

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC88133

Project Name	Strengthening Public Resource Management
Region	EUROPE AND CENTRAL ASIA
Country	Ukraine
Lending Instrument	IPF
Project ID	P161586
Borrower Name	Ministry of Economic Development and Trade
Implementing Agency	Ministry of Finance of Ukraine, National Civil Service Agency
Environment Category	C - Not Required
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Initiation Note Review Decision	The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Ukraine has faced enormous political, security and economic challenges over the past three years. The Maidan uprising led to a change in Government, followed by annexation of Crimea by the Russian Federation and a separatist military conflict in the eastern part of the country that has caused an estimated two million people to become internally displaced. The new President and the new reformist government declared the continuity of the long-term political goal of Euro-Atlantic integration, and are working toward an end to the conflict whilst addressing the immediate needs of the displaced population, normalizing the political situation in the country, attaining macroeconomic stability, and laying a foundation for stable democratic and economic development.

Political and economic disruption has led to a severe contraction of industrial production and drastic falls in revenue. Real GDP fell by 6.8 percent in 2014 with further 10 percent fall in 2015. The fall in global commodity prices brought about recession in trading partner countries and negatively impacted terms of trade and associated revenue in Ukraine. Depreciation of the Hryvna continued through 2014-2015 causing an acute deterioration in living conditions, increases in unemployment and poverty rates .

Prior to the dramatic events of 2013-2015, structural reforms had been limited and the country found itself poorly prepared to dealing with sharply deteriorating macro-economic and social situation. Economic stagnation during 2008-2013 brought about negative growth averaging -0.7 percent annually. Increases in social spending (pensions) and the public sector wage bill, considerable subsidies to Naftogaz and other State Owned Enterprises ➤ all contributed to accumulation of imbalances in public expenditure and fiscal deficit averaging 5.8 percent of GDP during 2011-2015.

Collective action during the Maidan uprising generated hopes and demand for change, transparency, justice, combating of corruption and accountable institutions. The Government took steps toward stabilizing the economy, adjusting expenditure to match the reduced revenue, implementing safety net measures for the internally displaced population, and maintaining the level of performance of public sector institutions to bring normalcy to the people's psychologically and economically traumatized lives.

The World Bank Systematic Country Diagnostic (SCD) for Ukraine (still in draft at the moment of preparing this Concept Note) identifies three key directions for the stabilization and laying the foundation for future growth and prosperity: first, macroeconomic stability; second, improvements in productivity and job creation; and third, more effective service provision to the population. Intensification of anti-corruption and governance reforms to reduce the influence of vested interests and strengthening institutions is considered as a prerequisite for achieving results in the three broad areas identified by SCD.

For the European Union, Ukraine is a priority country within the European Neighborhood Policy and the Eastern Partnership . The EU policy toward Ukraine promotes political association and economic integration. Financial support to reforms in Ukraine earmarks an unprecedented support package of EUR 11 billion. The latest initiatives in the area of governance provide support to strengthening public financial management and public administration reform in Ukraine. Along with the policy dialogue, the EU Support Group for Ukraine (UASG) provides technical assistance and budget support that underpins progress in these two areas. Nevertheless, the scope of reforms is immense and requires a concerted effort by donor partners, including the World Bank, to support an ambitious government agenda aimed at Euro-Atlantic integration.

Sectoral and Institutional Context

Public sector institutions in Ukraine are weak. The World Bank Worldwide Governance Indicators (WGI, 2015) ranked Ukraine on Governance Effectiveness at 40.4%, Regulatory Quality at 28.8%, the Rule of Law at 23.1%, and Control of Corruption at 14.9%. The World Economic Forum (WEF), an authoritative global rating entity, ranks Ukraine on such Basic Requirements for Global Competitiveness as Institutions and Macroeconomic Environment in the bottom quintile of 140 countries. The rating for Institutions is only 3.1 of 7 points, which places Ukraine in 130th rank out of 140 countries (WEF 2015/2016 Report), with Public Institutions rated at 2.9 of 7, and Private Institutions at 3.7 of 7 points, placing Ukraine in 110th rank on this indicator. Ukraine rating for Macroeconomic Environment is also low, only 3.1 of 7 points, or 134th rank of 140 countries.

The new Government, formed in April 2016, has expressed its commitment to strengthen public institutions by approving and implementing a Public Financial Management Strategy and Public Administration Reform Strategy. The political leadership of these reforms was assigned to the Deputy Prime Minister responsible for European and Euro-Atlantic integration, who is actively working with the European Union and other donors, the National Reform Council, key government institutions and local think tanks to prepare, approve and initiate implementation of reforms. Improvements in public administration and public services, reform of public financial management and macro-economic stabilization are key priorities of the Government Action Plan for 2016. On June 24, 2016, the Public Administration Reform Strategy for 2016-2020 and Action Plan were approved by the Cabinet of Ministers of Ukraine. The Ministry of Finance, with the advice of the Bank and other donor partners, is working to update the Public Financial Management Reform

Strategy, approved in 2013. The EU Budget Support Program and Technical Assistance in the area of governance provide the resources and technical expertise needed to deliver sustainable improvements in the functioning of the public administration.

The Government succeeded in maintaining fiscal discipline and containing fiscal deficit with IMF support, while performing short-term crisis management to address the fiscal pressures triggered by the multiple crises in 2013-2014. Fiscal consolidation was the main short-term concern, which prevented the Ministry of Finance from focusing on more long-term institutional reforms to strengthen public financial management. The challenging fiscal situation after the years of stagnation further aggravated during 2013-2015, exposing structural weaknesses in SOE governance, banking supervision (regulation) and management of the Deposit Insurance Fund.

The Public Expenditure and Financial Accountability (PEFA, 2016, Report ISBN 978-617-7239-11-5) shows some progress in the area of budget execution and control. It also commends Ukraine for a relatively strong Treasury Function with adequate control structure, access to budget execution information and improvements in investment management assisted by the amended Budget Code. At the same time it argues that the budget function has a space for improvement through alignment of policies with expenditure, expanding the budget planning horizon to medium term, and strengthening the system of internal and external audit to facilitate improved operational performance and accountability. Limited information exchange between the key fiscal management institutions and a burdensome and compliance-focused control environment remain significant constraints to effective financial management. Introduction of non-financial performance angle into the budget transparency initiative could improve accountability and clarity for citizens.

A substantial body of analytical work in the PFM area lays a foundation for modernization of the public financial management system in Ukraine. The new PFM Strategy and Action Plan will benefit from the analyses and recommendations of the recent analytical and technical assistance work conducted by the EU, the WB, Sida, DFID, GIZ, and the IMF in the Ministry of Finance through separate focused initiatives, including PEFA and a Strategy for ICT Development in the State Fiscal Service for 2016-2018. In parallel to the review of PFM Strategy, the Ministry of Finance is conducting a functional review with the support of EU experts. This project plans to support the implementation of reforms in key areas of macro-fiscal forecasting, policy-based budgeting, internal management and other areas deemed as important by the Ministry of Finance and reflected in the PFM Strategy.

The new Public Administration Reform Strategy supports implementation of a merit-based civil service. A new Civil Service Law became effective on May 1, 2016. The Law depoliticizes the civil service by clarifying the delineation between political and administrative functions within the public administration, establishes merit principle for competitive appointment of civil servants, including senior managers, restricts party membership for senior civil servants of category A, and makes senior civil servants responsible for all human resource management functions in public administration organizations. The law reintroduces the position of State Secretaries of Ministries abolished in 2006. The merit principle in the civil service will be protected by a high-level Commission on Senior Civil Service. The National Civil Service Agency (NCSA), led by a Cabinet-appointed Head, is in charge of formulation and enforcement of state policy on civil service.

Effective enforcement of the new Civil Service Law assumes that NCSA has accurate and timely information on the numbers, qualifications, ranks, careers, performance and remuneration of civil servants. Ukraine's State Administration employs around 250,000 civil servants at the central and regional level, but does not have a central personnel registry system. In the absence of a single automated registry, the number of civil servants and public employees is reconciled by the National Civil Service Agency manually, through quarterly and annual consolidation of personnel data from some 130 state institutions at the central, oblast and rayon level. However, employment statistics do not form a basis for effective supervision, enforcement or amendment of personnel policies.

The wage bill of civil servants and public employees represents a significant part of government expenditure, but it is managed without adequate efficiency or controls. According to the 2015 Budget Execution Report of the State Treasury, the state employee wage bill amounted to 13.8 percent of State Budget Expenditures and 14.9 percent of total State Budget Revenues. In 2015, 186.1 billion Hryvna or 9.4 percent of GDP was spent on wages and compensations of public sector employees, according to the Ministry of Finance. To authorize monthly salary payments, the Ministry of Finance reviews personnel payment requests from Spending Units (SU) on a monthly basis and approves a lump sum payment to every SU for processing through the banking system. The whole procedure involves manual review by MOF staff and is time-consuming and inefficient. An automated payroll system linked to a human resource management information system (HRMIS) is indispensable for monitoring the civil service employment, effectively managing civil servants, and controlling personnel expenditure for state employees.

Both the Ministry of Finance and the National Civil Service Agency expressed a need for an automated registry of civil servants (HRMIS) and a payroll calculation module. The implementation of a payroll module, linked to the personnel registry would help automate the administration of wage payments, provide transparency in personnel expenditures, and enable the government to effectively design a new affordable and equitable salary structure. The latter is especially important given that the real value of salaries deteriorated significantly during 2013-2015, averaging at an equivalent of EUR 450 per month. Low salaries prevent the revitalization and renewal of the public administration with qualified professionals.

In the absence of a central HRM information system, state bodies found their own solutions for managing this type of information. While such a distributed approach may serve state bodies well, it makes central monitoring and control of state employment and its fiscal costs difficult and inefficient. The lack of reliable and timely information on staffing levels and personnel structure and the lack of data on actual salary structure limits the ability of the central institutions to improve transparency and economic efficiency of state personnel expenditure on the one hand, and prevents informed policy decisions on the other. The recent policy that allows state bodies to trim their staffing and use personnel expenditure savings for salary top-ups may help some state institutions retain key staff, but there is no means to exercise an effective oversight of this policy and emerging inequities in earnings across the state administration.

The recently approved Public Administration Reform (PAR) Strategy, supported by the European Union and other development partners, provides a framework for improving institutional structures and functional capabilities, developing efficient procedures and information systems, rightsizing the public administration and enhancing its professionalism, modernizing the provision of public services, and strengthening internal controls. It provides for the implementation of an automated HRMIS linked to Payroll, which will be implemented under this operation.

Relationship to CAS/CPS/CPF

The operation is fully aligned with the Systematic Country Diagnostic (SCD) which identifies the need for strengthening government effectiveness, improving transparency, strengthening anti-corruption institutions and rightsizing the public service. This operation will contribute to government effectiveness and transparency through improving the capacity of the Ministry of Finance in its core functions and implementing an automated human resource management information and payroll system that will support future rightsizing of the state administration and optimizing personnel expenditure.

II. Project Development Objective(s)

Proposed Development Objective(s)

Improving Transparency and Efficiency in Public Resources Management by:

- (i) Automating government personnel and payroll information; and Strengthening selected PFM functions and systems in the MOF; and
- (ii) Strengthening selected PFM functions and systems in the MOF.

Key Results

1. Effective management of state employees and related personnel expenditure through ICT solutions.
2. Improved operational balance of the state budget through strengthened revenue forecast and cash management; and
3. A clear vision for ICT development in PFM is developed.

III. Preliminary Description

Concept Description

The proposed operation will be implemented as a hybrid Multi-Donor Trust Fund, involving Recipient-Executed and Bank-Executed activities for a tentative amount of USD 5.6 million. Presently, the European Union has agreed to finance this Trust Fund, while other donors are expected to join in at a later stage and support activities under the umbrella of the PAR and PFM Strategies.

The Trust Fund activities will be grouped in two components:

The Trust Fund activities will be grouped in two components:

1. Strengthening Human Resource and Payroll Management Function through the design and implementation of a human resource management information system and consolidation of the state employee payroll; and.
2. Strengthening Public Financial Management through improved cash flow forecasting and development and approval of the PFM ICT Strategy.

The Recipient will implement the following activities:

C1. Under the Strengthening Human Resource and Payroll Management the National Civil Service Agency will achieve the following results:

- 1.1 Develop Functional and Institutional Requirements (for HR incl. salary calculations) and System architecture;
- 1.2 Design and enable Telecommunication infrastructure for HRMIS/Payroll operation country-wide;
- 1.3 Design, implement, test and initiate the roll out an HRMIS/Payroll system at the central level;
- 1.4 Implement change management program and train users in operation of HRMIS; and
- 1.5 Develop normative changes that regulate the operation of the HRMIS/Payroll country-wide.

C2. Under component Strengthening Public Financial Management the Ministry of Finance will implement the following activities:

2.1. Improved cash flow management and revenue forecasting: by improving enhanced business processes, procedures and methodology for cash flow forecasting; enhancing technical skills in cash flow forecasting of the MoF staff; and implementing an efficient information sharing protocols agreed and enacted for cash flow forecasting.

2.2 ICT capability of MOF is enhanced by: designing a blueprint for information management for the upgraded PFM procedures; designing an ICT strategy for upgrading MOF's information system(s); upgrading the functionality of the budget preparation module to incorporate the medium-term budget planning; and addressing urgent IT sustainability needs.

Notwithstanding the agreement on the core areas of engagement and expected outcomes, the Government and EU partners expressed the need for flexibility in the scope of the Trust Fund, so that it can respond better to evolving understanding of the parties on how to address existing constraints in a more effective and efficient way and new financing opportunities that may arise.

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	

V. Financing (in USD Million)

Total Project Cost:	3.485	Total Bank Financing:	0
Financing Gap:	0		
Financing Source			Amount
Free-standing TFs for ECA CU2 Country Unit			3.485

VI. Contact point

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