Crédit Agricole Group economic and sector analysis

Prospects

No. 23/185 – 19 July 2023

EUROPE – Financing the reconstruction of Ukraine in the context of the European recovery plan

The European Commission has presented a proposal to increase the EU budget as part of the mid-term review of the 2024-2027 Multiannual Financial Framework (MFF).

The budget must now address new areas of expenditure:

- ✓ expenditure related to internal and external migration, the overall consequences of the war in Ukraine, and the strengthening of partnerships with third countries;
- ✓ the increase in the cost of financing of the Next Generation EU (NGEU) programme stemming from the rise in interest rates;
- ✓ spending on the Union's long-term competitiveness (critical technologies) with the creation of the Strategic Technologies for Europe Platform (STEP);
- ✓ support for Ukraine in its immediate needs and reconstruction.

While most of this spending will be financed directly via the EU budget, the creation of an instrument external to the EU budget, the Ukraine Facility, will be financed mainly by EU debt on the markets. This market-financing approach has been adopted because the MFF, voted in 2020, is unable to meet the entirety of new expenditure.

Endowed with €50 billion for the 2024-2027 period, the Ukraine Facility covers only a part of the country's reconstruction needs. According to an estimate by the World Bank, the United Nations, the European Commission and the Ukrainian government, reconstruction will require €384 billion in the next ten years, of which €142 billion for the 2023-2027 period and €13 billion in 2023 alone.

The IMF has estimated the Ukrainian government's financing needs at €76 billion for 2023 to 2027, a sum covered in part by IMF support of €14.4 billion over a four-year period.

European aid to Ukraine has thus far totalled €70 billion, with €30.5 billion from the EU budget, €7.8 billion in bilateral aid from Member States, €15 billion in military assistance from Member States, for a total of €53 billion provided by Team Europe. In addition, some €17 billion in aid has been provided to Ukrainian refugees by both the EU and Member States.

The Ukraine Facility is organised around three pillars:

- ✓ The first pillar is focused on financing the reconstruction plan developed by the Ukrainian government through grants and loans;
- ✓ The second pillar consists mainly of guarantees to international financial institutions, international organisations and companies with a view to facilitating the involvement of non-EU investors, including the private sector;
- ✓ The third pillar concerns the financing of EU technical assistance and (total) subsidies of interest rates on loans provided by the Facility.

The Ukraine Facility thus provides for grants, guarantees and loans. For the non-refundable portion of the grants, a new instrument, the Ukraine Reserve, will be created and financed by the EU's annual budget (and therefore funded by Member State contributions).

For all new financing, the Ukraine Reserve will replace all previous programmes, including Macro-Financial Assistance Plus (MFA+), the

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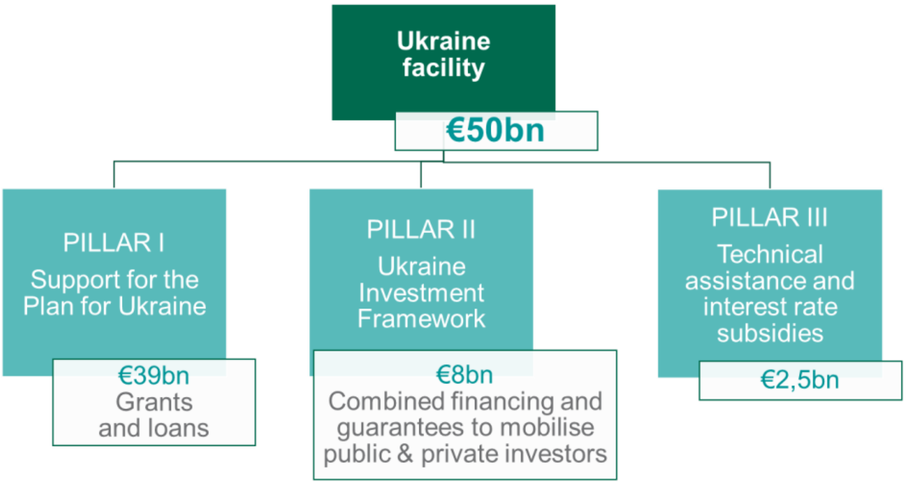
Neighbourhood, Development and International Cooperation Instrument (NDICI), and the Instrument for Pre-accession Assistance (IPA).

The guarantees provided in the Ukraine Investment Framework (Pillar II) will be rolled out gradually depending on progress made in financing.

The financing of repayable loans consists of highly concessional loans with a 35-year maturity, a repayment of principal expected from 2034 and the total interest expense subsidy from 2024 to 2027. The European Union is financing on the markets in the place of Ukraine with a "unified" financing strategy. The latter provides for the issuance of short- and medium-term European bonds for all existing programmes in favour of Ukraine both through syndication and auction, the aim being to provide the EU with the flexibility required to seize on the best market conditions and meeting the country's needs immediately.



The guarantee against non-reimbursement is provided by the existing room for manoeuvre in the EU budget, i.e. the difference between the ceiling on own resources (the maximum amount of resources that the Commission can request from Member States in a given year) and the funds the Commission actually needs to cover the expenditure determined in the budget.

Other donors may contribute to the Facility and the use of revenues generated by frozen and locked-in Russian assets is under review. The framework is that of the G7 Multi-agency Donor Coordination Platform.

The Commission has confirmed that the allocation of grants and loans will be determined on an annual basis, but it has already presented an indicative allocation with a timetable, capping the annual payment at €12.5 billion. This is less than the amount allocated by the EU to Ukraine in 2023 with the €18 billion in MFA+ aid. Pre-financing of 7% will be available as soon as the Ukrainian government's reconstruction plan is approved.

Ukraine facility (€, bn)	2024	2025	2026	2027	2024-2027
Subsidies	**4.25**	**4.25**	**4.25**	**4.25**	**17**
o/w Pillar I	1.5	1.5	1.5	1.5	6
Pillar II	2	2	2	2	8
Pillar III	0.625	0.625	0.625	0.625	2.5
of which administrative costs	0.125	0.125	0.125	0.125	0.5
Loans Pillar I	**8.25**	**8.25**	**8.25**	**8.25**	**33**
Total	**12.5**	**12.5**	**12.5**	**12.5**	**50**

Our opinion – The objective of the Ukraine Facility is to provide a transparent and predictable medium-term funding framework for the beneficiary and to signal the EU's presence to other investors as part of a risk-reduction approach. By creating a dedicated instrument, the EU intends to make the reconstruction, transformation and modernisation of the Ukrainian economy a strategic priority (green transition and digital transformation). The model employed is the NGEU resilience and recovery plan for EU Member States. To that end, the payment approval process is subject to a reform and investment programme, and the funds are distributed on a quarterly basis once the plan has

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been reviewed and approved by the European Commission and the Council. This plan has thus become a fundamental step in the EU accession process. The objective is to implement the plan in early 2024. As such, the Commission has called on the Spanish Presidency of the EU Council to iron out an agreement by the end of the summer so that the European Parliament can vote on it before the end of 2023.

Completed on June 27 2023

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