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Testimony of Daleep Singh, Deputy Assistant Secretary for Europe & Eurasia before the House Foreign Affairs Committee

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Introduction

Chairman Royce, Ranking Member Engel, and members of the committee, thank you for the opportunity to testify today.

The U.S. Treasury is carefully monitoring the situation in Ukraine, and we are coordinating closely with our counterparts in Europe and the international financial institutions. I visited Kyiv last week and met with government officials to discuss the latest developments and to express our support during this difficult moment. Secretary Lew has spoken several times with the Ukrainian Prime Minister, who has assured us that the government is prepared to take the necessary steps to build a secure economic foundation, including urgently needed reforms to restore financial stability, unleash economic potential, and allow Ukraine's people to better achieve their economic aspirations. The fragility of Ukraine's financial condition underscores the urgency of its new government committing to an IMF-led reform program and securing the financing it needs while necessary economic adjustments are made.

Economic Situation

The economic situation in Ukraine is quite fragile – stemming from many years of unsustainable economic policies under previous governments, as well as the negative confidence impact from Russia's recent actions in Crimea. Deposit withdrawals from banks have accelerated in recent weeks and Ukraine's currency – the hyrvnia – has experienced marked pressure, prompting the central bank to cease defending the fixed-exchange rate and to impose administrative controls. Without access to international capital markets and with limited foreign exchange reserves to repay maturing debt and purchase imports, Ukraine's new government has requested official assistance from the IMF and signaled a commitment to economic reforms in order to avoid intensification of the current crisis.

Extensive state involvement in the economy continues to hinder growth and investment, and Ukraine's recovery from the global financial crisis of 2008 – which hit Ukraine especially hard as GDP fell by 15 percent – lags well behind its peers. Tight credit conditions and foreign exchange controls in support of Ukraine's managed exchange rate have constrained business activity and exacerbated existing vulnerabilities to external shocks. A difficult business climate impairs private sector development, as weak property rights, corruption, and an inefficient legal system deter investment and hinder economic growth. And despite one of the highest average costs of gas supply in Europe, Ukraine's residential gas and heating tariffs are among the lowest in the region. These large, poorly-targeted energy subsidies contribute to unsustainable government deficits and, perhaps most significantly, underinvestment in Ukraine's domestic energy sector – ultimately increasing Ukraine's dependence on Russian natural gas and vulnerability to Russian influence. The IMF and World Bank have estimated that overall energy subsidies cost roughly 7 percent of GDP in 2012, with relatively well-off households capturing the larger share of benefits.

Taken together, the lack of progress tackling much-needed reforms in these segments of the economy continues to prevent Ukraine, from realizing its full potential. As such, Ukraine was stuck in recession for much of 2013, and the outlook for 2014 and beyond has deteriorated significantly in light of recent events.

In response to the evolving crisis in Ukraine, we have been working closely with international partners to develop a coordinated assistance package that will help the Ukrainian government implement the reforms needed to restore financial stability and economic growth. Ukraine's new government has declared publicly its commitment to undertake the necessary steps to secure assistance from the IMF and others, and the United States has made clear that as Ukraine undertakes meaningful reforms, we stand ready to work with our partners to provide the support needed to avoid a further deterioration of the situation in Ukraine.

International Assistance Package

An international assistance package to Ukraine would be centered around an IMF program, as only the IMF has the capacity and expertise to help Ukraine develop a comprehensive adjustment program. In exchange for implementation of credible macroeconomic reform commitments, the IMF can provide significant financing to meet Ukraine's needs and set the economy on sound footing. At the request of Ukraine's new government, an IMF mission team is currently in Kyiv working with the Ukrainian authorities to assess the country's economic and financing needs.

Any IMF-based support package can be complemented by assistance from multilateral development banks such as the World Bank and European Bank for Reconstruction and Development (EBRD), which stand ready and willing to support Ukraine. Together, the World Bank and EBRD can provide additional financial and technical support to achieve energy sector and social safety net reforms while easing the impact of necessary economic reforms on Ukraine's most vulnerable individuals. Additionally, our partners in the European Union have expressed their intention to provide significant bilateral support to Ukraine should the government take the steps to implement robust, market-oriented reforms.

As part of this international effort, the United States has developed a package of bilateral assistance focused on meeting Ukraine's four most pressing needs: (1) implementing critical economic reforms and cushioning their impact on vulnerable Ukrainians; (2) conducting successful elections and strengthening independent media and civil society; (3) combating corruption and recovering stolen assets; and (4) withstanding politically motivated trade actions by Russia.

Specifically, we are seeking Congressional authorization to provide the Government of Ukraine with sovereign loan guarantees for up to $1 billion in Ukrainian borrowing, the proceeds of which could be used to protect poor Ukrainian households from the impact of required economic adjustments. Also, we are asking that Congress approve IMF quota legislation, which would support the IMF's capacity to lend additional resources to Ukraine while also helping to preserve continued U.S. leadership within this important institution.

The United States is also moving quickly to deploy a range of other financing and technical expertise, including providing highly experienced technical advisors to help the Ukrainian financial authorities manage immediate market pressures and support Ukraine as it negotiates with the IMF.

IMF Quota Reform

The United States stands ready to support Ukraine as it undertakes the economic reforms it needs to return to stability. But, as I've mentioned here today, U.S. bilateral assistance must be accompanied by an IMF program to succeed in restoring Ukraine's economic health. Only the IMF has the capacity to provide the necessary large-scale resources, ability to restore market confidence, and capacity to design and support reforms in countries facing large-scale economic vulnerabilities, such as Ukraine.

The IMF is the world's first responder in a financial crisis: by providing financial support and hands-on policy advice, the IMF helps keep our allies and partners strong. In emerging economies such as Ukraine, the IMF can help provide needed financing and policy advice. The IMF works in fragile states alongside multilateral development banks to combat economic stagnation and dissatisfaction, which can give rise to political instability and extremism.

More specifically, the IMF has the expertise to develop, in consultation with the Ukrainian authorities, an economic adjustment program that eliminates unsustainable economic imbalances, removes costly and poorly targeted government subsidies, and improves Ukraine's business climate and competitiveness in order to unleash Ukraine's latent economic potential. Without the economic stability that only the IMF can provide to Ukraine, progress on much needed, long-overdue structural reforms will continue to lag – much to the detriment of the 45 million people who call Ukraine home and yearn for a better future.

For the United States to continue playing a leading role in international support efforts for Ukraine, centered on the IMF, one of the most significant steps we can take is to pass the 2010 IMF quota and governance reforms. As I mentioned, passage of this legislation would support the IMF's capacity to lend additional resources to Ukraine, while also helping to preserve continued U.S. leadership within this important institution. Approving these reforms puts the United States in a stronger position to exercise leadership at the IMF on a host of issues critical to our economic and national security.

There exists broad support in the American business community for these IMF reforms. The U.S. Chamber of Commerce, Financial Service Roundtable, Securities Industry and Financial Markets Association (SIFMA), Financial Service Forum, and Business Roundtable all agree that these changes are necessary and in the best interest of American businesses and the global economy. Likewise, a bipartisan group of former senior government officials at the Bretton Woods Committee has written to Congress urging support of these long-overdue reforms – emphasizing that a stronger IMF, driven by U.S. leadership, supports U.S. and global interests.

The IMF is a vital tool in our national security toolkit. The Fund's efforts to promote economic and financial stability across the globe often impact countries where greater instability would otherwise be harmful to U.S. global interests. The Fund's response to support nations impacted by the Arab Spring such as Jordan, Tunisia, and Yemen are a few examples. Needless to say, the IMF is critical to our nation's economic wellbeing – when instability abroad washes up on our shores, lower U.S. growth results in fewer jobs and exports, and our citizens' savings and 401Ks are hit through financial contagion.

The IMF is a safe and smart investment for the United States, with a rock solid balance sheet including reserves and gold holdings that exceed total IMF credit outstanding (about $127 billion). In addition, the IMF is recognized by its entire membership as the preferred creditor, with the unique ability to set conditions to assure repayment. The IMF has never defaulted on any U.S. reserve claims on the IMF since its inception nearly 70 years ago.

And the IMF has protected U.S. economic and security interests by helping many of our closest partners get back on their feet.

But if, as a result of our failure to pass the 2010 quota reforms, emerging economies turn away from the IMF toward regionalism, bilateral arrangements, or new institutions, the United States will lose the leverage and influence it has built up over decades through the IMF and its central role in anchoring countries in the multilateral system – influence which is vitally important as seen by ongoing events in Ukraine and Russia.

The United States is the last major economy that has yet to pass the 2010 quota reform and our approval is the only remaining step for these long-delayed important reforms to go into effect. Our failure to act has led other countries to worry that the United States is retreating from our leadership role at the IMF, and the Administration is actively working to include the 2010 IMF quota reform in any Ukraine legislation.

Conclusion

Chairman Royce, Ranking Member Engel, and members of the committee: Ukraine has asked for support from the international community during this difficult time and the United States, in partnership with the IMF, the World Bank, EBRD, and our allies in Europe, is ready to answer their call. We must continue to play a leading role in supporting Ukraine, both bilaterally and through the IMF. We can take an important first step at this critical time by providing support for our proposed loan guarantee and bilateral assistance and passing the 2010 IMF quota reform as part of any Ukraine assistance package.