobonds and repayments to the IMF. A significant portion of financing needs is expected to be met through international financing, which for 2021 includes disbursements from multilateral organizations (EUR 600 million from EU already received in October, US$700 million anticipated from the IMF SBA program and World Bank DPL operations each). As was the case in 2020, just over two-thirds is expected to be covered by domestic borrowings. Banking sector liquidity, including local bank deposits held at the central bank, is sufficient but carries risks of potentially crowding out private investment if tapped excessively by the government to meet its fiscal financing needs. Thus far, US$1.4 billion of Ukraine's IMF SDR allocation of US$2.7 billion has been drawn on, with the remaining US$1.3 billion providing some buffer in case of higher budget needs or external financing shortfalls. External FX reserve buffers remain sufficient; in addition, the CA is expected to remain close to balance in 2022 before shifting into a small deficit in the medium term that should be sufficiently covered by a gradual improvement in FDI and portfolio inflows.

Table 4: Balance of Payments Financing Requirements and Sources (US$ billion)

	2019	2020	2021p	2022p	2023p	2024p
Financing requirements (US$ Bn)	**32.8**	**22.8**	**28.1**	**28.7**	**28.2**	**36.0**
Current account deficit	4.1	-5.3	-1.4	-0.1	1.4	2.9
Public redemptions (incl. IMF)	5.7	6.0	5.0	4.6	4.7	5.4
Govt redemptions	4.1	4.9	3.7	2.5	2.5	4.8
IMF repayment	***1.6***	***1.1***	***1.3***	***2.1***	***2.2***	***0.6***
LT private debt amortization (incl. portfolio)	5.4	8.5	9.2	6.8	7.4	11.3
ST private debt and trade credit	17.6	13.6	15.4	17.4	14.7	16.4
Financing Sources (US$ Bn)	**32.8**	**22.8**	**28.1**	**28.7**	**28.2**	**36.0**
FDI and portfolio investment	10.3	-0.9	1.0	2.0	3.0	5.0
Public borrowing (incl. IMF)	8.9	9.9	7.1	7.2	6.0	7.0
Govt borrowings (incl. domestic bonds held by foriegners)	8.9	7.8	4.4	5.7	4.5	5.5
IMF disbursement	***0.0***	***2.1***	***2.7***	***1.5***	***1.5***	***1.5***
LT private debt disbursement (incl. portfolio)	4.5	2.3	4.5	5.8	4.8	4.8
ST private debt disbursements	13.6	15.4	17.4	14.7	16.4	20.7
Drawdown in reserves	-4.5	-3.8	-1.9	-1.0	-2.0	-1.5

Source: Ukrainian authorities and World Bank estimates. Notes: Projections for 2021-2024 are based on the reform scenario (discussed in this section). IMF disbursements in 2021 include drawdowns from SDRs allocated in August 2021.

19. The Debt Sustainability Analysis (DSA) shows that public and external debt, although sustainable, are highly vulnerable to shocks, with risks exacerbated by a growing reliance on non-concessional financing. Public and publicly guaranteed debt increased to 60.9 percent of GDP in 2020 due to negative economic growth and Hryvnia depreciation. However, in 2021, public and publicly guaranteed debt is expected to go down to about 54 percent mainly due to strong growth in nominal GDP and 3 percent appreciation of the Hryvnia against the US dollar. Repayments on public external debt also resulted in the gross external debt ratio declining from 80.8[12] as of December 31, 2020 to 75.2 percent of GDP as of end of 2Q21. However, Ukraine remains vulnerable to external shocks as almost 64 percent of public and publicly guaranteed debt remains denominated in foreign currency, increasing vulnerability to currency depreciation in the context of a heavy external public debt service burden. Sovereign FX denominated debt amortizations (domestic and external) are relatively high, averaging US$ 6.0 billion in 2021-23, albeit down from US$ 7.0 billion in 2020. The composition of the public debt by maturity is also shifting over time, reflecting in a growing share of short-term debt issued by the government on the domestic market and purchased by domestic banks at usually higher costs compared to the long-term external debt.[13] The baseline DSA projections under the reform scenario are consistent with the overall macroeconomic framework, including: a gradual pick-up in growth; adherence to medium term fiscal deficit targets in 2023 and 2024; a stable exchange rate; and continued official financing inflows, along with a gradual recovery of FDI and portfolio investment.

[12] Estimated using average annual exchange rates.

[13] The share of short-term debt has increased from 0.7 percent in 2015 to 3.6 percent in 2020 and is expected to reach 4.3 percent by end of 2021 and remain around 5 percent over the next five years. However, there is also uncertainty over the capacity for the domestic banking sector to absorb higher government debt issuance over an extended period, despite its current ample liquidity.

- **Public Sector DSA:** In the baseline scenario which assumes sustained progress on reforms, including those supported by this series of operation (financial, land, de-monopolization, concessions and anticorruption reforms) that ease impediments to investment and support a gradual recovery in growth, public and publicly guaranteed (PPG) debt is projected to average at around 51.5 percent of GDP in 2021-2024 supported by GDP growth of 3-4 percent and a small primary surplus of the general government balance in 2023-24. Risks to the base case are substantial. Exchange rate risks are particularly critical given the large share of FX denominated debt (about 64 percent of total PPG debt). A real exchange rate shock could push the PPG debt level to over 70 percent of GDP in 2022-2023 (Figure 1), while a combined macro-fiscal shock would increase PPG debt to about 110 percent of GDP. Macroeconomic stability is thus critical to maintaining public debt sustainability.

- **External DSA:** In the baseline scenario with reforms, total external debt is projected to decline from 80.8 percent at the end of 2020 to about 60 percent in the medium term as reforms are implemented and FDI inflows pick up. As with public debt, the external debt trajectory is subject to high risks. The external debt adjustment path is also particularly sensitive to exchange rate shocks. A 30 percent real depreciation shock in 2022 would drive debt to about 104 percent of GDP. Lower GDP growth (by half a historical standard deviation or 2.5 percentage points due e.g. due to a sharp surge in COVID cases that warrants severe curbs on economic activity), and a non-interest current account shock (one percentage point above the baseline) would keep the external debt to GDP ratio above 60 percent in 2022-2023 (Figure 2).

Figure 1: Public and Publicly Guaranteed Debt
(percent of GDP)

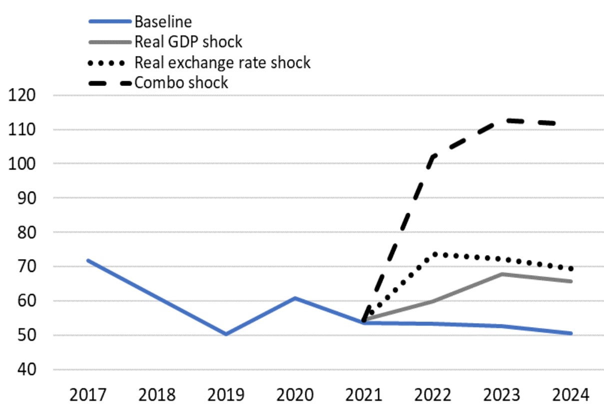
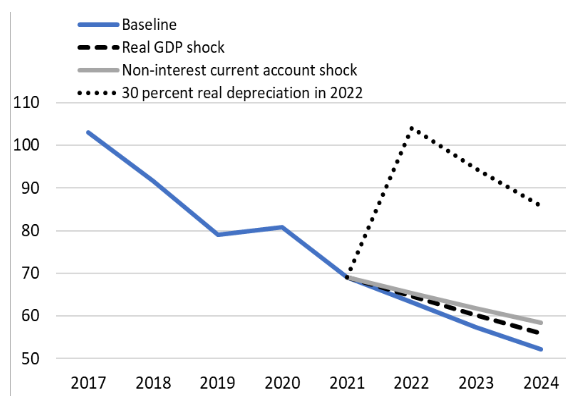


Figure 2: External Debt
(percent of GDP)



Source: World Bank staff estimates.
Note: Projections for 2021-2025 are based on the reform scenario.

20. **Still, macroeconomic risks remain substantial; unfinished reforms amid significant political and governance risks could also weigh on the economic recovery and investor confidence.** Ukraine is vulnerable to adverse shifts in global risk sentiment and economic conditions (e.g. due to monetary tightening in advanced economies, or a downshift in global commodity prices) given large financing

needs (including from external sources) and high costs of commercial borrowing.[14] Domestic risks include susceptibility to repeated COVID-19 infection surges which delay the recovery as well as fiscal risks from quasi-fiscal deficits in the energy sector, off-budget road sector spending, and from GDP-linked warrants issued without caps during the 2015 debt restructurings. Political and governance risks remain substantial due to still high influence of vested interests, unfinished reforms of anticorruption and judicial institutions, state-owned enterprises (SOEs) and banks (SOBs). The recent change of Naftogaz's management and possible further changes in supervisory boards of the other SOEs and SOBs, may create uncertainty among investors and developing partners. On the other hand, Ukraine has made progress in the establishment of the Ethics Council of the High Council of Justice, a critical reform. Macro-fiscal and external risks are partially mitigated by continued dialog and engagement to advance structural reforms to strengthen efficiency of public service delivery. Prudent fiscal policy is critical for reducing demand side pressures from building in a supply-constrained economy, and for safeguarding fiscal sustainability. Ukraine's parliament recently adopted the medium-term budget declaration for 2022-24, capping the 2022 budget deficit at 3.5 percent of GDP (declining to 2.7 percent in 2024) and was reflected in the 2022 draft budget approved in its first reading by Parliament in October. Deficit targets for 2022 are likely to be exceeded owing to temporary caps on household gas tariffs[15] amidst an unprecedented global energy price shock. Over the medium term, further pension reforms, improved targeting of social assistance (including housing utility subsidies), prudent wage policies, and close monitoring and management of fiscal risks, as well as revenue measures[16] are required to support a credible fiscal consolidation, rebuild buffers and reduce fiscal risks. Further progress on corporate governance of SOEs and SOBs, judicial and banking reforms, alongside cooperation with IFIs, will help to anchor confidence in global markets, support reform momentum and raise external financing on affordable terms.

21. **Despite risks, Ukraine's macroeconomic policy framework remains adequate for policy lending and the program remains on track.** The key pillars underpinning the adequacy of the macroeconomic framework include a commitment to implementing reforms supported by this proposed operation (land and credit markets, concessions and de-monopolization), continued adherence to prudent monetary policies and inflation targeting regime, as well as sustained progress on other critical reforms needed to support a recovery in investment (including judicial and corporate governance reforms, privatization, energy and banking). The resilience of the economy and banking sector to the COVID-19 outbreak is anchored by improvements in the macro-policy framework and banking reforms in recent years; Ukraine should continue to benefit from recent reforms to further strengthen the credibility and independence of monetary policy and the central bank, as well as ongoing banking sector reforms. Large external imbalances have been a major factor driving past crises; the CA remains close to balance, supported by strong growth in exports (especially in the second half of the year) and remittances. Large external liquidity buffers have been further augmented by the sizable IMF SDR allocations, and ongoing dialogue between the IMF and Ukraine and the staff-level agreement in October 2021 on an updated set of economic, financial, and structural policies to help address the economic and health crisis caused by COVID-19, while maintaining macroeconomic and financial stability, reducing vulnerabilities, and

[14] Spreads of 470 basis points on Ukraine's international issuances are among the highest in the ECA region, while yields average 11 percent on short term domestic debt.
[15] Tariffs were fixed for the duration of the heating season (ending April 2022).
[16] Law 5600 currently tabled in Parliament is expected to raise 0.5 percent of GDP in revenue administration and tax policy measures, if passed.

tackling key obstacles to private investment, should help anchor macroeconomic policies. Political and governance risks to reforms, although substantial, are mitigated by continued policy dialogue and sustained engagement with external partners and IFIs, and advocacy among Ukrainian civil society for the most critical reforms. The World Bank and IMF work closely to monitor macroeconomic developments and to support the design and implementation of key reforms.

2.3. IMF RELATIONS

22. **This proposed DPL is coordinated with the IMF, including in supporting the design and implementation of key reforms, and in monitoring the macroeconomic and fiscal program.** The IMF Board of Executive Directors approved an 18-month Stand-by Arrangement (SBA) for Ukraine in June 2020, with access equivalent to SDR 3.6 billion (about US$5 billion or 178.9 percent of quota), set to expire in December 2021. The new program aimed to help Ukraine to cope with COVID-19 pandemic challenges by providing support to cover balance of payments and budget needs, while safeguarding achievements to date and advancing key structural reforms, to support Ukraine's return to growth when the crisis ends. The first US$2.1 billion tranche was disbursed in June 2020; following considerable delays, a staff-level agreement with Ukraine on the first review of the SBA was reached in October 2021. Completion of the first review would enable disbursement of US$ 700 million; the authorities also requested an extension of the program to end-June 22. The program remains focused on: (i) returning fiscal policies to settings consistent with medium-term debt sustainability while protecting the socially vulnerable, strengthening revenue administration, and reducing fiscal risks from quasi-fiscal operations, including in the energy sector; (ii) safeguarding central bank independence and focusing monetary policy on returning inflation to its target; (iii) ensuring banks' financial health, including through good governance, with the goal of reviving sound bank lending to the private sector; (iv) tackling corruption and pushing forward with the implementation of judicial reform; and (v) reducing the role of the state and vested interests in the economy to improve the business environment, strengthen corporate governance, attract investment and raise the economy's potential. The IMF and World Bank have continued to coordinate in key areas, including financial sector, pensions, energy and anticorruption and judicial reforms.

3. GOVERNMENT PROGRAM

23. **After taking office in August 2019, the Government highlighted higher economic growth and poverty reduction as key priorities of its program.** The Government's Action Program for 2019-2024 set ambitious and aspirational goals, including: 5-7 percent annual GDP growth over the next five years; attracting US$50 billion in foreign direct investment (FDI); the development of infrastructure, the creation of 1 million new jobs, and significant poverty reduction and better public services for the population. Key priorities included: adopting safeguards to ensure transparent and effective functioning of agricultural land market, de-monopolization and further progress in strengthening rule of law and anticorruption institutions. It also targets further progress in the effectiveness and sustainability of social services, a significant reduction in market concentration in the 5 largest markets; development of an effective instrument for structural divestiture of monopolies; large-scale privatization of SOEs and strengthening the governance of the strategic SOEs, that will remain in state ownership.

24. **To respond to the COVID-19 pandemic in early 2020 and limit its social and economic impact, the new Government that took office in March 2020 launched a comprehensive relief and stimulus package**. On March 26, 2020, the parliament adopted the Law on COVID-19 responses, followed by the adoption of the 2020 Budget amendment. The introduction of the measures was swift, time-bound, and transparent. The measures aimed at dealing with the health emergency, while supporting household incomes and firms. The legislation provided for direct support to the health sector and introduced social and economic measures. The Government also updated its Reform Program, reiterating its efforts to strengthen incentives for private sector development in Ukraine including through increased exports to the EU, and increased financial resources for the farm sector, including family farms.

25. **In July 2021 the Government updated its Nationally Determined Contributions (NDCs), aiming to reduce its Greenhouse Gas emissions by 65 percent by 2030 from 1990 levels** (versus a previous commitment to reduce by 40 percent). Ukraine is also one of the few countries in the world to have submitted a Low Emissions Development Strategy (LEDS) in 2018, laying out the path for sustainable development up till 2050. The Presidential Decree of March 23, 2021[17] is further indicative of the increasing importance of climate change and decarbonization in the Government's agenda. Among decarbonization pathways indicated in the Updated NDCs, transport is a major sector. More broadly, meeting NDC targets and emissions reduction in Ukraine will require the implementation of structural sectoral reforms, as well as mobilization of significant volumes of investment to enable the transition to a low-emissions economy, while supporting sustainable economic growth. Per the Government, the necessary investments are conditional upon US$115 billion of finance, including from private investment. In this context, the proposed operation helps to ease major impediments to private investment in the river transport, which in turn will enable a shift to low-emission mode of transport; transparent land markets, strengthened state land management and increased access to finance for farmers can, meanwhile, support more sustainable management of agricultural land, including investments in sustainable practices such as irrigation, and crop rotation.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

26. **This is the second in a series of two DPL operations: its design supports the advancement of critical, pending legislative reforms relating to the transparent and inclusive functioning of land markets (including land financing).** The use of a programmatic series enabled sustained support for legislation critical for ensuring that land markets functioned efficiently and transparently when they eventually opened, and for ensuring access to credit for small farmers. The first DPL (DPL-1), for US$ 350 million, was approved by the World Bank's Board of Executive Directors in June 2020 in recognition of the passage of two key historic reforms – namely the lifting of the moratorium on land sales, which paved the way for the eventual opening of land markets in mid-2021 – and the unbundling of Naftogaz, as well as further progress on banking and anticorruption reforms. However, it was declared effective only in June 2021. The delay was necessary to allow authorities to adequately address a Constitutional Court decision that affected the fulfillment of the key anticorruption prior action in DPL-1. In turn, the

[17] https://zakon.rada.gov.ua/laws/show/n0018525-21/print

delay has provided the opportunity to strengthen and to deepen the design of DPL-2 to include an additional action that is consistent with the first objective of the series to foster de-monopolization and to weaken powerful vested interests – a root cause of Ukraine's inability to achieve and sustain inclusive economic growth. [18]

27. **The operation supports key structural reform priorities of the government for building a strong, inclusive recovery**. Although the economic crisis has been less severe than anticipated, as with previous downturns, the recovery remains slow and uneven, in part due to weak structural foundations for growth, particularly investment and productivity. To overcome these impediments, Ukraine needs to continue to address pervasive and widespread challenges related to systemic corruption, weak institutions and rule of law that weigh on investor confidence and impede growth and investment. An anticompetitive environment and regulatory weaknesses distort key markets, help entrench incumbents (by preventing entry and contestability), impede investment and weigh on economy-wide productivity and competitiveness. The historic opening of the land market on July 1, 2021 gives small and medium-sized farmers in Ukraine a new type of asset - land. Yet, agriculture's potential for driving growth and jobs remains unfulfilled by structural bottlenecks**,** including well-functioning land markets, limited access to credit by Ukraine's four million small family farms, and major land governance challenges as well as logistics and transport bottlenecks. At the same time, economic and social vulnerability has been heightened by the COVID-19 shock: Ukraine is currently experiencing a third surge, the share of the population that is fully vaccinated remains low, and the elderly remain particularly vulnerable both to the health shock and to income volatility.

28. **The proposed operation aims to ease impediments to investment and productivity and mitigate the impact of the COVID-19 shock on vulnerable households**. In this context, it is aligned with the World Bank's GRID framework, by mitigating the impact of COVID on the most vulnerable, while promoting a more inclusive, resilient, and sustainable recovery. It: (i) fosters de-monopolization and anticorruption institutions (Pillar 1), through inland waterways reforms, which support a shift to a more environmentally friendly and sustainable modes of transport; (ii) strengthens land and credit markets (Pillar 2) through the implementation of legislative safeguards enabling the transparent functioning of land markets, strengthened land governance (both also addressing land-related corruption) and financial inclusion of small farmers; and (iii) bolsters the social safety net (Pillar 3), through greater predictability on pension benefits for the vulnerable elderly population, which will also help to cushion the impact of the crisis on them The proposed operation complements the Ukraine Emergency COVID-19 Response and Vaccination Project to support efforts to vaccinate priority groups, specifically healthcare workers and the elderly, to strengthen COVID-19 testing and to improve infrastructure for vaccine storage and logistics. It supports the Government's priorities laid out in the 2019-24 Action Program, especially in relation to de-monopolization, anticorruption and land reforms, as well as the Updated Program in 2020, which identified increased financial resources for small farmers, trade integration with the EU, and support for pensioners as key priorities. Actions on inland waterways are also consistent with sustainable development pathways identified in the 2018 LEDS that prioritize a shift to low carbon emissions modes of transport for cargo and people. Per EU estimates, negative externalities (climate emissions, air

[18] See Implementation Status and Results Report - Economic Recovery Development Policy Loan - P172597 - Sequence No : 01 (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/131461636140749388/Disclosable-Version-of-the-ISR-Economic-Recovery-Development-Policy-Loan-P172597-Sequence-No-01

pollutants, noise and accidents) associated with river transport amount to EUR 0.27/ton-km versus EUR 0.8 and EUR 2.01 for rail and road transport respectively.[19] The development of inland waterways also opens significant job-creating economic opportunities including access to new markets, and to diversify trade in goods and services (e.g. through the development of logistics zones along waterways),[20] saving costs as well as time while benefitting the environment.

29. Measures supported by this operation contribute to structural reforms in areas where the World Bank has had a long-running engagement with the Government of Ukraine. In Pillar 1, actions on regulatory reforms in inland waterways are directly linked to the World Bank Group's technical assistance in this area. This included the development of a Logistics Strategy and Action Plan for Ukraine in 2018, technical assistance for strengthening the ports' policy and regulatory frameworks, as well as assistance in developing PPPs in the port and inland waterway sector.[21] In Pillar 2, actions on land reforms stem from deep and extensive technical assistance, and close partnership with the Government to unlock the full potential of Ukraine's agricultural sector, including a DPL in 2018 and a Program-for-Results on Accelerating Private Investment in Agriculture approved in 2019. They are also linked to major financial and banking sector reforms supported by the World Bank in various TA and DPL operations over the past seven years to strengthen financial intermediation and improve credit allocation to the most productive parts of the economy. By preventing monopolization in land markets and addressing major sources of weak governance in land management and land-related corruption, measures supported in Pillar 2 also contribute to Pillar 1. Pillar 3 reforms to enhance social safety nets build on pension reforms supported in the 2018 DPL operation.

30. Actions under all three pillars are expected to have neutral or positive poverty and social impacts and, in Pillar 1, align with climate change commitments. While actions in Pillar 1 are not expected to have short-term distributional effects, over the medium-term increased competition in the inland waterway sector is expected to lead to increased investment and job creation due to improved domestic and regional connectivity to markets. However, increased waterway freight traffic may have an impact on aquatic fauna, flora and water quality overall. This is recognized in the inland waterway law which stipulates mitigation in line with environmental regulations. Measures in Pillar 2 support increased opportunities for Ukraine's 4.6 million small farmers (60 percent of whom are women) to grow their incomes and productivity, including through improved land tenure and higher land prices, ability to use land assets as collateral and access to credit. At the same time, while the relevant land laws prohibit the change of activities that result in land use change for environmentally sensitive lands, there is a chance that the transfer of state land to communities may lead to the loss of environmentally sensitive lands due to conversion to other uses. Measures in Pillar 3 improve the predictability of pensions for a particularly vulnerable group: household survey data show that living in a household headed by a pensioner is a strong correlate of poverty in Ukraine – such households account for 30

[19] EU (2021). "EU assistance in the development of inland waterways." Presentation on May 26, 2021, by EU-funded Dnipro Transport Development project at roundtable conference "Ukraine on the Path to European Mobility: Synergy of Sustainable Development of rail and waterborne Transport" organized by Ministry of Infrastructure.

[20] Per EU (2021), "EU assistance in the development of inland waterways" presentation on May 26, 2021, by EU-funded Dnipro Transport Development project, a typical 40 Ha logistic zone in an inland port has the potential to develop 3,600 direct jobs and 7,200 additional indirect jobs, boosting the local economy as well as revenues.

[21] Lower Dniepr River Waterway and Port PPP (P161153). The IFC conducted a Global Infrastructure Facility (GIF) funded preliminary feasibility study for the Kherson port and Lower Dnipro waterway. See https://blogs.worldbank.org/ppps/ukraine-how-international-partnerships-are-contributing-development-transportation-infrastructure

percent of all households and 46 percent of all the poor. The proposed DPL aligns with the World Bank Group's and the Governments climate change commitments, insofar that actions under Pillars 1 (and indirectly in Pillar 2) support an environmentally sustainable recovery from the COVID-19 shock by encouraging a revitalization of low-emissions mode of transport, especially for bulk cargo, and by enabling farmers to undertake the necessary investments including in sustainable farming practices.

31. **Lessons learned in the implementation of previous development policy operations have been reflected in the design of this operation.** The experience of two earlier programmatic DPL operations in FY14 and FY16, and the standalone DPL operation in 2018 suggest that meaningful progress on structural reforms in a politically complex environment, with major governance challenges and pushback from vested interests, and very often a narrow window of opportunity requires: (i) sustained engagement and investment in dialogue with the Government, but also a multi-pronged approach to disempowering vested interests; (ii) advocacy, support and collaboration with development partners, a critical factor in forward movement; and (iii) technical knowledge and analytical assistance, given deep-rooted structural challenges and multi-year nature of reforms, and innovation to improve the palatability of reforms without compromising on outcomes. These lessons are reflected in the proposed operation, which is based on strong policy dialogue, engagement and sustained technical assistance, is closely coordinated with international partners, including the EU, USAID, JICA and IMF and curbs the power of vested interests and risks of corruption in key sectors of the economy (waterways and land). The proposed operation has been developed in close collaboration with the Government, reflecting a key lesson learned from other DPLs on the importance of country ownership and commitment to achieve the program's objectives.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

32. **Adjustments to the scope and timing of the Government's reform agenda and concerns regarding implementation led to the modification of some indicative Triggers foreseen in DPL-1, without a material impact on the strength of the program.** Overall policy reforms under the DPL-2 remained largely on track in relation to land safeguard legislation, for which indicative Triggers were transformed into Prior Actions, with only minor modifications with no material impact on the substance. In addition, the Program was strengthened by including a new policy action on inland waterways under Pillar 1,[22] which builds on actions in DPL-1 to increase private investment in critical infrastructure in the country. Concession reforms supported under DPL-1 enabled the signing of the first-ever public private partnerships (PPPs) in Ukraine for two major ports. The terms of the PPP agreements require a shift in in port cargo-transshipment towards water and rail-based modes. Supporting this shift, the policy action in DPL-2 on inland waterways deregulates the river transport sector and increases competition. The reform is also aligned with a "greener" recovery over the medium term. The modifications to the program are summarized in Table 4.

[22] This had Initially been a prior action at the time of preparation of DPL-1, but was excluded at appraisal owing to a heavy legislative agenda regarding banking, anticorruption and land reforms that was delaying timely passage of inland waterway reforms.

Table 5 Indicative Triggers from DPL-1 and Prior Actions for DPL-2

Indicative Trigger	**Prior Actions for DPL-2**	**Comments**
Pillar 1: Foster De-monopolization and Anticorruption Institutions		
	Prior Action 1**.** *The Borrower has enacted Law No. 1054-IX dated December 3, 2020 "On Inland Water Transport," and duly published in the Borrower's Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.*	New Prior Action, building on concession reforms in DPL-1 that increased private financing in port infrastructure.
Pillar 2: Strengthen Land and Credit Markets		
Trigger 1. Enact legislation to strengthen land management, streamline land transfer and registration procedures, and make emphyteusis rights transferable and mortgageable.	*Prior Action 2: The Borrower has enacted Law #1423-IX dated April 28, 2021 "On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations," and duly published in the Borrowers' Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land management, which streamlines procedures to create, transfer, and use land parcels; and transfer the ownership and administration of state land from the Geocadaster to local authorities.*	Reworded with no material change to the substance of the prior action.
Trigger 2: Enact legislation to introduce electronic auctions and restrict discretionary handouts of state land via free privatization.	*Prior Action 3: The Borrower has enacted Law #1444-IX dated May 18, 2021 "On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions" and duly published in the Borrowers' Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales.*	Reworded with minor modifications, with no material change to the substance of the prior action.
Trigger 3: Establish affordable and effective financing instruments for small farmers by: (i) enacting legislation to create a partial credit guarantee facility; and (ii) approving a Cabinet resolution to improve the targeting of agricultural subsidies.	*Prior Action 4: The Borrower has enacted Law #1865-IX dated November 4, 2021 "On the Fund for the Partial Guarantee of Loans in Agriculture" and duly published in the Borrowers' Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.*	Reworded with no material change to the substance of the prior action.
Pillar 3: Bolster the Social Safety Net		
Trigger 4: Improve predictability and sustainability of pension benefits, including timely indexation and clear rules for supplementary benefits for those over age 80.	*Prior Action 5: The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 "On the Budget Declaration for 2022-2024" requiring indexation of pensions for all categories of*	Reworded with no material change to the substance of the prior action.

	retirees not later than March 1st of each year from 2022 to 2024.	

Pillar 1: Foster De-monopolization and Anticorruption Institutions

33. The reforms under the first pillar help to demonopolize key parts of the economy and safeguard anticorruption efforts; by leveling the playing field and addressing concerns about weak trust in rule of law, they help to attract private investment, including in important sectors of the economy. Ukraine's economy has long faced an anticompetitive environment arising from rent-seeking, weak rule of law, and state capture by powerful vested interests. Reforms are supported in three key areas as follows:

- High market concentration and low contestability are key challenges for Ukraine's economy, including in transport, logistics and infrastructure sectors and, in turn, negatively impact economy-wide productivity and competitiveness and strengthen powerful vested interests. Concession reforms in DPL-1 enabled the first-ever PPP contracts in the ports sector in 2020 and increased private sector participation in infrastructure investment. Awarded for the modernization of two major ports on Ukraine's key river arteries, the PPP contracts also require a shift of port transshipment volumes from road towards more cost-efficient and environmentally friendly river transport. Inland waterway reforms supported in DPL-2 enable this shift, by increasing competition among local and foreign vessels and facilitating private investment in the river transport sector; they also help Ukraine converge with EU legislation and regulatory standards as required under the Association Agreement.

- Actions in DPL-1 aimed to address gaps in the anticorruption architecture, including in relation to the governance of the NACP (responsible for asset declarations). The NACP, along with several other institutions, was established to counter high-level corruption and the influence of vested interests and establish a level-playing field that would facilitate competition and economic growth. Ever since their establishment, the NACP and other anticorruption institutions have been subjected to efforts to undermine their functioning – a clear signal that these institutions present a potent threat to the status quo. Given these efforts, DPL-1 had supported legislation (Law #140-IX) to strengthen NACP governance, provided for true risk-based and non-discretionary electronic verification processes of asset declarations, and liability for illicit enrichment and civil forfeiture remedies. However, in October 2020, several parts of Law #140-IX, related to the legal foundation for key pillars of the asset declaration and verification regime, were found unconstitutional by the Constitutional Court (CC). Ukrainian authorities passed legislation in December 2020 (Law #1079-IX) and Law 1576 in June 2021 to restore the verification process of asset declarations, key powers of the NACP and other fundamental parts of the legal framework on asset declaration. While no subsequent prior actions are included in DPL2, World Bank experts provided technical assistance in drafting these legislative acts and continue to support strengthening the governance structures to ensure that NACP is able to fulfill its long-term mandate. In addition, the ambition of the results indicator has been increased to reflect progress made: it targets 1,500 full verifications of high-risk declarations by 2022 versus 1,000 targeted for 2021 previously. Carrying out detailed verifications of asset declarations based on a more risk-sensitive approach with reduced discretion should help increase accountability and bolster investor's confidence in Ukraine's nascent efforts to establish a level playing field.

- Reforms in DPL-1 supported the unbundling of NAK Naftogaz and establishment of certified GTSO on January 1, 2020. Following this, revenues for transit of Russian gas through Ukraine have been collected by GTSO in accordance with the new Gas Transit Agreement with Gazprom signed on December 30, 2019. Notwithstanding the repayment of transit revenues to Naftogaz in October (to cover the costs of higher priced gas imports during an unprecedented global energy price shock), the flow of transit revenues to GTSO was transparent in 2020 and 2021. While no subsequent prior actions were considered in DPL-2, the World Bank remains closely engaged with the government through advisory and technical assistance support to address pending challenges in the gas sector.

Establishing an open regulatory framework for inland waterways

Prior Action 1: The Borrower has enacted Law #1054-IX dated December 3, 2020 "On Inland Water Transport," and duly published in the Borrowers' Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.

34. Rationale. Addressing the lack of an open regulatory framework is an important opportunity to modernize and attract investment to Ukraine's inland waterways, and for supporting the development of modern, environmentally sustainable ports and river transport logistics to support further growth in the agricultural sector, and to diversify and deepen trade links with trading partners in the region. It is also in line with Ukraine's commitments under the Accession Agreement with the EU. Reforms of ports and inland waterway logistics have been supported by technical assistance and project finance from the EBRD, EU and World Bank Group,[23] including with respect to concession reforms supported in DPL-1 that led to the award of first-ever PPPs in Ukraine based on best international practice. These PPP contracts were awarded for upgrading and modernizing Kherson and Olvia ports located on the Dnipro delta and Dnipro-Bug river estuaries respectively. Currently cargo transportation to and from these (and other major) ports is mainly fulfilled by road or by rail which is not optimal. In addition to facing congestion on the roads, overloading further damages a road network which is generally not in good condition, similarly railway cargo transport services face problems due to infrastructure quality and reliability.[24] The terms of the concession agreements for both ports stipulate that, in future, a significant volume of cargo transshipment must be delivered by rail and water transport given their lower environmental footprint and potentially large cost-savings.[25] Currently however, the quantity of commodities

[23] The IFC conducted a Global Infrastructure Facility (GIF) funded preliminary feasibility study for the Kherson port and Lower Dnipro waterway. (See *https://blogs.worldbank.org/ppps/ukraine-how-international-partnerships-are-contributing-development-transportation-infrastructure*). In addition, the World Bank Group helped support the drafting of the inland waterway legislation and, in collaboration with the US Corp of Army Engineers, provided technical assistance on the management of the inland waterway system and multimodal bulk transport of grains and liquids in the lower Mississippi.

[24] World Bank (2015). Shifting into Higher Gear: Recommendations for Improved Grain Logistics in Ukraine; World Bank (2020) Modernizing Ukrainian Railways, Concept Project Information Document (P173448); K. Grushevska, T. Notteboom (2016) The Development of River-based Intermodal Transport: The Case of Ukraine. Journal of International Logistics and Trade.

[25] The first two concessions in Kherson and Olvia ports have resulted in US $137 million of private investment commitments. Under the terms of the PPPs, the private investors will upgrade the ports with new infrastructure and technologies, while also

transported on inland waterways is considerably diminished relative to volumes transported at the time of independence: some 66 million tons of goods were transported on rivers in 1990; by 2013, the amount dropped to a meagre 4 million tons, with this erosion in transport capacity undermining Ukraine's most competitive sectors. At present, only 3 percent of exported grain is transported on rivers. Various factors are responsible for this drastic drop, but critical distortions in the regulatory framework and the dominant position of a single company contribute significantly. Specific anticompetitive elements include the requirement for foreign vessels to obtain a permit every time to enter a river port[26] so that the total number of foreign flag voyages numbered only 391 in 2020. River transport is also negatively impacted by the lack of investment in dredging and modernizing locks. The new law provides a policy and regulatory framework for the financial sustainability of inland waterways. This together, with the liberalization of this mode of transport, will enable investment supported by development partners.

35. **More broadly, Ukraine's poor transport and connectivity infrastructure, including for inland waterways, holds back integration into global value chains and is a major bottleneck for getting cargo (particularly grains) to export markets.** In 2020, the quality of Ukraine's trade and transport infrastructure in the World Bank's Logistics Performance Indicators was ranked 66th out of 160 countries even though it is one of the most transport-intensive countries in the world due to low population density, geography, and the structure of output (heavy metals, agriculture, basic industry).

36. **Substance of the prior action.** The Law on Inland Water Transport, which was passed by Parliament in December 2020 defines the legal, economic and organizational basis for regulation of inland water transport. The Law includes the implementation norms of five main EU directives and brings Ukrainian legislation in line with EU requirements per Ukraine's commitments in the transport chapter of the EU Ukraine Association Agreement and is also in line with Ukraine's long-term priorities for low emissions development as indicated in the 2018 LEDS report. It addresses the anticompetitive elements associated with inland waterways, ensuring market opening and non-discriminatory access of local and foreign operators by removing unjustified regulatory and bureaucratic barriers. It also envisages the creation of a state fund for the development of inland waterways for allocating money to the maintenance of waterways and their infrastructure. Furthermore, it deregulates the sector by allowing the movement of foreign ships in the Dnipro River from January 1, 2022 onwards, which is expected to increase international trade, and introduces free passage through locks and a partial exemption of inland waterway vessels from fees in seaports. The Law provides for the option to invest in the strategic facilities of inland water transport infrastructure by means of public-private partnership mechanisms such as concession, rent, joint venture and other types of investment agreements. Since the adoption of the law last December, the Ministry of Infrastructure has introduced a pilot project earlier this year for allowing access by foreign vessels under simplified procedures. In addition, the government has developed with EU support a 2031 strategy and action plan for inland waterway transport which is

introducing climate-smart practices that use renewable energy and greater use of rail and water transport, replacing diesel trucks. See: *https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/providing-safe-harbors-for-ukraines-economic-growth* and https://www.ebrd.com/news/2020/ebrd-supports-first-concession-project-in-ukraine-.html

[26] Vessels flying a flag of states which have not concluded an international agreement on navigation on inland waterways with Ukraine have to obtain a one-time permit for calling at a Ukrainian river port. Delays in receiving these permits can lead to significant damages and losses for shipowners and cargo owners. Moreover, foreign flagged ships are entitled to carry cabotage voyage only subject to obtaining the special permit from the Ministry of Infrastructure, which creates bureaucratic obstacles and corruption risks.

currently going through the approval process. In addition, a number of government resolutions are under preparation for regulating the technical oversight of vessels, competency and qualifications of crew and river information management systems.

37. **Expected result***: Number of port concession projects signed with private investment mobilized through project financing by lenders increases from 0 in 2019 to 2 in 2021. Number of voyages by ships (including cargo) on Dnipro River increases by about 20 percent from 11,938 in 2019 to 14,300.* Overall, inland waterways reforms, coupled with concession reforms supported in DPL-1, are expected to increase competition, and enable private sector investment in the river transport and port logistics sector with potentially significant positive spillovers for the environment and economic efficiency**.** Concessions reforms are expected to increase private sector participation in the port sector through the completion of two port concession projects while inland waterways reforms will help to develop river systems, including the Dnipro River (a major river system), into key arteries for transporting cargo reliably and at low cost. Together, the two are critical inter-linked elements of developing a modern, environmentally friendly port and river logistics infrastructure connecting Ukraine's hinterland to river and seaports and to trading partners. Negative externalities (emissions, air pollution, accidents and noise) from river transport are one tenth of those from road transport and the law stipulates the need to mitigate these externalities in line with environmental regulations. Costs of transport by waterways are estimated at US$ 0.011- 0.027/tkm, vs around US$0.24/tkm for road and US$0.015-0.18/tkm for rail.[27] Overall, revitalizing inland waterways transport in Ukraine will require careful planning and significant investment over several years. Adoption of the law is expected to increase the cargo flow up to 35 million tons per year, preserves the roadway (through easing congestion) and saves UAH 1 billion for the road repair in the coming four years, for each 1 million tons of cargo transported by river and redirected from road. It will require continued support by international partners.[28]

Pillar 2: Strengthen Land and Credit Markets

38. **The reforms under the second pillar are fundamental for supporting a well-functioning agricultural land market and increasing access to credit for farmers.** Transparent, efficient, and inclusive land markets, and access to affordable credit for small and medium sized farmers, are critical pre-conditions for unlocking the true potential of the agricultural sector. They are necessary for enabling productivity enhancing land-attached investments and sustainable farming practices, especially by the 4.6 million small household farmers who farm some 15.7 million hectares of land. Greater transparency and strengthened land governance also help to reduce the risk of corruption and monopolization in the newly opened land market. Over the medium to long term, reforms supported are expected to contribute to a shift towards higher value-added products and job creation in rural areas, and overall growth. DPO-2 does not include follow-up prior actions for financial sector reforms supported in DPL-1, which supported by continued dialogue and technical assistance by the World Bank remain on track as reflected in strong progress in the reduction of NPLs at SOBs (which amounted to UAH 288bn as of September 2021), and strengthened supervision of NBFIs with the NBU (one of the two new regulators)

[27] See Bazaluk, O. Havrysh, V., and Nitsenko, V (2021) Energy Efficiency of Inland Waterways Transport for Agriculture: The Ukraine Case Study. Appl. Sciences.
[28] Several partners are involved. The IFCs advisory work is supporting the development of additional concessions tender for the Chornomorsk port. through the "Assistance for Dnipro Transport Development Project," while the EU is providing support on the development of an inland waterway transport development strategy and action plan and is undertaking a Strategic Environmental Assessment.

preparing and submitting to parliament new draft laws on regulating markets of nonbank financial services.[29] In parallel, the National Securities and Stock Market Commission (NSSMC) has also undertaken efforts in strengthening its legal and regulatory framework for capital markets and pension funds.[30]

Establish a transparent market for agricultural land with adequate safeguards

Prior Action 2: The Borrower has enacted Law #1423-IX dated April 28, 2021 “On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations”, and duly published in the Borrowers’ Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land

Prior Action 3: The Borrower has enacted Law #1444-IX dated May 18, 2021 “On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions” and duly published in the Borrowers’ Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales.

39. **Rationale.** The current government has advanced transformative legislation to open Ukraine’s massive agricultural land market: the land turnover law, adopted in April 2020, effectively lifted the 20-year-old moratorium on agricultural land sales, a reform that was supported by DPL-1, a prior 2018 Development Policy Operation and intensive EU-funded EUR 3mn Bank Executed Trust Fund (BETF) technical assistance[31] (that has also subsequently supported operationalization). The land market opened on July 1, 2021, and official statistics show (as of October 3, 2021) 28,961 land sales transactions for a total of 58,582 ha, at a median price of US$ 2,200 per ha. However, further complementary legislation was necessary to safeguard the transparency and efficiency of the land market, to prevent monopolization, and reduce systemic corruption in state land management and land governance. Absent these safeguards, there is a risk of even worse outcomes than existed prior to the land reforms. Two important safeguard legislations passed prior to the opening of the land market. These included: (i) Law #554-IX (approved April 13, 2020) that provides free and open access to the cadaster data and mandates interoperability between the cadaster and registry, which is important to reduce manipulation of ownership records and opportunities for corruption; and (ii) Law #340-IX preventing multiple

[29] Ukrainian regulatory framework for the nonbanking financial sector was outdated and operated by a compromised regulator, requiring major overhaul following the approval of the “Split Law” (PA under the PBG). The laws prepared and submitted by the NBU include the following: the Draft Law of Ukraine “On Financial services and financial companies” which has already been approved in the first reading in April 2021 and awaits the second reading in the Rada; drafts of the new versions of Laws On Credit Unions and On Insurance that are also pending the second reading by the Parliament; On Mandatory Third Party Liability Insurance of Owners of Land Motor Vehicles a draft Law was registered at the Parliament and is processed by the Committee while draft Law On Insurance Distribution is still in preparation.

[30] Law on Investment Facilitations and Introduction of new Financial Instruments (with new versions of the Laws “On Commodity Exchanges” and “On Capital Market and Organized Commodity Markets”) was approved and enacted in July 2020. A draft Law on Amendments to the Law of Ukraine “On State Regulation of Capital Markets and Organized Commodity Markets and some other legislative acts of Ukraine on regulation and supervision of capital markets and organized commodity markets” was approved by the Finance Committee for the first reading by the Verkhovna Rada aimed at providing NSSMC with a clear mandate, powers, as well as political and financial independence , supported by a strong legal and regulatory framework for supervised entities. Moreover, draft laws on Compulsory Cumulative Pension System (Pillar 2) and Undertakings for the Collective Investment in Transferable Securities (UCITS) are under preparation.

[31] "Supporting Transparent Land Governance in Ukraine" Multi-Donor Trust Fund, No. TF072938.

registrations and raider attacks by fully automating exchange of information between the registry and cadaster, mandating digitization of all paper records to registry, and requiring registration of all transaction prices for sales and leases (approved December 5, 2019).

40. Substance of the prior action. Two critical safeguard legislations were still pending during 2021, that are supported in this proposed operation as prior actions. These included the Law #1423-IX, which is an important supplementary law as it focuses on improving transparency and efficiency of land markets by simplifying procedures and mandating movement towards distributed storage of cadastral information and the ability to prevent tampering using blockchain technology[32] enabling decentralized land management through the transfer of ownership and administration of state land to local governments and increasing transparency and simplifying procedures. After it failed to pass in the first reading in Parliament in December 2020, the law passed on April 28, 2021, with considerable support from the Presidential Administration in explaining its merits. Land Law #1444-IX, which passed May 18, 2021, regulates local state land use, and mandates electronic auctions for state land sales. According to the amendments to the Land Code introduced by the Law #1444-IX, the organizers of the sale and lease of land plots are obliged to conduct tenders in the electronic trading system, which eliminates the possibility of any illegal contacts between its organizers and participants, allows the public to control the course of electronic auctions online, and also increases the size guarantee fees for bidder; the Prozorro platform[33] was designated the administrator of the electronic trading system, as of September 28, 2021 by decree #1013. Building on the legal and regulatory reforms supported by the DPO, the BETF[34] provides analytical support and technical assistance to the Government with respect to: (i) design and piloting of a public system for land governance monitoring that draws on administrative data regarding transaction volumes, prices, land-related public revenue, land-related court cases, and individuals' awareness of legal provisions; (ii) rigorous impact evaluation of efforts to improve land governance and generating and promoting evidence-based research using monitoring data to feed into policy debates; (iii) supporting design and piloting of the Agrarian Registry as a mechanism for transparent targeting and disbursement of public support to the agricultural sector in a way that uses such support to minimize transaction costs for bank and leverage private capital; (iv) and support to local Governments to collect land-related taxes and fees and monitor compliance with land use restrictions. In several cases, approaches to be piloted by the BETF are expected to be scaled up by the 'Accelerating Private Investment in Agriculture' Program for Results.

41. **Expected results**: *Area of agricultural land previously under moratorium sold/purchased by eligible individuals increases from 0 hectares in 2019 to 150,000 hectares in 2022.* The establishment of a record of transparent agricultural land transfer transactions, with registered prices, would help increase the security of land tenure and facilitate investment in higher value-added agriculture. It would also boost financing for agriculture, particularly to small farmers, by enabling the use of land as collateral. Decentralization of state land and strengthened land governance will reduce risks of corruption, and sustainable revenue mobilization at the local level, as well as in land management and support. While

[32] Information in the State Land Cadaster is to be stored in a distributed ledger using blockchain technology with nodes maintained by relevant state bodies or enterprises.
[33] The launch of the e-procurement system Prozorro in 2016 is regarded as one of the major reform successes in Ukraine in recent years, that has substantially increased transparency in bidding for government contracts and government revenues, reduced corruption in public procurement and has been successfully used to kickstart small-scale privatization.
[34] "Supporting Transparent Land Governance in Ukraine" Multi-Donor Trust Fund, No. TF072938

the laws do not allow for the change of land use for environmentally sensitive land, there is some concern that relatively weak local government capacity for environmental and social risk oversight over lands newly transferred to them may result in the redesignation of lands with nature preservation value. However, as discussed in Section 5.2, these risks are mitigated by provisions in Law 1423 establishing the possibility of prohibitions on land use while technical studies for protection of wetlands are undertaken as well as technical assistance and support by the World Bank and EU to monitor forest loss and expansion of agricultural cultivation into protected or otherwise unsuitable areas.

Strengthening access to finance for small farmers

Prior Action 4: The Borrower has enacted Law #1865-IX dated November 4, 2021 "On the Fund for the Partial Guarantee of Loans in Agriculture" and duly published in the Borrowers' Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.

42. Rationale. Access to financing for small credit-constrained farmers through sustainable and effective financing instruments is fundamentally important to ensure their inclusion in land markets, and to support them in undertaking productivity enhancing investments**.** Small farmers in Ukraine (i.e. those cultivating less than 500 hectares) are significantly credit constrained because banks consider them high risk. Limited access to finance, including bank loans, has long been a barrier for small and medium-sized agricultural producers, who produce more than 50 percent of Ukraine's total agricultural output. According to a World Bank study, most of them do not have access even to basic banking services. Moreover, interest rates on loans for SMEs are on average 5 to 7 percent per annum higher than those available for large enterprises. If loans are attracted, they are short-term to cover current expenses. Lack of long-term loans, as well as adequate collateral and credit history, have long deprived small and medium-sized agricultural businesses of the opportunity to invest in development. This represented a market failure in that the market for lending in the agricultural sector, especially for loans where land is used as collateral, is extremely under-developed.[35] The adoption of the Law on the Partial Credit Guarantee Fund in Agriculture is the last cornerstone of the legislative foundation of land reform.

43. Substance of the prior action. The Law #1865-IX on the establishment of the Partial Credit Guarantee (PCG) Fund in Agriculture (in the form of a non-bank financial institution with the participation of the state, under the supervision of the National Bank of Ukraine) to support the land purchase by small farmers regulates the legal framework for establishment of a Partial Credit Guarantee Fund with a sound independent governance framework. While it would initially need to be capitalized by the state, the plan is for it to be run on a self-sufficient basis in line with international best practice, with guarantee fees covering operational expenses of the fund. Allowing private sector participation will also facilitate contributions from international development partners to the capital of the facility. The effective establishment of the new Partial Credit Guarantee Fund also requires a budget allocation provision for its capital in the 2022 Budget Law, which will be voted in November-December 2021. After enactment of the needed legislation, fully operationalizing the Fund is expected to take at least nine months, including registering, capitalizing and licensing the Fund as well as passing internal bylaws,

[35] For instance, 65 percent of agricultural sector loans in the US are secured by agricultural land, while in Ukraine this share is virtually zero.

selecting Supervisory Board and top management, staffing it, and signing framework agreements with participating financial institutions. In this period, the authorities have committed to provide a bridge guarantee instrument to support small farmers until the third quarter of 2022 and for this the state portfolio guarantee instrument for SMEs will be used. The relevant Cabinet of Ministers resolution was already adopted in July 2021, however the list of participating financial institutions is yet pending approval by the Cabinet of Ministers, to make the instrument operational.

44. **Expected result***: Loans are issued to small farmers and backed by Partial Credit Guarantee (PCG) facility.* Improved access to finance for small, credit constrained farmers would allow them to participate in the land market and expand opportunities for agriculture to move into higher value-added products in Ukraine. Supporting small farmers to participate in the land market would also help support the economic recovery from the COVID-19 crisis. It would also help prevent the concentration of land ownership following the opening of the market, which is critical for preventing monopolization by vested interests as seen in many other sectors of the economy.

Pillar 3: Bolster the Social Safety Net

45. Bolstering the social safety net, with a focus on the elderly population, is important to cushion the impact of the COVID-19 crisis. Ukraine's recovery from the pandemic remains uneven. The economy slipped back into recession in H1 2021 even as inflation accelerated (reflecting in part the impact of both local and global supply frictions). A third surge in COVID-infections in September meanwhile has led to an extension of quarantine measures (which had been eased over the summer) until December. The largest part of the social safety net in Ukraine is pensions, with public spending amounting to about 11 percent of GDP. Pensions are also a significant part of household incomes, particularly for those in the bottom 40 percent of the population. In 2020, among the old age population, 9.1 million received old age pensions, of which 1.5 million were over the age of 80. In this context, bolstering pension benefits, especially for the elderly in the bottom part of the income distribution (for whom the average old age pension benefit is 30 percent of the average reported wage), is an important instrument to cushion the impact of the crisis on the elderly population, who have been affected by health-related impacts and higher expenditures on key services including health, transportation, and other necessities.

Bolster pension benefits

Prior Action 5: The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 "*On the Budget Declaration for 2022-2024*" requiring indexation of pensions for all categories of retirees not later than March 1st of each year from 2022 to 2024.

46. Rationale. As part of the COVID-19 response the Bank provided support to strengthen Ukraine's social safety nets. Notably, the Bank deployed two Additional Financings (AF) to the Social Safety Nets Modernization project: the first AF for US$150m in April 2020 (which included US$50 for temporary social assistance support, followed by a second AF in late 2020 which scaled up that social assistance support with additional cash transfers to the poor and vulnerable by a further US$300m). However, to reduce the risk of poverty and to safeguard the income of pensioners in real terms the indexation of pensions remains a key tool. Prior to the Pension Reform adopted in 2017, no clear rules of indexation existed for existing pensioners. Pension indexation was done in an ad-hoc basis and in a pro-cyclical manner. During 2014-15 crisis, pensions were not indexed, eroding the real income of the old-age population relying almost exclusively on pensions. As a result, the average pension in 2016 was 35 percent lower than the actual subsistence minimum and poverty rates among pensioners increased steeply. Furthermore, to cushion the elderly from the impact of the COVID shock, another top-up was introduced in 2020, a COVID-relief action supported in DPL-1. Again, supported by DPL-1, indexation rules have been consistently applied between 2020 and 2021; however existing legislation allows flexibility on the date of statutory pension indexation each year undermining the predictability of pension benefits and contributing to risks of volatility in purchasing power. Pension top-ups have also proliferated undermining predictability of pension benefits and of the associated fiscal costs, with those in the 75-80 age-group also receiving top-ups, and proposals to extend one-off benefits permanently and to expand them to people with disabilities. A September 2020 Cabinet of Ministers of Ukraine resolution[36] provided for an increase in compensation payments for those aged 75 and over, and 80 years and older.

47. **Substance.** The Government has taken steps to enhance the predictability on the date of pension indexation by embedding it in legislation. In particular, from 2022 it is envisaged to establish the annual indexation of pensions no later than March 1. The Budget Declaration for 2022-2024, which was adopted by Parliament in July 2021, encapsulates the provision under which the indexation of pensions will be carried out for all categories of retirees without exception. In addition, Draft Law # 4668 was adopted in the first reading on September 9, 2021, with a second reading due soon.

48. **Expected result:** *Pension benefits increase in line with the indexation formula within the first half of each calendar year, allowing adequate support for pensioners, of which at least 65 percent are women*. Reducing discretion in the date of pension indexation each year will provide greater predictability in the purchasing power of the pension benefit each year, which is particularly important during a sharp economic downturn and during periods of high inflation. With incomes of elderly women relying more on pension benefits, greater predictability in the benefit addresses an important gender related disparity. The inclusion of the pension indexation formula in the Budget Declaration serves to ensure transparent fiscal policy and predictable financing in line with the medium-term budget deficit targets. This, in turn, should also contribute to the sustainability of public finances. At the same time, it is clear that over the medium term, social and fiscal sustainability of the existing pension system would require more substantive reforms. Reforming the pension system will be a complex technical task, which would require balancing interests of different generations. The World Bank, with its ongoing technical assistance in this area, will continue to support authorities in developing reform options.

[36] The Cabinet of Ministers of Ukraine adopted the resolution "Certain issues of increasing pension benefits for certain categories of persons in 2021".

Table 6: DPL Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
Pillar 1: Foster De-monopolization and Anticorruption Institutions	
Prior action #1: *The Borrower has enacted Law # 1054-IX dated December 3, 2020 "On Inland Water Transport", and duly published in the Borrower's Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.*	WB. Shifting into Higher Gear: Recommendations for Improved Grain Logistics in Ukraine. (2015). This identified river transport as key to a sustainable grain logistics mix in the future, comments on earlier versions of the law during consultations.
Pillar 2: Strengthen Land and Credit Markets	
Prior action #2. *The Borrower has enacted Law #1423-IX dated April 28, 2021 "On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations", and duly published in the Borrower's Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land management, which simplifies procedures to create, transfer, and use land parcels; and transfer the ownership and administration of state land from the Geocadaster to local authorities.*	WB, "Special Focus Note on Reforming land markets for agricultural growth", (2019); WB ASA, "Supporting transparent land governance in Ukraine" (2017); Kyiv School of Economics, "Restrictions on farmland sales markets: a survey of international experience and lessons for Ukraine" (2016).
Prior action #3: *The Borrower has enacted Law # 1444-IX dated May 18, 2021 "On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions", and duly published in the Borrower's Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales.*	WB, "Special Focus Note on Reforming land markets for agricultural growth", (2019); WB ASA, "Supporting transparent land governance in Ukraine" (2017); Kyiv School of Economics, "Restrictions on farmland sales markets: a survey of international experience and lessons for Ukraine" (2016).
Prior action #4: *The Borrower has enacted Law #1865-IX dated November 4, 2021 "On the Fund for the Partial Guarantee of Loans in Agriculture" and duly published in the Borrowers' Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.*	WB Technical Assistance (2018-21). Financial sector analytical and monitoring work under the Financial Sector Recovery and Resilience Project.
Pillar 3: Bolster the Social Safety Net	
Prior action #5. *The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 "On the Budget Declaration for 2022-2024" requiring indexation of pensions for all categories of retirees not later than March 1st of each year from 2022 to 2024.*	WB Technical Assistance on pensions (2019-21).

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

49. **The proposed DPL is closely aligned with the objectives of the Ukraine Country Partnership Framework (CPF) for FY17-21**. The objective of the CPF (Report # 114516-UA discussed at the Board on June 20, 2017) is to promote sustained and inclusive economic recovery through a program focusing on four areas including: (i) making markets work; (ii) fiscal and financial sustainability; (iii) efficient, effective, and inclusive service delivery; and (iv) better governance, anticorruption, and citizen engagement. The proposed DPL is a central component of the CPF's strategy to prioritize support for critical reforms. The CPF recognizes that the achievement of results will depend on reforms that face opposition from vested interests and thus require deep engagement by the Government and other stakeholders. The reforms supported by the DPL are closely tied to the priorities identified in the 2017 Ukraine Systematic Country Diagnostic (SCD) on "Toward Sustainable Recovery and Shared Prosperity," the 2019 study on "Ukraine Growth: Faster, Lasting, Kinder," and the 2021 SCD Update "Pathways to Resilience, Sustainability and Inclusion". Together, these three provide the analytical underpinnings for many of the reform areas supported by the DPL series, and the SCD Update will also inform the priorities of the CPF for FY22-25, that is currently under preparation. The reform areas supported by the DPL are also closely aligned with World Bank investment projects and/or technical assistance in energy, agriculture, transport, financial sector, and anticorruption. Importantly, this operation complements the COVID-19 support by the World Bank, including the recently approved Additional Financing for the Social Safety Net Project and Additional Financing for the Health Project.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

50. **The authorities have carried out consultations with stakeholders on the reforms supported by this proposed operation.** The reforms supported by this operation are consistent with the Government's program~~,~~ which has been discussed with civil society, development partners, and the public through various channels. More specific consultations have been held on the different reform areas. On land reform, for instance, the authorities have held consultations through a variety of channels, including events with a wide variety of farmers, farmer associations, landowners, and the general public. A parliamentary working group with support from the World Bank and other development partners has been working on the legislative framework. The President and the Prime Minister have publicly advocated for the reform, and Presidential Administration have played an instrumental role in the passage of key land safeguard legislation. On the anticorruption reforms, extensive discussions and debate has taken place including the government, members of parliament, and civil society representatives in the media. Across various reform areas, government representatives have appeared on media programs to explain the rationale, design, and outcomes of the reforms.

51. **Collaboration among development partners has been a cornerstone in the effort to support policy reforms in Ukraine.** The World Bank has coordinated the proposed DPL's support for reforms closely with the IMF, the European Union/Commission, the European Bank for Reconstruction and Development (EBRD), the United States/USAID, UK/DFID, Switzerland, Canada, Japan, Sweden, and other development partners. In addition to collaboration with international development partners, the Bank's support for policy reforms has also collaborated closely at the national and subnational level with

the private sector, academia, and civil society to organizations to ensure knowledge sharing and coordination of efforts.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

52. **The prior actions under this proposed DPL are expected to have positive or neutral poverty and social impacts in the context of the COVID-19 crisis.** Several of the proposed reforms are likely to have positive social and distributional effects, even in the short term (e.g. Prior Action 5 on the predictability of pension benefits), while none of the prior actions is expected to have substantial adverse social impacts if appropriate safeguards are in place. However, as with any reform, there is a potential for unintended consequences, and the risk of these materializing needs to be minimized. While inland water transport prior actions may induce localized adverse impacts if not properly assessed and managed, the risk of unintended consequences mainly relates to the land reform prior actions. For instance, the requirement of electronic auctions for state land may exclude certain vulnerable groups of people due to financial and digital constraints. In addition, institutional weaknesses and corruption at both the central and local government level may affect implementation of prior actions and diminish positive distributional effects. These may be exacerbated by future economic pressures associated with COVID-19 and climate impacts on agricultural productivity. The expected effects of each of the prior actions are discussed in detail below.

Pillar 1: Foster De-monopolization and Anticorruption Institutions

Prior Action 1*:* The Borrower has enacted Law # 1054-IX dated December 3, 2020 “On Inland Water Transport”, and duly published in the Borrower’s Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.

53. **While increased competition in inland water transportation can lead to short-term job reallocation and job loss as the current sole operator loses market share, it is expected that the overall effects on employment will be positive given the large demand for cargo transportation in Ukraine and the fact that railways, the dominant mode of cargo transportation, struggle to meet the demand for transportation during the peak agricultural season.** In addition, if, as expected, the recent opening of the agricultural land market increases agricultural production, demand for cargo transportation will further increase with potentially important job creating effects. In sum, while this prior action may lead to some short-term labor adjustments at the current sole operator of inland waterway transportation, the medium-term effects on job creation are likely to be positive given high demand for reliable and affordable modes of transport.

54. **Changes in transport patterns may disturb local river use and require assessment and management of existing community practices.** Dredging, river works, lock modernization and consequent increase in cargo traffic may affect riverside business and community activities, local aquaculture, and river transit safety as well as have impacts on the cultural heritage values associated with the rivers. These risks are likely to be localized, although in some areas, dredging may pose significant environmental hazards and risks which could potentially impact poor households the most.

These risks require effective consultation with riverside communities and households and avenues for feedback and grievance redress on proposed changes, and as also noted in Section 5.2 below, careful environmental and social impact analyses to understand, manage and mitigate risks effectively.

Pillar 2: Strengthen Land and Credit Markets

55. **The moratorium on sales and purchases of farmland was lifted on July 1, 2021 - supported by the previous DPL in this series - creating a fully-fledged yet still nascent agricultural land market.** Land transactions have steadily increased since July 2021 as people are gradually gaining confidence in the market, and the volume of land traded in September 2021 was already over four times higher compared to July 2021 (over 25,000 Ha in September compared to 6,000 Ha in July). Land prices appear to have remained largely stable in the three months since the opening of the market, though have increased sharply since 2015, when discussions to open the market began in earnest.

56. **The land market opening is expected to have positive economic and social impacts.** The land reform is expected to have the following positive impacts. First, the reform is expected to increase agricultural and overall economic growth through increased investments on land with clear property rights. Second, the reform will transfer resources to landowners (in the form of increased land prices) and create collateralizable assets. As landowners are mainly rural, older, less educated, and female, the reform would essentially transfer resources to the more vulnerable segments of the Ukrainian population. Third, the reform has the potential to revive local communities and enhance local services through the revenue streams generated by auctioning off state and communal land.

57. **The land reform however also comes with some risks, reinforced by Ukraine's weak institutional environment and an elevated incidence of corruption.** These risks mainly relate to land concentration in the hands of vested interests, especially if credit market imperfections would curb small farmers' possibility to buy land, and irregularities in the sale or lease of state land. In addition, vulnerable groups may lack knowledge and access to information that would enable them to participate in the market or may face discrimination in access to finance, effectively shutting them out of the market. Delays or failure to pass legislation or to comprehensively implement all provisions of already approved laws also pose a key risk for the development of an inclusive and transparent land market. Prior Actions 2, 3, and 4 aim to minimize some of these key risks related to the land reform.

58. **More broadly, for improved land governance to lead to more investment, and thus income, it is especially important that Ukrainian landowners or land users be aware of their rights and how to exercise them, and have these rights protected**. This is particularly true for small and medium farmers. They must be able to have any actual or attempted violations of their rights redressed quickly. Farmers and other private participants must know how to use land as collateral to access credit. Banks and other financial institutions must be able to professionally assess the value of the collateral and have the incentives to lend to smaller borrowers. Once relevant laws and regulations are in place, there is thus a need for a broad-based legal awareness and a financial literacy campaign.

Prior Action 2: The Borrower has enacted Law #1423-IX dated April 28, 2021 "On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations", and duly published in the Borrower's Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land management, which simplifies procedures to create, transfer, and use land parcels; and transfer the ownership and administration of state land from the Geocadaster to local authorities

***Prior Action 3**:* The Borrower has enacted Law # 1444-IX dated May 18, 2021 "On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions", and duly published in the Borrower's Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales.

59. As part of the land reform, ownership and management of state land has been transferred to local Governments, providing them with a potential annual revenue stream of US$2 billion. While these revenues could provide a much-needed boost to the quality of often lagging local service delivery and the provision of infrastructure, it also creates risks due to weak local management capacity and pervasive corruption in state land management. Safeguard legislation to minimize some of the risks had been passed prior to the land market opening (Law #554-IX and Law #340-IX). Prior actions 2 and 3 consist of two supplementary safeguards legislations whose effective implementation will further increase transparency and efficiency of land transactions through detailed recording and limit the risk of corruption in state land auctions through the mandatory use of electronic auctions. Together with previous safeguards legislations, Prior Actions 2 and 3 aim to maximize the likelihood that the land reform is just and results in broad-based welfare gains.

60. Prior Action 2 establishes local governments as the legitimate creators of land relations, dramatically increasing local authorities' power. A key risk in this regard, according to an assessment of social implications of the land reform commissioned by the Bank, is the variable capacity at local government level to support the interests of smallholders and withstand the influence of vested interests. The assessment also identifies risks of disputes associated with errors in the Geocadaster due to data gaps or absence of field verification. Local governments still also have no free access to spatial data and some information in the cadaster, despite the adoption of law # 554- IX. Key mitigation measures for risks associated with this prior action involve (i) establishing functioning grievance redress and feedback response mechanisms at various levels of government for detecting and responding to irregularities in a timely fashion; (ii) implementation of law # 554_IX on access to spatial information, (iii) facilitating public access to cadastral and registration records for field verification of Geocadaster and Registry of Rights data, and (iv) strengthening smallholders' access to and improved monitoring of the Free Legal Aid System to provide them with legal and process information and specialist advice related to the land market.

61. By requiring electronic auctions of state land and mandating market-based valuation, Prior Action 3 limits opportunities for collusion and corruption, and maximizes local revenues potential. Though a large improvement from the previous model, the requirement of electronic auctions can have the undesired effect of excluding small farmers and disadvantaged segments of the Ukrainian population from the auctions of state land. First, the law 1444-IX provides that the participants to the land auction must pay registration and guarantee contributions. While the guarantee fee is reimbursed to the unsuccessful bidder, the registration fee is not, which may act a disincentive to participation for lower-income farmers (the registration fee is set at 10 percent of the minimum wage). Second, participating in electronic auctions requires internet connectivity and digital skills, which may be unavailable to older rural farmers. It is therefore recommended to establish safeguards to provide equal access to the electronic land auction for people at a financial or digital disadvantage.

62. **In general, as the opening of the agricultural land market reform is still in its first few months, continued monitoring and evaluation is warranted to assess whether the reform is achieving its intended positive effects** and to capture any localized vulnerability or disproportionate adverse outcomes on certain groups that are not reflected in a macro-economic assessment of distributional impacts. A July 2021 phone survey by the by the Free Legal Aid (FLA) system in Ukraine, on the legal awareness and knowledge of land markets of 1,000 adults who received legal aid at least once in past 1.5 years encountered reticence to discuss issues related to ownership, use and sale-purchase of agricultural land. The survey, which was supported by the EU-funded World Bank technical assistance project,[37] suggests that this indicates fears about the consequences of opening the land market and risk of being harmed by offence in this field despite high confidence in the legal aid system itself. The reputation of local governments for providing assistance to landowners was also controversial. Overall the survey indicated significant information and legal information gaps among landowners and land users, and the need to communicate through channels that are easily accessible. Ensuring free legal aid is widely accessible, especially to the most vulnerable stakeholders, is a key transparency initiative supporting the prior action. The FLA is conducting regular surveys of its clients (only cases that are land-related), which will also allow monitoring any adverse social effects of the reform, and whether any improvement in level of legal and informational awareness occurs. The World Bank has commissioned field research on a more representative survey of landowners and users, on the preliminary social effects of the land reform; this is currently being prepared and is expected to start in November 2021. More broadly, the TA complements ongoing US$200mn Bank Program-for-Financing (US$160mn which is land-related) under which US$11mn has been allocated to supporting the design and implementation of a FLA/Ministry of Justice land case monitoring system, dissemination of information materials and implementation of monitoring systems. The TA has also worked with the EU- PRAVO[38] project to provide recommendations on anti-raider expert office.[39]

Prior Action 4: The Borrower has enacted Law #1865-IX dated November 4, 2021 “On the Fund for the Partial Guarantee of Loans in Agriculture” and duly published in the Borrowers’ Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.

63. **This prior action is critical for small and medium farmers to fully seize the opportunities provided by the land market reform**. While the land reform creates billions of dollars of collateralizable assets for rural investment and jobs, most small and medium-sized farmers currently do not have access to bank credit. Banks mostly work with clients perceived as less risky (farmers whose farms are larger than 500 hectares), and annual interest rates on loans for SMEs are on average 5-7 percentage points per annum higher than those available for large enterprises. The lack of long-term loans for small and medium-sized farmers risks having several adverse effects. First, it risks precluding smaller farmers from investing in productivity-enhancing technologies, foregoing their potentially large income and welfare

[37] Eu-funded and Bank executed "Supporting Transparent Land Governance in Ukraine" Multi-Donor Trust Fund, No. TF072938
[38] This promotes greater rule of law. See https://www.pravojustice.eu/
[39] See Presentation on achievements and priorities of the “Supporting Transparent Land Governance in Ukraine” project available at *https://ukraine-landpolicy.com/about-the-program/*

gains. Second, it risks resulting in excessive land concentration among wealthy individuals, especially in the second phase of the land reform (the land market reform currently limits land purchases to individuals and only up to 100 hectares; as of January 1, 2024, individuals will be able to buy land up to 10,000 Ha and legal entities will also be allowed to purchase land).

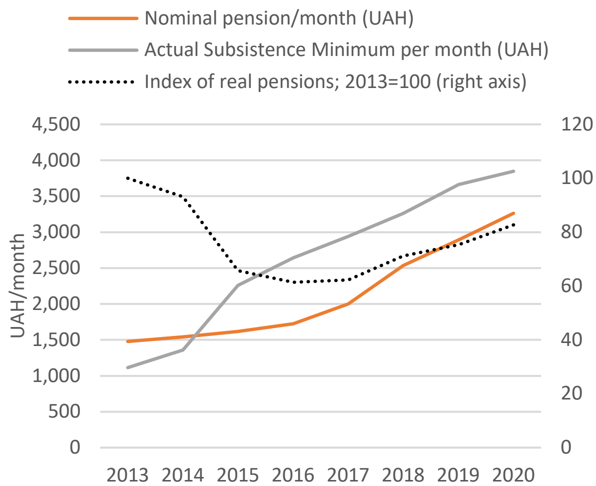
64. Prior Action 4 established a Partial Credit Guarantee (PCG) fund with the goal of lowering the risk for banks to lend to small and medium-sized farmers. The fund will allow banks to cover part of their losses in the event of a borrower's default, increasing the attractiveness of lending to SME farm operations, reducing interest rates and extending loan repayment periods. Given that the PCG fund will take time to set up (is unlikely to be operational before the end of 2022) the GoU should make swift arrangements for the earliest possible implementation of a temporary government program to provide portfolio guarantees or matching grants programs to those farmers who need them now to participate in land markets. Indeed, smallholders' ability to benefit from land reform will critically depend on whether bridging finance will be put in place until the PCG is fully operational. Additional services may also need to be provided to assist vulnerable smallholders access the PCG and participate in the land market (financial awareness services, assistance for business plan development, etc.). While the risk of adverse social impacts is anticipated to be low for individual loans backed by guarantees, environmental and social management systems of participating financial institutions may also require updating to ensure screening for cumulative impacts across the portfolio.

Pillar 3: Bolster the Social Safety Net

Prior Action 5: The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 "*On the Budget Declaration for 2022-2024*" requiring indexation of pensions for all categories of retirees not later than March 1st of each year from 2022 to 2024.

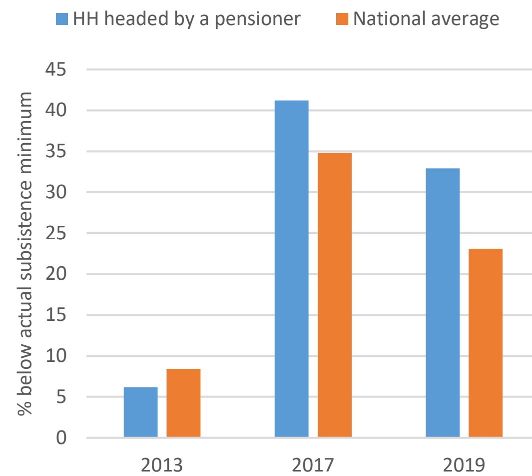
65. Due to the ageing population, pensions are an important income source for Ukrainian households. The nominal pension freeze that was introduced in 2014 and 2015 amidst high inflation led to a substantial decrease in the real value of pensions and a severe impoverishment of households reliant on them (see Figure 3 and Figure 4). The Bank-supported pension reform of 2017 reversed the pension freefall through the introduction of systematic rules for annual indexation of pension benefits to safeguard the income of pensioners in real terms. While real pensions have increased since, they remain below their 2013 value and below the actual Subsistence Minimum, the official poverty line in Ukraine. As a result, pensioners account for the bulk of the poor in Ukraine. In 2019, people living in households headed by a pensioner accounted for close to half of the poor in Ukraine, far higher than their population share (31 percent).

Figure 3: Trends in pensions and the actual subsistence minimum



Source: Ukraine Pension Fund.

Figure 4: Share of the population below the actual subsistence minimum (%)



Source: World Bank staff calculations on HLCS.

66. **Supported by the first DPL in this series, the indexation rules have been consistently applied between 2020 and 2021.** Existing legislation however allows flexibility on the date of statutory pension indexation each year, undermining the predictability of pension benefits and contributing to risks of volatility in purchasing power, especially in the current environment of higher inflation. This prior action enhances the predictability on the date of pension indexation by embedding it in legislation. In particular, from 2022 it is envisaged to establish the annual indexation of pensions no later than March 1. As such, the prior action is expected to stabilize real income streams for pensioners, 63 percent of whom are women, and avoid the need for consumption cutbacks, especially during times of high inflation and economic downturns

67. **The prior actions on pensions, agricultural land market opening, and land financing, are expected to address gender-related disparities in Ukraine.** More than 70 percent of pensioners are women, primarily due to higher female life expectancy. Bolstering pension benefits and strengthening their predictability and purchasing power would address a major gender related disparity in the impact of the pandemic. Older women also account for a large share of the 4.6 million landowners in Ukraine. With most landowners renting out their land and with rental prices depressed below their real economic returns, the lack of an agricultural land market depresses the rental incomes of women. The opening of the agricultural land market is thus expected to address this gender related disparity. Second, women are more likely to face constraints in access to finance. In agriculture, a greater share of small agricultural farmers, who are most credit constrained, are likely to be women. The Prior Action on land financing, which improves access to finance for small, credit-constrained farmers, is likely to address this gender related disparity.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

68. **The proposed prior actions are likely to have some beneficial environmental effects (see Annex 4 with the Environmental and Poverty/Social analysis table)**. At the same time, actions under Pillar 1 and 2 will require careful integration of environmental issues to effectively mitigate any potential adverse environmental impacts. For example, the Prior Actions on land markets can increase private investment, including in better natural resource management, energy efficiency, and climate adaptation technologies. However, they could also lead to an increase of pesticide and fertilizers use in agriculture which if not careful managed could be harmful to environment and communities. Therefore, actions under Pillar 1 and 2 will require careful integration of environmental issues to effectively mitigate any potential adverse environmental impacts and risks associated with investments.

69. **Climate and environmental benefits.** Four out of the five prior actions supported by the operation can yield direct and indirect benefits in two important sectors of the economy, namely agriculture and river transport. Land-related Prior Actions (3,4 and 5) strengthen the security of land tenure and provide incentives for landowners and land users to more sustainably manage land assets, undertake investments to manage climate impacts, and avoid deforestation. Prior Action 1 supports the development of inland waterways, which should help divert freight transport away from the more energy-intensive road network. This is consistent with sustainable development pathways identified in the 2018 LEDS that prioritizes a shift to low carbon emissions modes of transport for cargo and people, with environmental benefits from reduced air pollution.

70. **Climate and environmental implications of the inland waterways prior action.** The reform to establish an open regulatory framework to provide transparent access to the inland waterways of Ukraine and a sustainable mechanism for financing maintenance is expected to have likely significant positive climate mitigation impacts compared to the counterfactual. The absence of a sound regulatory framework for the waterways has deterred development partners from investing in river works and lock modernization. With the regulatory reforms and investment in modernization, the waterways will be able to attract a larger share of freight traffic that would have otherwise travelled by roads and railways. This would likely contribute to a reduction in Greenhouse Gas (GHG) emissions, road accidents, and fatalities. Per EU estimates, negative externalities (including climate emissions, air pollutants, noise and accidents) associated with river transport amount to EUR 0.27/ton-km versus EUR 0.8 and EUR 2.01 for rail and road transport respectively.[40] Ukraine is ranked as one of the worst performing countries in the ECA region in terms of levels of air pollution and related mortality impacts,[41] with evidence suggesting that exposure to air pollution worsens the severity of COVID-19 on people's health:[42] the road transport sector accounts for a third of air pollutants.[43] Meanwhile, the opening of the land market is expected to result in an increase in agricultural productivity (currently only a fraction of that in other countries) and an associated increase in demand for freight services. Without reforms in the waterways, much of the increase in cargo would have to be accommodated using road and railway haulage which would likely

[40] EU (2021). "EU assistance in the development of inland waterways." Presentation on May 26, 2021, by EU-funded Dnipro Transport Development project at roundtable conference "Ukraine on the Path to European Mobility: Synergy of Sustainable Development of rail and waterborne Transport" organized by Ministry of Infrastructure.
[41] See https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7058139/
[42] European Public Health Agency. https://epha.org/covid-19-and-air-pollution/
[43] https://mepr.gov.ua/en/content/misiya-ta-strategiya.html

increase GHG emissions. On the other hand, dredging—although necessary for waterways to have the required depth for navigation[44]— poses environmental and biodiversity risks,[45] that require careful and detailed environmental impact assessments (EIAs), and active risk mitigation measures (related to design of dredging operations, grievance redress mechanisms and outreach to local communities). The inland waterway law stipulates adherence to Ukraine's environmental regulations which are in line with those of the EU. The implementation of EIAs is supported in ongoing and planned World Bank dialogue with the Ministry of Infrastructure. In addition, the EU is currently undertaking a Strategic Environmental Assessment as part of the "Assistance for Dnipro Transport Development Project". The first draft has been disclosed for public review and consultation.[46.] Additionally, for dredging and other related activities could benefit from the development of specific methodological guidance for the Environmental and Social Impact Assessment (*OVD* as per Law of Ukraine 'On Environmental Impact Assessment').

71. **Climate and environmental implications of the land market prior actions.** Ukraine is one of the largest agricultural producers in the world and a significant portion of the population relies on the agriculture sector for livelihood. However, this sector is highly vulnerable to climate change, which threatens this major source of economic growth and household incomes. Higher temperatures could cause shifts in agricultural zones across Ukraine, and floods and water deficiencies have had a significant impact on agricultural output and household incomes over the last 20 years. An exacerbation of these vulnerabilities through the anticipated impacts of climate change could undermine Ukraine's overall development objectives, as well as the objectives of this operation. By undermining incentives to sustainably manage land and undertake adaptation investments, the insecurity of land tenure and limited access to finance for small farmers leaves Ukraine's agricultural sector and associated household livelihoods potentially even more vulnerable to climate change. These have been identified as important factors driving land degradation, low levels of farm efficiency and low investments in land protection in Ukraine. [47] In this context, the overall land reform is expected to support a shift towards more sustainable and efficient farming practices, including investments in land protection and more efficient land use and management. The EU-funded Bank technical assistance project,[48] in coordination with the State Geocadaster and Ministry of Environment (MoE), has been supporting digitization of boundaries and publication on the cadastral map of about 8,000 Nature Reserves of national, regional, and local significance, thereby effectively protecting these areas. [49] However, MoE has been unable to undertake technical studies to determine potential eligibility for protection of a potentially large number of wetlands. To prevent that higher land prices and the associated demand for land leads to potentially irreversible loss of such lands, Law 1423 establishes the possibility of registering a temporary (5-year) encumbrance on lands with potential environmental value. This would prohibit any land use change while MoE supports technical studies and if applicable administrative procedures to establish permanent

[44] Only 57 percent of Ukraine's navigable waterways have guaranteed depth. See Ukraine Sea Ports Authority, UN Economic Commission for Europe (2020) "Development of Inland Waterways in Ukraine – an effective measure towards sustainable growth of the region",
https://unece.org/fileadmin/DAM/trans/doc/2020/sc3wp3/08._Development_of_Inland_Waterways_in_Ukraine.pdf
[45] specially if it occurs in the Chernobyl zone.
[46] https://mtu.gov.ua/news/33077.html
[47]. Kuryltsiv, R., Hernik, J., Kryshenyk, N. (2018). Impact of land reform on sustainable land management in Ukraine. Acta Sci. Pol., Formatio Circumiectus, 17(2), 105–115.
[48] "Supporting Transparent Land Governance in Ukraine" Multi-Donor Trust Fund, No. TF072938
[49] See Presentation on achievements and priorities of the "Supporting Transparent Land Governance in Ukraine" project available at *https://ukraine-landpolicy.com/about-the-program/*

protection. The WB/EU project has collected training data and developed a machine learning algorithm (implemented on Google Earth Engine) to generate boundaries of potential wetlands that could be used by MoE as candidates for placing such a temporary encumbrance. The data generated as well as the underlying code will be shared with MoE. A similar machine learning approach has been implemented annually from 2017-2021 to identify, for every 10x10 m pixel in Ukraine the type of land use (built up, forest, water, agricultural) and, for agricultural land, the type of crop grown. While Ministry of Agrarian Policy and Food (MAPF)'s main interest is to use this for market intelligence and crop forecasting, the information has also been used to monitor forest loss and expansion of agricultural cultivation into protected or otherwise unsuitable areas. [50]

72. **Climate and environmental implications of access to finance prior action.** With small farmers in Ukraine particularly vulnerable to climate change, enhancing access to credit will help build resilience to these impacts. Available data shows that Ukraine's climate has already started changing. Climate modeling indicates that air temperature will continue to rise, and the precipitation region will alter through the year. Anticipated impacts include change in climatic seasons and growing season duration, reduced stable snow cover, changes in water resources availability (with likely down trend), increased frequency and magnitude of extreme weather events, shifts in agro-ecological zones, and increases in diseases and pests. All these factors will directly impact agricultural production. Assessments by experts show that about 60-70 percent of losses caused by extreme climate events fall to agriculture and crops losses (mostly due to droughts) fall in the range of 10 to 70 percent. In this context, improving access to credit will allow small farmers to implement necessary adaptive measures to cope with the changing climatic conditions, and bounce back from potential adverse impacts of extreme whether events and climate-related disasters.

73. **Country environmental policy framework.** Ukraine has environment policies and regulations aimed to mitigate and manage potential impacts of economic activities and is in the process of further aligning those with the EU. So, potential adverse impacts and risks of this DPO will be addressed and monitored through the national legislation and procedures in place in Ukraine. The environmental assessment of activities is governed by the national legislation, in particular, the Law 'On Environmental Impact Assessment'. The Law lists the types of projects that require Environmental Impact Assessment (EIA), procedures for EIA scoping, development, disclosure and consultation, as well as monitoring and reporting. The Ministry of Environmental Protection and Natural Resources (MEPNR) is responsible for review and approval of EIA reports, as well monitoring of activities both on national and regional levels. All EIAs are published on a public online registry maintained by the MEPNR. So, following the environmental legislation, any activity/investment that might be associated with a potential adverse impact on the environment or communities would be subject to the compliance with EIA legislation. Capacity building is a general issue, but some progress has been made within the Ministry of Environmental Protection and Natural Resources (MEPNR) in terms of capacity strengthening with Technical assistance such delivery of training sessions to familiarize government's entities with the Environmental and Social Framework (ESF) vision of sustainable development as well as international environmental protection best practices

[50] See Presentation on achievements and priorities of the "Supporting Transparent Land Governance in Ukraine" project available at *https://ukraine-landpolicy.com/about-the-program/*

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

74. **The PFM system is reliable, and the government has made progress in strengthening it in recent years.** The PFM Reform Strategy approved in 2017 aimed at establishing a modern and efficient PFM system that provides quality public services by allocating spending in line with medium- and long-term development priorities. The latest Public Expenditure and Financial Accountability (PEFA) assessment for Ukraine was undertaken in 2019. It concluded that since the previous assessment in 2016, the Government has made progress in: (i) implementing medium-term budget planning; (ii) increasing transparency in public financial management through the introduction of an open budget portal; (iii) integration of International Public Sector Accounting Standards (IPSAS) into Ukraine's statutory framework and the adoption of the 2025 public sector accounting (PSA) strategy; (iv) improving macroeconomic and budget forecasting tools; (v) fiscal risk management, and (vi) gradually introducing a gender-oriented approach to budgeting. At the same time, some challenges remain in: (i) the lack of strategy and transparency in public investment management, as the clear criteria for project selection are not used beyond the state budget; (ii) limited progress toward a comprehensive medium-term expenditure framework, including absence of reporting against outcomes and focus of the overall fiscal strategy only on the budget year; and (iii) weak payroll system, as information on employees and remuneration is not reconciled across budgetary agencies. Since the last PEFA assessment, significant progress has been made in the implementation of medium-term budget planning. In particular, the Government approved the Budget Declaration (BD) for 2022-2024, which was supported by the Verkhovna Rada, and developed a draft State Budget for 2022 aligned with the BD. In addition, a draft PFM Reform Strategy for 2021-2025 was developed with support from international partners and is expected to be approved by the Government shortly. The aim of the Strategy is to build a modern, sustainable, and effective public financial management system designed to maintain the country's financial stability and create conditions for sustainable growth of a socially inclusive economy by increasing the efficiency of mobilization and spending of public funds.

75. **Public access to fiscal information is strong. The Chart of Accounts, which underpins budget preparation, execution and reporting, is comprehensive.** Government finance statistics are produced monthly and are available on the MOF website and the State Treasury website. In addition, the MOF created an e-data portal (spending.gov.ua), which provides detailed information on public expenditure, and a web portal of the budget for citizens (openbudget.gov.ua), which provides data on the implementation of state and local budgets. In addition, to increase transparency in public finance, the MoF developed a tool on the basis of the World Bank methodology BOOST to analyze budget indicators, interactive analytical tools ("dashboards"), and created a portal containing information on social and economic development projects of Ukraine, which are implemented with the support of international financial organizations (IFIs) (proifi.gov.ua). Ukraine also improved its position in the Global Open Data Index and was ranked 26th out of 117 countries in 2019.

76. **Ukraine has also advanced its public procurement system, but the share of contracts based on competitive bidding could increase further**. A new Law on Public Procurement (LPP) was adopted in December 2015 that establishes legal and economic principles for procurement of goods and services. During 2016-18, the LPP was strengthened further to introduce a new framework on online monitoring of procurement by the State Audit Service using automatic risk indicators. Starting from 2016, all public procurements are made through the ProZorro centralized electronic procurement system. The tool

provides for quick and thorough analysis of information on tenders, with easy and unlimited access granted to civil society. The ProZorro system has been recognized internationally and received several awards. However, the share of competitive procurement via the ProZorro system could be increased. In 2018, the total cost of all public procurement on a competitive basis using electronic auctions was 78 percent.

77. **The IMF conducted safeguards assessments of the NBU in 2014, 2015, and 2019.** The assessments confirmed that the NBU has made progress in strengthening its governance and control environment. The NBU legal framework was amended in 2015, further improving financial autonomy and governance. In addition, the NBU's institutional framework has been substantially strengthened and modernized, focusing on core functions and improving its decision-making processes and internal controls. The NBU also adopted a new ethics code for members of its decision-making bodies and for its staff. A new Audit Committee was established under the new NBU Council and an internal audit charter has been adopted. To address the credit risks stemming from the financial assistance to domestic banks, the loan management process and related risk management processes were reformed under a new loan management department. Consolidated financial statements of NBU prepared under requirements of IFRS were audited by Deloitte (year 2018) and by Ernst and Young (years 2019 and 2020). Independent auditors conducted respective audits under requirements of ISA and issued clean (unmodified) audit reports for these past three consecutive years. Within seven days of remittance of funds by the Bank, the Government will provide a confirmation to the World Bank that the funds have been received by the treasury account in the NBU and that these funds are available for financing budget expenditures.

78. **Disbursements**. The loan proceeds will be disbursed in one single tranche to the existing treasury account at the NBU, to be used for budget financing, and will form part of Ukraine's official foreign exchange reserves. The proposed loan will follow the WB's procedures for development policy lending. Disbursement will be made upon declaration of loan effectiveness and submission of a withdrawal application to the World Bank. No additional fiduciary arrangements, including audit, are required for the operation, given the progress in public financial management reforms.

79. **Overall Conclusion.** The public financial management systems, together with the Borrower's commitment to reform, are adequate to support this operation.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

80. **The Ministry of Finance is responsible for the overall coordination of the proposed operation.** While the Ministry of Finance is the primary coordinating counterpart, some of the line ministries are responsible for implementation in their respective areas. The Ministry of Agrarian Policy and Food , the Ministry of Finance and the Ministry of Justice have the responsibility for implementing the land reform, the Ministry of Agrarian Policy and Food in coordination with the National Bank of Ukraine and Ministry of Finance has the responsibility for implementing the PCG reforms, the Ministry of Infrastructure has responsibility for inland waterway reforms, the Cabinet of Ministers and Ministry of Justice are responsible for anticorruption reforms and Ministry of Social Development together with Ministry of Finance are responsible for implementing pension indexation.

81. **The specific expected results indicators, set out in Annex 1, will be used to monitor implementation of the operation.** The Bank, in collaboration with the Ukrainian authorities, will monitor and evaluate the program's achievement of these results.

82. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, because of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit *www.inspectionpanel.org*.

6. SUMMARY OF RISKS AND MITIGATION

83. **The overall risk to the proposed operation is substantial.** The risks to the proposed DPL have been assessed using the Standardized Operations Risk-rating Tool (SORT), as summarized in Table 5. The main risks to the proposed operation that are rated Substantial are political (including security) and governance risks; macroeconomic risks; sector strategies and policies; environment and social; and institutional capacity for implementation. The achievement of the development objective of this operation crucially depends on the containment of the COVID-19 pandemic, with risks of Ukraine cycling between reoccurring surges of the pandemic and activity slowdowns/pickups that could hinder the overall quality of recovery, and slow momentum on advancing reforms and moving forward with their implementation.

84. **Political and governance:** Substantial political and governance risks arise from the deep-rooted influence of powerful vested interests that could derail, or even reverse reforms supported by this operation. Anticorruption reforms, for example, require safeguarding the independence of key anticorruption institutions. These risks are mitigated by the government's willingness to advance major reforms (including long-awaited judicial reforms, that are critical for fostering rule-of-law), the strong voice of civil society in advocating for continued reforms, and Ukraine's continued cooperation with the international community and development partners. Another dimension of political and security risk is the conflict in eastern Ukraine which could intensify and adversely impact economic prospects through weaker investor confidence.

85. **Macroeconomic:** While the macroeconomic framework remains satisfactory, with sound exchange rate management and prudent fiscal policies, the country's exposure to shocks is substantial. Key macroeconomic risk factors include expenditure and fiscal pressures from a large public-sector wage bill, COVID-related spending, and large debt repayment needs, that are further exacerbated by rising quasi-fiscal deficits in the energy sector (related to high global gas prices, and arrears). Fiscal financing needs are substantial in 2021-24, leaving Ukraine vulnerable to adverse shifts in risk sentiment and

global financial volatility, and political, security and reform developments. The proposed operation contributes to mitigating macroeconomic risks by supporting reforms to bolster investor confidence, while cushioning the impact of COVID-19. The close engagement of the authorities with the World Bank, IMF and the EU on reviewing the macroeconomic policy framework, as well as in design and implementing key reform measures is another key mitigating factor.

86. Environment and social risks. On balance, land-related and inland waterway benefits are expected to lead to positive environmental and social impacts; however, reforms could also result in substantial risks if not managed properly. Mitigating factors for environmental risks include continued technical assistance by the World Bank and external partners (e.g., supporting EIAs, and digitization and publication of environmentally sensitive lands and assets). The implementation of land safeguard legislation supported by this operation will further increase transparency of land transactions through detailed recording and limit the risk of corruption in state land; other social risks are mitigated by substantial engagement with the Government and local stakeholder, especially consultations. Overall, although substantial, environmental and social risks, are mitigated in part by long-running dialogue and technical assistance (including the World Bank, US and EU) and by close engagement of civil society organizations.

87. Implementation (including sector policies and institutional capacity). The risks pertaining to sector strategies are closely intertwined with the risk pertaining to the institutional capacity for implementation. Reforms in key sectors require follow up actions to yield results. The risks associated with agricultural land reform are particularly significant, given the complex nature of the reform. Specifically, despite the implementation of land safeguard legislation, participation in land markets and/or development of credit instruments or other support schemes by small farmers that enable land-attached investments may take time to bear results. This risk is mitigated by the government's commitment to supporting land reforms to harness the full potential of the agricultural sector, as well as policy advocacy and technical assistance from international development partners on land reform. Progress on anticorruption, judicial and pension reform, in particular, is being anchored by long term engagement and investment in dialogue and technical assistance, in conjunction with international partners. Many of the reforms supported by the proposed DPL also require strong capacity for implementation and monitoring. These risks are mitigated in part by technical assistance provided by development partners (including the World Bank and EU) and by close engagement of civil society organization.

Table 7: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Substantial
8. Stakeholders	Moderate
9. Other	Moderate
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions and Triggers		Results		
Prior Actions under DPL-1	**Triggers for DPL-2**	**Indicator Name**	**Baseline**	**Target**
Pillar 1---Foster De-monopolization and Anticorruption Institutions				
Prior Action #1. Completed the unbundling of the state-owned gas transport system from Naftogaz on January 1, 2020 through: (i) the enactment of Law #264-IX on Unbundling; and (ii) the transfer of state-owned gas transport system's assets from the balance sheet of UTG to Gas TSO LLC.		**Results Indicator #1**: The share of gas transit revenues flowing in a transparent manner from Naftogaz to the new independent Gas TSO, based on the tariff set by the NEURC.	Baseline (2019): 0 percent	Target (2022): 100 percent
Prior Action #2. Enacted Law #155-IX on Concession to enhance the legal framework for attracting private investment in infrastructure and ensuring transparency in concession projects.	**Prior Action #1.** The Borrower has enacted Law # 1054-IX dated December 3, 2020 "On Inland Water Transport", and duly published in the Borrower's Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.	**Results Indicator #2**: Number of port concession projects signed with private investment mobilized through project financing by lenders. **Results Indicator #3.** Number of voyages by ships (including cargo) on Dnipro River increases by about 20 percent.	Baseline (2019): 0 Baseline (2019): 11,938	Target (2021): 2 Target (2021): 14,300
Prior Action #3. Enacted Law # 140-IX to strengthen the governance of the National Agency of Corruption Prevention (NACP) and Law # 263-IX to restore liability for illicit enrichment and enable civil forfeiture of		**Results Indicator #4**: Number of full verifications of high risk declarations selected using prioritization criteria, assigned automatically to staff, and implemented using an	Baseline (2020): 0	Target (2022): 1,500

unjustified assets.		improved methodology.		
Pillar 2---Strengthen Land and Credit Markets				
Prior Action #4. Enacted Law # 552-IX to enable the sale of agricultural land and the use of land as collateral and Law # 554-IX to strengthen transparency by improving access to cadastral data and links between the cadaster and registry	**Prior Action #2.** The Borrower has enacted Law #1423-IX dated April 28, 2021 "On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations", and duly published in the Borrower's Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land management, which simplifies procedures to create, transfer, and use land parcels; and transfer the ownership and administration of state land from the Geocadaster to local authorities. **Prior Action #3.** The Borrower has enacted Law # 1444-IX dated May 18, 2021 "On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions", and duly published in the Borrower's Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales. **Prior Action #4.** The Borrower has enacted Law #1865-IX dated November 4, 2021 "On the Fund for the Partial Guarantee of Loans in Agriculture" and duly published in the Borrowers' Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.	**Results Indicator #5:** Area of agricultural land previously under moratorium sold/purchased by eligible individuals **Results Indicator #6**: Loans are issued to small farmers and backed by Partial Credit Guarantee (PCG) facility	Baseline (2019): 0 hectares Baseline (2019): No	Target (2022): 150,000 hectares Target (2022): Yes

Prior Action #5. Issued NBU prudential regulations #49 and #52 on write-offs for fully provisioned NPLs and approved Cabinet of Ministers of Ukraine Resolution # 281 to enable state-owned banks NPL resolution through conventional tools including restructuring and sale with haircut on principal, as well as write-offs.		**Results Indicator #7:** Gross Pre-2020 NPL Portfolio of State-Owned Banks	Baseline (2019): UAH 397 billion	Target (2021): Under UAH 300 billion
Prior Action #6. Enacted Law # 79-IX to enhance the regulatory framework for nonbank financial institutions by abolishing the National Financial Services Commission and assigning the regulatory functions to the National Bank of Ukraine and National Securities and Stock Market Commission.		**Results Indicator #8:** NBU and NSSMC adopt action plan on reshuffling supervisory regimes for insurance, credit unions, pension funds, and other NBFIs.	Baseline (2019): No	Target (2021): Yes
Pillar 3---Bolster the Social Safety Net.				
Prior Action #7. Approved Cabinet Resolution # 251 to set the date and rate for the statutory pension indexation in 2020 and bolster the purchasing power of the pension benefit.	**Prior Action #5.** The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 “On the Budget Declaration for 2022-2024” requiring indexation of pensions for all categories of retirees not later than March 1st of each year from 2022 to 2024.	**Results Indicator #9:** Pension benefits increase in line with the indexation formula within the first half of each calendar year, allowing adequate support for pensioners, of which at least 65 percent are women.	Baseline (2019): No	Target (2022): Yes

ANNEX 2: FUND RELATIONS ANNEX

IMF Executive Board Completes First Review Under Stand-By Arrangement for Ukraine, Approves Extension of the Arrangement
November 22, 2021

Washington D.C: The Executive Board of the International Monetary Fund (IMF) completed today the first review of Ukraine's economic performance under the 18-month Stand-By Arrangement (SBA) that was approved on June 9, 2020. The completion of the review allows the authorities to draw the equivalent of about US$699 million (SDR 500 million), bringing total disbursements under the current SBA to about US$2.8 billion (SDR 2 billion).

The Board also approved an extension of the Stand-By Arrangement to end-June 2022 and a rephasing of program disbursements as well as the Ukrainian authorities' request for a waiver for non-observance of the December 2020 performance criterion on government guaranteed debt in light of the corrective actions already taken.

Ukraine's IMF supported economic program aims to help the authorities address the effects of the COVID-19 shock, sustain the economic recovery, and move ahead on important structural reforms to reduce key vulnerabilities.

In particular, under the agreed policy priorities the Ukrainian authorities are committed to (i) returning fiscal policies to settings consistent with medium-term debt sustainability while protecting the socially vulnerable, strengthening revenue administration, and reducing fiscal risks from quasi-fiscal operations, including in the energy sector; (ii) safeguarding central bank independence and focusing monetary policy on returning inflation to its target; (iii) ensuring banks' financial health, including through good governance, with the goal of reviving sound bank lending to the private sector; (iv) tackling corruption and pushing forward with the implementation of judicial reform; and (v) reducing the role of the state and vested interests in the economy to improve the business environment, attract investment and raise the economy's potential.

IMF Executive Board chairperson statement to follow.

IMF Communications Department
MEDIA RELATIONS
PRESS OFFICER: RAPHAEL ANSPACH

PHONE: +1 202 623-7100EMAIL: MEDIA@IMF.ORG

ANNEX 3: LETTER OF DEVELOPMENT POLICY

КАБІНЕТ МІНІСТРІВ УКРАЇНИ

CABINET OF MINISTERS OF UKRAINE

ЛИСТ СТОСОВНО ПОЛІТИКИ РОЗВИТКУ

37711/0/2-21 від 19.11.2021

Шановний пане Малпасс!

1. ВСТУП. Від імені Уряду України я хотів би скористатися цією можливістю, щоб висловити наші теплі вітання та вдячність Світовому банку та особисто Вам за Вашу підтримку і допомогу Україні на шляху досягнення найважливіших цілей розвитку. Наше плідне партнерство допомогло втілити ряд важливих реформ, які підтримуються проектом "Друга позика на політику розвитку у сфері економічного відновлення". На сьогодні Україна переживає повільне відновлення економіки після початку пандемії гострої респіраторної хвороби COVID-19, спричиненої коронавірусом SARS-CoV-2 (далі — COVID-19), на яке впливають повторні спалахи зараження. Україна щиро цінує готовність Світового банку створити умови для міцного та стійкого економічного відновлення та допомогти зменшити негативний вплив кризи на найбідніші та найуразливіші групи населення нашої країни, зокрема на людей похилого віку. Слід зауважити, що важливі реформи, які підтримують позики на політику розвитку, мають визначальне значення для України, яка докладає значних зусиль на шляху зміцнення основ економічного відновлення шляхом сприяння демонополізації та посилення антикорупційних інституцій, покращення роботи ринків землі та капіталу, а також покращення системи соціальної підтримки.

2. РЕФОРМИ ТА АКТУАЛЬНІ ВИКЛИКИ. Починаючи з 2014 року Україна здійснила масштабні реформи за рахунок інструментів підтримки Світового банку у 2014—2015 роках, у 2018 році та у 2020 році в рамках проекту "Перша позика на політику розвитку у сфері економічного відновлення". До пандемії такі реформи допомогли відновити макроекономічну та фінансову стабільність, зменшити державний та гарантований державою борг до більш стійкого рівня (з пікових 80,9 відсотка валового внутрішнього продукту на кінець 2016 року до 50,3 відсотка валового внутрішнього продукту на кінець 2019 року)

пану Девіду МАЛПАССУ
Президентові Світового банку
м. Вашингтон, округ Колумбія

та відновити економічне зростання. Такі досягнення допомогли не лише продемонструвати успіхи України у проведенні реформ, а також підтримали сформований завдяки реформам запас міцності, таким чином допомагаючи посилити макроекономічну стабільність протягом 2020 року та запобігти більш стрімкому падінню валового внутрішнього продукту, ніж чотирьохвідсоткове падіння, яке відбулося. Однак із збільшенням дефіциту державного бюджету до 6 відсотків державний та гарантований державою борг зріс майже до 61 відсотка валового внутрішнього продукту на кінець 2020 року. Істотний вплив на кризу мала також ситуація у сфері охорони здоров'я. Станом на 1 листопада 2021 р. в Україні зареєстровано 2,94 млн. підтверджених випадків коронавірусної хвороби та 68 027 летальних випадків. Лише 7,4 млн. людей, або менше п'ятої частини від загальної кількості населення, що становить близько 41 млн., повністю вакциновані на цей момент.

3. ПАНДЕМІЯ. Пандемія продовжує впливати на здоров'я і економічне становище нашого населення та продовжує стримувати економічне відновлення. Крім того, пандемія також загострила основні проблеми розвитку, з якими стикається Україна. Україна взяла на себе зобов'язання подолати такі виклики, щоб забезпечити кращий рівень життя українського народу. Зокрема, незважаючи на прогрес останніх років, залишається багато структурних перешкод, що стримують потенціал економіки України. Наша держава поставила за мету провести реформи, які усунуть зазначені перешкоди для приватних інвестицій та підвищення продуктивності, задля того, щоб дати можливість економіці відновитися після завершення кризи у сфері охорони здоров'я. Очікується, що після слабкого відновлення у першій половині 2021 року економіка зросте на 4,1 відсотка у 2021 році. Україна значно посилила карантинні обмеження у зв'язку з третьою хвилею зростання захворювань на COVID-19. Також було вжито заходів, у тому числі за підтримки Світового банку, щодо прискорення темпів вакцинації та зміцнення потенціалу сфери охорони здоров'я, щоб запобігти, виявити та реагувати на наслідки пандемії. Водночас зроблено значні кроки на шляху зміцнення сфери соціального захисту, щоб пом'якшити вплив кризи на населення. Висловлюємо сподівання, що такі заходи разом із ключовими реформами, які підтримуються кредитами в рамках позики на політику розвитку, допоможуть підтримати відновлення у 2022 році, коли очікується, що зростання валового внутрішнього продукту становитиме 3,8 відсотка.

4. БЮДЖЕТНА ПОЛІТИКА. Україна прагне повернутися до поступової фіскальної консолідації, щоб закріпити фіскальну стійкість у середньостроковій перспективі. Середньострокова бюджетна декларація на 2022—2024 роки, схвалена Урядом та підтримана Верховною Радою України, передбачає поступову фіскальну консолідацію. Відповідно до декларації Україна зобов'язується скоротити дефіцит державного бюджету із запланованих 5,5 відсотка валового внутрішнього продукту у 2021 році

до 3,5 відсотка у 2022 році, а потім до 2,7 відсотка у 2024 році. Метою нашої держави є забезпечення макроекономічної та фіскальної стійкості. Підтримка України шляхом надання кредиту в рамках позики на політику розвитку від Світового банку разом з підтримкою з боку МВФ та ЄС — принципово важливі у процесі сприяння Україні у задоволенні потреб у фінансуванні на доступних умовах, у тому числі на міжнародних фінансових ринках.

5. МАКРОЕКОНОМІКА. Макроекономічна політика України є міцною і посилюється нашими зобов'язаннями щодо фіскальної та зовнішньої стабільності. Україна прагне скоротити державний борг у 2022 році разом з відновленням економічного зростання. Водночас органи, відповідальні за монетарну політику, вживають усіх необхідних заходів для підтримки гнучкого та стабільного обмінного курсу, відслідковуючи при цьому інфляційні ризики. Наша держава працює над втіленням програми структурних реформ, що спрямована на (i) підтримку відновлення економічного зростання шляхом збільшення інвестицій та покращення продуктивності; (ii) зменшення дефіциту державного бюджету та державного боргу на фоні відновлення економічного зростання; (iii) збільшення експорту та залучення прямих іноземних інвестицій для підтримки стійкості до зовнішніх ризиків; (iv) створення умов для відновлення зростання кредитування приватного сектору. Макроекономічна стратегія України підтримується цими позиками на політику розвитку, макрофінансовою допомогою Європейського Союзу та програмою "Стенд-бай" з МВФ, завершення першого перегляду якої очікується у листопаді 2021 року.

6. РЕФОРМИ. Уряд України зобов'язується втілювати свою амбітну програму структурних реформ. Наші дії будуть економічно обґрунтованими, технічно можливими та направлені на тривалий позитивний ефект. Підтримка з боку міжнародних партнерів дуже важлива для подальшого зміцнення нашої спроможності ефективно виконувати зобов'язання, водночас підтримуючи інституційні та системні реформи, які проводяться в Україні.

7. ПОЗИКИ НА ПОЛІТИКУ РОЗВИТКУ ТА РЕФОРМИ УРЯДУ. Підтримка Світового банку має вирішальне значення для успіху нашої амбітної програми реформ. Запропонована Друга позика на політику розвитку у сфері економічного відновлення направлена на підтримку ключових елементів нашої програми реформ, метою яких є усунення критичних перешкод для інвестицій та економічного відновлення, а також пом'якшення негативного впливу глобальної пандемії. Вона ґрунтується на важливих реформах, які були підтримані Першою позикою на політику розвитку у сфері економічного відновлення. Особливо це стосується земельної реформи, необхідної для забезпечення прозорого та безперешкодного функціонування ринку землі. Надання позики підтримало також продовження реформ у сфері річкового транспорту та

портової логістики, антикорупційних реформ і пенсійного забезпечення. Зазначені реформи спроектовані навколо трьох ключових компонентів, які повністю відповідають нашим цілям розвитку: (i) сприяння демонополізації та антикорупційним інституціям; (ii) зміцнення ринків землі та капіталу; (iii) посилення системи соціальної підтримки.

8. КОМПОНЕНТ 1. Підтримка демонополізації та протидія корупції. Реформи в рамках такого компонента сприяють демонополізації ключових секторів економіки та посиленню антикорупційних інституцій для зміцнення довіри інвесторів. Україна продовжує втілювати реформу у сфері внутрішніх водних шляхів, яка сприятиме залученню більшої кількості учасників з приватного сектору та конкурентоспроможності у цій сфері, а також сприятиме інвестиціям у зазначений сектор економіки. Україна у 2020 році підписала дві концесії портів за підтримки Світового банку, а також планує додаткові концесійні проекти у портовому секторі. Модернізація, оновлення та розширення річкового транспорту є ключовим елементом нашої довгострокової стратегії розвитку, направленої на зменшення перешкод нашому експорту (особливо сільського господарства) та розширення логістичних зв'язків з нашими регіональними партнерами. Слід запевнити, що такі заходи сприятимуть досягненню наших довгострокових цілей щодо скорочення викидів вуглецю.

Наша держава продовжує втілювати реформу, направлену на зміцнення антикорупційних інституцій, для подальшого підвищення прозорості та підзвітності і створення рівних умов для інвесторів в Україні. Зокрема визначено правову, економічну та організаційну основи для регулювання сектору внутрішніх водних шляхів та забезпечено недискримінаційний доступ операторів до внутрішніх водних шляхів завдяки прийняттю Закону України "Про внутрішній водний транспорт". Триває втілення цієї реформи з метою створення умов для зростання використання річкового транспорту в Україні, що вже призвело до збільшення кількості рейсів (включаючи вантажні) по річці Дніпро. У середньостроковій та довгостроковій перспективі віримо, що така реформа сприятиме інвестиціям приватного сектору в ключову інфраструктуру в Україні та підтримає продуктивність і ефективність економіки. Це також сприятиме збільшенню обсягів перевезень вантажів видами транспорту з низькими викидами вуглецю відповідно до вимог портових контрактів, підписаних у рамках державно-приватного партнерства. Враховуючи екологічні ризики, в Україні триває приведення екологічних стандартів у відповідність з нормативними актами ЄС, а також розробляються методологічні вказівки для окремих секторів інфраструктури.

Протягом минулого року відбувалася плідна робота над відновленням процесу перевірки декларацій осіб, уповноважених на виконання функцій держави або місцевого самоврядування, ключових повноважень Національного агентства з питань запобігання корупції та інших фундаментальних частин правової системи декларування майна, яка опинилася під загрозою. Буде продовжено втілення таких реформ для збільшення кількості повних перевірок декларацій з високим ризиком (вибраних із застосуванням критеріїв ризику, автоматично присвоєних персоналу та здійснених за вдосконаленою методологією) з 0 у 2019 році до 1500 у 2022 році. Вважаємо, що проведення значної кількості детальних перевірок декларацій про майно на основі більш вдосконаленого та чутливого до ризику підходу має сприяти підвищенню підзвітності та зміцненню довіри до заходів протидії корупції, що проводить Україна. Крім того, Уряд України затвердив критерії та методику проведення оцінювання ефективності діяльності Національного агентства з питань запобігання корупції. Також створено Комісію з проведення незалежної оцінки ефективності діяльності, яка має посилити підзвітність та громадський нагляд за Національним агентством з питань запобігання корупції і таким чином ізолювати його від корупційного впливу та підвищити його ефективність.

Реформи в рамках Першої позики на політику розвитку у сфері економічного відновлення, включаючи успішне відокремлення оператора газотранспортної системи та його сертифікацію з 1 січня 2020 р., сприяли тому, що частина доходів від транзиту російського газу через Україну були зібрані ТОВ "Оператор ГТС України" відповідно до нової Угоди про транзит газу з "Газпромом", підписаної 30 грудня 2019 року. Однак фінансову звітність ТОВ "Оператор ГТС України" за 2020 рік не було затверджено наглядовою радою АТ "МГУ". Новий склад наглядової ради призначено 5 жовтня 2021 р. та на сьогодні опрацьовується питання затвердження фінансової звітності АТ "МГУ" та ТОВ "Оператор ГТС України" за 2020 рік.

Безпрецедентне зростання цін на енергоносії призвело до внесення змін до Договору купівлі-продажу частки в статутному капіталі ТОВ "Оператор ГТС України", підписаного між АТ "Укртрансгаз" та АТ "Магістральні газопроводи України", що забезпечило можливість перерахування 27 млрд. гривень (доходу ТОВ "Оператор ГТС України" за 2020—2021 роки) Укртрансгазу. Подальші перекази можливі лише за умови позитивного висновку новопризначеної наглядової ради АТ "МГУ" щодо наслідків таких переказів для компанії.

Україна дотримується політики прозорого перерахування доходів від транзиту газу до оператора газотранспортної системи згідно з тарифом, встановленим НКРЕКП, що відповідає її прагненню досягти довгострокової фінансової стійкості та впровадження надійного корпоративного управління відповідно до практик ЄС.

Важливо створити умови, щоб ТОВ "Оператор ГТС України" міг виконувати свою стратегічну місію підтримки розвитку конкурентного, прозорого, недискримінаційного ринку газу та забезпечувати надійний транзит газу для українських та європейських споживачів найефективнішим способом. Україна зобов'язується тісно співпрацювати з міжнародними партнерами для розробки заснованого на правилах прозорого та передбачуваного фінансування державних послуг.

9. КОМПОНЕНТ 2. Зміцнення ринків землі та капіталу. Реформи, які підтримує Друга позика на політику розвитку у сфері економічного відновлення в рамках цього компонента, допомагають підвищити ефективність розподілу ресурсів в економіці шляхом підтримки ринку землі сільськогосподарського призначення та розширення доступу фермерів до кредитів. Підтримка прозорого ринку землі, а також покращення доступу до кредитів для дрібних виробників у сільськогосподарському секторі дасть змогу підвищити продуктивність земельних інвестицій та сталого ведення сільського господарства, особливо для 4,6 млн. дрібних фермерів, які обробляють близько 15,7 млн. гектарів землі. У середньостроковій і довгостроковій перспективі це сприятиме переходу на продукти з вищою доданою вартістю, створенню робочих місць у сільській місцевості, а також загальному економічному зростанню.

Україна прийняла важливий земельний закон, спрямований на підвищення прозорості та ефективності земельних угод, що забезпечує децентралізоване управління шляхом передачі права власності та управління державною землею органам місцевого самоврядування, а також підвищує прозорість та спрощує процедури (Закон України від 28 квітня 2021 р. № 1423-IX "Про внесення змін до деяких законодавчих актів України щодо вдосконалення системи управління та дерегуляції у сфері земельних відносин"). Крім того, прийнято закон, який регулює місцеве державне землекористування та передбачає проведення електронних аукціонів з продажу державних земель (Закон України від 18 травня 2021 р. № 1444-IX "Про внесення змін до деяких законодавчих актів України щодо продажу земельних ділянок та набуття права користування ними через електронні аукціони"). Україна зобов'язується забезпечити повне виконання Держгеокадастром положень Законів України від 5 грудня 2019 р. № 340-IX "Про внесення змін до деяких законодавчих актів України щодо протидії рейдерству" та від 13 квітня 2020 р. № 554-IX "Про національну інфраструктуру геопросторових даних" (підтриманих Першою позикою на політику розвитку у сфері економічного відновлення) щодо доступу громадськості та органів місцевого самоврядування до даних про землю, прийняти постанову щодо моніторингу земельних відносин, оприлюднену для консультацій до кінця листопада, щоб забезпечити ефективне впровадження та моніторинг запобіжних заходів. За підтримки програми Світового банку "Прискорення приватних інвестицій у сільське господарство" також буде зроблено необхідні кроки для забезпечення повної інвентаризації всіх державних земель, включаючи ліси; закуплено карти, щоб дати змогу об'єднаним територіальним громадам планувати свої території та збільшити дохід; запущено Державний аграрний реєстр до кінця 2021 року.

Верховна Рада України 4 листопада 2021 р. прийняла Закон України "Про Фонд часткового гарантування кредитів у сільському господарстві" (реєстраційний номер 3205-2) для створення механізму часткового гарантування кредитів у сільському господарстві. Україна прагне впровадити цей механізм, щоб уможливити надання у 2022 році кредитів дрібним фермерам, виданих за підтримки механізму часткового гарантування, для того, щоб механізм був незалежно керований, вільний від політичного втручання та в рамках вимог, передбачених органом, який здійснює державне регулювання ринків фінансових послуг (Національний банк України). Віримо, що покращений доступ до фінансування для дрібних фермерів із обмеженим доступом до фінансування дозволить їм стати активними учасниками на ринку землі, розширити можливості для сільського господарства в Україні, а також перейти до продукції з вищою доданою вартістю. Це також допоможе запобігти концентрації власності на землю після відкриття ринку. Щоб підтримати введення в дію Фонду часткового гарантування кредитів, Україна зобов'язується передбачити відповідні бюджетні асигнування у Законі України "Про Державний бюджет України на 2022 рік", прийняття якого планується до кінця 2021 року. Крім того, постановою Кабінету Міністрів України надано проміжний інструмент державних гарантій для підтримки дрібних фермерів (постанова від 14 липня 2021 р. № 723) до моменту повного запуску механізму часткового гарантування кредитів. Уряд тісно співпрацюватиме з Антимонопольним комітетом України щодо виконання зазначеної постанови, щоб сприяти видачі необхідного висновку і внесенню на розгляд Кабінету Міністрів України до середини грудня 2021 року проекту постанови щодо лімітів державних гарантій стосовно кожної банківської установи-учасника з метою запуску інструменту до початку січня 2022 року. Також Україна протягом трьох місяців з дня набрання чинності Законом України "Про Фонд часткового гарантування кредитів у сільському господарстві" (реєстраційний номер 3205-2) здійснить всі необхідні заходи для забезпечення ефективної роботи Фонду часткового гарантування кредитів у сільському господарстві, формування та сплати його статутного капіталу з подальшим визначенням незалежних механізмів корпоративного управління, незалежних членів наглядової ради, голова якої обирається радою Фонду часткового гарантування кредитів у сільському господарстві з числа незалежних членів відповідно до затвердженого Урядом Статуту.

Уряд України продовжив впроваджувати реформу фінансового сектору, яку підтримувала Перша позика на політику розвитку у сфері економічного відновлення, що відображено у скороченні частки непрацюючих кредитів державних банків та посиленні нагляду за небанківськими фінансовими установами з боку Національного банку

України (одна з двох нових сфер нагляду), який готує та подає до парламенту нові законопроекти про регулювання ринків небанківських фінансових послуг. Паралельно Національна комісія з цінних паперів та фондового ринку (НКЦПФР) також доклала зусиль щодо зміцнення своєї правової та нормативної бази для ринків капіталу та пенсійних фондів.

10. КОМПОНЕНТ 3. Зміцнення системи соціальної підтримки. Криза COVID-19, що розгортається, акцентувала увагу на важливості захисту вразливих верств населення, особливо людей похилого віку. Найбільшу частину системи соціального захисту в Україні становлять пенсії, причому пенсійні виплати становлять значну частину доходів домогосподарств з незахищених верств населення. Однією з ключових особливостей ухваленого у 2017 році закону про пенсійну реформу є щорічна індексація пенсійної виплати. Оскільки закон передбачає гнучкість щодо визначення дати індексації пенсії щороку, це обумовило непрогнозованість щорічних пенсійних виплат, що призвело до певної нестабільності купівельної спроможності. Було перенесено дату законодавчої індексації пенсії у 2020 році та послідовно застосовано її у 2021 році. У цьому році це сприяло передбачуваності і купівельної спроможності пенсійних виплат. Однак зазначена передбачуваність ще мала б бути закріплена законодавчо.

У зв'язку із зазначеним Уряд України схвалив Бюджетну декларацію на 2022—2024 роки, яку підтримала Верховна Рада України. Цей документ містить положення, згідно з яким індексація пенсій буде проводитися не пізніше 1 березня. Також передбачено ухвалення Верховною Радою України законопроекту, що передбачає своєчасну індексацію (реєстраційний номер 4668). Парламент ухвалив проект цього закону у першому читанні 9 вересня 2021 р. та невдовзі має розглянути його у другому читанні.

11. Користуючись можливістю, слід підтвердити прихильність України принципам підзвітності та прозорості в контексті управління державними фінансами та координації діяльності партнерів з розвитку. За останні роки успішно здійснено реформи, спрямовані на впровадження середньострокового бюджетного планування, покращення механізму міжбюджетних трансфертів, зміцнення системи державних закупівель та управління державними інвестиціями. Україна й надалі готова дотримуватися принципів повної підзвітності та прозорості, у тому числі щодо взаємодії з усіма міжнародними партнерами.

12. Уряд України забезпечить проведення земельної реформи таким чином, щоб це не зашкодило навколишньому природному середовищу та підвищило якість життя. Буде продовжено роботу над зміцненням спроможності органів місцевого самоврядування проводити належну екологічну перевірку, упорядкувати процедури оцінки впливу на довкілля процесів відведення/використання земель, зосереджуючись, зокрема, на екологічно чутливих та цінних землях.

13. Україна продуктивно співпрацює із Світовим банком з метою розроблення програми реформ, що підтримується позиками на політику розвитку, і надалі тісно співпрацюватиме для моніторингу виконання цієї програми реформ. У наступному році Україна підтримуватиме динаміку реформ, забезпечуючи як якість, так і очікуваний позитивний результат цих реформ.

З повагою

Прем'єр-міністр України **Денис ШМИГАЛЬ**

[unofficial translation]

КАБІНЕТ МІНІСТРІВ УКРАЇНИ

CABINET OF MINISTERS OF UKRAINE

To: David MALPASS, President of the World Bank, Washington, D. C.

LETTER OF DEVELOPMENT POLICY
37711/0/2-21 of November 19, 2021

Dear Mr. Malpass,

1. On behalf of the Government of Ukraine, I would like to take this opportunity to express our warm regards and gratitude to the World Bank and personally to you for your support and assistance to Ukraine along the path toward its most important development goals. Our fruitful partnership has contributed to implementing a number of important reforms supported by the Second Economic Recovery Development Policy Loan project. Currently, Ukraine's economy is gradually recovering after the onset of the COVID-19 pandemic caused by the novel SARS-CoV-2 coronavirus ("COVID-19") but the recovery is affected by the recurring waves of infection. Ukraine appreciates sincerely the World Bank's willingness to create conditions for the strong and sustained economic recovery and help with mitigating the impact of this crisis on the poorest and most vulnerable groups in our country, in particular the elderly. If bears mentioning that the important reforms supported by the DPL series of loans are critical for Ukraine's considerable efforts aimed at strengthening the foundations of economic recovery by supporting de-monopolization and strengthening anticorruption institutions, improving the operation of land and capital markets, and bolstering the social safety net.

2. REFORMS AND CURRENT CHALLENGES. Since 2014, Ukraine has implemented far-reaching reforms supported with the World Bank's instruments in 2014–2015, 2018, as well as in 2020 with the First Economic Recovery Development Policy Loan project. Before the pandemic, these reforms helped to restore macroeconomic and fiscal stability, reduce public and publicly guaranteed debt to a more sustainable level (from a peak of 80.9 percent of the gross domestic product as of late 2016 to 50.3 percent of GDP in late 2019), and resume economic growth. These achievements have not only made it possible to demonstrate Ukraine's successful track record in implementing reforms but also bolstered the buffers created due to the reforms; in doing so,

they helped to strengthen the macroeconomic stability during 2020 and prevent a deeper GDP drop than the actual four-percent decline. However, the public and publicly guaranteed debt grew to almost 61 percent of the GDP as of late 2020 with an increase in the general government deficit to 6 percent. The situation in the health care sector has also contributed to the crisis substantially. As of November 1, 2021, there were 2.94 million confirmed coronavirus disease cases and 68,027 deaths. Only 7.4 million or less than a fifth of the total population of around 41 million have been fully vaccinated so far.

3. PANDEMIC. The pandemic is still affecting the health and livelihoods of our people and continues to constrain the economic recovery. In addition, the pandemic has exacerbated the major development challenges faced by Ukraine. Ukraine is committed to tackling these challenges to improve the living standards for the Ukrainian people. Specifically, a lot of structural bottlenecks constrain the potential of Ukraine’s economy in spite of the progress of recent years. Ukraine has focused on delivering the reforms that would eliminate these impediments to private investment and productivity improvement to enable the economy to recover once the health crisis is over. The economy is expected to grow overall by 4.1 percent in 2021 after a weak recovery in the first half of the year 2021. Ukraine has significantly tightened its quarantine restrictions in response to the third wave of COVID-19 infections. Steps have been taken, including those supported by the World Bank, to speed up the vaccination pace and strengthen the capacity of the health care sector to prevent, detect, and respond to impacts of the pandemic. At the same time, significant steps have been taken toward bolstering the social safety net to mitigate the crisis impact on the population. We hope that these measures, together with the key reforms supported by the DPL series, will support the recovery in 2022, with the expected GDP growth rate of 3.8 percent.

4. FISCAL POLICY. Ukraine is committed to return to the path of gradual fiscal consolidation to anchor its fiscal sustainability in the medium term. The 2022–2024 Medium-term Budget Declaration endorsed by the Government and supported by the Verkhovna Rada of Ukraine calls for the gradual fiscal consolidation. Under the declaration, Ukraine commits itself to reducing the budget deficit from a planned 5.5 percent of GDP in 2021 to 3.5 percent in 2022, and further to 2.7 percent in 2024. Our country is focused on safeguarding macroeconomic and fiscal sustainability. The support to Ukraine in the form of the World Bank’s DPL loan, together with support from the IMF and the EU, is of great importance in the process of supporting Ukraine to meet its financing needs on affordable terms, including in international financial markets.

5. MACROECONOMICS. Ukraine’s macroeconomic policy is strong and underpinned by our commitment to the fiscal and external stability. Ukraine aims at reducing public debt in 2022, together with resuming economic growth. Meanwhile, the monetary authorities are taking all the steps needed to maintain a flexible and stable exchange rate, while monitoring the inflation risks. Our country is working in implementing a structural reform agenda focused on (i) supporting economic recovery by bolstering investment and productivity; (ii) reducing the fiscal deficit and public debt as economic growth resumes; (iii) raising exports and attracting FDIs to

support external sustainability; and (iv) enabling a resumption of credit growth to the private sector. Ukraine's macroeconomic strategy is supported by these Development Policy Loans, the European Union's Macro-Financial Assistance, and the IMF Stand-by Arrangement, with the first review expected to be completed in November 2021.

6. REFORMS. The Government of Ukraine is committed to implementing its ambitious structural reform agenda. Our actions will be economically sound, technically feasible, and aimed at attaining a long-lasting positive impact. Support from international partners is very important to further reinforce our capacity to effectively deliver on this commitment, while at the same time sustaining the momentum of institutional and systemic reforms that are underway in Ukraine.

7. DEVELOPMENT POLICY LENDING AND GOVERNMENT REFORMS. Support from the World Bank is critical to the success of our ambitious reform agenda. The proposed Second Economic Recovery Development Policy Loan is designed to support key elements of our policy reform agenda to address critical impediments to investment and economic recovery, while mitigating the impact of the global pandemic. It builds on critical policy reforms supported by the First Economic Recovery Development Policy Loan. This is especially the case in relation to land reforms needed to ensure transparent and inclusive functioning of land markets. The loan supported the continued reforms in the river transport and port logistics sector, anticorruption reforms, as well as the pension system reform. These reforms are organized under the following three pillars fully aligned with our development objectives: (i) fostering de-monopolization and anticorruption institutions; (ii) strengthening land and credit markets; and (iii) bolstering the social safety net.

8. PILLAR 1. Fostering De-monopolization and Anticorruption. The reforms under this pillar help de-monopolize key sectors of the economy and strengthen anticorruption institutions. Ukraine is committed to continuing the implementation of the further reforms in the inland waterway sector that should help to increase private entry and competition in the sector, and facilitate investment in a critical sector of the economy. With the World Bank's support, Ukraine signed two port concessions in 2020, with additional concession projects also in the pipeline in the port sector. Modernizing, upgrading and expanding river transport is a core element of our long-term development strategy for removing impediments for our exports (especially of agricultural products) and increasing logistical connectivity to our regional partners. It bears reiterating that these measures will contribute to our long-term goals for reducing carbon emissions.

Ukraine keeps implementing the reform aimed at strengthening anticorruption institutions to further improve their transparency and accountability and create a level playing field for investors in Ukraine. For instance, the legal, economic, and organizational basis has been defined for the regulation of the inland waterway sector, and non-discriminatory access of operators to inland waterways has been enabled by enacting the Law of Ukraine "On Inland Water Transport."

This reform aimed to facilitate increased usage of river transport in Ukraine is ongoing, reflected in the result of increasing voyages (including cargo) on the Dnipro river. Over the medium to long term, we believe that this reform will facilitate private sector investment into key infrastructure in Ukraine and will support productivity and efficiency in the economy. It will also help enable a shift in port cargo transshipment volumes towards low carbon emissions modes as required by the port PPP contracts. Given environmental risks, Ukraine is aligning environmental standards with EU regulations, as well as developing sector-specific methodological guidance for infrastructure interventions.

Over the past year, we have worked successfully to restore the verification process of asset declarations of individuals authorized to exercise state or local government functions, key powers of the National Agency on Corruption Prevention and other fundamental parts of the legal framework on asset declaration that had come under threat. We will keep implementing these reforms to achieve the result of increasing the number of full verifications of high-risk declarations (selected using risk criteria, assigned automatically to staff, and implemented using an improved methodology) from 0 in 2019 to 1,500 in 2022. We believe that carrying out a significant number of detailed verifications of asset declarations based on an improved and more risk sensitive approach should help increase accountability and bolster confidence in Ukraine's anticorruption efforts. In addition, the Government of Ukraine approved the criteria and the methodology for the performance appraisal of the National Agency on Corruption Prevention. An Independent Performance Audit Commission was established to further improve accountability and public oversight of the National Agency on Corruption Prevention, and thus insulate it from the corrupt influence and make it more effective.

Reforms supported by the First Economic Recovery Development Policy Loan, including the successful unbundling of the Gas TSO and its certification from January 1, 2020, enabled a portion of the revenues from transit of the Russian gas through Ukraine to be collected by Gas TSO LLC in accordance with the new Gas Transit Agreement with Gazprom signed on December 30, 2019. However, the 2020 financial statements of Gas TSO LLC were not approved by the Supervisory Board of "Main Gas Pipelines of Ukraine" (MGPU) JSC. New members of the Supervisory Board were appointed on October 5, 2021; currently, the work is ongoing on the approval of the 2020 financial statements of both MGPU JSC and Gas TSO LLC.

An unprecedented energy price hike resulted in the amendment of the Gas TSO LLC Equity Interest Sale/Purchase Agreement signed between Ukrtransgaz JSC and MGPU JSC; the amendment made it possible to transfer UAH 27 billion (Gas TSO LLC's 2020–2021 income) to Ukrtransgaz. Further transfers would only be possible in the case of a positive opinion of the new supervisory board of MTPU JSC on consequences of such transfers for the company.

Ukraine is committed to the policy of transparent transfers of the gas transit revenue to the gas transmission system operator at a tariff rate set by the National Energy and Utilities Regulatory Commission; this commitment is aligned with its focus on the long-term financial stability and the implementation of the reliable corporate governance in line with the EU practices.

It is important to create conditions for Gas TSO LLC to be able to carry out its strategic mission of supporting the development of a competitive, transparent, and non-discriminatory gas market, and maintain reliable gas transit for the Ukrainian and European consumers in the most efficient manner. Ukraine is committed to closely cooperating with its international partners in order to develop the rule-based, transparent and predictable funding of the public services.

9. PILLAR 2. Strengthening Land and Capital Markets. The reforms supported by the Second Economic Recovery Development Policy Loan under this pillar help to increase the efficiency of resource allocation in the economy by supporting an agricultural land market and increasing access to credit for farmers. Supporting transparent land markets, as well as improved access to credit for small producers in the agricultural sector would enable productivity enhancing land-attached investments and sustainable farming practices, especially for the 4.6 million small household farmers who farm some 15.7 million hectares of land. Over the medium to long term, it would support a shift into higher value-added products and job creation in rural areas, and overall economic growth.

Ukraine enacted an important law focused on improving transparency and efficiency in land transactions to enable decentralized management through the transfer of ownership and administration of state land to local governments and increasing transparency and simplifying procedures (Law of Ukraine No. 1423-IX of April 28, 2021, “On Amending Some Legislative Acts of Ukraine for the Management System Improvement and Deregulation in the Field of Land Relations”). In addition, a law was enacted that regulates the local state land use and calls for holding electronic auctions to sell state-owned land (Law of Ukraine No. 1444-IX of May 18, 2021, “On Amending Some Legislative Acts of Ukraine with Regard to the Sales of Land Plots and Obtaining the Right to Use Them via Electronic Auctions”). Ukraine undertakes to ensure the full compliance of the State Geodesy, Cartography and Cadaster Service with provisions of the Law of Ukraine No. 340-IX of December 5, 2019, “On Amending Some Legislative Acts of Ukraine to Counteract Corporate Raiding” and No. 554-IX of April 13, 2020, “On National Geospatial Data Infrastructure (both supported by the First Economic Recovery Development Policy Loan) with regard to granting access to the general public and local governments to land data, issue a resolution on the monitoring of land relations published for consultations by the end of November in order to ensure efficient implementation and monitoring of safeguards. With the support of the World Bank’s Accelerating Private Investment in Agriculture Program, the appropriate steps will be made to take complete inventory of all the state-owned land, including forests; maps will be procured to enable consolidated communities to plan their territories and increase their revenues, and the State Agrarian Register will be launched before the end of the year 2021.

On November 4, 2021, the Verkhovna Rada of Ukraine enacted the Law of Ukraine “On Partial

Agricultural Credit Guarantee Fund" (registration number 3205-2) in order to set up a mechanism of partial credit guarantees in the agricultural sector. Ukraine is fully committed to implementing this framework to achieve the result of loans to small farmers issued backed by the PCG facility in 2022, with this facility independently governed, free from political interference and operating within the scope of requirements of the agency in charge of the state regulation of financial service markets (the National Bank of Ukraine). We believe that improved access to finance for small, credit constrained farmers will allow them to participate actively in the land market and expand opportunities for agriculture in Ukraine, and move into higher value-added products. It will also help prevent the concentration of land ownership once the market opens. To support the operationalization of the Partial Credit Guarantee Fund, Ukraine is committed to providing appropriate budget allocations in the 2022 Budget Law, which will be voted before the end of the year 2021. In addition, Resolution of the Cabinet of Ministers of Ukraine No. 723 of July 14, 2021) provided a bridge guarantee instrument to support small farmers until the PCG framework becomes fully operational. The Government will work closely with the Anti-Monopoly Committee on implementing the above-mentioned Resolution to facilitate issuance of the required opinion and the submission of the draft resolution with public guarantee limit allocations to each of the participating financial institutions to the Cabinet of Ministers by mid-December 2021 with a view to making the instrument operational by early January 2022. Within three months of the effective date of the Law of Ukraine "On Partial Agricultural Credit Guarantee Fund" (registration number 3205-2), Ukraine will take all the measures needed to ensure efficient operation of the Partial Credit Guarantee Fund, set up and contribute its capital, with the subsequent implementation of independent corporate governance mechanisms and the appointment of independent members of the supervisory board, with its chair to be elected by the board of the Partial Credit Guarantee Fund from independent members of the board in accordance with the Charter approved by the Government.

The Government has continued to implement the financial sector reform supported under the First Economic Recovery Development Policy Loan, as reflected in the reduction of non-performing loans at state-owned banks, and strengthened supervision of non-bank financial institutions (one of two new areas of supervision), with the NBU preparing and submitting to the parliament new draft laws on regulating markets of non-bank financial services. In parallel, the National Securities and Stock Market Commission (NSSMC) has also undertaken efforts in strengthening its legal and regulatory framework for capital markets and pension funds.

10. PILLAR 3. Bolster Social Safety Net. The unfolding COVID-19 crisis has emphasized the importance of protecting the vulnerable individuals, especially elderly. The largest part of the social safety net in Ukraine is pensions, with pension benefits accounting for a significant part of household incomes for the vulnerable population. One of the key features of the pension reform law approved in 2017 was the introduction of the annual indexation of the pension benefit. However, with the law providing flexibility on the date of the statutory pension indexation each year, this made the pension benefits unpredictable each year, resulting in some volatility of purchasing power. The date of the statutory pension indexation was brought forward in 2020,

and applied consistently in 2021 as well. This has introduced greater predictability and purchasing power of pension benefits this year. However, this predictability had yet to be embedded in legislation.

To do so, the Government of Ukraine endorsed the 2022–2024 Budget Declaration supported by the Verkhovna Rada of Ukraine. A provision of this document calls for carrying out the indexation of pensions no later than March 1. The Verkhovna Rada of Ukraine is also expected to pass a draft law that provides for the timely indexation (registration number 4668). The Rada supported the draft law in the first reading on September 9, 2021 and is expected to review it in the second reading soon.

11. Taking this opportunity, we reiterate Ukraine’s commitment to the principles of accountability and transparency in the context of the public finance management and coordination of development partners. In recent years, we have successfully implemented reforms aimed at improving medium-term budgeting, revamping intergovernmental transfers, and strengthening public procurement and public investment management systems. Ukraine remains strongly committed to the principles of full accountability and transparency, including in relation to the interaction with all international partners.

12. The Government will cause the land reform to be implemented in a way that would not cause damage to the natural environment and would improve the quality of life. The work will continue on strengthening the capacity of local governments for environmental due diligence, streamlining the procedures for environmental impact assessment for land allocation/utilization processes, focusing especially on environmentally sensitive and valuable lands.

13. Ukraine has been cooperating productively with the World Bank on designing a reform agenda supported by development policy loans and will work closely to monitor the implementation of this reform agenda. In the next year, Ukraine will maintain the reform momentum, while ensuring both the quality and the intended positive impact of these reforms.

Sincerely yours,

Denys SHMYHAL, Prime Minister of Ukraine

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Foster De-monopolization and Anticorruption Institutions		
Prior Action #1. The Borrower has enacted Law # 1054-IX dated December 30, 2020 "On Inland Water Transport", and duly published in the Borrower's Official Gazette on January 9, 2021, establishing an open regulatory framework and enabling non-discriminatory access of operators to inland waterways.	Overall positive environmental impacts from supporting shift in cargo transport from higher-emission modes (road) to low-emission (waterway), but potential negative environmental/biodiversity impacts that require environmental impact assessments and mitigating actions as waterways are upgraded.	Positive indirect impacts through increased opportunities for trade, jobs and increased regional connectivity.
Operation Pillar 2: Strengthen Land and Credit Markets		
Prior Action #2. The Borrower has enacted Law #1423-IX dated April 28, 2021 "On amendments to some legislative acts of Ukraine to improve the system of management and deregulation in the field of land relations", and duly published in the Borrower's Official Gazette on May 26, 2021, streamlining land transfer procedures and decentralizing land management, which simplifies procedures to create, transfer, and use land parcels; and transfer the ownership and administration of state land from the Geocadaster to local authorities.	Yes. This action can lead to better incentives to sustainably manage land and undertake investments to mitigate climate impacts. While the relevant land laws prohibit the change of activities that result in land use change for environmentally sensitive lands, there is a chance that the transfer of state lands to communities may lead to the loss of environmentally sensitive lands due to conversion to other uses thus further implementation of land reform will need to be accompanied by provisions to identify and protect environmentally sensitive lands.	Yes, positive, through improved rental price for 5 million small landowners (2 million households) who often rent out their land. However, significant risks remain in the completion and implementation.
Prior Action #3. The Borrower has enacted Law # 1444-IX dated May	No	There are potential positive impacts through increased local revenues

18, 2021 "On modification of some legislative acts of Ukraine concerning sale of the land plots and acquisition of the right of their use through electronic auctions", and duly published in the Borrower's Official Gazette on June 25, 2021, regulating local state land use, including mandating electronic auctions for state land sales.		
Prior Action #4. The Borrower has enacted Law #1865-IX dated November 4, 2021 "On the Fund for the Partial Guarantee of Loans in Agriculture" and duly published in the Borrowers' Official Gazette on November 23, 2021, creating affordable and effective financing instruments for small farmers through the establishment of a partial credit guarantee facility.	Potential positive impacts by enabling credit-constrained farmers to undertake investments in sustainable farming practices	Significant positive impacts for 4.6 mn small farmers through ability to access financing for land-attached investments, enhancing their ability to grow their incomes and productivity. However, significant risks remain in the completion and implementation
Operation Pillar 3: Bolster the Social Safety Net		
Prior Action #5. The Borrower, through its Cabinet of Ministers, has approved the Budget Declaration for 2022-2024 and submitted it to the Verkhovna Rada of Ukraine through Resolution No. 548 dated May 31, 2021 "On the Budget Declaration for 2022-2024" requiring indexation of pensions for all categories of retirees not later than March 1st of each year from 2022 to 2024.	No	Yes, positive, through more timely indexation of pension benefits each year. This helps bolster the purchasing power and predictability of the pension benefit for the elderly population which is most vulnerable to sharp economic downturns and/or periods of high inflation.