GUEST COMMENTARY
NO. 13, 2023

SCEEUS STOCKHOLM CENTRE FOR EASTERN EUROPEAN STUDIES

SCEEUS GUEST PLATFORM FOR EASTERN EUROPE POLICY NO.32

The EU Cannot Afford *Not* to Support Ukraine Financially

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1 March 2023

Russia's war on Ukraine carries enormous costs in terms of human suffering, ruined infrastructure, destruction of agricultural land and environmental damage more generally. These costs will keep mounting for as long as the war carries on and Russia continues to target critical civilian infrastructure and residential areas. The only short-term solution to limit this destruction is to provide Ukraine with enough military support to defend its territory and citizens. This support has long been coordinated at regular Ramstein meetings. The subject of this brief is not first order military support, but the still highly important issue of financial assistance.

Coordinating Financial Support to Ukraine

Becker (2022) and Gorodnichenko et al. (2022) argue in favour of coordinating financial support in meetings such as the military Ramstein meetings, and that there should also be an EU-affiliated institution that provides the institutional backing to help Ukraine coordinate donors, increase efficiency and ensure that all funding is used in the best interests of the citizens of Ukraine.

Something that looks like an economic version of Ramstein is finally starting to emerge. The Multi-agency Donor Coordination Platform (MDCP) met for the first time on 26 January 2023 after G7 leaders committed to such a platform in December 2022 (White House, 2023). It took 11 months to put this in place while the military Ramstein meetings started in April 2022. This is consistent with the view that military support is the number one priority for securing the independence of Ukraine. However, it is also a sign of how hard it will be to coordinate the financial support that Ukraine so desperately needs.

The first MDCP meeting had three co-chairs: one each from Ukraine, the United States and the European Union. Japan also played a special role as G7 lead in 2023. There were also representatives from the major International Finance Institutions (IFIs) and other donors will be invited over time. The next meeting is planned for March but it is too early to tell how efficient this structure will be.

How Much Money Does Ukraine Need?

The first question to address is how much money Ukraine will need and when. After that there are the issues of what type of funding is available and from where, and what conditions (if any) should be attached to the financial support.

On the first issue, it is useful to think separately about immediate funding needs in the current year and longer-term reconstruction needs. Funding the government in the shorter term and devising a macroeconomic framework for the war is discussed in Shapoval et al. (2022) and Rogoff et al. (2022). A rough estimate of need is US$35–50 billion. The Government of Ukraine projects a funding gap of US$38 billion or US$3.2 billion per month. This is a significant number but might still be somewhat optimistic and rely on tax revenues that cannot be collected or underestimate the costs of the war, which are likely to increase still further. A more realistic estimate is closer to US$50 billion, but there is a significant amount of uncertainty attached to any forecast given the circumstances.

This funding gap must be closed by external support rather than domestic funding. During periods when donor support has not been forthcoming, the government's deficit has to a large extent been funded by the printing press of the National Bank of Ukraine. This risks setting off an inflationary spiral that could trigger a full-blown currency crisis and destabilise the financial system. This type of economic shock must be avoided at all costs during the war. Since the value of any currency rests on trust and expectations, there should be a high degree of confidence that the funding required will be delivered on time. This is the first funding task facing Ukraine's international partners.

The other task facing Ukraine and its international partners is providing long-term funding for reconstruction. This will require substantially more funding than short-term budget support. However, it will be spread out over a longer period of as much as a decade. There are also a wide range of estimates of the amounts needed for reconstruction that include different components. The Kyiv School of Economics (KSE) is documenting damage to infrastructure such as housing, roads and bridges, but also businesses, schools, healthcare facilities, and so on. By the end of 2022, its estimate was close to US$140 billion. In August 2022, the World Bank presented an estimate of US$349 billion, which also includes the effects of land decontamination, lost industrial and agricultural production and the effects on other sectors of the economy. At the Lugano meeting in July, 2022, the Ukrainian government presented an estimate of US$750 billion, which included additional items.

Given the amounts involved, reconstruction will require a significant amount of coordination. The EU should play a leading role in organising donors, since the guiding principle of reconstruction is to make Ukraine a fully fledged EU member state. It is also clear that the G7 does not have the institutional structure to make it a realistic alternative to the EU, while neither the IFIs nor the US can provide the same long-term perspective as EU membership (Becker et al. 2022).

What Financial Support Has Been Offered So Far?

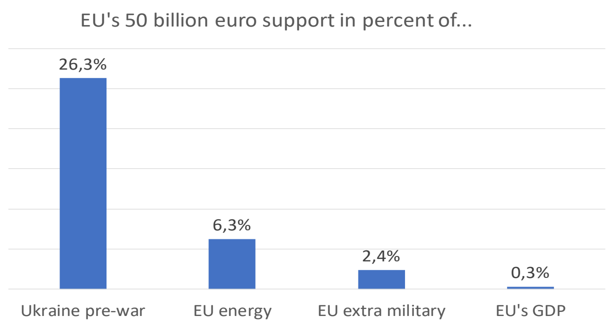
The support already offered to Ukraine has been documented by the Kiel Institute. It distinguishes between the financial value of military, humanitarian and financial support. By January 2023, total aid commitments had reached €144 billion. The EU and the US are the biggest donors, at €55 and €73 billion, respectively, while other donors add a further €15.

These aggregates hide important details when it comes to commitments vs disbursements and grants vs loans. Across both these dimensions, the US is far ahead of the EU, delivering more support now rather than later and doing so in the form of grants rather than loans. All the financial support provided by the EU is in the form of loans: very long term and on favourable terms, but still loans. This is not consistent with the long-term conditions of debt sustainability.

The EU's most recent package of financial support to Ukraine provides €18 billion for 2023. This is half of the projected budget gap discussed above, with the assumption that the US and other donors will cover the remainder. One positive aspect of this support is that it makes the financial situation of the Ukrainian government more predictable throughout 2023. The less good news is that it is in the form of loans and that it leaves little room for bad economic news during 2023.

Is this because the EU cannot afford to send more money to Ukraine? The simple answer is no. First, the total amount of committed support in all categories, at around €50 billion, is just **0.3%** of the combined size of the economies of the EU member states (around €16 trillion). The support EU member states have provided to households and companies in energy subsidies amounts to around €800 billion (Sgaravatti 2021, most recent update 13 February 2023) or **16 times the support to Ukraine**. The envisaged increase in military expenditure by EU member states as a result of Russia's aggression is measured in percentage points of member states' GDP. A one percentage point increase on average would be €160 billion per year. If we discount a stream of 20 years of €160 billion extra military spending back to today's monetary value at a 4 percent interest rate, this amounts to more than €2 trillion, which is **40 times the support to Ukraine**.

To support Ukraine still further, the EU could simply borrow money on the international financial markets at low cost. Given the size of the EU economies and the needs of Ukraine, the impact on EU member states' debt to GDP ratio would change by only 0.3 percent for every €50 billion of borrowing. This would not be a serious debt sustainability issue for the EU.



In the longer term, there will be additional questions to be addressed regarding the reconstruction of Ukraine. How much should Russia pay and how can its frozen assets be transferred to Ukraine? What role will IFIs play in the reconstruction? What type of guarantees will be needed to get the private sector involved or to generate long-term growth?

Conclusions

The collective West must support Ukraine by all means necessary to withstand Russian aggression. Military support is crucial to end the war and stop the senseless killing of people in Ukraine and the continued destruction of infrastructure. In addition to military support, however, there must be predictable and long-term financial support to avoid an even greater economic crisis.

The EU has a special role to play and much to gain when it comes to providing financial support to Ukraine. It obvious that there are significant benefits of a strong Ukraine in Europe and massive costs attached to an aggressive Russia on our borders if we fail to support Ukraine. What at first might look like massive costs are on closer inspection relatively little money invested by the EU in the victory of Ukraine.

In sum:

- The EU should commit much more financial support to Ukraine not only for 2023, but also for the reconstruction of Ukraine on the path to EU membership.
- This support should be predictable and in the form of grants rather than loans.
- The support could be funded by common borrowing by EU member states.
- The support should be coordinated with other donors in close consultation with the government of Ukraine in an institution committed to the reconstruction of Ukraine.
- Plans should be made now so they are ready for when the war ends and all actors, including the private sector, know what the aims are.

Ukraine's victor will be to the benefit of all Europeans and we cannot afford *not* to fund it.

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