

Stockholm Conference on Private Sector Engagement in Ukraine's Recovery and Reconstruction

# Private Investment Will Modernize Ukraine's Economy<sup>1</sup>

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Russia's ongoing war in Ukraine has produced devastating human and physical destruction in the country. The current war has caused global reverberations through increased food insecurity, a growing energy crisis, and disruptions of the broader global supply chains.

But with the destruction comes a rare opportunity to modernize Ukraine's economy. A successful reconstruction would include a Ukraine that is connected to and firmly embedded in the Euro-Atlantic community. Ukraine has a large consumer market and strong industrial base, with a well-educated and skilled population that has the potential to build a highly competitive manufacturing sector to complement the European Union. Ukraine must emerge as a new country after the war, with its economy transformed from one dominated by oligarchs, vested interests, and state-owned enterprises (SOEs) to one that is innovative, green and inclusive. It is in the national security interest of the G7 and European Union for Ukraine to become a modern economy and secure democracy. The geostrategic stakes are such that failure could have disastrous consequences not just for Ukraine but also for the broader region.

Experience has shown that countries should not wait until the end of a war to begin planning for the postwar period. The government of Ukraine is leading the planning effort: in 2022 it prepared the National Recovery Plan as a blueprint for reconstruction and in 2023 it set up a state agency in charge of restoration and reconstruction. However, given the scale of the damage and the fragile postwar state of the Ukrainian economy, the international community (including bilateral donors, the European Union, and international financial institutions) will play a big role in supporting that recovery and modernization through financing, advisory services and oversight. Ukraine will need to attract massive amounts of funding from various sources, ranging from \$349 billion to as high as \$1 trillion. Central to this effort will be enabling more private funding into the country by breaking down investment barriers that existed even before the war.

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<sup>1</sup> This document draws heavily on the following publications: <https://www.csis.org/analysis/modernizing-ukraines-transport-and-logistics-infrastructure>; <https://www.csis.org/analysis/enabling-economic-transformation-ukraine>; and <https://www.cesifo.org/en/publications/2023/article-journal/eight-recommendations-reconstruct-and-modernize-ukraine>

## The Role of Private Investment

In the immediate term, donors are providing significant budget support to the Ukrainian government. The economy's backbone, its vibrant small and medium enterprise (SMEs) ecosystem, also needs to keep operating. In the medium term, foreign direct investment (FDI) and other financial sources will enable the rebuilding of the country and most importantly, be the driver of modernization for the economy.

However, historically, FDI in Ukraine remained low compared to other markets. Investors cited barriers such as an unpredictable tax regime, weak rule of law and rampant corruption as main impediments to doing business in Ukraine. To attract FDI, and private sector financing, Ukraine will need to improve its business environment by implementing significant policy and regulatory reforms. International donors can work alongside the Ukrainian government to identify how risk mitigation and development finance tools can best be designed and deployed to entice private investments into Ukraine.

## What Should Donors Do?

- 1. Make a multiyear, multibillion-dollar commitment with a set timeline for EU accession.** Central to this modern vision of Ukraine is a robust security arrangement with the West, and membership in the European Union (EU) to guarantee Ukraine's sovereignty and independence. The EU should make a commitment to offer a specific timeline and set of conditions for Ukraine's accession as a full member no more than 10 years. Any delay could weaken Ukrainian resolve to pursue the needed reforms. Alongside pledged financial assistance, this will ensure Ukraine has a clear, time-defined road map outlining what is required to join the European Union and thereby give businesses the confidence to invest for the long term.
- 2. Clarify their roles, assess their strengths, and have a division of labor in terms of supported projects so that they are leveraging their strengths, not overlapping and using scarce resources efficiently.** This is the time to clarify the roles and strengths of different donors and actors while maintaining coordination to prevent inefficiencies down the road. If donors do not create a harmonized mechanism for prequalification and preselection of projects now, there will be huge confusion and waste of reconstruction resources and rebuilding efforts, with donors chasing after the same projects. In addition to clearly defining roles, it will be equally important to align resources and coordinate as much as possible. In addition, all conditionality requirements should be aligned with the reforms the Ukrainian government will need to undertake for accession to the European Union and to ensure successful delivery on the International Monetary Fund (IMF) program.
- 3. Support the Ukrainian government by developing a strong pipeline of feasible, priority infrastructure projects.** Not all the projects laid out in Ukraine's National Recovery Plan will be able to attract funding. These projects need to be well prepared, meet high standards, and demonstrate economic, social, and environmental benefits. This is an area where donors have significant expertise and can support the Ukrainian government.
- 4. Help the Ukrainian government with contractor procurement and investor screening,** preventing malign influence and—by vetting and prequalifying companies and contractors—ensuring a new class of oligarchs does not emerge from the reconstruction

process. As part of the coordination process, the various international actors need to work alongside the Ukrainian government to preselect all the consultancy needs, get them in place, and assess specific priority projects.

- 5. Set up an independent monitoring and evaluation (M&E) system so that funds are tracked properly, and projects really deliver their intended goals.** Working closely with the Ukrainian government, the United States, European Union, and other international partners should establish an independent monitoring and evaluation (M&E) system so that funds are tracked properly, and it is possible to judge the success or failure of projects.
- 6. Offer innovative financing solutions.** These includes risk mitigation tools, seeding private equity funds, and using the frozen Russian central bank assets in the G7. One such tool would be to mitigate risk for private investors by creating a pool of development finance funding from partners, amounting to \$5 billion per year for five years. This commitment would provide \$25 billion in risk-mitigation financing for Ukraine's reconstruction and enable the private sector to mobilize at least four times that amount in private capital (\$100 billion). Ideally, this funding pool would enhance alignment and cofinancing among development finance institutions in Ukraine by agreeing to a term sheet, due diligence principles, and a shared pipeline of deals.

## What Should Ukraine Do?

- 1. Strengthen governance and accountability and create the enabling conditions for greater private investment in Ukraine to support economic transformation.**

The government of Ukraine should undertake certain economic and governance reforms across the economy—including to fight corruption and overhaul customs management—for private investors to be enticed to invest in the country. These reforms should coincide with the requirements of Ukraine's candidacy as an EU member and should include strengthening rule of law, increasing transparency, and implementing accountability mechanisms. Mission critical for all these reforms related to business is strengthening Ukraine's judicial system to ensure it is free from corruption. On the economic front, this will include breaking the power of oligarchs and vested interests and creating a level playing field for Ukrainian businesses of all sizes free of the undue influence of corrupt actors. Another key aspect is developing a well-functioning, independent court system that draws upon the dispute resolution and bankruptcy laws of Ukraine's Western allies. Main areas that require further reform include:

- Civil service modernization
- An independent, fair, and transparent judiciary system
- Financial autonomy and quality assurance in higher education institutions
- Digitalizing customs systems
- Simplification of taxation regimes
- Implementing anti-corruption legislation
- Digitalization of SMEs
- Restructuring and privatization of state-owned enterprises
- Break up of media conglomerates

- 2. Focus on Projects and Initiatives That Build on Ukraine's Human Capital and Incentivize Ukrainians to Return Home:** When the war ends, there will be 10–15 million Ukrainians who, in principle, will wish to relocate back to (and within) Ukraine. Therefore, it will be important to recover basic infrastructure such as electricity, heating, and water services; social infrastructure such as housing, schools, and hospitals; and transport and logistics infrastructure. Considering the number of Ukrainians who are currently unemployed due to the war, the government working with donors should find a way to maximize the use of Ukrainian human capital in the reconstruction process. Projects should rely as much as possible on the Ukrainian people to help with rebuilding efforts.
- 3. Embed digitization in the reconstruction effort to create the transparency and accountability that assure donors and the private sector of progress toward a well-governed economy.** Digitization should be particularly appealing as the destruction of existing infrastructure provides an opportunity to build digital infrastructure (e.g., sensors, fiber, antennas) without digging twice. Digitization provides a platform for all vertical economic sectors to become more sustainable (greener) and more resilient. It will be equally critical to EU and NATO accession. Ultimately, modernizing the economy will help rebuild a Ukrainian society that is more inclusive, more accountable, and better prepared for the future.
- 4. Continue the Process of Decentralization:** Additionally, prewar efforts to decentralize the government must continue, and the international community should work with municipal governments on reconstruction efforts. Although Ukraine is a unitary state, it has decentralized government functions and resources by empowering regional and local governments. Under decentralization, Ukraine created combined *hromadas* by merging smaller, municipal-level administrative units into larger units. It also transferred resources and power to local authorities, strengthening local self-government and provision of public services at a subnational level. Ukraine has pursued a policy of fiscal decentralization to ensure local governments have access to the funding they need to pay for services. With the implementation of martial law in response to Russia's invasion, however, increased centralization by the Ukrainian government has caused some reversal of these efforts.

## Conclusion

The free world has an opportunity to help Ukraine in its democratization and modernization journey. Ukraine should not simply rebuild its old infrastructure and institutions but embark into a modernization path. Private investments including FDI can facilitate funding, technology and know-how but at the same time Ukraine needs to enact significant governance, social, and economic reforms that are anchored in the European Union (EU) accession process. International donors can accompany rebuilding efforts, applying the lessons learned from past reconstruction experiences and help Ukraine become that modern society. A modern, democratic, and sovereign Ukraine is the foundation for security and well-being of Europe and for defending democratic principles globally.