



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 18-Jun-2018 | Report No: PIDC156981

**BASIC INFORMATION****A. Basic Program Data**

Country Ukraine	Project ID P166941	Parent Project ID (if any)	Program Name De-risking Investment in Agriculture Program
Region EUROPE AND CENTRAL ASIA	Estimated Appraisal Date 24-Sep-2018	Estimated Board Date 30-Oct-2018	Does this operation have an IPF component? No
Financing Instrument Program-for-Results Financing	Borrower(s) Ministry of Finance	Implementing Agency Ministry of Agrarian Policy and Food	Practice Area (Lead) Agriculture

Proposed Program Development Objective(s)

The development objective of the proposed Program is to assist the Government in improving the enabling environment to promote private investment in agriculture and agribusiness sectors.

COST & FINANCING**SUMMARY (USD Millions)**

Government program Cost	205.00
Total Operation Cost	205.00
Total Program Cost	205.00
Total Financing	205.00
Financing Gap	0.00

FINANCING (USD Millions)

Total World Bank Group Financing	200.00
World Bank Lending	200.00
Total Government Contribution	5.00



B. Introduction and Context

Country Context

1. **Ukraine's economic growth has been uneven since the country's independence in 1991 and has been influenced by its strong dependence on external factors, the global financial crisis of 2008, and the recent internal conflict that began in 2014.** During the 2000-2007 period, Ukraine sustained high annual growth rates of seven percent on average. Capital inflows surged and credit growth boomed, fueled by the external borrowing of the commercial banks. This enabled an expansionary fiscal policy that resulted in the accumulation of a structural deficit. Growth was almost entirely driven by the favorable external conditions but was not supported by structural reforms needed to sustain long-term growth. With the onset of the global financial crisis in 2007, the Ukrainian economy contracted rapidly. During 2008-2013, growth was negative and averaged -0.7 percent annually. The Maidan revolution of 2013/2014, the events in Crimea in March 2014, and the armed conflict in the east of the country since 2014 resulted in a continued severe recession and the economy contracted by 16 percent during 2014-2015. The Government of Ukraine subsequently undertook a series of fiscal and business environment-related reforms that helped stabilize the economy. Economic growth resumed albeit at a modest rate. Gross domestic product (GDP) grew by 2.3 percent in 2016 and by 2.5 percent in 2017. While the long-term economic recovery continues to face significant risks, growth is expected to reach 3.2 percent in 2018 (IMF).

2. **Poverty has been increasing since 2015.** The deep recession, the currency depreciation, and the compression of the public current expenditures contributed to a significant contraction of disposable incomes in Ukraine, with both labor and non-labor incomes decreasing in real terms in 2015. As a result, the estimated poverty rate, measured at US\$5 per day (2005, PPP) increased from 3.3 percent in 2014 to 5.8 percent in 2015. At the same time, the estimated moderate poverty increased to 22.2 percent. Poor households, which spend a significant share of their budget on heating and utilities, were especially negatively affected by the large increase in energy prices in 2015. Reversing the recent trend in increasing poverty rates and achieving shared prosperity remain significant development challenges in Ukraine and require the country to identify new drivers of growth, including agriculture, and implement the associated structural and policy reforms to capitalize on such growth drivers.

Sectoral (or multi-sectoral) and Institutional Context of the Program

3. **Agriculture has been as a steady driver of growth, even during the crisis periods.** Currently, primary agriculture accounts for 10 percent of GDP (2017) and 18 percent of formal employment (2016) (World Bank, 2013). Close to 23 million hectares (or 54 percent) of the agricultural land in the country is comprised of highly fertile black soils, which, together with the favorable climatic conditions and abundant water resources, provides a conducive environment for agricultural production in the country. During 2001-2016, agriculture real value added increased by 97 percent compared services (35 percent) and industry (12 percent). Agricultural exports remain a key engine of the Ukrainian economy, representing almost 42 percent (US\$ 18 billion) of the total export value (US\$ 43.3 billion, 2017). Ukraine is the world's largest exporter of maize, the third largest exporter of grain after the US and the EU, and a large producer and exporter of sunflower seeds and oil.

4. **The Ukrainian agricultural sector has significant underutilized productive and export potential that can make an even larger contribution to economic growth and dynamic in the rural areas.** A 30-percent productivity increase in agriculture could result in a 4.4 percent growth in GDP over five years and a 12.5 percent growth over ten years. Exports

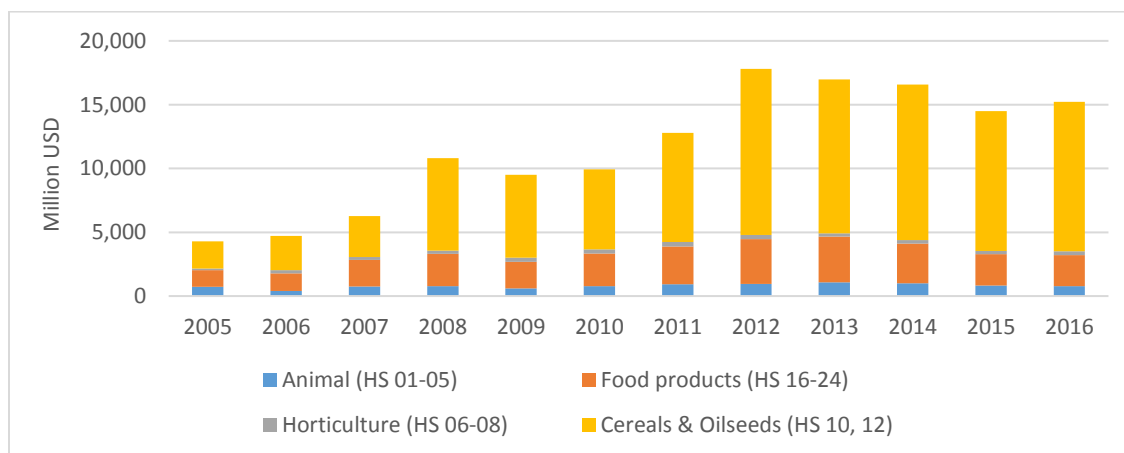


remain well below their potential¹, implying eight billion² US Dollars of foregone export revenue annually for the country. The agri-food products that have the greatest export potential include cereals (estimated additional US\$2.9 billion of revenue), vegetable oils and fats (US\$2.3 billion), and oilseeds (US\$0.7 billion). In addition, the majority of the higher-value agri-food products, including vegetable oils, dairy and meat products, fresh produce/fruits and vegetables, remain below 50 percent of their export potential. The recent trade agreements, including, the Deep and Comprehensive Free Trade Area (DCFTA) with the EU (effective since September 1, 2017), the signed trade agreement with Canada, as well as the agreements under negotiations with Turkey and Israel create important opportunities for Ukraine to further increase agricultural exports.

5. **Yields in Ukraine's agricultural production have not reached their full potential.** Over the last decade, crop production has doubled and production of some livestock products has significantly increased. However, overall productivity in Ukraine's agriculture sector lag behind those of comparator countries. For instance, average wheat yields in Ukraine stand at 4.1 tons/hectare compared to 5.6 tons/hectare in the EU-28 countries; average corn yields average 5.5 t/ hectare compared to up to 10 t/ hectare in the United States; and the average yield for barley stands at 2.7 t/ hectare compared to 4.8 t/ hectare in the EU-28.³ While there is plenty of upside potential for yields given Ukraine's abundant natural resources, improving yields will only partially close the value-added gap between Ukraine and its comparator countries.

6. **Low value addition in the agriculture and agribusiness sectors is constraining export value growth.** While Ukraine is at the top of the world export charts for some commodities (wheat, corn, sunflower oil), it ranks only 24th in agricultural exports value. This reflects the dominance of annual crops in the crop production mix and overall low value addition in agricultural production, as most of these crops are exported in unprocessed/slightly processed form, representing more than 49 percent of total agri-food exports (Figure 1). The low value addition is driven by two key factors: the relatively high return on investment in grains and oilseeds, and, simultaneously low investments in higher value-added production due to an unpredictable land policy and business climate.

Figure 1: Agricultural export structure is dominated by unprocessed/slightly processed field crops, 2017



Source: UN COMTRADE (2018)

¹ For export potential assessment methodology, see http://exportpotential.intracen.org/media/1089/epa-methodology_141216.pdf

² ITC.

³ USDA PSD, 2017.



7. **Current levels of investment in agriculture are insufficient for realizing the productivity and export potential.** Between 2000 and 2013, both domestic and foreign investment in agriculture increased but the trend reversed in 2013 reflecting concerns about the business environment and the conflict in the east of the country. Overall, agricultural investment as share of total investment remains low. Agriculture accounted for only 6 percent of total capital investments on average over the last decade. The food processing sector accounted for 5.5 percent of total investment on average since 2007 (Figure 2).

Figure 2: Agriculture and Food Processing Sectors are Underrepresented in FDI and Capital Investment (2004 – 2013)

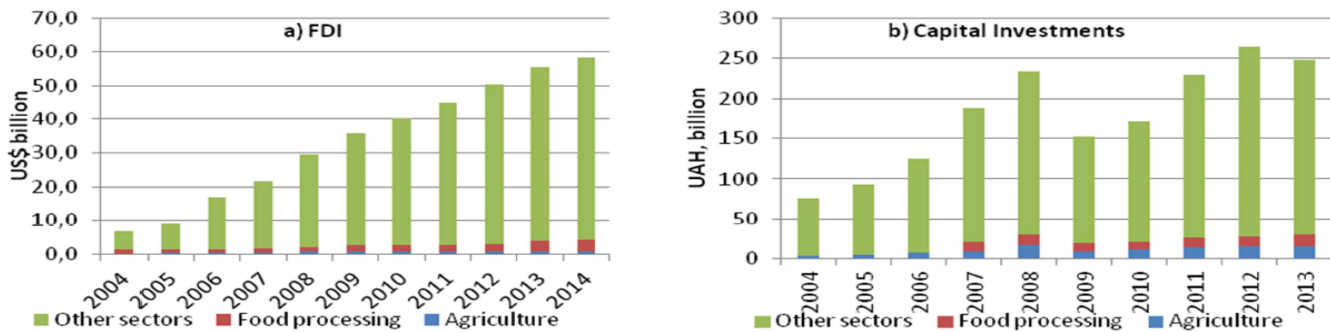


Figure 6 Development and structure of FDI and capital investments in Ukraine (Source: Ukrstat)

8. **Numerous market failures lead to sub-optimal provision of goods and services and insufficient private investments.** Their main underlying causes for agriculture's sub-optimal performance include concentrated market power and limited competition in the agricultural input markets, high transaction costs and risks, limited provision and poor targeting of public goods and services, and misdirected public policies and regulations that exacerbate market failures and limit more optimal private sector provision of goods and services.

More specifically:

- (i) **Business regulations do not sufficiently promote private investment in the agriculture sector.** Ukraine has made important progress in streamlining its business environment in recent years, with its Doing Business ranking improving from 140th in 2013 to 80th in 2017. However, structural constraints, such as weak infrastructure, a highly concentrated and anticompetitive market structure, and weak land management continue to undercut investor confidence.
- (ii) **State support for agriculture is not effectively guided by evidence-based policy analysis and a medium-term expenditure framework, which undermines long-run competitiveness.** State support to date has predominantly focused on market-distorting payments to producers. In addition, the allocation of the state support funds is often administratively cumbersome and non-transparent. A large share of support is reaching the largest producers while 41 percent of all small- and medium-sized agricultural enterprises, including individual farmers, are not aware of the state support program and only 20.3 percent had applied during 2000 – 2017.⁴
- (iii) **Primary input markets do not function properly, hindering productivity and investment.** A local monopoly exists in the nitrogen fertilizer market. Irrigation water supply is publicly managed and unreliable. The land reform remains incomplete. About 25 percent of agricultural lands are under state control. Land markets do

⁴ FAO (2018).



not function due to the existing moratorium on sale of land. Financial instruments such as leasing, crop receipts, transaction finance and other innovative instruments for improved productivity and efficiency of supply chains are almost non-existent in the financial sector⁵.

- (iv) **Adherence to food safety standards is weak and transport and port logistics are costly and inefficient.** International trade accounts for over 100 percent of Ukraine's GDP⁶. However, Ukrainian exporters suffer from non-tariff measures, including sanitary and phytosanitary and food safety barriers due to poor adherence to appropriate food safety standards. Cost of logistics also remain high. For example, the cost to move grain from farms to ports is approximately 40 percent higher than in France and Germany. The higher cost of logistics in Ukraine is due to the predominant use of road and rail transport for agricultural commodities, which also results in comparatively higher carbon emissions, as the truck fleet is fuel-inefficient and results in high CO₂ emissions.

9. **The State Target Program for the Development of the Agriculture Sector of the Economy up to 2021 identifies the Government's priority areas for the sector development.** These include a broad range of instruments for sector support, including in the areas of food safety, taxation, environmental support measures, credits and financial instruments, agricultural research and development, agricultural waste management, forestry, and several other measures. The Concept of the State Target Program was approved by the Cabinet of Ministers in 2015⁷. The State Target Program is awaiting its adoption by the Verhovna Rada (the Parliament) by the end of 2018.

Relationship to CAS/CPF

10. **The proposed Program is fully aligned with the World Bank – Ukraine Country Partnership Framework (CPF) 2017-2021.** The Program seeks to contribute to the CPF Focus Area 1: *Making Markets Work* by unlocking the potential of development finance in the agriculture and agribusiness sectors. The Program would focus on removing key obstacles and mitigating a number of risks identified as hindering increased investment in the agriculture and agribusiness sectors. Program activities would result in: (a) improved efficiency of the state support to the sector; and (b) increased development finance, including investment from private sector, IFC, and possibly MIGA. The Program would also contribute to the second objective of the Focus Area 1: *Creating a level playing field in the private sector* by working with the Government of Ukraine to tackle the monopoly in the nitrogen fertilizer market, which increases the input costs for Ukraine's farmers and stymies innovation. Under the third objective of the Focus Area 1, the CPF highlights the lack of land markets, along with weak land administration and management, which constrain investment and productivity in agriculture. The Program would aim to support the completion of the registration of state land (around 10 million hectares of 25 percent of the total agricultural land).

11. **The Program would contribute to the CPF cross-cutting theme of Better Governance and Anti-corruption through:** (a) removing remaining constraints for private sector investment; (b) improving the strategic approach, transparency and accessibility of the State Support Program under the Ministry of Agrarian Policy and Food (MAPF), which should result in improved analytical capacity, better targeting and overall improved efficiency of the public support programs to the sector; and (iii) supporting the registration of the state lands and transparent auctions of the lease or ownership rights that would improve the transparency of the management these lands, effectiveness in land rental

⁵ Potential for Agricultural Finance in Ukraine, European Fund for Southeast Europe, 2012 estimated that only about 30 percent for the needs for the agriculture finance in the sector are met.

⁶ The Sustainable Logistics Strategy and Action Plan for Ukraine, 2018.

⁷ Cabinet of Ministers Decree, December 30, 2015, #1437-p.



collection, and local (communal) revenue and public financial management. This would benefit the public at large and improve the base for local land tax revenue in the long run.

12. **The project would contribute to the CPF's focus on addressing climate change. The Program-assisted interventions would support Ukraine's pledge to the UNFCCC to maintain its GHG emission level in 2030 at 60 percent of the 1990 level** that was presented by Ukraine as part of its Nationally Determined Contributions (NDC) ratified in September 2016. The Project would contribute to this commitment by supporting development of river transport for transportation of agricultural commodities as well as introduction of a special taxation regime to modernize Ukraine's truck fleets and promote fuel-efficient and low GHG-emission trucks.

Rationale for Bank Engagement and Choice of Financing Instrument

13. **The Government of Ukraine is keen to encourage private investment in agriculture and agribusiness sectors, and the Bank will support the government in identifying and addressing key market failures currently hindering private sector investment.** A number of risks and constraints that contribute to the persistence of market failures in the agriculture and agribusiness sectors have been identified through extensive consultations with private and public sector stakeholders, recent Bank analytical work, including the "Ukraine: Sources of Growth" study and the Public Sector Expenditure Review in Agriculture (both 2018), a review reports of other international organizations, as well as the Government's Agriculture and Rural Development, Water, and Transport Sector Strategies and Action Plans. In response, a set of actions related to Agriculture, Land, Water, Agro-logistics, and Access to Finance were identified by a multi-sectoral team, focusing on: (a) the improvement of the policy and regulatory environment for private investment and the reduction of distortionary effects of public spending; and (b) public investment to reduce private sector transaction costs and risk. Given its multi-sectoral knowledge and skills, the Bank is well placed to offer integrated solutions and assist the Government of Ukraine to address the range of constraints hindering private sector investment in agriculture and agribusiness sectors in a comprehensive manner.

14. **Bank engagement in the sector is proposed as a Program-for-Results (P4R).** In selecting the P4R instrument, the following considerations were taken into account: (a) the proposed Program would ensure addressing a set of policy, regulatory and institutional reforms in support of the Government's Agriculture and Rural Development, Water, and Transport Sector Strategies and Action Plans; (b) the policy, regulatory and institutional reforms supported by the proposed Program would complement the Land Turnover Law⁸, to promote the mobilization of private investment in agriculture and agribusiness sectors; (c) the proposed operation would strengthen the capacity of the Government to implement the Strategies and Action Plans for the Agriculture and Rural Development, Water, and Transport Sectors, and improve the Government's responsiveness to issues raised by the private sector; and (d) the proposed approach would be programmatic, addressing the immediate constraints and risks in a number of engagement areas, including Agriculture, Land, Water, Agro-logistics and Access to Finance, to benefit from sectoral synergies and maximize the private investment potential.

C. Program Development Objective(s) (PDO) and PDO Level Results Indicators

Program Development Objective(s)

⁸ The Land Turnover Law, which would lift the moratorium on land sales, is awaiting ratification at the Verhovna Rada.



15. The development objective of the proposed Program is to assist the Government in improving the enabling environment to promote private investment in agriculture and agribusiness sectors.

PDO Level Results Indicators

16. At the PDO level, it is proposed that the following indicators would be used to assess Program results:
- (i) Increased investment in the agriculture and agribusiness sectors.
 - (ii) Completed registration of the state-owned lands towards advancing the land reform.
 - (iii) Strengthened capacity of the MAPF by adoption of medium-term expenditure strategic policy framework for state support planning.
 - (iv) Increased number of companies which are authorized to export finished products of animal and vegetable origin to the EU for human use.
 - (v) Reduced cost of shipping agricultural exports.
 - (vi) Increased percentage of land with secure water tenure (measured by the number of water abstraction permits, irrigation service agreements).

D. Program Description

PforR Program Boundary

17. The proposed Program is grounded in three strategic documents:
- (a) ***The State Target Program for the Development of the Agrarian Sector of the Economy for the period of up to 2021.*** The Concept of the State Program was approved by the Cabinet of Ministers by its Order No1437-p, dated December 30, 2015 (with changes and additions from February 14, 2018, N 102-p). The Concept identifies the Government's priority areas for development of the sector going forward, which include a broad range of instruments for sector support in the areas of food safety, taxation, environmental support, credits and other financial instruments, agricultural research and development, agricultural waste management, forestry, and many other measures. The State Target Program is awaiting approval of the Verhovna Rada by end of 2018. The MAPF has also developed *the Single and Comprehensive Strategy for Agriculture and Rural Development in Ukraine 2015-2025*, which provides a strategic framework for the development of the agricultural sector, addressing crop production, land tenure and land management, access to credit, taxation, agricultural research and education, state support mechanisms, food safety, environment and other related issues. The Strategy was approved by the Reform Council in 2015, and is awaiting its approval by the Verhovna Rada.
 - (b) ***Irrigation and Drainage Strategy of Ukraine (2017)***, which was prepared to complement the *Agriculture and Rural Development Strategy for Ukraine* lays out a reform agenda in the irrigation and drainage sector during 2017-2025, focusing on facilitating the sector's adjustment to the new market conditions, reversing the decline in the irrigation and drainage sector, and improving efficiency. The key reform areas include: (i) improving stewardship of the national water resource; (ii) improving the bulk delivery and removal of water; (iii) transferring management to water user's organizations; (iv) ensuring financial sustainability; and (v) stimulating profitable investment.
 - (c) ***The Sustainable Logistics Strategy and Action Plan for Ukraine (2017)*** was prepared to complement the ***National Transportation Strategy for Ukraine (NTSU) until 2030***. The goal of the Sustainable Logistics Strategy is to support Ukraine to: i) realize the country's logistics potential; ii) enhance multimodality and interconnectivity among



transport modes; iii) maintain, modernize, and expand efficient transport and logistics infrastructure and promote energy-efficient freight transport; iv) improve skills and services related to transport and logistics; and v) enhance trade facilitation. The recommendations address both physical and regulatory bottlenecks, but do not cover a comprehensive restructuring of the entire transport sector or its complex entities, which is discussed in the NTSU. The four priority axes of the NTSU 2030 are: (i) achievement of a competitive and efficient transport system; (ii) innovative development of the transport sector and strategic investment projects; (iii) provision of socially safe, environmentally friendly and energy efficient transport; and (iv) achievement of seamless mobility and regional integration.

18. Within this broader strategic context, the project would address a number of legal, regulatory and institutional bottlenecks and constraints identified as a priority during the extensive stakeholder consultations⁹ in the agriculture and agribusiness sectors and the existing analytical work. The full list of the actions is included as Annex 1. The activities supported by the project are aimed at de-risking and leveraging private investment, which would result in increasing productivity in the agriculture sector and improving efficiency of agricultural production, processing and logistics. The specific actions proposed to be supported under the program are listed below. The list will continue to be refined/reduced during further preparation work, in agreement with the Government of Ukraine.

E. Initial Environmental and Social Screening

19. The proposed project is aimed at improving institutions, systems and instruments in the country to reduce the risks to private investments in agriculture and agribusiness sectors. Physical infrastructure development only involves the improvement of existing facilities or agricultural land; therefore, no acquisition of private lands or resettlement impacts are anticipated. However, the project aims at supporting the land reform, which may involve land transfer and registration of state lands currently used by various land users.

20. In order to ensure that social and environmental risks are adequately and transparently addressed, an Environment and Social Systems Assessment (ESSA) will be conducted as part of the project preparation processes. The ESSA will include (a) a review and assessment of applicable regulatory frameworks (those include for social – land registration and ownership determination, compensation, etc.; and for environment - agricultural production, irrigation and water resources management, pest management, transport, health and safety, etc.); (b) an assessment of the agencies' capacity to enforce existing regulations and systems and proposals for strengthening that capacity, particularly in the context of the proposed project; (c) review of the oversight mechanisms in place and measures that could be introduced to strengthen them; and (d) an overall assessment of environmental and social risks and proposals for managing and mitigating those risks. The assessments would establish, as appropriate, an initial baseline that could be monitored throughout project implementation.

⁹ Stakeholder consultations were held with representatives of Committee of Agrarian Policy and Land Relation, Ministries of Agrarian Policy and Food, Finance, Infrastructure, Economic Development and Trade, and Environment, National Investment Council, State Service on Food Safety and Consumer Protection, as well as a number of trade associations and organizations: All-Ukrainian Agrarian Union, Ukrainian Grain Association, Association of Ukrainian Orchard Producers, Ukrainian Club of Agribusinessmen, European Business Association, American Chamber of Commerce in Ukraine, and financial institutions: OTP Bank and Credit Agricole.

**CONTACT POINT****World Bank**

Name :	Sandra Broka		
Designation :	Senior Agriculture Economist	Role :	Team Leader(ADM Responsible)
Telephone No :	458-9644	Email :	sbroka@worldbank.org

Borrower/Client/Recipient

Borrower :	Ministry of Finance		
Contact :	Yuriy Butsa	Title :	Deputy Minister for European Integration
Telephone No :	380-44-277-5336	Email :	yb@minfin.gov.ua

Implementing Agencies

Implementing Agency :	Ministry of Agrarian Policy and Food		
Contact :	Maksym Martynyuk	Title :	First Deputy Minister
Telephone No :	380-44-226-32-42	Email :	maksym.martynyuk@minagro.gov.ua

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

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