

ANNEX 5: CPS PRINCIPLES AND OPERATIONAL FRAMEWORK FOR SELECTION OF PROGRAMS

1. **Three principles underlie the development of the CPS: (i) selectivity, (ii) flexibility, and (iii) partnerships.**

Selectivity

2. **In moving towards greater selectivity in Bank activities in the next strategy period, a framework for the selection of programs was developed as part of the CPS preparation.** Three criteria were established to inform the selection:

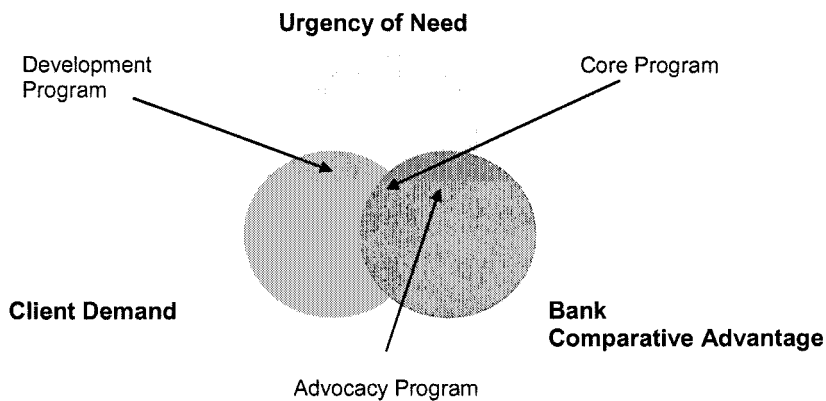
- Client ownership: the Bank's activities should respond to the demands of the client in order to be effective.
- Development urgency: to the extent that particular development challenges stand out, the Bank should be willing to support measures to address these challenges. This may or may not coincide with the priorities of the client.
- World Bank's comparative advantage: this criteria encompasses the Bank's current capacity to address a specific issue, and the related potential needs for investment in diagnostic work or in staff skills, as well as the role other donors are playing in a particular area.

3. **In the implementation of this framework, the diversity of comparative advantages among various World Bank Group institutions needs to be taken into consideration.** Because IFC responds to the needs of private sector clients in addition to the government and its comparative advantage may differ from that of IBRD in meeting their needs, the classification of programs according to the criteria above may be different for the two institutions. Specifically, due to a different set of instruments at its disposal (ability to provide direct financing to the private sector) and a vast experience focusing specifically on private sector development, IFC may be better positioned to take the lead on addressing the challenges faced by the private sector clients, while IBRD would predominantly apply its competencies in the public domain.

4. **Based on the rules for selectivity presented above, a typology of programmatic interventions was developed depending upon which criteria they fulfill (Figure A.4.1).** At the intersection of the three perspectives of client demand, urgency of need and Bank capacity to lead are the "core programs". At the intersection of client demand and urgency of need, but where a reform path (or the Bank's capacity to lead) remains to be fully developed, are the "development programs". At the intersection of urgency of need and Bank capacity, where client demand is limited are the "advocacy programs"⁷¹.

⁷¹ The notion of client demand is naturally quite subjective. Client demand may not be uniform depending on who in the Government one talks to. What matters for selectivity is that there is clear and expressed demand for engagement from the central authorities, in particular the MoF, the Ministry of Economy, the Cabinet of Ministers and the Deputy Prime Minister responsible for the Economic Block.

Figure A.4.1: Selectivity in the CPS



5. **Core programs combine a range of instruments, including investment and adjustment lending, and AAA** targeted towards specific needs that have already been identified as part of an overall reform path/agenda. Core programs are programs, where basic strategic AAA has already been carried out and a reform path has thus been developed. The Bank is therefore in a position to bring its full support to bear on this area and to do this based on a reform strategy owned and supported by the client. Core programs are also expected to benefit from synergies across different thematic engagements and instruments.

6. **Development programs would typically not include investment lending (although they might include one first “door-opening” operation).** Development programs would be expected to be AAA heavy, with significant spending on the development of a reform roadmap and investment into a sequenced policy agenda that might be supported by adjustment. AAA may include basic ESW, but would be expected to also include targeted policy notes, selected pieces of advocacy work and the mobilization of technical assistance.

7. **Advocacy programs would not include investment or adjustment lending and would be driven entirely by AAA.** Since the purpose is to advocate for reform where client ownership is limited but the Bank judges development urgency to be high, these programs would include substantial outreach efforts to society at large.

8. **The framework for selectivity among thematic areas will be complemented in the new Strategy with a move towards fewer, larger and more efficient investment lending operations.** The CPS foresees no more than four lending operations each year, of which one is planned to be a DPL. The remaining three investment lending operations are expected to be concentrated in the core programs of the strategy. In addition, the CPS aims to bring preparation and implementation times down from current high levels. Success in doing so will be one of the benchmarks modulating the level of assistance in the CPS (see below).

9. **IFC investments and advisory services will complement IBRD lending and non-lending activities across all three types of programs.** In response to strong demand from the private sector and the government, IFC is planning to scale up its

operations by i) extending direct loans to private companies, ii) exploring opportunities to mobilize direct private investment as co-financing for public projects, and iii) providing advisory services for broad-based improvements in the business environment, corporate company practices, and supply chains. Through its operations, IFC would support the demand for policy change and create positive demonstration effects in the private sector. IFC would also aim to reach the relatively poorer regions in the west and south of Ukraine as well as underserved segments of the private sector, where the availability of financing and expertise has been limited to date. Due attention will be dedicated to ensuring to development effectiveness and long-term sustainability of IFC interventions.

10. The concentration on fewer lending operations and the reduction of preparation and implementation timetables will set free administrative resources for advisory services but also for advocacy and communication work. A key principle of the CPS is that the Bank's engagement in Ukraine should become more programmatic and less oriented towards the preparation of investment projects. The greater focus on AAA activities will see investment in greater dissemination and communication efforts. In this regard, a renewed engagement with civil society will be a key plank of the Bank's governance strategy in Ukraine and reflects the views of non-government stakeholders, which have encouraged the Bank to provide a forum for debate on key development and social issues.

11. An additional benefit of the increased focus on non-lending activities is that it generates positive knowledge spillovers for other Bank clients. Ukraine's experience as a fast-growing middle income country and its need to innovate institutionally to adapt existing world practice to its specific circumstances could benefit other countries likely to follow a similar path. The Bank's global knowledge can help Ukraine, but Ukraine's specific experience will also enrich the Bank's global knowledge. In reflection of this two-way learning, non-lending activities where possible will be carried out jointly with local partners, and opportunities sought to share Ukraine's expertise with other countries in the region.

12. The cross-sectoral DPL will continue, but here too conditionality will become more selective. Policy conditionality will aim for a realistic assessment of reform progress and focus attention on those areas where reforms are most urgent but also success is most likely. The DPL-II, prepared in parallel with this new CPS, continues a cross-sectoral focus in order to maintain a broad anchor for the policy dialogue during a time of increased uncertainty. The program contains reform benchmarks for one additional policy operation in the series, which would bring to a close several important reform agendas initiated under the PAL program in the 2000-2003 and 2003-2007 CASs. Beyond the DPL III, the CPS leaves open the possibility of a move towards more thematically focused DPLs if the government sees benefits in deepening the policy engagement and support in a particular area (see Section VI on CPS pillars).

Flexibility

13. As a MIC, Ukraine requires a flexible menu of support. The current CPS does not develop a full lending pipeline or a complete business plan for the entire four-year period. Instead, consistent with Ukraine's status as a lower middle income country with

significant implementation and fiduciary risks, and inherent country uncertainties, a two-year lending and AAA program is specified, while activities in the outer years of the CPS would be discussed and finally agreed during the mid-term review of the strategy after two years.

14. **Flexibility in the CPS applies to both themes and instruments.** The choice of programs can be reviewed at mid-term and some development or advocacy programs may have matured enough to qualify for focused investment lending support in the subsequent period. Other core programs may have failed to live up to expectations and the scope of the Bank's support may be reduced. The decision whether to move from cross-sectoral to thematic DPLs would also be part of the review process at mid-term.

15. **The greater focus on AAA activities raises significant challenges to be addressed in the course of implementation of this CPS, including:**

- (i) Increased responsiveness to client demand in the selection of topics for AAA;
- (ii) Developing a results framework for AAA to strengthen accountability;
- (iii) Cooperation and co-funding of key analytical work with other donors;
- (iv) Exploring fee-for-service arrangements with the Government at various levels to allow AAA to be scaled up.

16. **One specific proposal still in the process of discussion with the authorities is the creation of an "Innovation Fund" that would bundle AAA resources and make them available for demand-driven analytical and advisory services.** The authorities have so far not indicated interest in fee-for-service arrangements as in Russia or Kazakhstan. However, the creation of such an Innovation Fund that would contain perhaps initially up to US\$400-500,000 in administrative budget could lay the basis for subsequent co-financing. Co-financing from other donors, including Ukrainian charitable foundations, will also be explored.

Partnerships and Harmonization

17. **Since 2006, the WBG has been overtaken by the combined European institutions (EBRD, the EC, and the EIB) as the largest provider of official development assistance to Ukraine.** The Action Plan agreed with the EU sets a framework for reform in many areas of interest for the Bank. Other large donors are USAID (with a very significant program in the development of capital markets and financial services, for instance), the Millennium Challenge Corporation, CIDA (the leading provider of finance for the People's Voice project), the Swedish International Development Association (SIDA) (with a keen interest in environment), as well as Dutch, German and Japanese bilateral assistance (all currently involved as co-financiers or as donors to Bank-managed trust funds in Ukraine). Close coordination is therefore imperative. Annex 6 provides an overview of donor activities by thematic area.

18. **Coordination with partners has implications for selectivity.** On the one hand, it is possible that the Bank may be asked by the donor community to take the lead in a particular area because it has the greatest expertise or because other donors are not currently present in it. On the other hand, the Bank may decide not to be active in a particular sector because it is crowded by other donors and the Bank's value added is not

immediately obvious. But there are also many areas in which donors complement each other and the presence of partners may increase the returns to the Bank's investments. In deciding which areas to focus on, the Bank needs to take these considerations into account.

19. **The importance of the donor community in influencing policy choices in Ukraine should not be over-estimated.** Combined donor assistance (including EBRD lending to the public sector) may currently be in the order of US\$1-1.5 billion per annum, which is around 1 percent of GDP, or 2.5 percent of total government revenues. However, donor assistance is a much larger proportion of Ukraine's capital budget.

20. **Compared to the size of financial transfers, the transaction costs for Ukraine of dealing with the donor community are high.** Despite a commitment to harmonize aid procedures, coordinate on policies, and avoid duplication, the donor community remains relatively fragmented in Ukraine. Many donor assistance projects bypass the budget, are implemented under special procedures from procurement to financial management, and require the Ukrainian side to set up costly project management functions which are not well integrated into existing government ministries and agencies. A perceived high level of fiduciary risks limits the extent to which donors are willing to move fully towards the adoption of country systems. However, the current parallel processes are not only costly and fail to build adequate government capacity, but also contribute to the fragmentation of the capital budget system itself. Individual government agencies are given a license to chase after their own assistance projects without these having been reviewed against a set of strategic priorities.

21. **Improved coordination will require government leadership. But the Bank will continue to explore avenues for greater harmonization of its procedures with those of Ukraine and encourage other partners to follow the same route as one of the main tools to force greater coordination from the government's side.** Key milestones of the CPS in this regard include routing all project disbursements through the State Treasury, including World Bank projects in the state budget, and improvements in the state procurement system. Over the medium-term, the Bank will work on a framework for assistance to specific sector programs through the budget and tied to meeting specific performance benchmarks. The EU is also working on a framework for sector budget support, providing a good opportunity for donor collaboration. This could evolve into a series of SWAs in the outer years of the CPS.