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Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 10-Aug-2024 | Report No: PIDIA00868



BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Region	Operation ID	Operation Name
Ukraine	EUROPE AND CENTRAL ASIA	P506476	Strengthening Government Capacity for Fiscal Reform Implementation (STRONG)
Financing Instrument	Estimated Appraisal Date	Estimated Approval Date	Practice Area (Lead)
Investment Project Financing (IPF)	26-Aug-2024	13-Sept-2024	Governance
Borrower(s)	Implementing Agency		
Ministry of Finance	Ministry of Finance		

Proposed Development Objective(s)

To enhance the Government's capacity to plan and finance recovery and reconstruction.

Components

- Component 1: Public Investment Management for Reconstruction
- Component 2: Planning Systems and Subnational Planning and Reconstruction
- Component 3: Local Government Fiscal Governance Recovery
- Component 4: Integrity and Compliance in Revenue Administration
- Component 5: Project Management and Operational Support

PROJECT FINANCING DATA (US\$, Millions)

Maximizing Finance for Development

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

Is this project Private Capital Enabling (PCE)? No

SUMMARY

Total Operation Cost	10.00
Total Financing	10.00
Financing Gap	0.00



DETAILS

Non-World Bank Group Financing

Trust Funds	10.00
Ukraine Relief, Recovery, Reconstruction, and Reform TF	10.00

Environmental And Social Risk Classification

Moderate

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **Russia’s invasion has imposed a severe humanitarian 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, 70 percent of them women, and over 8.1 million are displaced abroad.¹ Most of these displaced intend to return after the invasion.² 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. The levels have remained the same in 2023. 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** The overall decline in economic activity and the inability to collect taxes in some regions led to a sharp decline in revenues. 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 spending to meet security needs and mitigate the humanitarian impacts of the invasion. The authorities enacted an amended budget for 2023 in October with 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 2025 and beyond. Ukraine has 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.

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

² <https://ces.org.ua/refugees-from-ukraine-ukr-final-report/>



3. **Ukraine is highly vulnerable to the impacts of climate change and has committed to reducing GHG emissions in the long-term.** The country is vulnerable to natural disasters, including droughts, heat, wildfires, soil erosion, mudflows, extreme precipitation, and flooding. Ukraine has experienced increased frequency and severity of droughts and floods due to climate change, causing fatalities and leading to significant economic losses. Annual average temperatures and variability in precipitation are projected to increase further and heat waves will similarly become more frequent. This may increase the risk of wildfires in certain oblasts. Ukraine's Strategy for Environmental Security and Adaptation to Climate Change to 2030⁵ lays out policy measures addressing climate vulnerabilities and increasing climate resilience. Following up on the 2050 Low Emission Development Strategy⁶ from 2017, in the updated Nationally Determined Contribution (NDC)⁷ submitted in 2021, Ukraine committed to the economy-wide reduction of GHG emissions by 65% (compared to the 1990 levels) by 2030.

Sectoral and Institutional Context

4. **While the authorities have so far focused on national security, stabilizing the economy, and sustaining core government services, there is growing recognition that Ukraine needs to start building capacity for reconstruction, long-term development, EU accession, and income convergence.** The National Government will need to increase domestic resource mobilization to finance recovery and strengthen Public Investment Management (PIM) to ensure that domestic resources and external financing are allocated to priority areas. Subnational governments (SNG) will have to strengthen their capacity to undertake reconstruction planning, prioritize investment needs, manage budgets, and implement projects.

5. **Reconstruction of the extensive damage to infrastructure presents a huge challenge for Ukraine's fragile public investment management system.** The recent RDNA3³ identified total recovery and reconstruction needs of approximately US\$486 billion. Implementation of the investment program to address these needs would require a significant increase in PIM capacity. The reconstruction challenge is compounded by the need to improve the quality of investment, building back better and greener to modernize and restructure the infrastructure stock. The government recently developed a new Digital Restoration Ecosystem for Accountable Management (DREAM), which collects, organizes, and publishes open data across all stages of reconstruction projects. However, this system is not reflected in public investment management routines and is not integrated with other Public Financial Management (PFM) and procurement information systems in real-time. Reconstruction and recovery efforts will require a comprehensive approach that addresses both the immediate relief needs and medium to long-term reconstruction and resilience-building priorities. Reconstruction 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. **SNGs in Ukraine will bear significant responsibility for reconstruction efforts, following a decade of ambitious political, administrative, and fiscal decentralization reforms.** These reforms, aimed at enhancing local self-governance, public service delivery, and regional development, consolidated approximately 10,000 local communities into 1,470 amalgamated units termed Hromadas. Hromadas comprise one or more settlements (villages, towns, or cities) that collaboratively manage local public services and development. Hromadas have elected councils and heads, adhering to the principles of the European Charter of Local Self-Government. They have budgetary autonomy and provide essential services including education, healthcare, public utilities, transportation, social services, emergency response, and local administration. However, they depend heavily on shared taxes and transfers from the central government, a system disrupted by the invasion. This disruption has severely impacted SNGs' fiscal capacity, with revenue losses estimated at

³ <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099021324115085807/p1801741bea12c012189ca16d95d8c2556a>



\$3.2 billion due to infrastructure destruction and population displacement.⁴ Consequently, the fiscal resources of invasion-affected SNGs, which were already largely allocated to recurrent expenditures, are under immense strain, complicating the reconstruction of vital local infrastructure and services.

7. **Despite progress in financial management at the subnational level in Ukraine, challenges in strategic planning and budgeting persist, exacerbated by Russia's full-scale invasion.** Public Expenditure and Financial Accountability (PEFA) assessments from 2019 showed gradual progress in PFM at the subnational level in Ukraine, highlighting strengths in compliance with payment rules, expenditure commitment controls, and cash balance consolidation.⁵ However, challenges remain in strategic planning and budgeting, exacerbated by Russia's invasion. These challenges include delays in budget preparation, lack of clear guidance, insufficient budget comprehensiveness and transparency, and weak financial management capacity due to inadequate human resources and technical expertise. Most local governments also struggle with effective long-term planning and resource allocation, often influenced by political factors, lacking standardized performance indicators and systematic training. Medium-term budgeting has been suspended, with a return planned for 2025 at the central level while local governments continue annual budgeting.

8. **Ukraine must address inefficiencies in tax administration to mobilize domestic resources for reconstruction.** Ukraine's tax-to-GDP ratio increased from 13 percent in 2001 to just over 20 percent in 2016 but then declined to 17 percent after the Russian invasion. Challenges include a narrow tax base due to the informal economy, simplified tax regimes, multiple exemptions, and an overstaffed State Tax Service (STS) with inefficiencies in tax administration. Many STS staff are engaged in low-value tasks, in contrast to modern tax administration, where staff focus on compliance management and data analytics. Although Ukraine uses IT extensively in tax administration, fragmented systems and lack of strategic data use hinder efficiency, leading to high compliance costs. Corruption further undermines tax collection. In 2019, 36 percent of surveyed taxpayers reported that they are expected to give gifts to tax officials, a significantly higher proportion than regional averages. STS recently launched an Anti-Corruption Program and a taxpayer feedback survey.

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

To enhance the Government's capacity to plan and finance recovery and reconstruction.

Key Results

9. **The project addresses critical challenges in the development of the institutional framework for supporting reconstruction in Ukraine across four areas.** First, the project supports improvements in PIM for reconstruction by developing systems integration, incorporating green criteria, and building staff capacity, leading to better data flows, environmental sustainability, and the more efficient management of public investments. Second, it will strengthen national and subnational planning systems and support reconstruction activities, resulting in high-quality territorial plans, enhanced local government capabilities, and improved coordination of reconstruction efforts. Third, the project will enhance fiscal governance at the local level by improving methodologies for the population estimates used for the allocation of resources, developing fiscal risk assessment frameworks, and integrating performance budgeting guidelines. This will ensure more equitable resource distribution, fiscal stability, and accountability in budgeting processes. Fourth, it will bolster integrity and compliance in revenue administration through better data sharing and risk management strategies, leading to improved compliance enforcement. Robust project management and operational support will ensure efficient implementation and strong stakeholder engagement.

⁴ <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099021324115085807/p1801741bea12c012189ca16d95d8c2556a>

⁵ <https://www.pefa.org/country/ukraine>



D. Project Description

10. The Strengthening Government Capacity for Fiscal Reform Implementation (STRONG) project aims to enhance the Ukrainian government's capacity to plan and finance recovery and reconstruction efforts. The project comprises five key components. The first component, Public Investment Management for Reconstruction, focuses on integrating IT systems, incorporating climate adaptation and mitigation criteria into public investment management (PIM), and building institutional capacity within the Ministry of Finance (MoF), Ministry of Economy (MoE), and Ministry for Community Territorial and Infrastructure Development (MCTID). This integration and capacity building aim to streamline data management, improve environmental sustainability, and ensure efficient public investment management.

11. The second component, Support to Planning Systems and Subnational Planning and Reconstruction Activities, is designed to reform national and subnational planning systems and develop comprehensive recovery and development plans for conflict-affected communities. This includes reviewing and revising the planning system, integrating climate change considerations into strategic planning, and providing technical assistance for developing high-level recovery plans. By focusing on medium- to large urban hromadas, the project aims to enhance local government's strategic investment prioritization and planning capabilities, ensuring effective resource allocation and sustainable development.

12. The third component, Local Government Fiscal Governance for Recovery, aims to improve financial management, resource allocation, and budget transparency at the local level. This involves enhancing data collection methodologies for population and service estimates, developing performance indicators aligned with local priorities, and training local government officials on performance budgeting. The fourth component, Integrity and Compliance in Revenue Administration, seeks to strengthen tax administration through IT system integration and improved compliance risk management. The final component, Project Management and Operational Support, provides the necessary advisory services and capacity building to support the implementation and monitoring of the STRONG project and the broader Supporting Reconstruction through Smart Fiscal Governance (SURGE) program.

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

13. The Environmental Risk Rating for the IPF component is considered Substantial. The project does not support physical works or envisages any land allocation. The capacity building activities themselves do not pose social or environmental risks. There are potential health and safety risks for trainers and participants of training activities stemming from war hazards like ERWs and aerial attacks. This adds an element of extreme uncertainty and risk of fatality or serious injury to project workers and nearby communities that cannot be entirely mitigated by environmental and social management measures. The project will prepare Emergency Preparedness and Response Plan that will be applicable to all such activities and Labor Management Procedures (LMP) for the Project consistent with ESS2. The ESCP specifies requirements for labor & working conditions consistent with ESS2 including worker health & safety in emergency situations and SEA/SH Code of Conduct and clear guidance provided in the POM to comply with the relevant requirements



of ESS2. A draft Stakeholder Engagement Plan (SEP) proportional to the nature and scale of the project and associated risks has been prepared based on the feedback received during consultation for the project and will be updated throughout project implementation.

E. Implementation

Institutional and Implementation Arrangements

23. **The Ministry of Finance will be the Program Implementing Agency.** The First Deputy Minister of Finance will be the Project Coordinator and primary contact point for the World Bank on Program-related issues. The Project Coordinator will oversee project implementation, monitor progress, and ensure prompt delivery and reporting on project indicators. The Project Coordinator will act as a focal point for communication with the World Bank team on project-related issues.

24. **The MoE, MCTID, and the STS will be Implementing Partners.** The Implementing Partners will be responsible for: identifying and managing technical assistance needed to support project implementation; participating as needed in selection processes for technical assistance procurement under their respective components; and reporting on the implementation progress to MoF as the Implementing Agency. The Interagency Working Group on PIM established in March 2024 will provide the venue for coordination of across ministries during project implementation. The Working Group comprises deputy ministers from MoF, MoE, and MCTID.

25. **MoF will establish a Project Implementation Unit (PIU).** The PIU Director will report to the Project Coordinator. The PIU will be shared with the SURGE Program (P504773). The PIU will provide administrative support to MoF in fulfilling its functions as Implementing Agency. The PIU will be based in MoF’s International Finance Directorate. The PIU will: serve as secretariat to the Program Steering Committee; assist Program Implementing Partners; prepare Program implementation and results reports based on information provided by the Implementing Partner; identify, procure and manage of technical assistance; and support other actions established under the SURGE program.

26. **The project will be implemented based on a Project Operational Manual (POM) which will be adopted by the MoF before project effectiveness.** The POM will lay out the project’s overall operating, fiduciary, decision-making procedures, and results monitoring arrangements.

CONTACT POINT

World Bank

Urska Zrinski
Senior Public Sector Specialist

Oleksii Balabushko
Lead Governance Specialist

Borrower/Client/Recipient



Ministry of Finance

Implementing Agencies

Ministry of Finance

Olga Zykova

Deputy Minister of Finance

zykova@minfin.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>

APPROVAL

Task Team Leader(s):

Urska Zrinski, Oleksii Balabushko

Approved By

Practice Manager/Manager:

Country Director: