Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 28-Feb-2023 | Report No: PIDA35211

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Ukraine	P180242	Strengthening the Partial Credit Guarantee (PCG) Fund for small farmers in Ukraine	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	10-Feb-2023	31-Mar-2023	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Agrarian Policy and Food	Ministry of Agrarian Policy and Food, Partial Credit Guarantee Fund	

Proposed Development Objective(s)

The Project development objective (PDO) is to operationalize the partial credit guarantee fund (PCGF) to help improve access to financing for small farmers in Ukraine.

Components

Capitalization of the PCGF

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	96.17
Total Financing	96.17
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	10.69

European Commission Development Fund - TF	10.69
Commercial Financing	85.49
Commercial Financing Guaranteed	42.74
Unguaranteed Commercial Financing	42.74

Environmental and Social Risk Classification

Substantial

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

1. **The 20-year-old moratorium on sales and purchases of farmland was lifted on July 1, 2021, opening the agricultural land market**. The approved law lifted the moratorium on land sales and allowed purchases by individuals up to 100 ha from July 1, 2021 and purchases by legal entities from January 1, 2024, with the right to buy agricultural land initially limited to Ukrainian citizens. The land market opening is expected to have positive economic and social impacts. First, the reform is expected to increase agricultural and overall economic growth through increased investments in land with clear rules on property rights. Second, the reform will transfer resources, in the form of increased land prices, to landowners and create collateralizable assets for rural investments. As landowners are mainly rural, older, less educated, and female, the reform would essentially transfer resources to the more vulnerable segments of the Ukrainian population. Third, the reform has the potential to revive local communities and enhance local services through the revenue streams generated by auctioning off state and communal land.

2. **The land reforms have already shown positive impact despite the difficult environment**. During the first 4 months of its operation, mandatory e-auctions for farmland in state and communal ownership, combined with transfer of public land ownership to local councils, doubled the leases paid. After a brief suspension at the start of the Russian invasion of Ukraine (hereinafter referred as “war in Ukraine”), land markets continue to operate at almost pre-war levels in the areas not directly affected by the war. Moreover, in the context of the country’s European Union (EU) accession, key elements of land reform implementation were adopted in a law in June 2022.

3. **Before the war in Ukraine began, the government of Ukraine (GoU) put in place key legal, regulatory, and supervisory elements of a commercially viable partial credit guarantee fund (PCGF), with a sound independent governance framework, which will support access to finance of small credit-constrained farmers**. The related legislation came into effect on November 24, 2021. Steps towards operationalization of the PCGF are progressing well. The Cabinet of Ministers of Ukraine (CMU) adopted resolution #125 dated February 16, 2022, on establishing the PCGF and adopting the PCGF Charter. Three other resolutions detailing the recruitment process, remuneration and eligibility criteria for independent PCGF Supervisory Board members were also adopted. The adopted PCGF Charter foresees that the PCGF Supervisory Board shall consist of five members, three of which shall be independent, and with its chairperson selected among its independent members. In August 2022, the National Bank of Ukraine (NBU), as the regulator of the PCGF, adopted a special regulation on PCGF activities, which includes a set of micro-prudential requirements for the PCGF. On February 6, 2023, the NBU licensed PCGF as a nonbanking financial institution focused on providing guarantees.

4. **In parallel, the State Agrarian Registry (SAR) has been launched successfully in mid-August 2022 and now has more than 80,000 farmers registered**. It has been used to implement programs funded by the development partners in recent years. Based on this experience, the Ministry of Agrarian Policy and Food (MAPF) intends to make the use of SAR mandatorily for transparent processing of all types of state support, including guarantees. MAPF is also working on an automated data exchange between SAR, State Fiscal Service, and State Statistics Service, as a way to reduce transaction cost of supplying credit to small farmers and allowing smaller banks to compete with larger ones on an equal footing, ideally in a way that would allow farmers to graduate to full commercial financing in due course. It is recommended for SAR to be the preferred platform for PCGF loan applications.

5. **Ukraine, in general, and the agricultural sector, in particular, is vulnerable to the impacts of climate change.** Increasing temperatures and more uneven precipitation patterns have led to more frequent and more severe drought periods in the last decade. Based on modelling using different scenarios, climate change impacts are expected to

decrease the yields of many crops, such as barley, maize and sunflower, which are critical export goods. The frequency and intensity of extreme weather events, including heatwaves, thunderstorms, heavy precipitation, pluvial and river flooding, droughts, and hailstorms, are expected to rise with higher warming, negatively impacting agricultural productivity. Furthermore, the risk of diseases and pests as well as wildfires increases with climate change. There are options to mitigate the impacts by introducing climate-smart agriculture practices.

Sectoral and Institutional Context

6. **While the financial sector is an essential building block for fostering private-sector led sustainable growth, it was not fully equipped to play that role in the country even prior to the war in Ukraine.** The Ukrainian banking sector lacks depth and makes only a relatively small contribution to private sector development with a private sector loan-to-GDP ratio of 28.4 percent in 2020 compared to a 55.2 percent average in ECA region (excluding high-income countries). A large share of state-owned banks (SOBs) with a high percentage of nonperforming loan (NPL) ratio and elevated exposure to government bonds continues to undermine the efficiency of financial intermediation and credit growth to the private sector. Among the challenges to firm performance in Ukraine, access to finance has historically been one of the biggest growth obstacles and particularly problematic for smaller enterprises.

7. **Constrained access to finance for small farmers has been further exacerbated by the war in Ukraine.** Pre-war WB studies show that many small farmers (up to 500 ha) are underbanked and do not even have access to basic banking instruments. Banks mostly work with clients perceived as less risky (agricultural companies whose farms are larger than 500 ha). Pre-war constraints relate to lack of collateral, credit history, and reliable financial accounts that would mitigate asymmetric information risks and enable financial institutions to better assess their creditworthiness. In the context of the land reform, the lack of long-term loans for small farmers risks having several adverse effects. First, it risks precluding smaller farmers from investing in productivity-enhancing technologies, foregoing their potentially large income and welfare gains. Second, it risks resulting in excessive land concentration among wealthy individuals, especially in the second phase of the land reform. As a result of the war in Ukraine, commercial banks have been cautious in intensifying their lending activity to enterprises while small farmers' demand for additional financing has increased.[1] High interest rates as well as collateral requirements remain the main factors deterring businesses from taking new loans.[2]

8. **Since the start of the war in Ukraine, state programs have become the main engine of lending.** Amid the tightening of banks' credit conditions, the 5-7-9 Loan Program in combination with State Portfolio Guarantee Program were almost the only channels of corporate crediting. The 5-7-9 Loan Program was launched in 2020 and is based on a mechanism of (partial) compensation of interest rates. CMU expanded the program in early spring 2021. This included a lending program to agribusinesses at favorable terms (short-term loans up to 6 months, with full interest rate compensation, and an increased loan amount of UAH 60 million), with bigger

[1] Preliminary results of a WB survey among 2000 farmers conducted in 2022 found that over 90 percent of farmers with a farm size between 50-500 ha want to borrow while close to 40 percent in that group have never received a loan. Almost all demand relates to working capital loans.

[2] A recent NBU survey (NBU Business Outlook Survey, Q3) found that more than half of agricultural companies stated that their borrowing needs will increase in the near future. High interest rates on loans remain the main factor deterring businesses from taking new loans, as indicated by about half of the survey respondents, and 40 percent of agricultural companies participating in the survey. Collateral requirements are another constraint for about a quarter of respondents and one-fifth of agricultural companies that consider applying for a loan.

enterprises also becoming eligible.[3] As part of the state guarantees on a portfolio basis, 6,969 loans worth UAH 33.48 billion were issued to agribusinesses.[4]

9. **Partial credit guarantees by the PCGF form an important and complementary support vehicle aimed at enabling small farmers to capitalize on the land reforms and leveraging private capital for financing support during the war and reconstruction phase**. Despite the challenging environment as a result of the war, design features of the PCGF are still highly relevant in the Ukrainian context where banks are highly liquid and increasingly risk averse. The establishment of the PCGF has been a key element of the broader land reform package envisaging loan maturities of up to ten years whose availability is currently limited in the market (including through state support programs). The GoU is committed to accelerating the PCGF operationalization and replacing the current temporary credit guarantee arrangements based on good governance, safeguards, financial and systems standards. At the same time, the 5-7-9 Loan Program, can play an important role in supplementing guarantees with additional interest rate compensation instruments

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

The Project development objective (PDO) is to operationalize the partial credit guarantee fund (PCGF) to help improve access to financing for small farmers in Ukraine.

Key Results

PDO Level Indicators

- The PCGF is fully operational as an independent financial institution regulated by the NBU;
- Number of small farmers cultivating less than 500 ha of agricultural land access loans with the PCGF guarantee;
- The total volume of outstanding guaranteed loan portfolio at the end of each calendar year.

D. Project Description

10. **The project comprises one component on capitalization of the PCGF in the total amount of EUR 10 million**.[5] The component is designed as a recipient executed (RE) trust fund (TF). The project aims to contribute to the capitalization of the new PCGF, with a sound independent governance framework, which will support credit-constrained farmers and significantly improve sustainability of the current credit guarantees, thereby providing long-term benefits for agricultural development and food security. The contribution through the EU funded TF will be disbursed in two tranches. The first tranche of EUR 6 million will be disbursed as soon as the

[3] As of December 2022, the program accounted for 26 percent of the net hryvnia corporate portfolio.
[4] For agriculture companies, the state guarantee cannot exceed 80 percent of the individual loan compared to 70 percent for other SMEs.
[5] Another approximately USD 10 million capitalization for the PCGF – as matching contribution to the EU funds - is foreseen in the 2023 Budget Code.

grant agreement becomes effective for the authorized capital of the PCGF to reach its legally foreseen amount of UAH 200 million. The second tranche (EUR 4 million) will follow once the PCGF is fully operational with its institutional, legal and operational framework acceptable to the WB.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

11. **Potential environmental impacts are connected to purchase of land, purchase and use of agrochemicals (pesticides, fertilizers), establishment of irrigation systems and include impact on biodiversity, surface and ground water sources, soil quality, OHS and community health and safety impacts, as well as war-related hazards such as land contamination and explosive remnants of war (ERW).** Environmental risks are expected to be site-specific, temporary and can be readily addressed through standard mitigation measures and compliance with national laws, however, these risks may be exasperated by ongoing war in Ukraine and war-related hazards and threats (such as aerial attacks and ERW). On the social side, project activities associated with the provision of credit guarantees for land purchase, working capital, and equipment installation and construction works for small and medium-scale agricultural activities are unlikely to involve some site-specific adverse risks and impacts on workers and communities which in most situations will be easily manageable. However, the invasion and ongoing war in Ukraine pose significant contextual risks associated with worker and community health and safety and may induce incidents of harmful labor or further displacement of refugees using vacant land if inspection activities are not carried out. To address potential adverse environmental and social impacts, the Borrower will develop and adopt a fund-level Environmental and Social Management Systems (ESMS) to be followed by PCFG and participating financial institutions (PFIs).

12. **Project activities are likely to involve some site-specific adverse social risks and impacts on workers and communities which in most situations will be easily manageable but are rendered unpredictable by the contextual risks associated with the national emergency.** The invasion and ongoing war in Ukraine pose significant contextual risks that are beyond the control of the project such as risks associated with aerial bombardment, war fighting or further displacement of refugees. Community and worker health and safety risks common to the activities being supported include risk of interaction with nearby communities during transport of equipment and machinery or during localized construction activities. Loans intended for the purchase of land need to be screened to ensure that any land acquisition occurs on a willing seller-willing buyer basis documented by legal transaction records on fully registered and notarized private land where the absence of dispute over ownership or use is confirmed. Sexual exploitation and abuse and sexual harassment (SEA/SH) risks are estimated to be low but preventative measures should be put in place. There is a risk that provision of credit financing may benefit those enterprises with existing financial capacity, and not reach rural new starters or those with insolvency records or cultural minorities and the elderly without access to information or awareness of the program. Small entrepreneurs may be more reluctant to apply and take on debt during the current crisis. Financial products and training tailored to smallholders is required, for example, for women-led business,

community enterprise, borrowers lacking a credit history or lacking financial skills. The quality of management systems deployed by PFIs is likely to vary and a capacity building approach will need to be integrated into the bank TA activities to ensure that these systems are subject to due diligence review and updated for consistency with ESS9.

E. Implementation

13. **This project is designed as a Recipient Executed Investment Project Financing.** The Recipient Executed grant will focus on the capitalization of the PCGF. The WB will be in charge of project supervision, which covers monitoring, evaluation review and reporting. Both MAPF and PCGF are implementing agencies. The project implementation team (PIT) will be composed from staff of both institutions. The project coordinator and financial management expert will be appointed from within MAPF. The environmental and social safeguards specialist will be hired by the PCGF. A subsidiary agreement will be signed to reflect the obligation of the PCGF to comply with the WB policies and procedures (effectiveness condition).

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APPROVAL

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