September 18, 2002

THE BLEYZER FOUNDATION

Edilberto Segura, Nina Legeida

Ukraine and the IMF

1. History of Relations Between Ukraine and the IMF

Ukraine joined the IMF on September 3, 1992. Ukraine's quota was SDR997 million (about $1.6 billion). Collaboration between Ukraine and the IMF on the implementation of economic programs started in October 1994. Since that time five major programs have been approved: (i) a Systemic Transformation Facility (STF) in October 1994; (ii) a first Stand-by Arrangement in April 1995; (iii) a second Stand-by Arrangement in May 1996; (iii) a third Stand-by Arrangement in August 1997; and (iv) an Extended Fund Facility in September 1998 (See Table 1). This IMF financing for balance-of-payments support was accompanied by IMF economic surveillance and was subjected to conditionality to ensure that necessary structural policies were pursued within a macroeconomic stability framework.

Table 1. Ukraine: History of Lending Agreements as of August 31, 2002*, USD million

Facility	Date of Arrangement	Date of Expiration	Amount Agreed	Amount Drawn	Amount Outstanding
Extended Fund Facility	Sep 04, 1998	Sep 03, 2002	2,548	1,584	1,584
Stand-by Arrangement	Aug 25, 1997	Aug 24, 1998	530	241	18
Stand-by Arrangement	May 10, 1996	Feb 23, 1997	794	794	0
Stand-by Arrangement	Apr 07, 1995	Apr 06, 1996	1,324	715	0
Systemic Transformation	Oct 26, 1994	N/A	795	795	303
Total			5,990	4,128	1,905

* Amounts in SDR have been converted into USD amounts using exchange rate USD/SDR as of August 31, 2002
Source: IMF

On October 26, 1994, a Systemic Transformation Facility (STF) was approved. Its maximum amount could be 50% of Ukraine's quota. The

In 1999, SigmaBleyzer initiated the International Private Capital Task Force (IPCTF) in Ukraine. Its objective was to benchmark transition economies to identify best practices in government policies that improve the investment climate and attract private capital. An Action Plan was developed and presented to the Ukrainian government, which identified the economic policy actions necessary to improve the investment and business climate in Ukraine; attract additional flows of private capital to the country, support economic growth, and improve the quality of life for their citizens. In 2001, this effort was expanded to all countries of the FSU, and IPCTF ratings for all 15 countries of the FSU were developed. They are available from SigmaBleyzer and The Bleyzer Foundation.

The Bleyzer Foundation was established in 2001 in order to promote the IPCTF framework and help countries implement the policies necessary to successfully complete transitions to market economy.

The Foundation's Managing Director is Mr. Victor Gekker, who is supported by a team of economists and business analysts. The Advisory Board of The Bleyzer Foundation is chaired by Dr. Edilberto Segura and provides advice and guidance to the activities of the Foundation.

SigmaBleyzer
Where Opportunities Emerge.

Edilberto L. Segura
SigmaBleyzer
Chief Economist & Director, Kyiv Office

Nina Legeida,
SigmaBleyzer,
Economist-Analyst, Kyiv Office

IMF defines the STF as a temporary IMF financing facility that provides assistance to member countries facing balance-of-payments difficulties arising from severe disruptions in their international trade and payments arrangements owing to a shift from reliance on trading at non-market prices to multilateral market-based prices. Most policy commitments under the STF program were achieved, particularly the tightening of financial policies. Its results were generally evaluated as good, though difficulties in such areas as inflation control, the balance of payments disequilibrium, and structural imbalances were noted.

To address these difficulties, on April 7, 1995, the IMF approved the first Stand-by Program for Ukraine. The Ukrainian authorities had requested a 12-month Stand-by Arrangement to support their adjustment and reform program. The program of the Ukrainian authorities had three major objectives: to bring down inflation by reducing the fiscal budget deficit, to strengthen export performance and to promote market-based economic reforms. In the first half of 1995, Ukraine achieved some progress: lower inflation, nominal exchange rate stability, higher capital inflows, strong export performance, and revived private sector activity. However, in the second half of 1995, delays and drawbacks in policy implementation were recorded. Ukraine did not receive the full amount of the loan. Only three of the four envisaged tranches were released, because of the non-fulfillment by Ukraine of the 1995 Memorandum conditions. As a result, Ukraine received only 54% of the previously assigned amount.

In early 1996, the government tried to improve the situation and on May 10, 1996 the IMF approved a nine-month Stand-by credit for Ukraine to support the government's 1996 economic reform program. The program was aimed at resuming stabilization and liberalization of the economy. The targets were to reduce inflation to 1–2% per month until the end of the year, slow down the decline in output, and speed up the realization of Ukraine's economic potential. The 1996 program also envisaged the reduction of the consolidated fiscal budget deficit, removal of ad hoc tax exemptions, reductions in expenditure arrears, reductions in subsidies, the replenishment of net international reserves, structural reforms, and the improvement of social protection policies. Ukraine's performance in the realization of the program was evaluated as quite significant: inflation was reduced; progress was made in price liberalization, privatization and trade liberalization; and the VAT and EPT were introduced. The STF and 1996 Stand-by Program were the only IMF programs within which Ukraine managed to receive the full amount of the envisaged financing.

On August 25, 1997, the IMF approved the third Stand-by credit for Ukraine for 12 months to support the government's 1997–1998 economic program. The key objectives of the program were to resume economic growth based on further economic reforms, decrease further inflation and strengthen the external reserve position of the NBU. But in March 1998 the IMF refused to grant Ukraine the subsequent tranches of the Program because Ukraine violated some indicators of Ukraine's Economic Memorandum, in particular the budget deficit figure and excessive increases in the monetary base. Ukraine received only 46% of the original amount within this Program.

2. The Extended Fund Facility

Following the Russian financial crises of August 1998, Ukraine agreed to implement a strong program of economic reforms. On this basis, on September 4, 1998, the IMF approved a three-year loan for Ukraine in the amount of $2.2 billion under the Extended Fund Facility (EFF) to support the government's 1998–2001 economic program. The expiration date for the facility was set at September 3, 2002. About $257 million was available at once in September 1998. The key objectives of the EFF Program were to improve public finances, conduct structural reforms to foster economic growth and improve the living standards of the population. The program was designed to achieve 4% GDP growth, an inflation rate of 7%, and gross international reserves equivalent to 7 weeks of import cover (all for 2001).

Quarterly monitoring was conducted to signal the need for any adjustments. These reviews formed the basis for the dialogue between the Ukrainian authorities and the IMF and for the decisions to disburse the monthly tranches during the first year and quarterly tranches thereafter.

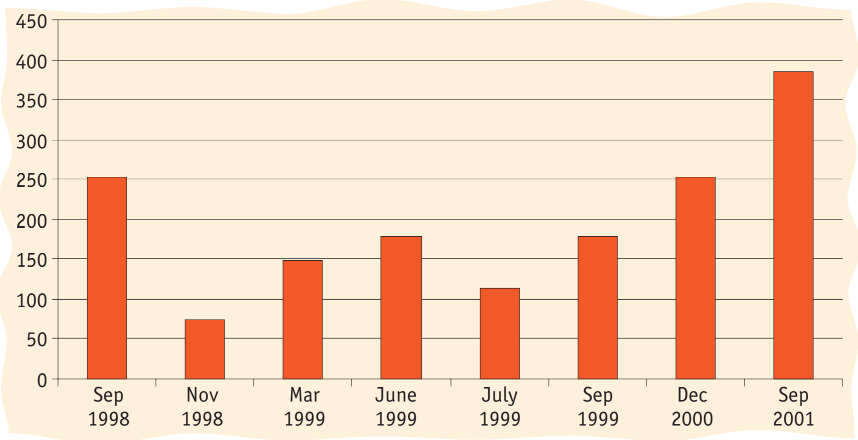
On May 27, 1999, the IMF approved the request of the Ukrainian authorities to increase IMF financial support under the EFF Program by about $366 million. The request for the increase was explained by a worsening external position as a result of weak commodity prices for Ukraine's exports, in particular metals, lower regional demand because of the difficult situation in Russia, and effects of the Kosovo crisis.

The history of the disbursements under the EFF Program is presented in Figure 1 below.

Periodic disbursements were made until September 1999, though the timing and amounts varied to reflect slippages in performance. But in October 1999, the IMF temporarily stopped tranche disbursements to Ukraine because of the slow pace in the implementation of agreed upon economic reforms and Ukraine's non-fulfillment of measures envisaged by the Program. The EFF made a disbursement in December 2000, when a tranche of $246 million was released. Further tranches were again withheld due to disagreements on implementation of agreed upon reforms and the claim that Ukraine had provided non-reliable information in 1996–1998 on the amount of the

NBU's international reserves. The last tranche under the EFF Program was provided in September 2001.

Figure 1. Disbursements to Ukraine under the EFF Program, USD million



Source: IMF

Although it was expected that a final large tranche could be disbursed in August 2002, before the expiration of the EFF Program on September 3, 2002, the IMF decided not to disburse any funds due to further disagreements on policy reforms. In particular, the following items were considered inadequate by the IMF: inability to repay arrears on overdue VAT refunds to exporters, failure to abolish excessive tax privileges and exemptions, and the possibility that this failure would lead to poor implementation of Ukraine's fiscal budget for 2002. The IMF was concerned that a number of tax privileges and exemptions enacted by Parliament in 2001 would result in lower budget revenue, fiscal non-transparency and the creation of an uneven tax burden across the economy. The IMF also felt that the delays in refunding overdue VAT payments to exporters would worsen and harm Ukraine's position in the eyes of the world community, pushing away potential foreign investors.

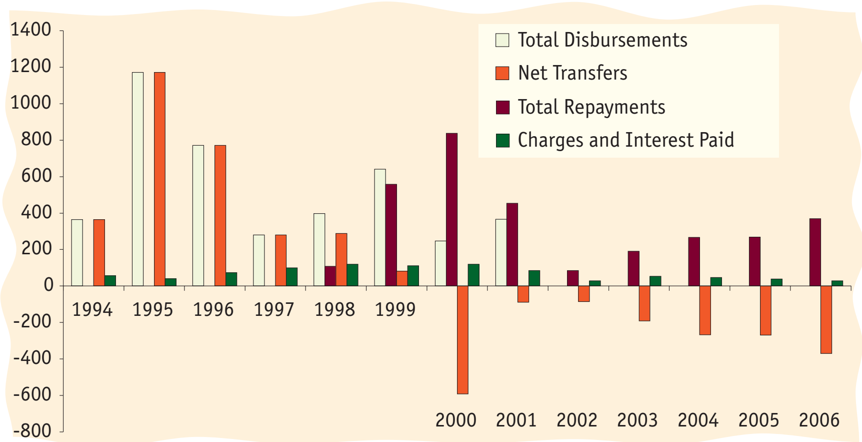
Nevertheless, Ukraine was able to achieve the original major macroeconomic targets of the Program. In 2001, the GDP growth rate was high at 9.1%, the inflation rate was low at 6.1%, and international reserves grew to an equivalent of 7.8 weeks of imports. Furthermore, many reforms were undertaken in the sphere of public finances, notwithstanding a number of unsolved problems, one of which was the delay in the enactment of the Tax Code. Economic growth in 2000–2001 helped to raise the living standards of the population through real and nominal growth of population incomes, wages and pensions, which started being paid on time.

In addition to IMF financial assistance, Ukraine benefited from IMF technical assistance. Many Ukraine government officials, including senior and junior levels, received training in various programs at the IMF Institute in Washington, D.C. and at the Joint Vienna Institute in Austria. IMF experts have assisted the government in bringing Ukrainian macroeconomic statistics in line with international standards. The IMF also provided technical assistance to officials from the State Statistics Committee, the Ministry of Finance and the National Bank of Ukraine. In September 1999, the IMF produced a report on observance of financial standards and codes, the "Experimental Module on Fiscal Transparency for Ukraine".

3. IMF Financing: Disbursements, Repayments and Net Transfers to Ukraine

As shown in Figure 2 below, Ukraine received significant volumes of disbursements and net transfers in 1995 and 1996, each averaging $900 million per year. In 1997 and 1998, net transfers were lower, but still significant, at about $300 million per year. Ukraine started to repay its debt to the IMF in 1998 (before that time it only paid charges and interests), with large debt repayments in 1999–2001. As a result, starting in 2000 net transfers became negative, at minus $600 million. In 2002, debt repayments are relatively small, but starting in 2003, debt service obligations will become significant again, producing negative transfers averaging about $300 million per year during the 2003–2006 period, as noted below.

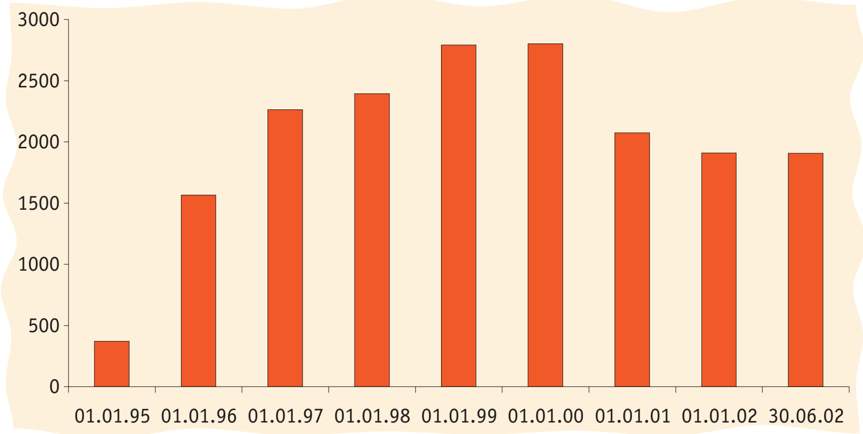
Figure 2. Ukraine: Transactions with the IMF*, USD million



* For 2002–2006 projected payments to the IMF take into account all currently scheduled payments to the IMF and assuming no new IMF financing programs.
Source: IMF

The IMF is presently one of Ukraine's largest creditors. As of June 30, 2002, the share of IMF debt in Ukraine's total external public debt was about 20% (at about $1.9 billion from total external debt of $10.1 billion (see Figure 3)).

Figure 3. Ukraine: Outstanding Debt to the IMF, USD million



Source: Ministry of Finance of Ukraine

4. Options for Future Collaboration

To review options for future collaboration between Ukraine and the IMF, it would be useful to first review the types of programs that the IMF can have with its member countries. The IMF's major operations involve (a) IMF Staff Monitoring, (b) financial assistance, and (c) technical assistance.

A. IMF Staff Monitoring

Under its Staff Monitoring Programs, the IMF closely monitors and consults with government officials on the adequacy of the economic and financial policies undertaken by the government. Based against the background of quantitative benchmarks, the IMF addresses the question of whether a country's economic developments and policies are consistent with the achievement of sustainable growth and domestic and external stability. This evaluation provides a clear signal to other investors on the adequacy of the government's economic policies. Other forms of IMF surveillance do not include quantitative targets, such as the IMF Enhanced Surveillance (which includes periodic consultations with the country and could involve several missions per year but without the determination and monitoring of quantitative economic and financial benchmarks), and the mandatory Article IV Consultation, which the IMF holds every year with each of its members according to the requirements of the IMF Charter.

B. Financial Assistance

Financial assistance is the major IMF function. The organization provides loans to countries that experience balance-of-payments problems. The objective is to enable the countries to rebuild their international reserves, stabilize their currencies and pay for imports without imposing trade restrictions or capital controls.

The IMF loan instruments envisage concessional and non-concessional lending. Concessional lending is provided to low-income countries, which can borrow at low interest rates through the Poverty Reduction and Growth Facility (which replaced the former Enhanced Structural Adjustment Facility (ESAF)). Non-concessional loans are provided through the following five facilities: Stand-by Facilities, the Extended Fund Facility, the Supplemental Reserve Facility, the Contingent Credit Lines, and the Compensatory Financing Facility. These facilities are described below.

Poverty Reduction and Growth Facility (PRGF):

This facility focuses on poverty reduction programs. It is provided to eligible low-income countries. The interest rate on PRGF loans is 0.5% pa, with loans to be repaid in 5.5–10 years. As of September 6, 2002, there are 38 arrangements according to this facility, including PRGF facilities for the following transition economies: Albania, Armenia, Azerbaijan, Georgia, Kyrgyz Republic, and Moldova. Ukraine does not qualify for this facility.

Stand-by Arrangements:

Stand-by Facilities are designed to address short-term balance-of-payments problems. It is the most widely used IMF facility. It has a typical length of 12–18 months, though some Stand-bys have been granted for 2 years. Repayments take place over 2¼–4 years. Surcharges are applied in cases of high levels of lending (access to the facility). Under Stand-by Arrangements, the countries are committed to maintain sound fiscal and monetary policies. The agreement would also require the country to implement structural economic reforms that would ensure sustainable internal and external equilibrium. The Stand-bys can be Regular or Precautionary. Under a Regular Stand-by, periodic disbursements are scheduled in advance. Under a Precautionary Stand-by, disbursements are not scheduled in advance as the country had expressed its desire not to withdraw funds unless there were to be unforeseen circumstances. If the government were to decide to withdraw funds under the Precautionary Stand-by, it can do so and receive all pending "tranches", provided that the country is meeting all program conditions. As of September 6, 2002, there are 14 Stand-by Arrangements with the following countries: Argentina, Bosnia and Herzegovina, Brazil, Bulgaria, Dominica, Guatemala, Jordan, Latvia, Lithuania, Peru, Romania, Sri Lanka, Turkey, and Uruguay.

Extended Fund Facility (EFF):

The EFF is designed to address deeper and more protracted balance-of-payments problems with roots in weaknesses in the structure of the economy. These arrangements are normally for disbursements over a period of three years, with repayment in 4.5–7 years. Surcharges are also applied to high levels of access. Under the EFF arrangements, the countries are committed to maintain sound fiscal and monetary policies. The agreements would contain conditionality stronger than the conditionality contained in Stand-by Facilities, requiring the country to implement a large number of structural economic reforms that would ensure sustainable internal and external equilibrium. As of September 6, 2002, there were three extended arrangements with Colombia, Indonesia, and Yugoslavia.

Supplemental Reserve Facility (SRF):

This facility is designed to meet a need for very short-term financing on a large scale, for example, in a financial crisis. The repayments of the loans must be made within 1 and 1.5 years. A significant surcharge of 3–5 percentage points would apply to this facility. SRF facilities were approved for Uruguay in 2002, Argentina in 2001, Turkey in 1999, and Russia in 1998.

Contingent Credit Lines (CCL):

The Contingent Credit Line is designed to help members to prevent crises. It is offered to countries that are implementing sound economic policies, but find themselves threatened by a crisis elsewhere in the world economy — a phenomenon known as financial contagion. For this crisis, the CCL would be made available to the country. It is expected that the availability of such CCL would discourage speculation and the contagion effect. This CCL Facility has the same repayment conditions as the Supplemental Reserve Facility, but with a smaller surcharge of 1.5–3.5 percentage points. Mexico and Chile are examples of countries that have benefited from this facility.

Compensatory Financing Facility (CFF):

The CFF is intended to assist countries that face either a sudden shortfall in export earnings or an increase in the cost of imports caused by fluctuating world commodity prices. Its financial terms are similar to those of the Stand-by Arrangement, but without a surcharge. IMF CFF programs were approved for Azerbaijan (in response to export losses associated with the Russian crisis), Pakistan and Macedonia.

Emergency Assistance:

Emergency Assistance is provided to countries that have experienced a natural disaster, such as earthquakes, or are emerging from a military conflict. The charge is the basic IMF rate with a repayment of 3.5–5 years.

The IMF also provides assistance to eligible countries under the Heavily Indebted Poor Countries (HIPC) Initiative.

C. IMF Technical Assistance

The objective of IMF Technical Assistance is 'to contribute to the development of the productive resources of member countries by enhancing the effectiveness of economic policy and financial policy'. Technical assistance support is provided for capacity building and for policy design.

Technical assistance is normally provided free of charge in the following areas: fiscal policy, monetary policy and macroeconomic statistics. About three-quarters of IMF technical assistance goes to low and lower-middle income countries. Sub-Saharan Africa currently receives most technical assistance.

Demand for technical assistance far exceeds supply, thus, the priority is given to main policy areas, covering crises prevention, debt relief, poverty reduction, and capacity building. Resources are also devoted to assist countries to combat money laundering and terrorism financing, assistance for which is provided under two joint IMF-World Bank programs: the Financial Sector Assessment Program and Reports on the Observance of Standards and Codes.

Technical assistance is delivered in different ways: staff missions of limited duration, the placement of experts for periods ranging from a few weeks to a few years (if long-term, the country may be asked to make financial or equivalent in-kind contribution), preparation of technical and diagnostic reports, training courses, seminars, workshops, on-line advice, and support from the headquarters in Washington, D.C.

The IMF stresses a regional approach. Currently, two regional technical assistance centers operate in the Pacific and the Caribbean, and two are being established in East and West Africa. Training is offered at headquarters and through overseas regional institutes and programs: the Joint Regional Training Center for Latin America, the Joint Africa Institute, the IMF-Singapore Regional Training Institute, and the Joint Vienna Institute. Bilateral training programs are set up with China and the Arab Monetary Fund.

5. Considerations of the Merits for Ukraine of an IMF Program

The main consideration for Ukraine on whether it will need future financing from the IMF is the potential capacity of the country, in the future, to earn sufficient foreign exchange through exports to cover necessary imports, serve its international debt, and maintain a reasonable level of international reserves. If this capacity to earn foreign exchange were to be lacking, the country could face balance-of-payment problems, including a drop in international reserves, internal and external instability of the currency, and possible default in international debt obligations.

During the last two years, Ukraine was able to grow at a solid pace and generate surpluses in the current account of the balance of payment that enabled it to cover imports, serve foreign debt and rebuild its international reserves. The national currency was quite stable during the last two years due to these favorable external conditions and sound fiscal and monetary policies. This allowed the National Bank of Ukraine (NBU) to build up international reserves, which reached $4.1 billion at the end of August 2002.

The following sections review: (a) the future prospects for Ukraine's international trade, (b) the country situation with international debt service, and (c) the adequacy of international reserves.

(A) International Trade Prospects

During the last two years, Ukraine experienced positive current account balances, which reached $1.7 billion in 1999 (or 5.4% of GDP) and $1.4 billion in 2001 (or 3.7% of GDP). For 2002, the NBU expects an even larger positive current account balance in the amount of $2.1 billion. However, for 2003, the NBU forecasts that the current account surplus may be reduced somewhat to $1.5 billion, due to the expectation that export prospects would be less favorable than today.

It should be noted, however, that the current account projection for 2003 faces significant uncertainties. Ukraine's major export items are metals and chemicals, which account for 50% of exports. These are low value-added products, mostly raw materials or semi-finished products. The markets for these commodities are highly volatile, which makes Ukraine's external position vulnerable to changes in world demand or supply. Steel export earnings have changed as much as $500 million to $1,000 million from year to year. Ukraine has been able to increase the export share in agricultural commodities, which are also highly volatile and difficult to predict.

The country's exports are also dependent on developments in the Russian economy, as Russia is still one of the major trading partners of Ukraine, accounting for about 23% of exports. In fact, during the last few years, given protectionist policies in Russia, Ukraine's exports to Russia have declined significantly. So far, Ukraine has managed to make up for the fall of exports to Russia by expanding trade with other non-traditional partners. But it is uncertain whether Ukraine will be able to continue to developing new markets to cover shortfalls in its traditional markets.

The Ukrainian economy is also highly dependent on imports, especially such vital goods as energy imports from Russia and Turkmenistan. Energy imports account for 43% of total imports. The country, therefore, has limited flexibility in reducing import levels without affecting the performance of its economy. Furthermore, any rise in energy prices, assuming the same domestic demand for energy imports, can have a large impact on the value of Ukraine's imports. This is a major risk factor given Ukraine's lack of potential to increase exports easily to compensate for the import rise. Ukraine's import ratio, calculated as the ratio of total imports to international reserves, was 663% in 2001, which is extremely high. International reserves cover only 7 weeks of imports. The greater the need for imports, the quicker the country may be expected to deplete its foreign exchange reserves.

These uncertainties on the capacity of Ukraine to generate sustainable current account surpluses to serve foreign debt suggest that Ukraine should have the ability to access international funds in the future, if its international trade situation were to deteriorate.

(B) International Debt Service

The level of public foreign debt of Ukraine is not excessive. At $10.1 billion (including IMF debt), Ukraine's external debt to GDP is about 26%, which is about half the international accepted threshold of 50% of GDP for foreign debt. Also Ukraine's external debt to exports ratio is about 48%, which is significantly below the international critical value of external debt to exports ratio of 200%. General external debt service ratios have also been reasonable. In 2001, Ukraine's external debt service to GDP was 2.3% (less than critical value of 5%) and external debt service to exports was 4.1% (less than critical value of 25%).

However, during the next two years, Ukraine will face a peak in foreign debt repayments. In 2003 and 2004, Ukraine will need to repay about $2.0 billion per year, including IMF debt service by the NBU. These amounts are larger than the current account surpluses of $1.5 billion that Ukraine is expected to generate in these two years.

In order to serve its foreign debt obligations, Ukraine will need to have access to international borrowings, either from private sources or from official institutions.

Regarding private sources, Ukraine does not currently enjoy easy access to private capital flows. In the immediate future, Ukraine cannot rely on significant increases in the amount of Foreign Direct Investments (FDI). Until now, the flows of FDI have been relatively modest and it would take some time for these flows to become significant. Private foreign debt financing is a more immediate possibility. In fact, Ukraine has already stated that in 2003, it intends to borrow about $750 million to $900 million on international private capital markets to serve international debt. This financing may take the form of Eurobonds or syndicated loans with international banks. It is quite possible, however, that if an active IMF program were not in place, the terms and conditions for this private debt financing would be less favorable. In fact, the existence of an IMF Program (even if it were to be limited to IMF Staff Monitoring) reassures private international lenders that the macroeconomic situation of the country is being monitored and imbalances would be identified and addressed more expeditiously than if no such program were to exist. Thus, private lenders watch the country's relations with the IMF since they may have imperfect information about the country. Stronger IMF Staff Monitoring will make more timely and necessary data available for investors to form an opinion about the country's creditworthiness and investment opportunities.

The lack of an IMF Program may also affect balance-of-payment (structural adjustment) loans by other multinational and bilateral agencies such as the World Bank and the European Union. For these multilateral and bilateral institutions, the IMF should normally be the first agency to provide balance-of-payment support. It has been the policy of these institutions that they would only complement, not substitute, the IMF in balance-of-payment financing. Furthermore, the World Bank would normally wait to receive confirmation from the IMF that a sustainable macroeconomic framework is in place before a proposal for balance-of-payments disbursement is presented to the World Bank's Board of Executive Directors for approval. Except for non-project structural balance-of-payment loans (such as the Programmatic Adjustment loans), other project specific loans by the World Bank would not be affected by the lack of an active IMF Program. But in the absence of an IMF Program, World Bank staff will need to make an independent assessment for project lending that the general macroeconomic situation of the country is satisfactory.

Thus, an IMF program may have a positive effect on private and official lenders by creating confidence in the soundness of the countries' economic policies. The IMF may also facilitate debt-restructuring agreements, thus correcting another market failure — lack of coordination between lenders. In fact, the recent successful restructuring of Ukraine's bilateral debt with the Paris Club was made possible by the existence of an active program with the IMF.

(C) International Reserves Situation

The level of international reserves to imports is one of several measures on the adequacy of international reserves and is the most widely used measure by the IMF. The traditional rule of thumb is that international reserves should be equivalent to no less than 12 weeks of imports. Currently, Ukraine's international reserves amount to $4.1 billion or about 7 weeks of imports. The NBU would like to have international reserves equivalent to 9 weeks of imports by the end of 2002. Whether this target is achieved or not, the point is that the current level of international reserves is not excessive and should not be counted on as the major source for the service of foreign public debt. Significant reductions in the current level of international reserves may have a destabilizing effect for the national currency.

(D) Other Factors

Another important consideration on the merits of an IMF program is the potential risk that the country may not be able to successfully monitor its economic performance by itself and take prompt corrective measures as necessary. Ukraine has made progress with its economic reforms; but these reforms need to be accelerated to promote and make present economic growth sustainable. The IMF can play a useful role to put pressure on vested interests to accelerate the process of reforms.

6. Possible Ukrainian Position on IMF Cooperation

From the above discussion, it can be concluded that some form of IMF Program may be useful for Ukraine. Under some circumstances, financing per-se may not be as important as the existence of an active IMF policy dialogue and monitoring, such as under the IMF Staff Monitoring Program or the Precautionary Stand-by Program. In fact, successful transition and developing countries have been able to "graduate" from IMF financing, as they were able to secure access to private international capital markets. But most of them continued to receive some form of IMF Surveillance. For example, Poland, Russia, the Czech Republic, and Hungary cooperate with the IMF only under an IMF Surveillance Program. From time to time they may rely on the IMF financial assistance to solve balance-of-payments problems.

In the case of Ukraine, it seems that the uncertainties in its international trade prospects, the high volatility of international capital markets today, and the high foreign debt service repayments due in 2003 and 2004 would call for some form of IMF financial assistance. The IMF might not be able to grant to Ukraine another Extended Fund Facility, since it is not the normal policy of the IMF to provide two consecutive EFFs back-to-back. However, in Kazakhstan, Indonesia and Jordan the IMF was able to provide two consecutive EFF facilities.

The advantages and disadvantages of IMF Staff Monitoring, Regular Stand-by, Precautionary Stand-by, and combined Regular-Precautionary Programs are as follows:

The **IMF Staff Monitoring Program** would provide a signal to international investors on the adequacy of the government's economic and financial policies and on whether these policies are proceeding in accordance with agreed upon quantitative benchmarks. This would help in attracting other sources of international financing, since a positive IMF assessment constitutes a form of IMF endorsement of the country's policies. An IMF Staff Monitoring Program, however, may not be sufficient for Ukraine, given the possibility that the balance-of-payment situation may be more difficult in the next two years, and given the size of foreign debt service payments. Furthermore, it is possible that an IMF Staff Monitoring Program alone would not be sufficient for the World Bank, the European Union and some bilateral agencies to provide balance-of-payment support to Ukraine. As noted earlier, in the past, the IMF has taken the lead in providing balance-of-payment funds. If an IMF Staff Monitoring option were to be chosen by Ukrainian authorities, it may be desirable for them to reach a clear agreement with the World Bank and the EU beforehand that they will continue their structural adjustment lending based on a positive assessment of the IMF under its Staff Monitoring Program. There is no overwhelming reason why Ukraine would not be able to reach these agreements.

A **Precautionary Stand-by Program** would have some additional advantages for Ukraine. First, it would send a clear message to private foreign lenders that Ukraine is serious in monitoring its economic performance and that the country may have access to IMF resources if they were needed. Second, the Stand-by will contain macroeconomic and structural conditions, but these conditions are likely to be less comprehensive than the conditions under an EFF program, because they will cover a shorter time slice, e.g., one to two years under a Stand-by, rather than three to four years under an EFF.

One of the drawbacks of a Precautionary Stand-by is that the country will have to pay a commitment fee regardless of whether or not it uses financial resources. If the country would need the resources and if its economic program has been considered satisfactory by the IMF, the country can withdraw all previous tranches. But if the economic situation is considered unsatisfactory at the time when disbursements are needed, the country will not be able to withdraw any funds, regardless of the commitment fees that may have been paid.

Several Precautionary Stand-bys have been approved by the IMF in the recent past. The following are examples of Precautionary Stand-bys:

> In 2000, the IMF approved an 18-month Precautionary Stand-by credit for Estonia in an amount equivalent to $39 million to support the government's 2000–2001 economic program. Estonia treated the Stand-by credit as precautionary and did not intend to draw on it. Three previous Precautionary Stand-bys were approved in 1995, 1996, and 1997.
>
> Other Precautionary Stand-by Arrangements have been agreed for Guatemala in 2001, five for Latvia in 1995, 1996, 1997, 1999, and 2001, and Peru in 2002.

The third option for Ukraine would be a **Regular Stand-by Program**, possibly for two years. If the government is concerned about not increasing its foreign public debt, the Stand-by could be in an amount that would not result in the accumulation of new public debt to the IMF. That is, it could be equal to the amount of the principal payments to be made to the IMF during the two-year Stand-by period. On this basis, for 2003 and 2004, the two-year Regular Stand-by Program could amount to about $500 million. The main advantage of the Regular Stand-by is that it would signal to investors that funds would become available at least to serve IMF debt. On the other hand, foreign lenders may interpret delays in the disbursement of IMF scheduled tranches as clear indications that the country's economic performance was inadequate. In fact, this may or may not be the case, as there may be other reasons for slippage in disbursements.

A fourth option for Ukraine would be a combined **Regular-Precautionary Stand-by**. Under this program, about $500 million could be disbursed early in the program to have the funds required to serve IMF principal payments. An additional amount of about $1.0 billion could be treated as precautionary; to be called upon only if the balance-of-payment situation were to deteriorate significantly. One advantage of a Regular Stand-by Program or a Regular-Precautionary Stand-by Program is that they may provide greater incentives for the government to follow the agreed upon economic reforms and requirements for the program.

On balance, it seems that a combined Regular-Precautionary Stand-by could be the most desirable for Ukraine. The country could obtain, early on, the funds needed to serve principal payments to at least meet the IMF debt, and an additional precautionary amount would give signals to other investors that the country would have the resources needed in case of balance-of-payment difficulties. The IMF has recently approved the following combined Regular-Precautionary Stand-bys:

> In 2001, the IMF approved a 14-month $255 million Regular-Precautionary Stand-by credit for Croatia. About $51 million was drawn immediately. But further tranches were not scheduled taking into account Croatia's satisfactory international reserve level, its good access to capital markets, and its positive external outlook. Because of these factors, the Croatian authorities did not intend to make purchases. The Croatian authorities approved a three-year economic program for 2001–2003 aimed at achieving 'sustainable high rates of economic growth with price stability and external viability through fiscal adjustment, wage discipline and structural reforms in the context of continued exchange rate stability.

In 2000, a Regular-Precautionary Stand-by Program was approved for Gabon to support the government's economic program for 2000–2001. It was treated as precautionary, starting from 2001, on the assumption that the projected world oil prices assumed in the program would materialize.

The 2000 and 2001 Stand-by Programs for Lithuania envisaged some part to be disbursed immediately, with the rest of the arrangement treated as precautionary.

Regardless of the type of program that Ukraine may wish to have with the IMF, the government should try to get specific commitments from the IMF on expanded technical assistance. In fact, implementation capacity is a major constraint to successfully implement reforms in Ukraine. This capacity can be increased with expanded technical assistance. The major areas of technical assistance such as fiscal policy, monetary policy and statistics continue to be of great relevance for Ukraine.