Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 24-Nov-2022 | Report No: PIDC35171

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Ukraine	P180242		Strengthening the Partial Credit Guarantee (PCG) Fund for small farmers in Ukraine (P180242)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	Dec 15, 2022	Jan 20, 2023	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Agrarian Policy and Food	Partial Credit Guarantee Fund	

Proposed Development Objective(s)

The Project development objective (PDO) is to operationalize the partial credit guarantee fund (PCGF) to help improve access to financing for small farmers.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	11.30
Total Financing	11.30
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	11.30
European Commission Development Fund - TF	11.30

Environmental and Social Risk Classification	Concept Review Decision
Substantial	Track II-The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **The moratorium on sales and purchases of farmland was lifted on July 1, 2021, opening the agricultural land market.** Land transactions have been steadily growing since July 2021 as people are gaining confidence in the market. The volume of land traded in September 2021 was already over 25,000 ha, which is more than four times higher if compared to 6,000 ha in July 2021. Land prices appear to have remained largely stable in the first three months since the opening of the market averaging at UAH 33,000 per Ha and increasing by 12% in 2022 to UAH 40,000.

2. **The land market opening is expected to have positive economic and social impacts.** First, the reform is expected to increase agricultural and overall economic growth through increased investments in land with clear rules on property rights. Second, the reform will transfer resources, in the form of increased land prices, to landowners and create collateralizable assets for rural investments. 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 a potential to revive local communities and enhance local services through the revenue streams generated by auctioning off state and communal land.

3. **The land reforms have already shown positive impact despite the difficult environment.** During the first 4 months of operation, mandatory e-auctions for farmland in state and communal ownership, combined with transfer of public land ownership to local councils, doubled the leases paid. After a brief suspension at the start of the Russian aggression in Ukraine, land markets continue to operate at almost pre-war levels in the areas not directly affected by the war. Moreover, in the context of the country's EU accession, key elements of land reform implementation were adopted in a law in June 2022. A resolution of the Cabinet of Ministers of Ukraine (CMU) detailing a time-bound action plan to implement the land reform is expected to be approved before the end of the year.

4. **Partial credit guarantees are critical for completing the land reforms and leveraging private capital for reconstruction.** While establishment of the Partial Credit Guarantee Fund (PCGF) has been a key element of the broader reform package, its full implementation is even more important with the widespread destruction and decapitalization of the agricultural sector in the context of the war, tighter macro-economic environment, and the drying up of other avenues for farmers to acquire working capital and finance much needed investment, which affects small and medium farmers in particular.

Sectoral and Institutional Context

5. **While the financial sector is an essential building block for fostering private-sector led sustainable growth, even prior to the war, it was not fully equipped to play that role in Ukraine.** The Ukrainian banking sector lacks depth and makes only a relatively small contribution to private sector development with a post-crisis private sector loan-to-

GDP ratio of 28.4 percent in 2020 compared to a 55.2 percent average in ECA region (excluding high-income countries). A large share of SOBs with a high percentage of NPL ratio continues to undermine the efficiency of financial intermediation and credit growth to the private sector. Among the challenges to firm performance in Ukraine, access to finance has historically been one of the biggest growth obstacles and particularly problematic for SMEs. Ukrainian businesses will need substantial financing to restock their inventories and finance investments after the war.

6. **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**. Pre-war World Bank studies show that most small farmers (up to 100 ha and most farmers up to 500 ha) are underbanked and do not have access even to basic banking instruments. Banks mostly work with clients perceived as less risky (agricultural companies whose farms are larger than 500 hectares). 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 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 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).

7. **Before the war began, the GoU put in place key legal, regulatory, and supervisory elements of a commercially viable partial credit guarantee fund (PCGF), with a sound independent governance framework, which will support the land purchase by small credit-constrained farmers**. The related legislation came into effect on November 24, 2021 and was followed by the passage of the 2022 State Budget Law on December 2, 2021, that allocated UAH 200 million for the authorized capital of the PCGF, UAH 190 million of which have been re-allocated to other purposes as a result of the war. Steps towards operationalization of the PCGF are progressing well. The CMU adopted resolution #125 dated February 16, 2022, on establishing the PCGF and adopting the PCGF Charter. Three other resolutions detailing the recruitment process, remuneration and eligibility criteria for independent Supervisory Board members were also adopted. The adopted PCGF Charter foresees that PCGF's Supervisory Board shall consist of five members, three of which shall be independent, and with its chairman selected among its independent members. In August 2022, the NBU, as the regulator of the PCGF, adopted a special regulation on PCGF activities which includes a set of micro-prudential requirements. Currently, the Ministry of Agrarian Policy and Food (MAPF) and NBU are working on complying with the NBU's regulatory requirements for licensing of the PCGF. Next steps will be the recruitment of the Supervisory and Management boards. The EU requested the possibility of being informed in advance and in written about the appointed Supervisory Board dependent members and given the possibility to react in case need be. Furthermore, the EU has also requested the possibility of being invited to assist to the General Shareholders meetings with an observer status.

8. **In parallel, the authorities have established a bridge guarantee instrument to support small farmers until the PCGF becomes fully operational**.[1] CMU resolution #1262 allocating limits to 12 financial institutions with Ukreximbank being the implementing agency was adopted on December 02, 2021, with the bridge guarantee instrument becoming fully operational shortly thereafter. The program facilitates lending through a partial credit guarantee (up to 80 percent). A total of 6,800 agribusinesses received loans since the start of the year amounting to UAH 29 bln as of June 1st, 2022.

[1] The relevant Cabinet of Ministers resolution (Resolution #723) was adopted on July 14, 2021. Moreover, the resolution received the necessary conclusion issued by the Anti-Monopoly Committee (AMCU) on its compliance with state aid.

This PCGF will replace the existing system for the provision of blank guarantees without additional due diligence and create a sustainable institution for the long-term support to small-sized farms. The GoU is committed to accelerate the PCGF operationalization and replace the current temporary credit guarantee arrangements based on good governance, financial and systems standards.

9. **In parallel, the State Agrarian Registry (SAR) has been launched successfully in mid-August 2022 and now has more than 80,000 farmers registered**. It is being used to implement (i) a EUR 50 mln program of cash grants to small farmers (< 120 ha or 100 cows) that was started in early September and is almost exhausted (with an expected additional contribution from Germany); (ii) a program to provide grain storage to large farmers (800-10,000 ha) implemented by the Food and Agriculture Organization (FAO) on behalf of Canada, Japan and the Minderoo Foundation; (iii) EUR 6 mln program implemented by FAO on behalf of the EU, aimed at the establishment of an investment matching grant scheme for farmers operating in specific value chains of Western Ukraine. The EU thereby considers that the latter program could help small farmers access the PCG and in doing so graduate from grant to commercial financing in due course. USAID envisages similar investment interventions, with a similar overall objective. The application to PCGF by small farmers would be submitted through SAR to which financial institutions will have an access.[2]

Relationship to CPF

10. **The ongoing war has fundamentally impacted the context for the current Country Partnership Framework (CPF) FY17-FY21 (Report 114516-UA)**. However, by supporting small farmers, the project contributes to achieving Objective 3, which supports *agricultural development and land reforms*, within Focus Area 1, *Make markets work*, which is aimed at unlocking the potential of the private sector through institutional reform and key investments. Strengthening government/PCGF's capacity to exercise its functions in supporting agriculture also limits the war's negative impact on achievement of the Twin Goals, eliminating extreme poverty and boosting shared prosperity, thereby achievement of all pillars of the CPF.

C. Proposed Development Objective(s)

The Project development objective (PDO) is to support the operationalization of the partial credit guarantee fund (PCGF) to help improve access to financing for small farmers.

Key Results (From PCN)

The proposed development objective is expected to achieve the following outcomes.

a. The PCGF is fully operational as an independent financial institution regulated by the National Bank of Ukraine (NBU);
b. Number of small farms[3] cultivating less than 500 ha of agricultural land access loans through the PCGF;

[2] SAR will be the exclusive platform for processing of applications of farmers for PCGF guaranteed loans, provided that the operational interface is operating for banks.

[3] According to the Law of Ukraine "On Partial Credit Guarantee Fund in Agriculture" (PCGF Law) the PCG instrument could be used by a micro, small and medium-sized business entities and natural persons - entrepreneurs, the main activity of which is the production of agricultural products, which meet the requirements for micro-enterprises, small and medium-sized enterprises according to the

c. The total volume of outstanding loan portfolio at the end of each calendar year.

D. Concept Description

Component 1: Partial credit guarantees (EUR 10 mln) – Recipient executed trust fund (TF). The project will contribute to the capitalization of the new PCGF, with a sound independent governance framework, which will support credit-constrained farmers and significantly improve sustainability of the current credit guarantees, thereby providing the long-term benefits for agricultural development and food security. The contribution through the EU funded TF will be disbursed in two tranches. The first tranche of EUR 6 mln will be disbursed as soon as the grant agreement becomes effective for the authorized capital of the PCGF to reach its legally foreseen amount of UAH 200 million. The second tranche (EUR 4 mln) will follow once the PCGF is fully operational with its institutional, legal and operational framework acceptable to the World Bank.[4] We count on a standalone Ministry of Agriculture, acting as Managing Authority of state support in the agriculture and rural development (ARD) sector, thereby guaranteeing that EU Common Agriculture Policy principles and components of the Farm-to-Fork approach are being progressively adopted. The initial capitalization is expected to get other donors, including the EU, to consider providing more funds into PCGF as it becomes operational. Overall, a capitalization of EUR 100 million had been envisaged prior to the war – EUR 50 mln tentatively provided by the EU which would be matched by a similar contribution of the GoU. Due to the Russian war of aggression against Ukraine, the EU contribution had to be revised downwards, while future possible contributions could not yet be secured. Once operational, guarantees will be provided on a wholesale basis through participating banks on a portfolio basis based on clearly defined eligibility criteria. According to the NBU's regulation the total volume of guarantees provided by the PCGF may reach up to 4 times the capital of the PCGF. The allowed leverage could potentially be increased after the PCGF becomes fully operational.

Component 2: Project supervision and administration (EUR 0.4 mln) – Bank executed TF

Project Implementation Support and Supervision (EUR 0.34 mln): This sub-component will finance the World Bank Group implementation support activities for the project over 4 years, which will include overall project implementation support, payments processing, disbursement monitoring, preparation of financial reports, and other project management functions. Project supervision covers monitoring, evaluation review, reporting, and technical assistance activities to (a) systematically ascertain that the recipient is carrying out the project with sufficient due diligence to achieve its development objectives in conformity with the legal agreements; (b) identify problems promptly as they arise during implementation and recommend to the borrower ways to resolve them; (c) undertake a mid-term review; (d) recommend changes in project concept or design, as appropriate, as the project evolves or circumstances change; (e) identify the key risks to project sustainability and recommend appropriate risk management strategies and actions to the borrower; and (f) prepare the Bank's Implementation Completion Report to account for the use of resources, and to draw lessons to improve the design of future projects, sector and country strategies, and policies.

Project Management and Administration (EUR 0.06 mln). This item covers activities related to managing and participating in Project's related donor/stakeholder meetings, discussions and other communications; project work – planning and execution; communications (external/internal) and outreach; soliciting and evaluating activity proposals;

Law of Ukraine "On Accounting and Financial Reporting in Ukraine" and which own and/or use agricultural land not exceeding 500 hectares, including land plots purchased with funds received on credit.

[4] The due diligence for the fund and compliance with the governance, systems and other aspects of the 16 Principles for Credit Guarantees established by the Bank as well as future monitoring of implementation will be conducted by a team from the Finance, Competitiveness and Innovation Global Practice.

allocation of funds to activities; project level resource related planning and budgeting; developing and implementing project-specific management tools and systems; negotiating the replenishment / expansion of existing project; monitoring and evaluation.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

Potential environmental impacts are connected to purchase of land, purchase and use of agrochemicals (pesticides, fertilizers), establishment of irrigation systems and include impact on biodiversity, surface and ground water sources, soil quality, OHS and community health and safety impacts, as well as war-related hazards such as land contamination and explosive remnants of war (ERW). Environmental risks are expected to be site-specific, temporary and can be readily addressed through standard mitigation measures and compliance with national laws, however, these risk may be exasperated by ongoing war and war-related hazards and threats (such as aerial attacks).
On the social side, project activities associated with the provision of credit guarantees for land purchase, working capital, and equipment installation and construction works for small and medium-scale agricultural activities are unlikely to involve some site-specific adverse risks and impacts on workers and communities which in most situations will be easily manageable. However, the invasion and ongoing war in Ukraine pose significant contextual risks associated with worker and community health and safety and may induce incidents of harmful labor or further displacement of refugees using vacant land if inspection activities are not carried out.
To address potential adverse environmental and social impacts, the Borrower will develop and adopt an fund-level Environmental and Social Management Systems (ESMS) to be followed by all institutions participating in the Project implementation.

Project activities are likely to involve some site-specific adverse social risks and impacts on workers and communities which in most situations will be easily manageable but are rendered unpredictable by the contextual risks associated with the national emergency .The invasion and ongoing war in Ukraine pose significant contextual risks that are beyond the control of the project such as risks associated with aerial bombardment, war fighting or further displacement of refugees. Community and worker health and safety risks common to the activities being supported include risk of interaction with nearby communities during transport of equipment and machinery or during localized construction activities. Loans intended for the purchase of land need to be screened to ensure that any land acquisition occurs on a willing seller-willing buyer basis documented by legal transaction records on fully registered and notarized private land where the absence of dispute over ownership or use is confirmed. Sexual exploitation and abuse and sexual harassment (SEA/SH) risks are estimated to be low but preventative measures should be put in place. There is risk that provision of credit financing may benefit those enterprises with existing financial capacity, and not reach rural new starters or those with insolvency records or cultural minorities and the elderly without access to information or awareness of the program. Small entrepreneurs may be more reluctant to apply and take on debt during the current crisis. Financial products and training tailored to smallholders is required, for example, for women-led business, community enterprise, borrowers lacking a credit history or lacking financial skills. The quality of management systems deployed by PFIs is likely to vary and a capacity building approach will need to be integrated into the bank TA activities to ensure that these systems are subject to due diligence review and updated for consistency with ESS9.

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