

# Modern Cooperation Between Ukraine and the IMF: Dynamics, Trends and Problems

Galina Myskiv

*Lviv Institute of Economy and Tourism, Ukraine*

*galinamyskiv@gmail.com*

Lyubov Halkiv

*Lviv Polytechnic National University, Ukraine*

*lubakram2015@gmail.com*

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## Abstract

**Purpose** – The paper considers and analyzes IMF's credit activity in Ukraine in the years 1994–2016.

**Methodology** – To achieve this, the analysis of data presented in the period 1994–2016 at IMF official website, the Ministry of Finance of Ukraine and the National Bank was undertaken. Some key documents of IMF were also taken into consideration.

**Findings** – The authors examined the indicators of lending activity between the IMF and Ukraine and identified the positive and negative impact of it on the national economy. In addition, the authors emphasize the problems that accompany loans for Ukraine and propose the ways to increase efficiency

**Originality/Value** – The paper presents role of IMF in effective development of the country, potential opportunities and threats, and emerging trends.

**Paper classification** – Research paper.

**Keywords** – credit, credit program, IMF, foreign creditors, economy.

## 1. Introduction

Modern development of Ukraine's economy is closely linked with the global credit markets, international financial flows and dependent on global trends and factors of economic development. The globalization of world financial environment does not localize the financial and credit relations only at the domestic level, but also encourages the free movement of loan capital within the global economy, allowing attract the necessary funds for the needs of national economies.

In modern system of international relations, effective use of international financial institutions' credit resources is an important source for realization priority projects and tasks of social and economic development, a tool for institutional reforms and international integration.



As a borrower on the international credit market, Ukraine cooperates with many foreign state and international financial and credit institutions. However, quite a low credit rating of Ukraine, which in 2016 fell to a negative level S&P (CCC); Moody's (Caa3); Fitch (CCC) (International rating agency, 2016) and confirms the long-term issuer default rating of Ukraine in foreign and local currencies, does not allow the state to effectively borrow on the open credit market. Therefore, cooperation with institutional lenders is particularly relevant.

The current crisis of Ukraine national economy, the difficult socio-economic situation of Ukrainians and unstable military-political situation in the country require finding unusual ways to overcome them and develop preventive programs to prevent political and economic crisis. However, the implementation of these programs requires significant financial resources, larger proportion of which could provide the loan funds attracted from foreign lenders.

In this context, quite relevant and useful for Ukraine is the cooperation with the International Monetary Fund (IMF). However, the variability of external and domestic economic environment of Ukraine actualizes the research and analysis of financial and credit indicators of cooperation between Ukraine and the IMF.

The main tasks, which are to be solved in this article, are:

- to explore and to analyze the dynamics of given credits and credit relations between Ukraine and the IMF;
- to determine the advantages and disadvantages of the IMF's loans for Ukraine;
- to identify the problems of the modern period of Ukraine and the possibility of further cooperation with the IMF.

## 2. Research results

The current period of Ukraine's economy in 2016 is characterized by a certain rise compared to the previous 2015: real GDP in the second quarter of 2016 increased by 1.4% (2015 – -9.9%); inflation rate the third quarter of 2016 was 9.4% (2015 – 39.5%); the volume of capital investments in the third quarter increased by 116.4% to the corresponding period of 2015; the growth rate of foreign direct investment in 2016 – 106.2% (Cabinet of Ministers of Ukraine, 2015). However, despite the growth of the economy, in the country remain unsolved problems: a significant pension fund deficit (UAH 150 billion) the vast majority of which is funded by the state budget; decline in exports by 7.8% (in 2015 – by 27.0%); the deficit of the current account balance in October was USD 234 million (October 2015 – USD 431 million), there are large macroeconomic imbalances because of systematic overstating of macroeconomic indicators, etc. Although some positive changes in the economy are observed, the final overcoming the crisis still remains a long way off.

In this difficult situation, international financial assistance will allow Ukraine to stabilize the economic situation, increase solvency, provide macroeconomic growth and intensify investment processes. And not least, high expectations are imposed on IMF loans.

The importance of foreign loans for Ukraine lies in the fact that the government can raise funds that lead to overcoming the problems of fiscal and budgetary system

and structural modernization of the economy. Therefore, cooperation with the IMF at a certain stage of Ukraine's development has become a very profitable and necessary.

Cooperation between Ukraine and the IMF started in 1992 with the adoption of the Law of Ukraine "On Ukraine's accession to the International Monetary Fund, the International Bank of Reconstruction and Development, International Finance Corporation, the International Development Association and the Multilateral Investment Guarantee Agency" on June 3, 1992 # 2402-XII (National Bank of Ukraine, 2016).

During all the years of Ukraine's independence, the IMF stayed as the largest creditor of Ukraine among international financial institutions. Credit resources of the IMF, which came in the form of preferential long-term credits and made the most noticeable impact on the country's social and economic development, allowed sustaining the financial and monetary system and implementing important investment projects.

IMF provides crediting Ukraine in SDR under the "Stand-By" program (lending macroeconomic stabilization programs). Terms of lending are short: 12–24 months, to a maximum of 36 months. At the same time, it is obligatory to implement several criteria of efficiency of macroeconomic stability without which the country will not receive the next tranche, including: the level of net international reserves, monetary indicators and budget deficit achievement of macroeconomic stability, reforms in the economic and political spheres.

Terms and conditions of credits from the IMF to Ukraine are given in Table 1.

| The name of institution | Credit amount  | Terms        | Interest rate                             | Mortgage | Additional Terms  |
|-------------------------|--|--------------|---|----------|---|
| IMF                     | Quota – 1,372 billion SDR (any special credit terms) | 12–24 months | "Stand-By" program – 3.25% (average rate) | –        | Performing a number of economic and political requirements as performance criteria in the form of economic stabilization program. |

Source: Authors' own study based on IMF (2016)

Despite the rather extended list of credit conditions for Ukraine, loans from international financial institutions remain financially viable and cost effective. The loans allow the state to solve macroeconomic problems and to finance important investment projects.

IMF's transactions with Ukraine during 1994–2016 are presented in Table 2.

Overall, during the years of cooperation with the IMF (1994–2016) Ukraine has received more than SDR 15.23 billion credit resources which is about USD27.8 billion (IMF, 2016). At the same time, it is almost 69% of the total amount of loans from international financial institutions. The largest payments occurred in 2013. (But until settlement of the Fund is far – Ukraine pays by programs 2010, 2014 and 2015).

Administrator of financial resources that were provided by the IMF is the National Bank of Ukraine.

Credits which Ukraine has received from the IMF helped to solve many problems of macroeconomic instability in the country during the last 20 years. Borrowed funds

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**Table 1.**  
Conditions for credits from the IMF to Ukraine

| Year | Purchases and Loans |               | Charges and Interest Paid |
|------|---------------------|---------------|---------------------------|
|      | Disbursements       | Repayments    |                           |
| 2016 | 716,110,000         | 0             | 113,949,329               |
| 2015 | 4,728,100,000       | 968,750,000   | 106,297,866               |
| 2014 | 2,972,670,000       | 2,390,625,000 | 38,583,660                |
| 2013 | 0                   | 3,656,250,000 | 110,651,324               |
| 2012 | 0                   | 2,234,375,000 | 198,041,797               |
| 2011 | 0                   | 0             | 230,042,458               |
| 2010 | 2,250,000,000       | 0             | 157,671,211               |
| 2009 | 4,000,000,000       | 57,283,337    | 87,374,376                |
| 2008 | 3,000,000,000       | 215,618,334   | 8,608,160                 |
| 2007 | 0                   | 278,975,000   | 25,278,365                |
| 2006 | 0                   | 278,974,998   | 35,979,125                |
| 2005 | 0                   | 202,825,419   | 34,108,497                |
| 2004 | 0                   | 201,800,002   | 30,057,314                |
| 2003 | 0                   | 144,516,665   | 31,075,544                |
| 2002 | 0                   | 140,748,392   | 42,719,449                |
| 2001 | 290,780,000         | 361,231,584   | 68,164,641                |
| 2000 | 190,070,000         | 643,491,270   | 92,499,478                |
| 1999 | 466,600,000         | 407,031,249   | 80,734,514                |
| 1998 | 281,815,500         | 77,331,250    | 84,795,670                |
| 1997 | 207,262,000         | 0             | 74,062,799                |
| 1996 | 536,000,000         | 0             | 51,289,813                |
| 1995 | 787,975,000         | 0             | 27,551,931                |
| 1994 | 249,325,000         | 0             | 38,868                    |

**Table 2.**

Transactions with the  
Fund from May 1, 1994 to  
October 31, 2016

Source:IMF (2016)

allow the country to facilitate economic difficulties and provide macroeconomic growth, support and stabilize the banking sector, finance imports and the domestic market commodities.

The main uses of IMF loans were loans to Ukraine's Ministry of Finance for servicing external debt, financing payments and trade balance. Thanks IMF's loans, the formation of foreign exchange reserves of the National Bank of Ukraine made it possible to maintain stability of the national currency, to successfully conduct monetary reform, and, eventually, to introduce full convertibility of the UAH for current operations (The National Institute for Strategic Studies under the President of Ukraine, 2016).

In addition, cooperation with the IMF is an indicator for relations with other international financial institutions and private foreign investors that promote Ukrainian economy among the world's community.

However, despite the possible negative consequences, the government of Ukraine in 2014 began negotiations on a new IMF loans to overcome the economic crisis in the country. As a result, the IMF Executive Board decided to complete the first review of "Stand-By" and allocate the second tranche of SDR 914 million to Ukraine (approximately USD 1.39 billion).

Overall, in 2014, Ukraine received SDR 2.972 billion credit from the IMF.

It should be noted, that at the end of January 2015, there were prepared a new memorandum and new program. Previous cooperation program was designed for a short-term military conflict in the eastern Ukraine, but the situation is getting worse. Now Ukraine needs financial support that will assist in conducting a number of key reforms in the investment climate, the rule of law, fighting corruption, establishing an independent judiciary. The list of reforms still needs to be accepted by the IMF.

Under the "Stand-By" program (SBA), the authorities began implementing difficult reforms to tackle unsustainable policies of the past, including fiscal adjustment, greater exchange rate flexibility, and increases in energy prices, as well as simplifying the regulatory environment for business activity and taking steps to improve governance. Despite these efforts, meeting the program objectives became difficult given the size of the new shocks. To address these challenges, it was necessary to cancel the SBA. Lending program "Stand-By" was replaced by the Extended Fund Facility (EFF) as more effective in Ukraine.

The Executive Board of the IMF in 2015 approved a four-year extended arrangement under the Extended Fund Facility for Ukraine. The arrangement amounts to the equivalent of SDR 12.348 billion (about USD 17.5 billion) and was approved under the IMF's exceptional access policy (IMF, 2014).

The new program of cooperation with the IMF will be a major factor to stabilize the foreign exchange course and strengthen the banking system, which will enable the economy to grow and open access to funds of other international lenders and private investors.

The economic program supported by the Fund aims to secure external and financial stability and restore robust economic growth, while protecting the most vulnerable. Specifically, the policies would aim at: strong monetary policy framework to restore price stability; a comprehensive strategy to strengthen banks' financial health. Together with energy sector reforms and the announced debt operation, this would reduce fiscal imbalances and achieve public debt sustainability with high probability. Social protection schemes would be revamped to protect the poorest and alleviate social costs (IMF, 2015).

The program is subject to exceptional risks, especially those arising from the conflict in the East, which may affect the country's ability to sustain the stabilization efforts and deliver the structural overhaul needed to resume growth. On the other hand, the crisis provides an opportunity for the government to make a decisive break from the past and implement reform-oriented and sustainable policies with strong ownership. The authorities' program responds appropriately to present challenges and deserves strong

support. The implementation risks are being mitigated by a critical set of measures adopted as prior actions and by securing broad political support for program objectives and policies. These should help unlock sizable international official assistance and private capital inflows (IMF, 2014).

The IMF Executive Board's approval of a new credit program for Ukraine will promote restructuring other creditors' debts.

Analyzing documents on cooperation with the IMF (letter of intent to the International Monetary Fund, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding with the IMF) (The National Institute for Strategic Studies under the President of Ukraine, 2016; IMF, 2016), we can formulate the basic provisions:

- restoring stability and confidence in the financial sector
- recapitalization of banks;
- strengthening of corporate governance and financial performance of banks;
- the introduction of effective monetary policy to stabilize the national currency, lower inflation, filling the reserves;
- strengthening public finances and reduce public spending in order to regulate public debt;
- reformation of social assistance programs and providing additional funds for their financing;
- energy sector reform, especially reform of "Naftogaz";
- deepening structural reforms.

### 3. Discussion questions

When exploring the basic principles of cooperation between Ukraine and the IMF and constantly increasing requirements that the fund always brings to its customers, it is worth thinking about the downside of these loans to Ukraine. The cooperation between Ukraine and the IMF is sufficiently ambiguous and has both positive and negative consequences.

The widespread criticism of IMF recommendations, which are considered too straight, "standard" and not flexible, can be observed. But, in fact, no one officially insists that the recommendations of the Fund shall be strictly enforced. Moreover, very recently, the IMF has paid particular attention to the fact that the stability program, financed through a loan Fund, was perceived as governmental, and not imposed from the outside (IMF, 2014).

However, there are risks of negative trends and negative results of cooperation between Ukraine and the IMF, namely: the threat to the financial security of the state, the transformation of Ukraine's financial system in a system dependent on IMF loans, in a significant increase in public debt, the inability to form a long-term competitive national economy, a threat to national sovereignty.

The imposition of the IMF's scenario of economic reformation in Third World countries without taking into account their geopolitical, climatic, ethnic, etc. features, is negative as well. Lack of knowledge about the situation of countries that take out loans and imposing universal package of reforms hinder the development for many years.



The IMF's loan conditions imposed upon borrowers often undermine country's national sovereignty (IMF, 2015).

Additionally, one should not forget about the fact that along with getting foreign credits, Ukraine's national debt and dependence on foreign creditors are increasing and it is fraught with the risk of insolvency, even in the post-crisis global economy.

Since 2016, the state debt of Ukraine totaled USD 71.175 billion and increased comparatively (2015) by 108.7% (UAH 1 572.2 billion or USD 65.488 billion). It should be noted that in 2013 (before the approval of IMF's lending program "Stand-By"), state debt of Ukraine amounted to USD 24.54 billion. In other words, within four years it increased by 2.9 times! Including state foreign debt in 2016, it amounted to 58.5% of the total state debt of Ukraine, and in 2015 – 52.6%. In 2013, state foreign debt amounted to USD 20.27 billion (State debt of Ukraine, 2016).

Such a rapid growth of Ukraine's state debt and state foreign debt in particular, leads to increased financial dependence on creditors and threatens its financial and economic security. There is a question of expediency debt policy on which the government spent the last years and can offer suggestions for the withdrawal of Ukraine from the critical situation and to protect its financial security.

In the analysis of the impact of external public debt, one should pay attention to such indicators as the ratio of external debt to GDP, which shows the level of dependence of national economy on external creditors. In 2016, the ratio of foreign loans to Ukraine's GDP amounted to 39.7%, whereas in 2015 – 49.8% and increased – compared to 2014 (35.3%) – by 14.5 percentage points, and 2013 – 15.4%. In other words, the impact of foreign lending on the Ukraine's economy is enhanced and, accordingly, increasing its dependence on foreign creditors.

Such a situation may result in the state's inability to repay a debt on its own, which could lead to default and the loss of sovereignty. In other words, misuse of foreign loans can be quite severe and, in consequence, can even devastate the national economy of Ukraine.

Obviously, further cooperation with the IMF should be based on a comprehensive consideration of both its positive and negative sides.

However, most doubts concern the requirements of the financial institution's stabilization program, which Ukraine needs to meet in return for regular tranches. Representatives of the Fund attempt to explain their decisions to stabilize the macroeconomic situation, to prevent inflation and the budget deficit as well as worsening balance of payments. However, in today's Ukraine, this led to unprecedented poverty by raising prices for public utilities, including natural gas price for individual customers, which puts the Ukrainian society on the brink of survival. All these measures were a requirement of the IMF!

On the other hand, the state government is trying to attract new loans and new tranches of the IMF. State debt increases from year to year, but the Ukrainians are not informed about the exact list of projects which are to be implemented owing to loans received from foreign creditors. At the same time, there is no information about the status of projects, the level of debt or repayments. In our view, it is unlawful not to provide information on foreign loans and their use in Ukraine's economy, especially when the loans were backed by government guarantees.

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Another problem of foreign lending is the lack of assessment of efficiency of foreign loans. This evaluation should be conducted in public institutions and beyond. However, in Ukraine it almost never happen. In 2011–2012, the Accounting Chamber of Ukraine analyzed in detail only the implementation of the World Bank projects in our country. For credits extended by the IMF peer review was not performed.

## 4. Conclusions

Thus, having examined cooperation between Ukraine and the IMF in terms of foreign credits extended to Ukraine, we can draw the following conclusions:

1. Current credit relations with the IMF give rise to a number of questions concerning terms of loans and Ukraine's implementation of the agreements reached, as well as the effectiveness of lending.
2. In recent years significantly increased the dependence of Ukraine on foreign loans, which manifests itself in their rather high share (over 40%) in Ukraine's GDP and threatens the financial security of the state.
3. Overall, during the years of cooperation with the IMF (1994–2016), Ukraine has received more than SDR 15.23 billion credit resources which is about USD 27.8 billion (IMF, 2016).

However, despite all the organizational shortcomings, foreign credit remain essential to Ukraine as they contribute to improvement in the economic situation of the state and its macro-financial indicators, a competitive market environment, the stabilization of the national currency, enhancement of the investment process, the development of private enterprise. In addition, foreign loans allow one to implement many projects that are too expensive for the Ukrainian government and private entrepreneurs, namely environmental, energy saving, infrastructural, energy efficiency industries, large-scale transportation projects and more.

We believe that the only effective use of IMF credit received by Ukraine in the years 2014–2015 and conducting economic reforms more rapidly will enable later cooperation with the IMF and other international financial institutions without their loans, but only on the basis of their involvement in technical assistance and consulting support.

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