

Presidency Issues Note for Working Session III: UKRAINE RECONSTRUCTION AND COORDINATION OF SUPPORT

Economic and social impacts of the war

More than a year has passed since Russia launched its full-scale invasion of Ukraine on 24 February 2022. Russia's aggression continues to cause immense human suffering and widespread destruction of Ukraine's economy and infrastructure. The social impact of the war is devastating, with an escalating number of military and civilian casualties. According to the United Nations (UN), the war has caused massive numbers of displaced people, and are at a level not witnessed since the Second World War. As of January 2023, the number of Ukrainian refugees recorded in Europe was 8 million, while the number of internally displaced Ukrainians was approximately 5.4 million.¹ An estimated 8 million Ukrainians are now living in poverty, a fivefold increase in one year and a reversal of 15 years of development gains.²

Meanwhile, economic activity has been severely hampered by the destruction of productive capacity, damage to agricultural land and infrastructure, and the reduction in labour supply. According to the International Monetary Fund (IMF), Ukraine's economy contracted by 30 per cent in 2022 and the budget deficit is projected at 20.5 per cent of GDP in 2022 (compared with 3.9 per cent of GDP in 2021). Increased military spending has been one of the main drivers of the increasing budget deficit.³ Moreover, exceptionally high uncertainty stemming from the war has significantly reduced market confidence, heavily constraining private investment and resulting in a loss of access to international capital markets. The inflation rate reached 26.6 per cent in 2022, fuelled by scarcity of goods, logistical supply challenges and monetary financing of the fiscal deficit.

¹ Source: United Nations Office for the Coordination of Humanitarian Affairs (OCHA).

² Source: World Bank.

³ Source: IMF.

In terms of physical destruction, the damage to critical infrastructure is severe. As of February 2023, the Kyiv School of Economics estimated the total cost of direct physical damage to infrastructure at USD 138 billion, more than 70 per cent of pre-war GDP, with the majority attributable to the destruction of residential buildings and roads.

In 2023, real GDP growth is expected at 1 per cent,⁴ but risks are heavily tilted to the downside. The critical issues include the scale, intensity and duration of the war, and its impact on the functioning of the economy, through its effects on labour supply and human capital, physical infrastructure, purchasing power and poverty.

External financing needs

As a result of Russia's ongoing aggression, Ukraine is facing significant financing needs. Ukraine will continue to require external financial assistance in the short and medium term to maintain essential state functions, ensure macroeconomic stability and restore critical infrastructure. According to the IMF, the external fiscal funding needs are estimated at around USD 40 billion for both 2023 and 2024, in a baseline scenario where the war is expected to end sometime in mid-2024. In a downside scenario, in which the war continues for a longer period, the funding gap could be much larger. In addition, long-term financing needs for the reconstruction phase will be massive and extend beyond the rebuilding of physical assets. Total recovery and reconstruction needs were estimated at more than USD 411 billion as of February 2023 by the World Bank, which is more than 200 per cent of the country's pre-war GDP.⁵ Costs will continue to grow as the war continues.

Financing sources and need for coordination

Bilateral and multilateral donors as well as international financial institutions have mobilised extensive financial support to help mitigate Ukraine's acute needs. However, for the post-war reconstruction, it is clear that public funding will not be enough, and support will have to come from several sources. Mobilisation of European private capital and private sector investment, in the form of foreign direct investment and public-private partnerships, will be critical.

⁴ Source: IMF.

⁵ Source: Lugano conference, July 2022.

Moreover, it will be important to continue exploring possibilities for the use of frozen and immobilised Russian assets, including Russian public assets.

Given the multiple sources of financial support, coordination is critical to ensure efficiency and ease the administrative burden on Ukraine. To avoid overlapping and duplication, support to Ukraine from multilateral organisations and international financial institutions should remain guided by their comparative advantages and their respective mandates. The Multi-agency Donor Coordination Platform, launched in January this year, could have a crucial role to play as it brings together relevant donors such as the G7, EU, international financial institutions, and the Ukrainian authorities. Furthermore, at EU level, both the Ad Hoc Working Party on the Multi-agency Donor Coordination Platform and the Ad Hoc Working Party on Frozen and Immobilised Assets will be important in facilitating discussions and progress on collective support measures.

EU integration as an anchor for reconstruction efforts

The overarching principles for the reconstruction process should be full ownership by the Ukrainian authorities and EU membership as the political and economic endpoint for the post-war phase. The path to membership and integration into the EU economic bloc should hence provide an anchor for the reconstruction efforts, and conditionality attached to external support should underpin this agenda. Reform efforts should include the strengthening of market mechanisms, institutional frameworks, good governance, the energy and infrastructure sectors and the social safety net with the objective of ensuring a modern, greener, more inclusive, and dynamic economy fit for EU membership.

Questions for discussion:

- How can the EU together with other relevant stakeholders in the international community ensure efficient and effective coordination of financial support to Ukraine?
- How should the need for acute liquidity financing be coordinated with other long-term efforts, such as the planning of Ukraine's reconstruction and the transition to longer-term financing support with the aim of securing a path towards EU membership?