

Ukraine

Systematic Country Diagnostic

Discussion
October 2016

OUTLINE

1. New WBG Country Engagement Approach: What is an SCD?
2. Growth and Sustainability in Ukraine
3. Poverty and Shared Prosperity in Ukraine
4. Ukraine SCD Framework:
 - Cross-Cutting Pathway: Governance and Anticorruption Institutions
 - Pathway 1: Macroeconomic Stability
 - Pathway 2: Productivity and Jobs
 - Pathway 3: Effective services and targeted assistance

World Bank Group

New Country Engagement Approach

Two discrete products:

- Systematic Country Diagnostic (SCD)
- Country Partnership Framework (CPF)

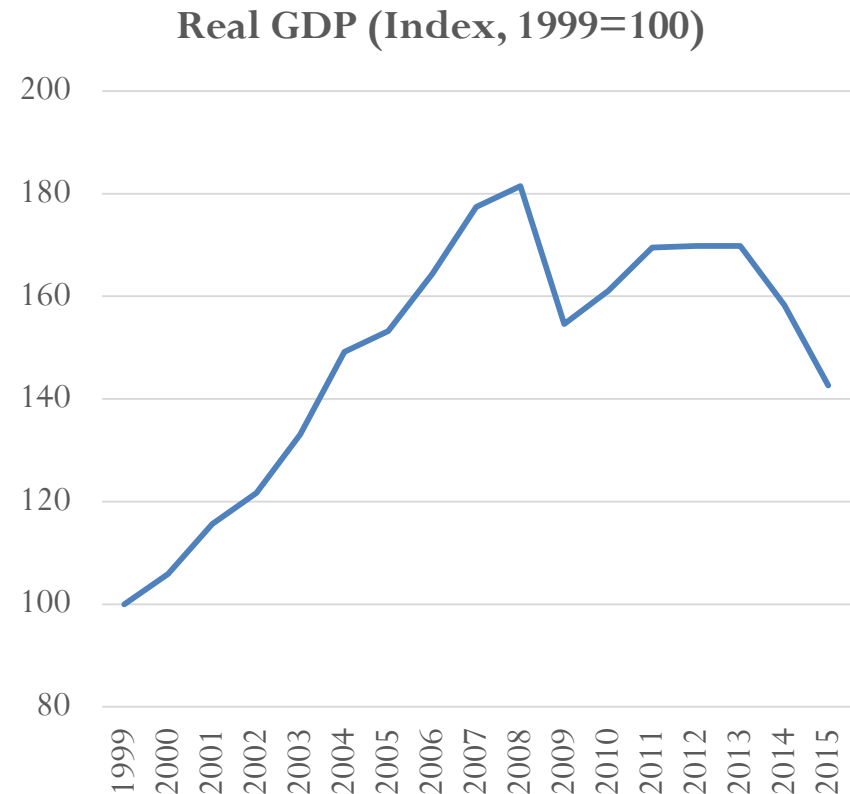
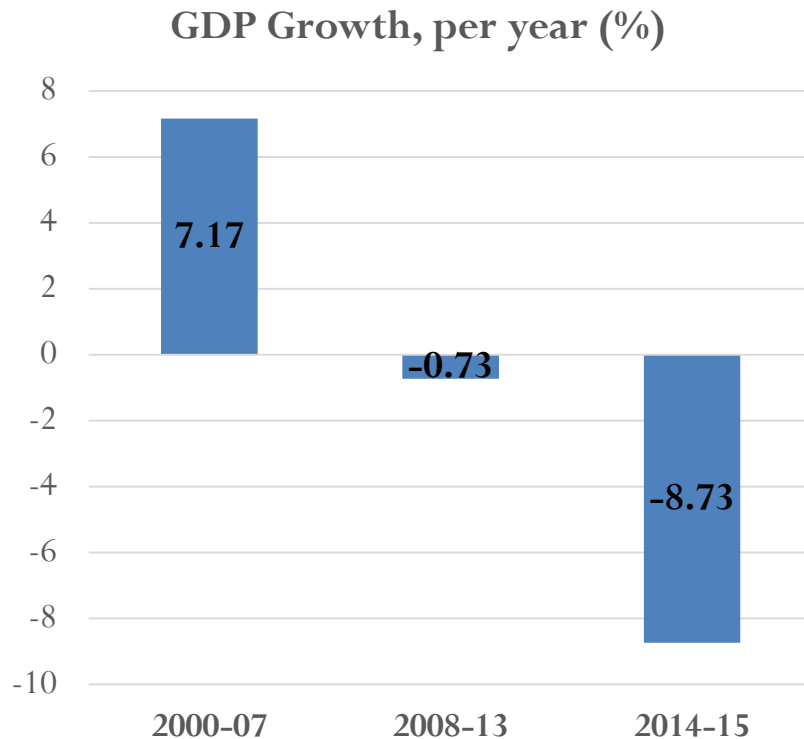
SCD	CPF
Diagnostic of constraints and priorities to address goals of reducing poverty and promoting shared prosperity	Integrated and selective framework for WBG's partnership with country, underpinned by SCD analysis
Evidence-based, analytical report, not limited to areas of WBG engagement	Strategy document to select areas of WBG engagement
Addresses question: What does Ukraine need to do?	Addresses question: Where should the WBG support Ukraine?
Conducted before CPF	Conducted after SCD

What is an SCD?

- Evidence-based, diagnostic report to identify key constraints and priorities for the country to accelerate progress toward reducing poverty and promoting shared prosperity in a sustainable way
- Integrative (not piecemeal) analysis, combining growth, poverty, sustainability
- Not limited to expected areas of WBG engagement
- Inform policy discussion with broad community of stakeholders in Ukraine's development (Government, private sector, civil society, donors)
- Conducted in advance of the Country Partnership Framework

Economic Growth in Ukraine has Stagnated on average since 2008

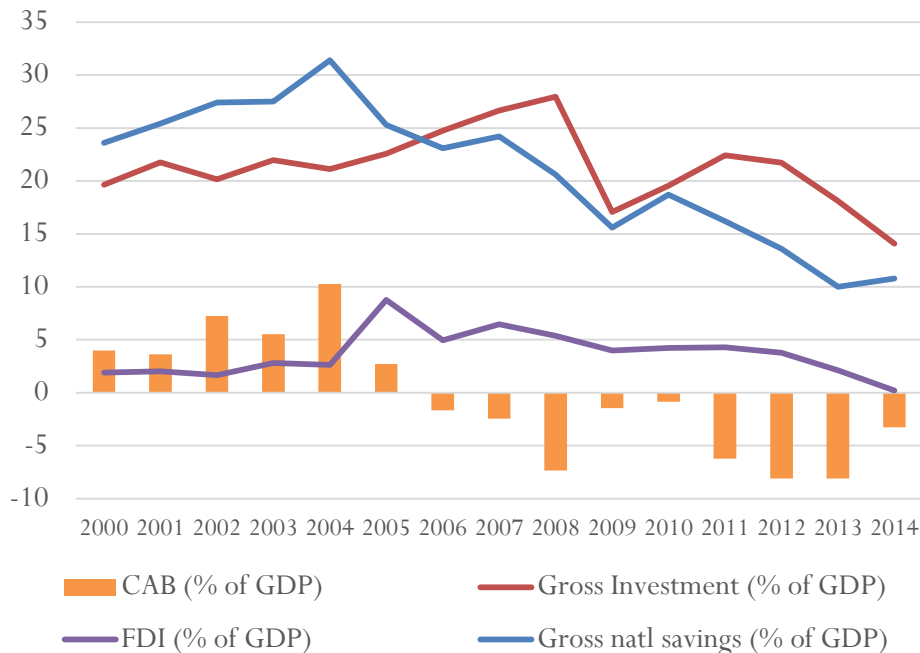
- Three phases of growth since 2000
- Boom of 2000-2007 driven by favorable external conditions, stagnation during 2008-13, and collapse from severe shocks during 2014-15.
- No pattern of sustained growth



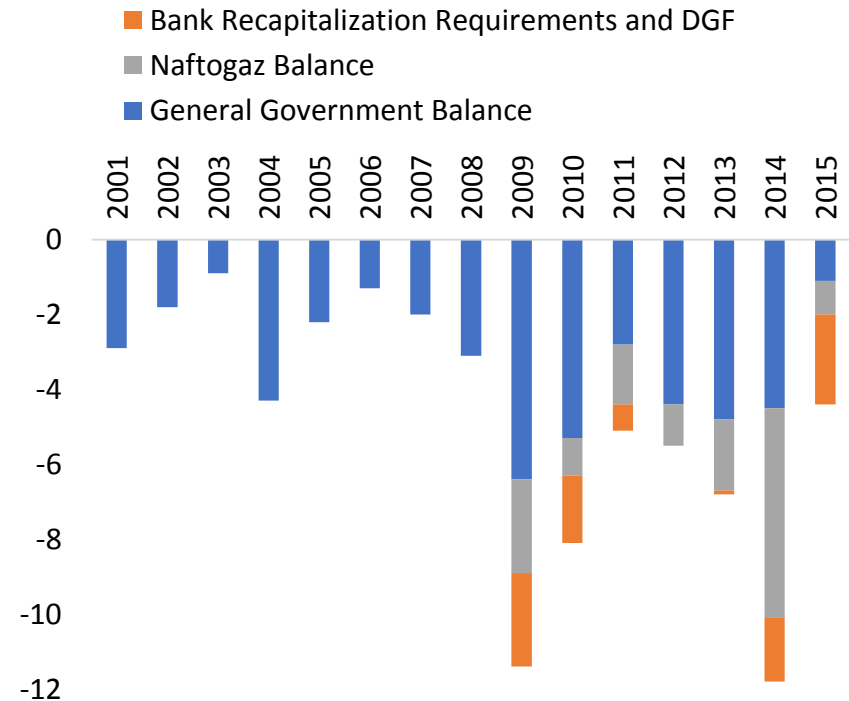
Macroeconomic imbalances and instability... ...have contributed to an unsustainable growth path

- Credit fueled consumption boom, inadequate macroprudential regulations
- Large structural fiscal and quasi fiscal deficits
- Large current account deficits lead to bust when financing dries up

CA Bal, Savings, Investment, FDI (% of GDP)



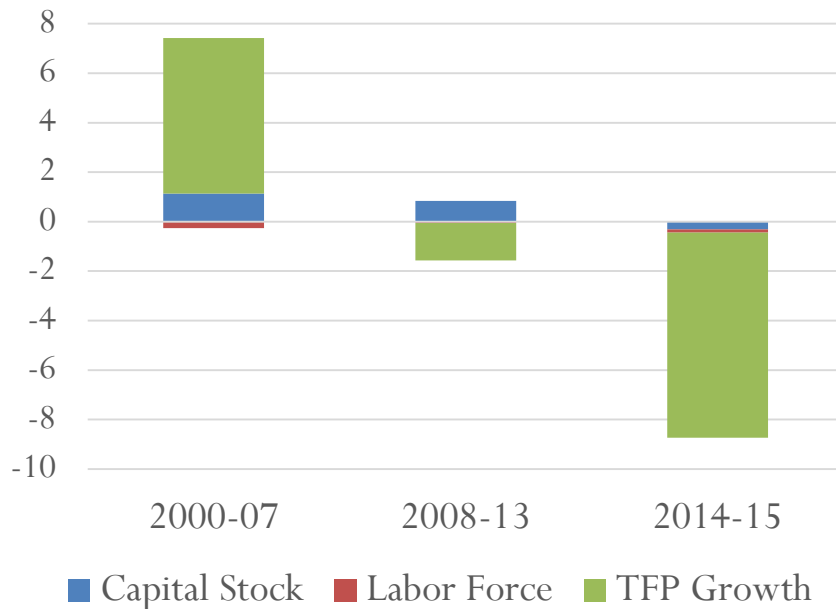
Fiscal & Quasi-Fiscal Balances (% GDP)



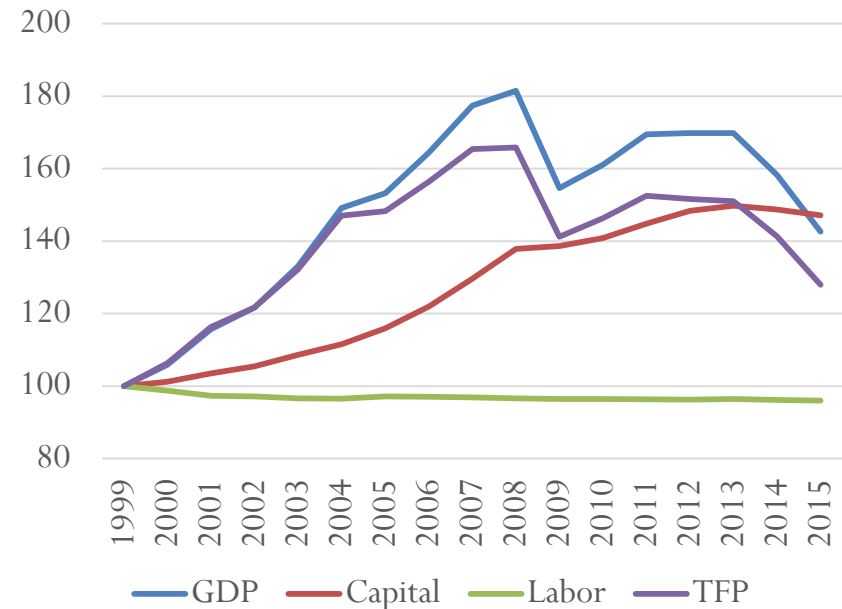
Weak productivity growth... ...has also contributed to an unsustainable growth path

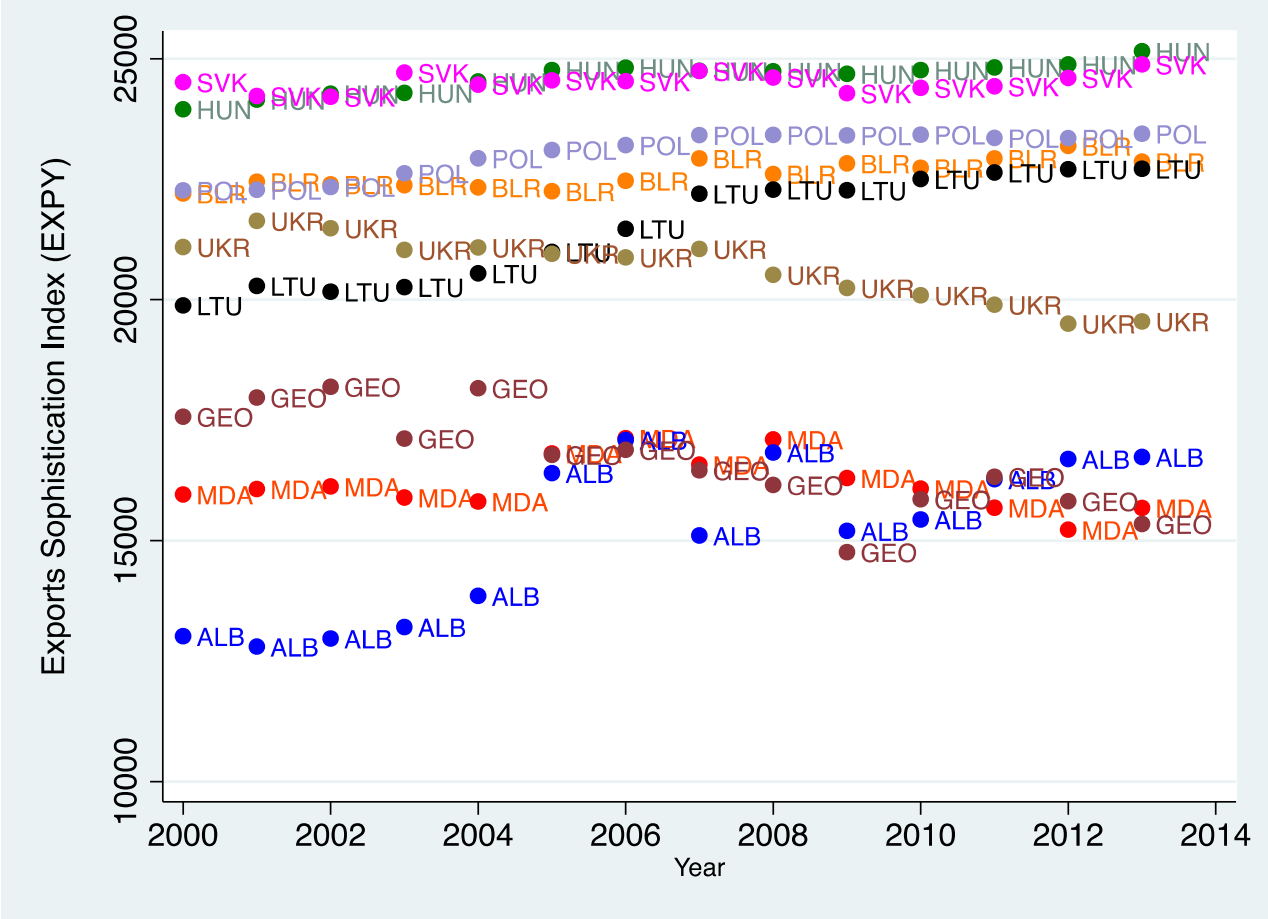
- Productivity growth averaged 1.2 percent per year during 2001-2015
- Productivity growth during 2000-07 was due to rebound in capacity utilization
- Productivity actually declined during 2008-2013

Contributions to GDP Growth
(%)



Real GDP and Drivers
(Index, 1999=100)





Sustained moderate growth going forward will require both higher investment and higher productivity growth

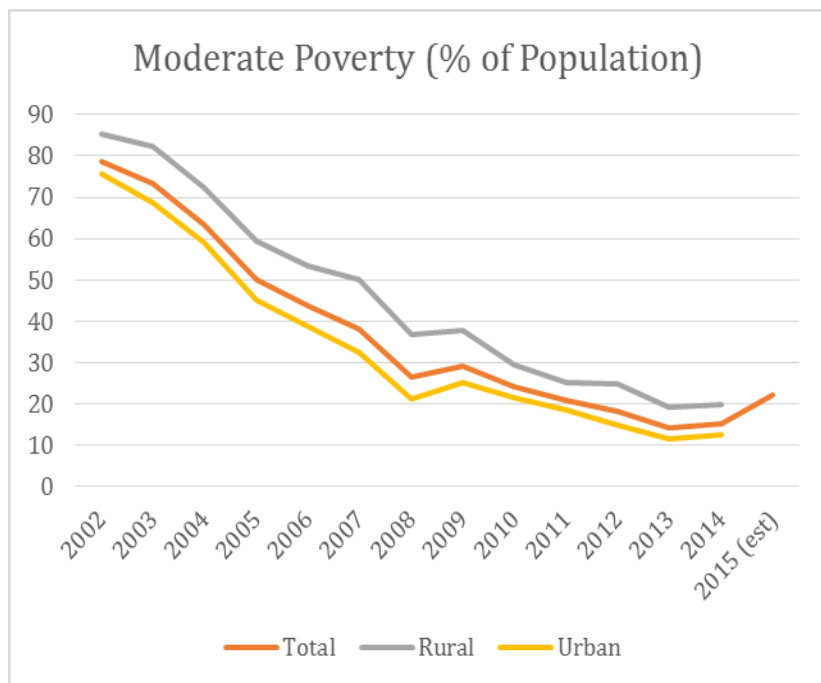
- Higher investment and higher productivity growth will require:
 - More sustainable macroeconomic stance to bolster public and private savings
 - Deep structural reforms to support FDI and productivity growth

Ukraine: Growth Scenarios for 2016-2020

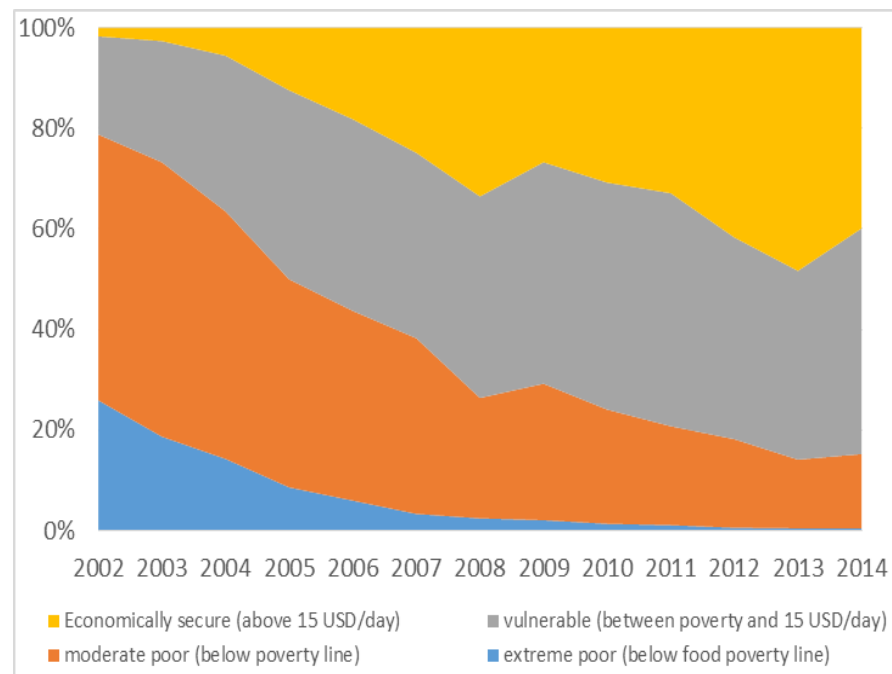
Growth	Investment (%GDP)	TFP Growth
5.0%	20%	4.5%
5.0%	25%	4.0%
5.0%	30%	3.4%
5.0%	35%	3.1%
3.0%	20%	2.5%
3.0%	25%	2.1%
3.0%	30%	1.9%
3.0%	35%	1.6%
Actual Growth (for Comparison): 2001-2015		
2.0%	21%	1.2%

Poverty has declined significantly since 2000, but less so since 2008, and poverty has increased significantly during 2014-15.

- Moderate poverty:
 - declined from 79 percent in 2002 to 38 percent in 2007
 - Declined further to 14 percent in 2013
 - Increased to 22 percent (estimated) in 2015



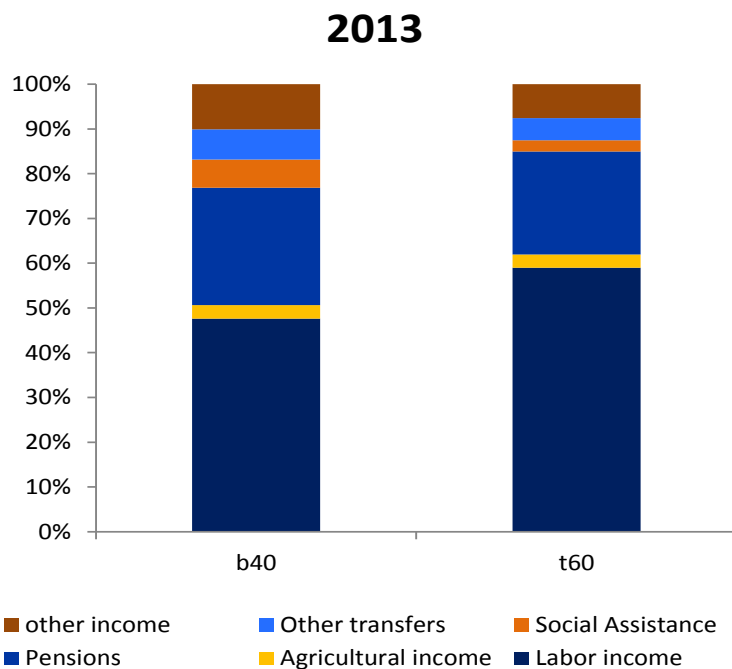
Share of population that is: (i) economically secure; (ii) vulnerable; (iii) moderate poor; (iv) extreme poor



Household incomes, particularly for the poor, rely on pensions and transfers, raising concerns about sustainability of poverty reduction

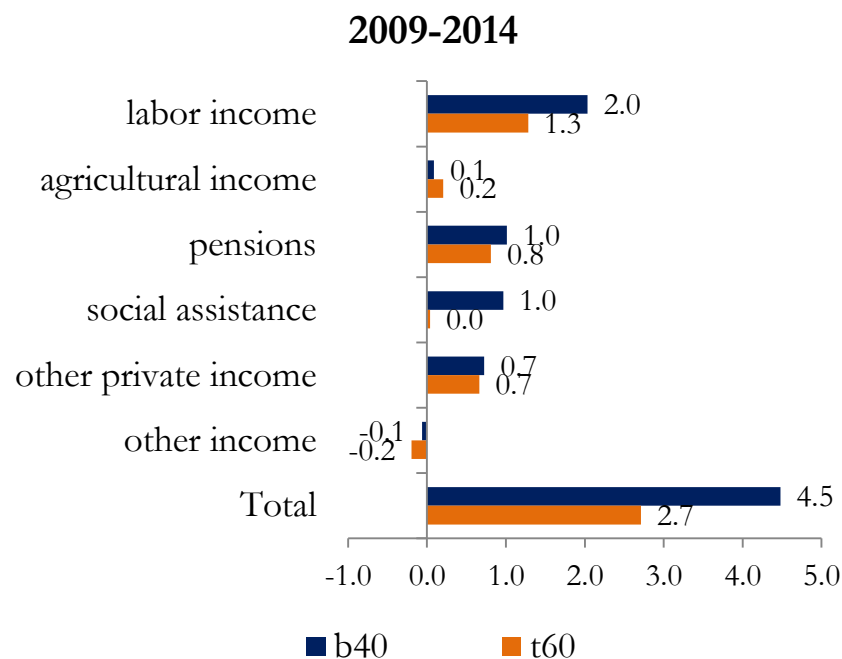
- Bottom 40 percent of population derive more income from pensions, social assistance, and other transfers, than from labor income
- Income growth of bottom 40 percent of population also relied on pensions and social assistance

Share of HH Income sources (B40 and T60)



Source: UkrStat, World Bank staff estimation

Growth of HH Income Sources (B40 and T60)



Education and other services...

...provide an important route out of reliance on social benefits

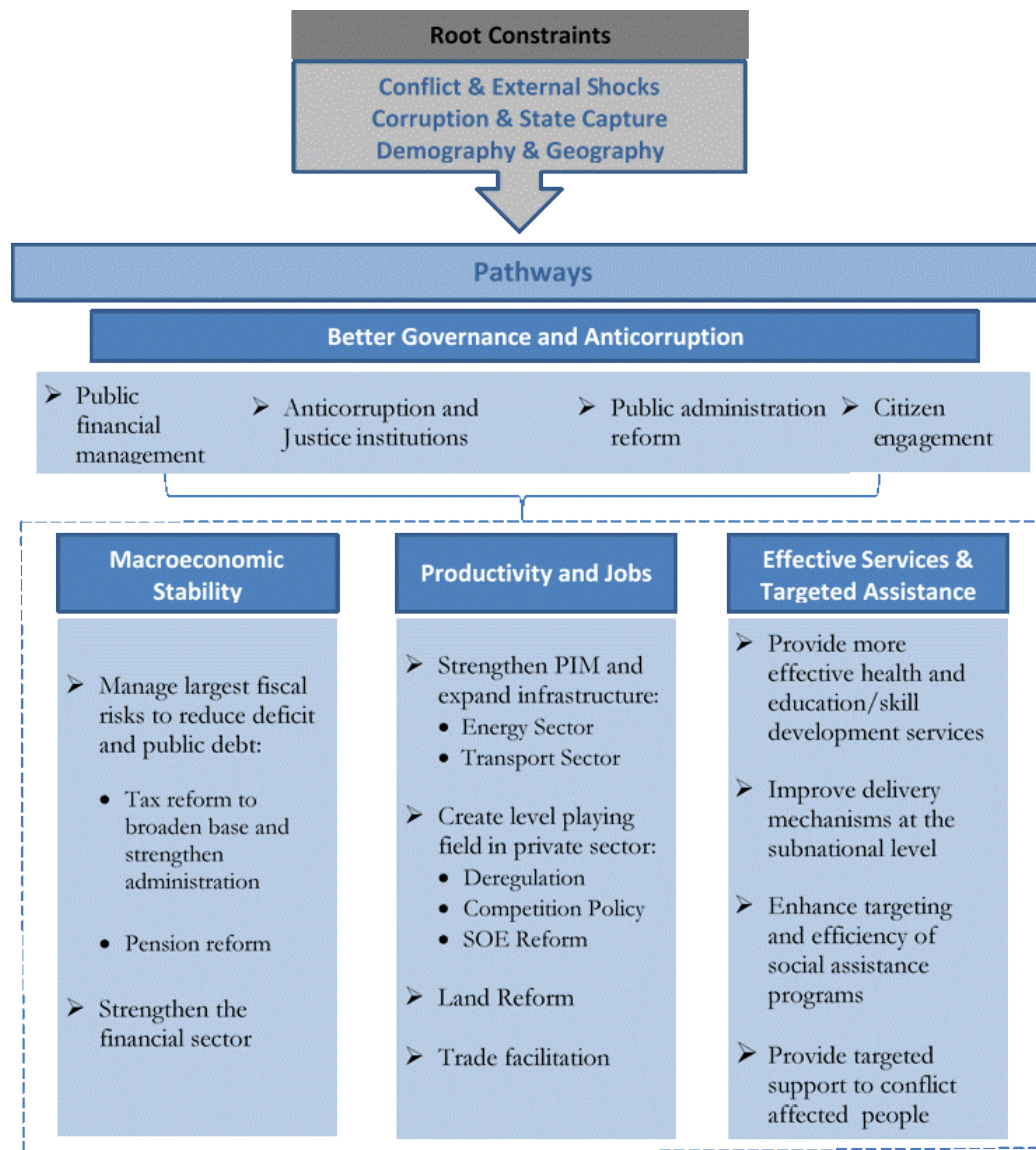
- Higher levels of education lead to a higher share of income from labor and lower share of income from pensions, social assistance, and other transfers
- Education and other services can support a more sustainable model of poverty reduction

Share of Labor Income for different Education Levels (B40 and T60)

	total				rural				urban			
	b40		t60		b40		t60		b40		t60	
	2008	2013	2008	2013	2008	2013	2008	2013	2008	2013	2008	2013
tertiary	55.2%	56.1%	68.4%	66.9%	40.6%	49.0%	51.4%	53.5%	59.0%	57.5%	70.5%	69.2%
full secondary	48.3%	46.6%	62.3%	56.5%	39.3%	41.1%	45.9%	43.7%	54.7%	50.1%	68.0%	62.4%
incomplete secondary and below	38.6%	42.6%	49.1%	49.8%	31.0%	32.5%	28.5%	31.5%	47.8%	52.2%	61.9%	61.7%

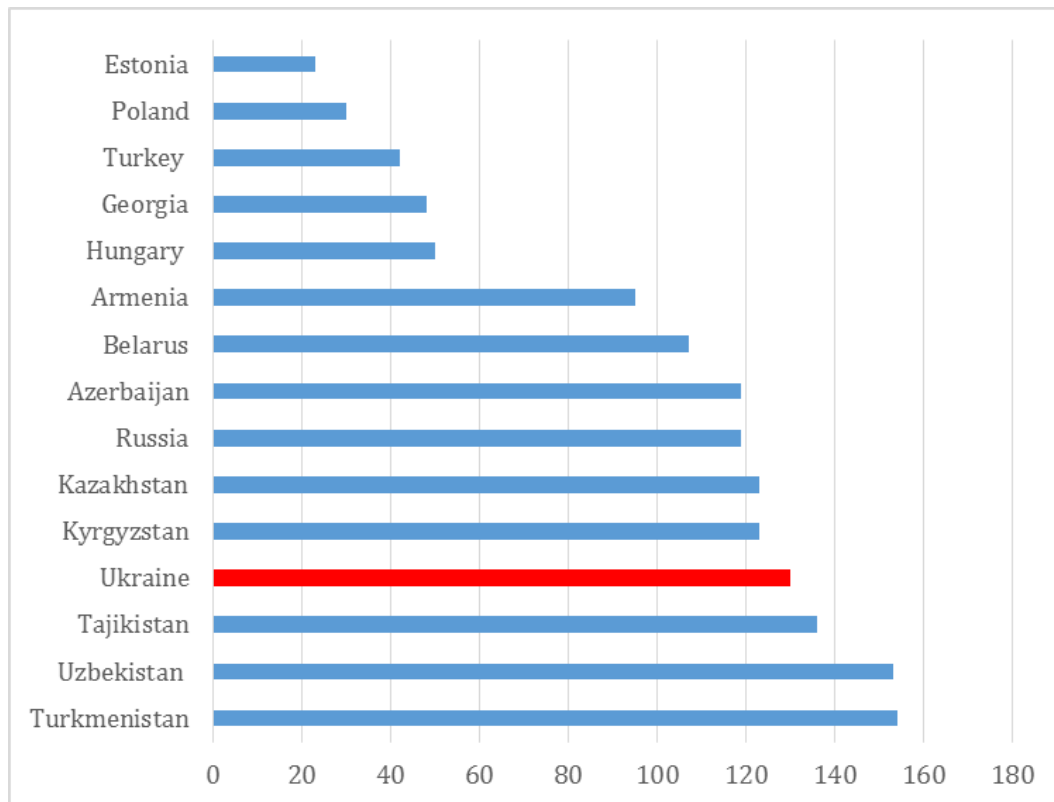
	total				male				female			
	b40		t60		b40		t60		b40		t60	
	2008	2013	2008	2013	2008	2013	2008	2013	2008	2013	2008	2013
tertiary	55.2%	56.1%	68.4%	66.9%	58.8%	59.3%	69.1%	67.8%	52.7%	54.1%	67.9%	66.2%
full secondary	48.3%	46.6%	62.3%	56.5%	51.4%	50.6%	65.4%	59.2%	45.9%	43.3%	59.4%	54.0%
incomplete secondary and below	38.6%	42.6%	49.1%	49.8%	44.8%	48.2%	53.2%	54.1%	34.0%	38.2%	45.7%	46.6%

Ukraine SCD Framework: Pathways to Sustainable Recovery and Shared Prosperity



Good Governance and Anticorruption Institutions

- Ukraine lags EU member states on corruptions perceptions
- Vested interests undermine development progress on multiple fronts:
 - Tax evasion and related party lending undermine macroeconomic stability
 - Concentrated production structure undermines productivity
 - Weaknesses in public resource management undermine effective service delivery



A two pronged strategy to address governance and corruption

- Build institutions of good governance and anticorruption
 - Public financial management (PFM) institutions
 - Anticorruption and justice institutions
 - Public administration reform
 - Citizens Engagement

- Advance reforms in different areas to disempower vested interests
 - Strengthen tax administration and address related party lending
 - Create more competitive production structure
 - Strengthen service delivery mechanisms

Priorities

Better Governance and Anticorruption Institutions

Priorities	Criticality	Time horizon
Public financial management: Update PFM Strategy; implement medium term budgeting; streamline performance based budgeting; and introduce fiscal risk assessment framework.	High	Short, Medium
Anticorruption and Justice Institutions: Effectively implement new anti-corruption laws; strengthen public trust in justice system by improving enforcement and HR reform.	Critical	Short, Medium
Public administration reform: Improve policy and decision-making; merit-based appointments and improve salaries; and streamline personnel while improving human resource management.	Critical	Short, Medium
Citizens Engagement: Build on successful post-Maidan mobilization by promoting more systematic planning, management, and communications based on information and evidence-based analysis.	Critical	Immediate, Short

Criticality for Twin Goals: Critical, High, or Medium?

Time Horizon: Immediate (6 months); Short (1-2 years); Medium (3-5 years)

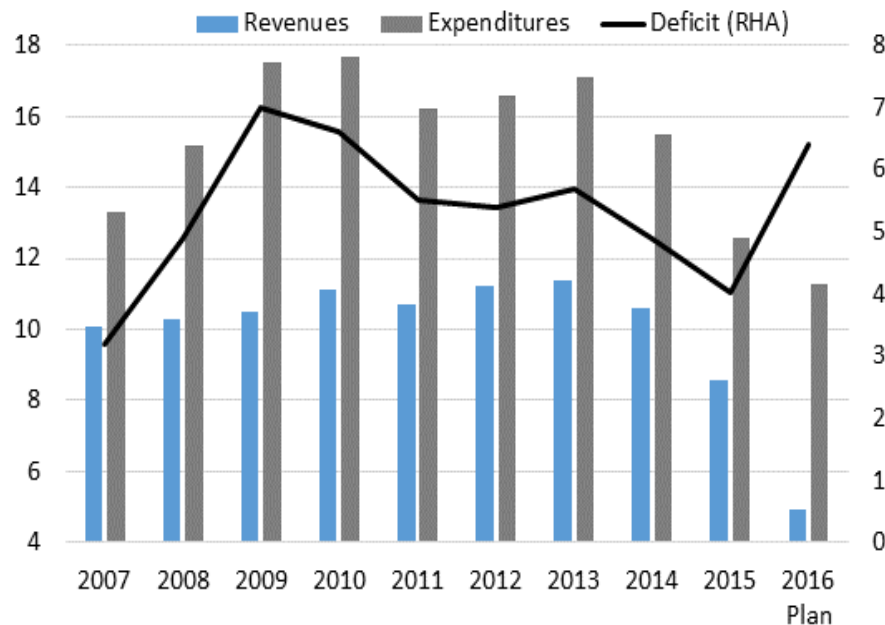
Pathway 1: Macroeconomic Stability

- A narrow tax base (with large number of exemptions and loopholes) and weak tax administration undermine fiscal stability
- The pension system represents a major fiscal vulnerability: pension expenditures accounted for 31 percent of public spending in 2015
- Considerable fiscal risks from a wide range of quasi-fiscal liabilities: energy sector, other SOEs, bank recapitalization and DGF
- Financial sector under severe stress

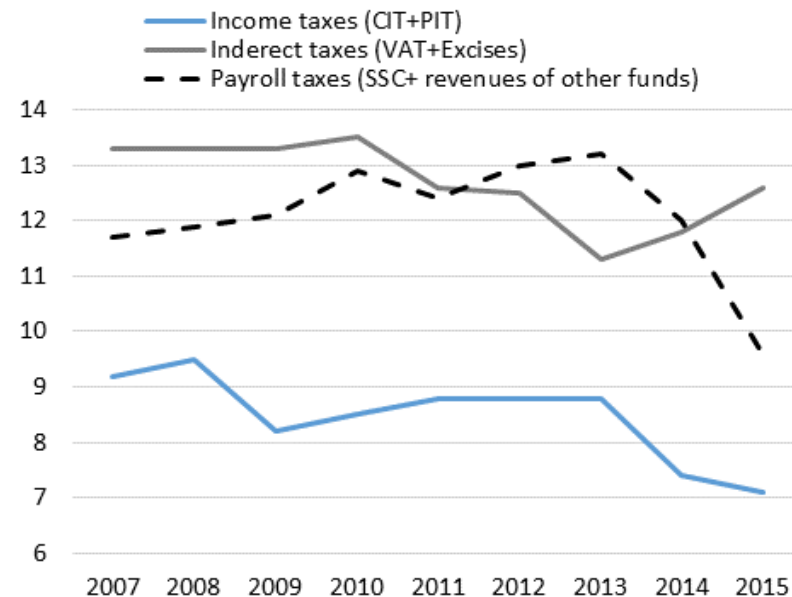
Tax and pension reform are critical to address fiscal vulnerabilities

- Tax reform will require removing exemptions and loopholes and strengthening tax administration
- Pension reform will require restructuring the current benefit package to better link contributions to benefits, but also incremental reforms to retirement age, categorical benefits, and early retirement

Fiscal Burden from Pension Fund (% GDP)



Tax Revenue (% GDP)



Addressing financial sector vulnerabilities is critical to safeguarding macroeconomic stability

- Economic shocks have compounded deep rooted structural problems (related party lending, weak supervision) to result in a serious crisis
- The authorities have put in place a framework to resolve and recapitalize banks and strengthen supervision, which is helping to stabilize confidence and needs to continue
- Reforms to facilitate a resumption of credit growth important:
 - NPLs 28 percent at end-2015, so an effective NPL resolution framework important
 - Governance of state owned banks needs profound reform

Priorities

Macroeconomic Stability

Priorities	Criticality	Time horizon
Tax Reform: Broaden tax base by removing exemptions and loopholes; improve international taxation treaties; and strengthen tax administration	High	Immediate, Short
Pension Reform: Incremental/parametric reforms to retirement age, categorical benefits, and early retirement; and restructure benefit package to better link contributions to benefits	Critical	Immediate, Short, Medium
Strengthen Financial Sector: Implement framework to recapitalize and resolve banks and strengthen supervision; restore credit growth by putting in place effective NPL resolution framework; and improving governance of state owned banks	Critical, High	Immediate, Short

Criticality for Twin Goals: Critical, High, or Medium?

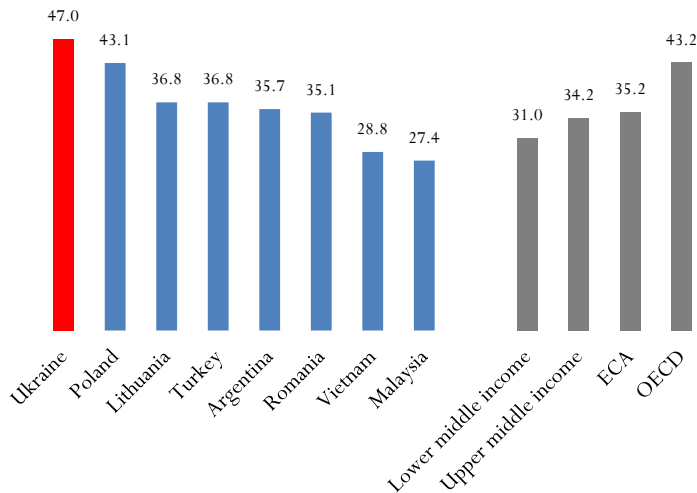
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Pathway 2: Productivity and Jobs

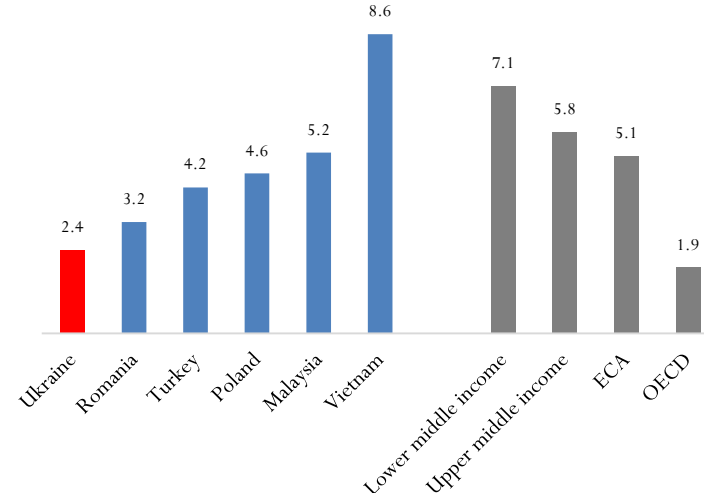
- Public investment in Ukraine is very low and with weak management, which undermines development of critical infrastructure
- Improving infrastructure, especially in transport and energy, is an important priority
- The production structure is concentrated and anticompetitive, which is a serious impediment to productivity and job creation
- Weak land governance undermines investment and productivity
- Ukraine's export potential remains untapped

Infrastructure

Gen Government Expenditures (% GDP)



Public Capital Expenditures (% GDP)

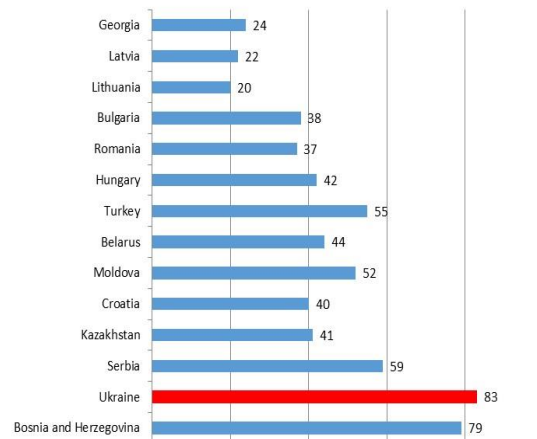


- Creating fiscal space for public investment and strengthening public investment management (PIM) systems will be important
- In the energy sector, improving governance and transparency, reducing losses, and supporting efforts to reduce high energy intensity will be important
- Efficient multimodal transport system is critical to unleashing Ukraine's trade potential

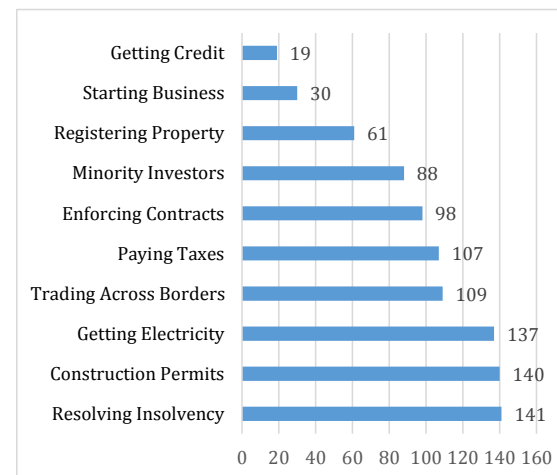
Private Sector: creating a level playing field

- Deregulation: Ukraine has taken steps to improve its regulatory environment, but still lags other countries by a considerable distance
- Competition Policy: More effective implementation of the legal framework is needed
- SOE reform will require strengthening accounting and financial reporting, improving governance, and restructuring and privatization

Doing Business Ranking: Ukraine and Comparators, 2016



Doing Business Ranking: Regulatory dimensions, Ukraine, 2016



Priorities

Private Sector Productivity

Priorities	Criticality	Time horizon
Strengthen PIM and Expand Infrastructure: <ul style="list-style-type: none"> • Create fiscal space for public investment and strengthen PIM systems • Energy sector – improve governance and transparency, reduce losses, and reduce high energy intensity • Transport sector – promote efficient multimodal transport system to unleashing Ukraine’s trade potential 	High Critical/ High Medium	Short Medium Medium
Create Level Playing Field in Private Sector: <ul style="list-style-type: none"> • Deregulation – further streamline business regulatory environment • Competition Policy – enhance capacity of Anti-Monopoly Committee to implement legislation and streamline state aid for enterprises to reduce distortion of competition • SOE Reform – triage of SOEs for restructuring and privatization; strengthen accounting and financial reporting; and improve corporate governance 	High High High	Short Short/ Medium Short

Priorities

Private Sector Productivity (Continued)

Priorities	Criticality	Time horizon
Land Reform: Increase efficiency of state land management through new legal framework; open sales market for private agricultural land ensuring transparency and equal access; and clear status of unclaimed property.	Critical	Short Medium
Trade Facilitation: Strengthen and harmonize quality and standards arrangements to tap potential of international trade agreements	Medium	Short

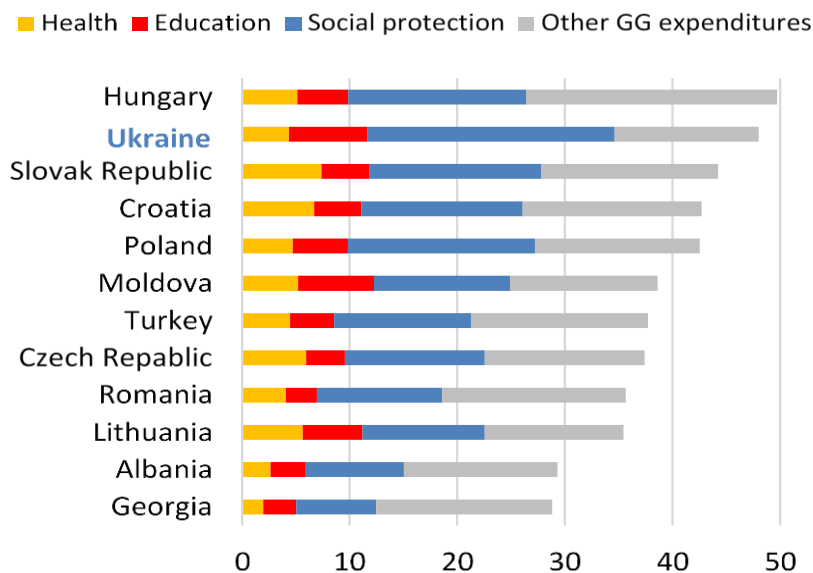
Criticality for Twin Goals: Critical, High, or Medium?

Time Horizon: Immediate (6 months); Short (1-2 years); Medium (3-5 years)

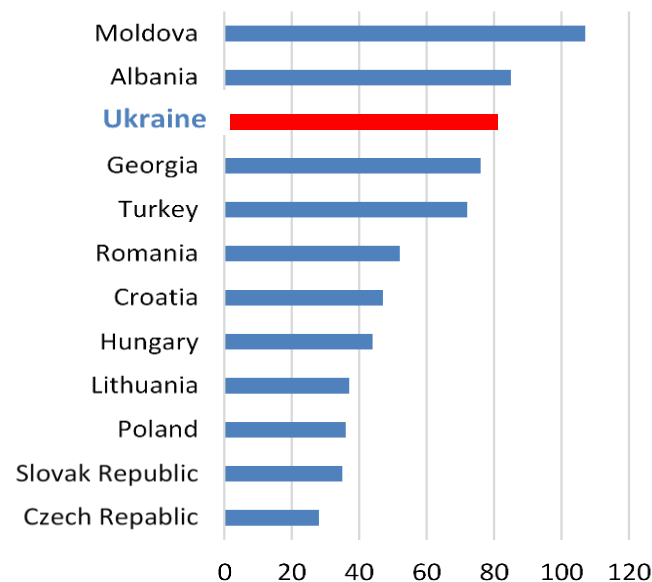
Pathway 3: Targeted and Effective Services

- Ukraine spends a large share of GDP on social services and assistance, although this does not translate into high quality service delivery
- More targeted and effective services will not only reduce expenditure pressures, but also result in tangible improvements for population and improve labor market outcomes

**Composition of general government expenditure,
Ukraine vs peers, 2013**

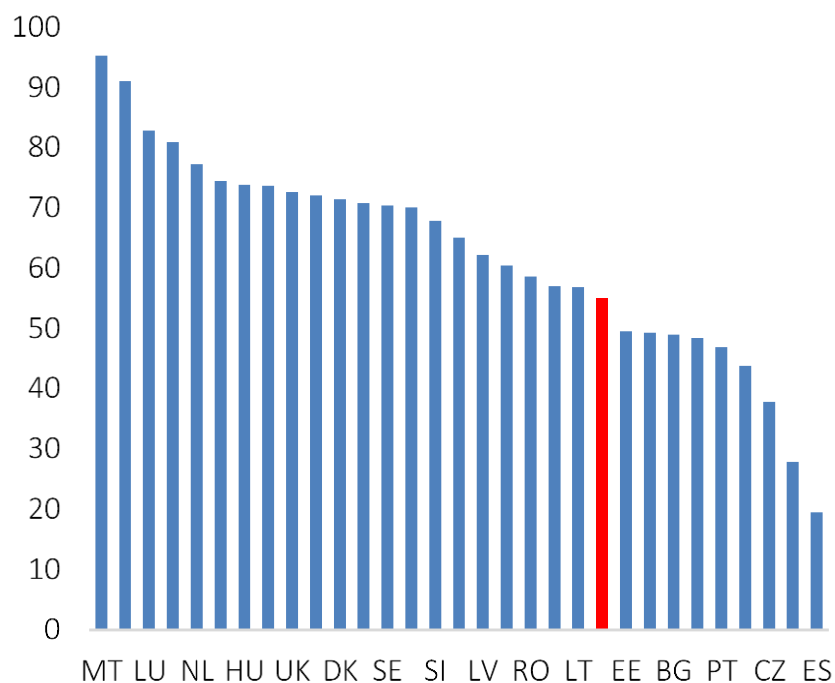


Human Development Index Rank 2014
(lower rank means higher development)

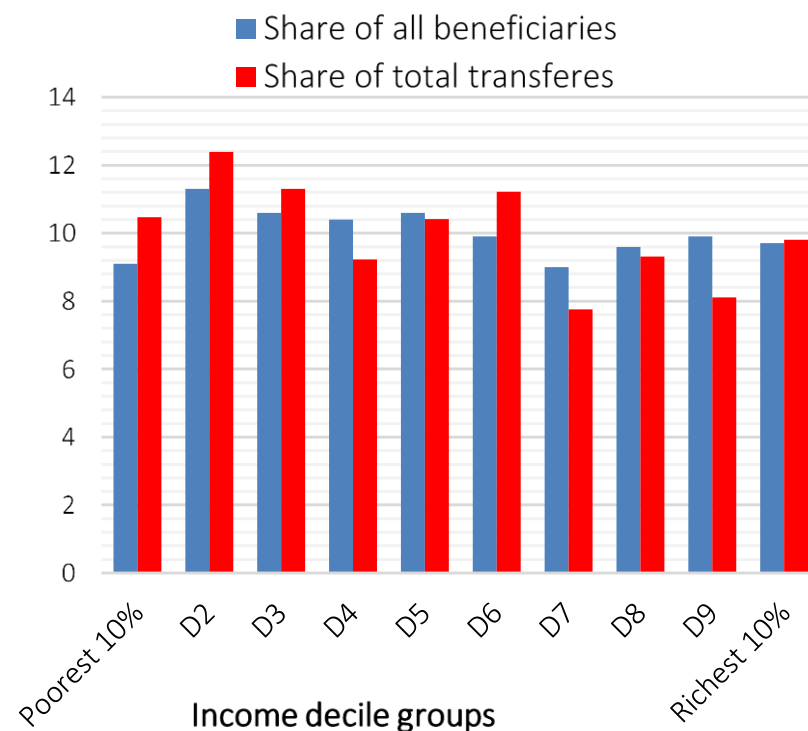


Ukraine spends a considerable amount on social assistance, although much of it is not well targeted

Coverage rate for various countries, 2012 and for Ukraine, 2014



Share of total beneficiaries by deciles and share of total transfers by deciles of expenditure



Reforms to improve targeting and effectiveness of services

- Health financing model requires serious reform from input-based norms toward payment systems where “money follows” the patient
- Health infrastructure oversized, with 40 percent more beds per capita than European average, while the non-communicable disease burden is very high
- Ukraine spends a considerable amount on social assistance (4 percent of GDP in 2014, among the highest in the region), but does not adequately protect the poor
- Providing more effective protection to the poor will require moving from categorical to targeted benefits and improving targeting of the housing utility subsidy (HUS) program, which has providing temporary relief from energy tariff increases to large numbers of households

Priorities

Effective Services and Targeted Assistance

Priorities	Criticality	Time horizon
Health Reform: Revise health financing model from input-based norms toward payment systems where “money follows” the patient	High	Short
Education: Implement “hub schools” program to optimize school network while prioritizing investments in quality-enhancing inputs	Medium	Short
Subnational delivery mechanisms: Improve norm-based financing for services, increase financial autonomy, and clarify roles and responsibilities	Medium	Short

Priorities: Effective Services and Targeted Assistance (Continued....)

Priorities	Criticality	Time horizon
Social Assistance: Continue shift from categorical to targeted benefits and improving targeting of the housing utility subsidy (HUS) program	Critical	Immediate, Short
Targeted support to conflict affected people: skills, training, and MSME in affected areas and host communities and extend systematic assistance to vulnerable households	High	Immediate, Short

Criticality for Twin Goals: Critical, High, or Medium?

Time Horizon: Immediate (6 months); Short (1-2 years); Medium (3-5 years)

Conclusion

- The economy has stabilized but longstanding structural challenges stand in the way of sustained recovery and shared prosperity
- Simultaneous progress on reforms on multiple fronts is critical
 - Safeguarding macroeconomic stability will require addressing largest sources of fiscal risk and addressing financial sector vulnerabilities
 - Unlocking productivity requires more effective PIM, creating level playing field, reforming land governance, and facilitating trade
 - Providing more effective services will require health financing reform, effective decentralization, and improved targeting of social assistance
 - Tackling corruption and improving governance are central