



# UKRAINE'S DEBT IS GROWING DURING THE WAR. WHAT TO DO NEXT?

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PREPARED:

Maria Repko, Deputy Director of the CES  
Maria Tomilina, CES economist  
Maksym Samoiliuk, CES economist

Presentation of the study

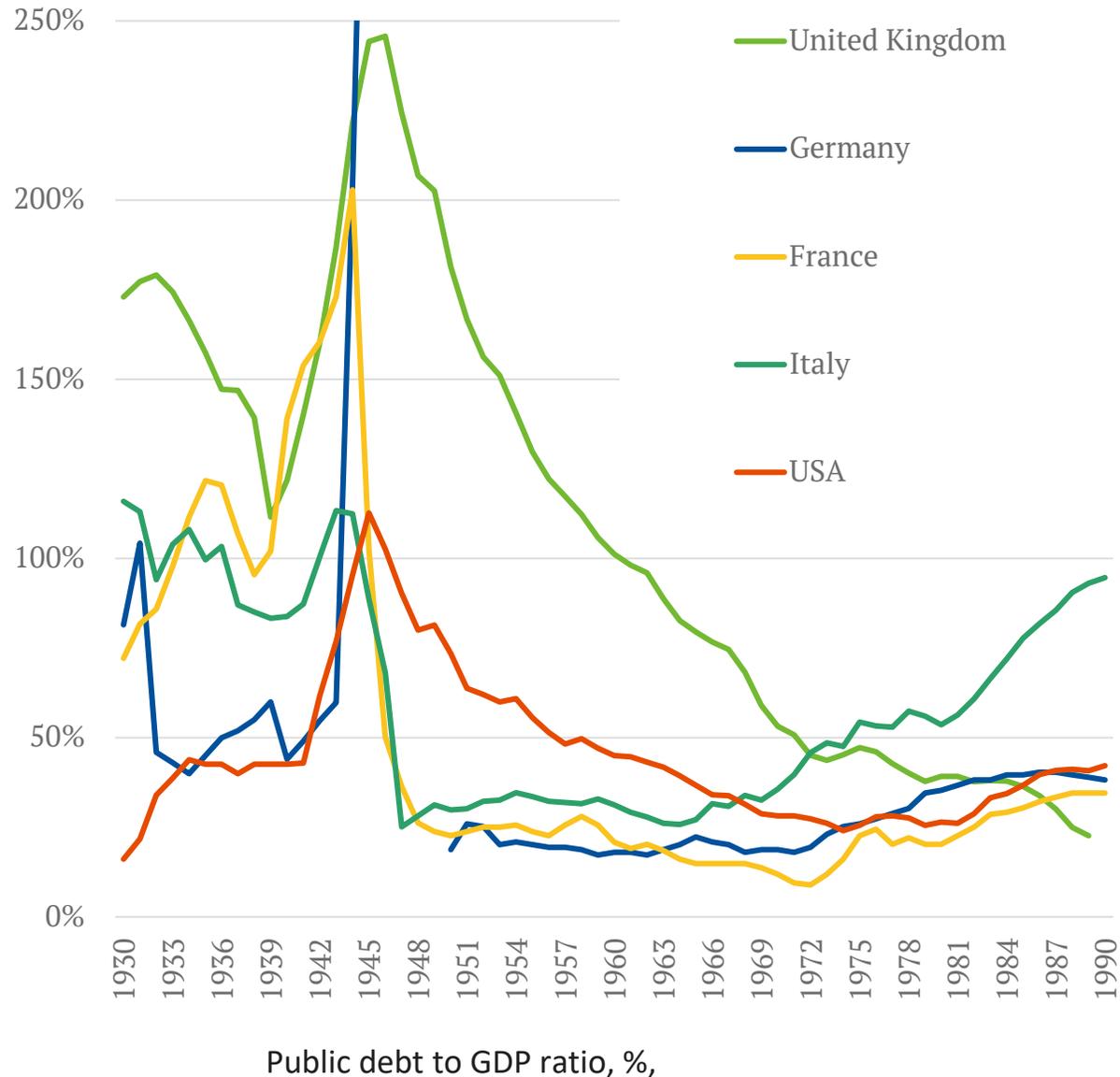
## ABOUT THIS PROJECT

Aid to Ukraine: a rescue rope in times of war – and a hangman's noose in times of peace?

- This note is our first approach to the issue of post-war public debt management and a search for areas for further analysis.
- We have reviewed various cases and mechanisms of debt relief, analyzed the situation in Ukraine and opinions of experts
- The uncertainty is enormous, and decisions will be made in accordance with the actual circumstances of a particular time. Right now we propose general priorities, not a specific roadmap
- Instead of giving recommendations, in our conclusions we present different mechanisms for influencing public debt and provide our assessment of their pros and cons

# INTERNATIONAL EXPERIENCE

# POST-WAR RECOVERY IN EUROPE



## Debt management practices in the USA, UK, France, Italy and Germany

- Countries have "outgrown" their debts due to high nominal economic growth (inflation plus real growth), facilitated, in particular, by the Marshall Plan.
- "Financial repressions" were widely applied - debt rates were artificially lower than inflation
- The London Treaty and the 1948 monetary reform allowed Germany to restructure and cancel the lion's share of its debt
- The UK and the US adhered to the policy of primary budget surplus

Source: The Atlantic, Uk Public Spending, Alternatives Economiques, Banca D'Italia, Jahrbucher Phillips, Matt. "The Long Story of U.S. Debt, From 1790 to 2011, in 1 Little Chart." The Atlantic. 13 November 2014. [Link](#). UK National Debt Since 1900. Uk Public Spending. [Link](#). Evolution of the dette publique française, in % of PIB. Alternatives Economiques. [Link](#). Balasone, Fabrizio, Maura Francesc, and Angelo Pace. "Public Debt and Economic Growth." October 2011. [Link](#).

# POST-WAR RECOVERY IN EUROPE



The United States actively applied financial repressions in combination with a prudent budget policy (ensuring a budget surplus), and managed to reduce the debt from 106% in 1946 to 42% in 1974.

These two factors account for **50 of the 83 percentage points** of debt relief between years 1947 and 1974

Acalin, Julie, and Laurence Ball. Did the U.S. really grow its way out of its WWII debt? CERP. 3 February 2023. [Link](#).

# POST-WAR RECOVERY IN EUROPE



In 1953, Germany restructured its foreign debt as part of the London Agreement.

As part of this agreement, **50% of the debt was cancelled**, and the repayment of the remaining debt was tied to Germany's economic growth and exports (the ratio of public debt service to export revenues was not to exceed 3%).

The economic consequences of the London Debt Agreement, Galofre-Vila et al, 2018, European Review of Economic History, 23. [Link](#)

# INTERNATIONAL DEBT RELIEF INITIATIVES

- **Brady Bonds (1989)** - a large-scale debt restructuring with debt cancellation (16 middle-income countries, including 11 in Latin America). The indirect positive effect of debt relief was three times greater than the direct effect, i.e. countries have received more new capital inflows than debt write-offs due to the effect of eliminating the "debt overhang".
- **Heavily Indebted Poor Countries (HIPC, 1996) and Multilateral Debt Relief Initiative (MDRI, 2006)** - it was agreed to write off part of the debts of poor countries with large debts (37 poor countries, including 31 countries in Africa). However, researchers did not find any major impact on economic growth or investment in these countries, and also no debt overhang effect was observed.
- **"Debt-for-climate" swaps** - the creditor country writes off the debt in exchange for the indebted country's commitment to invest in local climate change projects

# POST-WAR RECOVERY IN EUROPE



Among the main risks of debt relief for indebted countries are potential reputational problems, further debt accumulation, and the possibility of misuse of relieved fiscal resources.

Critics of debt relief point out that partial or complete debt cancellation can solidify the **reputation of a debtor country as one that does not fulfill its obligations**. The emergence of new debt relief initiatives may encourage debtors to further increase their loans in the hope of future debt relief.

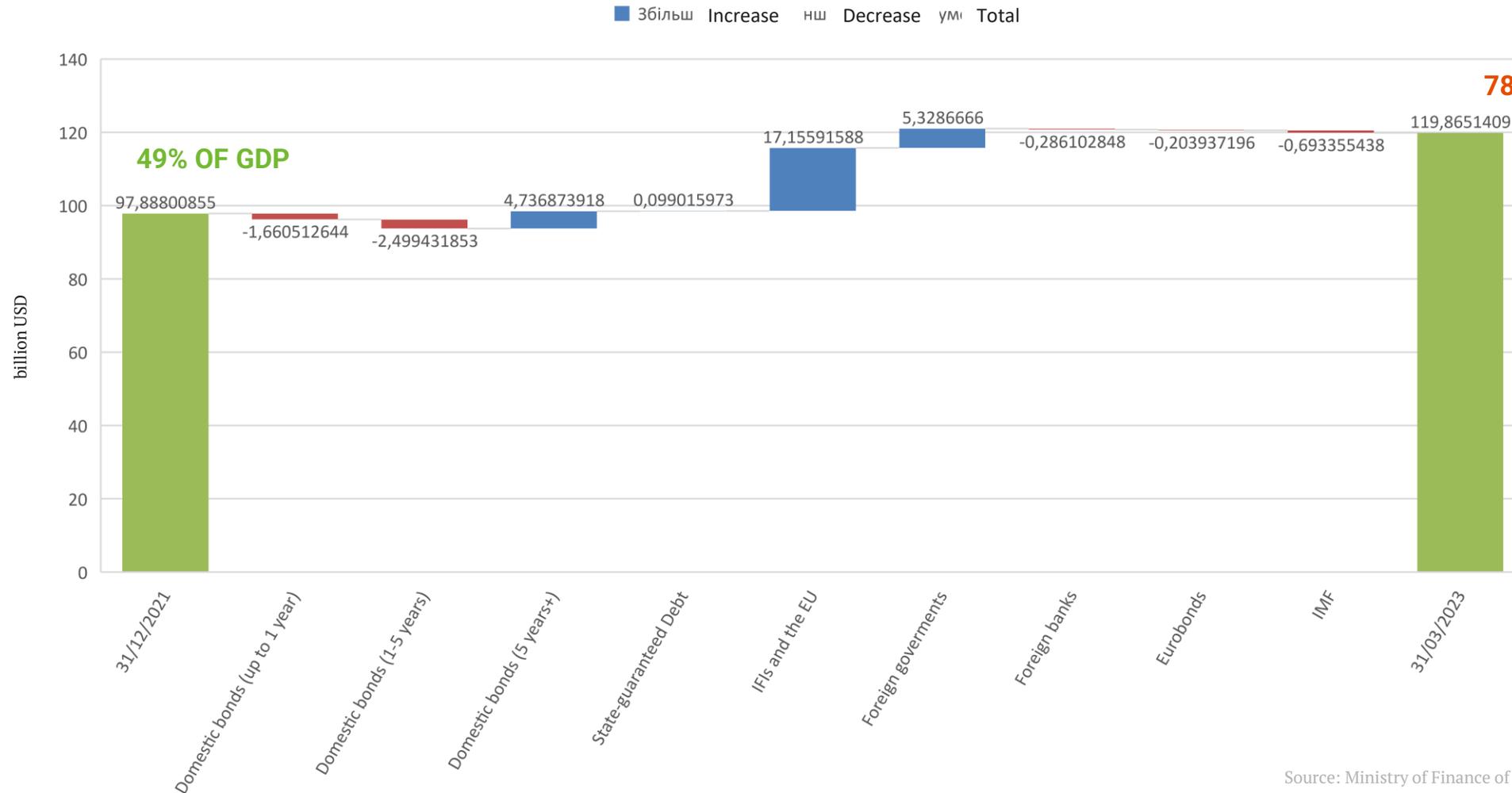
Debt Relief, William Easterly, Foreign Policy, 2001 [Link](#)

How Did Heavily Indebted Poor Countries Become Heavily Indebted? Reviewing Two Decades of Debt Relief, William Easterly, World Development, 2002 [Link](#)

# THE SITUATION IN UKRAINE

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During the war, the debt load increased from 49% of GDP in 2021 to 78% in 2022.



78% OF GDP

49% OF GDP

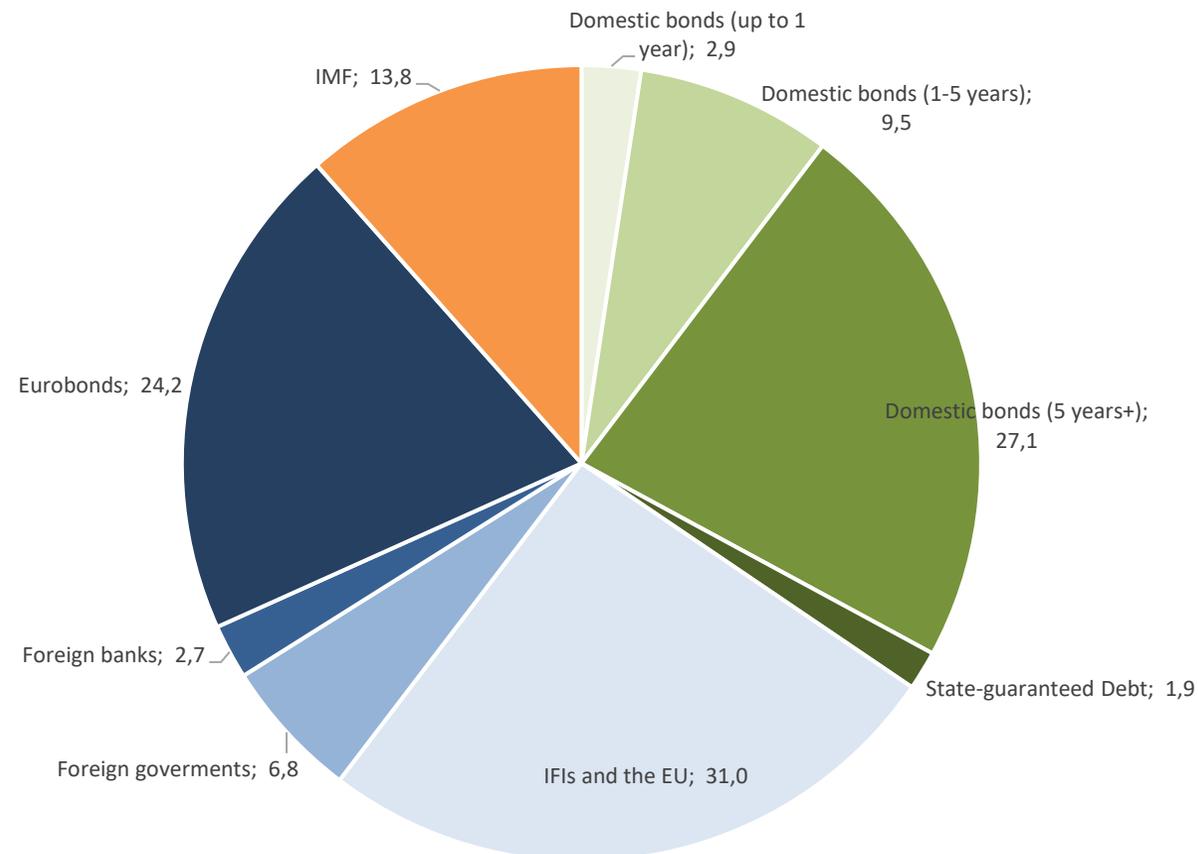
Majority of debt burden increase is **caused by the 29% GDP drop**, and to a lesser extent by the new debt accumulation

18 billion in **grants** in budget revenues; if they were in the form of debt, the debt load would be **86% of GDP**

# THE SITUATION IN UKRAINE

External debt dominates (65% of debt)

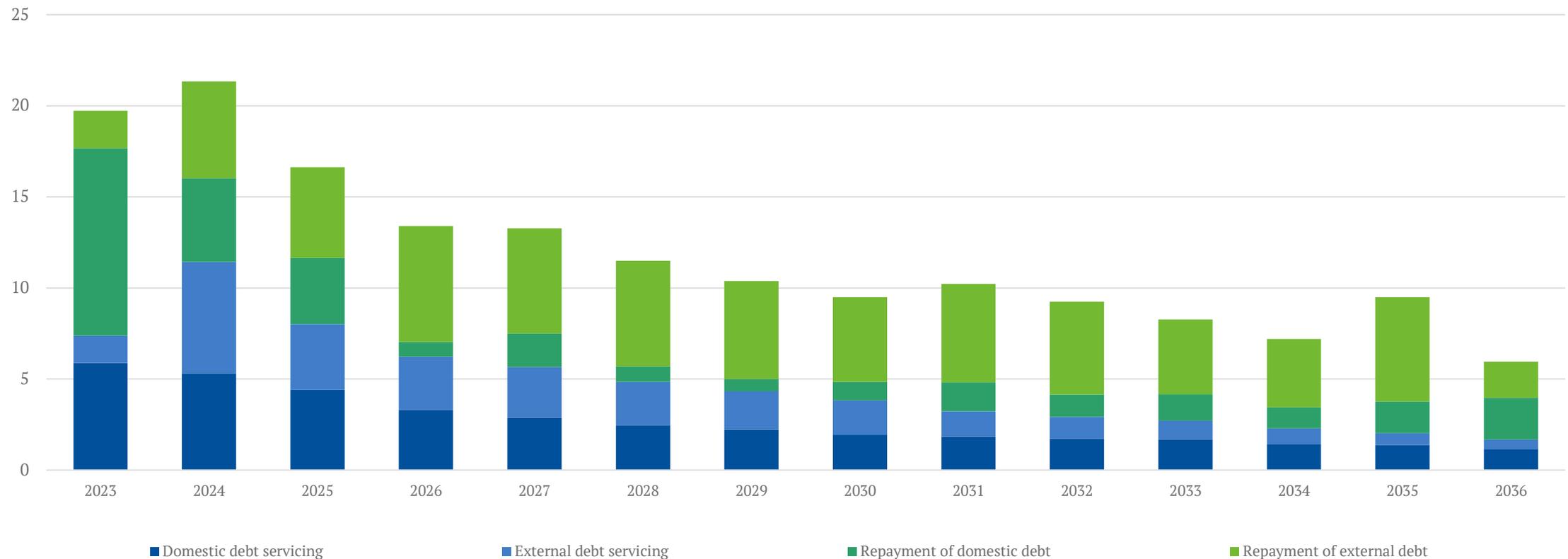
Public and guaranteed debt of Ukraine, as of 31.03.2023, USD billion



Source: The Ministry of Finance of Ukraine, according to the IMF website, the amount of Outstanding Purchases and Loans was SDR 9 billion, or USD 12 billion at the exchange rate as of 31.03.2023

# THE SITUATION IN UKRAINE

Flow is more important than accumulated stock: over the next three years, annual debt payments will average 12% of GDP-2022



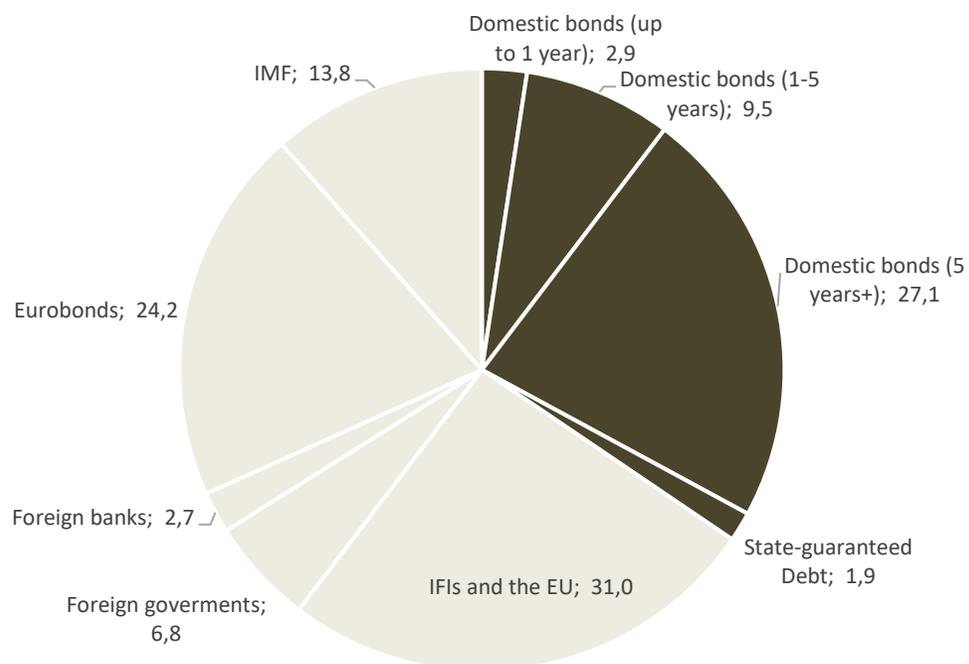
Projected payments on public debt servicing and repayment, as of 01.05.2023,  
USD billion at current exchange rate

Source: Ministry of Finance of Ukraine

# PROSPECTS IN DEBT POLICY

## DOMESTIC GOVERNMENT BONDS - DOMESTIC DEBT

Economic growth, financial repressions, restructuring, refinancing, repayment



Ukraine's public and guaranteed debt,  
31.03.2023, USD billion

Sources: Ministry of Finance of Ukraine

The largest domestic creditor of the government, which holds almost half of the domestic government bonds, is the National Bank; state-owned banks hold about 30%; the rest is distributed among private commercial banks, companies, non-residents, and the Ukrainian population. It means that public finances can only be influenced by the restructuring of \$9 billion in domestic government bonds.

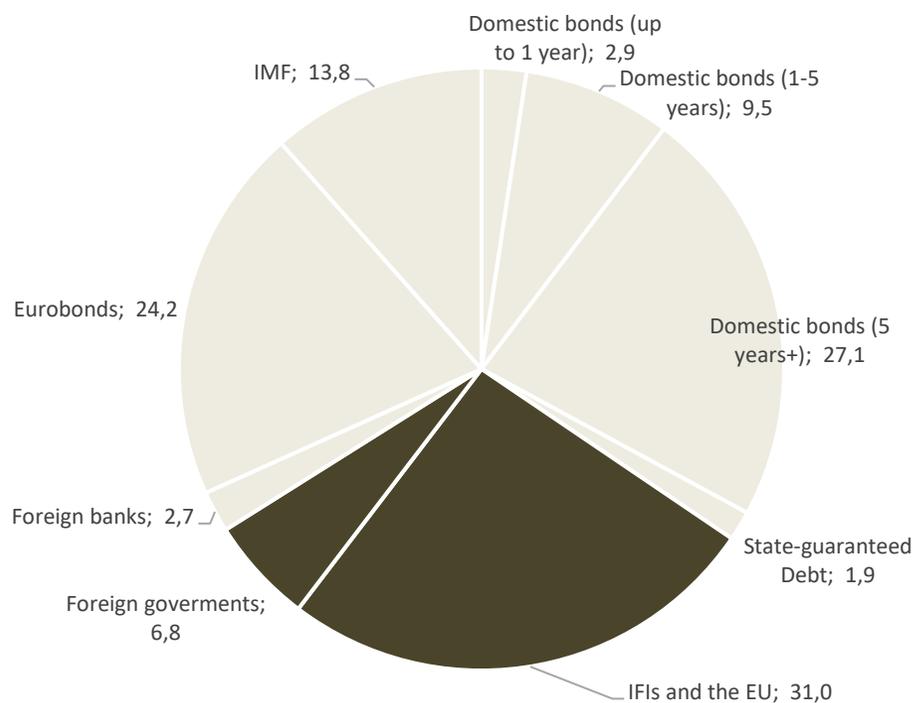
This will cause damage to the financial system (about \$3 billion) and result in a loss of trust of the population (about \$1 billion), which buys military bonds to support the Armed Forces.

The Ministry of Finance tried to use financial repressions (attracting debt at rates lower than inflation) at the beginning of the war, but they didn't work out. After the war, if inflation is high, such debt burden decrease may happen naturally.

Sources: Ministry of Finance, NBU

## DEBTS TO IFIs AND THE EU

Economic growth, ~~financial repressions~~, restructuring, refinancing, repayment



Ukraine's public and guaranteed debt,  
31.03.2023, USD billion

Sources: Ministry of Finance of Ukraine

The \$17.5 billion in loans from the EU and loans from other governments are the softest and most favourable borrowing options one can imagine with a long term to maturity and most favorable interest rates. No restructuring is needed here.

Loans from the other IFIs (\$12 billion) could potentially be discussed as part of the "Debt for Climate" swap initiatives. As a future EU member and a country needing large-scale reconstruction, Ukraine should take advantage of opportunities to invest in "green reconstruction" while reducing its debt burden. "Green growth" is usually included in the mandate of an IFI. Such negotiations could be successful.

Sources: Ministry of Finance

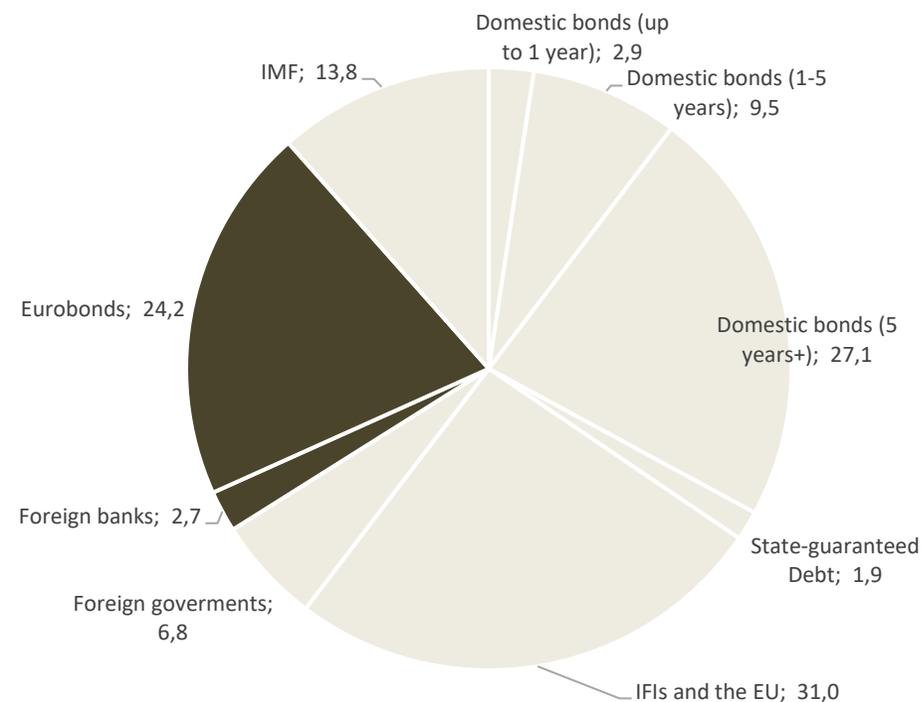
## EXTERNAL COMMERCIAL DEBT

Economic growth, ~~financial repressions~~, restructuring, refinancing, repayment

In 2024, the standstill agreement - a freeze on debt and interest payments on a private debt - will expire.

If the war is not over by then, the debts will have to be restructured. But if the war ends with Ukraine's victory, the government and creditors will have many options, the feasibility of which will depend on specific market conditions at a particular time. One of the options is the extension of the debt service under the terms set out in the current issues' conditions.

Eurobonds on \$3 bn issued under Yanukovich rule to Russia should be excluded from the umbrella and never redeemed



Ukraine's public and guaranteed debt,  
31.03.2023, USD billion

Sources: Ministry of Finance of Ukraine

Maturity extension	Annual ceiling on the interest and principal payments	AAA-rated partner's guarantees
Interest rate	Write-off (or not)	Pledge/securitisation with Russian assets
Warrants (or not)		

## DEBT TO THE IMF

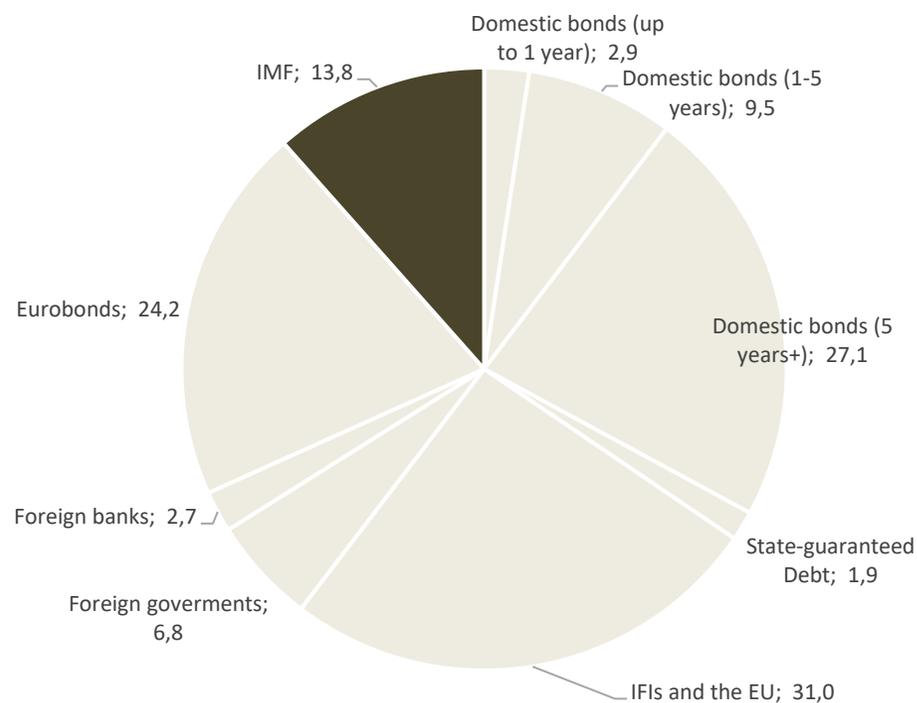
Economic growth, ~~financial repressions, restructuring, refinancing, repayment~~

Debt to the IMF is shorter and more expensive (5-6% per annum)\* than EU concessional loans.

In 2023, the Fund changed its own rules to lend to Ukraine.

The IMF program serves as an anchor for other donors, a reform plan and a reference point for assessing Ukraine's financial needs, and a means of refinancing the current debt to the Fund through subsequent loan tranches.

It is worth to negotiate the lightening of the burden through the more favorable conditions for surcharges and interest, possibly in the form of SDR contributions by other partner countries.



Ukraine's public and guaranteed debt,  
31.03.2023, USD billion

Sources: Ministry of Finance

According to the IMF website, the amount of Outstanding Purchases and Loans was SDR 9 billion, or USD 12 billion at the exchange rate as of 31.03.2023

\*O.Betlii, [Unpacking Ukraine's New IMF Programme - Carnegie Endowment for International Peace](#)

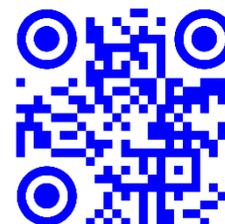
# CONCLUSIONS

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- Decisions on **debt restructuring** should be made carefully, taking into account the type of debt and current market conditions. The only restructuring option that will not bring obvious negative consequences is a "debt-for-climate" swap under agreements with international financial institutions.
- **Economic growth** is the best way to get rid of the high debt burden and the least disruptive for the country. It can be achieved through reconstruction projects and international assistance, within the framework of EU integration, if Ukraine completes its reform homework.
- At the same time, **high inflation**, which helped post-war Europe to reduce its debt, is a very risky approach and does not apply to the majority of public debt issued in foreign currency.
- **The primary budget surplus** should be gradually achieved in the post-war years by expanding the tax base and increasing the efficiency of certain expenditure categories. Still, excessive fiscal austerity for the economy and war-torn citizens threatens to turn into a deep crisis.
- State-owned assets should be **privatized**, if at all, only after the war, when economic growth becomes evident and asset prices rise to bring tangible funds to the state budget.
- **Obtaining funds from the aggressor** as part of reparations and seized assets is the most obvious source of debt repayment and reconstruction of the destroyed, but it will take a long time and a lot of legal work.

THANK YOU FOR YOUR ATTENTION

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