Civil Society Letter on a new External Shock Facility to the International Monetary Fund Managing director, Kristalina Georgieva, and the IMF Board

7 October 2022

The situation with the financial assistance to Ukraine during the full-scale invasion by Russia revealed that developed countries and the IFIs, including the IMF, are not fully ready for the financial challenges and global impacts of such an affront to international law. Ukraine was on track with economic policies during recent years, which resulted in a sound banking and financial sector, and a sustainable state debt situation. However, Ukraine (like any other country similarly situated) cannot stand alone against such an aggressor as Russia as the war comes at an incredible cost, resulting in losses of lives and a sharp decline in the economy. Unfortunately, at this time, financing from international partners is irregular and substantially lower than verified by the IMF USD 5 bn need by Ukraine every month. As leading economic CSOs in Ukraine, we suggest the IMF –as a lender of last resort– approve a big supporting program for Ukraine either in the framework of existing instruments or through the elaboration of a new mechanism of support: an 'External Shock Facility'.

Ukraine was on track with a set of laws and policies supporting a sound banking and financial systems as well as a sustainable debt situation and path to sustainable economic growth. In particular, the debt-to-GDP ratio was at 50% in 2021 to the opposite of many countries where debt increased due to higher COVID-related spending. The efficiency of many institutions was illustrated by the fact that the Government and the National Bank of Ukraine (NBU) remained in operation after the full-scale invasion by Russia started on February 24. They approved important decisions to finance necessary defense efforts and maintain the stability of the banking system of Ukraine. Additionally, social payments were paid in time to ensure that low-income families did not find themselves in real hardship. Moreover, before August payments to external creditors were maintained despite the economic pressures. In fact, responsible fiscal spending was highly prioritized with almost half allocated for defense and security and a large part for social payments.

Immediately following the full-scale invasion, the Government and the NBU also started active talks with international partners on the need for financing and we are grateful not just for the bilateral aid received to date, but to the IMF for its quick provision of USD 1.4 bn under the Rapid Financing Instrument (RFI). The Ukraine Government also calculated the need to finance the fiscal gap at USD 5 bn per month, which were verified by the IMF in April. However, to date, the monthly international assistance committed (grants and concessional lending) has not reached that number. Moreover, the assistance committed has been disbursed in an irregular manner, which frustrates the Government's efforts to plan responsibly for all spending. All these factors contribute to a continuing need for financing the budget by the NBU, which unnecessarily undermines Ukraine's macroeconomic sustainability in the short and long run.

The IMF itself appeared not to be ready to react fast enough to the unexpected economic hardship that Ukraine has found itself in, even though the Fund is a lender of last resort for countries with macroeconomic and BoP problems. In normal circumstances, the Fund requires a debt sustainability plan for a country seeking an IMF plan of significance, which is not possible for a country not only experiencing an external shock not of their control, but one that is ongoing (like the aggression against Ukraine). Ukraine has welcomed, and the undersigned are grateful for the decision of the IMF Board to approve a new Food Shock Window under its emergency financing instruments, which would help Ukraine to receive another USD 1.3 bn in 2022. However, total IMF financing to Ukraine in 2022 is not much higher than the USD 2.4 bn payment from Ukraine to the IMF.

The financing needs of Ukraine will remain high in 2023. According to the draft 2023 State Budget, external financing is expected at about USD 34 bn including the IMF loan at USD 15 bn. However, the talks are slow with the IMF. While all agree that Ukraine needs this program as emergency financing as soon as possible, the IMF program requirements present a challenge given Ukraine's current predicament not of its own making. The talks on the provision of the G7 guarantees for this concessional loan, as far as we are aware, are also slow. While the IMF and its Board members may not have been set up for the multiple crises facing the world today and situations like those faced by Ukraine today, we would still urge the Managing Director and the Board members to approve the Program for Ukraine. There is also a need for regular monitoring and technical assistance to Ukraine to develop a macroeconomic framework that can sustain its economy under such distress and establish a way forward for sustainable debt management and economic recovery.

Simultaneously and / or alternatively should a traditional formal IMF program present too many challenges, we also would suggest that the IMF consider the rapid elaboration of a new mechanism of support for such a situation as Ukraine's. We suggest the creation of an '***External Shock Facility***'. Building on the template of the Food Shock Facility, this additional emergency facility could operate when it is determined that a country was implementing sound macro economic policies, but was then faced with a *force majeure* type situation: an external shock that was not within their control (for example, military aggression by a foreign power or a massive natural disaster). Such a program would be triggered when there is an emergency economic situation that is externally driven. The program would be front-loaded with money, have as few conditionalities as possible, and have long maturity with a grace period of interest payments.

The emergency aid could also be accompanied by the recently approved Staff Monitored Programs with Board Involvement (PMBs). The PMB could provide regular monitoring to donors/board members, and after the initial large disbursement, provide the basis and recommendations for additional incremental shock disbursements. It also could advise on and keep regular track on what is happening macroeconomically. In addition to strengthening the monitoring of this external shock facility program, the PMB also could help a country like Ukraine ease its transition into a formal IMF program (and eventually place it in a better position to secure complementary aid from other bilaterals and financing institutions going forward.)

The above-recommended '*External Shock Facility*' could be piloted for Ukraine and later elaborated into a standard emergency support instrument. The IMF can use this facility to address other narrowly defined situations of externally-driven economic crises that would otherwise challenge the IMF's formal programs and its typical requirements and conditions.

We will really appreciate the increase in the speed and the volumes of the IMF financial support for Ukraine. It was promised to the country and it would ensure that Ukraine will return to the economic stability and sustainability contemplated by its prior economic policies.

Note: The letter is prepared by four Ukrainian civil society organizations listed below, that formed the Consortium *RRR4Ukraine* (Resilience, Reconstruction and Relief for Ukraine) with the financing support of the Open Society Foundation. The initial objective of the Consortium is to promote just, green, and people-centered economic recovery. To ensure this, we currently advocate for transparent and predictable emergency financing for Ukraine.

1. *Institute for Economic Research and Policy Consulting, Kyiv, Ukraine*
2. *Center for Economic Strategy, Kyiv, Ukraine*
3. *DiXi Group, Kyiv, Ukraine*
4. *Institute of Analysis and Advocacy, Ukraine*