



# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 11-Nov-2021 | Report No: PIDA33033



**BASIC INFORMATION**

**A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Ukraine	P177931	Second Economic Recovery Development Policy Loan (P177931)	P172597
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EUROPE AND CENTRAL ASIA	17-Dec-2021	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Ministry of Finance	Ministry of Finance		

**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.

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	350.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	350.00
World Bank Lending	350.00

Decision

Other

Explanation

Decision: The Chair authorized the team to proceed with negotiations and appraisal for the proposed US\$350mn Development Policy Loan subject to taking into account the decisions taken during the meeting (see note attached).

**B. Introduction and Context**

Country Context

**This proposed Second Economic Recovery Development Policy Loan (DPL-2), the second in a series of two for US\$350mn each, supports reforms to ease impediments to Ukraine’s long-term growth, against the backdrop of the COVID-19 pandemic.** The development objective is to: (i) foster de-monopolization and anticorruption institutions; (ii)



strengthen land and credit markets; and (iii) bolster the social safety net. These areas are major impediments to investment and growth and critical for supporting a strong inclusive recovery from COVID-19. DPL-2 sustains reforms in the first DPL and continues to support the Government in its objectives to lift growth and investment while protecting the vulnerable from the COVID-19 shock, with Pillar 1 measures promote competition and facilitate much-needed investment in a key sector of the economy (inland waterways); pillar 2 measures support adoption of complementary legislation needed to ensure well-functioning, transparent and inclusive agricultural land markets and access to finance by small farmers; Pillar 3 measures support increased predictability in pension benefits for the elderly, for whom pensions are a key source of income, and whose health and income vulnerability increased significantly with the COVID crisis. The proposed operation is aligned with the WBGs COVID-19 Crisis Response Approach Paper, the current CPF and is consistent with the WBG framework for Green, Resilient, Inclusive Development (GRID).

**Even before the COVID-19 shock, Ukraine faced structurally weak growth and high levels of economic vulnerability; the pandemic has further compounded these challenges.** Although past reforms helped Ukraine maintain macro-stability and prevented a deeper contraction, the economy shrank by 4 percent in 2020. The recovery since has been slow and uneven, held back by repeated surges in infections and structural bottlenecks to growth and investment that contributed to a weak growth performance even prior to the COVID shock. On average, the economy struggled to grow by more than 3 percent per year between 2016 and 2019 due to low levels of fixed investment, an anti-competitive environment and persistent and pervasive challenges related to weak institutions and rule of law. Economic vulnerability was also high, with one in five people living below the national poverty line. With the COVID-19 shock, nearly a million jobs were lost, with unemployment rate reaching 10.5 percent in Q1 2021, the highest on record. Health impacts are among the worst in the ECA region, with some 2.56 mn reported cases and e 60,000 deaths as of October 1. The fiscal response to the crisis, together with the GDP contraction, contributed to a fiscal deficit of 6 percent in 2020; public debt ratios that had been declining since 2015 reversed course and rose by 10ppts to 60.6 percent in 2020. The macroeconomic framework is adequate for the proposed operation owing to prudent monetary policy, substantial capital buffers in the banking system, no major external imbalances (a key factor in past crises), continued access to market financing and substantial external FX buffers (further supplemented by IMF SDRs). The recently adopted medium-term budget declaration for 2022-24, and continued dialogue with the World Bank and IMF (the latter reflected in the recently staff level agreement on the first review of the IMF SBA program) are additional anchors for prudent macroeconomic policy. Still, the proposed operation remains exposed to significant risks (rising medium term fiscal pressures and substantial fiscal risks, low rate of vaccinations, and complex political and governance environment with significant influence still exerted by vested interests. These highlight the importance of sustained dialogue and engagement by IFIs and other stakeholders

#### Relationship to CPF

**The proposed DPL is closely aligned with the objectives of the Ukraine Country Partnership Framework (CPF) for FY17-21** which aims 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 reform areas 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 Nets Modernization Project, Second Additional Financing for COVID-19 Response under the Social Safety Nets Modernization Project, and Additional Financing for the Health Project. Actions under the three pillars of the operation are expected to have neutral or positive poverty and social impacts and, in Pillar 1, align with climate change commitments. Actions in Pillar 1 support increased investment and job creation in the medium term due to increased competition in the inland waterway sector and to strengthened connectivity to markets.



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. Measures in Pillar 3 improve the predictability of pensions for the 80+, a particularly vulnerable group, with such households accounting for 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.

### C. 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.

#### Key Results

**The operation supports the conditions for a strong, inclusive recovery.** To overcome impediments to weak investment and growth, and to cushion the impact of the COVID-19 shock on the poor, the operation: fosters de-monopolization and anticorruption efforts through regulatory reforms that increase competition and facilitate investment in inland waterways, which should help support a shift to (and job creation in) more environmentally friendly and sustainable modes of transport ( "greener growth") (Pillar 1); strengthening land and credit markets through the implementation of legislative safeguards enabling the transparent functioning of land markets, strengthened land governance and financial inclusion of small farmers (Pillar 2); and bolster the social safety net by increasing the predictability of pensions benefits for the elderly population that is economically vulnerable.

### D. Project Description

**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 the second in a series of two.

- **Pillar 1 supports de-monopolization and anticorruption.** 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, 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 reform of the legal framework for concessions.
- **Pillar 2 strengthens land and credit markets.** The partial credit guarantee fund helps to increase financing for farmers, thus supporting an inclusive recovery, especially for smaller 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 support the transparent and efficient functioning of land markets, and 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 also complement Pillar 1.



- **Pillar 3 seeks to bolster the safety net by cushioning the impact of COVID-19 crisis on the elderly.** 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. 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 (versus the norm of ad-hoc, arbitrary top-ups, which also undermine fiscal predictability)

## E. Implementation

### Institutional and Implementation Arrangements

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. The specific expected results indicators are available and 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, including through ongoing technical assistance for the implementation of land reforms, banking and finance (including land financing), logistics and pensions reform.

## F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

### Poverty and Social Impacts

**The prior actions under this proposed DPL are expected to have positive or neutral poverty and social effects 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 6 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. 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.

### Environmental, Forests, and Other Natural Resource Aspects



The proposed prior actions are likely to have some beneficial environmental effects (see Annex 4 with the Environmental and Poverty/Social analysis table). The Prior Actions on agricultural land can increase private investment, including in better natural resource management, energy efficiency, and climate adaptation technologies. Increased investment in agriculture (with introduction of targeted support policies for climate-smart and sustainable agriculture practices) should safeguard against land degradation, soil and water pollution. However, this could also lead to an increase of pesticide and fertilizers use in agriculture which if not carefully 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.

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 DPL 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 as 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 as 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.

## G. Risks and Mitigation

**The overall risk to the proposed operation is substantial.** The main risks to the proposed operation that are rated Substantial are political 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 that reoccurring surges of the pandemic and activity slowdowns hinder the recovery, and slow momentum on reforms. While the macroeconomic framework remains satisfactory, with sound exchange rate management and prudent fiscal policies, the country's exposure to shocks is substantial amidst large financing needs and fiscal risks from quasi fiscal deficits in the energy sector. Political and governance risks are high due to still strong influence of vested interests, and unfinished reforms of anticorruption institutions, judiciary and state-owned enterprises (SOEs) and banks (SOBs), but are mitigated by the government's willingness to advance major reforms, the strong voice of civil society in advocating for continued reforms, and Ukraine's continued cooperation with the international community and development partners. 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. Many of the reforms supported by the proposed DPL also require strong capacity for implementation and monitoring. Finally, inland waterway and land reforms require careful integration of environmental issues to effectively mitigate any potential adverse environmental impacts. These risks are mitigated in part by technical assistance provided by development partners and by close engagement of civil society organization.



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**APPROVAL**

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**Approved By**

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