

highlighted above. A civil service law has been drafted in compliance with EU standards, but its approval remains uncertain. Two presidential decrees outline the country's vision on judicial reform. Yet without a resolution of the underlying constitutional issues, a fundamental reform of the judiciary seems difficult. Efforts are more likely to concentrate on improving material conditions in the judicial system, and modernizing the courts so as to lay a basis for more efficient operations and increased credibility in the eyes of the public. More generally, institutional reforms in the public sector have tended to lag reform measures designed to support private sector development. This pattern may continue.

## V. WORLD BANK GROUP STRATEGY

### A. LESSONS LEARNED FROM THE 2003-2007 CAS

#### The CAS Completion Report (CAS CR)

64. **The CAS CR notes that the CAS was broadly aligned with the development priorities expressed in Ukraine's "European Choice" agenda developed in 2003 (Annex 3).** The robustness of this construction is apparent in the fact that the authorities and the Bank jointly agreed not to change the assistance framework during the mid-term review in 2005, although the Government had changed in the meantime following the "Orange Revolution" of late 2004.

65. **Ukraine, over the period of the 2003-2007 CAS, achieved or even exceeded many of the long-term development outcomes set as targets under the CAS.** Growth exceeded projections, public debt levels declined, and Ukraine made significant progress in trade liberalization and financial sector development. The political changes at the end of 2004 brought significant improvements in media freedoms and the expression of political voices. In the social dimension, progress was mixed, as the significant reduction in poverty was not matched by similar progress in other social indicators.

66. **The overall positive assessment notwithstanding, the CAS CR highlights the variability of results across pillars and areas of engagement.** Thus work on macroeconomic stabilization, financial sector development and international integration was successful, whereas work to improve corporate governance and the environment for private sector development, was less successful. While poverty reduction was achieved as a result of rising incomes, the much needed reform of social assistance and insurance systems advanced less rapidly than had been hoped for. Similar variability in outcomes is observed within the social sectors, with some progress in access to education but limited advances in the reform of health care, the containment of the HIV/AIDS and TB epidemics, or in improved quality of municipal services. The public sector governance agenda advanced in the area of public financial management, but stalled in public procurement and in the reform of public administration.

67. **This variability in outcomes is also observed across instruments.** Many of the results achieved during the CAS period can be attributed to adjustment lending (initially the Program Adjustment Loan (PAL) program later transformed into the DPL program). By contrast, investment lending contributed only marginally to the achievement of results during the CAS period, both because investment lending operations naturally take longer to achieve results, but also because their implementation was highly uneven, with many projects experiencing preparation, effectiveness and implementation delays. The integration of investment lending into the results framework was incomplete. Recognizing the implementation problems in the investment lending portfolio, the Bank carried out an Investment Lending Review in 2005, the recommendations of which are being implemented (see Box 5).

68. **The authorities have become increasingly aware of the need to improve the effectiveness of investment lending.** Notably, a Working Group on improving the effectiveness of lending by IFIs was set up in the government in 2006. The Chamber of Accounts has also issued a report reviewing IFI lending. It should be emphasized that several investment loans were completed rapidly and successfully during the previous CAS period, including Treasury-I, EDP-I, or Kyiv District Heating, to list a few examples (a full list is provided in Annex 3).

69. **The CAS CR draws the following lessons from the review of outcomes and their variability during the 2003-2007 CAS implementation:**

- **Institutionally capable and committed counterparts support effectiveness.** Weak institutions are less likely to implement agreements even if there is a high level of formal “ownership.” However, the capacity to implement is not fixed and can increase through strong political mandates, good leadership and institutional reform.
- **Linkages across themes reinforce the effectiveness of interventions.** For instance, improving payments and fiscal discipline has helped make further progress in the financial and the energy sectors. Opportunities for further strengthening of linkages are in public financial management (including inter-governmental fiscal relations) and the delivery of social services.
- **Clear objectives are not enough to achieve results.** Effectiveness requires not only a clear vision, including expected results, but an understanding of the remedies to remove the barriers to achieve them. The Bank must understand political economy constraints to implementation and work on reform roadmaps that allow it to overcome these constraints.
- **A broad agenda risks wide variability of results.** The 2003 CAS agenda was broad because it endeavored to cover most aspects of the government agenda. The price has been a wide variability of results. With hindsight, greater selectivity would have helped improve the quality of the overall delivery. Selectivity requires putting in place rules of engagement and enforcing them. Flexibility helps move in areas of opportunity and drop slow-moving agendas

### **Box 5: Portfolio Performance and the Investment Lending Review**

During the CAS period, six new investment loans were approved and new commitments amounted to US\$629 million, around half of the total. Disbursements however were only US\$241 million, or around 21 percent of total disbursements. The total investment loan portfolio remained steady at between 11-12 operations, of which 3-4 were in problem status in each year of the CAS. Projects at risk thus accounted for around one third of the total, with commitments at risk rising through the CAS period to 46 percent in FY07 (largely because the single largest operation – the Rural Land Titling and Cadastre Development project - moved into the risk category in that year).

Ukraine's portfolio has consistently been one of the weakest in the region, with high risk levels, low disbursements, long preparation times, effectiveness delays and a large number of dropped projects. Under these circumstances it is not surprising that investment lending has not contributed effectively to achieving CAS results. To begin to address these challenges, the Bank carried out an Investment Lending Review in 2005. The 2005 Investment Lending Review proposed to: (a) restructure or cancel non-performing projects; (b) reduce the institutional complication of investment projects; (c) move to a greater use of country systems; (e) encourage the government to simplify its procedures, and (f) improve internal coordination within the Bank teams.

The Bank and the government have advanced in cleaning up the portfolio of Bank projects through cancellations or re-programming. In addition, new operations have sharper objectives and are less institutionally loaded, which should make it easier to implement and evaluate results. Greater use of country systems is making progress by shifting disbursements under all projects with the central government to the treasury. Nonetheless, disbursement rates, although improving, remain low, and preparation and implementation times are well above ECA and Bank averages. The new performance standards developed jointly by the Bank and the authorities during the 2007 CPPR/CPS are designed to address the persistent problems in investment lending.

- **Achieving results demands sustained efforts that combine the use of various instruments.** Although there may be cases of quick wins, in most circumstances, progress came about through a combination of intensive dialogue supported by analytical work and adjustment, and, in a few cases, investment. While there must remain room for exploration and innovation, this requires expectations to be properly managed.

70. **Going forward, the CAS CR recommends greater selectivity in the choice of areas of engagement, whilst arguing for a thematic approach that recognizes synergies across interventions and directly addresses the trade-offs between client ownership and development needs.** It therefore recommends a combination of interventions in areas with strong delivery potential with a presence in key strategic arenas, where progress has lagged and where this risks holding back development progress as a whole.

71. **The report also urges the Bank to maintain flexibility, both across areas of engagement and across instruments, and suggests to program activities on a rolling basis.** It recommends the greater use of Analytical and Advisory Activities (AAA) to build ownership in areas where reforms are slow-moving, both as background for the design of development policy and investment lending. Such AAA should also reveal

potential implementation obstacles prior to embarking on new lending commitments and thereby limit the variability of results.

**72. With regard to investment lending, the CAS CR suggests moving towards clearer rules of engagement and performance standards to complement the attention on internal processes in project preparation on the Ukrainian side during the 2003-2007 CAS.**

**73. Finally, the report strongly encourages greater cooperation both across the World Bank Group (WBG) and with other donors, and recommends the Bank to intensify the dialogue on the challenges of transition with a broad group of stakeholders in Ukraine.**

### **The Country Assistance Evaluation**

**74. The Independent Evaluation Group (IEG) evaluation of the Bank's support to Ukraine from FY99 through FY06 echoes many of the findings of the Bank's CAS CR.** It evaluates the Bank's assistance across three broad pillars: (i) Sustainable Economic Growth and Integration into the World Economy, (ii) Public Sector Reform, and (iii) Poverty Reduction and Comprehensive and Harmonized Human Development. The outcomes of the Bank's assistance are rated moderately satisfactory overall, with a satisfactory, moderately satisfactory and moderately unsatisfactory across the three pillars. Within each pillar, ratings also differ across activities, highlighting the variability of outcomes across a broadly-based program. While the overall assessment of the IEG report is somewhat less positive than the Bank's own assessment, the ranking of outcomes across pillars and activities is broadly consistent.

**75. IEG further rates the institutional development impact of the Bank's assistance as modest, in particular with reference to limited progress in the reform of public administration and remaining governance problems.** Risks are regarded as significant and the report takes the view that Ukraine's unexpectedly strong economic performance may not be sustained without a deepening of structural reforms and improvements in public and private sector governance. The IEG report confirms the positive impact that adjustment lending had on advancing the policy reform agenda in Ukraine, while noting that the breadth of engagement in investment lending may have reduced its effectiveness.

**76. Going forward, the IEG evaluation makes the following recommendations.** The Bank's response to these recommendations is contained in Annex 4:

- *Strategy*. The Bank *strategy* should strive for greater selectivity, focusing on public financial management, PSD, energy, and social protection, and within these areas, on improving governance and institutional development.
- *Economic and Sector Work (ESW)*. The Bank should be placing greater emphasis than in the past on *private sector development and infrastructure*.
- *Investment lending*. A tighter alignment is needed between investment projects and the government priorities. In addition, the Bank should simplify investment projects and reduce their scale to match implementation capacity, and ensure line ministries' engagement in project preparation, and also their more direct involvement in project implementation, avoiding off-line Project Implementation Units (PIUs).
- *Adjustment lending*. A shift from broad, multi-sectoral loans to loans that are more narrowly focused and disbursed in a single tranche is appropriate for Ukraine, which would also provide the opportunity for follow up and deeper policy and institutional reforms.

## **B. OPERATIONAL PRINCIPLES AND RULES OF ENGAGEMENT**

### **Operational Principles**

77. **Three principles underlie the operational approach in this CPS: (i) selectivity, (ii) flexibility and (iii) partnerships.** These principles are directly derived from the lessons of experience in the previous CAS. They are also fully consistent with emerging best practice in Middle Income Countries (MICs).

78. **In preparing this CPS, the Bank, together with the authorities, has developed an operational framework to select programmatic areas for its future engagement.** The operational framework is presented in Annex 5 of this CPS. The framework proposes a typology of programmatic interventions, including:

- (i) core programs – where the Bank would support government reform efforts through the entire range of instruments at its disposal;
- (ii) development programs – where Bank interventions would be targeted at developing a reform path, or complementing the efforts already under way by other donors (Annex 6 provides an overview over the activities of other donors);
- (iii) advocacy programs – where there is as yet insufficient ownership and public support for the necessary reforms and Bank efforts would consequently focus on creating greater consensus and demand for change.

79. **The framework will be applied flexibly over the course of the CPS.** An initial selection of programs for financial years 2008 and 2009 is proposed below. However,

the selection remains open to modification at a mid-term review, as reform priorities evolve, as the consensus in support of a reform path develops, and as the Bank determines its particular role in the concert of other donor support. The flexibility will also extend to support instruments, ranging from traditional investment lending, DPLs, through more innovative instruments, including increasing focus on performance-based budget support, and moving towards SWAs.

**80. A particular focus of the CPS will be on non-lending interventions, with particular attention placed on timeliness, dissemination and communication to achieve greater impact.** Commensurately, the Bank will aim to deliver fewer, larger and better financial support operations, in order to make room for greater non-lending support in the Bank's administrative budget. By implication, improvements in the performance of the existing lending portfolio will need to remain at the center of the Bank's efforts during the CPS.

**81. The framework also takes into account the specific role of the IFC.** The IFC's ability to work directly with private sector clients and its expanding advisory services, will allow it to provide significant support in areas where the private sector can act as a catalyst for reform. The CPS thus integrates the different comparative advantages of IFC, the Multilateral Investment Guarantee Agency (MIGA), the Foreign Investment Advisory Service (FIAS) and the International Bank for Reconstruction and Development (IBRD) into a coherent framework.

### **Lending Range and Benchmarks**

**82. Ukraine has greatly improved its external creditworthiness since the last CAS was approved.** The public debt to GDP ratio has fallen to less than 15 percent of GDP; growth has been maintained at high rates, and inflation has remained at moderate levels. Fitch upgraded Ukraine's Sovereign Long Term Foreign Debt Rating to BB- in January 2005 (upgrading the outlook to positive in October 2006), while Standard and Poor's followed in May 2005. The OECD transferred Ukraine from the sixth to the fifth risk group in its classification of export credit risk in January 2007. These improvements have been reflected in growing international market access, and overall the appetite for Ukrainian risk remains reasonably strong despite a gradual re-pricing of Ukrainian risk in the international bond market since May 2007, in line with developments in other emerging markets.

**83. The size of Ukraine's economy in US dollar terms has tripled since 2000 and is set to continue to grow further.** As with many other transition economies, Ukraine, over the medium-term, is expected to experience further real exchange rate appreciation.

**84. Taking into account Ukraine's substantial investment needs (estimated at US\$100 billion over ten years) and the significant growth of its economy since the last CAS, the CPS proposes a lending range of between US\$2 to 6 billion over a four year period.** The proposed lending range is around 30 percent higher than that provided

for in the previous CAS, which is, however, considerably less than the expansion of the US dollar GDP since 2003. At the same time, the Bank has not been able to fully utilize the base-case lending envelope during the previous CAS, on account of delays in meeting key policy lending conditionality and in investment lending preparation. Therefore, this CPS proposes a more flexible architecture with lending levels within the overall range modulated by progress in reforms, maintenance of an appropriate macro-economic framework and improvements in portfolio implementation and project preparation. In respect of the latter, it is expected that as the Bank consciously moves towards fewer but larger projects, with fewer investments in complex institutional reforms, project preparation and implementation will speed up considerably. Thus, in infrastructure, disbursement rates have tended to be above 20 percent as against 3-5 percent in projects supporting institutional reforms.

**85. DPL is expected to decline in relative importance during the CPS period from up to half of planned total lending to around 40 percent.** Access to DPL lending would be contingent on the maintenance of an adequate macroeconomic framework, as detailed below. Thus, at the low end of the lending range, the share of DPL lending would be zero, increase to around 40 percent in the middle of the range, and above that level, subject to stronger progress on reform and government demand. This implies a target size for DPLs in the middle of the lending range of around US\$300-400 million per annum. The target size takes into account the current pace of policy reforms, which requires a re-calibration of the DPL program in terms of its ambition. Large but less frequent DPL operations could also be considered, but the strategic orientation for the CPS is to design a DPL program that is feasible to be implemented in annual sequences in order to maintain momentum and avoid the long delays in the previous CAS. This includes the possibility to move towards thematic DPLs in support of the two CPS pillars respectively, which would allow support to be concentrated and bundled in a particular area each year, with the two DPL series designed to alternate, but with the flexibility to move faster in one area than in the other. At the top of the lending range, two parallel DPL series in support of a comprehensive and deep reform program in both CPS pillars could be envisaged.

**86. Key benchmarks to modulate the level of financial assistance would include:**

- Maintenance of a satisfactory macroeconomic framework. The maintenance of an adequate macroeconomic framework would be a pre-condition for access to DPL lending. In the absence of satisfactory macroeconomic policies, no DPL lending would be provided and the overall level of assistance would drop to the bottom of the lending range.
- For Ukraine to move towards the top of the lending range, additionally, action to address current macroeconomic risks, by gradually introducing a more flexible exchange rate framework, improving financial sector supervision and reducing the share of consumption and transfers in the overall budget, while maintaining overall fiscal discipline and low public sector debt levels, would be key benchmarks.

- Satisfactory progress in improving portfolio implementation. Reductions in project preparation times and increased disbursement rates would be key targets to permit lending to expand towards the top of the range. Conversely, should portfolio performance deteriorate further from current levels, lending would remain near the bottom of the lending range.
- The degree of progress on structural reforms (including governance), which would be evaluated comprehensively, would also modulate lending levels. Naturally, without overall progress measured against a set of reform milestones and benchmarks defined in the accompanying DPL II document, the DPL program would not proceed and investment lending would also remain at the bottom of the range. Conversely, to progress towards the top of the lending range, successful implementation of DPL II and DPL III would be an important benchmark.

### C. CPS PILLARS AND OBJECTIVES

**87. In response to the development challenges summarized in Section III, this CPS proposes a two pillar strategy of support.** The first pillar has the overall objective to contribute to sustained economic growth and improve the competitiveness of Ukraine. The second pillar's objective is the reform of public finance and administration and the improvement of public services. The choice of a two-pillar construction reflects the aim to maximize synergies across thematic areas and at the same time emphasize selectivity in the choice of programs.

**88. The CPS emphasizes the strong links and synergies between increasing investments in infrastructure on the one hand, and improvements in the investment climate and in conditions for private businesses on the other.** Improved infrastructure services have a direct positive impact on the investment climate. At the same time, improvements in the investment climate facilitate the attraction of private investment to address key infrastructure needs.

**89. Similarly, the CPS emphasizes the links between reforming public finance and public administration and improvements in the quality of public services.** Only if budgets are allocated in a way that rewards good performers, and spending units are given the authority to decide how to allocate money, and fiduciary controls are adequate to prevent inefficient spending or leakage of funds, can public services be improved. But ultimately, it is also true that only through improvements in public services will the state regain the credibility and authority that is key to reducing monitoring and enforcement costs and thus making the public sector more efficient. However, the approach chosen in this strategy is to use the reforms of public financial management and the administration of social assistance and insurance as entry points into a dialogue on improving public service quality. This choice reflects the lessons learned that only through strong ownership at the level of the MoF can interventions aimed at improving service quality succeed.

90. Within these two broad pillars, ten programs have been identified based on the Bank’s existing activities and matched to key government priorities. The ten programs have been selected from a longer list with the help of the framework summarized above. Table 5 summarizes the resulting overall framework of assistance by each pillar and by grouping programs into core development and advocacy programs (see Annex 5). Programs are listed under the heading of the strategic goal underlying the program.

**Table 5: The CPS Programs by Pillar and Typology**

Core Programs	Development Programs <sup>13</sup>	Advocacy Programs
<b>Pillar 1: Sustaining Growth and Improving Competitiveness</b>		
Ensuring energy security and improving energy efficiency	Promotion of innovation and knowledge economy	Improving the business climate
Making use of Ukraine’s transit potential and improving transport infrastructure	Deepening financial markets and reducing financial risks	
<b>Pillar 2: Public Finance, Public Sector Reform and Improved Service Delivery</b>		
Strengthened public finance	Improved quality of education	Improved quality of public health and health services, and reduced environmental health risks
	Improved quality of housing and municipal services	
	Improved targeting and financial sustainability of social transfers	
<b>Cross Cutting Themes</b>		
<i>Governance and Anti-Corruption</i>		
<i>Macroeconomic Stability</i>		

91. **The choice of core programs reflects the basic storyline of the CPS: financial assistance will be concentrated in areas where there is strong government ownership and demonstrated capacity to implement.** This is the case in public infrastructure and, as demonstrated by the successful dialogue on fiscal stabilization and the creation of a State Treasury, in the management of public finances. In other areas, either government ownership or capacity to implement smoothly along a clearly defined reform path, remains to be fully developed. The specific activities planned over the next two years, as explained below, reflect and substantiate the allocation proposed here. Most investment lending is concentrated in the core programs, while AAA activities feature prominently in both development and advocacy programs.

92. **In addition to the ten programs identified in Table 5, two additional programs are listed as cross-sectoral at the bottom of the table.** The improvement of governance is a core corporate strategy for the WBG and this is reflected across the design of all

<sup>13</sup> Please note, as per discussion in Annex 5, paragraph 3, that “Promotion of Innovation and Knowledge Economy” and “Deepening Financial Markets and Reducing Financial Risks” under Pillar 1 will be considered core programs for IFC and utilize a range of instruments, including investment lending.

activities in the CPS. Box 6 summarizes the operational approach to governance in the CPS. Details are provided in Annex 2. In collaboration with the IMF, the World Bank will continue to exercise close macroeconomic surveillance and provide assistance as required to maintain Ukraine's solid macroeconomic record of recent years.

**93. Several ongoing activities are not captured by the selection of programs made but are integrated under other program headings.** The Bank's work in support of land reform and agricultural competitiveness has been included under the heading of improved business climate and promoting innovation and knowledge economy. The latter also includes advisory work, on-the-jobs agenda and skill upgrading. The Bank's support for judicial reform is part of the governance agenda, although this CPS is careful not to commit to ambitious outcomes in this area, given the lack of a clear political consensus.

#### **D. OPERATIONAL ACTIVITIES BY PILLAR**

##### **Pillar 1: Sustaining Growth and Improving Competitiveness**

**94. The first pillar of the CPS brings together a diverse menu of interventions to improve Ukraine's international competitiveness.** The basic underlying theme is that to sustain growth, Ukraine needs to move from extensive growth, relying on cheap labor, the existing asset base and a commodity dependent structure of production and exports, towards intensive growth, based on improvements in labor productivity and growing export diversification. The key driver of this change is likely to be the growth in competition, through WTO accession, improvements in the business environment, improved management of SOEs, and deepening financial markets to facilitate domestic entry and business growth. However, additional supporting measures by the state are required. These concern first and foremost improvements in infrastructure, in particular improvements in energy efficiency and in transport infrastructure, to reduce costs. In addition, the state must support economic diversification through policies that facilitate product and process innovation and technology adoption and that ensure a sufficient supply of skilled labor to make technological upgrading feasible. Key outcomes supported by the first pillar include GDP growth above 5.5 percent per annum, labor productivity growth in industry above 8 percent per annum, and growing export diversification.

**95. In support of the transition from extensive to intensive growth the CPS gradually reorients financial and analytical support.** Table 6 below shows the transition from themes of the previous CAS to the emerging new areas of support. It also relates these to the main long-term development results targeted by the first pillar. The diagnostic and analytical basis for the existing extensive growth agenda were developed in the Country Economic Memorandum (CEM) 2004 and the Trade Study of 2005, as well as in a series of sector notes, in particular in the energy sector. The analytical basis for the forward looking agenda is yet to be fully articulated and a strong AAA investment is thus planned in the new CPS.

**96. In support of this broad agenda, new investment lending operations in FY08 and FY09 are planned in the transport and energy sector.** A Road Rehabilitation and Safety project (the key component of which is the rehabilitation of the Kyiv-Kharkiv highway) for US\$400 million is under preparation for FY08. A further road transportation investment is under consideration for FY09 with financing in the range of US\$200-400 million. Both projects are expected to contribute to reduced transportation costs, as well as improvements in road safety. A Power Transmission project (US\$200 million) was approved in early FY08. Additional investments in Ukraine's power generation and transmission system are planned in the range of US\$200-300 million. The investments in the power sector are linked to a programmatic engagement, which aims to increase reliability of supply and reduce costs through greater competition, support growing integration of the energy sector with Europe, and create the conditions for increased private investment through improved financial sustainability. Investment requirements at the municipal level and in the context of the European Football Championships in 2012 are also potential candidates for WBG financing in FY09 or in future years of the CPS.

**97. Policy reforms in support of improvements in the business climate, in the financial regulation, in the financial sustainability of the energy sector, and in the attraction of private investment into infrastructure, are supported by the DPL program.** DPL II, under preparation, supports prior actions in the area of trade liberalization, the liberalization of the telecommunications sector, the adoption of a new inspections law, the restructuring of energy debts, and the reduction in quasi-fiscal deficits in the energy sector. Future benchmarks and triggers in the DPL program support the reform of standards and technical procedures in compliance with EU regulations (thus directly supporting the negotiation of a FTA with the EU), the adoption of public private partnership (PPP) legislation to attract private investment in transport and other infrastructure sectors, the adoption of a new Joint Stock Company Law, the move towards consolidated and risk-based supervision for banks and non-bank financial institutions, continued efforts to raise energy prices and maintain collections in the face of import price shocks, and the enactment of a law making the energy regulator independent. Both loans are expected to be in the US\$300-500 million range.

**98. Improvements in governance are mainstreamed into pillar 1 activities.** A planned Judicial Support project (FY08 – US\$40 million) focuses on improvements in the physical condition of court houses and on the establishment of automated case management systems. While it is not expected to contribute to major reforms in the judicial sector, it may provide a basis to intensify the dialogue on judicial reform once greater political consensus has been established. This would be a key contribution to greater investor confidence. At the same time, a number of demand-side initiatives under the GAC agenda are planned. This includes the dissemination of the Faces of Corruption Report in Ukraine and application to the Ukrainian reality. A key governance agenda is the management of SOEs. Subsidies and non-transparent management practices are distorting competition, creating significant quasi-fiscal losses and overall reducing

Ukraine's competitiveness. While the Bank would like to see privatization advance, this may not be possible in the absence of a broader political consensus. Against this background, the management of SOEs becomes all the more important and would be expected to be an area of engagement through both DPLs and non-lending.

99. **Increasing energy efficiency is also a key goal from the perspective of reducing carbon emissions, in the light of increased global attention to climate change.** The Bank's current and forthcoming carbon funds, including the new Carbon Partnership Facility will look for opportunities to support emission reductions under the Kyoto protocol, Article 6, through the Joint Implementation framework, and Article 17, through the International Emissions Trading framework, as well as any future agreements on climate change. Because of its initially highly energy inefficient structure of production, Ukraine is one of the largest potential beneficiaries of international emissions trading, and the resulting revenues could potentially make a key contribution to modernizing Ukraine's economy.

100. **The objectives of the pillar are also supported by a substantial portfolio of existing projects in the power sector, in the financial sector and in land reform.** A Second Export Development project is a follow-up operation providing credits to Ukrainian exporters through the banking system. In parallel, the Access to Financial Services project provides credit lines to Ukrainian banks to reach smaller borrowers, in particular, in rural areas and among smaller municipalities, as well as providing technical assistance to the non-bank financial regulator. A Rural Land Titling and Cadastre Development project is ongoing to assist in the creation of a competitive market for agricultural land and a State Tax Service Modernization project aims to reduce the costs of compliance for tax payers and thus improve the business environment.

**Table 6: The Transition from Extensive to Intensive Growth – Pillar 1 Themes**

<b>Pillar 1: Sustaining growth and improving competitiveness</b>		
<b>Foundations of growth:</b>	<b>Emerging constraints for future growth</b>	<b>Key long-term development results</b>
<ul style="list-style-type: none"> <li>• Macroeconomic stability</li> <li>• Business environment</li> <li>• Regulatory reform</li> <li>• Corporate governance</li> <li>• Financial stabilization and market deepening</li> <li>• WTO accession and international integration</li> </ul>	<ul style="list-style-type: none"> <li>• Infrastructure (energy &amp; transport)</li> <li>• Trade logistics and trade and transport facilitation</li> <li>• Energy efficiency</li> <li>• Skills and labor market</li> <li>• Innovation and technology transfer, knowledge economy</li> </ul>	<ul style="list-style-type: none"> <li>• Sustained GDP, labor productivity and export growth</li> <li>• Improved business climate and transparency ratings</li> <li>• Reduced transport and logistics costs</li> <li>• Improved energy efficiency</li> <li>• Increased investment ratio and increased levels of FDI per capita</li> </ul>
Analytical basis: CEM 2004, Trade Study 2005, DPL I	Analytical basis: CEM (FY08/09), Knowledge Economy Assessment (FY08), Jobs Study (FY06), Jobs Agenda TA (FY08/09)	<ul style="list-style-type: none"> <li>• Increased private sector involvement in infrastructure</li> <li>• Deeper and more stable financial sector</li> </ul>

### Box 6: Operational Approach to Governance in the CPS

Weak governance and widespread corruption pose a serious developmental challenge for Ukraine. However an internal review of the degree of vulnerability of the Bank's portfolio to the country's fiduciary risks has found that these can be mitigated to acceptable project levels.

Three broad strategic recommendations follow: (i) The World Bank response to the GAC challenge must remain pragmatic and gradualist until new opportunities emerge; (ii) given the current implementation and institutional obstacles, as well as the lack of a broad-based political consensus, national-level governance reforms need to be addressed through efforts to strengthen the demand for good governance in addition to standard investment lending instruments; (iii) the GAC agenda should be implemented as cross-cutting themes through the WBG's policy lending platform, and as design and implementation features in the investment operations for infrastructure and public service delivery.

These strategic recommendations have the following operational implications for the WBG's engagement in Ukraine:

- 1) Adjustment of the portfolio in the short- to medium-term towards capacity building of civil society and local stakeholders. The Bank will aim to scale-up successful pilots like the *People's Voice* project and develop further the synergies with other sectors (housing, utilities, etc.). The Bank will propose new institution-building loans to the central government beyond those already in the pipeline only when it judges prospects for successful implementation are reasonable, with reference in the first instance to needed improvements of existing lending interventions in this area.
- 2) A significant amount of resources will be allocated to non-lending activities. The purpose of this work will be to strengthen and broaden demand for good governance. Among the vehicles to support this objective will be the tailoring to Ukraine's context and dissemination of reports distilling international policy lessons, as the recent "*Many Faces of Corruption*", as well as continuing work with NGOs and civil society.
- 3) The Bank will intensify its work with local governments, which are seen in some areas as more effective counterparts. Given that most government-provided public goods are delivered at the local level, such an approach may deliver results faster and propagate itself through demonstration effects.
- 4) The Bank will intensify efforts to move towards SWAps and disbursements through the budget as a means to increase the effectiveness and efficiency of its assistance. As implied by PEFA indicators, disbursing through the budget in Ukraine appears to be relatively low risk and may generate benefits of greater country ownership, more efficient processing and ultimately deliver results more effectively. However, developing a roadmap toward this approach will require significant additional effort to strengthen strategic planning capacity in partner ministries and to align World Bank and country processes.
- 5) To mitigate fiduciary risks in Bank operations, the strategy envisions strengthening existing fiduciary standards, such as enforcing the Bank's procurement rules, competitive bidding, as well as adequate supervision and attention to capacity building among project counterparts. Innovative ways to track money flows and build accountability mechanisms into project design such as Public Expenditure Tracking Surveys, stakeholder involvement in project governance or independent technical audits will need to be explored on a case-by-case basis taking into account resource constraints and the need to avoid adding additional complexity to project design in the Ukrainian context.

101. **Under the first pillar, IFC will continue to invest directly in the real and financial sectors and provide a range of advisory services.** IFC would contribute to the first pillar through direct investments targeting higher value added sectors as well as sectors that require improvements in energy efficiency and overall modernization of production, such as manufacturing and services, agribusiness, and associated development of logistics, freight, and warehousing industry. IFC would also contribute to upgrading the companies' managerial and corporate governance practices through its advisory services on an individual company basis, where needed, and through a planned Comprehensive Advisory project on company internal controls. IFC would support the development of the financial sector by both investing in local banks and supporting the entry of regional players into the Ukrainian market, with a particular focus on such priority areas as energy efficiency, mortgage, SME, leasing, insurance and consumer finance. IFC would seek to develop innovative financing instruments that are commensurate with clients' needs and those of the market as a whole, including potential support for securitizations, provision of partial credit guarantees and local currency financing. Advisory work in the financial sector would promote the standardization of housing finance practices across the industry, develop energy efficiency finance, and establish a framework for the development of agro-insurance. Additional support for the development of agribusiness would be provided through linkages programs for agribusiness supply chains. IFC is also looking to engage in pilot PPP transactions in a variety of areas and potentially assist in the post-privatization restructuring of the energy sector (subject to this being done transparently). IFC would expand its provision of sub-sovereign financing in Ukraine to address the development needs on municipal level and potentially contribute to the development of financial markets. This will include work on new financial instruments, including local currency financing.

102. **MIGA will continue to support foreign investors through the provision of political risk guarantees.** MIGA would support projects in the manufacturing and agribusiness sectors which promote the modernization of production and contribute to the diversification of the economy. Also, MIGA would contribute to the development of the financial sector by continuing to support foreign strategic investors. In particular, MIGA intends to focus on investments which: i) improve SMEs' access to finance, ii) increase the provision of specialized banking products, including leasing and mortgage financing, and iii) strengthen banks' capitalization. The Agency would also explore opportunities to support capital markets transactions in Ukraine, including asset-backed securitizations. Further areas for potential involvement in Ukraine include the infrastructure and power sectors. MIGA could also play a role in promoting foreign direct investment in infrastructure at the sub-sovereign level.

103. **Substantial non-lending assistance will complement financial support to the first pillar.** Ukraine's competitiveness agenda will be developed under a new flagship CEM to be delivered in FY09, but with earlier dedicated inputs on the Knowledge Economy (Knowledge Economy Note and Assessment FY08) and Labor Markets and Skills (Labor Market Policy Note FY08, TA and dialogue on skills FY08). Additional diagnostic work is planned in FY09 in infrastructure, with policy notes on the coal sector

and on the development of a gas market. A Trade and Transport Facilitation audit (funded under a Trust Fund from the Dutch government) is also planned in FY09, which would lead to the establishment of a performance measurement system along key transit routes during the same year. A Financial Sector Assessment Program (F-SAP) update, completed in 2007, takes stock of the remaining vulnerabilities and development challenges in Ukraine's financial sector.

**104. Significant technical assistance and advocacy work is planned to further improve the business climate.** The IFC's Business Environment project (FY07-11), under the Private Enterprise Partnership, will take a leading role in advising the government on necessary changes in business regulations, including in the important areas of certification, permits and licensing and inspections reform. In addition, the World Bank Institute (WBI), in collaboration with FIAS, will carry out a training program for public officials on selected topics in promoting innovation and investment in Ukraine. This will include detailed policy advice in the areas of PPPs, the design and implementation of investment promotion regimes, including special economic zones.

**105. The Bank's regional studies and flagship reports will also contribute to the policy dialogue in support of the first pillar.** Key reports in the coming year are the ECA Productivity Study to be disseminated in FY08, the World Development Report (WDR) on Agriculture (FY08), and the BEEPS planned in 2008.

## **Pillar 2: Public Finance, Public Sector Reform and Improved Service Delivery**

**106. The Bank has in the past attempted to improve public services through selected investment operations with individual line ministries.** This approach has delivered mixed results at best, as the underlying financial and structural problems have not been resolved and insufficient drive and momentum from the MoF and other central government agencies has slowed down implementation.

**107. In reflection of this past experience, the CPS proposes a shift in approach in support of the second pillar – using the reform of public finance as an entry point for the improvement of public service delivery.** The aim is to use the ownership of the MoF behind the agenda of improving public financial management and increasing the efficiency of spending to structure a dialogue around changes in incentives, accountability frameworks and budgeting processes at the line ministry and local government level, without which improvements in service delivery will be difficult. In parallel with this central strategic orientation, the Bank will strengthen its AAA activities to stimulate demand for greater local accountability, encourage bottom-up initiatives, and advocate the need for structural changes in the delivery of public services, including a reduced role for top-down state control.

**108. The second pillar supports the achievement of the following long-term development results:**

- Reduced overall size of the government sector.
- Reduced tax burden and improved tax compliance.
- Increased public capital spending, and greater alignment of public capital spending with strategic priorities.
- Improved social sector outcomes through increased efficiency of social sector spending.
- Reduced environmental and health risks and increased social awareness of these risks.
- Increased citizen satisfaction with the quality of public services.
- Improved employment prospects, reduced poverty and improved targeting of social assistance.

**109. Unlike in pillar 1, where investment lending accounts for a large proportion of the targeted CPS outcomes, in pillar 2, more emphasis is laid upon non-lending engagement and the results of the adjustment program.** Maintaining high quality in the policy dialogue in this critical area is therefore a pre-eminent challenge for this CPS.

**110. New investment loans in the pipeline for FY08 and FY09 in support of the second pillar include at the core a Public Finance Modernization project (PFM, US\$50 million, FY08).** The PFM project is a key to the construction of the second pillar, since it will contribute to improve information systems across the entire PFM sector, including the MoF, internal audit and the Treasury, with associated links to the State Tax Administration and the State Customs service. This will facilitate budget preparation and execution. Moreover, a significant technical assistance component is planned to improve medium-term budgeting, debt management, and strategic planning. The project has been closely coordinated with a large group of donors providing additional technical assistance. A Dutch Trust Fund is being mobilized to support improvements in capital budgeting, including a large-scale training effort supported by WBI. In addition, Bank technical and advisory services will continue in the context of the Public Finance Review and follow-on fiscal work.

**111. Additional new investment lending will be provided for the Social Insurance Administration project (SIAP, US\$113 million FY09).** This project lays the foundation for a more efficient administration of social insurance by unifying the current four social insurance funds under the auspices of the State Pension Fund. The project would also lay the foundation for the introduction of a second pillar to the pension system planned for 2009. The project is closely linked with the Social Assistance Modernization project (SAMP, approved FY06) which aims to reduce the cost of administrating social assistance.

**112. The objectives of these investment loans are complemented and supported by the DPL program.** The DPL II includes prior actions in the improvement of public financial management related to the overall fiscal envelope, the approval of a public financial management strategy, the management of SOEs, and the introduction of an independent testing system for secondary education (Trends in International Mathematics and Science Study (TIMMS)). Future triggers and benchmarks relate to improvements in tax administration, inter-governmental fiscal relations, greater accountability and transparency of the state-owned enterprise sector, parametric changes to the pension system to improve its financial sustainability and creating the legal basis for the unification of social insurance contributions. There is therefore a close link between the core investment lending operations planned in support of the second pillar and the conditionality of the DPL in this area. In addition, the DPL supports changes in input norms in the health and education sectors, which would be key catalysts to improve financing and introduce greater incentives for efficiency in these two social sectors.

**113. The Bank has been increasing its financing support to the modernization of municipal infrastructure with the approval in early FY08 of a US\$140 million Urban Infrastructure project.** This project aims to support investments into the rehabilitation of municipal utilities through a financing umbrella. Additional investments with a similar construction (Municipal or Infrastructure Financing Fund) are planned in future years. However, a key challenge in this area is how to ensure that top-down allocations of financial support are consistent with and support bottom-up initiatives to improve municipal and housing services through the formation of housing associations and other citizen initiatives. There is also a great need to strengthen strategic planning capacities at the level of municipal and oblast authorities, which future projects at the local level will need to address. An important pilot in demand-side initiatives in this area is the People's Voice project funded through a Canadian International Development Agency (CIDA) grant, expiring at the end of 2007. A follow-on initiative is planned, and the Bank will allocate non-lending resources to support this work. Going forward, the objective is to bring bottom-up initiatives together with the financial support the Bank can provide through the central government. IFC is also planning support in this area through investments in PPPs at the municipal level and through its support to widen municipal access to financing. MIGA may also help promote foreign direct investment in infrastructure at the sub-sovereign level through the provision of guarantees. The WBG will collectively seek ways to expand the range of instruments it can offer to municipalities, including guarantees, local currency funding, pooled funding facilities etc. The advice of the Bank's Treasury Department will be sought in this endeavor.

**114. In the health sector, the CPS proposes a shift towards greater emphasis on advocacy to increase awareness of public health risks on the one hand, and a gradual move towards targeted budget support on the other.** The existing portfolio includes a TB and HIV/AIDS Control project, which has faced significant difficulties in implementation, without apparently contributing so far to reducing the rate of HIV infections (greater success has been met by the aim to combat TB among the prison population). Public awareness of health risks from communicable diseases to lifestyle

and environment health risks is developing slowly, and hence demand for fundamental changes in the health care system is low. Most people seem to expect improvements largely as the result of more public spending. The CPS proposes to attack this challenge from two fronts. On the one hand, a significant increase in non-lending and advocacy work is targeted to increase public awareness and to contribute to a public debate about the state of health care and associated demographic and economic costs. On the other hand, using the undisbursed balance of the TB and HIV/AIDS Control project as a pilot, the Bank will attempt to move towards targeted budget support in the health sector. Bank financing would go through the budget and be directly linked to government funding for the HIV/AIDS action plan. Disbursements could be tied to performance measures, thereby piloting the move towards SWApS in the social sectors. To make this possible, significant additional technical work by the Bank's Human Development, Fiduciary and Public Sector Reform teams will be needed to develop corresponding procedures.

**115. In the area of protecting the environment, the Bank's approach will combine advocacy work to highlight the economic and social costs of industrial pollution with advisory services to support emission reductions and allow Ukraine to benefit from carbon trading opportunities.** In an innovative activity, the Bank initiated a local environmental TA in the city of Zaporizhzhia to work on a local environmental risk management plan together with businesses, representatives of civil society, the media and the local administration. This model is intended to be expanded to other cities and potentially scaled up at the national level. In addition, the Bank will continue advisory work to ensure that Ukraine benefits to the maximum extent from the opportunities under the Kyoto protocol and any future international agreement on climate change to sell emission reductions and create an incentive for reduced industrial pollution.

**116. In the education sector, the existing investment operation will continue to aim for improved access to quality secondary education.** In addition, working with other donors and WBI on training of education policy makers, the Bank will focus its policy dialogue on the importance of reforming national standards and independent attestation to improve the quality of education. No new investment loans are planned in this area for the time being, taking into consideration the substantial funds already allocated to the sector.

**117. The lending and non-lending activities for FY08 and FY09 are summarized in Table 7.** Activities in future CPS years will be reviewed on a rolling basis and confirmed at the time of the CPS Progress Report (PR) at the end of FY09.

## **E. RESULTS, MONITORING AND EVALUATION**

**118. The ultimate success of the Bank's strategy in Ukraine must be measured against the economic outcomes or results achieved.** Ukraine has in the past tended to perform well on macroeconomic results, even if crucial policy milestones were delayed. At the same time, the extent to which this can be attributed to the Bank's or other donors' presence in Ukraine is difficult to fully ascertain. The CAS CR points out that the results

framework in the previous CAS did not take sufficient account of the investment lending portfolio. It also points out that in many cases, the monitoring and evaluation frameworks for individual lending operations need strengthening.

**119. This CPS includes a results matrix (Annex 7), which will serve as the main accountability framework during implementation.** The matrix links the WBG lending and non-lending activities to specific economic outcomes, and specifies target values for each outcome. These are then related to longer-term country level outcomes and to the obstacles that need to be overcome to meet these outcomes. There is a close correspondence between these obstacles and the analysis of development challenges in Section III and Annex 1 and 2 of the CPS.

**Table 7: CPS Activities in FY08 and FY09**

Lending		Non-lending (AAA)
<b>Pillar 1: Sustaining Growth and Competitiveness</b>		
FY 08	FY09	FY08 + FY09
<b>IBRD lending</b> <ul style="list-style-type: none"> <li>• PTP– US\$200 mln</li> <li>• Road Safety – US\$400 mln</li> <li>• DPL II US\$300 mln</li> <li>• Judicial Support project US\$ 40 mln</li> <li>• Hydropower II US\$ 50 mln</li> </ul>	<b>IBRD lending</b> <ul style="list-style-type: none"> <li>• PTP II – US\$200 mln</li> <li>• Second Transport (road) project US\$400 mln</li> <li>• DPL III US\$300-400 mln</li> <li>• Local investment (EURO 2012) – US\$ 300 mln</li> </ul>	<b>IBRD AAA</b> <ul style="list-style-type: none"> <li>• CEM (2009, ESW)</li> <li>• Agricultural Policy Notes (ESW, 2008)</li> <li>• Knowledge Economy &amp; Competitiveness dialogue (2008, TA)</li> <li>• Labor demand and skills relevance (2008, ESW)</li> <li>• FSAP (2008, centrally financed)</li> <li>• Capital Market Technical Assistance Partnership Program (PTAP, with USAID, 2008-2010, TA)</li> <li>• Dutch grant to NBU + Financial Sector dialogue (TA, 2008-10) A&amp;A ROSC follow-up (TA, 2008)</li> <li>• Gas Market Note and Coal Policy Note update (2009)</li> <li>• Trade and Transport Facilitation audit (Dutch TF, 2009)</li> </ul>
<b>IFC investments, CF JI and MIGA guarantees</b> <ul style="list-style-type: none"> <li>• Direct investments in real and financial sector</li> </ul>		<b>IFC, FIAS, WBI</b> <ul style="list-style-type: none"> <li>• IFC BEE (PEP)</li> <li>• IFC advisory services for agribusiness (production chains and agro-insurance)</li> <li>• IFC advisory services for the financial sector (mortgage finance, energy efficiency)</li> <li>• Competitiveness Capacity Bldg (WBI, FIAS, IFC and IBRD)</li> </ul>
<b>Pillar 2: Public Finance, Public Sector Reform and Improved Public Services</b>		
FY08	FY09	FY08+FY09
<b>IBRD lending</b> <ul style="list-style-type: none"> <li>• PFM – US\$50 mln</li> <li>• DPL II –US\$300 mln</li> <li>• UIP – US\$140 mln</li> </ul>	<b>IBRD lending</b> <ul style="list-style-type: none"> <li>• SIAP – US\$113 mln</li> <li>• DPL III – US\$300-400 mln</li> </ul>	<b>IBRD AAA</b> <ul style="list-style-type: none"> <li>• IBRD AAA</li> <li>• PFR II (2008)</li> <li>• Dutch Trust Fund on capital budgeting, PFM and Trade and Transport Facilitation (2008-2010)</li> <li>• Social Sector Financing (AAA, 2009)</li> <li>• Housing and Municipal Utilities TA (linked with PVP follow-up, 2008)</li> <li>• Health and Demography Advocacy work (2009)</li> <li>• Environmental Partnership in Zaporizhzhia (TA, 2008)</li> <li>• Poverty Update (2009, ESW)</li> <li>• Kyoto TA (2008)</li> <li>• IET Institutions and Green Investment Schemes TA (2008)</li> </ul>
<b>IFC investments, CF JI and MIGA guarantees</b> <ul style="list-style-type: none"> <li>• Investments in municipal utilities under PPP schemes</li> <li>• Sub-national finance</li> </ul>		<b>IFC, FIAS and WBI</b> <ul style="list-style-type: none"> <li>• Training on capital budgeting and PFM (under Dutch TF)</li> <li>• Advisory services to municipal govts. in context of municipal lending</li> </ul>
<b>Cross-cutting themes: governance and macro-stability</b>		
<ul style="list-style-type: none"> <li>• DPL II (300m)</li> </ul>	<ul style="list-style-type: none"> <li>• DPL III (300-400m)</li> </ul>	<b>IBRD AAA</b> <ul style="list-style-type: none"> <li>• Macroeconomic monitoring (ongoing)</li> <li>• Strengthening demand for good governance and anti-corruption Advocacy work (ongoing)</li> </ul>
<b>Total IBRD FY08</b>	<b>Total IBRD FY09</b>	<b>Total Bank Budget and other sources for TA</b>
Up to US\$1,180 mln	Up to US\$1,413 mln	Around US\$1.5 million in Bank budget and perhaps an equivalent amount in additional sources of funding

120. **The matrix emphasizes that in key areas, the main results are expected to come from the implementation of the existing portfolio.** Hence, continued attention to improvements in portfolio performance will be critical to achieving the target CPS outcomes. The greater selectivity of the CPS is expected to free up resources to help increase the impact of the existing portfolio – for instance by working on the public financial management agenda and thereby increasing attention of spending inefficiencies in the social sectors.

121. **The need to remain flexible imposes modesty on the results framework.** The Bank, in several instances, may not be able to commit more than improvements in selected enterprises or sub-sectors. This is especially true for IFC investments, which although intended to generate demonstration effects, cannot quantify such effects ex ante. The strong emphasis on non-lending support also creates a challenge for the results framework, although the cross-sectoral DPL program allows in many instances to link key diagnostics with policy reforms supported by policy-based lending.

122. **Weaknesses remain in the monitoring and evaluation frameworks of existing projects and some changes will be necessary to align them more closely with the CPS.** Moreover, capacity for monitoring and evaluation is weak, both in the central and line ministries. To support capacity building for monitoring and evaluation, the Bank can draw on one existing lending operation (STATCAP) and plans to apply for an Institutional Development Fund (IDF) grant.

## F. CONSULTATION PROCESS

123. **The Bank team has conducted a series of consultations with different stakeholders on the design of the CPS.** The basic principles of the CPS were presented to the authorities at the CPPR in March 2007, and the present draft was extensively discussed and reviewed with the authorities. Roundtable discussions were held in Kyiv during May and October 2007, with donors and with civil society, and the full CPS draft was posted on the Bank's external website for three weeks in September-October 2007. The Bank also presented the same material to representatives of all major political parties and conducted five regional consultations in Donetsk, Kharkiv, Lviv and Lutsk and Simferopol. In addition, the Bank team held informal discussions on different economic and political development scenarios and the role of the international community with a group of independent political analysts.

124. **The consultation process held to date has confirmed significant support for the Bank's approach.** In particular, participants endorsed the principle of greater selectivity in the Bank's interventions. The greater emphasis on infrastructure lending in the portfolio going forward was supported by other donors, although the Bank was requested not to abandon the social and institutional reform agendas. In response, the Bank clarified that it would change the mix of instruments but not the degree of engagement on social and institutional reforms and emphasized the importance of close donor collaboration in achieving impact from its non-lending interventions. Representatives of

civil society raised concern about governance and corruption in Ukraine and highlighted that there was some disillusionment with the reform process, which they felt had not translated into sufficient improvements in living standards and in the quality of service delivery. Civil society representatives strongly endorsed the emphasis in the CPS on stimulating demand for improved governance and urged the Bank to establish a forum and a platform for greater national debate on reform priorities. NGOs expressed great interest to widen their collaboration with the Bank in the implementation of the CPS and some expressed a view that the CPS should adopt the strengthening of civil society as a key objective in its own right. The independent political analysts cautioned that improvements in governance may continue to be slow given strong vested interests, and argued for a pragmatic approach that failed to raise unrealistic expectations. There was general agreement that financial support to the government, through lending operations, was most effective in areas where a national consensus on the need for reform had been reached.

**125. Consultations with representatives from different political parties confirmed that there is no fundamental difference in economic vision and the commitment to reform.** All those consulted welcomed the Bank's continued engagement to support economic reform in Ukraine and felt the principles established by the CPS were adequate. A review of sectoral priorities also did not reveal major differences of opinion in relation to areas of focus for the Bank. A detailed summary of the consultation process held to date is in Annex 8.

## VI. RISKS AND RISK MITIGATION

### A. IMPLEMENTATION RISKS

**126. Implementation risks in Ukraine are considerable.** The track record of implementation, particularly in the investment lending portfolio, is poor. Ukraine has the lowest disbursement rates among any IBRD borrower, although there have been some significant recent improvements.

**127. The main sources of implementation risk fall into three categories: (i) lack of ownership, (ii) cumbersome internal procedures which are inconsistent with World Bank procedures, and (iii) policy delays or reversals.**

**128. Ownership:** The capacity of Ukraine's government for strategic planning remains relatively weak. The authorities have been making efforts to improve internal coordination, but strategic prioritization remains a challenge. In this environment, it is sometimes difficult to ascertain the extent of client ownership for a particular intervention. Yet, the Bank has in the past also been culpable of preparing lending operations at the request of line ministries, without verifying the extent of support (and or political resistance) by power brokers in the central government agencies (Cabinet of Ministers, MoF, Ministry of Economy).