I. Project Context

Country Context

1. The global economic and financial crisis of 2008 hit Ukraine particularly hard due to its pre-existing macroeconomic imbalances and structural weaknesses. As the crisis unfolded, capital inflows came to an abrupt stop, terms of trade reversed as steel prices declined and export markets shut down. In 2009 Gross Domestic Product (GDP) declined by 15 percent. The crisis also accentuated the vulnerabilities of the banking sector, leading to a systemic liquidity and solvency crisis, including the withdrawal of deposits. Domestic demand sharply contracted in 2009, with investments in fixed assets falling by 46 percent. Between October 2008 and February 2009 the national currency lost about 40 percent of its value against the US dollar. In July 2010, the IMF Board approved a new 2½ year Stand-By Arrangement (SBA) in the amount equivalent to SDR 10 billion (US$14.9 billion). This followed the earlier SBA of SDR 11 billion (USD 16.6 billion) that went off-track in November 2009 (after disbursing around USD 10.5 billion). In December 2010, the IMF Board completed the first review of the new program. The second review of the SBA has been delayed (since March 2011) until pension reform, utility tariff increases, and other measures are enacted and implemented.

2. Ukraine’s economy returned to growth in 2010-2011, but the recovery remains fragile. After a 14.8 percent GDP decline in 2009, real GDP grew 4.2 percent in 2010 and posted a 5.2 percent growth in 2011. Domestic demand has played an increasing role in driving growth in 2010 and 2011, in contrast with 2009. Industrial production has also recovered but with volatile growth rates, highlighting the dependence on few commodity prices such as steel. Lower food prices, delays in utility price adjustments, and monetary tightening led consumer price inflation to sharply decelerate to around 3 percent in early 2012 y/y, the lowest level since 2003. Our base case scenario anticipates GDP growth to slow to 2.5 percent in 2012 as Ukraine enters a period of lower external demand, higher funding pressures, and instability in international markets.

II. Sectoral and Institutional Context

Road Sector Reform

6. Ukraine is strategically located between Russia and the European Union and is thus a key transit country. There are seven major transport corridors crossing its territory. Ukraine has a developed road network of about 170,000 km, of which about 21,000 km are national roads and 149,000 km are regional and local roads. While the corridors between Kyiv and Ukraine’s western border are being improved with funding from the EU, EBRD and EIB, it is important to continue to complement this effort through the improvement of corridors east of Kyiv towards the industrial heartland of Ukraine and the border with Russia, to get a maximum return on these major infrastructure investments. In 2010, Ukraine has adopted a new transport sector policy which seeks a balanced development of different transport modes, with rail transport retaining its role as dominating mode for heavy bulk goods, while the road network is being further developed to serve higher-value goods and to support better connection with Ukraine’s neighbors.

7. Ukraine’s economy, which traditionally has relied on metal production, heavy industry and agriculture, is shifting to an increased reliance on semi-finished products that have a higher value per ton. As the delivery of goods increasingly needs to comply with international standards in terms of timeliness and reliability, road transport will be increasingly important for carrying higher-value freight at both national and regional levels. This gradual shift to higher-value export products calls for the modernization of Ukraine’s main road corridors.

8. The chronic shortage of budget funding for roads that lasted since the breakup of the Soviet Union has created a large backlog of periodic maintenance and rehabilitation, resulting in poor riding quality and poor safety on a very substantial portion of the country’s road network. The Government is implementing a program for the upgrading of the major national road corridors with the highest traffic levels to European technical and safety standards; the proposed project is part of that program.

9. Ukraine’s road sector is managed by the State Road Agency—Ukravtodor—a central executive body under the Cabinet of Ministers of Ukraine, whose activities are directed by the Vice Prime Minister of Ukraine—Minister of Infrastructure. Ukravtodor is responsible for administering the country’s network of main roads (about 51,000 km); these are the roads considered of national importance and all international...
transit roads. The management of secondary and local roads is carried out at the Oblast level by the Oblast Road Services, which report to Ukravtodor. Road maintenance and a part of road construction are undertaken by the State Joint Stock Company “Roads of Ukraine” (DAK), with 100 percent of its share capital managed by Ukravtodor on behalf of the Government. Maintenance of regional and local roads is performed at the Oblast level by DAK Oblast subsidiaries (Oblavtodor), under contracts with the Oblast Road Services. Maintenance of national roads is undertaken by linear units (DED), which are subsidiaries of the DAK. Several road design and research institutions provide services to both Ukravtodor and the Oblast Road Services.

10. The Government’s existing plan to reform the management of the road system, approved by the Cabinet of Ministers on August 3, 2011, aims to improve the quality of the road network and the efficiency of road management through decentralization of responsibilities and resources. The reform agenda also includes improvement of financial sustainability, development of coordinated technical and economic policies, and improvement of road quality standards. During the first phase of the reform, during 2011-2013, Government is on course towards achieving the following goals:
   (a) To introduce a new road classification system that distinguishes state (or national) public roads and local public roads (legislative changes were approved by the Parliament in December 2011);
   (b) To upgrade the monitoring system for road conditions (under implementation);
   (c) To define responsibilities for road management between central and regional road authorities and local administrations (planned for 2012);
   (d) To introduce appropriate changes to the Laws of Ukraine: “On Roads”, “On local state administrations”, “On financing of roads of Ukraine”, and decrees of the Cabinet of Ministers on financing and managing of roads (planned for 2012);
   (e) To develop a road and pavement management system including a database and analytical tools (planned for 2012); and
   (f) To transfer management of local public roads to regional authorities.

11. During the second phase (2014-2015), the reform will focus on the improvement of road maintenance, including the reorganization of DAK and the broader introduction of performance-based road maintenance contracts.

12. Road sector financing has improved both in terms of its adequacy and efficiency over the last ten years. Government has substantially increased the fuel excise tax rates (from €20-40 per ton for gasoline and €10 for diesel in 2000, to €182 for gasoline and €66 for diesel in 2011). The additional revenues were allocated entirely for the road sector, resulting in a ten-fold increase of road sector funding between 2002 and 2011 (Table 1). The Government has also increased the share of road sector financing funded from the fuel excise tax revenues, which now accounts for about 80 percent of the total sector financing. This means that road sector financing is now more closely correlated with the use of the road network; in other words, an increasing share of the wear and tear caused by traffic is being paid by users.

Road Traffic Safety in Ukraine

14. People in Ukraine are four or more times likely to die from road traffic injuries than those in Western Europe, in spite of the much lower motorization rate and the relatively shorter trip distances. Ukraine has in fact one of the highest road traffic mortality rates in Europe and Central Asia: above 20 traffic deaths per year per 100,000 people, compared to less than 5 in several European Union countries. Road traffic injuries rank among the top 10 causes of death in Ukraine. Recent official statistics indicate that more than 22,000 people died and about 90,000 people required medical treatment as a result of road traffic injuries during the period 2007-2009.

15. Such high rates of road traffic injuries and fatalities, also characterized by the high share of pedestrian fatalities, disproportionally affect the economically active population in Ukraine; hence, the economic and social consequences are severe. The key factors that contribute to the poor safety records are (i) poor road conditions and the lack of safety features in road design, which the proposed Project aims to improve, (ii) unsafe driving behavior, and (iii) ineffective enforcement of traffic laws and regulations. Prevalent among drivers are speeding, driving under the influence of alcohol, and the use of communication devices (cell phones), while seat belts and other safety measures are not widely used. Despite the recent efforts, however, the country’s road safety management capacity is still inadequate: the Ministry of Public Health—the designated lead agency for road safety—does not have the legal mandate, funding, or capacity to deliver the necessary institutional functions for road safety management. Several strategies and action plans have been developed in the past, but often without measurable targets, clear ownership, or realistic funding; hence did not lead to successful implementation.

16. Notwithstanding the behavioral and institutional issues, from the road sector’s point of view, it is most urgent and critical to improve the physical features of the roads to reduce the likelihood and severity of crashes. The current regulatory framework and requirements for road design and construction need to be improved. A formal road safety audit should be required not only for new construction, but also for road rehabilitation and capital repair, which comprise the majority of Ukravtodor’s projects and provide ample opportunities to change the geometric design of roads and add other road safety features for improved safety. The general road design standards also need to be revisited in order to provide necessary protective features for road users and pedestrians.

III. Project Development Objectives

The proposed project is a follow-on (or repeater) project to the ongoing Road and Safety Improvement Project (RSIP, P100580) which was approved in 2009 and is under successful implementation. The proposed project would have the same development objective as the ongoing RSIP, which is an “improved condition and quality of sections of the M-03 road, and increased traffic safety on roads”. The new project will rehabilitate and upgrade additional sections of the same M-03 road and will improve road safety conditions on several road corridors in Ukraine.

IV. Project Description

Component Name

Component 1 - Road Rehabilitation. This component will rehabilitate and upgrade about 108 km of the M-03 road between Lubny and Poltava.
Component 2 - Road Safety Improvements. This component includes safety improvements along several high risk road corridors and road sections.
Component 3 - Institutional Support and Strengthening

V. Financing (in USD Million)
VI. Implementation

The RSIP2 will be the second World Bank funded road project executed by Ukravtodor as the implementing agency. Over the past ten years, Ukravtodor and the project implementation unit (PIU) for externally funded projects, presently named Ukrdorinvest, have gained much experience in the execution of large externally funded road projects (mostly by EBRD, Bank and EIB). Given the good track record of Ukravtodor and Ukrdorinvest in the preparation and execution of externally funded projects, the project implementation risks are considered to be moderate.

Despite the widely recognized governance issues in Ukraine at the country level, these high country risks have so far not translated into problems in the execution of externally funded projects in the road sector. The operational performance of Ukravtodor and the project implementation unit Ukrdorinvest has in fact improved over the past years. There have not been any reports of interference by higher-level authorities in the management of road projects by Ukravtodor. Externally funded road projects benefit from tight scrutiny and oversight by the external funding agencies. Additionally, all projects in the road sector, independent of the funding source, are subject to internal auditing and control through the Ministry of Finance and other Government agencies. Under the ongoing RSIP, regular technical audits by an independent international auditor are being carried out to verify that all road works have been executed in compliance with the technical specifications. The same type of technical audits will also be part of the implementation arrangements for the RSIP2.

The project has a Governance and Anti-Corruption Action Plan in place.

VII. Safeguard Policies (including public consultation)

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VIII. Contact point

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