

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA30612

<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>	Ministry of Finance
<b>Implementing Agency</b>	UKRAVTODOR
<b>Environmental Category</b>	B-Partial Assessment
<b>Date PID Prepared/Updated</b>	24-Sep-2015
<b>Date PID Approved/Disclosed</b>	24-Sep-2015
<b>Estimated Date of Appraisal Completion</b>	28-Aug-2015
<b>Estimated Date of Board Approval</b>	03-Nov-2015
<b>Appraisal Review Decision (from Decision Note)</b>	

## I. Project Context

### Country Context

1. Ukraine is facing unprecedented political and economic challenges ? a major financial crisis compounded by a protracted conflict in the East. 2014 witnessed the so-called “Maidan” uprising that ultimately led to the ousting of the previous President, followed by parliamentary elections in October. In March 2014, the Autonomous Republic of Crimea and the city of Sevastopol held referendum to join the Russian Federation which were widely criticized and declared as “having no validity” in the UN General Assembly resolution 68/262. The protracted conflict in the East of the country continues despite the ceasefire agreement concluded in Minsk on February 12, 2015. The new government, that took office last December, came in with a strong mandate for reforms, but it faces a challenging agenda.

2. Ukraine is in the midst of a deepening economic recession accompanied by large budget deficit, quickly rising public debt, a plummeting exchange rate, surging inflation and problems in the banking system. The current economic crisis has been long in the making. Fundamental governance failures, state capture by vested interests, deep-rooted corruption and political instability undermined the investment climate, resulted in a wasteful use of resources, and eroded

government capacity as well as citizens' trust in public institutions. Poor macroeconomic policies and delayed structural reforms led to widening and unsustainable internal and external imbalances, especially following the global economic crisis of 2008/2009.

3. In 2014 the government started macroeconomic adjustment but despite efforts to stabilize the economy, the economic performance were weak. Due to the ongoing adjustment and escalating conflict, GDP declined by 6.8 percent in 2014. The currency depreciated by about 50 percent in 2014, which together with increases in utility tariffs, pushed 12-month consumer price inflation to 24.9 percent y/y at the end of 2014.

4. The ongoing conflict caused significant contraction of the industrial production in the east of Ukraine as the result of loss of government control of the parts of Donetsk and Lugansk regions, broken supply chains and distorted economic ties with the Russian Federation. The connectivity with the center and west of the country is therefore gaining increased importance for reinvigorating the economic activity in the eastern and southern regions of Ukraine and ensuring greater resilience to the conflict through provision of temporary employment opportunities related to roads rehabilitation and maintenance.

5. An unfavorable global economic environment and conflict in the east led to a deepening decline in real GDP in the first half of 2015 to -16 percent. Industrial activity contracted 20.5 percent y/y, led by sharp declines in eastern regions. Currency depreciation and a one-off utility-tariff adjustment accelerated inflation, which peaked at 60.9 percent y/y in April and declined to 52.8 percent y/y in August. Meanwhile, fiscal consolidation stabilized the general government headline deficit outperforming the IMF program target. After a sharp depreciation in early 2015 followed by administrative restrictions on imports, the current account is nearly balanced since April. Net capital outflows persisted, driven mainly by external debt payments in excess of official financing flows. This helped to rebuild international reserves that cover 3 months of imports as of beginning of September.

6. The crisis threatens to reverse some of the gains Ukraine made in earlier years in reducing poverty and boosting shared prosperity. Against the backdrop of negative growth and high inflation, real wages and pensions have declined, thus reversing gains made earlier in income levels, particularly among the less-well off. This decline was only partially offset by social-assistance reforms aimed at better targeting existing benefits, while deteriorating labor-market conditions aggravated these trends. In Q1 the unemployment rate increased to 9.6 percent (from 9.0 percent a year earlier) and real wages declined by 21 percent. This decline is uneven across sectors, with the lowest nominal-wage growth in the public sector, particularly in health, education, public administration, and defense (which employ approximately 28 percent of those employed among the bottom 40 percent in the income distribution). All these factors combined led to an increase in the moderate poverty rate from 3.2 percent in 2013 to 5 percent in 2014. The moderate poverty rate is expected to double to 10.2 percent in 2015. And even if the modest recovery materializes in 2016 and 2017, it would remain above its 2014 levels.

7. Despite early signs of stabilization, economic prospects for Ukraine depend on how the conflict in the east unfolds and whether the authorities are able to sustain reforms in an uncertain environment. Real GDP is projected to contract by 12 percent in 2015, with sharp declines in metals and mining sectors as they are affected both by the conflict and weakening external demand. However, the currency depreciation would support net exports and a gas tariff increase coupled with improved spending efficiency should create fiscal space to unlock government investment going forward. In addition, continued resolution of problems in the banking system could permit gradual resumption of lending. These factors, along with a low statistical base, are expected to set the stage for a modest economic recovery, with real GDP growing 1 percent in 2016 and 2 percent in 2017.

## **Sectoral and institutional Context**

8. Ukraine's economic revival depends on the presence of a high quality transport system acting as the back-bone to the economy. The current crisis is also an opportunity to better align transport infrastructure policies with the freight intensive needs of the country. An efficient multimodal transport system is a prerequisite for unleashing the full potential of the Association Agreement with the European Union (EU), the Deep and Comprehensive Free Trade Agreement and to remove constraints from the development of the domestic agricultural and manufacturing industry. It is this vision which formed the basis for the Ukraine Transport Sector Strategy which was formally approved in 2010. The strategy sought a balanced development of different transport modes, with rail transport retaining its role as the dominant mode for heavy bulk goods, and the road network 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.

9. There is much to be done to realize the Transport Strategy's vision. Ukraine is currently ranked 61st from a total of 155 countries in the World Bank's Logistics Performance Index (LPI) 2014. Its ranking has improved over the last decade but it still lags the best performers in the region and all EU member states. According to this index, Ukraine still requires substantial reforms to improve customs performance, infrastructure, international shipments, the capacity to track and trace shipments and the competency of logistic operators. In addition to the overall logistics framework there is also a need for sub-sectoral reform, particularly in the rail and road sectors, to increase efficiency and ensure that these key sectors are operating on a sustainable financial basis. The Bank is providing advice in all these areas with Trust Funded activities in agricultural logistics, railways reform and road reform. This operation, The Road Sector Development Project (RSDP), will support implementation of some of the key reform issues of the roads sector many of which were identified through a recent Bank funded policy note on quality assurance within the roads sector.

10. The current political unrest has affected international traffic flows and priorities are shifting to domestic movements and maintenance. 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 and serving the key economic, industrial and agricultural heartlands of the country. The major investment to date has been on the East-West corridor where three main International Financial Institutions (IFIs) have combined forces with the State budget. The European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) have financed the road from Kiev to Ukraine's western border with Poland, and the World Bank is supporting improvement of the road from Kiev to Kharkiv, Ukraine's second city, in the East.

11. The current financial and institutional arrangements in the roads sector in Ukraine have not delivered results and the shortage of maintenance funding, combined with a large share of overweight trucks, has resulted in a premature deterioration of the network. Ukraine has a road network of about 170,000 km, of which 21,000 km are national roads and 149,000 km are regional and local roads. However, 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.

12. The road sector embarked on a reform in 2011 aimed at substantially changing the management of the sector from being overly centralized and vertically integrated. Currently road network management is centralized under the State Road Services of Ukraine 'Ukravtodor' who control most planning, design, maintenance and construction activities in the sector. Under Ukravtodor, virtually all road maintenance and much road construction is undertaken by the State Joint Stock Company 'Roads of Ukraine', known as DAK, and design is undertaken by 'Ukrhidprodor'. Under the proposed reform, the functions of policy making, program management and works execution would progressively be separated, with an aim at increasing reliance on commercialization in the interactions between managing and executing entities, including through increased reliance on participation of the private sector. However, since the reform was first approved little progress has been made with its implementation and it is only with the appointment of the new government in January that the process has been re-energized.

13. A new Road Map for road sector development in Ukraine for 2015-2017 was published by the Ministry of Infrastructure in June 2015. The strategic objectives of the road map areas are threefold: (i) the protection of roads from early deterioration, (ii) the reform of Ukravtodor and DAK; and (iii) a sustainable financial structure and collection of new revenues. The first priority will be dealt with through improved weight control (particularly from overloaded grain trucks), the implementation of a road asset management system and the rolling-out of a modern system of maintenance. The second priority area will lead to a more dynamic market with private sector involvement in the design and maintenance of roads through performance-based contracts. It will include the liquidation of the DAK and transfer of assets from Ukravtodor to the oblast state administrations and the divestiture of non-key assets of Ukravtodor including the design institutes. The third priority area aims to secure existing revenues from fuel levies etc to the roads sector and to raise new revenues through the introduction of a truck tolling scheme.

14. A key element to increasing accountability in the sector is the decentralization of the management of local roads to local administrations, the Oblasts and Rayons. Ukravtodor will focus on the national roads while the responsibility for regional and local roads will be delegated to regional and local governments. The government has already implemented the transfer of financial resources and now locally collected fuel levies go directly to local government. The process of transferring the local road networks will go in parallel with the reform of the DAK so that road maintenance capacity is aligned with each of the managing entities. A key question is how to start 'commercializing' the relationships between the Clients (national and Oblast levels) and the DAKs given that these companies are still the main maintenance providers in the country. Support to the implementation of this reform process will be provided through the institutional component of this project. The decentralization of the local roads management supported by the project's institutional component will have a demonstrable effect that is supposed to contribute to rebuilding trust between the citizens and the government.

15. The new government is acutely aware that corruption has adversely impacted quality and eroded confidence in the sector. There is now a strong emphasis on increasing accountability, transparency and disclosure in the sector and with Bank support Ukravtodor has recently become a

member of the Construction Sector Transparency Initiative (CoST). As part of CoST membership it will also form a multi-stakeholder group to oversee transparency in the sector and disclose data in accordance with strict guidelines. Open Data is central to the Ministry of Infrastructure (MoI) strategy and now all plans, progress reports, financial data, annual road map, work plans and current projects are all disclosed through web-portal and mass media. The MoI will also introduce independent technical audits for all internationally and domestically financed work and is looking to adopt International Federation of Consulting Engineers (FIDIC) contracts, program wide, to improve procurement and contract management particularly for domestically financed work.

16. 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. Of the 20 billion UAH which was allocated to the roads sector in 2014, 17 billion UAH went to service existing loans with just 3 billion UAH going to maintenance and operating costs. At this level of funding the overall deterioration of the network is inevitable and even the recently rehabilitated major highways are at risk of falling into disrepair. As for most countries, road maintenance is largely financed by fuel levies supplemented by vehicle import duties, vehicles registration fees and fees for oversized and overloaded vehicles. These revenues were hypothecated and made available to the State Road Fund but in 2015 that linkage was broken and Ukravtodor is now financed from the general fund of the State Budget. The impact of this change in budgetary policy is unclear but the reestablishment of a road fund is a priority for MoI although the legislative and institutional form that such fund can take and whether it can be readily implemented in the current constrained fiscal environment is yet to be determined. The proposed project will support the short-term stabilization of the sector through financing maintenance activities.

17. Addressing the funding shortages in the medium to long term will require improved network management tools both to improve utilization of existing assets and to raise additional revenues. The government is now finalizing legislation to allow tolling of heavy goods vehicles, better enforcement of weight control and automation of speed enforcement on the national roads network. With support through the proposed RSDP the government aims to gradually roll out a system of electronic tolling and other network management tools including weigh-in-motion and speed cameras. The system would be financed, installed and operated through a private concession in a similar way to the systems now in operation in neighboring countries. It is hoped that this system of network management tools will both raise additional revenues for the sector and protect the assets through enforcement of weight limits and speed limits. Annex 4 provides a more detailed assessment of the overall financial sustainability of the sector together with some of the measures needed to improve efficiency of expenditure.

18. Improving road safety is also an overarching objective. Road traffic fatalities have fallen over the last decade from around 7,000 deaths per year in 2004 to just under 4,500 deaths in 2014 which has been achieved in an environment of increasing motorization levels. However, improvements have stagnated over the last few years and fatality rates are four times those found in the better performing European countries. 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 several key accident black spots in the country, also piloting innovative road safety improvement approaches. However, there is also a need for better coordination and management of road safety, much stricter traffic enforcement, better awareness from road users and faster emergency response when accidents do happen. On the Kiev to Kharkiv

corridor, improved under Bank financed projects, it is estimated that 45 percent of accidents can be attributed to over speeding with the effectiveness of enforcement affected by lack of resources awareness and corruption. This project will also work with the traffic police to implement improved speed enforcement systems including the provision of automatic speed cameras. Road safety is a major focus for the development partners who support the transport sector and a Global Road Safety Facility (GRSF) grant managed by the Bank is preparing a framework for support so that between the development partners a comprehensive and multi-sectoral approach is taken to road safety.

## II. Proposed Development Objectives

The objective of the project is to improve transport connectivity, maintenance operations and road safety for road users on selected sections of the national roads network and improve road network management in Ukraine.

## III. Project Description

### Component Name

Component 1: Road Rehabilitation and Safety Improvement

### Comments (optional)

### Component Name

Component 2: Maintenance of Core National Road Corridors

### Comments (optional)

### Component Name

Component 3: Network Management and Development

### Comments (optional)

## IV. Financing (in USD Million)

Total Project Cost:	561.40	Total Bank Financing:	561.40
Financing Gap:	0.00		
<b>For Loans/Credits/Others</b>			<b>Amount</b>
Borrower			0.00
International Bank for Reconstruction and Development			561.40
Total			561.40

## V. Implementation

This project will be the third World Bank funded road project executed by Ukravtodor (the Ukrainian Road Agency) as an implementing agency. Over the past eight years, Ukravtodor and its Project Implementing Unit (PIU) for externally funded projects, Ukrdorinvest, have gained much experience in the execution of large externally funded road projects (mostly by WB, EBRD and EIB). Under this arrangement, Ukravtodor, as the main implementing agency, signs an annual contract with Ukrdorinvest to provide project management services including management of the

procurement process, contract management and monitoring and evaluation. However, all contract signatures, disbursements and financial management are directly through Ukravtodor ? no funds pass through Ukrdorinvest. For this project all components of the project will be undertaken on this basis.

Broadly this arrangement has been successful and Ukrdorinvest has good experience with procurement, financial management and safeguards, and has well trained and experienced staff. However, during peak periods of implementation there may be a need to increase the number of staff and this will be monitored through implementation of the project. There is also a need to appoint one additional safeguards staff which will be a condition of effectiveness. The recent events in the country have caused implementation delays which have been largely outside the control of Ukravtodor caused by a lack of counterpart funds for VAT and land acquisition payments. To mitigate these risks this project is designed to finance these activities together with other operating costs associated with undertaking effective project management.

For undertaking e-tolling, weigh-in-motion, speed enforcement and other road safety related activities it has been agreed to set up a working group consisting of the main stakeholders. These stakeholders will include Traffic Police, respective departments of the Ministry of Infrastructure (MoI) and Ministry of Internal Affairs (MoIA), the planned National Agency for Traffic Safety, Ministry of Finance, Ministry of Regional Development and other relevant government entities. While all procurement for this component will continue to be undertaken by Ukravtodor, a joint ministerial order or other appropriate regulation will be agreed between the various parties to formalize the roles associated with preparation, implementation and oversight of inter-institutional components of the loan project, including terms of reference, bid evaluation and contract execution.

## VI. Safeguard Policies (including public consultation)

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>
Environmental Assessment OP/BP 4.01	<b>x</b>	
Natural Habitats OP/BP 4.04		<b>x</b>
Forests OP/BP 4.36		<b>x</b>
Pest Management OP 4.09		<b>x</b>
Physical Cultural Resources OP/BP 4.11		<b>x</b>
Indigenous Peoples OP/BP 4.10		<b>x</b>
Involuntary Resettlement OP/BP 4.12	<b>x</b>	
Safety of Dams OP/BP 4.37		<b>x</b>
Projects on International Waterways OP/BP 7.50		<b>x</b>
Projects in Disputed Areas OP/BP 7.60		<b>x</b>

**Comments (optional)**

## VII. Contact point

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