



ANALYTICAL  
NOTE

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# MANAGEMENT OF THE GOVERNMENT DEBT OF UKRAINE DURING THE WAR AND IN THE POST-WAR PERIOD

## ANALITICAL REPORT

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### DATE:

May 10, 2023

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The Centre for Economic Strategy (CES) is an independent center for national policy research. The mission of the CES is to support reforms in Ukraine to achieve steady economic growth in the country. The Centre contributes to the development of Ukraine's economic growth strategy, conducts an independent analysis of the most important aspects of national policy, and works on strengthening public support for reforms. It was established in May 2015.

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The study was conducted with the support of the International Renaissance Foundation.

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# 1. BACKGROUND

So far, Ukraine has managed to keep the debt burden manageable at less than 80% of GDP, and thanks to the partners' help and the creditors' support during the war, the issue of debt repayment is not yet acute. After the war, however, debt management will become one of the key challenges. In 2024-2027, Ukraine's anticipated external debt payments will correspond to 6% of the 2022 GDP, and the problem of peak payments appears as much more important than the overall level of indebtedness relative to the size of the economy. These are not final figures yet because the war continues, and every month Ukraine incurs new debts to cover an unprecedentedly high budget deficit, while the attacks by russians continue to damage the economy daily. Moreover, even during the war, priorities in fundraising may rely upon the expected impact on future post-war repayments.

In this study, we looked at the international experience, mechanisms, and tools that countries have used to reduce their debt burden. To identify the scope for these and other tools in the strategy of government debt management during the war and in the post-war period, we conducted a series of interviews with leading Ukrainian and foreign analysts (Appendix 6.4).

Among the debt reduction factors, we considered the attraction of international aid in the form of grants as well as cheap and long loans; the "financial repression" policy, when interest rates on debts are lower than inflation; economic growth; primary budget surplus; debt restructuring; as well as privatization of state assets and reparations from the aggressor country.

One focus of the study was cooperation with the IMF. For the first time in its history, the Fund is providing loans to a country in a state of war and uncertainty regarding its ability to repay its debts. For this purpose, it has changed its policies. The IMF has been able to approve an Extended Fund Facility program of USD 15.6 billion. The program would make it possible to refinance the debt owed to the Fund, which would otherwise have had to be repaid using aid from other donor countries.

The main conclusion of the paper is that during the war Ukraine should attract as much grant funding and as many ultra-long-term loans at concessional interest rates as possible. And after the war, Ukraine should do all it can for its economic growth and gradually, when the economy recovers, move to a primary budget surplus.

## 2. INTRODUCTION

By publishing this report, we are taking a first approach to the issue of post-war government debt management. We cannot foresee when the war will be over, but we want to provide material to address one of the most important post-war questions – what the state should do with the debts accumulated during wartime.

This question will arise as one of the key considerations for the government's fiscal policy because the answer to it will entail appropriate tax and expenditure policies, private capital markets policy, monetary policy, and a series of regulations in the domestic banking and financial sector. In other words, the answer to the issue of public debt will have a great impact on the economic development of the country.

A debt burden level of 60% of GDP and below meet the criteria used to assess a country's eligibility to join the EU and the sustainability of its fiscal system. Therefore, to accelerate membership, Ukraine will probably want to address the issue of debt burden sooner than within a few decades – the time it took some countries to eliminate their debt after World War II.

Important limitations of the analysis are the lack of certainty regarding the amount of government and guaranteed debt at the end of the war, lack of certainty about estimates of the size of the economy, possible further losses of people, productive assets, and territories, increased volatility in global markets, particularly the situation with interest rates and banks in the United States, disruption of trade chains with the Russia, and tension between the West and China, leaving analysts in a highly uncertain situation.

Considering these facts, instead of recommendations, we present in the conclusions a description of the options for government debt management and our assessment of their pros and cons, as well as situations in which one or another tool would be relevant, in our opinion.

## 3. INTERNATIONAL EXPERIENCE

The countries that went through World War II have unique experiences in managing government debt. The pre-war and post-war periods in the United States, UK, Germany, France, and Italy have been extensively analyzed in academic and policy literature. Based on this information, conclusions can be drawn regarding the instruments used by countries and their more or less positive results in the post-war period.

Reinhart and Sbrancia (2011) identify the following debt burden reduction factors in the world financial history: (i) economic growth; (ii) substantial fiscal consolidation, tight fiscal policy; (iii) default or debt restructuring; (iv) an unexpected inflation surge; and (v) a permanent policy of "financial repression" (maintenance of bond interest rates low against a steady and noticeable level of price increase (inflation)).

Options (iv) and (v) are, however, only relevant for debt denominated in local currency, but they were one of the main factors of debt reduction in post-war Europe in 1946-1970. It was the erosion of government debt value due to price increases (and, consequently, nominal GDP) that, according to researchers' estimates<sup>1</sup>, allowed the United States and the UK to reduce their government debt by 3-4% of GDP annually. Italy, where inflation was higher, reduced its debt by 5% of GDP annually through this mechanism. Cumulatively over 10 years, this resulted in a reduction of the debt-to-GDP ratio by 30-50 percentage points.

IMF analysts<sup>2</sup>, in support of these conclusions, calculated that the main components of debt burden reduction for the 19 developed countries that experienced periods of high debt were primary budget surpluses and the difference between nominal rates on debt and the nominal economic growth rates. Nominal growth was approximately twice as high as nominal interest rates.

An important factor in the recovery of post-war Europe was the Marshall Plan, which reduced the debt burden and accelerated growth. In many countries of the region, the 1950s are considered the years of the "economic miracle". Also, some countries underwent debt restructuring with partial write-offs of the face value, which brought rapid debt relief and allowed for more funds to be directed toward development.

In this section, we will focus in more detail on these and other specific factors that shaped each country's debt policy.

### 3.1. EXPERIENCE OF COUNTRIES AFTER WORLD WAR II

We have analyzed the debt burden reduction experience of Great Britain, Germany, France, Italy, and the United States in the post-war period. The key factor for most of the countries was high inflation, which made servicing domestic debts cheaper. Also, both domestic and foreign debts were frequently restructured. Governments successfully implemented "financial repression,"<sup>3</sup> ensured a primary budget surplus and stimulated economic growth. The debt burden decreased in each of the examined countries (Figure 1). The difference lies in speed: in

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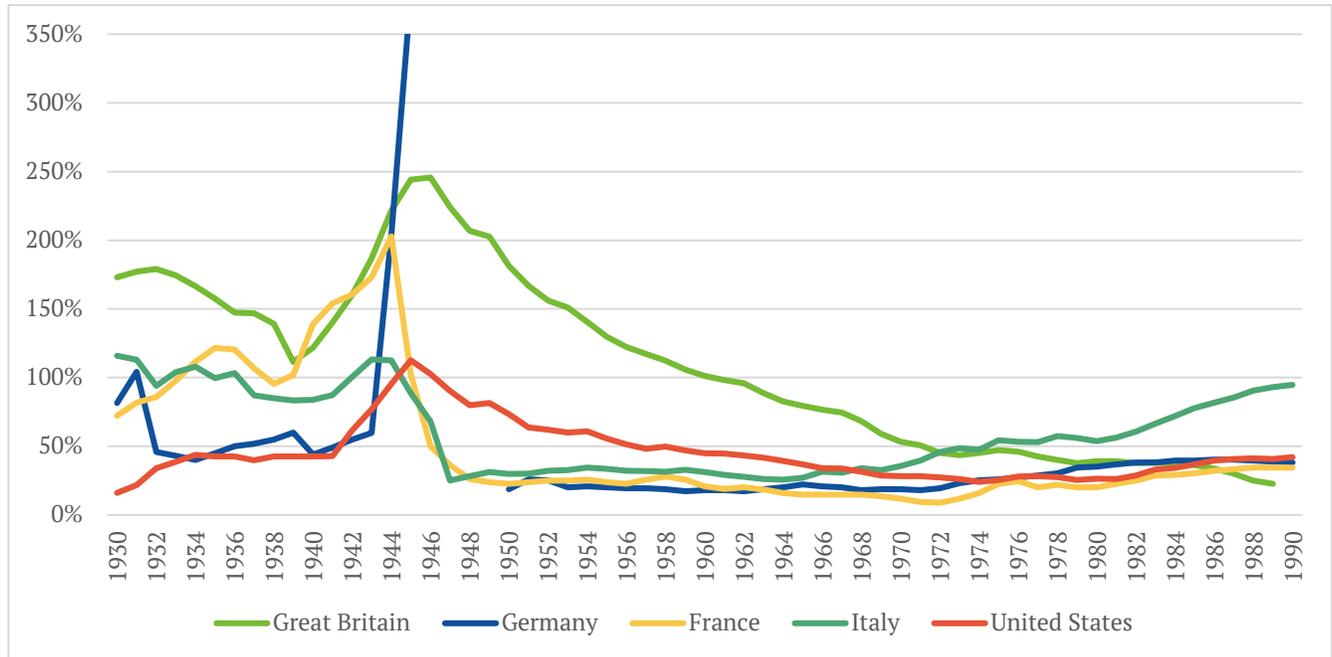
<sup>1</sup> The liquidation of government debt, Carmen M. Reinhart M. Belen Sbrancia, NBER Working Paper, 2011 [Link](#)

<sup>2</sup> Historical Patterns of Public Debt – Evidence From a New Database, Abbas et al., 2011 [Link](#)

<sup>3</sup> Reinhart, Carmen M., and M. Belen Sbrancia. "The Liquidation of Government Debt." IMF Working Paper. № 7. 2015. [Link](#).

Italy, France, and Germany, the government debt-to-GDP ratio went down to 20-30% during the first years after the war, while it took more time for the UK and the United States to reduce their debt burden.

Figure 1. Government debt-to-GDP ratio in 1930-1990, %



Source: The Atlantic,<sup>4</sup> UK Public Spending,<sup>5</sup> Alternatives Economiques,<sup>6</sup> Banca D`Italia,<sup>7</sup> Jahrbücher<sup>8</sup>

The key factor that contributed to the debt burden reduction was **high inflation** in the post-war years. Domestic debts simply depreciated due to price increases.

- High inflation in the UK made it possible to reduce the debt burden from 241% in 1947 to 111% in 1962. In a hypothetical scenario of no inflation, the debt burden would only have fallen to 186% over the same period.<sup>9</sup>
- In Italy, the high inflation in the mid-1940s (about 30% year-on-year at the beginning of the war and 80% toward its end) significantly reduced the country's debt burden. At the height of the war, Italy's government debt-to-GDP ratio reached 80-100%, but by 1947, it fell to its historical minimum of

<sup>4</sup> Phillips, Matt. "The Long Story of U.S. Debt, From 1790 to 2011, in 1 Little Chart." The Atlantic. November 13, 2014. [Link](#).

<sup>5</sup> UK National Debt since 1900. UK Public Spending. [Link](#).

<sup>6</sup> Evolution de la dette publique française, en % du PIB. Alternatives Economiques. [Link](#).

<sup>7</sup> Balasone, Fabrizio, Maura Francese, and Angelo Pace. "Public Debt and Economic Growth." October 2011. [Link](#).

<sup>8</sup> Burret Heiko T., Feld Lars P., and Ekkehard A.Köhler. "Sustainability of Public Debt in Germany." Jahrbücher f. Nationalökonomie u. Statistik. Vol. 233/3. [Link](#).

<sup>9</sup> Quantitative monetary policy and government debt management in Britain since 1919, William A. Allen, Oxford Review of Economic Policy, Volume 28, Number 4, 2012

25.8%.<sup>10,11</sup> This was made possible because the country mainly financed its military expenditures through domestic debt.

- In France, inflation in 1945-1948 was about 50% year-on-year. The French Vichy regime, which collaborated with the Nazis, had no access to foreign markets, so it mainly built up domestic debt. Like in other countries, high inflation helped reduce the debt burden. France's debt burden at the end of the war, in 1944, was 270% of GDP. It rapidly decreased after the war and fell to 15% of GDP within 20 years.

In combination with inflation, "**financial repression**" was implemented, which involved keeping interest rates on debt securities lower than inflation. An example of this policy is when the government, through persuasion, changes regulations for financial institutions and/or employs other intervention options to attract artificially cheap credit to finance budget expenditures in the domestic market. The combination of high inflation and financial repression works as follows: real negative interest rates reduce the debt-to-GDP ratio (this is also called a tax on savers – owners of debt instruments receive less money than their initial investments, adjusted for inflation).<sup>12</sup>

According to calculations made by IMF researchers, in 1945-1980, the real return on government domestic bonds was negative, averaging -0.3% in the United States, -6.6% in France, and -4.6% in Italy.<sup>13</sup>

The United States actively employed financial repression and combined with prudent fiscal policy – ensuring a primary (before interest payments) budget surplus – were able to reduce the debt burden from 106% in 1946 to 42% in 1974. These two factors explain 50 of the 83 percentage points of debt burden reduction from 1947 to 1974.<sup>14</sup> The UK also maintained a primary budget surplus, meaning that new borrowings were only made to cover the interest payments, while expenditures were financed exclusively with their funds. The increase in tax rates played an important role in this in the UK.<sup>15</sup>

Some countries resorted to **debt restructuring** as well. The most interesting case among the countries we have examined is Germany. Its domestic debt, a legacy of the Nazis, was significantly reduced during the 1948 monetary reform, as most of the public debt was converted into Deutschmarks at a rate of 1:10.<sup>16,17</sup> In 1953, the Germans restructured its foreign debt under the London Agreement. As part of this agreement, 50% of the debt was canceled, and the repayment of the remaining debt was tied to the economic growth of Germany and exports (thus, the ratio of public debt service to export income was not to exceed 3%).<sup>18</sup> France also restructured its debt as part of the bilateral agreement with the United States. The Blum-Byrnes agreement involved restructuring the

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<sup>10</sup> Carnazza, G. (2021). La storia del debito pubblico in Italia. [Link](#).

<sup>11</sup> Carlo BASTASIN, Manuel MISCHITELLI and Gianni TONIOLO – Living with high public debt: Italy 1861-2018. [Link](#).

<sup>12</sup> Reinhart, Carmen, and Jacob Kirkegaard. "Financial repression: Then and now." CERP. March 26, 2012. [Link](#).

<sup>13</sup> Mullin, John. "A Look Back at Financial Repression." Federal Reserve Bank of Richmond. [Link](#).

<sup>14</sup> Acalin, Julie, and Laurence Ball. Did the U.S. really grow its way out of its WWII debt? CERP. February 3, 2023. [Link](#).

<sup>15</sup> What the aftermath of WW2 can teach us about where taxes are heading now. Bluesky. [Link](#).

<sup>16</sup> Sustainability of Public Debt in Germany, Burret et al., 2013 –Historical Considerations and Time Series Evidence [Link](#)

<sup>17</sup> Hughes, Michael L. "Hard Heads, Soft Money? West German Ambivalence about Currency Reform, 1944-1948." German Studies Review. Vol.21. № 2. May 1998. [Link](#).

<sup>18</sup> The economic consequences of the London Debt Agreement, Galofre-Vila et al, 2018, European Review of Economic History, 23. [Link](#)

country's debt to the United States with a write-down of USD 2 billion, a reduction in interest rates, and an extension of the maturity period.<sup>19</sup>

Another factor contributing to the reduction of the debt burden was **economic growth**. The German "Miracle on the Rhine" brought average annual economic growth rates of 7.5% in the 1950s. Both France and Italy had high rates of economic growth (averaging 5-6% a year in the 1950s and 1960s). This reduced the debt-to-GDP, making debt payments easier for budgets.<sup>20,21</sup>

In addition, the **financial assistance under the Marshall Plan** – a manifestation of U.S. interest in the reconstruction and long-term recovery of Europe – contributed to the reduction of the debt burden in European countries. For example, the UK used almost the entire amount of the funds received (USD 3.1 billion of USD 3.2 billion, or 97%) to pay the debt.<sup>22</sup>

## 3.2. REPARATIONS AS A SOURCE OF FINANCIAL RESOURCES

After the end of World War II, at the Potsdam Conference, in 1945, Germany was obligated to pay reparations to many European countries, including Czechoslovakia, Denmark, France, Greece, the Netherlands, the United Kingdom, the United States, Yugoslavia, etc. The list also included Poland, but in August 1953, due to pressure from the USSR, they waived their right to further war reparations from East Germany.<sup>23</sup> Those reparations were paid in the form of industrial machinery, equipment, and resources.<sup>24</sup>

Also, according to the Treaty of Peace signed on February 10, 1947, in Paris, Italy – as an aggressor country – committed to paying reparations amounting to USD 360 million (125 million to Yugoslavia, 105 million to Greece, 100 million to USSR, 25 million to Ethiopia, and 5 million to Albania). These funds were paid over a period of seven years, mainly in the form of machinery and equipment, which were supplied to these countries for reconstruction and infrastructure development.<sup>25</sup>

In the case of Yugoslavia, the damages were estimated at USD 9.15 billion, which was equal to about 50% of the national wealth. However, the country received less than 1% of its estimated damages from Germany and only USD 125 million, which was equal to 1.4% of its losses.<sup>26</sup> At the same time, the United States, realizing the importance of Yugoslavia in the Cold War, offered the country additional financial aid of USD 50 million under the Emergency Relief Assistance Act for Yugoslavia in 1950, and a year later – military aid under the Mutual

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<sup>19</sup> Blum-Byrnes Agreement. Icff.co.uk. [Link](#).

<sup>20</sup> Bianchi, Nicola, and Michela Giorcelli. "Reconstruction Aid, Public Infrastructure, and Economic Development: The Case of the Marshall Plan in Italy." NBER. December 2021. [Link](#).

<sup>21</sup> History of the European Union 1945-59. EU. [Link](#).

<sup>22</sup> Tony, Judt. Postwar: A History of Europe since 1945. Our Format. 2020. 928 p.

<sup>23</sup> "The legal questions behind Poland's claim for war reparations from Germany." Notes from Poland. September 9, 2022. [Link](#).

<sup>24</sup> Agreement on reparation from Germany, on the establishment of an Inter-Allied Reparation Agency and on the restitution of monetary gold. United Nations Treaty Services. [Link](#).

<sup>25</sup> Treaty of Peace between the Allied and Associated Powers and Italy. February 10, 1947. [Link](#).

<sup>26</sup> Lajbenserger, Nenad. "Yugoslavia and reparation after second world war." LIMESplus. № 2-3. 2018. [Link](#).

Security Act. Thus, by 1953, Yugoslavia's budget deficit was covered by U.S. aid,<sup>27</sup> but not at the expense of reparations though.

The Soviet Union received reparations from Hungary and Romania as Hitler's former allies. In 1948, Romanian reparations accounted for 15% of their national income, and Hungarian reparations – to 17%. According to estimates, by the end of the 1950s, the Soviet Union received significantly more from East Germany, Romania, and Hungary than it spent on controlling these countries. In Czechoslovakia, expenditures were offset by the inflows. Aid to Bulgaria and especially to Poland from 1945 to 1960 probably cost Moscow far more than it returned through trade and other revenues.<sup>28</sup>

After Iraq's defeat in the Persian Gulf in 1991, the United Nations ordered Iraq to pay USD 52.4 million to Kuwait. Initially, payments were made from a 30% of Iraq's oil export revenues. However, this share was reduced several times, and in 2017 it decreased to 3%. Reparation payments took 31 years (Iraq made its last payment only in February 2022)<sup>29</sup> due to their temporary suspension in 2014-2018.<sup>30</sup>

However, reparations for post-colonial countries, mostly located in Africa, remain an unresolved task. In 2013, the UK paid USD 30 million to Kenyan survivors of British repression in the 1950s in Kenya, after a 4-year trial.<sup>31</sup> Only in 2022, after more than 100 years of genocide against Namibians, Germany agreed to pay Namibia 1.1 billion euros in reparations.<sup>32</sup> But these are only isolated cases of guilt recognition and payment of reparations – other countries have never been able to obtain compensations from the countries on which they were previously dependent. An illustrative example is the Caribbean countries, which have been demanding reparations from European countries for nearly a decade,<sup>33</sup> but so far without any success. Also, Jamaica demands USD 10.6 billion from the United Kingdom, while Burundi seeks USD 43 billion from Germany and Belgium. However, these cases are unlikely to be resolved due to the lack of political pressure from the former colonial state or diplomatic inducement.<sup>34</sup>

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<sup>27</sup> Tony, Judt. *Postwar: A History of Europe since 1945*. Our Format. 2020 and 928 p.

<sup>28</sup> Tony, Judt. *Postwar: A History of Europe Since 1945*. Our Format. 2020. 928 p.

<sup>29</sup> Iraq makes final reparation payment to Kuwait for 1990 invasion. UN News. February 9, 2022. [Link](#).

<sup>30</sup> Iraq pays last chunk of \$52.4 billion Gulf War reparations. Reuters. February 9, 2022. [Link](#).

<sup>31</sup> Cowell, Alan. "Britain to Compensate Kenya Victims of Colonial-Era Torture." *The New York Times*. June 6, 2013. [Link](#).

<sup>32</sup> Kaledzi, Isaac. "Africa revives push for colonial-era reparations." *DW*. April 8, 2022. [Link](#).

<sup>33</sup> Kedmey, Dan. "14 Caribbean Nations Sue Former Colonizers for Slave Trade." *TIME*. March 11, 2014. [Link](#).

<sup>34</sup> Fisher, Max. "The Long Road Ahead for Colonial Reparations." *The New York Times*. August 27, 2022. [Link](#).

### 3.3. GRANTS AS A LONG-TERM SOURCE OF FINANCIAL RESOURCES

Non-refundable financial assistance (grants) is a tool to cover budget deficits without increasing a country's debt burden.

Israel is one of those countries that has been in a constant armed conflict with several Arab countries since its independence. Nevertheless, it has managed to reduce the debt-to-GDP ratio from 160% in the mid-1980s to 60.9% in 2022.<sup>35,36</sup>

This achievement was largely due to non-repayable financial assistance from the United States. They provided USD 158 billion (the funds were allocated for both economic stability and defense needs) from 1948 to 2022,<sup>37</sup> as well as cooperation with the IMF in 1992 and the World Bank. From 1991 to 2003, the annual amount of grants from the United States during this period was about USD 3.5 billion, which accounted of 2.5% of GDP and 6.5% of budget revenues.<sup>38,39</sup> In subsequent years until 2021, the share of grants to GDP began to decrease to 1-1.5%, and to the budget – grants averaged 3-4%.<sup>40,41,42,43,44</sup>

Nevertheless, it should be admitted that Israel is the only known example of a developed country that has successfully used grant financing to such an extent.

### 3.4. INTERNATIONAL INITIATIVES

#### 3.4.1. DEBT-FOR-CLIMATE SWAP

One of the most promising ways to reduce the debt burden of debtor countries while promoting the implementation of environmental projects is through debt-for-climate (DfC) swaps. This is a type of debt swap under which a creditor writes off a debt in exchange for the debtor country's commitment to invest funds in local climate change projects.

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<sup>35</sup> Israel Review of the Financial System. *OECD*. September, 2011. [Link](#).

<sup>36</sup> Israel Government Debt to GDP. *Trading Economics*. Accessed on January 16, 2023. [Link](#).

<sup>37</sup> U.S. Foreign Aid to Israel. Congressional Research Service. March 1, 2023. [Link](#).

<sup>38</sup> Israel: Staff Report for the 1999 Article IV Consultation. IMF. April 21, 2000. [Link](#).

<sup>39</sup> Israel: 2003 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion. IMF Country Report № 158. June 2004. [Link](#).

<sup>40</sup> Israel: Staff Report for the 2009 Article IV Consultation. IMF. January 27, 2010. [Link](#).

<sup>41</sup> Israel: Article IV Consultation–Press–Release; Staff Report; and Statement by the Executive Director for Israel. IMF. September 16, 2015. [Link](#).

<sup>42</sup> Israel: 2002 Article IV Consultation – Press Release and Staff Report. IMF Country Report № 81. March 21, 2022. [Link](#).

<sup>43</sup> U.S. Foreign Aid to Israel: Total Aid (1949-Present). Jewish Virtual Library. [Link](#).

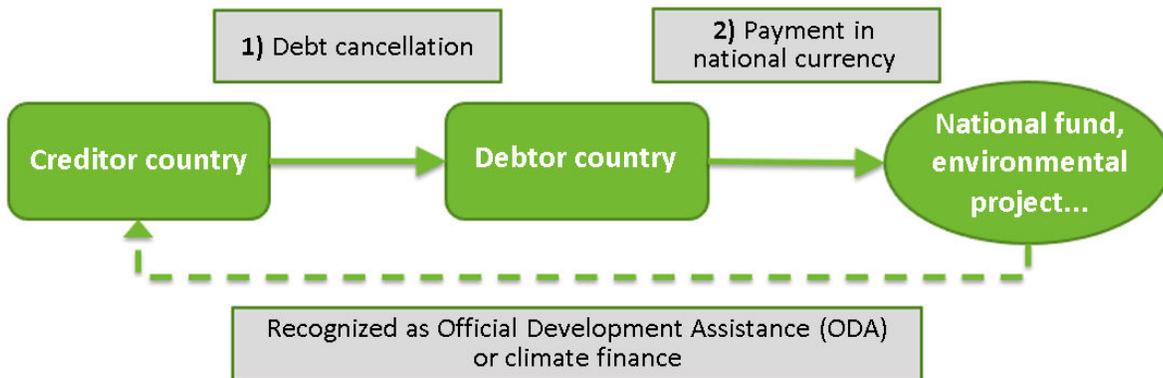
<sup>44</sup> GDP (current US\$) – Israel. The World Bank Data. [Link](#).

DfCs allow debtor countries to reduce their debt burden and allocate fiscal resources to green investments.<sup>45</sup> Another advantage of DfCs for the debtor country is that the freed-up funds are directed towards financing projects within the country – this stimulates the economy and at the same time eliminates the need to buy foreign currency to pay off the debt. For creditors, DfCs is beneficial for two reasons: firstly, reduction of the debt burden on the debtor will potentially increase the likelihood of paying off the remaining debt; secondly, the creditor can account for debt written off under DfC as its contribution to climate finance or development assistance.<sup>46</sup>

Debt-for-climate swaps are not a new concept. DfCs date back to the 1980s when “debt-for-nature” swaps (DfNs) were first applied. The difference between this type of swap and “debt-for-climate” is its greater focus on environmental projects aimed at the preservation of the environment. DfC is a broader concept, and “debt-for-climate” swap projects can be aimed at other climate projects – for example, the development of green energy.

There are two models for implementing debt-for-climate swaps. The first, basic model involves direct negotiations between the creditor and the debtor: in exchange for canceling the debt, the debtor commits to invest funds in a certain climate change initiative. The second, tripartite model, involves an intermediary: usually a nongovernmental organization that buys the debt from the creditor at market value and writes it off in exchange for the debtor's commitment to invest in combating climate change. The tripartite model is less flexible as it requires the involvement of an intermediary and is capable of attracting smaller amounts of funds for environmental projects. The tripartite model was typical of debt-for-nature swaps; the basic model is more typical for DfC swaps, such exchanges can be more extensive.<sup>47</sup>

#### The basic model of a debt-for-climate swap:



<sup>45</sup> Debt for Climate Swaps Supporting a sustainable recovery – Climate Policy Initiative. [Link](#)

<sup>46</sup> Debt-for-climate swaps Developing countries – IKEM. [Link](#)

<sup>47</sup> Debt for Climate Swaps Supporting a sustainable recovery – Climate Policy Initiative. [Link](#)

## Tripartite model of a debt-for-climate swap:



Source: IKEM<sup>48</sup>

The first successful debt-for-nature swap took place in Bolivia in 1987. At that time, Conservation International, a non-profit organization, purchased USD 650,000 of Bolivian debt on the secondary market and canceled it in exchange for Bolivia's commitment to enhance the protection of the local Beni Biosphere Reserve and allocate USD 250,000 to support the operation of the reserve.<sup>455</sup> One of the recent successful examples of a DfN swap is the Seychelles case: The Nature Conservancy, an American non-profit organization, bought on the market and wrote off almost USD 22 million of Seychelles' debts in exchange for enhanced protection of the country's territorial waters. Over five years, the area of protected waters has grown from 0.04% to 30% of the country's territorial waters, preserving valuable coral reefs and several rare mammal species from extinction.<sup>49</sup>

However, critics point out that since the 1980s, debt-for-nature swaps have only generated a little more than USD 1 billion for environmental projects, which is not enough to make definitive changes for the better.<sup>50</sup>

Proposals for implementing debt-for-climate swaps are being made more and more often. The idea is particularly popular in small island developing states, as the problem of climate change is extremely acute for them because of the threat of flooding due to rising world ocean levels. DfC swaps for such countries have been called one of the most promising ways to finance climate change projects because they would also free up fiscal resources for other pressing needs such as health care or education.<sup>51,52</sup> The implementation of debt-for-climate swaps for Caribbean countries is being discussed at the regional level within the framework of the Commonwealth of Nations.<sup>53</sup> At the international level, the United Nations supports the widespread adoption of debt-for-climate swaps to assist the implementation of the Paris Agreement arrangements.<sup>54</sup> According to available information, the World Bank and the IMF were expected to announce their joint support of DfC swaps at the COP26 climate

<sup>48</sup> Debt-for-climate swaps Developing countries – IKEM. [Link](#).

<sup>49</sup> The deal that saved Seychelles' troubled waters – BBC. [Link](#)

<sup>50</sup> IMF struggling over long-awaited 'green debt swap' push as COP26 nears. [Link](#)

<sup>51</sup> Debt for Climate Swaps: Caribbean Outlook. [Link](#)

<sup>52</sup> Debt-for-climate swaps for small islands. [Link](#)

<sup>53</sup> Debt-for-Climate Swaps Innovative Financial Instruments for Public Debt Management in the Caribbean. [Link](#).

<sup>54</sup> Debt-for-Climate Swaps as a Tool to Support the Implementation of the Paris Agreement. [Link](#)

forum, but the institutions decided to "continue discussions".<sup>55,56</sup> Instead, the President of Argentina announced his support for debt-for-climate swaps at COP26.<sup>57</sup>

### 3.4.2. BRADY BONDS' INITIATIVE

In March 1989, U.S. Treasury Secretary, Nicholas Brady established a debt relief program known as the Brady Plan. Its essence was a large-scale restructuring of the debts for 16 middle-income countries, 11 of which were in Latin America. Private creditors agreed to write off part of the debts (an average of 35%) of the debtor countries; in return, they received special bonds from the debtors that could be freely traded. As collateral, 30-year US Treasury securities were used, specifically issued for the implementation of the Brady Plan. Mexico became the first country to take advantage of the Brady Plan in September 1993; other countries joined gradually throughout the first half of the 1990s. A mandatory condition for a country's participation in the plan was a commitment by the government to implement certain necessary economic reforms agreed upon during the negotiations. Overall, the Brady Plan was quite a success: the participating countries wrote off approximately USD 60 billion of debts; also, within 5 years of the debt settlement, the countries received a capital inflow of USD 210 billion – before that, most of all countries experienced an outflow of financing and investment.<sup>58</sup>

The results of the Brady Plan serve as a vivid illustration of the direct and indirect effects of debt relief. The direct one involves the debt write-off *per se* and the release of fiscal resources; the indirect one consists in "resetting" the country's reputation and increased financing (including credit). In the case of Brady Plan participant countries, the indirect effect of debt relief was three times greater than the direct one, indicating its greater importance. This occurs, in part, due to the debt overhang effect when a country's debt burden is so high that the government has problems attracting new financing. The negative effect of debt overhang at the macro level has been theoretically investigated since the 1980s, particularly in the works of economists Paul Krugman and Jeffrey Sachs;<sup>59</sup> later, the existence of this relationship has been empirically confirmed.<sup>60</sup>

### 3.4.3. HIPC INITIATIVE

The next phase of debt relief after Brady Bonds was the initiative to alleviate the debt burden for poor countries with high debt, known as the Heavily Indebted Poor Countries (HIPC) initiative, launched in 1996. The Brady Plan was aimed at middle-income countries suffering a debt crisis because of excessive borrowing in the 1970s-1980s and a further decline in resource prices.<sup>61</sup> The HIPC initiative, on the other hand, focused on the world's poorest countries that were systematically in debt crisis, which worsened their governments' ability to finance key sectors such as education and health care.

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<sup>55</sup> Erdogan says Turkey signed \$3.2 bln green climate fund deal. Reuters. October 27, 2021. [Link](#).

<sup>56</sup> It is Time for Middle-Income Countries to Be Part of Debt Relief Initiatives for a Green and Inclusive Recovery: Alicia Bárcena. CEPAL. June 28, 2021. [Link](#).

<sup>57</sup> In his speech at COP26, Alberto Fernández pressured the IMF for a "debt swap to finance climate actions." [Link](#)

<sup>58</sup> Debt Relief (2006). [Link](#)

<sup>59</sup> Financing vs. Forgiving a Debt Overhang. [Link](#).

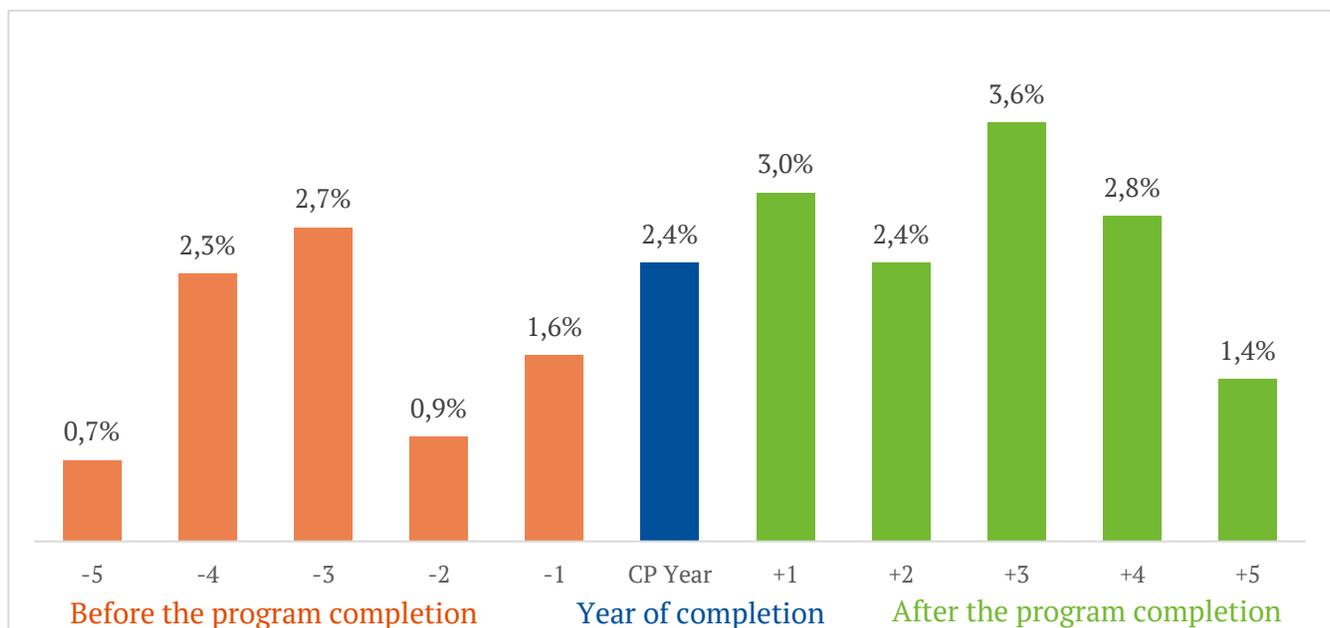
<sup>60</sup> Aid, Debt Relief and New Sources of Finance for Meeting the Millenium Development Goals. [Link](#)

<sup>61</sup> Latin American Debt Crisis of the 1980s. [Link](#)

Over the years of the initiative's operation, 37 countries, 31 of which were in Africa, were granted full or partial cancellation of debts totaling \$76 billion (an average of 65% of their debts.<sup>62</sup> In 2006, a new program of the Multilateral Debt Relief Initiative (MDRI) was launched within the HIPC paradigm, which was organized by the G8 countries. MDRI was an extension of the HIPC initiative: debt relief of USD 55 billion was agreed upon, and another USD 5 billion was allocated for the program by the IMF.<sup>63</sup>

Most experts agree that the Brady Plan worked well, but the scientific community is much more skeptical towards HIPC and MDRI. The programs faced several issues. At the outset of the HIPC initiative, the decision to allow a certain country to participate in the program was based more on political rather than on economic rationality – debt relief was provided not to the countries that would derive the greatest economic benefit from it but rather to those that would provide the largest political dividends to creditor countries.<sup>64</sup> Debt relief under these programs did not have a significant impact on economic growth, investments, and foreign direct investments. However, it did improve public administration practices by incorporating institutional reforms' requirements into the conditions for receiving debt relief.<sup>65</sup>

Figure 2. Average GDP growth per capita in HIPC countries in the year of debt relief completion (CP Year), for 5 years before and 5 years after the CP, %



Source: IMF<sup>66</sup>

<sup>62</sup> Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative. [Link](#)

<sup>63</sup> Multilateral Debt Relief Initiative – Q&A. [Link](#)

<sup>64</sup> Debt Relief and Governance Quality in Developing Countries. [Link](#)

<sup>65</sup> Debt-Relief Effectiveness and Institution-Building. [Link](#)

<sup>66</sup> Does Lower Debt Buy Higher Growth? The Impact of Debt Relief Initiatives on Growth. IMF. December 18, 2014. [Link](#).

Average GDP per capita growth in HIPC initiative participant countries during the 5 years after they reached the completion point (CP) of the program was about 2.6% per year, only 1 p.p. higher than the average annual growth in the five-year period before reaching the completion point (Figure 1). There is no empirical evidence of a positive effect of debt relief on investments in HIPC countries. The increase in GDP growth rates is attributed not so much to the direct effect of debt relief as to the positive effects of economic, political, and social reforms, which were a condition of the countries' participation in the HIPC initiative.<sup>67</sup>

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<sup>67</sup> Does Lower Debt Buy Higher Growth? The Impact of Debt Relief Initiatives on Growth. [Link](#)

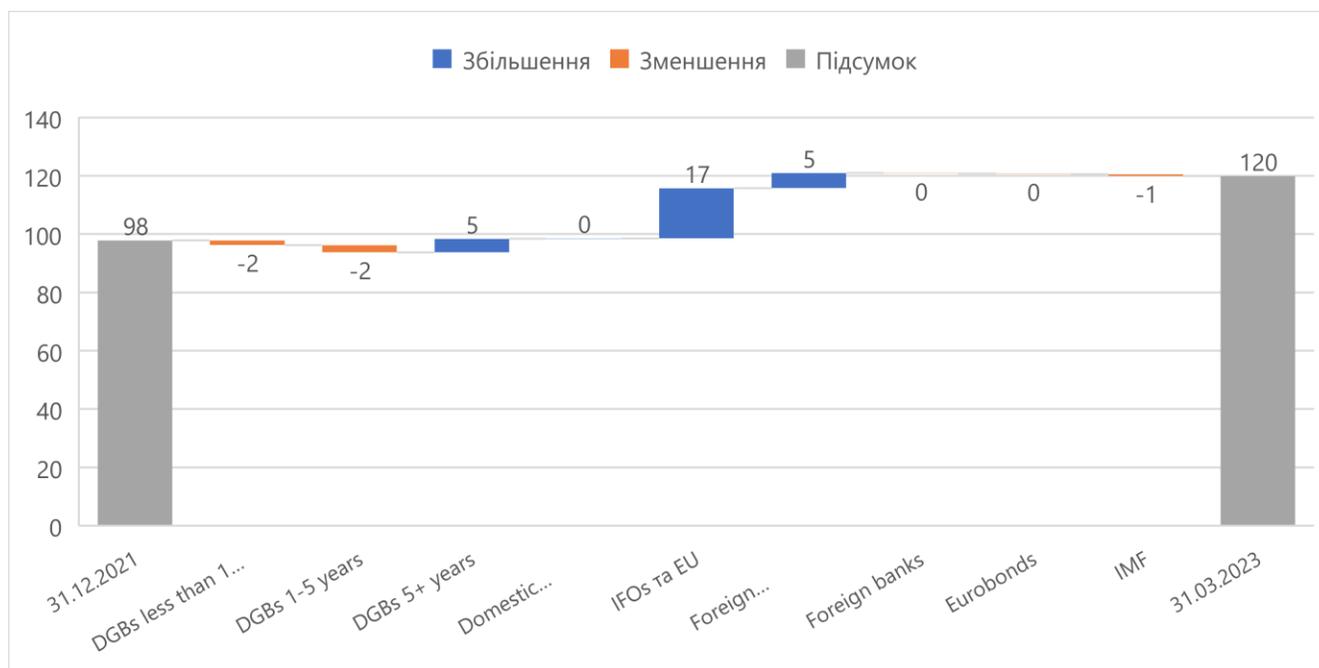
## 4. UKRAINE. GOVERNMENT DEBT SITUATION

### 4.1. DEBT SITUATION IN 2023

In 2015-2019, Ukraine pursued a prudent fiscal and debt policy, aiming to maintain a budget deficit of up to 3% of GDP and trying to keep a primary (pre-interest payment) budget surplus, and reducing its debt burden from 79% of GDP to 49% of GDP<sup>68</sup>. However, in 2022, a full-scale war began.

Due to a year of financing very high military spending for Ukraine and the related budget deficit (16.3% of GDP in 2022)<sup>69</sup>, the total amount of government and guaranteed debt rose to USD 120 billion. Ukraine had neither access to the foreign market, nor resources on the domestic market. As a result, the government's liabilities to the NBU in the form of long-term domestic government loan bonds (DGBs) (monetary financing) increased, and so did the external debt – from USD 48 billion in 2021 to USD 71 billion as of March 31, 2023, because the financial assistance from Western partners was not always in the form of grants.<sup>70</sup>

Figure 3. Change in public and guaranteed\* debt by category, from December 31, 2021, to March 31, 2023, billion USD.



Source: Ministry of Finance, \*guaranteed debt is included in the debt owed to IFOs, other governments, foreign banks, Eurobonds, and debt owed to the IMF

<sup>68</sup> For more details, see Appendices 6.1 and 6.2 for an overview of the historical national debt situation.

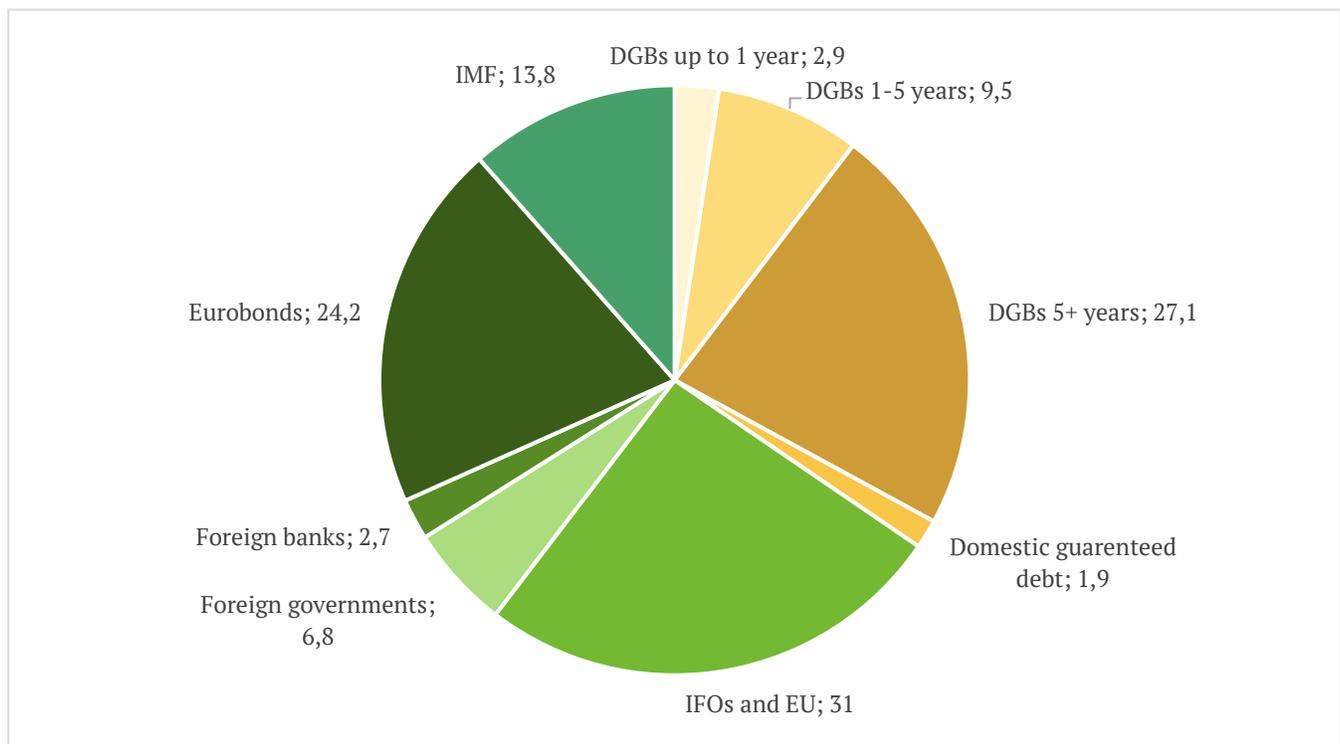
<sup>69</sup> Inflation report, April 2023. NBU. May 4, 2023. [Link](#).

<sup>70</sup> "Public and publicly guaranteed debt of Ukraine as of March 31, 2023." Ministry of Finance of Ukraine. [Link](#).

Moreover, the country's economy fell by almost a third - the loss of 12% of the territories controlled by Ukraine in 2021 (20% at the peak of the invasion), mass population migration, the brutal shelling of cities and energy infrastructure, and multiple increases in business risks led to a 29% decline in GDP in 2022. The devaluation of hryvnia led to the reassessment of debt denominated in foreign currency. As a result, by the end of 2022, the government and guaranteed debt-to-GDP ratio was 78%.<sup>71</sup>

A significant amount of international financial support in the form of grants (USD 17.7 billion from January 2022 to March 2023)<sup>72</sup> made it possible to slow down the growth of the debt burden, which otherwise would have exceeded 86%.

Figure 4. Government and guaranteed debt of Ukraine as of March 31, 2023, billion USD.



Source: Ministry of Finance of Ukraine<sup>73</sup>

As of the end of March, the external debt accounted for approximately 65% of the total government and guaranteed debt. More than half of it was concessional long-term loans from donors and foreign countries (EU, IBRD, IMF, Canada, and EIB being the largest creditors), provided on exceptionally favorable terms with maturity up to 35 years, grace periods of up to 10 years for principal repayments, and low-interest rates (more information

<sup>71</sup> "Ukraine's government debt rose to 78.5% of GDP over the year - Ministry of Finance." Ukrinform news agency. April 20, 2023. [Link](#).

<sup>72</sup> NBU statistics on state budget revenues. [Link](#).

<sup>73</sup> "Public and publicly guaranteed debt of Ukraine as of March 31, 2023." Ministry of Finance of Ukraine. [Link](#). According to the IMF website, Outstanding Purchases and Loans amounted to SDR 9 billion, or USD 12 billion at the exchange rate in effect as of March 31, 2023 [Link](#)

about the loan terms can be found in Appendix 6.3).<sup>74,75,76</sup> There are also obligations on Eurobonds and commercial loans from banks and other foreign financial institutions. The largest domestic lender to the government, holding almost half of the DGBs, is the NBU;<sup>77</sup> another 30% is held by state-owned banks<sup>78</sup>, and the rest is distributed among private commercial banks, companies, non-residents, and the Ukrainian population.

## 4.2. UKRAINE AND IMF

Ukraine's debt owed to the IMF was nearly USD 14 billion as of March 31, 2023, according to the Ministry of Finance.<sup>79</sup> This year, for the first time in its history, the IMF compromised on the rule of not lending to countries with high uncertainty of the debt sustainability.<sup>80</sup> To do so, the Fund had to change its rules in March 2023<sup>81</sup>.

Over the years, the IMF has played a crucial role in promoting economic development and stability in Ukraine. Since its accession in 1994, Ukraine has become one of the largest debtors of the Fund, with more than SDR 36.6 billion borrowed over the years (USD 48.8 billion as of April 2023). The role of the IMF became even greater in times of war, as the existence of a program with the Fund and its assessment of Ukraine's needs is an important component of the trust of other donors providing financial assistance to our country.

Ukraine has mostly drawn money from the IMF through various stand-by arrangements. In March 2022, the Ukrainian authorities submitted a request for terminating the agreement of June 2020 to open the way for an emergency loan through the Fund's Rapid Financing Instrument (RFI). At the end of March 2023, a four-year USD 15.6 billion Extended Fund Facility (EFF) arrangement was agreed.<sup>82</sup> However, the situation with Ukraine is exceptional.

If we look at the examples of other countries, at the obstacles they may face in obtaining a program, 3 main issues are addressed within the framework of the Fund's policies:

- **Lending into arrears policy** - if a country is not dealing with its creditors in a good manner, the Fund may not provide funding.
- **Debt sustainability policy** - the Fund performs debt sustainability analysis and finds out if it is economically and politically feasible for a country to pay back its future debt.

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<sup>74</sup> "Key information about the government debt in 2022 and forecasts for the debt situation in 2023." [Link](#).

<sup>75</sup> Regulation establishing an instrument for providing support for Ukraine for 2023. Council of the EU. [Link](#).

<sup>76</sup> Memorandum of understanding between The European Union as a Lender and Ukraine as Borrower. European Commission. [Link](#).

<sup>77</sup> NBU, OVDPs in circulation, by the amount of the principal debt [Link](#)

<sup>78</sup> NBU, Grouped balances (by banks) [Link](#)

<sup>79</sup> "Public and publicly guaranteed debt of Ukraine as of March 31, 2023." Ministry of Finance of Ukraine. [Link](#).

<sup>80</sup> Unpacking Ukraine's New IMF Program, O. Betliy, Carnegie, 2023 [Link](#)

<sup>81</sup> Changes to the Fund's Financing Assurances Policy in the Context Of Fund Upper Credit Tranche (UCT) Financing Under Exceptionally High Uncertainty [Link](#)

<sup>82</sup> "The IMF Board of Directors agreed upon a USD 15.6 billion extended financing program for Ukraine and approved the first tranche of USD 2.7 billion." NBU. March 31, 2023. [Link](#).

- **Conditionality policy** - the Fund has a country's government to agree on conditions, which might be serve.

**Lending into arrears policy** implied that the Fund could not provide loans to a country in arrears (when an actor/sovereign is behind on payments). However, this approach has evolved over the years, and now the Fund can lend to a country in default by circumventing a single creditor or small group of creditors blocking IMF lending for self-interested reasons. The Fund's policy regarding official bilateral creditors in this matter is called Lending into Official Arrears (LIOA). To protect its interests, the Fund has established a set of general criteria for lending a country in arrears, including the importance of prompt financial support, consistency of policies to settle the arrears, and the **debtor's good faith efforts**. Since 2015, this policy was used to exercise debt restructurings without creditor consent in 7 cases, including Greece, Ukraine, and Argentina.

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*Lending into arrears case: Ukraine, 2015:*

*The Lending Into Official Arrears policy has been used to exercise debt restructurings without creditors' consent in 7 cases, including the Ukraine vs. Russia case (the infamous "Yanukovich debt" when, probably in exchange for refusing to sign the Association Agreement with the EU, he borrowed USD 3 billion in funds from Russia and then fled the country after prolonged pro-European and anti-corruption protests during the 2013-2014 Maidan revolution). The Fund introduced the new policy in 2015,<sup>83</sup> when Russia refused to participate in the restructuring of Eurobonds, and Ukraine declared default on them in December of that year.<sup>84</sup> At that time, the IMF decided to disburse funds despite the disputed arrears because it was necessary to maintain a sufficient level of reserves and avoid a deeper recession in Ukraine following the annexation of Crimea and Russia's occupation of parts of the eastern regions. Ukraine demonstrated good faith in cooperating with other creditors regarding the resolution of arrears on private debt, and the Fund did not foresee negative consequences for Russia's contributions to the Fund.<sup>85</sup>*

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**Debt Sustainability Policy** is a critical condition describing a country's ability to service its debt over the long-term without risking a default or financial crisis. To estimate the debt sustainability of the sovereign state, the IMF is using the Sovereign Risk and Debt Sustainability Framework (SRDSF), which determines the level of risk for a country.

The Fund is generally reluctant to provide financial support to countries with unsustainable debt because it can contribute to long-term financial instability. As stated by the IMF, "Countries with high debt vulnerabilities need to tackle them through a combination of adjustment and measures to restore growth. An IMF-supported program can facilitate that adjustment, but the IMF can only lend to a member if its debt is sustainable." However, the IMF may provide emergency loans in exceptional circumstances, such as a balance of payments crisis, requiring the

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<sup>83</sup> <https://www.reuters.com/article/us-ukraine-crisis-imf-idUSKBN0TR28Q20151208>

<sup>84</sup> "UKRAINE SECOND REVIEW under the EXTENDED FUND FACILITY and REQUESTS for WAIVERS of NON-OBSERVANCE of PERFORMANCE CRITERIA, REPHASING of ACCESS and FINANCING ASSURANCES REVIEW-PRESS RELEASE; STAFF REPORT; and STATEMENT by the EXECUTIVE DIRECTOR for UKRAINE." IMF. December 2016. [Link](#).

<sup>85</sup> "Occasional Paper Series the IMF's Role in Sovereign Debt Restructurings IRC Task Force on IMF and Global Financial Governance Issues." European Central Bank. September 2021. [Link](#).

country to undertake significant economic and financial reforms to address the underlying causes of the unsustainable debt and prevent future financial crises.<sup>86</sup>

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*Lending at the time of debt unsustainability, Ukraine, 2023:*

*In the case of Ukraine, when Ukraine's debt sustainability analysis was published in October 2022, a significant increase in the debt-to-GDP ratio and an increase in financing were recorded. Uncertainty about the duration of the full-scale invasion and losses had led to an extremely high level of uncertainty in the medium-term forecast for Ukraine. Overall, it was determined that Ukraine's debt was not sustainable and, following the rules, the IMF was not supposed to provide a loan to Ukraine,<sup>87</sup> but changes in the Fund's lending policy were approved, which apply "in situations of extremely high uncertainty, including exogenous shocks beyond the control of country authorities and the scope of their economic policy." Therefore, the new EFF for Ukraine is the first and so far, the only program under this updated policy, the mechanisms of which will be available to other countries in the future if necessary.<sup>88</sup>*

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**The Conditionality policies**, however, still applies to Ukraine, albeit in a very moderate form. In general, the IMF requires debtor countries to implement economic reforms to ensure the ability to repay their debt to the Fund. As a rule, they include stringent fiscal policy, central bank independence, no monetization of the budget deficit, price and tariffs adjustments to market levels, and other conditions. Funds are disbursed in installments based on the results of regular, scheduled reviews of programs.

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*IMF program conditions for Ukraine, 2023:*

*In the case of the new EFF, Ukraine received the first tranche of USD 2.7 billion straight away, and the rest of the funds will be disbursed quarterly upon the fulfillment of previously agreed conditions.*

*They were the restoration of pre-war taxation practices (abolition of the preferential simplified taxation system), the reorganization of the Bureau of Economic Security, maximum mobilization of the domestic sources of expenditure financing, resumption of mandatory declaration of civil servants' income, completion of the process of forming supervisory boards for state-owned banks, the introduction of a national revenue strategy, aligning the tariffs for the households with market indicators, return to a floating exchange rate and inflation targeting in the post-war phase of the program, etc.<sup>89</sup>*

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<sup>86</sup> Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries." IMF. Policy Paper № 2022/035. August, 2022. [Link](#).

<sup>87</sup> "Ukraine: Request for Purchase Under the Rapid Financing Instrument - Press Release; Staff Report; and Statement by the Executive Director for Ukraine." IMF. October 19, 2022. [Link](#).

<sup>88</sup> "IMF Executive Board Concludes Changes to the Fund's Financing Assurances Policy in the Context of Fund Upper Credit Tranche Financing Under Exceptionally High Uncertainty." IMF. March 17, 2023. [Link](#).

<sup>89</sup> "Combined SPC PA SB." IMF. MONA Full Dataset (2002-current). [Link](#).

### 4.3. WHAT AWAITS UKRAINE?

According to the Law of Ukraine on the State Budget, in 2023, the government debt limit will be UAH 6.2 trillion,<sup>90</sup> or USD 152.3 billion at the IMF's projected exchange rate (USD 1 = UAH 40.7).<sup>91</sup> According to the IMF estimates, by the end of 2022, the debt-to-GDP ratio should have been 81.7% (according to the Ministry of Finance, the Ukrainian government debt increased to 78.5% of GDP)<sup>92</sup>, and in 2023 it will go up to 98.3%.<sup>93</sup> So far, thanks to the Armed Forces of Ukraine, the resilience of Ukrainians, donor aid, and the policies of the government and the NBU, Ukraine is moving along a more optimistic trajectory.

The state spends more than half of its funds on defense and security, and its revenues (tax and non-tax) are only sufficient to cover them. To finance all other sectors (public administration, education, medicine, and others), the government resorts to raising funds in the form of grants and loans.<sup>94</sup>

Ukraine entered 2023 with a record budget deficit in the history of independence – about USD 31.9 billion at the projected exchange rate,<sup>95,96</sup> or more than 20% of GDP. In March, it rose to nearly USD 42 billion<sup>97</sup> due to the need for additional defense expenditures. To cover the deficit and debt repayments, there are plans to attract a significant amount of aid from foreign partners (USD 39.5 billion),<sup>98</sup> which is conservatory provided in the form of loans rather than grants, so the involvement of grant aid may likely reduce the expected debt. In addition, there is a need to obtain USD 17 billion for fast recovery projects.<sup>99</sup>

According to the IMF estimates, the monthly financing needs of the State Budget from donors will be approximately USD 3 to 4 billion.<sup>100,101</sup> According to the head of the NBU, there are no plans for financing it by printing hryvnia, and monetary sources will be replaced by those already established in terms of availability,

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<sup>90</sup> The Law of Ukraine "On the State Budget of Ukraine for 2023." [Link](#).

<sup>91</sup> World Economic Outlook. A Rocky Recovery. April 2023. IMF. [Link](#).

<sup>92</sup> "Ukraine's government debt rose to 78.5% of GDP in 2022 – Ministry of Finance." Interfax. April 20, 2023. [Link](#).

<sup>93</sup> "Ukraine: Request for an Extended Arrangement Under the Extended Fund Facility and Review of Program Monitoring with Board Involvement-Press Release; Staff Report; and Statement by the Executive Director for Ukraine." IMF. March 31, 2023. [Link](#).

<sup>94</sup> Yaroslav Vinokurov. "Government debt of Ukraine will exceed 100% of GDP. What does this mean?" *Ekonomichna Pravda*. October 25, 2022. [Link](#).

<sup>95</sup> The Law of Ukraine "On the State Budget of Ukraine for 2023." [Link](#).

<sup>96</sup> According to the IMF estimates, the exchange rate will be UAH 40.7 for USD 1 at the end of 2023. United States - World Economic Outlook. A Rocky Recovery. April 2023. IMF. [Link](#).

<sup>97</sup> The budget deficit will amount to UAH 1.7 trillion after the adoption of the law to increase expenditures. Suspilne News. March 15, 2023. [Link](#).

<sup>98</sup> "Ukraine: Program Monitoring with Board Involvement-Press Release; Staff Report; and Statement by the Executive Director for Ukraine." IMF. December 21, 2022. [Link](#).

<sup>99</sup> "Ukraine is to be rebuilt by Ukrainians, – Yuliia Svyrydenko." Governmental Portal. November 18, 2022. [Link](#).

<sup>100</sup> "Remarks of the Managing Director at the International Expert Conference on the Recovery, Reconstruction and Modernization of Ukraine." IMF. October 25, 2022. [Link](#).

<sup>101</sup> Mariia Migal. "Volumes, sources, and forms of monetary support that Ukraine expects to receive in 2023 from foreign partners." Institute of Analytics and Advocacy. December 29, 2022. [Link](#).

including the activation of the domestic borrowing market and the mobilization of international funding and aid.<sup>102</sup>

Most of the current needs for 2023 have already been covered: at the end of 2022, macro-financial assistance of EUR 18 billion from the EU was agreed for 2023,<sup>103</sup> as so was a monthly aid of USD 1.1 billion from the United States through World Bank mechanisms in the form of grants for 9 months.<sup>104</sup> An IMF loan of USD 15.6 billion,<sup>105</sup> to be disbursed in tranches, will make it possible to refinance Ukraine's debt owed to the fund.

The Ministry of Finance forecasts that Ukraine, in 2023, will spend USD 19.7 billion on debt servicing and repayment, or 12% of the 2022 GDP (see Figure 5). Out of this amount, USD 7.4 billion will be allocated for debt servicing and USD 12.3 billion for debt repayment.

About 82%, or the equivalent of USD 16.2 billion, in 2023, will go towards payments to domestic creditors - the NBU, state-owned and private banks, and other bondholders. Over the next years, service payments of domestic debt will also be significant because the government has borrowed hryvnias at high-interest rates by using DGBs (the weighted average rate was 12.7% per annum in 2022). The short-term domestic debt is likely to be partly or fully refinanced, and in the following years, the expenditures of its servicing will not decrease significantly since the interest rate at which the government is now placing DGBs is 19.5% per annum in hryvnia. Foreign currency-denominated DGBs, on the other hand, are issued at the rate of around 3% per annum in euros and 5% per annum in dollars (in 2022, the rate for GDBs in euros was 2.7%, and in dollars – 4% per annum).<sup>106</sup>

Almost half (45%) of the foreign currency- and hryvnia-denominated DGBs will mature in the next three years, and they are likely to be partially or fully refinanced. In 2026-2036, payments will only be made for hryvnia-denominated bonds, but with a gradual upward trend in 2036. Since more than 50% of DGBs are owned by the NBU, payments made to the regulator account for the largest share. It is known that, in 2023-2025, the NBU expects to receive USD 6.4 billion<sup>107</sup> in interest payments for bonds purchased from the Ministry of Finance during the "printing of hryvnia" in 2022.<sup>108</sup> This corresponds to 41.3% of projected debt service payments in those years.<sup>109</sup> Concerning the 2022 GDP, aggregate domestic debt payments will be 10% of GDP in 2023, 6% of GDP in 2024, and 5% of GDP in 2025.

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<sup>102</sup> "The increased state budget deficit can be financed without currency issue – head of the NBU." Interfax. March 16, 2023. [Link](#).

<sup>103</sup> Yaroslava Pryshchepa. "Ukraine and the EU have concluded a memorandum on the EUR 18 billion macrofinancial assistance – Shmyhal." Suspilne News. January 16, 2023. [Link](#).

<sup>104</sup> Serhii Sydorenko. "Salvation in exchange for reforms: under what conditions Kyiv will receive money from the EU and the United States in 2023." Yevropeiska Pravda. January 16, 2023. [Link](#).

<sup>105</sup> "Ukraine: Request for an Extended Arrangement Under the Extended Fund Facility and Review of Program Monitoring with Board Involvement-Press Release; Staff Report; and Statement by the Executive Director for Ukraine." IMF. March 31, 2024. [Link](#).

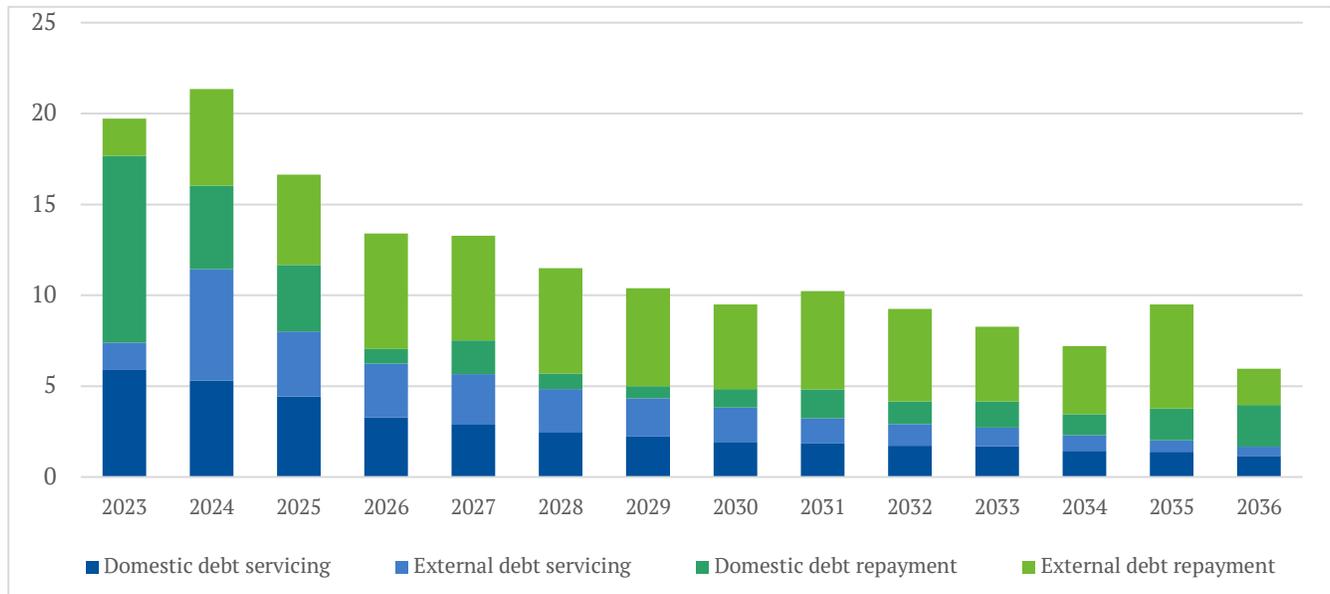
<sup>106</sup> OVDP yields in the primary market, monthly. NBU. [Link](#).

<sup>107</sup> According to the current exchange rate of the NBU: USD 1 = UAH 36.57

<sup>108</sup> Yaroslav Vinokurov. "The price of "printing money": in 3 years, the government may pay the National Bank of Ukraine UAH 235 billion for OVDPs." Ekonomichna Pravda. March 27, 2023. [Link](#).

<sup>109</sup> "Projected monthly government debt payments in 2023-2048 under existing agreements as of May 1, 2023." Ministry of Finance of Ukraine. [Link](#).

Figure 5. Projected annual payments for the servicing of domestic and external public debt under existing agreements as of May 1, 2023, in billions of dollars at the current exchange rate



Source: Ministry of Finance of Ukraine<sup>110</sup>

In 2023, USD 3.55 billion is allocated for government external debt payments - this is mainly interest payments and repayment of debts on loans from international financial organizations:

- payments for the IMF loan will be made in SDR (the total amount is USD 1.72 billion);
- USD loans from other international financial organizations (IFOs) (the total amount is USD 1.52 billion);
- other loans (USD 0.31 billion).

The external debt situation in the coming years is challenging. In 2023, the aggregate cost of servicing and repaying the government's external debt is 2% of the 2022 GDP, but the standstill agreement, under which payments to private creditors were frozen at the beginning of the full-scale invasion, will expire by 2024. If no new agreements are reached, then, in 2024, Ukraine will have to pay 7% of the 2022 GDP, or USD 11 billion of its external debts in the form of interest and principal. About half of this is payments on Eurobonds. In addition, a significant share of external debt service payments is represented by payments on SDR loans from the IMF, as well as loans received from other IFOs in euros and dollars. On average, in 2024-2027, the projected payments for Ukraine's external debt corresponds to 6% of the 2022 GDP.

Given the expected budget deficit during and immediately after the war, one can forecast further growth of the debt burden, along with an urgent need for debt policy measures.

<sup>110</sup> "Projected monthly government debt payments in 2023-2048 under existing agreements as of May 1, 2023." Ministry of Finance of Ukraine. [Link](#).

## 5. CONCLUSIONS

Considering the global experience and the Ukrainian situation, we can highlight several mechanisms of government debt management, the consequences of which we discussed with experts during in-depth interviews and will explore below.

### 5.1. USING RUSSIAN ASSETS AND REPARATIONS TO REPAY DEBTS

After World War II, reparations from the aggressor countries were paid in “natural” form, such as of machinery, equipment, and labor force. However, countries were not satisfied with the funds they received. For example, Yugoslavia was able to receive only 1% of its damages from Germany and Italy, and the reparation agreements themselves took time. Moreover, they were not paid all at once, but over many years. Here the example of Kuwait is very illustrative, as Iraq had been paying them money for 31 years with delays due to budgetary problems. And Poland's refusal to receive reparations from Germany because of Soviet pressure, in 1953, is an example of how they can be ceased at any moment due to geopolitical reasons. At the same time, the example of post-colonial countries shows that reparation payments were preceded by difficult and lengthy negotiations, often in courts, and most claims were not settled at all.

The experts we interviewed noted that external debt repayment at the expense of reparations from Russia is the most desirable and fair step for Ukraine to reduce its debt burden in the post-war period. The aggressor must pay for all the damages. However, receiving the funds may be delayed in time, so we should already be actively working toward confiscating the assets of Russia and its citizens in Ukraine and in countries that are friendly to us and transferring the funds to Ukraine. By using these funds, we could partially cover the financial losses of the country even now, if we apply asset securitization or ensure that the income on them is directed towards compensating the damage caused to Ukraine. For now, we need to actively explore possible options, choose desirable ones, and move as quickly and efficiently as possible.

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*Timothy Ash, Associate Fellow in the Russia and Eurasia Program at Chatham House and Senior Sovereign Strategist at Bluebay Asset Management in London, at the CES event devoted to the topic "Ukraine's debt is growing during the war. What to do next?":*

*"If there are problems from a legal perspective about how to direct the frozen Russian assets to recovery, we can start at least with the **interest on them**. For example, using these funds to **buy a new issue of Ukrainian Eurobonds**. In this way, the money will be automatically transferred to Ukraine, and Western countries will demonstrate that they are not encroaching on Russia's rights. **In fact, Russia will continue to own them, but the funds will automatically be transferred to Ukraine.**"*

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Yuriy Butsa, Government Commissioner for Public Debt Management, at the CES event devoted to the topic "Ukraine's debt is growing during the war. What to do next?":

*"Can we use the available funds to the official sector to increase the volume of financing we can get for reconstruction by involving the private sector? If we can, what instruments can be used? The variations here are vast. ... One of the interesting tools is **any use of frozen reserves of the central bank of russia or other russian reserves** as collateral until some mechanism for reparations is agreed upon, which will serve as collateral for raising funds."*

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Regarding the allocation of funds that Ukraine can potentially receive from russia, the experts we interviewed agree that not the entire amount of reparations/proceeds from assets should be solely directed towards debt repayment. It would make sense to repay expensive loans, and the rest could be used to compensate for losses suffered by individuals and legal entities and to restore the infrastructure.

## 5.2. USE OF FOREIGN FINANCIAL AID

During the war, Ukraine experienced the importance of grant funds firsthand. The country received about USD 18 billion, or 11% of the 2022 GDP, on a non-repayable and non-refundable basis. In wartime, it is important to attract as much financial aid as possible in the form of grants to avoid the increase of debt burden. The loans that Ukraine attracts now should be long-term and granted at preferential rates. Loans from the EU are a good example of such loans. They are granted for 35 years with a grace period until 2033, and the interest is paid by EU member states until 2027. If necessary, Ukraine will also be able to extend the subsidized interest rate on debt servicing after 2027.<sup>111</sup>

The IMF loan, at an estimated 5-6% per annum,<sup>112,113,114</sup> served as a way to refinance Ukraine's old debts owed to the fund (since the IMF cannot agree to restructure the debt), but the rate on this loan is higher than desired for Ukraine, and the term to maturity is much shorter (10 years).

The interviewed experts agree that attracting grants and cheap, long-term loans from IFOs, the EU, and partner countries is one of the most desirable ways to cover the budget deficit. Under such circumstances, the country will be able to service its debt and have room for economic growth without the need to quickly repay large military debts.

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<sup>111</sup> Regulation establishing an instrument for providing support for Ukraine for 2023. Council of the EU. [Link](#).

<sup>112</sup> Unpacking Ukraine's New IMF Program, O. Betliy, Carnegie, 2023. [Link](#)

<sup>113</sup> "Western lenders may regret forcing Ukraine to turn to the IMF." The Economist. March 30, 2023. [Link](#).

<sup>114</sup> Oleksandr Parashchii. "What's wrong with the new IMF program for Ukraine?" NV. April 4, 2023. [Link](#).

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*Yuriy Butsa, Government Commissioner for Public Debt Management, at the CES event devoted to the topic "Ukraine's debt is growing during the war. What to do next?":*

*"What matters is not the stock of debt that we get – it will be growing, but the **cost of it**. ...Any new financing for reconstruction should also be very cheap ... It is desirable that the **interest we pay be minimal or ... compensated.**"*

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### 5.3. ECONOMIC GROWTH, INFLATION, AND "FINANCIAL REPRESSION" POLICY

It is believed that European countries were able to overcome the post-war debt burden thanks to the "economic miracle" - high nominal economic growth rates, in some cases combined with a policy of financial repression, when government bonds` rates were below inflation (see the review of international experience for details). It was fueled by the U.S. "Marshall Plan," aimed to help post-war Europe. High nominal growth is achieved through two factors - inflation and real economic growth.

For Ukraine, the situation when government bonds` rates are below inflation is not new - at the beginning of the war, the government tried to place DGBs at rates that were significantly lower than the expected inflation. Naturally, the demand for such securities from the market was not great (see Appendix 6.2). This operation became something in between the transfer of risks from the state budget to the balance sheets of state-owned banks and indirect money emission through channels of refinancing of state-owned banks by the NBU using government bonds as collateral. Eventually, the Ministry of Finance got into a kind of "clinch" with the NBU, which raised its key policy rate in June 2022 from 10% to 25% to stabilize the country`s financial situation and started demanding increased yields on DGBs placements from the Ministry of Finance.

Researchers acknowledge that financial repression combined with inflation in the post-war period did help to significantly reduce the debt burden in post-World War II countries. They see it as a more gradual measure of debt reduction than if it had been restructured or canceled (unless, of course, it is combined with rapid inflation). However, in post-war Europe, financial repression took place at the time the Bretton Woods system was in effect, which means there were restrictions on capital flows.<sup>115</sup>

At the same time, the current financial markets differ from the 1940s-1970s due to the presence of free capital movement – the ability to choose where to invest and at what rate. In addition, researchers believe that for developing countries, financial repression does more harm than good. They undermine the operation of financial markets, distort the distribution of capital and the incentives to save. As a result, economies grow more slowly.<sup>116</sup>

The experts we interviewed believe that there is no need to resort to financial repressions because this would only contribute to even more pressure on economic agents and further capital outflows from the country. Only, if

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<sup>115</sup> Reinhart, Carmen M., and M. Belen Sbrancia. "The Liquidation of Government Debt." IMF Working Paper. № 7. 2015. [Link](#).

<sup>116</sup> Hoffmann, Andreas. "Beware of Financial Repression: Lessons from History." Intereconomics. Vol.54. № 4. 2019. [Link](#).

necessary, in the absence of any assistance, would it be possible to resort to the issuance of DGBs at low-interest rates that would not cover inflation.

According to our experts, stimulation of economic growth (real GDP growth), due to which we could naturally come to a reduction in debt-to-GDP ratio, is desirable for Ukraine. However, the question arises of how to achieve this during and immediately after the war, which goes beyond the scope of this study, but seems realistic, provided there is a new "Marshall Plan" for Ukraine - foreign aid for reconstruction.

## 5.4. PRIMARY BUDGET SURPLUS

Fiscal policy, which determines the primary deficit, means that budget revenues exceed expenditures before interest is paid on borrowings. Given that interest expenses for Ukraine are historically high even in peacetime (accounting for a tenth of the total state budget expenditures), and the average interest expenses over the next 5 years is projected to be around 5% of the nominal 2022 GDP, the government radically reduce spending and expand the tax base or increase the tax rates.

Such measures cannot be implemented during the war and are very difficult to take in the early post-war years when the humanitarian situation and the economic crisis will require fiscal stimulus rather than austerity.

Researchers point out that when the economy contracts or barely grows, tight fiscal policy will only exacerbate the pressure on the economy and may lead to its contraction<sup>117</sup>. Raising tax rates to generate a budget surplus is not seen as desirable and may do more harm than good. Meanwhile, reducing expenditures during economic growth are seen as the least harmful approach, and "tax enforcement," which involves full tax collection and ensuring a level playing field for all, may turn out to be a good interim solution.

The experts we interviewed agree that reducing expenditures is not the priority during the war. At the same time, some of them point out the need to optimize expenses and conduct reviews of budget expenditures` efficiency.

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*Olena Bilan, Director of the Analytical Department, Chief Economist at Dragon Capital; Co-Chair of the KSE Board of Directors; member of the Supervisory Boards of VoxUkraine and the Centre for Economic Strategy, at the CES event devoted to the topic "Ukraine's debt is growing during the war. What to do next?":*

*"The question is whether we can fulfill our obligations in the coming years. There is little room for maneuver – we need to reduce the budget deficit, but we cannot do that while the war continues and even during the recovery period, because we will need to finance the army, social, and capital expenditures. So **no one expects us to have a budget surplus in the next five years, even if it is a primary budget balance.**"*

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<sup>117</sup> Alesina, Alberto, Carlo A. Favero, and Francesco Giavazzi. "Climbing Out of Debt." IMF. March 2018. [Link](#).

## 5.5. RESTRUCTURING AND DEBT RELIEF

This is the most controversial topic among all possible options for managing Ukraine's debt. Researchers indicate that restructuring reduces the amount of debt, servicing costs, and minimizes the need for refinancing by extending maturities.<sup>118</sup> Post-war Germany, having received substantial debt relief because of the London Agreement, and with the Marshall Plan in place, began to grow rapidly, and the economic "miracle on the Rhine" was one of the reasons for reducing the debt burden from 379% in 1945 to 20% of GDP in 1954. Under the Brady Plan, the countries that were granted debt relief demonstrated a sustained economic recovery and the ability to ensure financial stability.

Nevertheless, there are significant negative consequences of restructuring. For example, a country that does not pay its debts is cut off from private debt markets or faces prohibitively high interest rates on its debts. This applies not only to sovereigns but also to private companies in such countries that have to access markets that are not favorable to them and pay high interest rates on their debts.<sup>119</sup> That is not new for Ukraine, as it has already experienced several defaults and restructurings in its history, and the rates on Ukrainian Eurobonds and bonds issued by Ukrainian entities have long been among the highest in the market. At the same time, after the war, access to private capital markets will be very important for Ukrainian companies and the sovereign.

In addition, sovereign debt defaults and restructuring may have long-term consequences for the economic growth and financial stability in the country. They can lead to a loss of investor confidence, higher interest rates, and lower investment demand in the future.<sup>120</sup>

Restructuring the domestic debt, where the main creditors are the NBU, state-owned banks, and, to a lesser extent, private players, does not make much sense, as the consequences will ultimately affect the state budget through losses incurred by state banks, a decrease in the NBU's profit transferred to the budget, or the bankruptcy of private banks, for which the state will have to pay guaranteed amounts.<sup>121</sup>

Restructuring the external private debt is something that Ukraine will have to make a very difficult decision about in the nearest future. The standstill agreement expires in 2024, and the IMF program contains a commitment to extend it for the duration of the EEF and, if necessary, after 2027.<sup>122,123</sup> If the war is not over by then, the debts will have to be restructured. If the war ends with Ukraine's victory, however, the government and creditors will

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<sup>118</sup> Reinhart, Carmen M., and Kenneth S. Rogoff. "A Decade of Debt." NBER Working Paper. № 16827. February 2011. [Link](#).

<sup>119</sup> Reinhart, Carmen M., Kenneth S. Rogoff, and Miguel A. Savastano. „Debt Intolerance.“ NBER Working Paper. № 9908. August 2003. [Link](#).

<sup>120</sup> Reinhart, Carmen M., and Kenneth S. Rogoff. "Growth in a Time of Debt." American Economic Review: Papers & Proceedings. № 100. May 2010. [Link](#).

<sup>121</sup> Law of Ukraine No. 2180-IX "On Amending Certain Laws of Ukraine on Ensuring the Stability of the Individual Deposit Guarantee System," dated October 28, 2022. [Link](#).

<sup>122</sup> Group of creditors of Ukraine provides financing assurances to support the IMF's approval of an upper credit tranche programme. Direction Générale du Trésor. March 24, 2023. [Link](#).

<sup>123</sup> Ukraine: Request for an Extended Arrangement Under the Extended Fund Facility and Review of Program Monitoring with Board Involvement-Press Release; Staff Report; and Statement by the Executive Director for Ukraine. IMF. March 31, 2023. [Link](#).

have several options,<sup>124</sup> the feasibility of which will depend on the specific market conditions that will prevail for Ukraine at that time, including the option to extend debt service under the terms set out in the current prospectuses.

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*Olena Bilan, Director of the Analytical Department, Chief Economist at Dragon Capital; Co-Chair of the KSE Board of Directors; member of the Supervisory Boards of VoxUkraine and the Centre for Economic Strategy, at the CES event devoted to the topic "Ukraine's debt is growing during the war. What to do next?":*

*"It is worth **negotiating a deferral of payments with private creditors** and, if possible, **reducing payments to official creditors** by postponing the due dates, or reducing/compensating interest."*

*"As for the holders of Eurobonds, the possible options are to extend the standstill or carry out another restructuring - to defer payments for a longer period, or maybe reduce interest rates or write off part of the debt. However, all this must be done with the consent of the parties, so that we can continue to attract funds in the post-war period."*

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Overall, there will be a need for external debt restructuring, but the best solution may be to approve a grace period for some time and resume servicing and repaying the debt only after the resumption of Ukraine's economic growth.

At the same time, there are steps that should be taken in external debt management. Firstly, this includes negotiations regarding interest rates and commission payments to the IMF. They amount to USD 3.25 billion for the next five years. A similar step is also worth discussing with other lenders – IFOs.

It is also worth considering relatively new mechanisms such as debt-for-climate swaps. As a future member of the EU and a country in need of extensive reconstruction, Ukraine should take advantage of opportunities to invest in "green recovery," while reducing its debt burden. Such negotiations would be advisable first and foremost with IFOs that are budget creditors, whose debts must be serviced and repaid in the coming years. Debt owed to the European Union is long-term and provided on very favorable terms, so reducing it is not a priority.

## 5.6. PRIVATIZATION

During the war, revenues from state assets privatization would be minuscule, and it would cause more harm than benefit. However, after the war and during the period of active reconstruction and the beginning of economic growth amid the prospect of joining the EU, investors may be interested in Ukrainian assets, and the state will receive additional financial resources.

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<sup>124</sup> Different options for terms to maturity, write-off of a portion of the debt, or no debt write-off, different interest rates, presence or absence of warrants linked to economic growth, presence or absence of limits for rates or annual payment amounts according to the economic situation in Ukraine, guarantees from partners, pledge of compensation payments from the rf, etc.

Most of the experts we interviewed pointed out that privatization is a desirable measure for us to reduce the need for borrowing in the post-war period. They explain this by the fact that after the war, investors will be more interested in acquiring state assets, so their value will increase significantly.

## 5.7. DURING AND AFTER THE WAR

### **During the war**

The most effective way to manage government debt during active hostilities is to obtain grants and cheap, long-term loans from partner countries and international financial organizations. Also, it would be advisable to work with the IMF to lower the rate on the credit program.

Ukraine should also work on confiscation of the assets owned by Russia and its citizens both in Ukraine and abroad to cover financial losses. More active involvement of lawyers, financiers, and diplomats is needed for this work, both in Ukraine and abroad.

Reprofiling and deferring DGB payments are not beneficial, as these would undermine trust in the bonds used as a source of financing military expenditures.

Privatization of state assets makes no fiscal sense since asset prices are low, and the proceeds would not cover a significant share of the budget deficit.

However, it is already possible to start negotiating a "debt for green recovery" swap with IFO lenders, whose mandate may include the climate goals for sustainable development. Ukraine will be making significant payments on loans owned by the IFOs in the coming years and allocating part of these funds for the "green recovery" of destroyed infrastructure could be an alternative.

### **After the war**

According to the majority of the experts we interviewed, the most realistic measure of fiscal policy is a combination of large-scale budget deficit reduction and tax reform to ensure full tax collection. However, its implementation could be complicated by social spending and the post-war reconstruction needs. Other options for managing the state debt for Ukraine include:

- **repayment of debt obligations through reparations from Russia**
- **stimulation of economic growth through prudent regulation without increasing the debt burden**
- **the attraction of non-refundable financial aid** and using it to finance post-war reconstruction projects
- **privatization of state assets** – the demand for assets should increase, and budget revenue will be higher than during active hostilities.

## 6. ANNEXES

### 6.1. UKRAINE'S GOVERNMENT DEBT IN 2014-2021

In 2014, Ukraine became a victim to Russia's military aggression. The war, along with economic and political challenges, deepened the debt crisis faced by the country. One of the key challenges was a significant budget deficit. In addition, the country's energy sector was affected by inefficiency and corruption, which resulted in high energy subsidies and losses to the state-owned energy company "Naftogaz."

The ratio of public and publicly guaranteed debt-to-GDP increased to 69.4% in 2014 and to 79.1% in 2015, and the total amount of debt was USD 69.8 billion and USD 65.5 billion, respectively.<sup>125</sup>

To overcome the debt crisis, the Ukrainian government continued to cooperate with international organizations, such as the IMF and the World Bank. In 2014, the IMF approved a USD 17 billion loan package for Ukraine to help the country stabilize the economy and reduce its debt burden.<sup>126</sup> However, by the end of 2014, Ukraine's government debt situation did not improve, and the debt was expected to continue growing, according to forecasts. In addition, the war unleashed by Russia against Ukraine continued to inflict even greater damage on the Ukrainian economy. With this in mind, in March 2015 the Ukrainian government initiated negotiations on an external debt restructuring to reduce the debt burden and improve the ability to manage its finances. In August, agreements were reached to reduce the amount of debt by USD 3.6 billion.<sup>127</sup>

In addition, in August 2015, the IMF approved a USD 17.5 billion loan package for Ukraine aimed at assisting the country in stabilizing its economy and reducing the debt burden. The loan was provided under the condition of implementing a series of economic reforms, including pension reform, reform of the energy sector, establishment of an anti-corruption court, etc.<sup>128</sup>

In the following years, Ukraine's government debt was still high, but the country managed to make some progress in stabilizing its economy and reducing its debt burden (the ratio of public and publicly guaranteed debt-to-GDP gradually decreased – see Figure 6.1.1). That was due to a low budget deficit (in 2016-2019, it was at 2% of GDP)<sup>129,130</sup> and, as a result, the lower need for borrowing<sup>131</sup> – the nominal GDP growth rate was higher than the accumulation of the state debt. In addition, in the fall of 2017, the Ministry of Finance restructured the domestic debt. During the restructuring, the DGBs from the NBU's portfolio were converted into long-term inflation-linked

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<sup>125</sup> Ukraine's GDP. Ministry of Finance of Ukraine. [Link](#).

<sup>126</sup> "Ukraine: First Review Under the Stand-By Arrangement, Requests for Waivers of Nonobservance and Applicability of Performance Criteria, and A Request for Rephrasing of the Arrangement." IMF. September 2, 2014. [Link](#).

<sup>127</sup> "Reaching a debt restructuring agreement is a significant success for Ukraine." Consulate of Ukraine in Edinburgh. August 31, 2015. [Link](#).

<sup>128</sup> "Ukraine: Request for Extended Arrangement Under the Extended Fund Facility and Cancellation of Stand-By Arrangement." IMF. March 12, 2015. [Link](#).

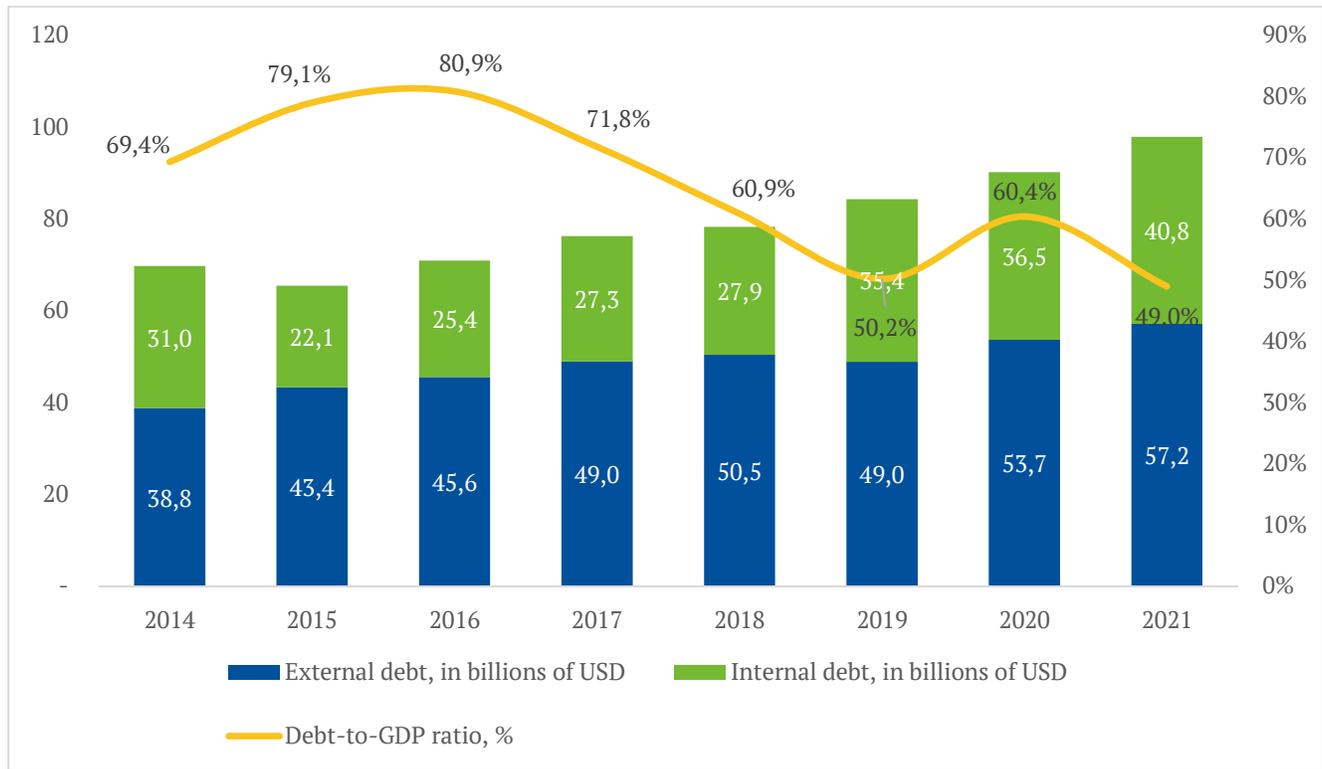
<sup>129</sup> Inflation report, January 2020. NBU. February 6, 2020. [Link](#).

<sup>130</sup> Inflation report, April 2020. NBU. April 30, 2020. [Link](#).

<sup>131</sup> "The ratio of public and publicly guaranteed debt to GDP decreased from 80.9% in 2016 to 71.8% in 2017." Ministry of Finance of Ukraine. March 23, 2018. [Link](#).

hryvnia-denominated bonds, which helped to reduce the peak debt payments in 2018-2020 and the burden on the state budget in the medium and long term.<sup>132</sup>

Figure 6.1.1. Dynamics of the accumulation of Ukraine's public and publicly guaranteed debt in 2014-2021, in billions of dollars, and the ratio of public and publicly guaranteed debt to GDP, in %



Source: Ministry of Finance of Ukraine,<sup>133,134</sup> State Statistics Service of Ukraine<sup>135</sup>

In general, during 2017-2019, the debt burden in Ukraine significantly decreased and, before the onset of the COVID-19 crisis, it was lower than in many European countries and met one of the Maastricht criteria (the debt-to-GDP ratio did not exceed 60%).<sup>136</sup> However, the introduction of the quarantine measures in 2020 and a significant decrease in demand led to a 4% decline in real GDP, an increase in the annual budget deficit to 5.3% of GDP,<sup>137</sup> and exchange rate fluctuations. As a result, the public and publicly guaranteed debt-to-GDP ratio increased to 60.4% (the government debt was USD 79.9 million and the total debt amounted to USD 90.3

<sup>132</sup> Halyna Kalachova. "Hidden levers of inflation. Who stands to benefit from accelerated price growth." *Ekonomichna Pravda*. November 15, 2017. [Link](#).

<sup>133</sup> "Public and publicly guaranteed debt of Ukraine as of December 31, 2017." Ministry of Finance of Ukraine. [Link](#).

<sup>134</sup> "Public and publicly guaranteed debt of Ukraine as of December 31, 2021." Ministry of Finance of Ukraine. [Link](#).

<sup>135</sup> Gross domestic product (in actual prices). State Statistics Service of Ukraine. [Link](#).

<sup>136</sup> Ihor Lubchuk. "Think piece: COVID challenges of government debt." *Expert Platform*. January 5, 2020. [Link](#).

<sup>137</sup> Inflation report, July 2021. NBU. July 29, 2021. [Link](#).

million).<sup>138</sup> To overcome the challenges of the pandemic and its negative economic consequences, in June 2020, the IMF approved a new USD 5 billion Stand-By program for Ukraine, which was intended to address fiscal needs and the issue of negative balance of payments. This program also included structural reforms<sup>139</sup> to guarantee the economic growth of Ukraine once the crisis was over.<sup>140</sup>

Although the public and publicly guaranteed debt increased to USD 98 billion in 2021, the debt-to-GDP ratio declined to 49% due to faster economic growth rates (the government debt grew by 4.7%, while the nominal GDP increased by 29.1%).<sup>141</sup> The increase in total debt is associated with the attraction of concessional financing from the IMF and IBRD and the growth of the government's domestic debt.<sup>142</sup>

Also, in December 2021, the Cabinet of Ministers of Ukraine approved a Medium-Term Government Debt Management Strategy for 2021-2024, which was developed to recover from the economic downturn caused by the pandemic. According to it, the Ministry of Finance of Ukraine set the following goals for debt management:

1. Increase the share of government debt in the national currency.
2. Extend the average maturity of debt repayment and ensure a smooth repayment schedule for government debt.
3. Attract long-term concessional financing.
4. Continue development of strong relations with investors and further improvement of the government debt management policy.

Additionally, the Strategy includes an analysis of projected debt indicators and conclusions about debt sustainability, as well as the development of an action plan for the period from 2021 to 2024, and the determination of target indicators, such as reduction of the government debt-to-GDP ratio to 47% by the end of 2024.<sup>143,144</sup>

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<sup>138</sup> "Information of the Ministry of Finance of Ukraine on executing the State Budget of Ukraine for 2020." Uriadovyi Kuryer (Government Messenger) [Link](#).

<sup>139</sup> Benchmarks of the Stand-By program were the development of a plan to reduce the share of NPL, adoption of amendments to the Law of Ukraine "On Banking," strengthening of corporate governance at state enterprises (Naftogaz) following the OECD recommendation, reform of the STS and the SMS, changes in the Law of Ukraine "On the Supreme Council of Justice," review of heating tariffs and checking of compliance of COVID-related expenses, by the State Audit Service of Ukraine and external consultants.

<sup>140</sup> "IMF Executive Board Approves 18-month US\$5 Billion Stand-By Arrangement for Ukraine." IMF. June 9, 2020. [Link](#).

<sup>141</sup> Ukraine's government debt. Ministry of Finance. [Link](#).

<sup>142</sup> "Government debt in relation to the projected GDP went down to 45.2% in 2021." Ministry of Finance of Ukraine. January 26, 2022. [Link](#).

<sup>143</sup> Resolution No. 1291 of the Cabinet of Ministers of Ukraine dated December 9, 2021 "Medium-Term Government Debt Management Strategy for 2021-2024." [Link](#).

<sup>144</sup> "The Government has approved the government debt management strategy until 2025." Ekonomichna Pravda. December 9, 2021. [Link](#).

## 6.2. IMPACT OF THE WAR ON UKRAINE'S DEBT INSTRUMENTS MARKETS.

The year 2022 began for Ukraine with news headlines about the possibility of Russia's full-scale invasion of our country. As a result of such pressure in the financial markets, the sale of Ukrainian assets by foreign investors continued, and the Ministry of Finance of Ukraine lost the opportunity to sell long-term DGBs because no one was ready to invest in them at the rates that were in effect during January-February 2022.<sup>145</sup>

The yield of Eurobonds was actively growing. If, in January, it peaked at 25% due to a decrease in the nominal value of Eurobonds as foreign investors were selling CMU liabilities at a loss to retrieve at least some of their funds. By mid-February, the yield of these Eurobonds exceeded 28%.<sup>146</sup>

From the beginning of January to February 24<sup>th</sup>, the share of non-residents in the total structure of DGBs decreased by 1.3 percentage points (from 8.7% to 7.4%), and the volume of DGBs in the portfolio of non-residents decreased by almost UAH 18 billion.<sup>147</sup> As a result of these actions, the fluctuations in the foreign exchange market<sup>148</sup> increased, and the hryvnia began to devalue, reaching the exchange rate of UAH 29.25 per USD 1 by February 24<sup>th</sup>.<sup>149</sup>

At the same time, the Ministry of Finance of Ukraine took advantage of such panic-driven behavior of foreign investors. For example, on February 5, 2022, the Ministry of Finance redeemed about 10% of the Eurobonds maturing in September 2022 (these securities had experienced the most significant depreciation in January 2022), which later allowed to save USD 912 million. In addition, the Ministry of Finance continued to repurchase a certain portion of GDP warrants (a debt or derivative security in which the issuer, the government, promises to pay income that varies depending on the growth rates of GDP<sup>150</sup>). According to the Ministry's statement of February 4, 2022, it conducted several such operations and increased the share of these securities to about 20% of the total nominal amount of securities. Such operations were made possible due to the state budget surplus in January, as revenues exceeded expectations by 13.1%.<sup>151,152</sup>

The analysts we interviewed had a rather positive attitude to the repurchase of external debts and GDP-linked warrants by the Ministry of Finance. These actions seemed logical, did not burden public finances, and the prices were quite attractive, even though some experts noted that they were still repurchased at an inflated price.

However, the full-scale Russian invasion of Ukrainian territory made its adjustments. If previously the option of increasing the volume of placement of DGBs in hryvnia, with international investors playing a special role in their

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<sup>145</sup> Dana Hordiichuk. "The hryvnia exchange rate and Eurobonds collapsed: why it is happening again." Ekonomichna Pravda. February 14, 2022. [Link](#).

<sup>146</sup> Yaroslav Vinokurov. "While everyone is in panic, Ukraine is buying up its debts. What's going on?" February 15, 2022. [Link](#).

<sup>147</sup> "OVDPs in circulation at nominal depreciation value as of." NBU. [Link](#).

<sup>148</sup> "A comment on the situation in the financial market of Ukraine." NBU. February 23, 2022. [Link](#).

<sup>149</sup> "Official hryvnia exchange rate against foreign currencies." NBU. [Link](#).

<sup>150</sup> «GDP-linked bond». Wikipedia. [Link](#).

<sup>151</sup> "Ukraine bought back 10% of the 2022 Eurobonds and brought the redemption of GDP warrants to 20%." Interfax Ukraine. February 5, 2022. [Link](#).

<sup>152</sup> Yaroslav Vinokurov. "While everyone is in panic, Ukraine is buying up its debts. What's going on?" February 15, 2022. [Link](#).

purchases, was considered, then as of the end of 2022, domestic investors were the main players (their share is 95.8%, up 4.5 p.p. compared to 2021), and the main buyer became the NBU (from February 24 to December 30, 2022, the share increased by 20.2 p.p.).<sup>153</sup> Moreover, DGBs, including military domestic government bonds, became one of the instruments for financing the state budget deficit in 2022 (USD 20.2 billion).<sup>154</sup> This instrument was mentioned by the analysts we interviewed as a good one for raising funds for the state to support the army and develop the financial market, even in the conditions of a full-scale war. At the same time, according to some of the interviewed experts, this method did not demonstrate significant efficiency due to the lack of involvement of the Ministry of Finance of Ukraine in the popularization of military DGBs among the population and the late increase in yield levels. Otherwise, it would have been possible to raise more funds in the domestic market and reduce the level of monetization of the budget deficit.

### 6.3. TERMS OF LOANS PROVIDED TO UKRAINE

Table 6.3.1. Information on the loan agreements provided to Ukraine since the start of the full-scale invasion

Creditor	Year of loan	Loan amount	Lending conditions
Japan	2022	EUR 600 million	<ul style="list-style-type: none"> <li>• Interest rate – 1% per annum;</li> <li>• Term to maturity – 30 years;</li> <li>• Grace period – 10 years.<sup>155,156</sup></li> </ul>
Italy	2022	EUR 200 million	<ul style="list-style-type: none"> <li>• Interest rate – 0% per annum;</li> <li>• Term to maturity – 15 years;</li> <li>• Grace period – 7.5 years.<sup>157</sup></li> </ul>
KfW	2022	EUR 150 million	<ul style="list-style-type: none"> <li>• Interest rate – n/a% per annum;</li> <li>• Grace period – 5 years;</li> <li>• Term to maturity – 15 years.<sup>158</sup></li> </ul>
	2022	EUR 7.4 million	<ul style="list-style-type: none"> <li>• Interest rate – 2% per annum;</li> <li>• Grace period – 10 years;</li> <li>• Term to maturity – 30 years.<sup>159</sup></li> </ul>

<sup>153</sup> "OVDPs in circulation at nominal depreciation value as of." NBU. [Link](#).

<sup>154</sup> "State budget financing sources in the period from February 24 to December 30, 2022." Ministry of Finance of Ukraine. [Link](#).

<sup>155</sup> Ministry of Finance of Ukraine: Ukraine has received about USD 100 million from Japan under a loan agreement on preferential terms. Ministry of Finance of Ukraine. May 24, 2022. [Link](#).

<sup>156</sup> Ministry of Finance of Ukraine: Ukraine has received additional USD 500 million from Japan. Ministry of Finance of Ukraine. June 27, 2022. [Link](#).

<sup>157</sup> Ukraine has received EUR 200 million from Italy. Ministry of Finance of Ukraine. August 16, 2022. [Link](#).

<sup>158</sup> "Ukrainian Government will receive EUR 150 million from the Credit Institute for Reconstruction (KfW) to finance social expenditures." Ministry of Finance of Ukraine. June 3, 2022. [Link](#).

<sup>159</sup> "Ukrainian Government will receive EUR 7.4 million from the Credit Institute for Reconstruction (KfW) for preferential lending to small and medium-sized enterprises." Ministry of Finance of Ukraine. June 10, 2022. [Link](#).

Table 6.3.2. continued

Creditor	Year of loan	Loan amount	Lending Conditions
Latvia	2022	USD 10 million	<ul style="list-style-type: none"> <li>• One-off fee – 0.25%;</li> <li>• Commitment fee – 0.25;</li> <li>• Term to maturity – 18.5 years;</li> <li>• Grace period – 4 years.</li> </ul>
IDA (IBRD)	2022	USD 50 million	<ul style="list-style-type: none"> <li>• One-off fee – 0.25%;</li> <li>• Commitment fee – 0.25;</li> <li>• Term to maturity – 10 years;</li> <li>• Grace period – 4 years.<sup>160</sup></li> </ul>
French Development Agency	2022	EUR 400 million	<ul style="list-style-type: none"> <li>• Interest rate – 1.04% per annum;</li> <li>• Term to maturity – 15 years following the date of the loan agreement (March 28 and November 28);</li> <li>• Grace period – 5 years following the date of the loan agreement.<sup>161,162</sup></li> </ul>
The Netherlands	2022	EUR 200 million	<ul style="list-style-type: none"> <li>• Interest rate – 3.64% per annum;</li> <li>• Term to maturity – 10 years following the drawdown date;</li> <li>• Term to maturity – 4.5 years following the drawdown date.<sup>163</sup></li> </ul>
IBRD (WB) guaranteed by the UK	2022	USD 500 million	<ul style="list-style-type: none"> <li>• Interest rate – 0.25% per annum (accrued on the unused part of the loan);</li> <li>• Term to maturity – 19 years;</li> <li>• Grace period – 5 years.<sup>164</sup></li> </ul>
EIB	2022	EUR 1.59 billion <sup>165</sup>	N/a
Canada	2022	USD 1.4 billion	<ul style="list-style-type: none"> <li>• Interest rate – 1.69% per annum;</li> <li>• Term to maturity – 10 years.<sup>166</sup></li> </ul>
	2023	USD 1.8 billion	<ul style="list-style-type: none"> <li>• Interest rate – 1.5% per annum;</li> <li>• Term to maturity – 10 years.<sup>167</sup></li> </ul>

<sup>160</sup> Ukraine has received additional financing from the World Bank from IDA and a USD 60 million guarantee from Latvia. Ministry of Finance of Ukraine. November 22, 2022. [Link](#).

<sup>161</sup> Ukraine will receive EUR 300 million from the French Development Agency. Ministry of Finance of Ukraine. March 29, 2022. [Link](#).

<sup>162</sup> Ukraine has received EUR 100 million from France. Ministry of Finance of Ukraine. December 13, 2022. [Link](#).

<sup>163</sup> Ministry of Finance of Ukraine: Ukraine has received additional EUR 200 million from the Netherlands. Ministry of Finance of Ukraine. December 20, 2022. [Link](#).

<sup>164</sup> Ukraine has received additional financing from the World Bank as a USD 500 million guarantee from the UK. Ministry of Finance of Ukraine. October 25, 2022. [Link](#).

<sup>165</sup> EIB Group starts disbursements from €1.59 bn EIB Ukraine Solidarity Urgent Response package. European Commission. September 15, 2022. [Link](#).

<sup>166</sup> Ukraine has received CAD 500 million from Canada. Ministry of Finance of Ukraine. December 20, 2022. [Link](#).

<sup>167</sup> Ministry of Finance: Ukraine has received CAD 2.4 million from Canada. Ministry of Finance of Ukraine. March 31, 2023. [Link](#).

Table 6.3.3. continued

Creditor	Year of loan	Loan amount	Lending Conditions
IMF	2022	USD 2.7 billion	<ul style="list-style-type: none"> <li>• Lending under the RFI program;<sup>168,169</sup></li> <li>• Interest rate – n/a% per annum;</li> <li>• Term to maturity – until 2027.<sup>170</sup></li> </ul>
IMF	2023	USD 15.6 billion	<ul style="list-style-type: none"> <li>• four-year Extended Fund Facility (EFF) program;<sup>171</sup></li> <li>• Interest rate ~ 5-6% per annum;</li> <li>• Term to maturity ~ until 2033.<sup>172</sup></li> </ul>
EU	2023	EUR 18 billion	<ul style="list-style-type: none"> <li>• Interest rate – n/a% per annum;</li> <li>• EU countries will pay interest and make other debt service payments instead of Ukraine until 2027;</li> <li>• Grace period – 10 years;</li> <li>• Term to maturity – 35 years.<sup>173</sup></li> </ul>
IDA (WB)	2023	EUR 189.3 million	<ul style="list-style-type: none"> <li>• Interest rate – n/a% per annum;</li> <li>• Grace period – 4 years.</li> <li>• Term to maturity – 10 years.<sup>174</sup></li> </ul>

## 6.4. LIST OF INTERVIEWS

Table 6.4.4. Information about the respondents

Full names of the respondents	Titles of the respondents
Olena Bilan	Head of Research, Chief Economist at Dragon Capital; Co-Chair of the Board of Directors of the KSE; member of the Supervisory Boards of VoxUkraine and the Centre for Economic Strategy
Oleksii Blinov	Head of Analytical Department, Sense Bank
Glib Vyshlinskyi	Executive Director of the Centre for Economic Strategy
Timothy Ash	Associate Fellow in the Russia and Eurasia Program at Chatham House and Senior Sovereign Strategist at Bluebay Asset Management in London.
Oleksandr Parashchii	Head of Research, Concorde Capital investment company

<sup>168</sup> IMF Executive Board Approves US\$ 1.4 Billion in Emergency Financing Support to Ukraine. IMF. March 7, 2022. [Link](#).

<sup>169</sup> IMF Executive Board Approves US\$ 1.3 Billion in Emergency Financing Support to Ukraine. IMF. October 7, 2022. [Link](#).

<sup>170</sup> Projected Payments to the IMF as of March 31, 2023. IMF. [Link](#).

<sup>171</sup> Ukraine: Request for an Extended Arrangement Under the Extended Fund Facility and Review of Program Monitoring with Board Involvement-Press Release; Staff Report; and Statement by the Executive Director for Ukraine. IMF. March 31, 2023. [Link](#).

<sup>172</sup> Projected Payments to the IMF as of March 31, 2023. IMF. [Link](#).

<sup>173</sup> Regulation establishing an instrument for providing support for Ukraine for 2023. Council of the EU. [Link](#).

<sup>174</sup> Ukraine has received EUR 189.32 million from the World Bank. Ministry of Finance of Ukraine. May 8, 2023. [Link](#).

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