ECONOMY AND ECOLOGY 18.07.2024 | Alexandra Dienes

A worthwhile investment

Reconstructing Ukraine will be expensive. But the EU would benefit from a strong Ukrainian economy

Supporting Ukraine in winning the war and securing a prosperous future are two sides of the same coin. Rebuilding efforts and the mobilisation of donors are already underway, as the recent Ukraine Recovery Conference in Berlin shows. For European politicians, the reconstruction of Ukraine is important — far beyond ensuring the war-time resilience of the economy and society. It is being planned with an eye on Ukraine's long-term development and EU accession process. It is thus viewed as an investment in European stability and security.

The scale of the devastation and the financial needs of war-torn Ukraine are enormous and will grow the longer the war lasts. The World Bank estimates it at nearly $500 billion — roughly the GDP of Austria and more than triple the amount of Ukraine's pre-war GDP. The physical destruction of cities and infrastructure comes with disrupted market activity and vastly increased risks for investors. This presents the Ukrainian state and its international allies with a huge financial challenge.

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Already now, the Ukrainian state-led war economy is extremely dependent on external support. Much of the current aid, as well as future financial pledges, come not as grants, but loans. These will have to be paid back and will add to the mounting debt. Already today, 70 per cent of Ukraine's debt is owed to foreign donors. In August, a two-year debt payment freeze expires. While Western creditor states (including Germany and the US) have agreed to extend the freeze until 2027, private creditors (like the world's largest asset manager BlackRock), which hold about a fifth of the country's debt, are pushing Ukraine to resume the interest payments. This leaves Ukraine with little time to either restructure the debt, extend

the moratorium or face a default.

Donor institutions such as the IMF have acknowledged the perils of unsustainable debt and the resulting fiscal austerity that harms people and suffocates economic growth. Debt relief should therefore be seriously considered from the outset of the reconstruction. As much future aid as possible should come in the form of grants.

People-centred recovery

The reconstruction of social infrastructure is no less important than the physical one. Ukraine's recovery must focus on the people and the critical sectors of a stable, resilient society — those catering to people's needs, such as education, child care, social security and healthcare. Spending on childcare and education will be crucial to the inclusion of women – who do the unpaid care work and are therefore not available to the labour market – in the workforce. Investment in social housing will be indispensable, given the scale of residential housing destruction as a result of Russian bombings. Overall, government spending in the social sector is a high-return investment with a multiplier effect that generates domestic demand and contributes to the stable, resilient society that is the backbone of successful reconstruction.

People will be crucial for the reconstruction effort. More than 6 million citizens have left Ukraine, leading to a 12 per cent decrease in the labour force. Only a socially stable country will be attractive to those who consider returning. While guarantees for businesses investing in Ukraine are being discussed, there is no such discussion about guarantees for returnees. Facing a declining population and workforce, Ukraine desperately needs both soldiers and workers. Hundreds of thousands of people, mostly men, are serving in the army and are not available on the labour market. Most companies are experiencing staff shortages. At the same time, about half of the labour force is inactive, and unemployment is high. Many men do not seek formal employment out of fear of being drafted.

Reconstruction should be planned with the green transition in mind, both to make the Ukrainian economy sustainable and to facilitate alignment with the EU Green Deal. Investment in clean energy will be key, as will efforts to decentralise energy production (Ukraine has a larger number of smaller power plants) to make it less vulnerable to Russian strikes. Donors and foreign investors could help Ukrainian companies that lack skills and human capital, and attract state-of-the-art technology, including advanced zero-emission technologies.

‘Building back better’ made in Ukraine

Throughout the war, Ukrainian companies in most sectors have lost market share to competitors from the EU. This is not surprising for an open economy in wartime conditions, but it needs to change if reconstruction is to be just and socially balanced. Ukrainian companies should be in the driver’s seat. Therefore, the revival of the industry should be the primary task of the Ukrainian state, along the lines of ‘building back better, made in Ukraine’. If the state provides regular orders to local companies (in both the defence and the civilian sectors) and supports them with subsidy programmes, it will secure future domestic growth, create jobs and help the private sector to cope with the shocks of war.

The Ukrainian government needs to find a balance between protectionism and opening up to the liberalised EU market, while the EU should find a way to compensate those actors likely to lose out.

‘Building back better, made in Ukraine’ also means that donors and foreign investors should prioritise local firms when allocating funds and make them primary contractors. As many goods as possible should be procured from Ukrainian producers. Foreign companies should be encouraged to pursue localisation and form joint ventures with Ukrainian companies. As much funding as possible should go to small- and medium-sized enterprises. Ukrainian companies have the manufacturing capacity (e.g., cement, steel) in the sectors most in need of reconstruction, such as residential housing and infrastructure. They are also competitive in the defence, food, garments and medical sectors. Local contracting and localisation will generate domestic demand, provide jobs and attract some returnees. It will generate higher and more sustainable growth because money will stay in the economy rather than leaving the country through foreign contractors or, worse, foreign contractors using foreign labour and imported building materials.

There are worries that if Ukraine rebuilds its industry, it could become a competitor for the EU. This may be true in the short term, but it overlooks the long-term benefits. Consider Europe’s experience with the Marshall Plan after the Second World War: It enabled the rise of the European industry, which became a rival to the American one. But in the long run, the US benefited from an economically strong Europe, just as the EU will eventually benefit from a strong Ukrainian economy. In the

big picture, the Ukrainian government needs to find a balance between protectionism and opening up to the liberalised EU market, while the EU should find a way to compensate those actors who are likely to lose out (protests by Polish and French farmers could be a harbinger of distributional conflicts).

National Development Agency

Reconstruction requires strategic planning, oversight and donor coordination. A dedicated National Development Agency could be set up to ensure that funds reach the people and to align reconstruction with EU accession.

When large amounts of aid flow into a country, the state's capacity to absorb the funds becomes key. Part of the foreign assistance to Ukraine should focus on building the capacity of the agency's employees to ensure that the institution can absorb unprecedented amounts of money, attract foreign capital and know-how where needed, and plan, execute and monitor large-scale projects.

To facilitate coordination, donors should consider channelling more aid through multilateral channels (e.g. through EU or EBRD funding) rather than bilateral channels. The reason is that a multitude of bilateral projects, with their respective requirements and monitoring standards, can put a strain on authorities charged with implementation on the ground, so that, in the worst case, local actors might be scared away from using the money at all. Their time should primarily be spent on project planning and implementation, not on the bureaucracy of managing aid funds.

Capacity building in local administrations can foster local ownership and ease implementation. As government contracting is highly susceptible to corruption and can affect both Ukrainian and foreign firms, fighting corruption will remain crucial. It is therefore rightly prioritised by Zelenskyy's government and should be supported by donors through capacity building, monitoring and accountability mechanisms.



Alexandra Dienes
Vienna

Dr Alexandra Dienes is a researcher at the Friedrich-Ebert-Stiftung's Regional Office for Cooperation and Peace in Vienna.