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UKRAINE

June 2020

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2015 EXTENDED ARRANGEMENT—PRESS RELEASE AND STAFF REPORT

The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 9, 2020 consideration of the staff report.
- The **Ex-Post Evaluation of Exceptional Access Under the 2015 Extended Arrangement** prepared by a staff team of the IMF for the Executive Board's consideration on June 9, 2020. The staff report was completed on April 21, 2020.

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PR20/239

IMF Executive Board Approves 18-month US$5 Billion Stand-By Arrangement for Ukraine

FOR IMMEDIATE RELEASE

- *The COVID-19 pandemic will bear heavily on the Ukrainian economy in 2020.*
- *To address large balance-of-payments and fiscal financing needs, preserve achievements to date, and advance a small set of key structural reforms to ensure that Ukraine is well-poised to return to growth when the crisis ends, the IMF approved an 18-month Stand-by Arrangement (SBA), with total access of about US$5 billion.*
- *The approval of the SBA enables the immediate disbursement of about US$2.1 billion.*

WASHINGTON, DC – **June 9, 2020**. The Executive Board of the International Monetary Fund (IMF) approved today an 18-month Stand-by Arrangement for Ukraine, with access equivalent to SDR 3.6 billion (about US$5 billion or 179 percent of quota). The new program aims to help Ukraine to cope with COVID-19 pandemic challenges by providing balance of payments and budget support, while safeguarding achievements to date and advancing a small set of key structural reforms, to ensure that Ukraine is well-poised to return to growth when the crisis ends.

Ukraine's track record in stabilizing the economy over the last 5 years has been strong. However, more reforms efforts are needed to ensure robust and inclusive growth. The outbreak of the COVID-19 pandemic has significantly worsened the outlook and has refocused government policies on containment and stabilization. Uncertainty is large, and the economy is projected to contract sharply in 2020 as strict containment measures—in Ukraine and globally—led to sizable falls in domestic and external demand. The 2020 budget is expected to be hit hard, with a sharp decline in revenues and large emergency spending needs to address the crisis. This has created large balance-of-payments and fiscal financing needs.

The new arrangement succeeds the 14-month SBA that was approved in December 2018, which was focused on maintaining stability during the election year (see Press Release No 18/483). Policies under the new arrangement will focus on four priorities: (i) mitigating the economic impact of the crisis, including by supporting households and businesses; (ii) ensuring continued central bank independence and a flexible exchange rate; (iii) safeguarding financial stability while recovering the costs from bank resolutions; and (iv) moving forward with key governance and anti-corruption measures to preserve and deepen recent gains.

The approval of the SBA enables the immediate disbursement of the equivalent of SDR 1.5 billion (about US$2.1 billion). The remainder will be phased over four reviews.

The Executive Board also discussed the ex-post evaluation of exceptional access under Ukraine's 2015 extended arrangement under the Extended Fund Facility (EFF), which concluded that the extended arrangement helped restore macroeconomic stability and growth but did not fully address Ukraine's underlying balance of payments vulnerabilities.

Following the Executive Board's discussion on Ukraine, Ms. Kristalina Georgieva, Managing Director and Chair, issued the following statement:

"Sound fiscal and monetary policies since the 2014–15 crisis have resulted in a sharp reduction in Ukraine's external and internal imbalances. Public debt was put on a downward path, inflation has declined, and international reserves have recovered. As noted by the Ex-Post Evaluation of Exceptional Access under the 2015 Extended Facility, while growth resumed, reform implementation has been uneven and steadfast implementation of structural reforms will be needed to create a more dynamic and competitive economy. At present, the humanitarian and economic crisis stemming from the COVID-19 pandemic, has refocused policy priorities away from deep structural reforms.

"The new Stand-By Arrangement will provide an anchor for the authorities' efforts to address the impact of the crisis, while ensuring macroeconomic stability and safeguarding achievements to date. Together with support from the World Bank and the European Union, it will help address large financing needs. The program will focus on safeguarding medium-term fiscal sustainability, preserving central bank independence and the flexible exchange rate, and enhancing financial stability while recovering the costs from bank resolutions. Concerted reform efforts aimed at tackling corruption and strengthening governance will be critical to ensure macroeconomic stability and achieve sustainable and inclusive growth.

"The risks to the new program are very large. The uncertainty about the severity and length of the global downturn is exceptionally high. On the domestic side, uncertainty about the direction of economic policies remains substantial.

"Public debt remains high and government financing needs are large. While fiscal policies under the program will initially be directed at addressing the impact of the crisis, fiscal policy will need to be tightened as the recovery sets in, to place public debt back on a downward path.

"The National Bank of Ukraine (NBU) has skillfully managed monetary policy during a very challenging period. Central Bank independence should be preserved, and monetary and exchange rate policies should continue to provide a stable anchor in the context of the inflation-targeting regime, while allowing orderly exchange rate adjustment and preventing liquidity stress. Financial policies should strike a balance between preserving financial stability and assisting the recovery.

"Full and timely implementation of policies under the Fund-supported program will be critical to mitigate economic risks and lay the ground for stabilization and recovery."

More information

IMF Lending Tracker (emergency financing request approved by the IMF Executive Board)
https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker

IMF Executive Board calendar
https://www.imf.org/external/NP/SEC/bc/eng/index.aspx

Ukraine: Selected Economic Indicators, 2018–2022					
		2019	2020	2021	
			Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)					
Nominal GDP (billions of Ukrainian hryvnias)	3561	3975	3908	4277	4659
Real GDP 1/	3.4	3.2	-8.2	1.1	3.0
Contributions to real GDP growth					
Domestic demand	5.6	3.5	-8.6	2.7	4.3
Net exports	-2.2	-0.3	0.5	-1.6	-1.3
GDP deflator	15.4	8.1	7.1	8.2	5.8
Consumer prices (period average)	10.9	7.9	4.5	7.2	5.6
Nominal monthly wages (average)	24.8	18.5	3.6	11.4	9.3
Unemployment rate (ILO definition; percent)	9.0	8.5	12.6	12.0	11.5
Public finance (percent of GDP)					
General government balance 2/	0.0	-2.0	-7.7	-5.3	-3.5
Public and publicly guaranteed debt	60.6	50.4	65.4	62.7	60.5
Money and credit (end of period, percent change)					
Broad money	5.7	12.6	4.0	11.0	12.5
Credit to nongovernment	5.5	-9.8	-7.3	-12.4	8.4
Interbank o/n rate (annual average, percent)	16.5	15.6	…	…	…
Balance of payments (percent of GDP)					
Current account balance	-3.3	-0.7	-1.7	-2.0	-1.9
Foreign direct investment	1.8	1.6	0.8	2.1	2.4
Total external debt	87.8	78.8	93.0	84.6	77.9
Gross reserves (end of period, billions of US$)	20.8	25.3	19.3	23.4	26.5
Months of next year's imports of goods and services	3.3	4.8	3.1	3.4	3.6
Percent of IMF composite metric (float)	71.8	86.1	70.2	78.8	83.9
Exchange Rate					
Hryvnia per U.S. dollar (end of period)	27.7	23.7	…	…	…
Real effective rate (deflator-based, percent change)	8.8	14.7	…	…	…

Sources: Ukrainian authorities and IMF staff estimates.

1/ Data based on SNA 2008, exclude Crimea and Sevastopol.

2/ The general government includes the central and local governments and the social funds.

INTERNATIONAL MONETARY FUND

UKRAINE

May 29, 2020

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2015 EXTENDED ARRANGEMENT

EXECUTIVE SUMMARY

This paper presents an Ex-Post Evaluation (EPE) of the 2015 Extended Fund Facility (EFF) arrangement with Ukraine. The four-year EFF—amounting to SDR 12.348 billion (900 percent of quota)—was approved in March 2015, after it had become clear that the conflict in the East had pushed Ukraine's balance of payments and adjustment needs beyond what could be addressed under the 2014 Stand-By Agreement (SBA). The new ambitious program supported by the 2015 EFF was seen by many as a unique opportunity for Ukraine to fundamentally reform its economy.

The program's broad objectives were to restore financial and economic stability and lift medium-term growth through deep structural reforms. Policies focused on stabilizing the foreign exchange market, rebuilding official reserves, repairing bank balance sheets, and strengthening public finances through expenditure-led adjustment. The program also envisaged a debt operation to improve debt sustainability. Building on the unfinished agenda of the 2014 SBA, the program included an ambitious structural reform agenda, with continued focus on energy sector reform and fiscal policy, and increased emphasis on anti-corruption, governance, and SOE-reform.

The program helped restore macroeconomic stability and growth but did not fully address Ukraine's underlying balance of payments vulnerabilities. The program largely avoided the common pitfall of growth optimism, and adoption of a flexible exchange regime, prudent monetary policy, and strong fiscal consolidation led to a sharp reduction in both the current account and overall fiscal deficits. The successful completion of the debt operation helped restore the sustainability of public debt. Confidence was strengthened, financial stability restored, and economic growth resumed. On the other hand, inflation started to decline but remained above the target. International reserves, while increasing, remained well below targeted levels, and as balance of payment vulnerabilities remained, a successor SBA was needed upon termination of the EFF.

While considerable progress was achieved in several areas of the ambitious structural reform agenda, the efforts to improve competitiveness and business climate fell well short of expectations. Very significant progress was achieved in a number of areas, including central bank independence and cleaning up the banking sector. Significant steps were also taken to reform the energy sector and the pension system. While some inroads were made in strengthening governance and tackling corruption, nevertheless, reform momentum dissipated as the economy stabilized and program ownership waned in the face of resistance from vested interests. With only three reviews completed, the program went irrevocably off track, leaving many structural vulnerabilities unaddressed. Some recent developments have highlighted the risk of reversals in areas where significant progress was achieved.

While the EPE agrees with the overall thrust of policies under the EFF, it also offers some possible lessons. For the most part, the program was appropriately designed. However, the program's structural reform agenda seems to have been overly ambitious, considering Ukraine's track-record under earlier Fund arrangements and the fragility of the program ownership. Against this backdrop, the EPE offers some lessons.

The first set of lessons could help build and sustain reform momentum in the face of strong vested interests and a fragmented political landscape. They include: (i) using prior actions judiciously and structural benchmarks parsimoniously in a manner that does not undermine efforts to genuine program ownership; (ii) laying the ground work so countries can take advantage of often narrow windows of opportunity for reform; (iii) fostering genuine and broad ownership of reforms, even if outcomes are not optimal from a narrow economic perspective; (iv) avoiding very heavy front-loading of access to help maintain reform momentum during longer programs; and (v) increasing importance of timely and well-targeted communication and outreach by country authorities, supported by Fund staff, to ensure broad buy-in for Fund-supported programs.

The second set of lessons could help strengthen certain aspects of the Fund's policies and procedures. The EPE suggests to give consideration to: (i) requiring the inclusion of a quantified downside scenario in all capacity to repay assessments in requests for Fund-support under exceptional access; (ii) clarifying what constitutes an official claim for the purposes of fund policies in debt restructuring; (iii) developing a rules-based approach to communicate long delays in completing program reviews under GRA arrangements; (iv) developing further guidance for assessing a program's prospect for success under the fourth exceptional access criterion; and (v) adopting a standardized presentation to describe the depth and the implementation record of structural conditionality since program approval in program documents.

Authorized for distribution by
The European and Strategy, Policy, and Review Departments

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CONTENTS

BOXES

FIGURES

TABLES

INTRODUCTION

1. This paper presents an Ex Post Evaluation (EPE) of the 2015 Extended Fund Facility (EFF) arrangement with Ukraine.[1] The four-year arrangement—amounting to SDR 12.348 billion (900 percent of quota or about US$17.5 billion)—was approved in March 2015, and the Stand-By Arrangement (SBA) approved a year earlier was cancelled at the same time. Three of the 15 reviews envisaged under the EFF were completed before it was canceled in December 2018, with the approval of a 14-month SBA. The 2015 EFF was an exceptional access (EA) arrangement, which requires an EPE to (i) review performance against original program objectives; (ii) discuss whether the program design was appropriate to address Ukraine's challenges; and (iii) assess whether program modalities were consistent with Fund policies.[2]

2. The paper is organized as follows: The next section describes the background and context for the 2015 EFF. The subsequent sections give an overview of the program strategy and design, summarize program objectives and outturns in the key policy and reform areas, explore questions related to the program design and strategy, and assess the program's consistency with Fund policies. The report concludes with lessons from the program. The key findings from the EPE were discussed with the authorities during a staff visit on November 21-22, 2019. The authorities broadly agreed with the general findings and recommendations of the EPE, and subsequently provided some useful factual clarifications that are reflected in the report.

BACKGROUND AND CONTEXT

This section provides an overview of the pre-program context, highlighting some key features of Ukraine's long history of Fund engagement and developments leading to the approval of the 2015 EFF.

3. Ukraine had a long history of engagement with the Fund before its 2015 EFF, including three exceptional access SBAs since the global financial crisis (GFC). The programs that preceded the EFF were generally relatively successful in achieving short-term macroeconomic stabilization. However, progress on reforms in areas such as energy and banking sectors, and governance, had been incremental and incomplete in the face of weak program ownership and strong vested interests. This lack of progress in structural reform, combined with weak policies and political instability, had left the country vulnerable to recurring economic crises, requiring repeated financial assistance from Fund. (Box 1 presents key findings and recommendations of earlier ex-post evaluations and assessments of Ukraine's Fund supported programs).

4. The 2015 EFF was put in place when the conflict in the East pushed Ukraine's balance of payments and adjustment needs beyond what could be addressed under the 2014 SBA. The

[1] For the sake of simplicity, the "2015 EFF" or "EFF" is used in the remainder of this document to refer to the 2015 Extended Arrangement for Ukraine. Unless otherwise indicated, this document reflects data and information as of cancellation of the EFF in December 2018.

[2] See *Ex Post Evaluation of Exceptional Access Arrangements—Revised Guidance Note* (2/25/10).

authorities had initiated ambitious reforms under the 2014 SBA under very challenging circumstances, in the aftermath of the Euromaidan Revolution and amid the conflict in Eastern Ukraine. However, after initial progress, the reform momentum had started to dissipate, reflecting waning ownership and influence of vested interests. As the conflict in the eastern part of the country intensified, the deeper and more protracted economic crisis aggravated existing vulnerabilities, fueling capital outflows, a sharp exchange rate depreciation, and increased balance of payments (BOP) needs. These developments weakened banks' balance sheets—which were vulnerable due to weak supervision and related party lending—worsened public debt dynamics, and drained international reserves to critically low levels. In this context, the 2015 EFF aimed at providing additional financing and more time to implement deeper structural reforms than would have been possible under the then-existing SBA. The new ambitious program supported by the EFF was seen by many as a unique opportunity for Ukraine to fundamentally reform its economy, and the international community pledged to support the program through extensive involvement and financial assistance.[3]

OVERVIEW OF THE 2015 EFF

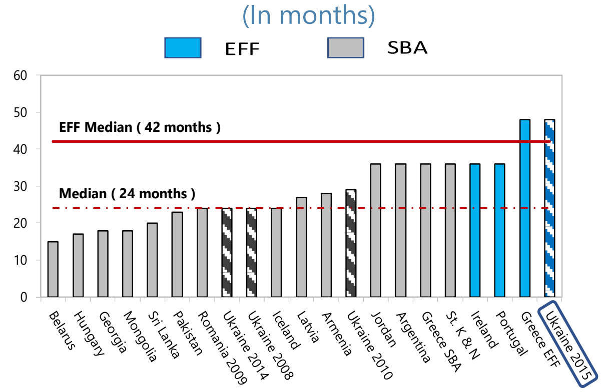
This section describes the program design in terms of its broad objectives and strategy and provides an overview of program conditionality and financing.

A. Program Objectives and Strategy

5. The EFF approved in March of 2015 aimed to build on reforms started under the previous SBA. The four-year duration of the program was motivated by the extensive structural reform agenda, Ukraine's protracted BOP needs, and the objective to get public debt to a sustainable level during the program period.[4] The chosen program length was the longest possible allowed for exceptional access cases, the only other four-year exceptional access program since the GFC being Greece's 2012 EFF (Figure 1).

Figure 1. Arrangement Duration 1/

(In months)



Sources: MONA database and IMF staff estimates.
1/ For non-precautionary EA arrangements since the GFC.

[3] See, e.g., *Ukraine: Request for Extended Arrangement Under the Extended Fund Facility and Cancellation of Stand-By Arrangement* (2/27/15) and *Ukraine's Unfinished Reform Agenda*, Marek Dabrowski, Policy Contribution, Issue No. 24 Bruegel (September 2017).

[4] The coverage of public debt includes: (i) central government direct debt; (ii) domestic and external government-guaranteed debt (loans and bonds) extended to SOEs; (iii) Eurobonds issued by the City of Kyiv; and (iv) Ukraine's liabilities to the IMF that are not included in central government direct debt.

6. The program had two main objectives:

- **Restoring confidence and financial and economic stability through strong adjustment policies.** Policies were focused on stabilizing the foreign exchange market, rebuilding official reserves, repairing bank balance sheets, strengthening banking supervision, and strengthening public finances through expenditure-led adjustment (including energy sector reform); the program also envisaged a debt operation to improve debt sustainability.

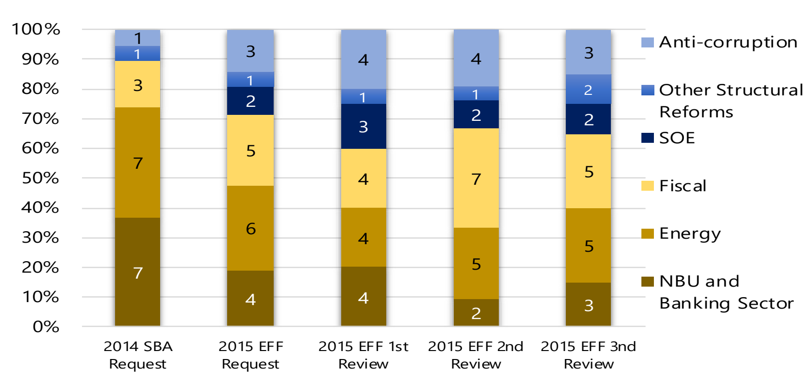
- **Lifting medium-term growth through deep structural reforms oriented towards improving competitiveness and business climate**. Investment and growth potential were furthermore to be boosted by economic governance reforms, including anticorruption and judicial measures, and reforms of state-owned enterprises (SOEs).

7. Program conditionality was aimed at securing these objectives through shoring up confidence in the short run and strengthening the policy framework in the medium term.

- **Quantitative performance criteria (QPC)** established ceilings on the cash deficit of the general government, the combined deficits of the general government and Naftogaz, and publicly guaranteed debt, complemented by a QPC on non-accumulation of external debt payment arrears by the general government. In the monetary area, QPCs set a floor on the National Bank of Ukraine's (NBU) net international reserves (NIR) and a ceiling on net domestic assets (NDA).

- **Structural conditionality** built on the unfinished agenda of the 2014 SBA, with continued focus on energy sector reform and fiscal policy. In addition, the 2015 EFF placed more emphasis on anti-corruption, governance, and SOE-reform (Figure 2, the section on program design issues provides more detail on structural conditionality).

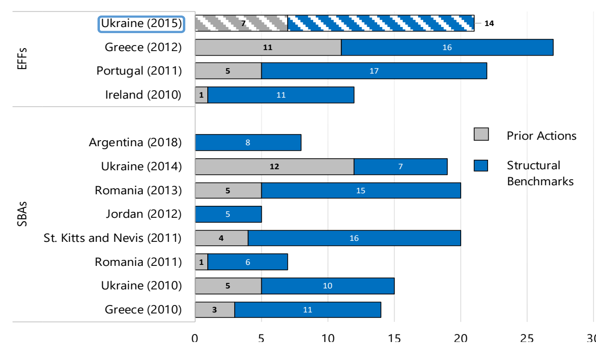
Figure 2. Ukraine: Structural Conditionality by Topic



Source: MONA database and IMF staff estimates.

8. The arrangement made extensive use of prior actions (PAs) and envisaged quarterly reviews. The EFF request included seven PAs—about half the number of PAs included in the 2014 SBA request, but still more than in most of the other recent exceptional access programs (Figure 3). Moreover, the role of PAs became more central when the structural reforms encountered headwinds later in the program and several delayed structural benchmarks (SBs) were converted into PAs.[5] The program envisaged 15 quarterly reviews to allow close monitoring and early corrective actions. However, only three reviews were completed, and two of them with significant delays (the second and the third reviews were delayed by 9 and 16 months, respectively).

Figure 3. Structural Conditionality at Program Request Exceptional Access Cases 2010–2018



Sources: MONA database and IMF staff estimates.

B. Program Financing

9. Approved access of about $17.5 billion was projected to cover 44 percent of Ukraine's financing gap, which was projected at $40 billion over the program period. More than two-thirds of the gap reflected the targeted increase in the NBU's international reserves that had declined to a critically low level.[6] Fund resources for budget support were limited to a quarter of the first purchase. The salient features of the financing package at the time of the program approval were:

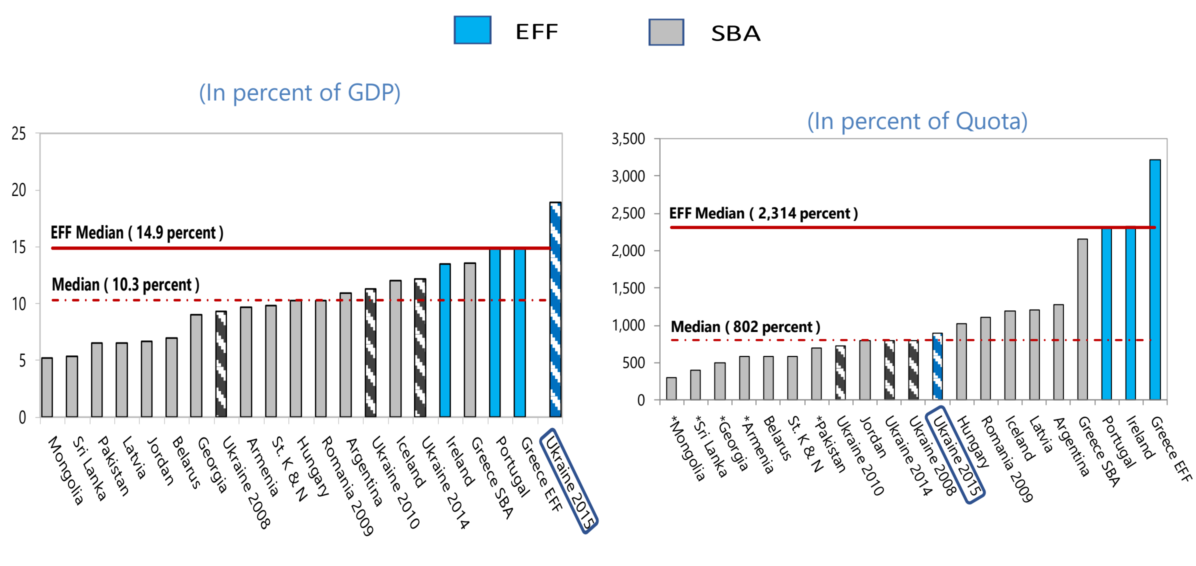
- The largest Fund access relative to GDP since the GFC, while access relative to quota was about half of the median of the EFF group, and broadly in line with the median for all non-precautionary EA arrangements since the GFC (Figure 4).
- About $7 billion pledged by other official creditors, including the World Bank, the European Union, the U.S., and other bilateral creditors.
- Private sector involvement through a debt operation to help solve the balance of payments problem and to restore sustainability of public debt. A key objective of this operation was to

[5] The first review included three PAs, while both the second and third review featured five PAs. In both the first and the second reviews, a delayed structural benchmark (SB) was converted into a PA, and in the third review, three delayed SBs became PAs.

[6] Gross international reserves stood at only 1.5 months of imports of goods and services, or 27 percent of the IMF composite metric for countries with a floating exchange rate. By end 2018, the program targeted 113 percent of the metric, which incorporated some cushion for significant repayments of external debt following the program period.

generate about $15 billion in financing during the program period by reducing Ukraine's debt service payments (Box 2).

Figure 4. Ukraine 2015 EFF—Access

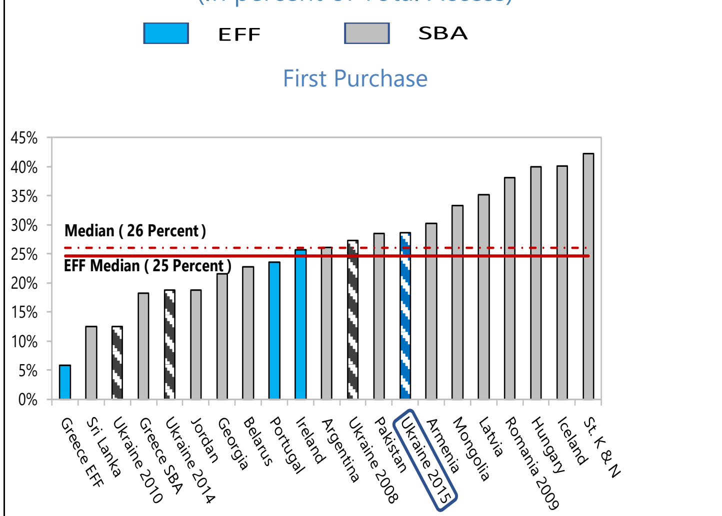


Sources: MONA data base and IMF staff estimates.

10. **Frontloaded phasing of disbursements aimed at achieving a minimum level of reserves necessary to restore confidence and stabilize market expectations**. As such, the frontloading also helped support the critical debt operation and secure financing assurances from other official creditors. The first purchase was about a third of overall access, slightly above the median of recent EA cases and the highest among the EFF subgroup (Figure 5).

Figure 5. Ukraine 2015 EFF—Phasing

(In percent of Total Access)



Sources: MONA data base and IMF staff estimates.

PROGRAM IMPLEMENTATION AND OUTTURN

This section summarizes program objectives and outturns in the key policy and reform areas, highlighting the broad success in macro-stabilization and uneven progress in addressing structural vulnerabilities.

A. Macroeconomic Framework

11. The program aimed at macroeconomic stabilization through strong adjustment policies and ambitious structural reform that would help lift Ukraine's growth. Underpinned by a strong monetary anchor, fiscal adjustment, cleanup and recapitalization of the financial sector, and supported by external official financing and the announced debt operation, macroeconomic stabilization was projected to take hold in 2015 and become more entrenched by 2016. This, combined with structural reforms, was expected to attract investment and private capital, and lift economic growth to its potential by 2018.

12. The program acknowledged that downside risks to the macroeconomic outlook were exceptionally high. These included: the possibility that fighting in the eastern part of the country could resume and spread, thereby unraveling confidence; possible complications in the debt operation, including lower than expected creditor participation; and slippages in program implementation in the presence of vested interests opposed to reforms. On the upside, it was noted that an early resolution of the geopolitical crisis would boost confidence. The program aimed to mitigate the downside risks by strong policies, frontloaded actions, significant external support, and program design that could withstand and adapt to moderate domestic and external economic shocks.

Outturn

13. Although the program experienced delays already shortly after its inception, it helped restore macroeconomic stability and growth. The first review under the program was completed broadly on schedule, after which the program experienced progressive delays. Nevertheless, tight macro policies and a more flexible exchange rate helped stabilize the economy, placing it on a path to recovery (Figure 6 and Table 1):

- **Growth:** In 2015, the conflict took a larger-than-projected toll on economic activity, but the economy started to grow again in 2016, as strong policies helped restore confidence. At the time of the program cancellation, GDP growth was 3.3 percent, modestly below the projections at approval of the program (4.0 percent).

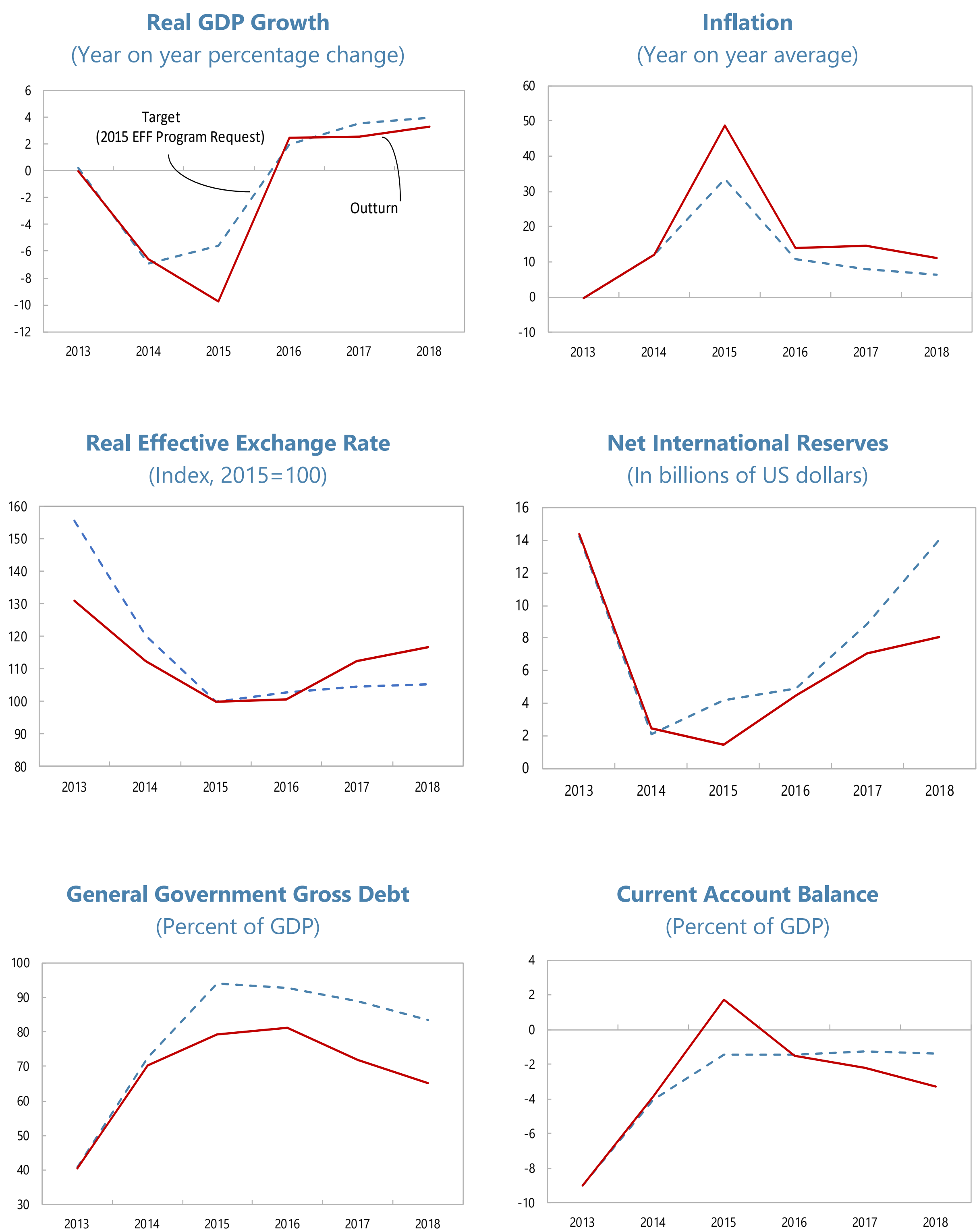
- **Inflation:** After surpassing projections in 2015 on the back of larger-than-anticipated exchange rate depreciation, inflation declined considerably but stayed above the initial program projections following large wage and pension increases and food price shocks in 2017.

- **Reserves** were partly rebuilt but remained significantly below projections, reflecting mainly lower than expected official disbursements. In particular, access under the EFF was rephased twice, in the context of the second and third reviews, reflecting significant delays in program implementation, and only about 50 percent of total access was disbursed. Also, the targeted increase in foreign direct investment (FDI) failed to materialize, reflecting only limited progress in structural reforms aimed at improving business climate.

- **Public debt** declined more than projected. At the approval of the program, the public and publicly guaranteed debt-to-GDP ratio was projected to peak at 94 percent in 2015 and then decline gradually to 71 percent by end of 2020. However, the debt ratio declined to 65 percent already by end-2018 on the back of fiscal overperformance, lower-than projected disbursements by the Fund and other IFIs, and higher-than-projected nominal GDP in USD.

14. Some of the risks identified at the time of approval materialized, with varying impacts. Tensions in the East increased and the authorities suspended trade with the non-government controlled area in March 2017. Also, Russia and some other countries of the Commonwealth of Independent States (CIS) restricted trade with Ukraine. As described in more detail in subsequent sections, after a promising start and notable achievements in several areas, the implementation of structural reforms largely stalled, and efforts to improve business climate and competitiveness fell short of what was needed to significantly boost medium-term growth. Nevertheless, the program broadly achieved the targeted macro stabilization and helped restore growth.

Figure 6. Ukraine 2015 EFF—Selected Macroeconomic Indicators 1/



Sources: IMF Staff Estimates.

1/ Outturn based on 2018 SBA program request.

B. Exchange Rate and Monetary Policy

15. The first priority was to stabilize the exchange market. Against the backdrop of pressures on the hryvnia, high inflation expectations, and an elevated current account deficit, the program was anchored early on by tight monetary targets, which, together with administrative measures, were projected to reduce demand for foreign currency. In addition, external disbursements under the program were frontloaded with the objective of calming the foreign exchange market by boosting international reserve levels.

16. The program strategy comprised four key elements. First, monetary policy was geared towards bringing inflation back to single digits. Second, the authorities committed to maintain exchange rate flexibility to cope with external shocks, with the aim of building reserves, while gradually removing exchange restrictions and capital controls. Third, building largely on the recommendations of the safeguards assessment of the 2014 SBA, measures were included to strengthen the NBU's governance, autonomy, and effectiveness. Finally, the program envisaged continued efforts toward future adoption of an inflation targeting framework by further strengthening the NBU's technical and operational capacity. On this front, the Fund's efforts were supported by assistance provided to the NBU from the EBRD and ECB.

Outturn

17. Inflation overshot program projections early on in the program. Soon after the NBU increased its main policy rate to 19.5 percent in early February 2015, triggered by a decline in confidence related to the conflict in the East, hryvnia came under significant pressure—depreciating by 20 percent in late February. To restore stability in the foreign exchange market, the NBU had to hike its main policy rate further to 30 percent while extending controls on foreign exchange.[7] Despite these measures, inflation overshot the initial program projections by more than would have been expected in light of the weakening of hryvnia, suggesting that the NBU's initial policy stance may have been too loose (Figure 6).[8]

18. The quantitative performance criteria were met with a few exceptions, but reserve accumulation remained well below program targets. NDA targets were met, while NIR targets were missed in September and December 2015, but met on the subsequent test dates until the

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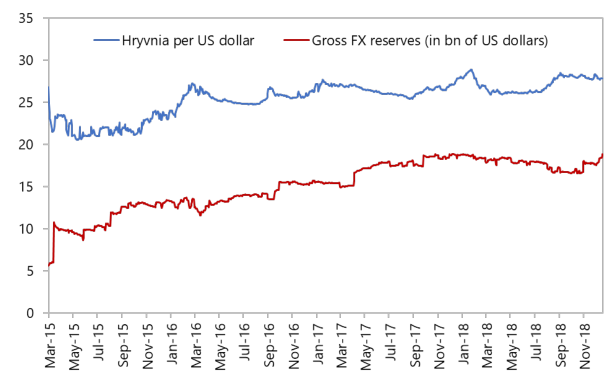
[7] The program's macroeconomic framework had already been set before these developments took place. Before the Board discussion on the EFF request on March 11, 2015, staff issued a supplement, which concluded that: "On the basis of recent developments, staff does not see a need to update the program's macroeconomic framework and program objectives remain attainable." See *Ukraine: Request for Extended Arrangement Under the Extended Fund Facility and Cancellation of Stand-By Arrangement - Supplementary Information* (3/9/15).

[8] At program request, 2015 period average inflation was expected to rise to 33.5 percent, with the subsequent outturn being 48.7 percent (the additional 1,050 basis point policy rate hike notwithstanding). Since exchange rate pass-through was estimated at about 30 percent in Ukraine (estimated using distributed lag regressions, as in Burstein and Gopinath (2014), on monthly data spanning 2000–2018; limiting the sample to more recent years yields similar results), the February 2015 depreciation of 20 percent would have been expected to have driven inflation up by some 6 percentage points. However, inflation overshot its projection by almost double (15.2 percentage points).

program went off-track. Although base money grew less than programmed, inflation turned out to be higher than projected, pointing to a weak link between monetary aggregates and inflation,[9] and possible changes in the normal transmission mechanism due to the ongoing restructuring of the banking sector. At the time of program request, gross reserves were projected to equal US$35.2 billion by end-2018; this compares with a subsequent realization of only US$20.8 billion (which includes a US$1.4 billion disbursement under the subsequent SBA). About 60 percent of this shortfall was due to lower purchases from the IMF owing to delays in program implementation, while the remainder of the shortfall was accounted for mainly by other lower foreign exchange inflows, including FDI.

19. Exchange rate flexibility was maintained under the program, albeit with the help of capital controls. To help prevent exchange rate overshooting shortly before the approval of the program, the authorities imposed new and tightened existing capital flow measures. The subsequent approach to phasing out the latter was guided by a conditions-based roadmap, and was characterized by gradualism, which helped limit exchange rate pressures. Foreign exchange interventions under the new regime aimed at smoothing hryvnia volatility and accumulating FX reserves, contributing to a gradual rise in gross reserves (Figure 7).

Figure 7. Ukraine: Exchange Rate and Foreign Exchange Reserves



Source: IMF Staff Estimates.

20. Over the course of the program, governance, effectiveness, autonomy, and transparency of the NBU saw impressive improvements. These improvements were supported by extensive technical assistance from the Fund and Ukraine's other international partners. The NBU's autonomy and governance were strengthened and institutionalized through legal amendments (initially a SB which became a PA in the first review). Key measures in this regard included optimizing the size, composition, and roles and responsibilities of the NBU Council and the NBU Board. Personal autonomy of the members of NBU's decision-making bodies was also strengthened, including by clearly defining the guaranteed term of Board members, along with specifying possible grounds for dismissal. The NBU's financial autonomy was strengthened by adopting legislation which ensures that NBU profits are only distributed after completion and auditing of the annual financial statements, and after NBU general reserves are replenished. Finally, the NBU also made

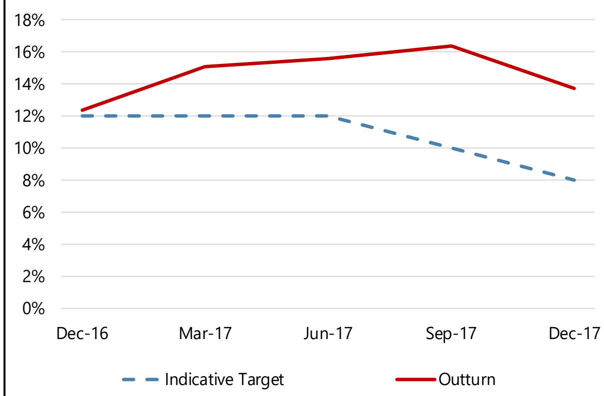
[9] This observation has been made in many countries with Fund-supported programs; for a detailed analysis *see* *Conditionality in Evolving Monetary Policy Regimes* (3/5/14).

significant strides in enhancing transparency, as evidenced by it winning the Central Banking Journal's "Transparency Award".[10]

Figure 8. Ukraine: CPI Inflation

(Consumer Price Index, EOP (1991=100))

Inflation exceeded projections.



Source: IMF Staff Estimates.

21. During the program, the NBU transitioned to an inflation targeting regime.[11] At NBU's request, the program included an indicative target on inflation from the second review onwards (Figure 8). Ukraine's choice to transition to an inflation targeting regime in December 2016, when international reserves stood still at a relatively low level, involved challenges as the central bank might be tempted to limit inflation by using scarce reserves to prevent exchange rate depreciation.[12] Further down the road, once inflationary pressures had subsided, it created some scope for policy dilemmas to arise: should disinflationary pressures stemming from currency appreciation be addressed by lowering the interest rate, or through FX purchases to increase international reserves? However, on the whole, such policy dilemmas did not significantly complicate program implementation.

C. Financial Sector Policies

22. A key goal of the program was to restore confidence in the financial system.[13] The program aimed to strengthen the regulatory and supervisory framework and clean-up the banking system. The latter was to be achieved through an updated recapitalization, restructuring, and resolution strategy. The phased-in recapitalization required banks to fully recognize losses, while also allowing some regulatory forbearance.[14] Importantly, the clean-up plan included several

[10] The earlier recipients of this award include the central banks of Ireland, Canada, Israel, Czech Republic, and Sweden. The award committee particularly praised the NBU's clear and open communication, as well as its efforts to fight "fake news". See https://www.centralbanking.com/awards/3948671/transparency-national-bank-of-ukraine.

[11] See *Ukraine: Selected Issues 2017* for background information on the adoption of an inflation targeting strategy by the NBU.

[12] To mitigate this concern, the NBU published in 2016 its foreign exchange intervention (FXI) strategy, which set out the three reasons for FXI: to smooth excess volatility, to accumulate reserves until an adequate level is reached, and to support monetary policy.

[13] The IMF worked in close cooperation with the World Bank, the EBRD (mostly for the reform of the state owned banks, NPLs resolution and asset recovery), the EU and US (who provided technical support on particular financial sector laws and supported the work on agency/institutional development).

[14] Banks had to present credible recapitalization plans by mid-2015 and when a second asset quality review performed later in 2015 identified further recapitalization needs, it set the timetable for banks to complete a phased-in recapitalization by December 2018. The total recapitalization needs were initially estimated at 9.5 percent

measures to tackle the widespread problem of related-party (RP) lending.[15] The program also aimed to enhance asset recovery and resolution of bad loans by improving the framework for dealing with NPLs, including through legal amendments to incentivize private debt restructuring and the introduction of an out-of-court system for debt restructuring.

Outturn

23. Very significant progress was made in reforming the banking sector. The achievements in this area were supported by generally well-designed conditionality and capacity building through technical assistance. The regulatory and supervisory framework was significantly improved,[16] insolvent banks were resolved, and the remaining banks strengthened their capitalization. In December 2016 the authorities nationalized Privat Bank, the largest bank of the country and backbone of the payment system, to avoid a systemic risk from a disorderly liquidation. This operation, which—if badly managed—could have caused panic and problems in the payment system—was adequately prepared and properly executed.[17] However, NPLs remained high, and their resolution difficult, although they were mostly provisioned by the end of the program period. Steps were also taken in improving governance, especially of State Owned Banks (SOBs), but the process is still ongoing. Prior actions and structural benchmarks were used to deal with RP lending and to amend the NBU law to strengthen its regulatory powers. Time-bound strategies for recapitalization plans were included in the program as MEFP commitments. Nevertheless, some key program conditionality was not met, including the improvement of the insolvency regime and the enforcement of payment discipline (Table 4).

24. A large number of banks were closed, and the health of the banking sector improved significantly (Table 2). Between 2014 and 2017, almost 50 percent of all the existing banks—many of which were engaged in connected lending and money laundering— were resolved, despite often strong resistance from vested interests. Meanwhile, the capitalization and profitability of the remaining banks improved (Figure 9). The recapitalization proceeded broadly in line with the steps

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of GDP, including a buffer of 4 percent of GDP for recapitalization of PrivatBank which was experiencing large liquidity needs already at the time of the first review.

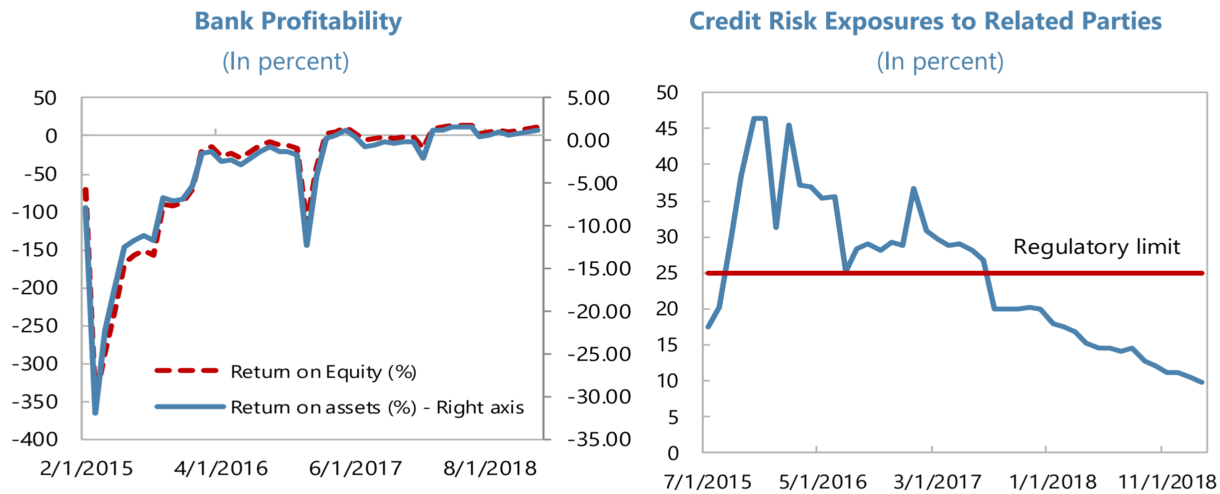
[15] The multi-pronged and innovative approach to tackle RP lending included: (i) legislation to make excessive RP lending a criminal offense; (ii) legislation establishing unlimited liability of banks' controlling shareholders for RP loans with presumption of economic relationship between lender and borrower, thereby putting the burden of proof for absence of RP lending on banks; (iii) revisions of NBU regulations to toughen the rules for identification of RP lending; (iv) establishment of a special monitoring unit within the NBU; and (v) adoption of unwinding plans after the audit of banks' reports of RP loans.

[16] Key achievements in this area include: raising the minimum capital requirement, tightening of rules for the calculation of credit risk, introduction of an annual stress testing to determine capital needs, adoption of IFRS9, establishment of a centralized credit registry, and enhanced disclosure requirements of banks' financial and prudential information to foster market discipline.

[17] The 2015 stress test and subsequent diagnostic tests revealed that PrivatBank had a regulatory capital shortfall of UAH 146.4 billion (about USD 6 billion or 7 percent of GDP). The capital shortfall stemmed mainly from loans to related parties that needed to be provisioned for, given the absence of adequate collateral or credible underlying cash flows. After shareholders' failure to address the capital shortfall, the NBU declared PrivatBank insolvent in December 2016. Several resolution options were considered, and the authorities decided to nationalize the bank in light of its systemic role in Ukraine's financial system and financial stability considerations.

outlined in the program. The NBU supported the process by allowing for some regulatory forbearance and by deferring some deadlines because of the complexity of the process and the introduction of new regulations. RP loans decreased dramatically and by the end of the program the number of banks in violation of the prudential requirement fell to 22, from 44 following the 2015–16 diagnostic.

Figure 9. Ukraine: Developments in the Banking Sector



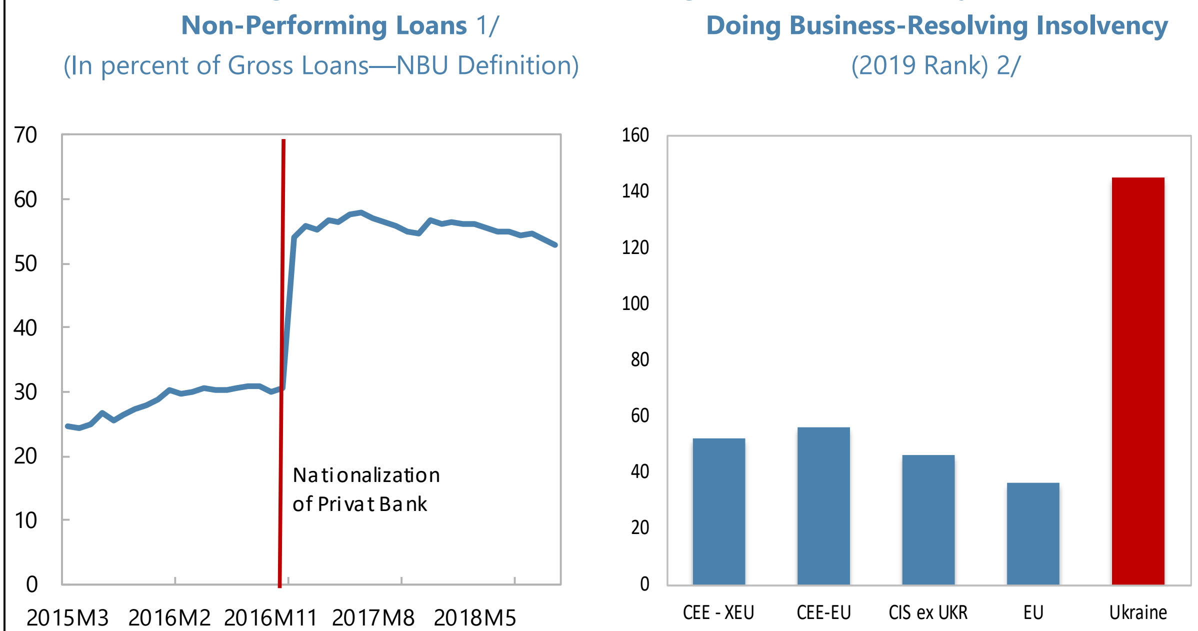
Sources: NBU, World Bank and IMF staff estimates.

25. Strong vested interests, weaknesses in the judicial system, and political gridlock hindered the successful completion of the reform process in the banking sector. Vested interests behind high RP lending contributed to high NPLs. Despite the removal of tax impediments that had earlier discouraged banks from resolving NPLs, they remain high due to weaknesses in the legal system[18] and the ineffectiveness of out-of-court debt restructurings introduced in 2016 (Figure 10). For the same reasons, the recovery of assets from failed banks was minimal. Moreover, the adoption of the Insolvency law was delayed (a missed structural benchmark under the program). The law was eventually adopted in October 2018. Finally, recent developments highlight the fragility of the progress achieved in reforming the banking sector.[19]

[18] Such weaknesses pertain to lengthy foreclosures and inefficient court processes, weak protection of creditors' rights, and absence of household insolvency and restructuring regimes.

[19] For example, the Nationalization of PrivatBank, the largest bank, which took place in December 2016, was ruled illegal by a lower court. This ruling will take effect if affirmed by the court of appeals.

Figure 10. Ukraine: Non-Performing Loans and Insolvency



Sources: NBU, World Bank and IMF estimates.

1/ In 2016, the NBU carried out an asset quality review (AQR), which revealed that the proportion of impaired loans was much greater than reported. This, together with the change in the methodology to capture loans that are more than 90 days past due as well as loans with low probability of repayment, led to a sharp increase in the NPL ratio.

2/ For a specific group of countries, refers to the average of the rank of the countries in the group.

26. The delayed efforts to strengthen governance of SOB's are ongoing, while the rest of the non-bank financial sector remains largely unreformed. Guidelines for corporate governance for the banks came into force only at the beginning of 2018, the same year when the ministry of finance approved its delayed reform strategy for SOBs.[20] The first step to enact the strategy was to approve the Law on SOBs,[21] which took place in July 2018. The governance and regulation of the non-bank financial sector (which at about 5 percent of financial sector assets is still modest in size) is weak. The so-called "Split Law", which would transfer regulatory and supervisory powers from the National Financial Service Commission (NFSC)—the current regulator—to the NBU and to the National Securities and Stock Market Commission (NSSMC), was drafted in 2015, and passed the first reading in Parliament in July 2016, but was not adopted within the program period.[22]

[20] Key elements of the strategy included: (i) a reform in corporate governance to increase the independence of SOBs and ensure that they would operate with sound commercial principles; (ii) the settlement of problem assets in a way that would minimize their impact on the balance sheets and maximize their resale value; and (iii) plans for the withdrawal of the state from SOBs.

[21] Law *"On Amendments to Certain Legislative Acts of Ukraine on Improving the Functioning of the Financial Sector in Ukraine"*.

[22] Both the law on SOBs corporate governance and the "split law" were MEFP commitments under the EFF and were converted respectively into a prior action and structural benchmark under the 2018 SBA.

D. Fiscal Policy

27. The program aimed to restore fiscal sustainability through a mix of expenditure-led adjustment, front-loaded reduction of energy subsidies, and debt restructuring.[23] A key fiscal anchor for the program was the primary balance of the combined general government (GG) and Naftogaz, which was projected to improve from a deficit of 6.9 percent of GDP in 2014 to a surplus of 1.6 percent of GDP in 2017 and 2018 (Text Table). Over the program period, this corresponded to an adjustment of 7.7 percent of GDP in the combined overall balance of the GG and Naftogaz (i.e., decline in the overall deficit from 10.3 to 2.6 percent of GDP).[24] Through a series of increases in gas and heating prices, and other measures to improve its financial health, Naftogaz was projected to contribute to more than half of the adjustment and reach a balance by 2017 (see the section on Energy Policies).

28. Structural savings in current expenditures aimed to reduce the deficit and create room for social assistance and capital spending. Building on the fiscal reform package adopted in late 2014, the EFF targeted a 5.3 percent of GDP contraction in current expenditures through pension reform and reductions in public wages and subsidies. These savings would be partly offset by targeted social spending needed to cushion the impact of energy price hikes on the most vulnerable households, and by an increase in capital spending driven by the immediate reconstruction needs (Text Table). On the revenue side, the tax reform aimed at rebalancing from non-tax income to tax receipts as well as at the strengthening of tax administration to fight corruption and improve business climate. The fiscal strategy also envisaged reforms to public financial management to enhance budget execution and cash management, and to reduce quasi-fiscal losses from state-owned enterprises (SOEs).

29. Program conditionality was designed to support the fiscal consolidation, including by ensuring early progress through prior actions. QPCs were set on ceilings on the GG cash deficit and the combined GG-Naftogaz deficits, and on publicly guaranteed debt. Prior actions on energy prices hikes and structural benchmarks on reforms of the revenue administration and the pension system aimed at ensuring progress on fiscal reforms at early stages of the program (see Table 4).

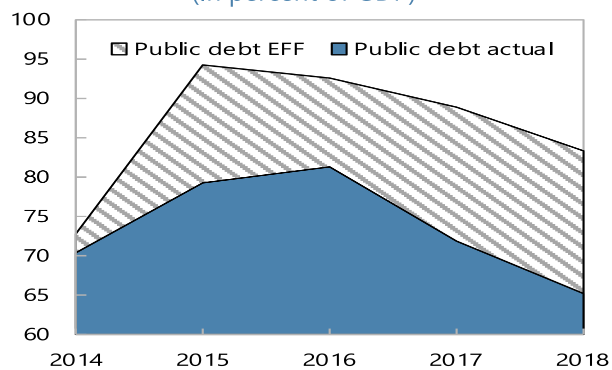
[23] During the EFF program, the IMF staff worked closely on fiscal issues with the World Bank (e.g. fiscal-structural reforms, especially reform of the pension system). The IMF staff also consulted, inter alia, with OECD (e.g. international taxation standards, tax control over transfer pricing), European Commission (energy reforms), and European Bank for Reconstruction and Development (e.g. public procurement system, energy reforms).

[24] The program request document noted that the primary balance of the combined general government (GG) and Naftogaz was "a key fiscal anchor". However, the program's quantitative PCs were set on ceilings on the GG cash deficit and the combined GG-Naftogaz deficits because staff measured the deficit from the financing side ("below the line"). Nevertheless, the program had an adjustor for interest savings from any restructuring or reprofiling of the existing government debt to NBU such that potential interest savings would not translate into higher discretionary fiscal space.

Outturn

30. The program achieved the targeted fiscal adjustment, helping to put the public debt on a declining trajectory. The combined GG-Naftogaz overall fiscal deficit declined to around 2 percent of GDP already in 2015 mainly on the back of substantial energy price hikes, exchange rate depreciation, and lower gas import bill, supported by a series of one-off measures.[25] Subsequently, the overall fiscal deficit remained around 1½ percent until the cancellation of the program. Moreover, by 2018 the GG overall fiscal deficit had declined to 2.5 percent of GDP, in line with the target set at the time of the EFF request. The broad composition of fiscal consolidation was also in line with program targets as the outturns of both revenues and expenditures matched closely the projections at the time of the program request, notwithstanding some deviations in the composition of expenditures and revenues. With the support of the fiscal adjustment and aided by the debt operation, public and publicly-guaranteed debt, which was originally projected to peak at 94 percent of GDP in 2015 before declining to 83 percent of GDP by the end of the program, declined considerably more than envisaged by staff and ended 2018 at around 65 percent of GDP (Figure 11).

Figure 11. Ukraine: Fiscal Deficit and Public and Publicly Guaranteed Debt, 2014–18
(In percent of GDP)



Source: IMF Staff Estimates.

Ukraine: Projected Fiscal Flows at EFF Request, 2014–18

	Est.	Projected				Estimate
	2014	**2015**	**2016**	**2017**	**2018**	**2018**
Revenues	41.7	42.8	40.3	40.7	40.8	40.6
Tax revenues	36.6	36.9	36.4	36.9	36.9	35.9
Non-tax revenues	5.1	5.9	3.9	3.9	3.8	4.7
Expenditures	46.3	47.1	43.9	43.8	43.4	43.1
Current	45.2	43.4	41.3	40.5	39.9	38.8
Capital	1.3	2.5	2.5	3.0	3.0	4.0
Net lending	-0.2	0.6	0.0	0.0	0.1	0.2
Discrepancy / reserve fund	0.0	0.5	0.0	0.3	0.5	0.0
Overall balance	-4.6	-4.2	-3.7	-3.1	-2.6	-2.5
Naftogaz balance	-5.7	-3.1	-0.3	0.0	0.0	0.0
Combined balance (GG + Naftogaz)	-10.3	-7.4	-3.9	-3.1	-2.6	-2.5
Memorandum item:						
Combined Primary bal. (GG+Naftogaz)	-6.9	-2.0	1.2	1.6	1.6	1.3

Sources: Figures for 2014 and projections 2015-18 from 2015 EFF Program Request EBS/15/12 (02/27/2015). Estimate for 2018 from Request for SBA and Cancellation of EFF, Country Report 19/3 (01/2019).

[25] The overperformance in 2015 was also supported by higher (inflation-boosted) revenues and one-off proceeds from exceptionally large central bank profit transfer and temporarily import duty surcharges. Lower interest payments were in part due to the capitalization of interest as part of the debt operation. For further details, see *Ukraine: Second Review Under the Extended Fund Facility and Requests for Non-Observance of Performance Criteria, Re-phasing of Access and Financing Assurances Review* (09/02/2016).

31. Early on in the program, some notable progress was achieved in structural fiscal reforms. Tax reform packages in 2015 and 2016 sought to simplify the tax system and reduce the labor tax wedge. The 2016 package slashed labor taxes, reduced exemptions, simplified and rebalanced the tax system towards indirect taxes, which lowered the overall tax burden and tax rates and brought them closer to the median of the CEE countries. Social protection was also boosted and somewhat better targeted with the support of means-tested procedures and the elimination of redundant compensation programs.[26] Initial spending measures, including to improve the efficiency of spending in health care, education, social assistance, and SOEs also aimed at permanently reducing outlays.

32. Notwithstanding some further progress on the structural front, the fiscal discipline and reform momentum started to weaken toward the end of the program period, and the reform agenda remains incomplete. A doubling of the minimum wage in 2016, the backtracking on the automatic adjustment mechanism for energy prices in 2017, and the expansionary supplementary budget that same year, were significant deviations from the program's objectives. Despite major delays in the pension reform, significant progress was achieved through key parametric changes, and by reforming special occupational pensions and early retirement options, which improved the sustainability of the social security system, despite the earlier deep reduction in social security contributions. However, further parametric reforms will still be needed (Box 3). Efforts to achieve efficiency gains in health and education spending, and the deregulation aimed to improve business competitiveness, remain a work in progress. More broadly, a combination of political resistance from vested interests and less binding financing constraints, especially during the second half of the program, contributed to a standstill in important fiscal-structural areas, such as revenue administration reforms that could have helped fight corruption in the various revenue agencies.

E. Energy Sector Policies

33. An overarching goal of the program was to restore the financial health of Naftogaz. Despite the progress made under the 2014 SBA through tariff increases, the exchange rate depreciation increased the deficit of Naftogaz to some 5½ percent of GDP in 2014. Recognizing that the loss-making and opaque energy sector was weighing heavily on Ukraine's economy, the EFF put forward an ambitious and comprehensive reform agenda, centered at eliminating Naftogaz's deficit by 2017.

34. The program aimed to reduce the energy sector's drag on the economy by taking measures on several fronts. The program included measures targeted to improve the financial

[26] Several initiatives aimed to reduce the scope of near-universal or largely-redundant coverage schemes, cut waste, and boost support to lower income citizens. For instance, in 2015, the authorities eliminated the energy compensation program and introduced income testing into the category-based energy privileges program, limiting eligibility for privileges to households with gross monthly income per capita under the threshold for taxing social privileges.

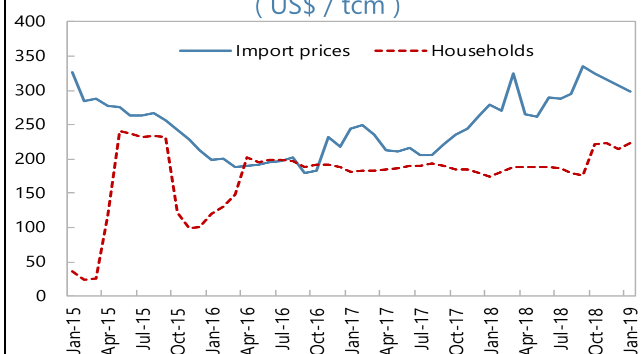
viability of Naftogaz by increasing gas and heating tariffs (prior action for the program approval), with the aim of reaching cost recovery based on international gas prices by 2017. Measures were also included to improve Naftogaz's collection of receivables. More broadly, the program aimed at fundamentally reforming the gas sector through measures that would support competition and establish transparent mechanisms in setting tariffs. To this effect, the program envisaged the unbundling of Naftogaz (i.e., separation of the elements which constitute the vertically integrated Naftogaz group) and measures to increase transparency in distribution. In parallel, the program aimed to protect the vulnerable by strengthening the social assistance system, and included an extensive public information campaign to explain the necessity of energy price increases.[27]

Outturn

35. Naftogaz's deficit was reduced dramatically and tariffs reached the level of cost recovery one year ahead of schedule, but part of the progress was reversed when an automatic adjustment mechanism was not implemented as planned. Phased increases in tariffs, together with a fall in international gas prices and contraction in gas imports due to a fall in demand, contributed to Naftogaz's positive financial result in 2016 and thereafter (Figure 12). In the same year, authorities took advantage of low international gas prices and brought tariffs at import parity one year ahead of schedule and adopted a formula to link tariffs with international prices. However, while they initially committed to quarterly adjustments (a structural benchmark for the second review), the authorities subsequently switched to a semi-annual frequency (a new prior action for the third review) and then failed to apply it in 2017 when gas prices increased, which contributed to the program going off track.[28]

Figure 12. Ukraine: Gas Prices and Households Tariffs

(US$ / tcm)



Sources: Naftogaz, Ukrainian authorities.

36. The social protection program was expanded but not sufficiently targeted, which led later required efforts to contain its costs. Expanding the subsidy system was critical to ensure

[27] The reform of the energy sector and of the utility subsidies benefited from the extensive cooperation with the IFC, the World Bank, the EBRD, and the energy community secretariat. The utility subsidy reform was also informed by FAD TA mission, which drew lessons from cross-country experience.

[28] The authorities' reluctance to implement the automatic adjustment seems to have reflected increased pressure from the public affected by price increases. Also, aligning the household tariffs with international prices would have reduced the opportunities for corruption, implying that vested interests likely contributed to pressure against such reforms. For more background on gas price liberalization and related challenges, see, e.g., *Revolution and Reform in Ukraine - Evaluating Four Years of Reform, PONARS Eurasia* (July 2018) and *What a $2.8 Million Scheme to Rip Off the State Says about Corruption in Ukraine*, *Matthew Kupfer, UkraineAlert,* Atlantic Council (3/7/19).

social protection and popular support for the tariff increases. However, the size of the program increased rapidly; by end 2015 it was already covering about half of the households, and its mounting fiscal costs forced the authorities to pass supplementary budgets in 2016 and 2017. Although the generosity of the program was tightened through several reductions in consumption norms,[29] decisive efforts to overhaul the system were not completed during the EFF.[30] The measures that were not implemented included: (i) revising the formula for the calculation of the subsidies; (ii) modifying the eligibility criteria to improve targeting; and (iii) establishing a centralized database of recipients of social assistance.

37. Important progress was achieved in restructuring the gas sector during the program, but the transformation in the energy sector remained incomplete. While Naftogaz's financial viability and governance improved, including through the introduction of a new Supervisory Board with independent members in 2016, the efforts to unbundle it stalled after the adoption of the action plan. The company continues to dominate the wholesale market with its monopoly in domestic gas production and control of the gas transportation network. The retail market remained uncompetitive, with tariffs below cost recovery and opaque regional gas supply companies acting as intermediaries between Naftogaz and consumers. In the absence of proper metering along the gas chain and without a comprehensive database of consumers, the significant difference between the tariff paid by firms and households provides opportunities for fraud. Also, building on the progress already achieved, there is still room to better target the energy subsidies. Finally, while the focus of the EFF was mainly on the gas sector, the reform of the electricity market remains a work in progress, while other parts of the energy sector, e.g., district heating, remain largely unreformed.

F. Governance and Other Structural Reforms

38. Ukraine's economic performance has been held back by long-standing structural obstacles to growth. The program noted that endemic corruption, a stifling regulatory burden, weak investor protection and contract enforcement have weakened the business climate and deterred investment, while a lack of technical upgrading of companies has held back productivity and eroded competitiveness. As a result, Ukraine's economic performance has lagged well behind that of other transition economies, despite its well-educated labor force.

39. The program's extensive governance reforms built on progress made under the previous SBA program, and benefited from close cooperation with other stakeholders. A diagnostic study of governance issues pertaining to corruption, the business climate, and the judiciary, was undertaken by the authorities in 2014, with assistance from Fund staff. This study

[29] Consumption norms are coefficients linking the size of the subsidy to physical features such as the size of the apartments.

[30] See, for instance, pending steps in spending reforms (Table 9 of the Staff Report) and structural benchmarks (Table 2 of the MEFP) in *Ukraine: 2016 Article IV Consultation and Third Review under the Extended Arrangement, Requests for a Waiver of Non-Observance of a Performance Criterion, Waiver of Applicability, Rephasing of Access and Financing Assurances* (3/30/2017).

helped inform the design and sequencing of the program conditionality under the EFF, building on the legal reforms that had been put in place in the context of the 2014 SBA.[31] Fund staff worked closely with other international organizations, including the European Commission and the World Bank, EBRD, as well as with bilateral creditors to ensure consistency and avoid overlap. Also, within the framework of the existing corruption diagnostics report, staff engaged closely with Civil Society Organizations / Non-Governmental Organizations (CSOs/NGOs) in assessing the proposed reform measures and monitoring their implementation and impact.[32]

40. Structural governance reforms covered measures related to anti-corruption, AML/CFT, judicial reforms, SOE reforms, and efforts to improve business climate. The following is an overview of the main governance issues covered by the program (Table 4).[33]

- **Rapid implementation of anti-corruption measures was considered a priority**, to ensure that the public would see tangible results and to counter vested interests. Anti-corruption benchmarks initially focused on institution building, with subsequent structural benchmarks on their operationalization and implementation. Building on some initial progress already made towards the establishment of the National Anti-corruption Bureau (NAB), the program focused first on its formal establishment, resourcing, and external oversight. Another important measure to address corruption related to asset declarations of high-level officials.

- **AML/CFT reforms were another critical component of structural reforms**. The strengthening of the implementation of the AML/CFT framework was considered important to prevent the misuse of the financial sector to launder the proceeds of corruption. This included regulatory and other measures related to domestic politically exposed persons, and arrangements to facilitate cooperation between the NBU, NAB, and Financial Intelligence Unit (FIU).

- **Reforms aimed to strengthen the effectiveness of judiciary, with measures to enhance its independence, integrity, and efficiency of legal enforcement**. These focused on two main measures: changes in court fees, and orders of payments and garnishment. These benchmarks were supplemented by a range of other measures, including in relation to the High Council of Justice (with a focus on a backlog of disciplinary cases).

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[31] The Fund's engagement with Ukraine on corruption issues has been noteworthy for its openness, as evidenced by the authorities' willingness to publish the diagnostic report and significant corruption related conditionality in Ukraine's recent Fund programs, when compared with other countries with a similar perceived level of corruption. For more background, see Boxes 6 and 7 in the *Role of the Fund in Governance Issues - Review of the Guidance Note - Preliminary Considerations* (8/2/17).

[32] For a discussion on the important role that the close engagement between Ukrainian civil society and the international community has played in supporting governance reforms in Ukraine, see *Revolution and Reform in Ukraine - Evaluating Four Years of Reform, PONARS Eurasia* (July 2018).

[33] Some of these measures have been more extensively discussed in existing Fund reports related to governance, see for example: *Selected Issues Paper Ukraine: Corruption and Growth* (3/7/17), Box 7 and Annex VI of the *Role of the Fund in Governance Issues - Review of the Guidance Note - Preliminary Considerations* (6/14/17) and Box 4 of the *Review of the 1997 Guidance Note on Governance - A Proposed Framework for Enhanced Fund Engagement* (3/9/18).

- **Measures to improve the business climate aimed to streamline the regulatory framework, and to develop a comprehensive SOE reform agenda**. Business climate measures included deregulation measures, a review of existing norms and a requirement to conduct regulatory impact analyses. SOE reforms aimed to enhance the financial viability and the efficiency of the SOEs while reducing fiscal risks emanating from these enterprises. A structural benchmark on the sale of agricultural land (land reform) was added during the second review.

Outturn

41. After a promising start, the momentum on structural reform slowed and then largely stalled altogether. A comprehensive overview of structural benchmarks and to what extent they were met is included in Table 4. The following are some highlights of varying progress achieved on the structural reform agenda:

- **Front-loaded program benchmarks related to anti-corruption and AML/CFT were generally met**. The authorities established the National Anticorruption Bureau (NAB) and took measures to strengthen the implementation of the AML/CFT framework. This included legal amendments regarding customer due diligence and other preventive measures, such as those related to Politically Exposed Persons, related guidance by the FIU, and inter-agency cooperation and information sharing. Asset declarations for high-level officials were successfully introduced. Also, a new Specialized Anti-Corruption Prosecutor's Office, which is an autonomous unit in the Prosecutor General's Office, was established. Some of the implemented AML/CFT reforms benefited from Fund technical assistance in relation to AML supervision.[34]

- **However, after a promising start, anti-corruption and AML/CFT related reforms lost momentum and then largely stalled**.[35] Momentum seemed to have been lost by the time of the third review in August 2017. Reforms that stalled concerned the establishment of an anti-corruption court (which was eventually passed into law in 2018), and parliamentary approval of detailed NAB-related legislation (including an unmet benchmark related to investigative techniques). The results of the implementation of some of the new measures were also underwhelming.[36]

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[34] In 2017, Ukraine underwent comprehensive AML/CFT assessment by MONEYVAL against the Financial Action Task Force (FATF) AML/CFT standards. (Part of the Council of Europe, MONEYVAL is the FATF-style regional body (FSRB) for Europe.) Regarding technical compliance, the majority of ratings were sufficient (compliance or largely compliant). While the effectiveness ratings leave room for improvement, only one technical rating was "low". Notably, Ukraine's results across both sets of measurements were sufficiently good for Ukraine *not* to qualify for FATF's listing process.

[35] The lack of continued progress on improving governance and tackling corruption became a significant and increasing concern for the Fund as the program progressed, as reflected in public statements by the IMF Managing Director, see, e.g., *Statement by the Managing Director on Ukraine* (Press Release No. 16/52, 2/10/16), and *IMF Statement on the Efforts to Fight Corruption in Ukraine* (12/6/17).

[36] For example, administrative verification of asset declarations by the National Agency for Prevention of Corruption (NAPC) needs to be improved. And while NAB and SAP were still able to use information from asset declarations in criminal investigations, court cases are pending without final decisions.

- **Only one of the two measures related to judicial reforms was implemented.** The measure related to changes in court fees was implemented in law, while the measure related to payment orders and garnishment of bank accounts is still pending.[37]

- **Early conditionality on SOE reforms were met broadly on time, but subsequently several structural benchmarks had to be reset**. The SOE reform strategy was developed as planned. Also, the authorities, in cooperation with the EBRD, prepared amendments to the privatization law, albeit with major shortcomings.[38] The legislation to reduce the number of companies banned from privatization remained stuck in parliament. By the time the EFF was cancelled, the authorities had enacted a new privatization law, and started the preparations for the sale of six large SOEs in line with international best practices. Governance of large SOEs improved somewhat following the appointment of new majority-independent supervisory boards. However, work was pending on clarifying and strengthening the powers of the newly appointed supervisory boards with parliamentary approval of the law on SOE governance.

- **Conditionality regarding the sale of agricultural land ("land reform") was reset and remained unmet as an existing moratorium was kept in place.** As issues related to land reform were not within the scope of the Fund's core expertise, other stakeholders, in particular the World Bank, have provided Ukraine with technical assistance in planning this important reform that could help expand the key agricultural section and provide opportunities to the rural population. However, during the EFF, economic and political vested interests prevented implementation of this much-needed reform.

PROGRAM DESIGN AND STRATEGY ISSUES

Drawing on the analysis of program outcomes, and with the benefit of hindsight, this section discusses first some general considerations related to the program design and strategy and then highlights selected issues in key policy and reform areas.

A. General Considerations

Was the macroeconomic framework appropriate?

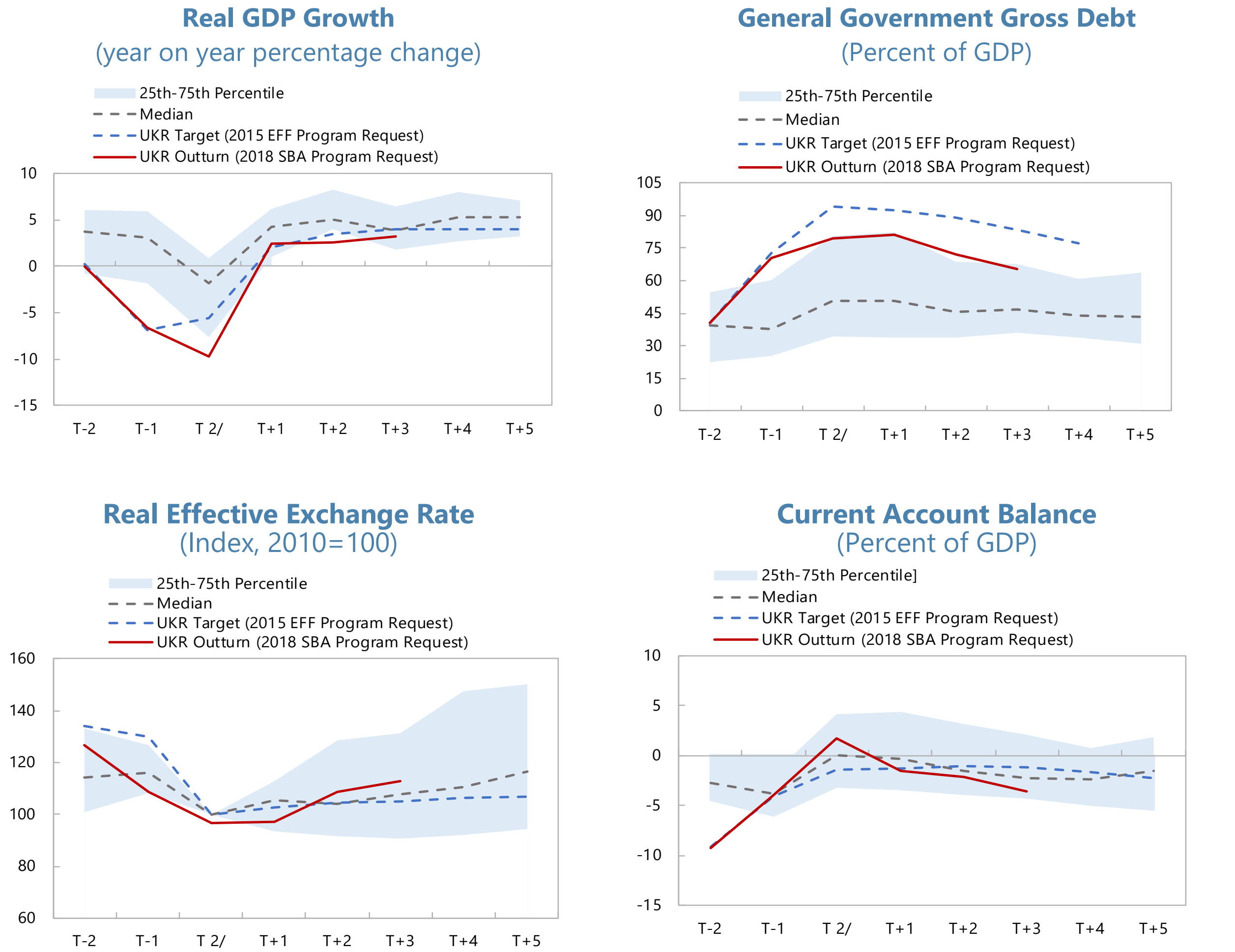
42. The macro framework of the program turned out to be broadly appropriate, which contributed to the program's success in macro-stabilization. The program was designed amid exceptionally high uncertainties, including related to the evolution of the conflict in the East and the outcome of the envisaged debt operation. Overall, growth projections for the program period were calibrated to be close to the bottom quartile of historical episodes of post crisis recovery in emerging market currency crises, reflecting the notion that Ukraine was facing a combined currency,

[37] However, legislation regarding garnishment in alimony cases has been adopted.

[38] In particular, the draft amendment provided Cabinet discretion on when to use reputable advisors for large SOE's.

banking, and twin deficit crisis. Although inflation remained higher than the program's initial projections, and the economic downturn during the first year of the program turned out to be more severe than initially assumed, the program largely avoided the pitfalls of growth optimism, which has been a common feature in many Fund programs in recent years, including those with Ukraine.[39] As such, the robust macro framework, combined with the authorities' decisive policy measures, helped bring about successful macro-stabilization broadly in line with the program objectives, despite the realization of some of the program risks (Figure 13).

Figure 13. Ukraine 2015 EFF vs. Historical Episodes of Post-Crisis Recovery 1/ 2/



Source: IMF Staff Estimates.

1/ Indicators calculated based on emerging market currency crises 1990-2014.

2/ T notifies the year of approval of each program included in the comparison.

[39] For instance, the EPE on Ukraine's 2014 SBA noted that the program's *"baseline was more of a best case scenario"*. For a discussion on growth optimism in recent Fund-supported programs, and the relationship between program design and program outcomes, see *2018 Review of Program Design and Conditionality* (4/5/19), and Ismail, K., R. Perrelli, and J. Yang (2019), "Optimism Bias in Growth Forecasts—The Role of Planned Policy Adjustments," IMF Working Paper (forthcoming).

Were political economy considerations appropriately taken into account in the program design?

43. The narrow window of opportunity to achieve transformative structural reform closed as the underlying dynamics of the political economy led to the loss of reform momentum. Initial strong ownership by the authorities representing the new broad coalition government, and extensive support from the international community and the civil society, pointed to a window of opportunity to implement an ambitious reform agenda. However, after some impressive progress on several fronts early on in the program, the reform momentum started to wane as the economy stabilized and vested interests reasserted their influence. The collapse of the broad coalition government in April 2016, and the accumulating slippages in completing quarterly program reviews, contributed to the loss of reform momentum.[40] Subsequently, the approaching parliamentary and presidential elections further undermined the implementation prospects for politically difficult measures. In these circumstances, a more parsimonious structural conditionality after the initial phase of the program—focused on a very limited set of critical reforms—might have helped sustain political support for reforms longer into the program period. An effort to this direction was made in the third review by, but at that time it was already too late. Finally, an earlier recognition that sufficient political support for further significant reforms no longer existed, would have allowed a timelier "reset" in Ukraine's Fund engagement.[41]

Was the EFF the most appropriate Fund instrument?

44. While choosing the EFF as the instrument had several advantages, the long duration of the arrangement implied additional challenges.[42] Ukraine's protracted balance of payments needs and the program's heavy focus on structural reforms were clear arguments in favor of an EFF rather than an SBA. Moreover, the EFF enabled a four-year length of the arrangement for implementing reforms and bringing the debt to a sustainable level. Such considerations suggest that the four-year EFF was probably a suitable instrument for Ukraine at the time. On the other hand, Ukraine's rather weak track record in implementing sustained structural reforms could have argued for a somewhat shorter EFF program, including because the four-year horizon extended close to the next electoral period, which implied additional challenges for maintaining strong program

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[40] In February 2016, the ruling coalition government narrowly survived a no-confidence vote, and subsequently lost its majority after two smaller parties, which criticized the government for having lost its will to carry out reforms, left the coalition. A new government, with a slim and fragile majority in parliament, was appointed in April.

[41] After the third review, another 18 months elapsed before the EFF was canceled and replaced with an SBA. However, already by the time of the third review (in April 2017) there were clear signs that the program momentum had been lost as five PAs were implemented for completion of the review and 8 of the 11 SBs for this review had to be reset.

[42] The SBA is the Fund's most-used instrument in exceptional access cases. When the Fund's toolkit was reviewed in 2009 amidst the global financial crisis (GFC), the Executive Board expressed the expectation that the EFF would not normally be used in high access cases. See *The Acting Chair's Summing Up - GRA Lending Toolkit and Conditionality - Reform Proposals* (BUFF/09/50, 3/27/09). Subsequently, in addition to Ukraine's 2015 program, there have been only three other exceptional access EFFs (Ireland 2010, Portugal 2011, and Greece 2012).

ownership. However, this option would have entailed a larger macro adjustment and/or a more extensive debt operation, which were not regarded feasible at the time of the program design.

Was the level and phasing of the exceptional access appropriate?

45. A somewhat lower access might have sufficed, and less frontloading could have helped to retain incentives for program implementation. With much lower-than-planned official disbursements, the reserves reached less than two-thirds of the program target. Despite this large shortfall, aided by the successful debt restructuring the situation stabilized, and Ukraine's market access was restored earlier than expected as its borrowing costs declined dramatically (Figure 14).[43] This suggests that even a somewhat lower access might have sufficed, although it must be recognized that favorable external developments also played a significant role in bringing down the spreads, and this was hard to predict at the outset of the program. On phasing, significant frontloading was appropriate considering the very low reserves and the need to restore confidence, including to secure financing from official and private sources. Nevertheless, less frontloaded access might have helped retain momentum for advancing structural reforms further into the program, while recognizing that it is very difficult to judge the extent to which scope for less frontloading existed at the time of program design.

Was the debt operation appropriately designed and implemented?

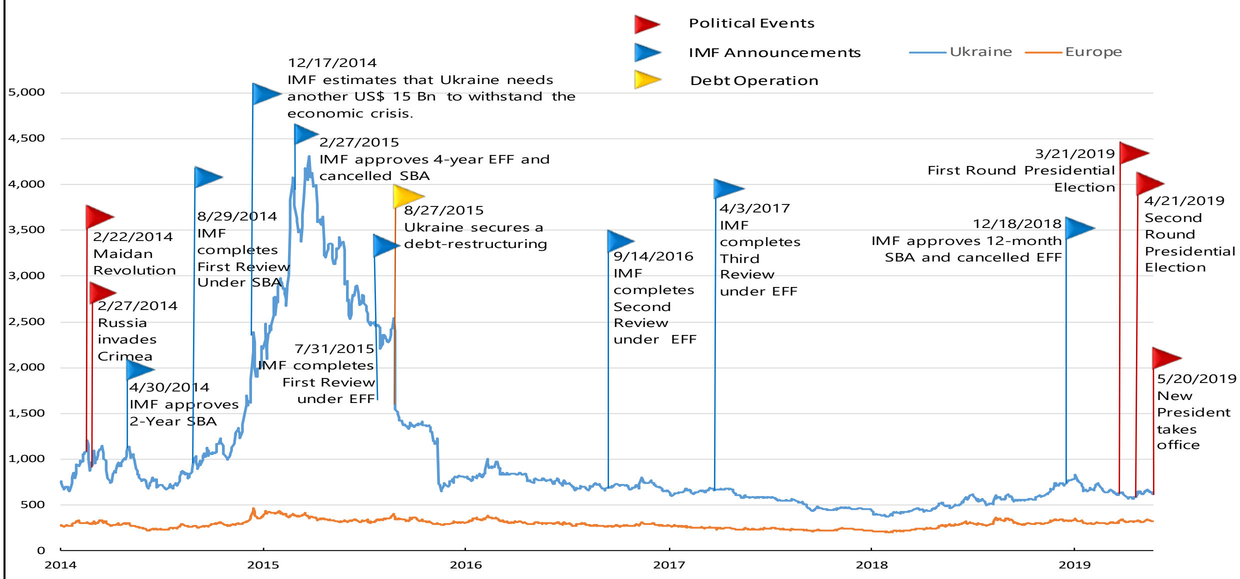
46. The debt restructuring—a key element of the program's financing strategy—was generally well-designed and implemented (Box 2). The crisis had exacerbated Ukraine's already large financing needs and increased its public debt level; and what had initially been only a liquidity problem had turned into a solvency problem. Guided by the Fund's debt sustainability framework for market access countries (MAC-DSA framework), the program set broad parameters for the pre-emptive debt operation that covered Ukraine's public and publicly guaranteed (PPG) debt. The key objectives of the operation were to: i) generate approximately US$15 billion in financing during the program period; ii) reduce the PPG debt-to-GDP ratio below 71 percent of GDP by 2020; and iii) limit average gross financing needs to 10 percent of GDP over the years 2019-2025. These objectives were generally appropriate and the pre-emptive debt operation prevented a potentially lengthy and costly default episode.[44] The operation was implemented largely as planned and it met its key objectives with some margin: it generated slightly more than the originally targeted amount of financing and limited the gross financing needs below the targeted level, while the debt-to-GDP ratio declined faster than anticipated, reaching 65 percent in 2018. This faster than projected decline in the debt-to-GDP ratio reflected a number of factors that were not foreseen at the time when the program's prudent macro framework was designed amid exceptionally high downside risks. In particular, such factors included: faster than projected appreciation of Ukraine's REER, fiscal

[43] Ukraine issued its first Eurobond during the EFF in July 2016, and then accessed markets multiple times during the program (in 2017Q3, 2018Q3, and 2018Q4).

[44] See Asonuma and Trebesch (2016) for evidence that preemptive debt restructurings are associated with lower output costs (and shorter periods of capital market exclusion) than restructurings that take place post-default.

overperformance early on in the program, and lower than programmed official disbursements.[45] [46] As such, the debt operation contributed to strengthening sustainability of Ukraine's public debt (Figure 15). However, earlier clarity on the official nature of a Russian-held Eurobond would have been helpful (see the following section). An apparent lack of clarity regarding the status of the claim under the Fund's arrears policies led to unhelpful market speculation. This claim was publicly recognized by the Fund as an official claim only *after* the bondholder restructuring had been negotiated, and prior to that Fund documents implicitly grouped the claim with private creditors for purposes of restructuring.[47]

Figure 14. Ukraine: EMBIG Spread 2014-Present



Sources: Bloomberg

[45] About half of the larger than projected decline in the debt ratio during the program was due to "the denominator effect" arising from faster than projected increase in Ukraine's nominal GDP in USD (reflecting faster than anticipated appreciation of Ukraine's REER). Other factors contributing to the faster than projected decline in the debt ratio included: significant fiscal over-performance, which was largely driven by reduction in Naftogaz's 2015 deficit and interest savings; and lower than programmed disbursements by the Fund and other IFIs (which were only partly offset by other borrowing, including higher than projected Eurobond issuance).

[46] Based on the most recent data from the authorities, the PPG debt-to-GDP ratio as of end-2018 was at about 61 percent. This lower figure does not change the thrust of staff assessment. (As noted earlier, the data in this document reflects data as of cancellation of the EFF in December 2018, which corresponds to the latest published IMF staff report on Ukraine. See, *Ukraine - Request for Stand-By Arrangement and Cancellation of Arrangement Under the Extended Fund Facility* (01/08/2019)).

[47] However, whether or not to include the claim in the scope of the restructuring was (as it must be) the decision of the Ukrainian authorities. More broadly, the Fund has no role to play in requiring specific treatment of an official claim vis-à-vis private claims in the course of a restructuring.

Did the Fund coordinate sufficiently with other IFIs and stakeholders?

47. The breadth and complexity of the program implied additional coordination challenges. The program included several reform areas where the Fund has only limited expertise (e.g., land reform), requiring Fund staff to coordinate closely with many other institutions, including, the European Commission, EBRD, EIB, USAID, and the World Bank. While emphasizing generally very good cooperation, Fund staff and other stakeholders noted that the quality of such cooperation varied over time and was highly dependent on personal relationships.

Figure 15. Ukraine: Evolution of Heat Map from 2015 EFF Request to 2018 SBA Request [1/]

Debt Level 2/	Real GDP Growth Shock		Primary Balance Shock		Real Interest Rate Shock		Exchange Rate Shock		Contingent Liability Shock	
	2015	2018	2015	2018	2015	2018	2015	2018	2015	2018
Gross Financing Needs 3/	Real GDP Growth Shock		Primary Balance Shock		Real Interest Rate Shock		Exchange Rate Shock		Contingent Liability Shock	
	2015	2018	2015	2018	2015	2018	2015	2018	2015	2018
Debt Profile 4/	Market Perception		External Financing Requirements		Change in the Share of Short-Term Debt		Public Debt Held by Non-Residents		Foreign Currency Debt	
	2015	2018	2015	2018	2015	2018	2015	2018	2015	2018

Source: IMF Staff Estimates.
1/ Cells indicated with "2015" show the heat map from the 2015 EFF program request, while "2018" shows the heatmap from the 2018 SBA program request.
2/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.
3/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.
4/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

B. Selected Questions in Key Policy and Reform Areas

Did monetary and exchange rate policies achieve their objectives?

48. Reforms to the NBU's monetary and exchange rate policies have delivered important and lasting improvements, but the authorities' early adoption of inflation targeting involved challenges. Driven by a sharp exchange rate depreciation, inflation initially overshot program projections by a wide margin. However, subsequently the monetary policy, aided by capital flow measures (see below), managed to bring inflation under control—albeit not all the way to the single digits level envisaged in the program design. Moreover, the NBU has continued to set monetary policy on a forward-looking basis, with an eye towards containing inflation. Progress on the exchange rate-side has proved lasting too, as the hryvnia has continued to float since program inception, with FX interventions only taking place to reduce volatility and accumulate FX reserves. While the authorities' early adoption of an inflation targeting regime (in December of 2016) entailed challenges,[48] it did not significantly complicate the program implementation, and helped anchor medium-term inflation expectations. To ensure greater consistency between program conditionality and the NBU's inflation targeting regime, the program could have considered the earlier introduction of an Indicative Target on inflation, along with the introduction of a Monetary Policy Consultation Clause.[49]

Were the capital controls warranted and appropriate?

49. The tightening of capital controls seems to have reduced pressures on the exchange rate, thereby contributing to keeping inflation under control and enabling the NBU to limit FX interventions to a minimum. In addition, they also helped stabilize the financial sector. The subsequent transition towards capital account liberalization was characterized by caution, which seems warranted considering the limited stock of FX reserves. With the benefit of hindsight, a somewhat faster relaxation of capital controls might have been possible, but on balance, erring on the side of caution in liberalizing capital controls was prudent, considering the lingering effects of the crisis.

What key factors contributed to progress made in strengthening the financial sector or lack thereof?

50. Several factors contributed to the progress in reforming the banking sector. First, strong leadership and reform-minded management within the NBU, supported by internal reorganization, helped ensure strong ownership for reforms. Second, reforms were reinforced by changes in the legal and regulatory framework, including the NBU law.[50] Third, program conditionality was appropriately designed and supported by well-coordinated capacity building from international partners, including the IMF. Fourth, the rules allowed for some flexibility, e.g., with respect to regulatory forbearance for losses. However, when Parliamentary action was required (i.e. for improving the supervision of the non-banking sector and the governance of SOBs, and for strengthening insolvency procedures) progress was often slower, and vested interests opposed to reforms were able to undermine the progress.

[48] Like in many emerging markets, exchange rate pass-through is high in Ukraine, which makes it difficult to anchor inflation expectations when reserves are at an insufficient level to smooth inflation-destabilizing exchange rate fluctuations (BIS, 2019). Moreover, in Ukraine's case, it is not clear that some other elements considered desirable for adopting inflation targeting were in place in 2016, e.g., the ongoing transformation in the still weak banking system and high dollarization implied constraints to effective monetary transmission.

[49] Such a clause was discussed in the context of the third review and then adopted as part of the conditionality under the 2018 SBA.

[50] The revision of the NBU law was a structural benchmark at the program approval, and then was turned into a prior action for the first review.

Were the size and the pace of fiscal adjustment appropriate and were fiscal reforms appropriately focused and balanced?

51. While the size and pace of the fiscal adjustment were broadly appropriate, the program could have focused more on reforms to support effective mobilization of revenues. The sizable adjustment, including the elimination of the Naftogaz's deficit, was appropriate given the large near-term financing needs, as recognized in the recent Review of Conditionality.[51] However, as noted earlier, some ambiguity about the program's main fiscal anchor early on in the program was evident in the program documents (see footnote 20). The fiscal reform agenda was generally comprehensive, covering critical areas that previous programs had left untouched, and paced so that the authorities could properly design rather complex and far-reaching reforms, while garnering public support to implement politically difficult measures. However, higher priority could have been given to the implementation of macro-critical revenue administration reforms already earlier on in the program, when reform momentum was still strong, as this might have helped to overcome resistance from vested interest. Such reforms were critical to place Ukraine on a sustainable and growth-friendly fiscal ground and could have served as a linchpin for the broader governance and transparency agenda.

Were the energy sector reforms well-designed and implemented?

52. Reforms in the energy sector were generally well-designed, yet difficult to implement, and for some aspects incomplete. The revision of tariffs to eliminate deficit in Naftogaz was accomplished, albeit with delays and setbacks (i.e., the failure to apply the formula-based adjustment in 2017), which highlight the need for effective communication and outreach to the public on the necessity and benefits of such reforms. Governance in Naftogaz was improved, although the company remains a monopolist in the wholesale supply for households—as long as gas for households is below import parity and tariffs are below cost recovery—barriers to entry in the retail market remain high. The independence of the energy regulator remains weak, and its authority has recently been questioned by a ruling from the Constitutional Court. Subsidy reform was generally successful in shielding the most vulnerable from increases in tariffs. However, scaling back the program proved difficult and efforts to reform it were piecemeal rather than being integrated into a strategy involving monetization of subsidies at the household level and transformation of that program into a broader guaranteed minimum income program.

Was the strategy to strengthen governance and tackle corruption appropriately focused and effective?

53. Reforming governance and weeding out corruption was based on a multi-pronged approach and recognized that sustained and further efforts are needed. The program rightly emphasized the need to tackle endemic level of corruption to improve business climate. Building on the legal foundation created in the context of the 2014 SBA, the EFF put an emphasis on institution building, and operationalizing these new institutions, e.g., anti-corruption bureau and anti-

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[51] *2018 Review of Program Design and Conditionality* (5/20/19).

corruption courts, which directly aimed at strengthening governance and reducing corruption through effective enforcement. This focus seems to have been appropriate, although some of the reforms are still yet to be effectively implemented.[52] Importantly, the above-discussed measures were complemented by other structural reforms under the program, which served to reduce opportunities for corruption, notably in the areas of procurement and in the financial and energy sectors. Close cooperation with other international organizations and civil society proved to be beneficial for the program and helped in designing and monitoring reforms. Notwithstanding the progress, challenges remain in this area going forward, including operationalizing the anti-corruption court, implementing investigative techniques, and SOE governance reforms. It is difficult to assess at this time to what extent the program helped achieve significant and lasting improvement in governance. Governance reforms can take a long time to bear fruit and measuring their impact is inherently challenging. Nonetheless, some non-IMF indicators on Ukraine's governance exhibited marginal, albeit not statistically significant, improvement over the program period.[53]

Was the structural reform agenda overly ambitious?

54. The program's broad and deep reform agenda was very ambitious, considering Ukraine's track-record and compared with other Fund programs. In addition to core Fund areas, the conditionality covered non-traditional areas, notably governance. The structural conditionality (SC) was also quite deep based on an IEO methodology used recently in the Review of Conditionality (RoC) (see Box 4 for more details). The program strategy rightly aimed to take advantage of a window of opportunity to achieve deep and transformational reforms, and this approach yielded some notable results in several areas. Nevertheless, in hindsight, a somewhat more parsimonious structural agenda after the initial stages of the program, would have had a better chance of maintaining reform momentum and been more appropriate. Such an approach would also have been consistent with lessons from earlier EPEs of Ukraine Fund programs, which have highlighted the country's track-record with fragile program ownership in the face of strong vested interests, and the need for careful prioritization of the structural reform agenda. At the same time, the extensive reform agenda was important for mobilizing financing and political support for the program from the international community, which may have contributed to the very ambitious reform agenda. While the program request acknowledged that the structural reforms targeted under the program were deep and ambitious, no overall systematic assessment of the depth of SC, which would have put the agenda into a wider context, was conducted at the time of the program design.

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[52] Experience with governance reforms in this EFF have helped inform the 2018 review of the Fund's framework on governance. See Box 4 in *Review of the 1997 Guidance Note on Governance - A Proposed Framework for Enhanced Fund Engagement* (4/22/18).

[53] For example, Ukraine's indicators in all six sub-components of the Worldwide Governance Indicators, which reflect survey-based perceptions on governance, showed marginal improvement over the program period, but none of the changes was large enough to be considered statistically significant.

CONSISTENCY WITH FUND POLICIES

This section examines whether the program modalities were consistent with Fund policies. In particular, Ukraine's 2015 EFF falls under the Fund's Exceptional Access (EA) policy and the policy governing lending into official arrears (LIOA). In addition, this section discusses whether financing assurances and capacity to repay were given due regard under the program.

A. Were the Exceptional Access Criteria Observed?

55. According to Fund policies, any exceptional access arrangement has to satisfy four criteria:[54]

- **Criterion 1 (EA1) – Exceptional balance of payments pressures that cannot be met within the normal limits**. At the time of the program request, Ukraine was experiencing exceptional balance of payments pressures emanating from both the current and capital account, while its official reserves stood at a critically low level. Notwithstanding progress achieved by the time of the third review, official reserves remained low and capital control measures were still in place to support financial stability. These considerations suggest that EA1 was met throughout the program.

- **Criterion 2 (EA2) – A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term**. According to EA2, debt sustainability is evaluated on a forward-looking basis, taking into account, *inter alia*, any intended restructuring to restore debt sustainability. Against this backdrop, at the time of program approval, EA2 was assessed to be met, conditional upon the debt operation taking place as intended and based on the premise of full implementation of policies under the program. The debt operation was completed in August 2015, broadly consistent with the envisioned effects on debt levels and gross financing needs, supporting staff assessment of EA2 at the time of the program approval. Moreover, since the restructuring, public debt has been on a declining trajectory, supporting the notion that EA2 was met also during the remainder of the program.

- **Criterion 3 (EA3) – Prospects of gaining or regaining market access**. At the time of the program request and subsequent three reviews, staff anticipated that, conditional on successful program implementation (including the debt operation), Ukraine had good prospects of regaining access to private capital markets before the end of the program. Ukraine issued its

[54] The Fund's Exceptional Access Policy was amended, effective January 20, 2016. The changes to the policy (which affected EA2 and EA3) applied also to all subsequent reviews under pre-existing arrangements, including Ukraine's second and third reviews under the EFF. See *The Fund's Lending Framework and Sovereign Debt - Further Considerations* (4/9/15). *The Fund's Lending Framework and Sovereign Debt - Further Considerations - Supplementary Information* (1/6/16), and Decision No. 15931-(16/4), adopted January 20, 2016.

first Eurobond in July of 2016 and subsequently accessed markets multiple times over the program period. This supports staff assessment that EA3 was met throughout the program.

- **Criterion 4 (EA4) – The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment**.
    - **At the time of the program request, the EA4 assessment was premised on the expectation that the authorities could deliver a decisive break from the past**. The authorities had performed reasonably well under the previous SBA-supported program despite the adverse environment. The EA4 assessment also noted the authorities' commitment to implement strong prior actions, strong willingness and capacity to implement the program, and the extensive involvement and financial assistance by the international community. The assessment of EA4 gave the country the benefit of doubt: it did not explicitly reference Ukraine's history of relatively weak track record in implementing Fund programs, but noted that a decisive break from the past was needed, involving strong ownership and full and sustained implementation of difficult measures. Against this backdrop, staff concluded that government's institutional and technical capacity would continue to be strengthened by extensive technical support from the Fund and other partners and judged it to be sufficient to deliver the core elements of the reform with reasonable strong prospects for success.
    - **In subsequent reviews, EA4 assessments placed greater emphasis on implementation risks on account of fragmented parliament and increasing pressures for populist policies and vested interests**. Nevertheless, the assessments considered that the criterion continued to be met, including because some of the program conditionality had been rephased to align it with observed implementation capacity. However, it seems that, more than the authorities' institutional capacity to deliver key reforms, the political cost of implementing some reforms may have become excessive in the face of increased resistance from entrenched vested interests, especially after the parliamentary majority of the government became narrower and the immediate economic crisis subsided. The tension between the increasing emphasis on program implementation risks and the requirement of "reasonable success" increased over the course of the program and was most pronounced in the third review.

B. Was the Lending into Official Arrears Policy Applied Appropriately?

56. Since December 2015, Ukraine has had outstanding arrears on a Eurobond held by Russia. On December 16, 2015, the Executive Board decided that the claim arising from the US$3 billion Eurobond issued by Ukraine and held by Russia's National Wealth Fund (NWF) is an official claim for the purposes of Fund's policy on arrears to bilateral creditors.[55] Shortly thereafter, before

[55] For background, see *Status of Ukraine's Eurobond Held by the Russian Federation* (12/16/15).

the bond's due date, the Ukrainian authorities announced a moratorium on this bond, resulting in the non-observance of the continuous performance criterion (PC) on the non-accumulation of external payment arrears. Subsequently, discussion took place on the restructuring of this bond, but they did not result in negotiated agreement and the bond remains in arrears. The dispute is currently pending before the court.[56]

57. According to IMF guidelines, the Fund can lend into official arrears to bilateral creditors when the following three criteria are met:[57, 58]

- Criterion 1 (LIOA1) - Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies.
- Criterion 2 (LIOA2) - The debtor is making good faith efforts to reach agreement with the creditor on a contribution with the parameters of the Fund-supported program (such that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution).
- Criterion 3 (LIOA3) - The decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.

58. At the time of the relevant reviews (i.e., the second and third reviews), staff assessed that these criteria were met.[59] Specifically, staff noted that in line with EA1, balance of payment pressures were exceptionally large with Ukraine being judged to pursue appropriate policies (thereby satisfying LIOA1). Ukraine was also judged to have made good faith efforts to reach agreement with Russia (LIOA2), considering that the terms offered to Russia were in line with financing and debt objectives of the program and did not imply a contribution that would be disproportionate relative to other official bilateral creditors; and that the Ukrainian authorities were

[56] Terms offered by the Ukrainian authorities, which were in line with the financing and debt objectives of the program, have not been accepted by the Russian authorities. In February 2016, the Trustee of the Eurobond held by Russia's National Wealth Fund brought summary proceedings in the UK's High Court of Justice seeking full payment of principal and interest. On March 29, 2017, the High Court ruled in favor of Russia but stayed execution of the judgement pending consideration of Ukraine's appeal. On September 14, 2018, the UK Court of Appeal reversed the High Court's summary judgement, returning the case to the High Court for full trial. The Russian authorities have appealed the decision to the Supreme Court, before which a hearing is scheduled for December 2019.

[57] See *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors (10/15/15)*. The ambiguity regarding the nature of the Russian held Eurobond was a key factor in expediting the Fund's review of the LIOA policy in late 2015. The need for such a review was identified already in 2013, when the Executive Board discussed a paper on *"Sovereign Debt Restructuring - Recent Developments and Implication for the Fund's Legal and Policy Frameworks"* (10/15/2013). In particular, in discussing the 2013 paper, most Executive Directors "saw merit in clarifying the framework for official sector involvement to ensure a more consistent, evenhanded, and transparent approach". See *The Chairman's Summing Up on Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework* (5/20/2013).

[58] These criteria only apply when (i) there is no representative Paris Club agreement, and (ii) the creditor does not provide explicit consent for LIOA.

[59] The second review was the first one to take place after the arrears had arisen.

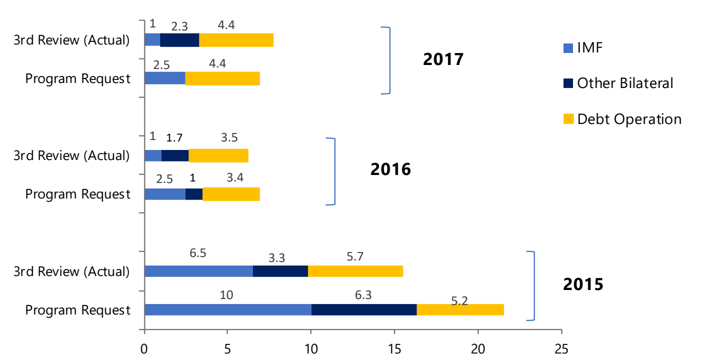
judged to have shown readiness to take negotiations forward, exchanged relevant information with the creditor on a timely basis, and welcomed Germany's offer to act as an intermediary. Finally, staff noted that, while taking Russia's strong track record of providing contributions in the context of Fund programs into account, the provision of financing despite the arrears was not expected to harm the Fund's ability to mobilize financing packages in the future (LIOA3) because of the exceptional nature of the dispute and efforts to resolve it, and as most of Ukraine's official bilateral creditors, representing the vast majority of the required financing contributions from such creditors, were supportive of Ukraine by providing new financing.

59. The policy governing LIOA seems to have been applied appropriately in this precedent setting case. Balance of payment pressures have remained large throughout and are still present to date; the Ukrainian authorities have continued to pursue good faith efforts vis-à-vis the creditor; and there is no evidence that the decision to lend into Ukraine's official bilateral arrears has hampered the Fund's ability to provide financing in any of the subsequent programs. Nevertheless, the case highlighted the ex-ante uncertainty regarding which claims the Fund considers official for purposes of its arrears policies.

C. Were Financing Assurances and Capacity to Repay Given Due Regard?

60. Financing assurances remained firm, though at a reduced level over 2015–17 due to delays with program implementation. The program request underscored the significant financial assistance from the international community in support of the program. This included new multilateral and official bilateral financing, as well as a debt operation. The financing from the debt restructuring was consistent with the targets set under the program. A re-phasing of the disbursements in the context of the second and third reviews, reflected the authorities' lower reform ambition following the achievements in macro stabilization and a somewhat better external environment (see Figure 16).

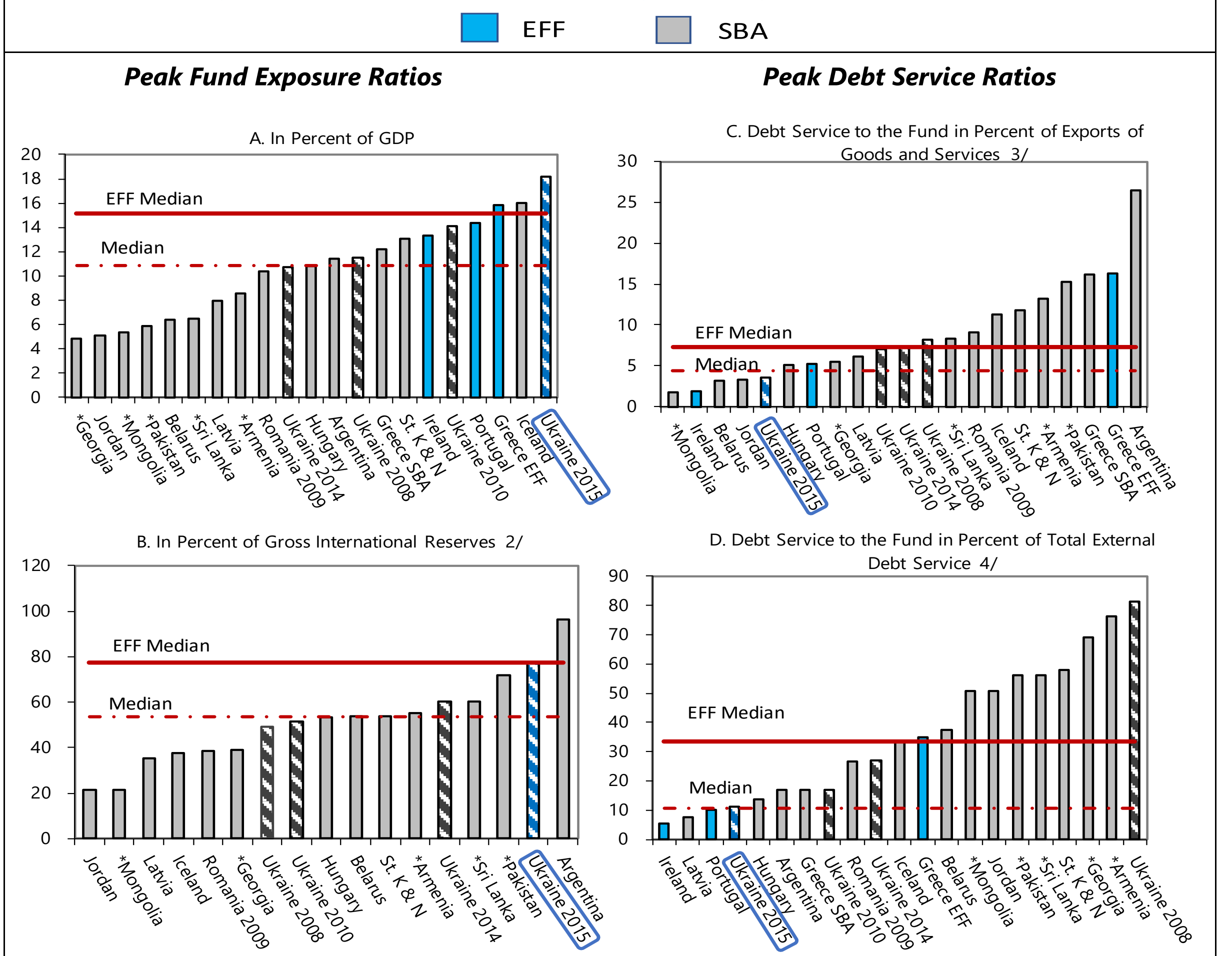
Figure 16. Ukraine 2015 EFF: Evolution of Program Financing
(US $ billion)



Source: IMF Staff Estimates.

61. Ukraine's capacity to repay the Fund was assessed as adequate, but staff was candid about the exceptionally high risks to the country's repayment capacity. The program request acknowledged manifold program risks and appropriately stressed that adequate capacity to repay was dependent on the planned debt operation, which would help contain financing needs during the period when the first large repayments come due to the Fund. Among other factors identified as affecting the capacity to repay were the implementation of the envisaged policies and reforms and the containment of the conflict in the East. While the staff report on program request was frank on the exceptionally high risks facing the program, and their potential impact on the country's capacity to repay, it would have benefited from inclusion of a downside scenario. Indeed, even under the program's baseline scenario, notwithstanding the projected revival of growth and the buildup of reserves, peak Fund exposure relative to GDP and reserves was projected to exceed or to be equal to the corresponding medians in other EA cases since the GFC, respectively (Figure 17).

Figure 17. Ukraine 2015 EFF Capacity to Repay: Selected Indicators



Source: IMF staff estimates and World Economic Outlook.

1/ Estimates as reported in relevant staff reports on the request of SBAs or arrangements under the EFF approved since September 2008, excluding all precautionary programs.

2/ Asterisks indicate PRGT-eligible countries at the time of the program.

3/ Excluding arrangements with members belonging to the euro area at the time of the approval of the arrangement.

4/ For arrangements of which total external debt (or debt service) ratio is not available, public external debt ratio is shown.

LESSONS FROM THE 2015 EFF

This section concludes and discusses some possible broader lessons that emerge from the 2015 EFF for future Fund engagement with Ukraine, program design in similar cases, and for Fund policies more generally.

62. The 2015 program broadly achieved the targeted macroeconomic stabilization, but its record on structural reform was uneven:

- **The program helped restore macroeconomic stability and growth following the severe economic crisis of 2014–15 but did not fully restore BOP sustainability**. The program largely avoided the common pitfall of growth optimism, and adoption of a flexible exchange regime, prudent monetary policy, and strong fiscal consolidation led to a sharp reduction in both the current account and overall fiscal deficits. The successful completion of the debt operation helped restore sustainability of public debt. Confidence was strengthened, financial stability restored, and economic growth resumed. On the other hand, inflation started to decline but remained above the target. International reserves, while increasing, remained well below targeted levels, mainly owing to lower than programmed official disbursements due to delays in program implementation and lower than projected private inflows. As a result, successor SBA was needed upon termination of the EFF.

- **While considerable progress was achieved in several areas of the ambitious structural reform agenda, the efforts to improve competitiveness and business climate fell well short of expectations**. Very significant progress was made in a number of areas, including central bank independence and cleaning up the banking sector. Significant steps were taken also to reform the energy sector and the pension system, and some inroads were made in strengthening governance and tackling corruption. Nevertheless, after promising initial steps, reform momentum dissipated as the economy stabilized and program ownership waned in the face of resistance from vested interests. With only three reviews completed, the program went irrevocably off track, leaving many structural vulnerabilities unaddressed. Moreover, some recent developments have highlighted the risk of reversals in areas where significant progress was achieved. All in all, while much was achieved under the program, especially considering Ukraine's previously rather weak record in implementing structural reforms, the efforts to fundamentally transform the economy to lift medium-term growth fell short of the program's objectives.

63. While the EPE agrees with the overall thrust of policies under the EFF, it also offers some possible lessons for future Fund engagements. For the most part, the program was appropriately designed, and it is exceedingly difficult to assess to which extent modifying certain design features of the program would have delivered materially different outcomes. However, it seems that more parsimonious structural conditionality after initial stages of the program would have been more compatible with Ukraine's track-record, political economy, and the fragility of the program ownership. Against this backdrop, the EPE offers some broad lessons that could be helpful for Ukraine's possibly future engagement with the Fund and for other countries in circumstances where strong vested interests and a fragmented political landscape make it challenging to implement and sustain structural reforms. In addition, the experience under the EFF offers a few lessons related to Fund policies.

Lessons on How to Build and Sustain Reform Momentum

- **Use prior actions judiciously and structural benchmarks parsimoniously**. Strong PAs can demonstrate the authorities' commitment to a new program, may help build support for reforms among other stakeholders, play an important role in jumpstarting important reforms, and can be helpful in getting delayed structural reforms back on track. At the same time, PAs are not a substitute for ownership and very extensive use of PAs after program approval may risk undermining program ownership. Especially when political capital is limited, sustaining reform momentum requires careful prioritization and sequencing of the structural reform agenda. Specifically, parsimonious use of SBs after initial stages of the program may help in sustaining political support for reforms that often imply short-term political cost in exchange of benefits that take a long time to materialize.

- **Lay the groundwork for countries to be able to take advantage of (often narrow) windows of opportunity**. In a political environment characterized by fragmented politics, periods of exceptional unity, often brought about by a crisis, provide opportunities for significant reforms. Therefore, it is important to lay the groundwork for such reforms, including through policy advice and capacity building, even when the near-term prospects for their implementation may not look favorable. Then, once an opportunity arises, otherwise difficult to implement structural reforms can be implemented, including by frontloading such reforms in the early stages of a new program.

- **Foster development of genuine and broad ownership**. Program ownership by a strong policymaking team within the executive branch is always critical for implementation of conditionality. Building broader ownership is also important, particularly after an acute crisis has subsided. When legislative changes are involved, legislative bodies should have time to exercise their role in a meaningful way, recognizing that this may provide opportunities for vested interests to try to undermine proposed reforms, and that outcomes often will not be optimal from a narrow economic perspective. As it may be difficult to align such processes with quarterly reviews, semiannual reviews (possibly complemented with quarterly staff visits) might be better suited for programs including deep structural reforms, in particular after immediate macro stabilization objectives have been achieved.

- **Avoid very heavy front-loading of access in EFFs to help sustain reform momentum**. Some frontloading of access is often crucial in restoring confidence at the outset of a program. At the same time, avoiding very heavy front-loading may help maintain reform momentum during longer programs with significant structural agenda.

- **Timely and well-targeted communication and outreach are increasingly important in ensuring broad buy-in for Fund-supported programs**. Fund staff and country authorities should work closely together in developing and implementing communication strategies on key reforms; staff can bring best practices to bear and complement authorities' expertise on country-specific circumstances. Their concerted outreach to key opinion leaders (e.g., in the academia and civil society organizations) and broader populations about a program's objectives and costs of failure can help support program ownership and dispel misconceptions that may undermine reform efforts. The increasing importance of social media underscores the need for timely, concise, and well-targeted communication.

Possible Lessons Related to Fund Policies and Procedures

- **Consider requiring the inclusion of a quantified downside scenario in all capacity to repay assessments in requests for Fund-support under exceptional access.** All requests for EA are accompanied by a supplement that assesses the risks to the Fund from a proposed arrangement. Such assessments already contain a discussion on key program risk and their bearing on a member's capacity to repay the Fund, however, they do not typically include an explicitly quantified downside scenario. The requirement to include such a downside scenario in all capacity to repay assessments for exceptional access cases would help strengthen the assessments of risk to the Fund's finances. Such a downside scenario could also support the assessment of whether debt is sustainable with high probability for the purpose of the second EA criterion.

- **Consider clarifying the boundaries between various classes of claims for the purposes of the Fund's arrears policies.** While assessments of whether a claim is private, official bilateral or multilateral under Fund arrears policies are likely to continue to require some case-by-case analysis, it would seem useful for the Fund to provide greater ex-ante clarity on how such determinations would be made, including to avoid potential complications in future debt restructuring cases.

- **Consider developing a rules-based approach to communicate long delays in completing program reviews under GRA arrangements**. Fund communications on delays in completing program reviews take place on an ad hoc basis.[60] Such communications could be complemented with an approach where, after an extended period has lapsed without a completed review (e.g., when the delay in completing a scheduled review exceeds 12 months)[61], the Fund would issue a standardized public statement explaining the reasons for the delay.[62] Such an approach would:

[60] Such communications include, e.g., statements and communications by Fund Management, Director of Communications Department, mission chief, and resident representative.

[61] This would imply a 15-month period without a completed review under a quarterly review schedule, and an 18-month period without a completed review under a semiannual review schedule.

[62] If deemed appropriate, such a statement could draw on a standardized taxonomy of reasons for delays in completing a review, e.g., akin to the approach used currently in periodic reports on excessive delays in Article IV consultations.

(i) improve the incentives to take timely corrective actions in programs encountering difficulties; (ii) increase openness and clarity of the Fund's communications; (iii) help ensure evenhanded treatment of members; and (iv) reduce unproductive attempts to restart "defunct" arrangements that lack realistic prospects of getting back on track. The risk that such communications would trigger adverse market reactions would be mitigated by a sufficiently long "trigger" period and predictability brought about by the rules-based approach.

- **Consider developing further guidance for assessing a program's prospect for success under EA4**. While recognizing that the application of EA4 ("reasonably strong prospects for success") will inevitably require a considerable degree of judgment, which is informed by the specific circumstances, developing more guidance on this area could contribute to increased rigor, greater evenhandedness, and realism in EA4 assessments. In addition to elements recommended in the EPE on Ukraine's 2014 SBA (e.g., past track record, electoral process, political context) such guidance could include a systematic assessment of the depth and implementation of structural conditionality (see below).

- **Consider adopting a standardized presentation to describe the depth and implementation record of structural conditionality (SC) in program documents**. The depth dimension of SC could build on the methodology used in the 2018 Review of Conditionality (see Box 4).[63] Table 4 illustrates a possible option for presenting the depth and implementation of SC. Such standardized presentations could help promote greater parsimony in SC and bring more transparency presenting progress in implementing SC during the life of a Fund program. They could also be used to provide a broad sense of how the SC in a particular Fund program compares with other programs. Finally, a more systematic assessment of the depth and implementation of structural conditionality, along with a discussion of the authorities track-record, institutional capacity and other relevant considerations, could help bring more objectivity to EA4 assessment.

[63] Under this methodology, the depth of SC is divided into three categories of high, limited (medium), and low depth. *High depth* implies legislative changes or measures to be carried out on a permanent basis which would bring about lasting changes, such as implementing civil service reform or privatization. *Limited depth* implies one-off measures that might bring immediate, but not lasting, effects, such as changes to controlled prices. *Low- or no depth* implies conditions that could serve as intermediate steps but would not by themselves bring meaningful economic change, such as preparation/announcement of plans.

Box 1. Key Findings of Ukraine's Prior Ex Post Evaluations/Assessments[1]

Previous evaluations of Fund engagement with Ukraine have found broad success in achieving short-term macro stabilization but limited progress in structural reforms. They reveal a pattern of halting progress in structural reform and difficulties in addressing weak program ownership and strong vested interests. Thus, Ukraine's previous programs supported by exceptional access deviated from program path quickly after completing one or two reviews. The evaluations identified approaches to program design, with varying emphasis on the appropriate program length and scope to help gain more traction in structural reforms.

The 2014 SBA Ex-Post Evaluation found that the program served as an anchor for economic policies in an uncertain economic and political environment. The EPE noted that authorities made good strides early on, including in long-standing difficult areas, such as maintaining flexible exchange rate, raising energy tariffs, banking sector reform, and Naftogaz restructuring. However, the EPE suggested that tackling the economic structures that give rise to vulnerabilities would not be possible with a short-term program aimed only at stabilizing the economy and emphasized the need for careful prioritization of the structural reform agenda. The EPE suggested the development of realistic adverse scenario and contingency plans, and new staff guidance on integrating risks to the outlook into a bottom line assessment regarding the probability of debt sustainability (the second EA criterion), and on assessing a program's prospects of success (the fourth EA criterion).

The 2010 SBA Ex-Post Evaluation found that the program helped restore market access and made some headway in eliminating preferential energy tariffs, strengthening central bank independence and pension reform, but failed to make progress in the areas of exchange rate flexibility, energy price adjustment, as well as bank and NPL resolution. The EPE noted that prior actions were responsible for the majority of progress under the program, while suggesting that smaller and shorter arrangements focusing on the most critical issues may have better odds of success in cases with poor track record of reform implementation. It also suggested automatic termination of GRA programs if no review was completed within a short grace period.

The 2008 SBA Ex-Post Evaluation found that the program had helped to prevent a financial meltdown amidst the global crisis by supporting an exchange rate adjustment and cushioning an even sharper demand shock. However, absence of sustained reform drive left large vulnerabilities in place. On strengthening ownership, the EPE found that prior actions had facilitated progress in some but not all areas, while less front-loaded access could have helped in maintaining policy incentives. The EPE also noted that a shorter program horizon would have better (i) reflected political realities; (ii) made more explicit the program's crisis management-focus; and (iii) helped to front-load the program design in line with financing.

The 2005 Ex-Post Assessment of Longer-Term Program Engagement found Fund-supported programs successful in redirecting focus of monetary and fiscal policies to macroeconomic stability objectives, but also noted a lack of reform-oriented political consensus hindering more sustained reforms toward a market-oriented macroeconomic framework. For future Fund engagements, the assessment underscored the need of strong program ownership and political support and streamlined structural measures focused on critical institutional bottlenecks. It also suggested addressing Ukraine's medium-term challenges with program horizons longer than one year, and with prior actions serving a key role in building a track-record.

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[1] This box builds on *Ukraine: Ex Post Evaluation of Exceptional Access Under the 2014 Stand-By Arrangement* (9/2/16) For more background, see also *Ukraine: Ex Post Evaluation of Exceptional Access Under the 2010 Stand-By Arrangement* (11/27/13), *Ukraine: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-By Arrangement* (7/6/11), and *Ukraine: Ex Post Assessment of Longer-Term Program Engagement* (10/18/05).

Box 2. Ukraine's 2015 Debt Operation

A key element of the program's financing strategy was a government-initiated debt operation. By the end of 2014, it became clear that Ukraine's public debt had become unsustainable and the authorities sought a pre-emptive debt operation to avoid a default. The external liabilities eligible for the operation covered public and publicly guaranteed (PPG) debt and SOE debt. Key objectives of this operation were to: i) generate approximately US$15 billion in financing during the program period (or over a third of the financing package); ii) reduce the PPG debt-to-GDP ratio below 71 percent of GDP by 2020 (i.e., close to the 70 percent DSA benchmark for market access economies); and iii) limit average gross financing needs to 10 percent of GDP over the years 2019–2025 (with a yearly maximum of 12 percent). At the time of program request, the debt operation was expected to be concluded by the time of the first review in June 2015.

Restructuring talks were concluded broadly as envisaged in August 2015.[1] Discussions took place through an ad-hoc creditor committee representing four large private bondholders (holding US$8.3 billion, or about 40 percent of the debt subject to restructuring). The exchange offer was launched in September 2015 and saw all creditors but Russia participate (in addition, there was a small holdout of US$101 million in the restructuring of local government debt). The terms for sovereign and sovereign-guaranteed Eurobonds included a 20 percent nominal haircut, accompanied by a maturity extension to 2019–2027 (compared with 2015–2023 for the existing claims). In return, creditors saw an increase in coupons to 7.75 percent (up from a pre-exchange average of 7.2 percent), augmented by the introduction of a value recovery instrument (a GDP growth warrant, with a face value of US$ 3.6 billion or about 5.5 percent of the end-2015 debt stock).

The operation achieved its key objectives. It generated US$15.7 billion in financing (US$0.7 billion more than targeted), while the PPG debt-to-GDP ratio fell below its target of 71 percent already in 2018 (amounting to 65.2 percent of GDP)—with continued reductions in this ratio expected over the medium-term horizon. By early 2019, gross financing needs are expected to average to 9.1 percent of GDP over the years 2019–2025—never exceeding 12 percent, as intended. The debt operation was highly successful in lowering Ukraine's cost of borrowing, with EMBIG spreads dropping by about 1,000 basis points when the restructuring was announced (and since then spreads have continued to tighten).

However, including a GDP warrant with no cap on potential payments implies uncertainty about the level of debt payments beyond 2025. The GDP growth warrants included in the debt restructuring package provide potential payments from 2021–40 if Ukraine's nominal GDP is above US$125.4 billion and real GDP growth is above 3 percent, with payments capped at 1 percent of GDP only during 2021–25. In contrast, other countries that have issued GDP warrants as part of debt restructuring operations, have typically ensured that potential payments remain capped throughout.[2] In general, complex warrants of the type included in Ukraine's debt operation can pose special challenges for debt sustainability analysis, including because the uncertainty related to the size of future debt payments.

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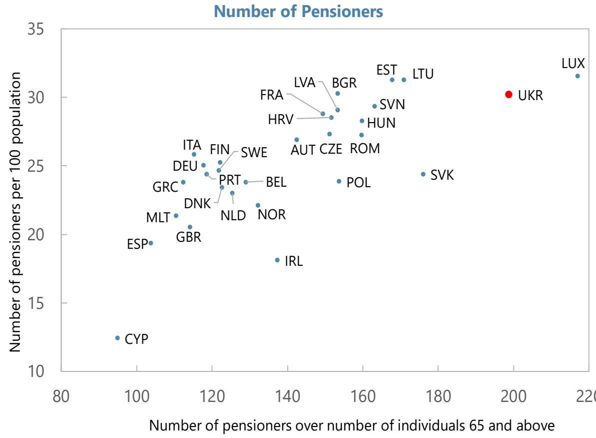
[1] For details on the debt operation, see *Ukraine: Second Review Under the Extended Fund Facility and Requests for Waivers of Non-Observance of Performance Criteria, Re-phasing of Access and Financing Assurances* (9/2/16).

[2] Such caps have been included in many other GDP warrants: for example, warrant coupon payments cannot exceed 1 percent of the notional amount in Greece, while the Argentinian ones capped payments to 48 percent of the face value. In Nigeria (where warrants were linked to the oil price), payments stopped rising if the crude price were to rise above US$43 per barrel.

Box 3. Ukraine's Pension Reform[1]

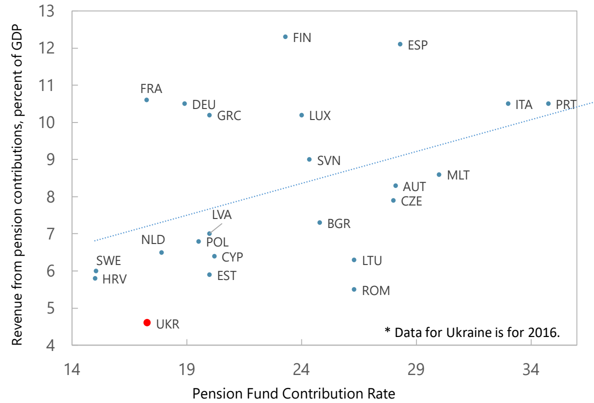
In 2016, Ukraine's social security spending was one of the highest in Europe, accounting for one quarter of total general government expenditures. Key problems were the sheer number of pensioners and the low individual contributions (text charts). Shrinking working-age population, declining fertility rates, and increasing longevity were expected to worsen social security finances in the medium to long run.

Number of Pensioners



Sources: Ukrainian authorities, European Commission and IMF staff estimates.

Pension Fund Contributions



Sources: Ukrainian authorities and European Commission.

It was imperative to restore the sustainability of the pension system, while bringing the average pension to socially acceptable levels. Ukraine's average retirement ages were lower than the EU's by at least 5 years. However, average gross replacement ratios were below 40 percent and average pensions ($65–$70 per month) were near international poverty levels. Parametric reforms to increase retirement ages and tighten early retirement options (therefore limiting the inflow of new retirees), along with measures to broaden the social security contribution base, were warranted.

The passage of the pension reform was a milestone for the program. The reform lengthened the number of qualifying years to receive a pension while strengthening the incentives for longer contribution, including bonuses for each year of delayed retirement. Benefits were indexed to a non-discretionary formula based on the previous year's inflation and previous three years' average salary growth. The reform prevented the blow-up of the pension fund deficit and pension spending, reducing the former towards 2–3 percent of GDP until 2030 (from above 6 percent of GDP in 2016), while keeping the latter around 10 percent of GDP. Nevertheless, individual benefits remained low, with an average replacement rate at around 35 percent.

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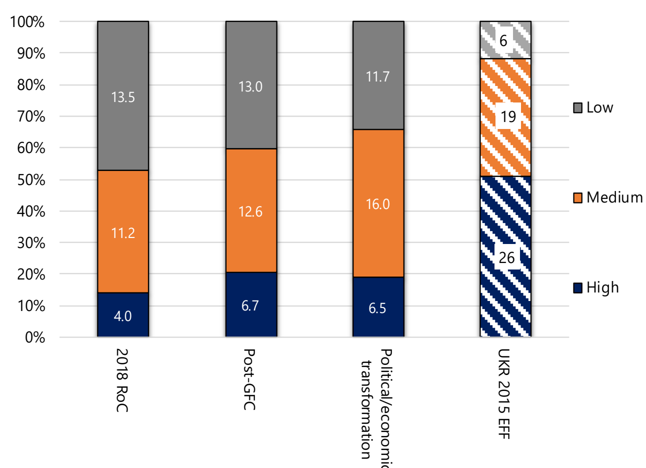
[1] This box builds on *"Reforming Ukraine's Pension System," in Ukraine - Selected Issues*, IMF Country Report No. 17/84 (04/04/2017), and on *Ukraine - Request for Stand-By Arrangement and Cancellation of Arrangement Under the Extended Fund Facility*, IMF Country Report No. 19/3 (01/08/2019).

Box 4. Ukraine 2015 EFF Structural Conditionality: Depth and Implementation

An assessment of Structural Conditionality (SC) under the program indicates the EFF had a high depth of SC when compared with data on comparator country groups from the recent Review of Conditionality (2018 RoC).[1] Consistent with the RoC, the high depth of SC in Ukraine was associated with lower implementation rates.

Methodology. 2018 RoC classified the depth of SC (i.e., structural benchmarks and prior actions) into three categories of high, limited (medium), and low depth. *High depth* implies legislative changes or measures to be carried out on a permanent basis which would bring about lasting changes, such as implementing civil service reform or privatization. *Limited depth* implies one-off measures that might bring immediate, but not lasting, effects, such as changes to controlled prices. *Low- or no depth* implies conditions that could serve as intermediate steps but would not by themselves bring meaningful economic change, such as preparation/announcement of plans.[2] This methodology was used in assessing the depth of SC under Ukraine's 2015 EFF.

Average Structural Depth: Ukraine Relative to Selected Comparator Groups



Note: Numbers represent the sum of structural benchmarks under each category.

50 percent (or 26) of the SC measures of the 2015 EFF were identified as high depth, while the share of SC of limited depth was 37 percent. Notably, the share of high structural depth SC in Ukraine's EFF was twice as high as the political transformation cases and post-GFC cases, which were identified by the RoC as the groups with the highest share of high depth of SC. Conversely, the shares of low depth SC (or intermediate steps) in Ukraine program was much lower than in comparable Fund programs on overage. The finding that SC under Ukraine 2015 EFF was generally of high depth, is consistent with the notion that Ukraine underlying structural BOP problems called for deep reforms.

The 2018 RoC found that higher structural depth tends to be associated with lower implementation rates.[3] This is consistent with the assessment of SC in Ukraine where the implementation rate of high depth of SC (excluding prior actions) was 16 percent, well below the implementation of SC with limited and low depth (in the range of 50 to 60 percent). Against this backdrop, and taking into account the breadth of SC (both in terms of areas covered as well as the overall numbers) and Ukraine's rather weak track-record in SC under previous Fund-supported programs, the structural reforms agenda under the 2015 EFF was very ambitious.

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[1] See *2018 Review of Program Design and Conditionality* (5/20/19).

[2] A shortcoming of this taxonomy is that adoption of legislation alone will not bring permanent change unless the new legislation is implemented and applied in an appropriate manner. The relationship between the dept of SC and its impact on outcomes is a potentially useful topic for further study.

[3] This association may be due to a selection bias: i.e., the Fund may be more likely to ask for high depth SC in cases where the authorities' ownership of reforms is low or when the underlying situation is particularly challenging.

Table 1. Ukraine 2015 EFF: Program Scenario – Selected Economic and Social Indicators, 2014–18

	2014	2015		2016		2017		2018	
		Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Est. 3/
Real economy (percent change, unless otherwise indicated)									
Nominal GDP (billions of Ukrainian hryvnias) 1/	1587	1850	1,989	2,087	2385	2,356	2983	2,626	3447
Real GDP 1/	-6.6	-5.5	-9.8	2.0	2.4	3.5	2.5	4.0	3.3
Contributions:									
Domestic demand	-13.3	-7.7	-12.7	2.6	7.1	4.1	7.1	4.5	5.4
Private consumption	-6.5	-5.2	-15.5	2.0	1.9	2.8	5.8	3.0	3.7
Public consumption	0.2	-0.2	0.3	-0.9	-0.1	0.5	0.7	0.5	0.5
Investment	-6.9	-2.3	2.5	1.4	5.3	0.8	0.6	1.0	1.2
Net exports	6.7	2.2	3.0	-0.6	-4.6	-0.6	-4.7	-0.5	-2.2
GDP deflator	15.9	27.6	38.9	10.6	17.1	9.0	22.0	7.2	11.9
Unemployment rate (ILO definition; percent)	9.3	11.5	9.1	11.0	9.3	9.6	9.5	8.6	9.2
Consumer prices (period average)	12.1	33.5	48.7	10.6	13.9	8.0	14.4	6.2	11.0
Consumer prices (end of period)	24.9	26.7	43.3	8.7	12.4	7.2	13.7	5.0	10.2
Nominal monthly wages (average)	6.0	14.5	21.2	10.6	23.3	11.8	37.1	10.2	23.0
Real monthly wages (average)	-5.4	-14.2	-18.5	0.0	8.2	3.5	19.1	3.8	10.8
Savings (percent of GDP)	9.9	10.0	17.7	11.8	20.2	12.5	18.6	13.2	18.1
Private	13.1	11.7	16.5	12.9	19.4	12.6	17.4	12.8	16.9
Public	-3.2	-1.7	1.2	-1.1	0.8	-0.1	1.1	0.4	1.3
Investment (percent of GDP)	13.4	11.4	15.9	13.1	21.7	13.6	20.7	14.4	21.5
Private	12.1	8.9	13.6	10.6	18.7	10.6	17.4	11.4	17.5
Public	1.3	2.5	2.4	2.5	3.1	3.0	3.3	3.0	4.0
Public finance (percent of GDP)									
General government balance 2/	-4.5	-4.2	-1.2	-3.7	-2.2	-3.1	-2.2	-2.6	-2.5
Overall balance (including Naftogaz operational deficit)	-10.0	-7.4	-2.2	-3.9	-2.2	-3.1	-2.1	-2.6	-2.5
Public and Publicly Guaranteed Debt (end of period)	70.3	94.1	79.3	92.6	81.2	88.9	71.9	83.3	65.2
Money and credit (end of period, percent change)									
Base money	8.5	27.3	0.8	11.3	13.6	11.0	4.6	9.7	12.9
Broad money	5.3	19.1	3.9	15.4	10.9	15.4	9.6	14.4	9.8
At program exchange rate	-16.8	8.5	-7.6	15.1	7.5	14.8	9.4	14.5	9.7
Credit to nongovernment	12.4	13.0	-1.0	11.8	-1.1	9.2	2.1	5.6	8.4
At program exchange rate	-15.6	-0.6	-19.4	10.9	-3.7	8.8	4.2	5.9	5.5
Velocity	1.7	1.6	2.0	1.6	2.2	1.6	2.5	1.5	2.6
Interbank overnight rate (annual average, percent)	12.2	…	21.5	…	16.9	…	11.9	…	16.6
Balance of payments (percent of GDP)									
Current account balance	-3.5	-1.4	1.7	-1.3	-1.5	-1.1	-2.2	-1.2	-3.3
Foreign direct investment	0.2	1.4	3.3	1.9	3.5	2.1	2.3	2.1	1.7
Gross reserves (end of period, billions of U.S. dollars)	7.5	18.3	13.3	22.3	15.8	28.5	18.8	35.2	18.8
Months of next year's imports of goods and services	1.8	3.3	3.0	3.7	3.0	4.5	3.3	5.2	3.2
Percent of short-term debt (remaining maturity)	13.3	43.7	26.7	57.4	33.8	69.0	41.1	82.9	53.1
Percent of the IMF composite measure (float)	23.3	65.9	46.2	79.5	55.5	96.3	65.0	113.2	66.3
Goods exports (annual volume change in percent)	-10.6	-4.2	-11.9	5.1	-3.6	5.8	7.8	6.1	3.9
Goods imports (annual volume change in percent)	-25.0	-11.9	-28.6	5.7	8.1	6.0	16.7	6.2	7.3
Goods terms of trade (percent change)	0.2	0.4	-13.8	-0.7	1.0	0.0	6.8	-0.1	-1.2
Exchange rate									
Hryvnia per U.S. dollar (end of period)	15.8	22.0	24.0	22.7	27.2	23.4	28.1	23.5	29.0
Hryvnia per U.S. dollar (period average)	12.0	21.7	21.9	22.5	25.6	23.1	26.6	23.5	27.4
Real effective rate (deflator-based, percent change)	-20.8	-16.8	-11.4	2.7	0.5	1.6	11.6	0.7	3.9
Real effective rate (deflator-based, 2010=100)	92.4	68.6	81.8	70.5	82.2	71.7	91.7	72.2	95.3
Memorandum items:									
Per capita GDP / Population (2017): US$2,640 / 44.8 million									
Literacy / Poverty rate: 100 percent / 2.9 percent									

Sources: Ukrainian authorities; World Bank, World Development Indicators; and IMF Staff Estimates.

[1] Data based on SNA 2008, exclude Crimea and Sevastopol; 2014 data are IMF estimates.

[2] The general government includes the central and local governments and the social funds.

[3] Actuals for 2014–17 and 2018 estimates are based on data from 2018 SBA program request report.

Table 2. Ukraine: Structural and Financial Soundness Indicators for the Banking Sector 2014–18

(Percent, unless otherwise indicated)

	2014	2015	2016	2017	2018
Ownership					
Number of banks, *of which 1/*	163	120	100	84	78
Private	156	114	93	79	73
Domestic	105	73	52	40	36
Foreign	51	41	41	39	37
Of which: 100% foreign-owned	19	17	19	19	23
State-owned	3	3	2	2	2
State-controlled (inc. in sanation)	4	3	5	3	3
Foreign-owned banks' share in statutory capital	32.5	42.5	51.0	34.3	30.1
Concentration					
Share of assets of largest 10 banks	59.7	70.6	72.2	75.7	76.9
Share of assets of largest 25 banks	82.0	88.7	91.4	93.4	93.8
Number of bank with assets less than $150 million	103	85	68	54	47
Capital Adequacy					
Regulatory capital to risk-weighted assets 2/	15.6	12.3	12.7	16.1	16.2
Regulatory Tier 1 capital to risk-weighted assets			9.0	12.1	10.5
Capital to total assets	11.2	8.0	9.8	11.9	10.8
Asset Quality					
NPLs to total loans (NBU definition) 3/	19.0	28.0	30.5	54.5	52.9
NPLs net of provisions to capital (NBU definition) 3/	61.1	129.0	89.4	70.2	60.2
Loan loss reserves to total (gross) loans	17.8	29.3	44.9	46.7	49.1
Net open FX position to regulatory capital (staff estimate) 4/ 5/	-32.3	-70.3	-100.8		
Liquidity Risk					
Liquid assets to total assets	26.4	33.0	48.5	53.9	51.1
Customer deposits to total loans to the economy	64.5	71.2	80.5	84.6	81.8
Earnings and Profitability					
Return on assets (after tax; end-of-period) 6/	-4.1	-5.4	-12.3	-2.0	1.2
Return on equity (after tax; end-of-period) 6/	-30.5	-70.0	-115.0	-17.2	11.4
Net interest margin to total assets	4.0	3.2	3.6	3.9	5.3
Interest rate spreads (percentage points; end-of-period)					
Between loans and deposits in domestic currency	6.9	9.7	7.3	8.0	7.6
Between loans and deposits in foreign currency	1.9	3.2	3.0	3.9	3.1
Between loans in domestic and foreign currency	8.4	12.3	9.6	11.0	16.0
Between deposits in domestic and foreign currency	3.3	5.7	5.4	6.9	11.6
Number of banks not complying with banking regulations					
Not meeting capital adequacy requirements for Tier I capital	14	11	10	3	1
Not meeting prudential regulations	34	37	39	32	20
Not meeting reserve requirements	34	6	7	3	3

Sources: National Bank of Ukraine; and IMF staff estimates.

[1] Excludes banks under liquidation.

[2]Prior to 2017, capital does not reflect the impact of June 2016 Credit Risk Regulation (No 351), which came into effect January 3, 2017.

[3] From 2012–2016, NPLs consisted of loans in categories IV and V as recorded on the balance sheet; total gross loans included off-balance sheet obligations on guarantees and loans used for credit assessments. Since 1th quarter of 2017 NPLs include loans classified into the lowest class, in particular: class 10 - loans to corporate borrowers (excluding banks and state owned entities); class 5 - loans to other borrowers/counterparties accounted; total gross loans as debts arising from credit transactions, including loans to customers, interbank loans and deposits, excluded off-balance sheet obligations on guarantees and loans given to banks and customers, used for credit risk assessment.

[4] Calculated according to IMF STA guidelines, with net open position equal to the sum of the absolute value of the net open position in individual foreign currencies.

[5] Net position calculated as on-balance sheet assets in foreign currency minus on-balance sheet liabilities in foreign currency.

[6] Cumulative profits year-to-date, annualized.

Table 3. Ukraine 2015 EFF: Quantitative Program Criteria and Indicative Targets 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2015							
	March		June		September		December	
	Adj. PC	Actual	Adj. PC	Actual	Adj. PC	Actual	Adj. PC	Actual
Ceiling on the cash deficit of the federal government (- implies a surplus) 2/	13,357	-14,536	35,530	10,133	57,937	-6,344	119,320	59,470
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	29,457	-243	59,192	31,422	95,682	13,512	162,632	77,644
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	-2,639	-2,125	-2,528	-1,492	-471	-638	575	-576
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	62,490	32,303	103,878	20,713	87,856	-1,924	81,731	11,892
Ceiling on publicly guaranteed debt 2/	30,000	0	30,000	0	30,000	0	30,000	12,758

	2016							
	March		June		September		December	
	Adj. PC	Actual	Adj. PC	Actual	Adj. PC	Actual	Adj. PC	Actual
Ceiling on the cash deficit of the federal government (implies a surplus) 2/	20,694	5,196	30,822	18,815	42,212	39,451	205,014	177,769
Ceiling on the cash deficit of the general government and Naftogaz (-implies a surplus) 2/	10,754	-6,534	29,693	-8,735	23,977	22,208	194,692	163,328
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	127	-987	809	1,084	2,234	2,283	2,627	2,692
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	87,577	9,595	96,817	2,362	-10,103	-16,808	30,835	3,135
Ceiling on publicly guaranteed debt 2/	20,000	0	20,000	0	28,200	0	28,200	16,523

Sources: Ukrainian authorities; and IMF staff estimates and projections.

[1] Definition and adjustors are specified in the Technical Memorandum of Understanding (TMU).

[2] Targets for 2015 are cumulative flows from January 1, 2015. For 2016, cumulative flows from January 1, 2016.

[3] Targets and projections are cumulative flows from January 1, 2015. For 2016, cumulative flows from January 1, 2016.

[4] Calculated using program accounting exchange rates specified in the TMU.

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality

	Structural Conditionality	Structural Depth	Implementation			
			Program Request Mar. 2015	1st Review Aug. 2015	2nd Review Sept.2016	3rd Review Mar. 2017
	NBU and Banking Sector					
1	Parliament will approve legislation that introduces unlimited liability of bank owners on losses arising from loans granted directly or indirectly to the benefit of bank shareholders holding 10 percent or more of total voting shares as of end-2014 (MEFP ¶13).	High	✓ PA			
2	Parliament will approve amendments to the NBU Law to strengthen the governance and autonomy framework of the NBU (¶9).	High	SB Apr. 2015			
2b	*Parliamentary passage of Laws 2742 and 2743 to strengthen the governance and autonomy framework of the NBU as agreed with IMF staff and also ensure that the law provides that an appeal before the judicial branch by borrowers classified by the NBU as related parties to a bank does not halt the bank's unwinding of excess lending to insiders (July MEFP ¶¶8, 14).*	High		✓ PA		
3	NBU will notify banks of any identified discrepancies in the related party exposure reports based on steps (i) and (ii) as described in ¶13.	High	SB ✓ Jul. 2015			
4	Resolution of all large banks that do not meet the minimum capital requirements (as specified in ¶8).	Limited				✓ PA
5	Selection of an international reputable firm on the basis of a transparent process, that negotiates the restructuring and collection terms of PrivatBank's impaired loans, on the basis of international best practices; and selection of a reputable international audit firm to conduct for the next two years a semi-annual independent loan review of PrivatBank's loan portfolio (in accordance with the legal and NBU regulatory framework), with the aim of properly monitoring asset value recovery (as specified in ¶8iv).	Limited				SB Apr. 2017
6	Parliament will approve amendments to legislation as described in MEFP ¶17, consistent with IMF staff advice, to strengthen the corporate insolvency and credit enforcement regimes, and to remove tax impediments (July MEFP ¶17).	High		SB Mar. 2016		
6b	*Parliament will approve amendments to legislation, consistent with IMF staff advice, to strengthen the corporate insolvency regime.*	High			SB Sep. 2016	SB Sep. 2017
7	Parliament will approve a law which strengthens the provisions in the Code of Civil Procedure on Order for Payment for domestic transactions and on garnishment of bank accounts (¶35).	High	SB Aug. 2015	SB Dec. 2015	SB Sep. 2016	SB Sep. 2017

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation			
			Program Request Mar. 2015	1st Review Aug. 2015	2nd Review Sept.2016	3rd Review Mar. 2017
	ENERGY AND UTILITY SUBSIDIES					
	Tariffs					
1	The energy regulator will adopt and officially publish a decision to raise household gas prices to UAH 3600/tcm for consumption in Tier 1 and UAH 7187/tcm for consumption in Tier 2, effective April 1, 2015 (MEFP ¶28).	**Limited**	**PA** ✓			
2	The energy regulator will adopt and officially publish a decision to raise household heating prices to UAH 625/gcal on average, effective April 1, 2015 (MEFP ¶28).	**Limited**	**PA** ✓			
3	Adoption and publication of a Cabinet of Ministers decision to unify and increase the retail gas tariffs at a level consistent with 100 percent of cost recovery based on import parity, effective May 1, 2016 (as described in ¶33a).	**Limited**			**PA** ✓	
4	Adoption and publication of necessary decisions to increase retail heating tariffs to 100 percent of the level consistent with gas priced at full import parity effective July 1, 2016 (as described in ¶33a).	**Limited**			**PA** ✓	
5	Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to adjust gas and heating tariffs on a quarterly basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (as described in ¶33a).	**High**			**SB Oct. 2016**	
5b	*Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to automatically adjust gas and heating tariffs on a semi-annual basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (as specified in in ¶24a).*	**High**				✓ **PA**
6	Parliament will approve a new gas market law (¶28).	**High**	**SB** ✓ **Apr. 2015**			
7	Reduce consumption norms from 5.5 to 5.0 per m^2 for gas for individual heating, from 65 to 51 kwh per m^2 for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m^2 for centralized heating effective May 1, 2017. (as specified in ¶23).	**Limited**				✓ **PA**

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation: Program Request Mar. 2015	Implementation: 1st Review Aug. 2015	Implementation: 2nd Review Sept.2016	Implementation: 3rd Review Mar. 2017
	Naftogaz					
1	The Cabinet will submit to Parliament legislative amendments to improve Naftogaz collections. These amendments should include (i) lifting two longlasting moratoria (Law 2711-IV/2005 and Law 2864-III/2001) that protect energy and other companies from enforcement proceedings; and (ii) disconnecting noncompliant customers from the gas supply grid (MEFP ¶28).	Low	✓ PA			
2	Parliament will approve legislative amendments to improve Naftogaz collections. These amendments should include (i) lifting two long-lasting moratoria (Law 2711- IV/2005 and Law 2864-III/2001) that protect energy and other companies from enforcement proceedings; and (ii) disconnecting non-compliant customers from the gas supply grid (¶28).	High	SB Mar. 2015			
2b[1]	*Parliament will approve legislative amendments to improve Naftogaz collections. These amendments should include (i) lifting two long-lasting moratoria (Law 2711-IV/2005 and Law 2864-III/2001) that protect energy and other companies from enforcement proceedings; and (ii) disconnecting noncompliant customers from the gas supply grid (February MEFP ¶28).*	High		✓ PA		
3	Parliamentary passage of Law 2956, lifting the 2001 moratorium on enforcement proceedings for companies with at least 25 percent state ownership that are debtors to Naftogaz and its daughter companies (July MEFP ¶25).	High		✓ PA		
4	Undertake an independent audit of all Naftogaz receivables (¶28).	Limited	SB ✓ Jun. 2015			
	Utility Subsidies					
1	Reform utility-related social assistance by (i) reducing the scope of energy privilege programs to cover only households that remain exempt from income testing according to Law 76-VIII/2014; (ii) converging the associated benefits to the levels in the HUS program; and (iii) revising the benefit formula of the expanded HUS program in consultation with IMF staff to channel benefits to vulnerable households and provide incentives for energy efficiency. The overall fiscal envelope for all energy-related social assistance programs (privileges and HUS) will be set at UAH 43 billion (July MEFP ¶24).	High		SB May. 2016	SB Sep. 2016	

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation			
			Program Request Mar. 2015	1st Review Aug. 2015	2nd Review Sept.2016	3rd Review Mar. 2017
1b	*Revise parameters of the household utility subsidies (HUS) system to improve targeting; introduce an adjustment to the social norm for offpeak heating months; and apply a capacity-based distribution tariff for gas and heat that would shift some of the costs to the summer, all effective May 1, 2017, thereby limiting household utility subsidy outlays to UAH 47 billion in 2017 (as specified in ¶23).*	**High**				**SB Jul. 2017**
2	Adjust the parameters of the utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (¶31a).	**Limited**			**SB Sep. 2016**	
2b	*Adjust the parameters of the utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (¶31a).*	**Limited**				✓ **PA**
3	Adopt CMU resolution to monetize utility subsidies at the level of utility companies (as specified in ¶24b).	**High**				**SB Aug. 2017**
4	Establish a centralized database in the MoF of recipients of social assistance (as specified in ¶21d).	**Limited**				**SB Dec. 2017**
	FISCAL POLICY					
	Budget					
1	Parliament will approve a 2015 supplementary state budget law and a package of tax and expenditure legislation consistent with the program deficit ceiling of UAH 78 billion for the general government, containing the elements described in MEFP ¶23.	**High**	✓ PA			
2	Parliamentary approval of the 2016 budget in line with program commitments and of a new tax code (as described in ¶26, except the measures due after July 1, 2016).	**High**			✓ PA	
3	Parliamentary approval of the 2017 budget and supporting legislation consistent with the program target of 3.1 percent of GDP (as specified in ¶18).	**High**				✓ PA
	Debt operation					
1	Government will hire financial and legal advisors to facilitate consultations with holders of public sector debt with a view to improving medium-term debt sustainability (MEFP ¶26).	**Low**	✓ PA			

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation			
			Program Request Mar. 2015	1st Review Aug. 2015	2nd Review Sept.2016	3rd Review Mar. 2017
	Revenue administration					
1	The State Fiscal Service will implement its new arrangements as specified under the revenue administration reform plan (¶25).	Limited	SB ✓ Dec. 2015			
2	The State Fiscal Service will transfer all taxpayers meeting large taxpayer criteria to the LTO (¶22).	Limited	SB ✓ Dec. 2015			
3	Government will prepare a revenue administration reform plan in order to overhaul the state fiscal service. The plan will include measures to implement governance and institutional reforms that clarify the tax agency's reporting to the Minister of Finance; and remove large numbers of underperforming officials as described in ¶25.	Low	SB Apr. 2015	✓ SB Jun. 2015		
4	Adopt legislation to merge the customs and tax administration into a single legal entity (¶27a).	High			SB Dec. 2016	SB Mar. 2017
5	Parliamentary approval of legislation to establish a new civil service responsible for investigation of financial offences under the MoF to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the State into a single agency, while avoiding duplication of functions (as specified in ¶20e).	High				SB Apr. 2017
	Pensions reform					
1	Parliamentary passage of pension reform legislation, as agreed with IMF staff that revises the parameters of the pay-as-you-go system to make it more sustainable, abolishes special pensions, and lays the conditions for the adoption of a funded system that would complement the pay-as-you-go system (July MEFP ¶24).	High		SB Dec. 2015	SB Dec.2016	
1b	*Parliamentary approval of pension legislation (as specified in ¶21a).*	High				SB Apr. 2017
2	Adopt a Cabinet of Ministers decree reducing the lists 1 and 2 of occupations eligible for early retirement by at least 40 percent in terms of eligible persons (¶29a).	High			PA ✓	

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation: Program Request Mar. 2015	Implementation: 1st Review Aug. 2015	Implementation: 2nd Review Sept.2016	Implementation: 3rd Review Mar. 2017
3	Parliamentary approval of legislation to: (i) gradually adjust the statutory retirement age and further reduce the scope for early retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 (¶29a).	High			SB Dec. 2016	SB Apr. 2017
	STATE-OWNED ENTERPRISES					
1	The Ministry of Economy in cooperation with the Ministry of Finance will prepare a statement of fiscal risks emanating from SOEs as described in ¶36.	Low	SB Apr. 2015	SB ✓ May. 2016		
2	The government will adopt a broad-based strategy (prepared in consultation with the IMF and the World Bank staff) to reform the SOE sector as described in ¶36, including measures needed to improve budgetary oversight, develop a comprehensive ownership policy, strengthen corporate governance, prioritize which enterprises should be made subject to restructuring, and examine options for improving management of other state assets.	Limited	✓ SB May. 2015			
3	Adoption by a cabinet resolution of the privatization action plan for five large SOEs from the priority privatization list (July MEFP ¶30).	Limited		SB ✓ Sep. 2015		
4	Agreement on detailed restructuring action plans, prepared in consultation with IMF staff, for five SOEs with the largest fiscal risks, between the respective line ministry, Ministry of Economy and the Ministry of Finance (July MEFP ¶30).	Low		✓ SB Jan. 2016		
5	Cabinet of Ministers approval and publication in the MEDT website of the completed triage of all SOEs, dividing them into companies to (i) remain under management of the State (including SOEs that are located in territories currently not under the control of the government); (ii) privatize; or (iii) liquidate; and transfer to the SPFU those SOEs incorporated in the privatization plan for 2016 (¶39c).	Limited			SB Oct. 2016	SB Aug. 2017

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (continued)

	Structural Conditionality	Structural Depth	Implementation: Program Request Mar. 2015	Implementation: 1st Review Aug. 2015	Implementation: 2nd Review Sept.2016	Implementation: 3rd Review Mar. 2017
6	Parliamentary approval of amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process (¶39e).	High			SB Dec. 2016	SB Aug. 2017
	OTHER STRUCTURAL REFORMS					
1	Parliament will approve a law on a selective increase of court fees, aiming to double court fee revenue in real terms within 12 months (¶35).	High	SB ✓ May 2015			
2	Submit law on agricultural land circulation to parliament (¶38d).	Low			SB Sep. 2016	SB May 2017
3	Parliamentary approval of a law on agricultural land circulation allowing for the current moratorium on the sale of agricultural land to expire by the end of 2017, thus allowing for the sale of state-owned and private land to start immediately thereafter (as specified in ¶27b).	High				SB May 2017
	ANTI-CORRUPTION/AML					
	National Anti Corruption Bureau (NABU)					
1	Parliament will approve legal amendments to ensure that the NAB is subject to a robust external oversight process, can investigate former Presidents, can access all relevant information for its investigations, and that appropriate mechanisms are in place to ensure hiring of staff with high integrity (MEFP ¶32).	High	✓ PA			
2	Take necessary measures to establish the National Anti-corruption Bureau (¶32).	Limited	SB Apr. 2015	SB ✓ May 2015		
3	Undertake measures to make the National Anti-Corruption Bureau operational, including with regard to its prosecutorial function (July MEFP ¶29).	Limited		SB ✓ Jan. 2016		
4	Establish a specialized anticorruption prosecution function in charge of overseeing NAB' s investigations, in accordance with the Law on the Prosecutor' s Office, and enable NAB timely access to relevant information from other public institutions (July MEFP ¶29).	High		SB Sep. 2015		
4b	*Appointment of the Head Anticorruption Prosecutor and his/her two deputies (¶35e).*	High			PA ✓	

Table 4. Ukraine 2015 EFF: Depth and Implementation of Structural Conditionality (concluded)

	Structural Conditionality	Structural Depth	Implementation: Program Request Mar. 2015	1st Review Aug. 2015	2nd Review Sept.2016	3rd Review Mar. 2017
5	Parliamentary approval of legislation ensuring that the NABU has: (i) the use of a wide range of investigative techniques, including undercover operations, intercepting communications, accessing computer systems and controlled delivery, without having to rely on other agencies' infrastructure; and that (ii) the registration of pre-court cases and of investigative judges' rulings pertaining to NABU should be protected from leakage of information related to ongoing investigations, by restricting access to the information to NABU and SAPO officers until the investigation of the case is completed, or the case is closed (¶36a).	High			SB Nov. 2016	SB May 2017
	High Anti Corruption Court					
1	Parliamentary approval of legislation to establish an anticorruption court (as specified in ¶26c).	High				SB Jun. 2017
	Assets Declaration					
1	Ensure all high-level officials filed their assets and income declarations, as defined under Article 46 of law 2014/49 for the calendar year 2015 and their full disclosures freely available to the public on a single website shortly after submission (¶36c).	Limited			SB Oct. 2016	
1b	*Enforce the filing of asset declarations for 2015 by high-level officials in accordance with the law on prevention of corruption, report cases of non-filers to NABU, and make publicly available the submitted declarations (as specified in ¶26a).*	Limited				✓ PA
	Anti Money Laundering (AML)					
1	Strengthen the implementation of the AML framework to prevent the misuse of the financial sector to launder the proceeds of corruption. This includes: (i) regulatory amendments to ensure proper implementation of the legal requirements related to domestic politically exposed persons (PEPs); (ii) the Financial Intelligence Unit (FIU) will develop a system to assist financial institutions in identifying domestic PEPs; and (iii) proper arrangements will be put in place to facilitate cooperation between the NBU, FIU and NAB (¶32).	Limited	SB Jun. 2015	✓ SB Jul. 2015		

Notes:

- 1 — These indicate structural benchmarks that were successively modified and turned into prior actions
- (green) Met structural benchmark or prior action
- (red) Missed/reset structural benchmark
- (purple) Missed structural benchmark but with some elements met
- (yellow) Structural benchmark met with delay
- (white) Structural benchmark set for after the third review
- ✓ Check marks notate that the conditionality has been met

- Date — Test date
- High — High Structural Depth
- Limited — Limited Structural Depth
- Low — Low Structural Depth

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