Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 13-Feb-2024 | Report No: PIDPC00076

BASIC INFORMATION

A. Basic Program Data

Project Beneficiary(ies)	Region	Operation ID	Operation Name
Ukraine	EUROPE AND CENTRAL ASIA	P504773	Supporting Reconstruction through Smart Fiscal Governance - SURGE
Financing Instrument	**Estimated Appraisal Date**	**Estimated Approval Date**	**Practice Area (Lead)**
Program-for-Results Financing (PforR)	13-May-2024	09-Jul-2024	Governance
Borrower(s)	**Implementing Agency**		
Ukraine	Ministry of Finance		

Proposed Program Development Objective(s)

To strengthen Ukraine's capability to finance and implement post-war recovery and reconstruction.

COST & FINANCING (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? No

Is this project Private Capital Enabling (PCE)? No

SUMMARY

Government program Cost	**2,500.00**
Total Operation Cost	**1,500.00**
Total Program Cost	1,469.90
IPF Component	30.00
Other Costs (Front-end fee,IBRD)	0.10
Total Financing	**750.00**
Financing Gap	**750.00**

FINANCING

Total World Bank Group Financing	**750.00**
World Bank Lending	750.00

Concept Review Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Russia's full-scaled invasion has imposed a severe humanitarian and economic toll on Ukraine.** In November 2023, the United Nations Human Rights Monitoring Mission in Ukraine (HRMMU) reported that at least 10,000 civilians, including more than 560 children, have been killed, and over 18,500 have been injured since Russia launched its full-scale armed attack against Ukraine on February 24, 2022. The International Organization for Migration (IOM) reports that, as of September 2023, 3.67 million people are displaced within Ukraine, and over 8.1 million are displaced abroad.[1] The invasion has led to a collapse in GDP of over 29 percent in 2022. Poverty in Ukraine increased from 5.5 percent in 2021 to 24.2 percent in 2022, with 7.1 million additional people pushed into poverty, erasing fifteen years of progress. Poverty rates in the territories temporarily not under government control and among those most affected by Russia's invasion have likely increased even more.

2. **Ukraine's public finances are under severe pressure because the disbursement of external donor financing only partially covers financing needs.** General government expenditure increased to 70 percent of GDP in 2022 and stayed above 60 percent of GDP in 2023, almost one-third more than in 2021, due to a significant decline in GDP and higher public spending to meet security needs and mitigate the humanitarian impacts of the invasion. The authorities enacted an amended budget for 2023 in October, which implies a general government fiscal deficit (excluding grants) of 36.9 percent of GDP, which will be financed predominantly through external borrowing. While Ukraine managed to collect 43.5 percent of GDP in revenues, financing needs reached 35.1 percent of GDP in 2022 and 36.9 percent in 2023. Financing needs are projected to remain similarly high in 2024. Ukraine met its financing needs through assistance from its international partners, domestic borrowing, and the monetization of the residual financing gap. Ukraine will continue to require budgetary financing from donors to ensure the provision of key public services and will continue to rely on internal sources to cover military expenditures.

3. **Attacks on energy and other civilian infrastructure have further impacted the economic and fiscal situation.** Missiles and drones have damaged power plants and substations, cutting electricity, heat, and hot water in many cities and forcing factories in some areas to close temporarily. These attacks left over 12 million people with limited or no electricity and disrupted supplies of water and heating.[5] Ukraine's power utility, Ukrenergo, has faced serious losses due to low demand and low collection rates, accumulating financial deficits of $50–100 million per month. Other utilities face similar financial pressures.

[1] https://dtm.iom.int/reports/ukraine-conditions-return-assessment-factsheet-round-4-july-august-2023?close=true

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

4. **Remarkably, Ukraine's public sector has managed to sustain public services despite the war.** A recent SIGMA OECD review concludes that public administration performance has remained at about the same level in 2023 as before the full-scale invasion in 2021, albeit with some variation across functions[2]. The review argues that leadership and co-ordination of public administration reform improved with the approval of an updated Public Administration Reform Strategy. Service delivery has also improved, with Ukraine making significant progress in the simplification of administrative procedures and rollout of digital services. Transparency and openness have been curtailed on security grounds, but civil society organizations note that the critical information needed to hold the authorities to account is usually available. Management and administrative capacity have declined due to loss of key personnel. In the first year of the war the public administration lost over 12,000 civil servants, 4,700 remained in occupied territories, 4,300 moved abroad, and 3,600 were drafted into the military.

5. **Reconstruction of the extensive damage to infrastructure due to the war presents a huge challenge.** The recent Rapid Damage and Needs Assessment (RDNA2) estimates that the cost of infrastructure damage sustained by Ukraine amounts to US$135 billion during the first year after the invasion and that needs for recovery and reconstruction amount to US$411 billion over a ten-year period.[3] Reconstruction will require significant improvements in investment capacity from pre-invasion levels: in the period 2011-2021, the consolidated public sector capital budget hovered around just 3 percent of GDP, and these budgets were usually under-executed. The challenge is compounded by the need to improve the quality of investment, building back better and greener to modernize and restructure the infrastructure stock. Reconstruction efforts will have to make much greater use of the private sector through a range of procurement and financing modalities, reserving scarce public resources for those investments that are unable to attract private capital.

6. **Subnational governments (SNG) will bear much of the responsibility for reconstruction.** The Government of Ukraine has pursued ambitious political, administrative, and fiscal decentralization reforms over the last decade. These reforms sought to strengthen local self-governance, improve public service delivery, and promote regional development, applying the principles of the European Charter of Local Self-Government by delegating significant responsibilities to newly organized territorial administrations. Some 10,000 local communities, towns, and settlements were consolidated into 1,470 amalgamated or unified communities.

7. **Public Expenditure and Financial Accountability (PEFA) assessments conducted in 2019 demonstrated gradual progress in PFM at the subnational level but also revealed challenges in strategic planning and budgeting, further weakened since the start of Russia's full-scale invasion.** Key strengths include compliance with payment rules and procedures, effective expenditure commitment controls, and consolidation of cash balances. These systems remain in place and have proved robust. However, PEFA assessments revealed weaknesses in SNG budget preparation processes, marked by delays and lack of clear guidance that contributed to rushed and incomplete proposals. Medium-term budgeting was suspended at the start of the war, so Governments at all levels now operate on an annual basis.

8. **Ukraine will have to broaden its tax base and overcome inefficiencies in tax administration if it is to mobilize the domestic resources needed for reconstruction.** Tax to GDP in Ukraine increased from just 13 percent in 2001 to just over 20 percent in 2016 but subsequently declined to 19 percent in 2021, dropping sharply to 17 percent after the full-scale invasion. Improvements in tax performance are hampered by the narrow tax base, a consequence of the large informal economy, simplified tax regimes, and multiple exemptions. Tax performance is also hampered by inefficient tax administration.

[2] SIGMA OECD Public administration in Ukraine Assessment against the Principles of Public Administration, December 2023, https://read.oecd-ilibrary.org/governance/public-administration-in-ukraine_078d08d4-en#page1
[3] https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099184503212328877

Relationship to CAS/CPF

9. **The proposed Program for Results (PforR) operation is part of the fast-track response under the strategic framework for the WB on the Global Impacts of Russia's invasion of Ukraine, supporting the priority themes under the WBG Strategy for Fragility, Conflict, and Violence 2020-2025 (Report No. 146551).** The PforR addresses short, medium, and long-term considerations outlined in the Proposed Roadmap presented by Bank management to the Bank's Board on April 12, 2022. The Roadmap seeks to increase support to Ukraine, including through financing sizeable non-military expenditure needs. The Fiscal PforR also supports the outcomes of the Ukraine Relief, Recovery, Reconstruction, and Reform Trust Fund, which are to provide a coordinated financing and support mechanism to assist the GoU in planning and implementing Ukraine's recovery, resilient reconstruction, and reform agenda.

10. **The PforR is consistent with and aligned with the country's climate action strategies.** The Strategy for Environmental Security and Adaptation to Climate Change foresees steps for addressing climate vulnerabilities and increasing climate resilience. Strategy for Environmental Security and Adaptation to Climate Change to 2030[4] requires the integration of climate adaptation in local economic and social development strategies, an environmental assessment process, and an environmental impact assessment. Adaptation planning should become an integral part of planning for SNGs. Following up on the 2050 Low Emission Development Strategy from 2017, in the updated NDCs submitted in 2021, Ukraine committed to the economy-wide reduction of Greenhouse Gas (GHG) emissions for 65% (compared to the 1990 levels) by 2030, including LULUCF. The NDC foresees climate-smart interventions in priority sectors, including energy, transport, and land use, and building climate resilience knowledge and considerations for economic development planning on adaptation. The PforR supports the country's efforts on mitigation, adaptation, and resilience through integrating and implementing a climate-sensitive public investment management for appraisal and selection of investments to enable the planning and building of climate-resilient and low-emissions public infrastructures at the national and sub-national levels.

Rationale for Bank Engagement and Choice of Financing Instrument

11. **PforR instrument is considered the most appropriate instrument to support the Fiscal Reform agenda because it focuses on reform implementation, uses government systems, supports institutional strengthening, and provides the basis for enhanced accountability**. The World Bank is a trusted partner for fiscal governance reform in Ukraine, contributing to the design of the PIM Reform Roadmap, PFM Reform Program, and National Revenue Strategy. The Fiscal PforR will support the implementation of these reform programs, focusing on priority reforms that will build capacity for reconstruction and recovery. The PforR complements Development Policy Operations which focus on the development and approval of policy and regulatory framework for reforms by supporting the implementation and application of policies and regulations. The PforR is preferrable to Investment Project Finance with Performance-Based Conditions because the operation does not envisage and require Bank support for complex procurement. Implementation of reforms will require substantial technical assistance. These needs will be met partly from an investment component under the PforR. However, the majority of the Ukraine's technical assistance needs will be met from parallel financing and technical assistance supported by Ukraine's development partners, notably the EU, IMF, and bilateral development agencies.

[4] https://www.kmu.gov.ua/npas/pro-shvalennya-strategiyi-ekologichno-a1363r

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

Program Development Objective(s)

To strengthen Ukraine's capability to finance and implement post-war recovery and reconstruction.

PDO Level Results Indicators

Financing capability

- PDO Indicator 1: Intergovernmental transfers allocated based on updated population estimates.
- PDO Indicator 2: Percentage increase in tax compliance rate.

Implementation capability

- PDO Indicator 3: Share of public investment projects aligned with strategic priorities and long-term development goals.
- PDO Indicator 4: Share of local governments that review applications on damaged or destroyed properties on time (within 30 days).

D. Program Description

PforR Program Boundary

12. **The Program will support the implementation of selected components of the Government's PFM Reform Strategy Action Plan, PIM Reform Roadmap, and National Revenue Strategy.** Table 2 provides details on PforR-supported components of the government reform programs. The Government has requested the Bank support for the implementation of reforms that are critical for reconstruction and recovery:

- **PFM Action Plan** components directly led by MoF, including: local medium-term budget planning; program-based budgeting at the local level; aligning intergovernmental transfers with expenditure assignments.
- **PIM Reform Roadmap**, led by MoF, including: strategic and medium-term budget planning for investments; selection and approval of public investment projects for financing; management of public investments at the local level; and human and IT capacity building for public investment management.
- **National Revenue Strategy**, led by MoF, including: compliance management; strengthening the audit process; exchange of information for tax purposes; improvement of excise tax administration; consolidation of IT systems; improvement of STS personnel policy.

E. Initial Environmental and Social Screening

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

Summary of Screening of Environmental and Social Risks and Impacts of the IPF Component

13. **The environmental risks of the program are Moderate.** The Program will have a number of positive environmental effects resulting from improving project appraisal methodology and introducing climate change and sustainability consideration into budget expenses planning, as well as building local governments' capacity in these matters. At concept stage, the main potential negative environmental impacts are the downstream effects of projects assessed through the new PIM system for implementation by local governments funded by local budgets and Program for the Recovery of Ukraine subventions. These projects will have potential environmental risks and impacts related to construction-related pollution (including air, water, soil pollution; waste management), resources utilization, biodiversity impacts and cultural heritage impacts, as well as OHS and community health and safety. The Program will ensure to implement screening to exclude activities with adverse environmental impacts of significant magnitude (such as projects impeding on critical habitats or known cultural heritage sites). Other Program risks include OHS and community health and safety issues related to war hazards (ERW, aerial strikes) and their impact on in-person activities (capacity building trainings, surveys). The Program will ensure incorporation of proper safety measures in line with national legislation and other relevant guidance into all envisaged activities requiring physical presence of people on site, in groups or individually.

14. **The social risks of the Program are rated Substantial.** The Program will have a number of positive social effects stemming from enhanced transparency and accountability measures associated with supporting PFM reform strategy and improvements in public investment management. The operation will not directly support works. The Program supports budget transfers covering government operating costs and appraising projects for future municipal infrastructure projects. At the concept stage, the main potential adverse social effects are the downstream effects of projects appraised for public investment (including water, education and municipal works) with feasibility studies, and expenditures for reconstruction projects under the subventions for Ukraine Recovery Program. These projects have potential social risks and impacts related to land acquisition, labor, and community and worker health and safety. The Program will incorporate screening criteria to exclude activities and expenditures that entail larger investments such as wastewater treatment facilities and significant land acquisition. Other social risks relate to potential socio-economic inequities of budget transfers to municipalities if there is insufficient outreach to ensure and awareness about subvention grant application processes (for example in de-occupied territories) and lack of inclusion of vulnerable groups in prioritizing municipal projects and service delivery, if there is inadequate stakeholder and citizen engagement processes. The Program includes measures to enhance gender inclusion in municipal budgeting processes and engaging citizens on reconstruction planning. The risks and system strengthening measures will be further assessed during Program preparation.

15. **An ESSA will be prepared by the Bank team by appraisal.** Based on confirmed Program boundaries, the ESSA will: (a) further assess the different environmental and social effects associated with the Program activities, including indirect and cumulative effects, contextual and political risks related to the E&S issues; (b) assess the capacity of national and relevant sub-national government bodies in addressing related E&S risks and identify any complexity risks in implementing E&S measures; (c) compares the borrower's systems—laws, regulations, standards, procedures, and implementation performance—against the PforR core environmental and social principles; and (d) formulate recommended measures to address capacity for and performance on policy issues and specific operational aspects relevant to managing the Program risks. The ESSA will be consulted on-line, with different stakeholders, taking into consideration the martial law restrictions, and feedback of stakeholders will be included in the ESSA. The ESSA will be disclosed before appraisal.

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