

# PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC11156

<b>Project Name</b>	Road Sector Development Project (P149322)
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Country</b>	Ukraine
<b>Sector(s)</b>	Rural and Inter-Urban Roads and Highways (95%), General transportation sector (5%)
<b>Theme(s)</b>	Infrastructure services for private sector development (80%), Trade facilitation and market access (20%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P149322
<b>Borrower(s)</b>	Government of Ukraine
<b>Implementing Agency</b>	UKRAVTODOR
<b>Environmental Category</b>	B-Partial Assessment
<b>Date PID Prepared/ Updated</b>	10-Jun-2015
<b>Date PID Approved/ Disclosed</b>	23-Jun-2015
<b>Estimated Date of Appraisal Completion</b>	31-Jul-2015
<b>Estimated Date of Board Approval</b>	03-Sep-2015
<b>Concept Review Decision</b>	Track II - The review did authorize the preparation to continue

## I. Introduction and Context

### Country Context

1. The political unrest that began in November 2013 culminated in a change of Government and a new President being elected in June 2014 in an environment of significant political risks, a still weak global economic environment, and rising regional tensions. After a near reform paralysis over the past years, Ukraine urgently needs to restore macroeconomic stability, undertake a complex set of structural reforms, and confront a crisis of poor governance. Economic growth came to a halt while a combination of de-facto fixed exchange rate and loose fiscal policy – together with considerable quasi-fiscal subsidies in the energy sector – led to unsustainable macroeconomic imbalances. Meanwhile, poor governance and corruption that permeate virtually every aspect of public service delivery have undermined the investment climate, resulted in wasteful use of public money, and eroded government capacity as well as citizen’s trust in public institutions. Deteriorating public infrastructure, burdensome tax environment, byzantine laws and regulations,

and poor contract enforcement have depressed private investment and growth.

2. Despite these problems poverty in Ukraine has been declining, with notable consumption growth among the bottom 40 percent of the population. As a result of rapid growth, especially before the global economic crisis, the poverty rate declined from 14.7 percent in 2006 to 3.9 percent in 2012. From 2007-12, consumption for the bottom 40 percent grew by more than three times that of the rest of the population (3.9 vs. 1.5 percent). This reflected higher growth in wage income for the bottom 40 percent than for the average of the population (24 vs. 19 percent), driven by improvements in their education profile and a slight decrease in the share of unemployed over the period. Higher growth in social assistance receipts and child benefits also played a role. Gender equality appears to be given lower priority compared to other social issues, and gender gaps persist in the area of economic opportunities with a gender wage gap of 22 percent and a women's labor participation rate of 63 percent, very low in comparison with men's labor participation rate of 73 percent.

3. Real incomes are expected to decline as a result of the exchange rate adjustment, high inflation and projected economic contraction in 2014. A public sector wage freeze and increases in utility tariffs will further affect the welfare of the middle class and the poor. After several years of robust growth, consumption is expected to fall. Willingness to endure these painful but necessary economic adjustments could be undermined if reforms are perceived to leave corruption unaddressed and to disproportionately affect low and middle income groups. To achieve a more balanced social burden sharing, reforms aimed at reducing leakage need to be carried – including decisive steps to curb widespread high-level corruption – and closing loopholes for tax avoidance and evasion.

### **Sectoral and Institutional Context**

4. Ukraine is strategically located between Russia and the European Union and is thus a key transit country. There are seven major transport corridors crossing its territory, both in East-West and in North-South directions, carrying transit freight for all neighboring countries as well as for countries further away (EU and Central Asia). The major investment to date has been on the East-West corridor where the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) have been financing the road from Kiev to Ukraine's western border with Poland and the World Bank has supported two operations on the road from Kiev to the Eastern border with Russia. This third operation will continue the support of this eastern road which is critical to link with the industrial heartland of Ukraine and increasingly for the political integration of the country. The Ukraine transport sector strategy from 2010 seeks a balanced development of different transport modes, with rail transport retaining its role as the dominant mode for heavy bulk goods, while the road network is being developed to serve higher-value goods and to support better connection with Ukraine's neighbors. Increasingly emphasis is also being given to the waterways sector as a means of relieving some of the harvest time bottlenecks on the railways but also as a means of getting bulk cargoes off of the roads to reduce congestion and road deterioration. A key priority for the sector as a whole is to prepare a multi-modal master plan that identifies the main transport corridors for development and prioritizes the projects to be undertaken first. A clear set of priorities, which have been professionally prepared, will greatly increase the chances of attracting funding and successfully completing implementation.

5. Roads in Ukraine. Ukraine's road network is about 170,000 km, of which 21,000 km are national roads and 149,000 km are regional and local roads. The shortage of budget funding for

roads has caused important delays in routine and periodic maintenance, resulting in a significant deterioration of the network. It is now estimated that 51 percent of the national network does not meet national road roughness requirements and 39 percent does not meet the strength requirements. With traffic growth, capacity bottlenecks on standard two lane roads have started to appear compounding the road safety issue resulting from the overall poor condition of the network. Ultimately average traffic speeds are affected with average speeds ranging between one half and one third of Ukraine's western European neighbors. In this context the transport strategy sets out the main policy goals for the road sector which have been implemented with varying degrees of success but still remain relevant. These include: prioritized upgrading of key national and local roads; innovative road infrastructure development; improved road safety; and reform of public roads governance through decentralization, adequate funding for sector, restructuring maintenance units, establishing pavement management systems, and improving quality assurance.

6. Road Safety. The Road safety record is a matter of concern, with fatality rates more than double those found in the better performing European countries. Road traffic fatalities have decreased since 2007 by 100 percent but improvement has been stagnating for the past three years. While improved safety conditions in new infrastructure are helping reduce road traffic accidents, Ukraine's road safety management and standards in most national and local roads are still to be improved. The on-going Bank financed projects have had a large focus on safety and have or will address many of the key accident black spots in the country. However, there is also a need for much stricter traffic enforcement, better awareness from road users and faster emergency response when accidents do happen. There is an approved road safety action plan in the country which has been developed through the European Union (EU) program; a key element to that plan was the creation of lead road safety agency and legislation has been drafted to that affect. However, the implementation of the legislation has not taken place and resolving this issue will be a key recommendation for all the stakeholders in the sector.

7. Road network Management. The road sector in Ukraine is centralized under the State Road Services of Ukraine "Ukravtodor". Ukravtodor directly manages the national roads and oversees the Oblast Road Services (ORS) at Oblast level, in charge of the management of the regional and local roads. Although policy formulation and regulation are administered solely at the level of the Ministry of Infrastructure and the Cabinet of Ministers, in practice Ukravtodor has a high degree of responsibility for developing policy. Most work related to construction and maintenance of national and local roads is carried out by subsidiaries of the State Joint Stock Company "Roads of Ukraine", known as the DAK and most design and research services are provided to Ukravtodor and ORS by a group of specialist institutions: "Ukridiprodor" for design, "DerzhdorNDI" for research, and "Dortsentr" for quality control. These professional institutes as well as DAK are 100 percent owned or controlled by Ukravtodor. A key element to the changes in the governance structure going forward will be to create more independence between these various functions but also to adopt a more user focused approach to road network management. There is also a need for a more road user focused approach to the management of the sector with increased transparency of Ukravtodor activities. With Bank support Ukravtodor has recently become a member of the Construction Sector Transparency Initiative (COST), which will improve their outreach to civil society and increase the level of information that is disclosed to the public.

8. Decentralization agenda. One of the main elements to improving the existing institutional structure will be through decentralization of the management of local roads to the Oblast level. Under this proposed program, Ukravtodor will focus on the national roads while the responsibility

for regional and local roads will be delegated to regional and local governments, with the technical expertise, institutional capacity and financial resources transferred to these levels. Related to the decentralization process is the reform of the DAK and its 26 subsidiaries into 25 separate Joint Stock Companies (JSC's), to be managed by each Oblast, and one JSC to be managed by Ukravtodor. The goal of this reform is partly to align road maintenance capacity with each of the managing entities, but also ultimately to foster competitive procurement in the execution of maintenance activities. A key question is how to start "commercializing" the relationships between the Clients (national and Oblast levels) and the JSC given that these companies are still the main maintenance providers in the country. There has been some progress in this regard with the award of a long term Output and Performance Based Contract (OPRC) to an international contractor and it is hoped that this will provide a successful model for more private sector contracting in the future.

9. **Restructuring of Road Sector Financing.** Ultimately, the overall condition of the road network can only be improved with sufficient resources and this is far from the case at the moment. As for most countries, road maintenance is largely financed by fuel levies supplemented by vehicle import duty, fees for oversized and overloaded vehicles, and loans from different sources including International Financial Institutions (IFIs). In April 2014, a law to avoid a new financial crisis was passed and included changes in the funding levels for the road sector. Excise duties for fuel were increased to a flat rate of 98 euros per ton. Up until April, the rate varied between 48 and 98 euros per ton depending on the quality of fuel. Levies on new imported vehicles doubled. With these changes, revenues from these sources to the sector increased from 15.2 billion UAH approved in January to 16.9 billion UAH effective April 1, 2014.

10. Although there has been a continuous increase in the revenues from excise duties on fuels, expenditures in maintenance of roads have been falling since 2011 and debt servicing has almost tripled since 2012. The development of the network is being funded almost 100 percent from loans. For 2014, the government strategy calls for resources close to 32 billion UAH to meet the targets set forth in the strategy. However, the current approved budget for 2014 only envisions 26 billion UAH. The gap in financing of 6 billion is about twice the resources planned for maintenance of the network, and about three times the budget for 2014 investments. The shortfall in resources will continue to affect the sustainability of the network with the current level of funding for maintenance of the network at about half the minimum level. Given the current stressed economic environment in Ukraine, addressing the maintenance funding issues will be difficult. However, if not addressed the long term costs will be much higher as the overall condition of the network continues to deteriorate. Addressing the funding shortages will require increasing charges on road users including through increasing the fuel levy, increasing vehicle registration fees and by starting to toll the main highways in the country. This needs to be complemented by the enactment of the road fund legislation, which would protect road revenues and ensure some stability in the flow of funds. In the short term, it is also important that the authorities enforce axle load controls and introduce systematic monitoring of existing maintenance expenditures.

### **Relationship to CAS**

11. The proposed project is fully consistent with the Country Partnership Strategy (CPS) for Ukraine for FY12-16. The CPS emphasizes "Improving policy effectiveness and economic competitiveness" (Pillar 2) with a focus on transport sector. One of the target results is to improve infrastructure for business activities. The CPS specifically described improved road connectivity and safety. The Bank will continue to support connectivity to key markets through investments in modernization of road networks and improving road safety. The proposed project will support both

elements of this strategy through continuing the engagement with the Ministry of Transport on their structural reforms and supporting the road industry move to a more market orientation. The improvement of the road will support in the provision of high quality and efficient public infrastructure. The proposed operation will also continue the dialogue from the on-going first and second Road and Safety Improvement Projects (RSIP and RSIP2 respectively), which have already facilitated the start of the reform process in the transport sector.

12. The project's contribution to reduction of poverty and increase in shared prosperity is expected to be significant and efforts will be made to assess it during preparation and implementation. The project's impacts on income will be through (i) an expected reduction in vehicle operating costs, travel times and accident rates on the roads to be rehabilitated, and (ii) the envisaged works that will lead to important social and economic outcomes in the regions where project roads are located. During the construction phase the project will create temporary jobs during project implementation, and once works are completed, the project will improve access to markets. Given the current regional tensions the investment in a road connecting with the East will also demonstrate the intention to share prosperity and maintain connectivity.

13. The government's recent signing of an association agreement with the EU will also increase the focus on regional connectivity and the transit corridor improvements are expected to facilitate this and increase economic activity by reducing travel time and transport costs between the main centers in Ukraine and with their regional trading partners. Finally, in the medium to longer term, better road infrastructure could ultimately translate into increased productive investments in beneficiary communities and employment opportunities for residents, which would improve household income and consumption, and decrease poverty rates. During project preparation and implementation an important effort will be made to design practical survey instruments (to be part of project implementation) to compare the improved transit corridor of impact with a control corridor without interventions. The idea will be to assess income benefits at the Oblast and community level. The instruments designed to analyze these changes will have to consider the limitation that effects from a large project tend to be long-run in nature.

## II. Proposed Development Objective(s)

### Proposed Development Objective(s) (From PCN)

The proposed project development objective is to improve transport connectivity and safety for road users on selected sections of the East West M-03 road Corridor and to improve road financing and road maintenance operations in selected sections of the national roads network in Ukraine.

### Key Results (From PCN)

The achievement of the PDO will be measured with the following key results indicators:

- Reduced travel time between Poltava and Kharkiv
- Reduced number of traffic fatalities on the Kiev to Kharkiv road.
- Improved condition of selected core national roads network
- Modernizing road sector management as measured through enactment of key legislation related to road management, safety and tolling
- Increased satisfaction of project beneficiaries (gender disaggregated).

## III. Preliminary Description

### Concept Description

The proposed project would be an Investment Project Financing (IPF) consisting of a loan in the amount of US\$800 million to the Ministry of Finance of Ukraine. The proposed loan will finance 100 percent of eligible expenditures including value added tax (VAT) and land acquisition costs. This project will be a continuation of RSIP and RSIP2, and will leverage returns on major road infrastructure investments in Ukraine, such as the EBRD and EIB funded improvements to European priority road corridors. The project will continue the improvement of the main road between Kiev and Kharkiv, the first and second largest cities respectively, strengthening economic and political integration with the East of the country. The project will also have a substantial component on capital repairs and maintenance to reverse the overall decline in the condition of the network. These elements will be complemented by an institutional program with a strong focus on the implementation of the sector's renewed reform and innovation process including: (i) introduction of modern road safety and network management principles to reduce accident fatalities, protect network assets and move towards sustainable finance; (ii) support in implementation of prioritized maintenance plans and restructuring of maintenance industry; and (iii) the development of a robust pipeline of sustainably financed road investments. The project will include the following components:

Component 1: Road Rehabilitation and Safety Improvement (total estimated cost US\$435 million from IBRD loan). This component would continue finance for the improvement to motorway standard of the road between Kiev to Kharkiv. The road would provide a high standard and safe corridor to integrate with the EU extended TEN-T network and further the connection of Ukraine's two largest cities. This component will finance the civil works for the improvement of approximately 65 kilometers of selected sections of the M03 highway, initially between Poltava and Chutove. The road would be built to a category 1 standard which is a four lane divided highway with high safety specifications including central crash barriers and side crash barriers where required. Through implementation of component 3(i) the road will also act as a pilot corridor for the implementation of automatic speed enforcement and improved weight control. The project would finance all necessary bridges, interchanges, bypasses, site supervision, technical audits, financial audits, Incremental Operating Costs (IOC), Value Added Tax (VAT) and land acquisition costs.

Component 2: Program of Maintenance and Capital repairs (total estimated cost US\$350 million from IBRD loan): This activity will finance urgent maintenance requirements on the core national road corridors with priority given to the 940 km corridor between Lviv and Mykolayiv. Specific road sections have not been identified but the focus will be on protecting the existing maintainable core network from premature deterioration due to the current budget constraints. The work will consist of capital repairs (overlays) within the existing right of way to bring existing roads to as built condition. Execution of these activities will be done in conjunction with component 3(ii) to insure that maintenance activities are effectively prioritized and the necessary reform takes place for sustainability of outcome. When undertaking maintenance interventions, care will be taken to also address outstanding safety issues such as poor junction design, missing crash barriers or lighting etc.

Component 3: Network Management and Development (estimated cost of US\$15 Million from IBRD loan). This component will finance institutional support to implementation of road management reform and cover the following areas:

Sub-component 3(i): Road Safety and Network Management (total estimated cost US\$3 million from IBRD loan): This activity will finance activities to implement an integrated network

management system consisting of a national system for e-tolling, weigh-in-motion system for axle load control and automatic speed enforcement cameras. A pilot system consisting of weight control and speed enforcement would first be installed on the improved sections of the M-03 road followed by the procurement of a national system. The following activities are envisaged:

- Support in the preparation of relevant legislation and implementation of agreed findings from the road safety capacity review;
- Support to increase social and key stakeholder awareness of interventions through public consultations;
- The preparation of a feasibility study and functional specification both for the M-03 pilot and subsequent national system;
- Procurement and installation of the equipment for the pilot on the M-03 corridor;
- The preparation of concession documents for an operator to finance, install and operate the national system;
- Consultants to oversee evaluation of the procurement process, supervise installation and monitor initial stages of operations and results.

Sub-component 3(ii): Maintenance Management (estimated cost of 5 million). Given the overall underfunding of the sector and in the context of the proposed reform of the maintenance industry and decentralization agenda, this sub-component would finance the institutional work required to implement key aspects of the reform agenda. It would also finance the necessary work to plan, implement and monitor the maintenance works in Component 2. The following key activities would be supported:

- Necessary data collection, planning, design, safety audits and project management support to ensure effective implementation of prioritized maintenance plans;
- Consultancy services to support Ukravtodor reform plans for maintenance industry including capacity building and institutional arrangements to facilitate implementation of improved systems and monitor subsequent implementation and impact.

Sub-component 3(iii): Design and Private Finance Options for Boryspil Bypass (estimated cost \$4 million from IBRD loan). This component would finance the preparation of detailed design and bidding documents for the Boryspil bypass which is part of the Kiev ring road. Given the high traffic volume on the road consideration is being given to exploring private finance options.

#### IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04			x
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11			x
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12	x		
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	

Projects in Disputed Areas OP/BP 7.60		x	
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## V. Financing (in USD Million)

Total Project Cost:	800.00	Total Bank Financing:	800.00
Financing Gap:	0.00		
<b>Financing Source</b>			<b>Amount</b>
Borrower			0.00
International Bank for Reconstruction and Development			800.00
Total			800.00

## VI. Contact point

### World Bank

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