Ukraine's debts to Western banks are destroying its social safety net

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OPINION: The reconstruction of Ukraine will be crippled by the debts it owes to the IMF and other institutions

The Ukrainian army continues to make territorial and military gains against invading Russian forces on the eastern front. But how is the country faring on the 'western front'?

Some have suggested that the dangers confronting the Ukrainian state come not only from Russian tanks but also Western banks and, more specifically, from Ukraine's growing foreign debt.

This debt could hinder Ukraine's spending on the war effort and drastically reduce its social spending. It also means that, once the war is over, Ukraine could face considerable pressure from its creditors on how the county's reconstruction should happen.

According to Ukraine's economy minister Yulia Svyrydenko, the Russian invasion has already cost Ukraine $564.9bn (£494.5bn) in destroyed infrastructure and lost economic growth. Post-war reconstruction costs so far are estimated at nearly $750bn (£632bn).

Ukraine's exports have collapsed by around 35% since 2021, and GDP is estimated to have contracted at a similar rate.

At the same time, inflation is soaring and the country's currency, the hryvnia, is collapsing – partly because, due to a lack of investor interest, the country's central bank had to buy bonds issued by the government to fund the war effort. Subsequently, the bank more than doubled interest rates – to 25%, the highest in Europe – to fight the inflation it had helped create.

Temporary debt freeze…

Ukrainians and their global supporters have long campaigned for debt relief. Finally, in August, after months of pressure and with $1bn (£840m) of bond payments due on 1 September, Kyiv was granted a temporary freeze on debt payments. This suspends Ukraine's need to service significant debts until the end of 2023, and potentially for another year.

Campaigners for Ukrainian debt relief rightly noted this as a positive development. However, the debt cancellation that some had hoped for now seems unlikely, and the debt excludes major creditors such as the International Monetary Fund (IMF) and the World Bank. The European Commission, which has loaned Ukraine more than €13bn (£11.4bn), also did not join the deal.

Before the freeze, Ukraine had already spent $2.8bn (£2.4bn) this year just on servicing its debt. To put this in perspective, it is a third of what the government has spent on social welfare during the Russian invasion.

Some major Ukrainian companies are also facing debt problems. In July, Naftogaz, the part-state-owned energy company, defaulted on payments to some bondholders who had not signed up to deferral plans. Ukrainians can't afford to pay their utility bills (domestic gas prices have increased 650% since 2014), which contributed to Naftogaz's default – but it's vital that the company continues to function as the country enters winter.

Roads agency Ukravtodor and electricity company Ukrenergo – both state-owned – managed to negotiate a two-year freeze on $1.5bn's worth (£1.26bn) of bond payments due at the end of the year. However, their debts are state-guaranteed, so the Ukrainian government will be responsible if there are problems with future payments.

… but not from the IMF and World Bank

International financial institutions that have loaned huge sums to Ukraine since the start of the war in Donbas in 2014 are insisting that the country continues to pay its debts to them – plus the associated interest, charges and fees. The annual meetings of the IMF and World Bank last month didn't even discuss suspending, relieving or forgiving Ukraine's debt.

> "The long list of monetary problems that Ukraine is facing means that, once the war is finally over, the country will have to dance to the tune of the IMF and World Bank"

This year, despite the war, Ukraine has repaid the World Bank $496m (£417m) plus $58m (£49m) in fees and interest, and the IMF $1.3bn (£1.09bn) plus $150m (£126m) in surcharges. Over 2022/23, Ukraine is expected to repay the IMF $2.7bn (£2.27bn), plus $486m (£409m) in surcharges.

These enormous amounts are even more astounding when compared to the country's vital expenditures. So far in 2022, Ukraine has spent $77m ($65m) on environmental protection, half the figure paid to the IMF in surcharges, and $1bn (£840m) on education, $300m (£252m) less than its repayment to the IMF.

Once the debt freeze is lifted

Thanks to these crippling debt repayments, as well as soaring military expenditure and increased social spending, the Ukrainian government has a monthly fiscal shortfall of $5bn to $6bn (£4.2m to £5m). It relies on loans to bridge the gap.

Although the freeze appears to give the embattled country a 'payment holiday', these loans will have to be repaid – along with the interest that is continuing to accumulate. In other words, this "market-friendly" deal straightjackets Ukraine into suffocating and unsustainable obligations.

This matters because Ukraine's debt levels will determine the country's future reconstruction.

This is dangerous for two reasons. First, because most of Ukraine's debt is denominated in US dollars (60%) or euros (24%), spiralling Ukrainian inflation ensures that debts are harder to repay.

Second, in addition to approximately $25bn (£21bn) in bond commitments, Ukraine has outstanding 'GDP-linked' obligations to creditors of $3.2bn (£2.7bn).

These instruments ensure that Ukraine will pay investors an increasing amount as post-conflict reconstruction increases GDP, as repayments on these obligations are tied to GDP growth.

Goodbye labour rights, hello privatisation

The long list of monetary problems that Ukraine is facing – crushing debt obligations, runaway inflation, collapsing exports, downgraded credit ratings, devalued currency – means that, once the war is finally over, the country will have to dance to the tune of the IMF and World Bank.

When it comes to post-conflict reconstruction, the strategies of these financial institutions is centred on ensuring a 'friendly environment' for private capital to guarantee 'business confidence'.

International creditors, financial institutions and 'experts' of various kinds are already calling for further deregulation, labour liberalisation, privatisation and reduced social spending in Ukraine.

Experts from London's Centre for Economic Policy Research (CEPR) even suggested that Medecins Sans Frontières and the Red Cross can take over the medical supplies and services in Ukraine. In other words, it envisioned the country as a hollowed-out state that abandons its citizens to the ravages of local and global capital.

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The Ukrainian government has seemingly jumped at the opportunity of enforcing a business-friendly environment, even as Russian bombs rain down. Ensuring the power of business at the expense of Ukrainian workers, parliament recently passed legislation that curtails trade union representation, makes it possible to remove Ukrainian workers from national labour law protections, and allows firms to suspend employees arbitrarily.

This new law – which the UN's International Labor Organization objected to, and the UK government secretly supported – was originally submitted by the Zelenskyi government in 2021, but only passed under wartime conditions. This is despite about 40% of Ukrainians losing their jobs since the invasion began, and Ukrainian businesses slashing nominal wages.

The government is also planning to merge its social insurance fund with its state pension fund, firing personnel, cutting state expenditure and reducing benefits in the process – even though millions of Ukrainians asked for social assistance when Russia invaded, and the pension fund provides a lifeline for the country's elderly. Even the government itself estimates that 60% to 80% of Ukrainians may end up below the poverty line.

Again, Zelenskyi's government first mooted this idea during the pandemic crisis, and only passed the changes now.

The debt freeze announced in summer appeared to be a win for the conflict-affected Ukrainian people, but a closer look reveals a much bleaker picture. It actually locks Ukraine into an era of distressing debt servitude, and also ensures that the country's reconstruction is dictated by the neoliberal imperatives of creditors, international financial institutions and bondholders.

Ukraine needs complete debt cancellation so that it can build a more free, equitable and collective society once the war is won.

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P.S.

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https://www.opendemocracy.net/en/odr/ukraine-debt-freeze-western-creditors/