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Evaluation of Ukraine's National Recovery Draft Plan

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Policy Notes and Reports 61

Evaluation of Ukraine's National Recovery Draft Plan

Tetiana Bogdan, Michael Landesmann and Richard Grieveson



The Vienna Institute for International Economic Studies
Wiener Institut für Internationale Wirtschaftsvergleiche

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Abstract

Russia's invasion of Ukraine has caused human suffering, the destruction of infrastructure and environmental damage on a huge scale. The Ukrainian government has already started to prepare for reconstruction, and presented its National Recovery Plan in July 2022. The plan has many strengths, including a focus on institutional upgrading, reducing the power of oligarchs, accelerating EU integration and convergence with EU standards, and a correct identification of the most pressing short-term measures to support the economy. However, we also identify several shortcomings and areas for improvement. The plan overestimates the cost of reconstruction: we estimate Ukraine's external financial needs for post-war reconstruction at USD 410bn (without security needs) – somewhat lower than the government's projection of USD 500bn. We also think that the government overestimates the economy's post-war growth potential. Adjustments need to be made both to the distribution of post-war financing across sectors and to the plans related to industrial policy and the financial sector. The aspiration to lower the tax burden is unlikely to be compatible with post-war demands on the state budget related to reconstruction. In addition, the proposed decentralised approach is unlikely to yield the best results: in most areas, reconstruction should be guided at the national level. Attention should also be given to the areas of overlap, the lack of coordination between different elements of the reconstruction plan, and, in some cases, the incorrect prioritisation of tasks.

Keywords: Ukraine economic recovery plan, Ukraine economic reconstruction, Ukraine-EU integration, Ukraine financing needs, Ukraine-Russia war, Reconstruction in the Balkan states

JEL classification: H56, P52, F35

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Evaluation of Ukraine's National Recovery Draft Plan

EXECUTIVE SUMMARY

Russia's invasion of Ukraine is the biggest military conflict in Europe for almost eight decades. It has caused untold human suffering and the destruction of infrastructure on a monumental scale, and has generated significant environmental damage. All of these costs are likely to rise further before the war ends.

We estimate Ukraine's external financial needs for reconstruction at USD 410bn (without defence and security needs), which is lower than the government's own projection (USD 500bn), but roughly in line with the estimates of other non-official researchers.¹ Our estimate includes three core components: the direct reproduction costs of the assets destroyed and damaged; the hypothetical costs of upgrading Ukraine's infrastructure from what it was prior to the Russian military invasion; and EU transfers for environmental, institutional and other purposes on the way to Ukraine acquiring EU membership. For legal reasons, the division of these costs between Russian compensation and Western assistance is not yet clear. Without doubt, Ukraine will need considerable financial support from its Western partners on its way to EU integration. It is important to recognise that Ukraine's EU-oriented reconstruction must be seen by its Western partners not just as an act of charity, but as pragmatic policy that is in the West's own interests.

Despite the continuing war, the Ukrainian government has already started to plan for reconstruction, and it presented a National Recovery Plan in Lugano on 4-5 July 2022.² The plan is contained in a broad-based, comprehensive and detailed document. It outlines the main tasks for the reconstruction and rehabilitation of the war-torn country; divides each direction or goal into a set of sub-goals; and covers the necessary supporting measures, including legislative initiatives.

The strengths of the plan are as follows:

- › **Correct identification of the most pressing and acute needs of the economy:** Short-term emergency measures and government financing needs are specified appropriately for 2022. The government plans to build up gas reserves, resolve the bottlenecks on rail and road exports to the EU, rebuild devastated social infrastructure (schools, hospitals, cultural institutions) and provide wartime emergency financing for small and medium-sized enterprises (SMEs) and agricultural producers.
- › **Institutional upgrading and reducing the influence of oligarchs:** The government has got some of its priorities correct by suggesting appropriate measures to strengthen institutional capacity and

¹ See, for example, Becker, T., Eichengreen, B., Gorodnichenko, Y., Guriev, S., Johnson, S., Rogoff, K., Mylovanyov, T., Weder di Mauro, B. (2022). A Blueprint for the Reconstruction of Ukraine. <https://voxeu.org/article/blueprint-reconstruction-ukraine>

² Ukraine Recovery Conference (2022). <https://www.urc2022.com/urc2022-recovery-plan>

achieve the 'de-oligarchisation' of the country. These are fundamental prerequisites for the sustainable and inclusive development of the Ukrainian economy in the future.

- › **Speeding up EU integration:** The government has correctly addressed the tasks related to EU integration, the harmonisation of Ukrainian regulations with the Copenhagen criteria and the safeguarding of mutual access to markets. In general, the plan is correct in seeing post-war reconstruction as a potential tool for improving Ukraine's compatibility with EU standards.

However, the plan does have some shortcomings that need to be tackled in the course of its refinement:

- › **The government overestimates the costs of reconstruction and makes questionable assumptions about how this will be financed:** Assuming that the war continues until the middle of next year, we think the aid-driven reconstruction needs will be USD 410bn (without defence and security needs), which is somewhat lower than the government's estimate of USD 500bn.
- › **Its macroeconomic assumptions are very ambitious and ill-founded:** The government's forecast that Ukraine's nominal GDP will grow fivefold in USD terms over 2023-2032 seems unrealistic; nor is it explicit about the assumptions concerning the real exchange rate dynamic underlying the GDP forecast. Other post-conflict examples further underline the suspicion that these targets are overly ambitious: nominal GDP in USD terms increased by 3.1 times in Bosnia and Herzegovina over 1996-2005 and doubled in Croatia over 1994-2003. Iraq's GDP soared by 13.8 times in the course of 2003-2012, but in many respects that case was unique.
- › **Some components of the Recovery Plan refer to traditional government functions, rather than post-war rehabilitation:** Securing macro-financial stability or developing sports seems odd in the context of a post-war reconstruction plan.
- › **The distribution of general financing across sectors is not well justified:** As an example, defence and security financing needs up to 2032 are put at USD 50bn, including the military assistance from allies in 2022. But this amount seems on the low side, given the intensity of the military struggle with the Russian army and the immense challenges involved in transforming the defence industry and modernising the Ukrainian armed forces in the post-war period.
- › **The proposed decentralised approach is probably not the right one:** According to the plan, recovery projects are to be concentrated in specific regions and supported by specific international partners. This may not produce good results when tasks of nationwide importance have to be tackled and when rehabilitation projects have powerful spill-over effects. However, there are areas where a decentralised approach does make sense: for example, the reconstruction of local infrastructure and housing may be carried out on a decentralised basis – i.e. under the aegis of local government, in cooperation with specific donors.
- › **Some of the plan's programmes overlap with one another and are assigned the wrong priorities:** Agriculture and ferrous metallurgy are treated as 'value-adding' sectors and are eligible for a broad set of privileges, with financing from different sources. This approach is reflected in the programme 'economic recovery and development', which overlaps with 'access to funding with a competitive cost of capital'. The selection of priority sectors is to some extent backward looking, and merely extrapolates current economic structures. Moreover, the sources of financing, the forms of capital inflow and the full range of instruments for achieving the set goals are not specified appropriately.

- › **The programme 'access to funding with competitive cost of capital' comprises quite vague instruments and lacks a complete list of implementing agencies:** Little is proposed in relation to those stimulus measures that were employed prior to the war. Besides, the financial plans for some projects are ill-founded (USD 40bn to encourage mortgage lending or USD 15-20bn for bank recapitalisation) and the urgency of undertaking them as part of post-war reconstruction is questionable.
- › **Some contradictions and inconsistencies across the plan indicate poor coordination of the various directions of reconstruction:** For instance, European integration and alignment with the EU acquis is combined with a ban on the reimbursement of VAT on exports of raw materials and huge state support for ferrous metallurgy. Such initiatives neglect the fact that the EU-Ukraine Association Agreement and EU Council Directives require the harmonisation of indirect taxation (including VAT reimbursements) and the fulfilment of EU Directives on state aid and competition policy.
- › **The various policy initiatives are also poorly balanced in a fiscal context:** For instance, a reduction in the tax burden on businesses and the population to a level not higher than 30% of GDP is unlikely to be compatible with the huge need for investment in infrastructure, the reimbursement of war-driven losses and massive fiscal support for enterprises in priority sectors. Nor is an expanding fiscal deficit (driven by tax cuts) in alignment with a declining public debt target, as prescribed by the plan.

Оцінка проекту Національного Плану відновлення України

ГОЛОВНЕ

Вторгнення Росії в Україну є найбільшим військовим конфліктом у Європі за майже вісім десятиліть. Воно спричинило незліченні людські страждання, гігантські руйнування інфраструктури, а також завдало значної шкоди навколишньому середовищу. Масштаб усіх цих збитків, скоріш за все, буде й надалі зростати аж до закінчення війни.

За нашими оцінками, потреби у зовнішньому фінансуванні України на відбудову передбачаються на рівні 410 млрд. дол. США (без урахування потреб у сфері оборони і безпеки). Ця сума дещо є меншою, ніж за оцінками уряду - 500 млрд. дол. США з урахуванням безпекових потреб, однак приблизно відповідає оцінкам інших неофіційних дослідників.³ Ми включали у свої розрахунки три основні компоненти: прямі витрати на відновлення знищених і пошкоджених унаслідок війни активів; ймовірні витрати на оновлення інфраструктури України до рівня, який був до військового вторгнення Росії; та трансферти ЄС на екологічні, інституційні та інші цілі на шляху до набуття Україною членства в ЄС. З юридичних причин поки що неможливо визначити чіткий розподіл цих витрат між джерелами фінансування, зокрема між компенсаціями з боку Росії та допомогою від західних партнерів. Безперечно, Україна потребуватиме значної фінансової підтримки міжнародних партнерів на своєму шляху до інтеграції в ЄС. Важливо визнати, що орієнтоване на ЄС відновлення України має сприйматися західними партнерами не просто як благодійність, а як прагматична політика, яка відповідає інтересам Заходу.

Навіть в умовах триваючої війни Уряд України розпочав роботу над проектом відбудови. Зокрема, 4-5 липня 2022 р. в Лугано було представлено Національний план відновлення. Загалом даний План можна охарактеризувати як всеохоплюючий, комплексний і детальний документ, в якому окреслено основні завдання відновлення та реконструкції зруйнованої війною економіки, чітко визначено кожний напрямок або ціль з деталізацією ініціатив, а також розкрито необхідні допоміжні заходи, включно із законодавчими змінами.

Сильними сторонами Плану є такі:

- › **Вірне визначення найбільш нагальних і гострих потреб в економіці:** Належним чином розроблено короткострокові екстрені заходи та оцінено потреби в державному фінансуванні на 2022 рік. Уряд планує здійснити накопичення газових резервів у сховищах, розблокування вузьких місць у залізничному і автомобільному сполученні для експорту в/через ЄС, відновлення зруйнованої соціальної інфраструктури, (шкіл, лікарень, закладів культури) та

³ See, for example, Becker, T., Eichengreen, B., Gorodnichenko, Y., Guriev, S., Johnson, S., Rogoff, K., Mylovannov, T., Weder di Mauro, B. (2022). A Blueprint for the Reconstruction of Ukraine. <https://voxeu.org/article/blueprint-reconstruction-ukraine>

забезпечення критичного фінансування у воєнний час для малих і середніх підприємств (МСП), а також сільськогосподарських виробників.

- › **Обґрунтовані заходи для інституційної модернізації та зменшення впливу олігархів:** Уряд правильно визначив деякі зі своїх пріоритетів, запропонувавши відповідні заходи для посилення інституційної спроможності та досягнення “деолігархізації” країни, що є основними передумовами для сталого та інклюзивного розвитку української економіки в майбутньому.
- › **Прискорення інтеграції в ЄС:** Уряд належним чином сформулював завдання, пов’язані з інтеграцією в ЄС, гармонізацією українського законодавства із Копенгагенськими критеріями і забезпеченням взаємного доступу до ринків. Загалом можна вважати, що у даному аспекті План побудований правильно, оскільки післявоєнна відбудова розглядається як потенційний інструмент для посилення відповідності України стандартам ЄС.

Однак План відновлення не позбавлений деяких недоліків, які необхідно усунути в ході його доопрацювання, а саме:

- › **Уряд, вірогідно, дещо завищує обсяг ресурсів, необхідних для відновлення та реконструкції, а також робить сумнівні припущення щодо шляхів їх фінансування:** якщо припустити, що війна триватиме до середини наступного року, то фінансові потреби на відбудову за рахунок зовнішньої допомоги можуть становити 410 млрд. дол. США (без урахування потреб у сфері оборони та безпеки), що дещо нижче, ніж оцінки уряду в 500 млрд. (а без урахування оборонних потреб – 450 млрд. доларів).
- › **Макроекономічні припущення, викладені в Плані, є необґрунтованими:** прогноз Уряду України щодо зростання номінального ВВП України майже в 5 разів у доларовому еквіваленті протягом 2023-2032 рр. виглядає нереалістичним; також у Плані не прописані припущення щодо динаміки реального обмінного курсу, що лежать в основі прогнозу ВВП. Післявоєнний досвід інших країн доводить надмірну амбітність цих цілей, зокрема: номінальний доларовий ВВП в Боснії та Герцеговині зріс у 3,1 рази протягом 1996-2005 рр., у Хорватії впродовж 1994-2003 рр. – у 2 рази. ВВП Іраку зріс у 13,8 рази протягом 2003-2012 рр., але досвід Іраку є унікальним у багатьох аспектах.
- › **Деякі компоненти Плану відновлення стосуються традиційних функцій уряду, а не післявоєнної відбудови:** забезпечення макрофінансової стабільності чи розвиток спорту виглядає дивним у контексті плану післявоєнної реконструкції.
- › **Розподіл загального фінансування між секторами є недостатньо обґрунтованим:** наприклад, фінансування потреб оборони та безпеки до 2032 року оцінюється на рівні 50 млрд. дол. США, включаючи військову допомогу від союзників, яку Україна отримала у 2022 р. Але ця сума є суттєво заниженою, беручи до уваги інтенсивність військових дій і значні виклики, пов’язані з трансформацією оборонної промисловості та модернізацією українських збройних сил у післявоєнний період.

- › **Запропонований у Плані децентралізований підхід не є виваженим:** згідно з планом, проекти відновлення мають зосереджуватися в окремих регіонах і реалізовуватися за підтримки конкретних міжнародних партнерів. У випадку, коли вирішення потребують завдання загальнонаціонального значення або проекти відновлення мають суттєві транрегіональні ефекти, такий підхід не даватиме належних результатів. Проте є сфери, де децентралізований підхід доречний: наприклад, реконструкція місцевої інфраструктури і житлового фонду може здійснюватися децентралізовано, тобто під егідою місцевих органів влади, у співпраці з конкретними донорами.
- › **Деякі програми Плану дублюють одна одну і мають неправильні пріоритети:** сільське господарство і чорна металургія розглядаються як сектори економіки з доданою вартістю і мають право на широкий набір привілеїв при фінансуванні з різних джерел. Цей підхід відображено в програмі “Економічне відновлення та розвиток”, яка частково збігається за змістом із програмою “Забезпечення доступу до фінансування з конкурентоспроможною вартістю капіталу”. Вибір пріоритетних галузей у рамках цих програм певною мірою носить застарілий характер і лише екстраполює (відображає) поточну структуру економіки. Крім цього, у Плані не конкретизовано належним чином ні джерела фінансування, ні форми надходження капіталу, ні навіть повного спектру інструментів для досягнення поставлених цілей.
- › **Програма “Забезпечення доступу до фінансування з конкурентоспроможною вартістю капіталу” включає досить нечіткі інструменти впровадження та не має повного переліку виконавців:** мало що пропонується відносно тих заходів стимулювання, які застосовувалися до війни. Крім того, фінансові плани деяких проектів є завищеними (40 млрд. дол. США для стимулювання іпотечного кредитування або 15-20 млрд дол. США на рекапіталізацію банків), а нагальність їх реалізації в рамках післявоєнної відбудови економіки взагалі викликає сумніви.
- › **Деякі суперечності та розбіжності Плану свідчать про низький рівень узгодженості і слабку координацію різних векторів реконструкції:** наприклад, євроінтеграційний курс та узгодження національного законодавства з *acquis* ЄС поєднуються із заборотою відшкодування ПДВ на експорт сировини та значною державною підтримкою чорної металургії. Такі ініціативи ігнорують той факт, що Угода про асоціацію між Україною та ЄС і Директиви Ради ЄС вимагають гармонізації непрямого оподаткування (у т.ч. і відшкодування ПДВ) та виконання Директив ЄС щодо державної допомоги та конкурентної політики.
- › **Різні політичні ініціативи недостатньо збалансовані також і у фінансовому контексті:** наприклад, зниження податкового навантаження для підприємств і населення до рівня, що не перевищує 30% ВВП, навряд чи буде сумісним із колосальними потребами в інвестиціях в інфраструктурні проекти, відшкодуванням втрат, спричинених війною, і масштабною фінансовою підтримкою підприємств у пріоритетних секторах. Збільшення бюджетного дефіциту, внаслідок зниження податків, також не узгоджується із скороченням державного боргу, що прописано в Плані відновлення.

INTRODUCTION

In April, the Ukrainian government established the National Council for the Recovery of Ukraine from the consequences of the war and set up several working groups to consider economic recovery and development, agriculture, the restoration of public services, housing, transport, communications, social service delivery and other issues. From this emerged the National Recovery Plan,⁴ prepared by the government and 2,500 experts in Kyiv, and presented in Lugano on 4-5 July.

In addition to the presentation of Ukraine's Recovery Plan, the Lugano Principles were announced as part of a special declaration by the participating governments and international organisations. The statement emphasised the following principles for Ukraine's reconstruction: partnership, focus on reforms, transparency and accountability, democratic participation, multi-stakeholder engagement, gender equality and inclusion, and sustainability. The National Recovery Plan is regarded as being 'owned' by Ukraine, so that its implementation will be the responsibility of the Ukrainian authorities. But before the plan can commence and before it receives funding, it must be fully endorsed by the European Commission and other international donors, and needs to be integrated into the operation of the 'Rebuild Ukraine' platform.

Generally speaking, the National Recovery Plan is a broad-based, comprehensive and detailed document, with many strengths and benefits. It captures the main directions of rehabilitation for the war-torn country; separates each direction or goal of reconstruction into various sub-goals; covers the supporting measures; and includes legislative amendments and initiatives. The plan therefore lays the foundations for the post-war reconstruction of Ukraine's economy and aims to create the conditions necessary for sustainable economic development in the long term. However, comprehensive analysis of this document reveals some contradictions and ill-founded benchmarks that must be tackled in the process of developing and finalising the document.

The purpose of this policy note is threefold. First, to reveal the strengths and weaknesses of Ukraine's National Recovery Plan. Second, to highlight important lessons learned from the post-war reconstruction of other countries that have been affected by invasion and conflict. In particular, we will use the example of the former Yugoslav states. Those countries provide suitable examples, given that their reconstruction was relatively recent and was also envisaged within the context of the EU integration process – and also because of wiiw's expertise in this region. Finally, this note aims to formulate policy proposals for the adjustment of Ukraine's National Recovery Plan (in terms of its strategic goals, core directions and major policy instruments), in order to make it consistent, comprehensive and as well suited as it can be to the challenges facing Ukraine, including the EU integration agenda.

⁴ Ukraine Recovery Conference (2022). <https://www.urc2022.com/urc2022-recovery-plan>

1. THE STRUCTURE OF THE RECOVERY PLAN

In this first section, we address the Recovery Plan as a whole, in order to assess whether it covers the right areas and determine whether anything important is missing. The plan consists of 15 national programmes (Table 1). In order to get a better understanding of the plan's structure and to put it into context, Table 1 includes a comparison with the 1997 Priority Reconstruction and Recovery Programme for Bosnia and Herzegovina (BiH). By comparing the Ukrainian plan with a relevant historical case, we should be able to identify similarities, overlaps and differences, which could provide additional insight into our evaluation of the Ukrainian plan.

Table 1 / Ukraine's national programmes, in comparison with Bosnia and Herzegovina (BiH) sectoral programmes and projects

Ukraine's national programmes		BiH projects within the Priority Reconstruction Programme
1.	Ensuring emergency funding	Emergency Recovery
	---	Emergency Farm Reconstruction
2a.	Providing access to funding with competitive cost of capital	Emergency Industrial Re-Start Guarantee Bosnia Enterprise Fund (IFC as a shareholder) Emergency Microbusiness/Local Initiatives Microfinance Bank (IFC as a shareholder)
2b.	Development of value-adding sectors of the economy	Sponsorship Trust Fund (MIGA as a guarantor) Public Finance Reform Banking Sector Reform
3.	Strengthening defence and security	Emergency Landmines Clearance
4.	Striving for EU integration	---
5.	Rebuild clean and safe environment	Water, Sanitation, and Solid Waste Urgent Work Emergency Wood Supply/Forest Management
6.	Integrated energy system resilience	Emergency District Heating Reconstruction Emergency Electric Power Reconstruction Emergency Natural Gas System Reconstruction
7.	Boosting business environment	Government Services
8.	Resolving logistical bottlenecks and integration with EU	Emergency Transport Reconstruction Transport Reconstruction II Emergency Telecommunications Rehabilitation
9.	Recovery and upgrading of housing and regional infrastructure	Emergency Housing Repair
10.	Recovery and modernisation of social infrastructure	Emergency Education Reconstruction
11.	Securing targeted and effective social policy	War Victims Rehabilitation Emergency Demobilisation and Reintegration Emergency Public Works and Employment
12.	Improving education system	Education Reconstruction I
13.	Upgrading healthcare system	Essential Hospital Services
14.	Developing culture and sports	---
15.	Securing macro-financial stability	---

Source: compiled by the authors on the basis of Ukraine's National Recovery Plan (2022) and 'Bosnia and Herzegovina – the Priority Reconstruction Program' (1997).

As outlined in the introduction, we believe that the successor states of the former Yugoslavia generally provide the most useful comparison, given that their reconstruction was recent and was undertaken within the framework of the EU accession process. We believe that the BiH recovery plan, in particular, is the most appropriate for comparison here. Of all the successor states of the former Yugoslavia, it was the economy of BiH that was most ravaged by the war. The country's total war losses were put at USD 50-70bn⁵ – many times greater than BiH's 1996 GDP (USD 3.6bn). At the end of the war, unemployment was close to 40% and the country had lost a major part of its industrial production.⁶ These figures imply an even more terrible cost, relative to the size of the economy, than is likely to be faced by Ukraine once the war is over.

Our general assessment, both in isolation and alongside BiH's programme strands, is that the programmes in the Ukraine Recovery Plan do largely accommodate the main needs of the country, both during and after the war. As the table shows, the plans of Ukraine and BiH overlap to a great extent. However, there are three differences that stand out for us as worthy of comment.

First, we can see from the table that BiH's emergency recovery programme (which was aimed, among other things, at restoring the government's administrative capacity) is replaced in the case of Ukraine by an emergency funding programme (section 1 in Table 1). In our opinion, this is a well-justified difference. In the case of BiH, the emergency recovery programme aimed at restoring administrative capacity was necessary because of the partial breakdown of government administrative capacity due to the fact that the war affected a large part of BiH's territory. By contrast, the Ukrainian army pushed the Russian forces out of most of the country very early on in the war, and Ukraine's government institutions have continued to function across by far the greater part of the country. This also implies that the provision of emergency donor funding to the Ukrainian government will give the government a greater opportunity to carry out emergency recovery actions even before the war ends.

Second, the development of the **value-adding sectors** of Ukraine's economy is a reasonable priority, taking into account the degradation of the manufacturing industry prior to 2022 and its partial destruction in the course of the war (section 2b in Table 1). However, the programme, as it appears in Ukraine's Recovery Plan, is vague and lacks any clear specification of the instruments for financing (or the kind of investments), the institutions to be involved and the government responsibilities. Besides, the definition of value-adding sectors in the Ukrainian context seems backward looking and influenced by business lobbyists, rather than derived from strategic reasoning (see below). The programme devoted to the value-adding sectors of Ukraine's economy overlaps in scope with the programme 'providing access to funding with competitive cost of capital'. These weaknesses in Ukraine's programme stand out when they are compared to the equivalent parts of the BiH plan. In the BiH plan, specific business-supporting projects made up the production component of the Priority Reconstruction Programme, and such projects were assigned to specific agencies (the Bosnia Enterprise Fund, Microfinance Bank, Sponsorship Trust Fund, Investment Guarantee Agency).

⁵ Nedic, G. (2006). Financial and Technical Assistance in the Reconstruction and Development of Post-Conflict Bosnia and Herzegovina, wiiw Balkan Observatory, Working paper 073.

⁶ Gligorov, V., Kaldor, M. and Tsoukalis, L. (1999). Balkan Reconstruction and European Integration, wiiw Balkan Observatory, Working paper 001.

Third, securing **macro-financial stability** (balance of payments and budgetary support) is included as a separate programme (section 15 in Table 1). There was no comparable programme in Bosnia (although international donors allocated significant funds to macro-financial stability in the 1990s via the normal channels). In the case of Ukraine, we do not believe this point should be included in the Recovery Plan, as it is a traditional government function that should be carried out anyway.

Despite the problematic parts of the Ukraine plan that we have identified relative to BiH, we can discern one important reason for optimism in the case of Ukraine. BiH is a federation and has one of the most complicated constitutional/political systems in the world. That explained the poor administrative capacity and low efficiency of the reconstruction programme in BiH. Taking into account the fact that Ukraine is a unitary state with political consensus and strong public support for economic recovery and reconstruction within the framework of EU integration, this will not be a problem in the way that it was in BiH. Therefore, Ukraine's institutional capacity will presumably be greater than in BiH, and the outcome of an aid-driven reconstruction process should be more encouraging.

2. WHAT THE PLAN GETS RIGHT

In chapter 1, we noted – albeit with some caveats – that the plan as a whole is generally well constructed and covers all the key areas. Here, we start to look at the Ukrainian plan in more detail, identifying and analysing what we see as its main strengths. As well as correctly identifying the most crucial short-term measures to be taken, the plan lays the foundations for institutional upgrading, a reduction in the influence of the oligarchs and an acceleration of EU integration.

2.1. Short-term emergency actions

The Recovery Plan provides a well-justified description of the **emergency actions required for 2022** and an appropriate estimate of government financing needs this year. Aside from military supplies and defence needs, the government envisages measures to secure military waste utilisation; build up gas reserves in storage facilities; free up bottlenecks in rail, road and Danube River exports to the EU; rebuild the social infrastructure that has been destroyed; find sources of financing for the state budget; provide SMEs with wartime emergency financing; set up a public-private partnership (PPP) re-employment platform with a reskilling programme; and provide agricultural producers with low-cost financing, storage opportunities, etc.

However, the extension of state grants to SMEs (included in the emergency programme) seems excessive, given the ballooning fiscal deficit in Ukraine. Emergency financing for SMEs in the form of government guarantees covering loans and concessional lending through the banks is available in the Recovery Plan and is already being applied. That might be regarded as a substantial financial tool for small business support, even without grants.

2.2. EU integration

One of the main strengths of the National Recovery Plan is that it offers potential synergies for EU integration. The plan correctly addresses the tasks related to EU integration, the alignment of Ukraine's regulations with the Copenhagen criteria and the safeguarding of mutual access to markets. Post-war reconstruction is seen as a tool for advancing Ukraine's compatibility with EU rules and standards.

In this regard, the Recovery Plan sets out some important tasks and measures:

- › Implement the EU acquis and undertake tasks related to the process of Ukraine's integration;
- › Ensure the full implementation of regulations stemming from obligations under the Association Agreement;
- › Integrate the country into the EU internal market, ensure food security and the functioning of the logistics network with EU countries;
- › Prepare an 'administrative capacity roadmap' to ensure the formation of an overall level of administrative capacity that is in line with EU best practice;
- › Carry out cross-sectoral measures to facilitate integration into the EU markets, (Digital Europe, Transport Network, joint transit regime); and
- › Include Ukraine in the list of beneficiaries for the purposes of Regulation EU 2021/1529 of 15 September 2021, related to the Instrument for Pre-Accession Assistance (IPA III).

The social and political foundations for implementation of the EU-Ukraine integration agenda are now quite favourable in Ukraine. A positive attitude on the part of citizens towards EU accession is very important for maintaining reform momentum and introducing the reforms mentioned above. A nationwide public opinion poll in Ukraine, conducted by the social research group Rating on 18-19 June 2022, showed that 87% of citizens would support Ukraine's membership of the EU, while only 4% would be strongly against it; 69% of those polled believed that Ukraine would join the EU within the next five years.

2.3. Improving institutions and 'de-oligarchisation'

The Ukrainian government has declared a strengthening of institutional capacity and 'de-oligarchisation' to be the fundamental prerequisites for the Recovery Plan. The government's priorities are correct, and it has proposed appropriate measures to construct the fundamental pillars, including: finalising an anti-corruption system; implementing the reform of law-enforcement agencies; the centralisation and digitalisation of public registers; the digitalisation of all key public services; the alignment of anti-trust procedures with European best practices; and enforcement of the new corporate governance legislation. In general, the Recovery Plan contains well-justified measures to modernise the state functions in Ukraine and to strengthen government institutional capacity.

3. CRITICISM OF UNDERLYING MACROECONOMIC ASSUMPTIONS AND RECOVERY COST PROJECTIONS

3.1. Macroeconomic assumptions

With regard to macroeconomic assumptions and projections, we believe that the National Recovery Plan is overly ambitious and partly ill-founded. The government is aiming for annual real GDP growth rates of 7% or more over the next decade. Applying a well-known mathematical formula states that annual growth of 7% should result in total value doubling over 10 years. At the same time, the government envisages nominal GDP in USD terms approaching USD 500bn in 2032. The apparent inconsistency of these two projections – with the USD nominal GDP target being far more ambitious, in our view – must presumably be explained by fairly heroic assumptions about real exchange rate dynamics. However, the assumptions are not available. Our rough estimates indicate that soaring nominal GDP of close to USD 500bn is barely achievable by 2032, given that the starting level in 2022 would be only marginally above USD 100bn. Obviously, over a long-time horizon and in a country like Ukraine, the real exchange rate dynamics are uncertain and highly volatile. But even taking that into account, the real appreciation of the hryvna is unlikely to drive Ukrainian GDP up fivefold in USD terms.

To get a better idea of the validity of the government's plan, we again use as a guide the post-war experiences of the countries of the former Yugoslavia. Cross-country analysis on the basis of the International Monetary Fund's (IMF) World Economic Outlook (WEO) data suggests that nominal GDP in USD terms increased by 3.1 times in BiH over 1996-2005 and doubled in Croatia over 1994-2003. Reliable data for other recent post-conflict experiences, such as Kosovo and Afghanistan, are not available. Interestingly, the nominal GDP of Iraq soared by 13.8 times in the course of 2003-2012. However, we should emphasise that Iraq was, in many respects, unique, since the country had been governed for decades prior to the war by a dictatorial leader, had suffered from previous wars and sanctions and it benefited significantly from the oil price boom of the early 2000s.

It is reasonable to assume that Ukraine's post-war economic performance will be influenced by the amount of external financial support that it gets. To gain a better understanding of this, we looked at the relationship between financial support and economic performance in four historical cases. Table 2 indicates real GDP growth rates in four war-ravaged countries – BiH, Croatia, Iraq and Afghanistan – and compares those rates against the net official development assistance (as a percentage of gross national income – GNI) received by their governments in post-conflict years.

The data do suggest that the government's target for Ukraine to achieve real growth of over 7% annually is quite realistic and achievable as a goal, assuming that the government is successful in implementing its structural reforms and attracting foreign aid. The historical precedents show an annual average growth rate in Bosnia of 7.9% in 1997-2006; in Croatia – 4.5% in 1994-2003; and in Iraq – 17.5% in 2003-2012.

Table 2 / Economic growth and foreign aid in post-conflict countries

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Bosnia & Herzegovina	Real GDP growth rates, %			22.9	13.8	10.8	4.4	2.4	5.1	3.9	6.3
	Foreign development assistance received, % of GNI	59.4	33.2	25	18.6	23.8	12.1	10.2	7.8	6.1	6.2
	Correlation coefficient (1997-2004)	0.84									
Croatia	Real GDP growth rates, %	6.6	5.9	6.6	1.9	-0.9	3.7	3	5.7	5.5	4.1
	Foreign development assistance received, % of GNI	0.24	0.56	0.17	0.15	0.21	0.31	0.49	0.49	0.36	0.29
	Correlation coefficient (1996-2003)	0.41									
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Iraq	Real GDP growth rates, %	81.8	53.4	1.7	5.6	1.9	8.2	3.4	6.4	7.5	13.9
	Foreign development assistance received, % of GNI	10.4	12.7	48.5	14.4	10.7	7.3	2.4	1.6	1	0.6
	Correlation coefficient (2003-2010)	-0.13									
		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Afghanistan	Real GDP growth rates, %	8.7	0.7	11.8	5.4	13.3	3.9	20.6	8.4	6.5	14
	Foreign development assistance received, % of GNI	49.4	39.3	37.9	33.4	25.5	24.1	22.1	22.2	20.1	20.8
	Correlation coefficient (2009-2018)	-0.33									

Source: IMF's WEO database, World Bank's World Development indicators, authors' calculations.

However, these historical examples also provide further evidence that nominal GDP growth in Ukraine of up to USD 500bn in 2032 is questionable, even assuming significant inflows of foreign aid. Table 2 indicates that the most significant volume of foreign aid (relative to the size of the economy) over a long period of time was allocated to Afghanistan. But foreign aid did not have a significant effect on real GDP development in that country. Iraq was also a big net recipient of foreign aid and had impressive real GDP growth rates over 2003-2012. However, the correlation between these two indicators was weak and even negative. By contrast, BiH demonstrated remarkable GDP growth through 1997-1999, when UN security forces were present and the country was the recipient of considerable foreign aid disbursements (amounting to 18.6-33.2% of GDP in the period 1996-1999). The correlation coefficient between real GDP growth and foreign assistance received was highest in this country – 0.84 for the period 1997-2004. But even in Bosnia's case, nominal GDP in USD terms increased by 3.1 times over a decade: from USD 3.6bn to USD 10.9bn.

These examples suggest that foreign aid is not the sole determinant of economic growth in a post-conflict economy: security factors and government institutional capacity in economic development also play an important role. In Iraq and Afghanistan, violence was prevalent and the administrative capacity of the national governments was extremely low: that underlies their highly volatile and unsatisfactory economic growth indicators. In Ukraine, although it is impossible to predict the future course of the war and the shape of the peace, the performance of the Ukrainian army and the unity of the country so far provide grounds for optimism that post-war reconstruction will take place in a much better security and institutional environment than in the historical examples we have looked at.

Taken together, these historical cases further support our contention that the Ukrainian government's assumption of a fivefold increase in nominal GDP by 2032 is overly optimistic. The adequate disbursement of foreign aid for reconstruction and its effective allocation are important factors in the restoration of self-sustaining economic development of a post-war country; but their role should not be overestimated.

3.2. Estimating the total cost of reconstruction

According to Ukrainian government calculations, to implement the Recovery Plan will require funding of USD 750bn over a decade. The government assumes that two thirds of the total amount (USD 500bn) will be provided by international donors in the form of grants, loans and equity, while USD 250bn would be injected by private investors. Our preliminary analysis (which assumes a continuation of the war until mid-2023) suggests that the total is rather overestimated and that several components of the financing needs are ill-founded. In calculating our own estimates, we first consider those of several other institutions.

First, the Kyiv School of Economics puts the financing needs for reconstruction of the physical assets (objects) destroyed as of 5th September 2022 at USD 197.8bn; that covers the replacement costs of housing, infrastructure, enterprises, land, administrative buildings, educational and medical entities and transport vehicles. Reconstruction costs are calculated on the basis of direct losses and do not take account of macro-level expenditure on stabilisation of the economy and institutional reform. Besides, the replacement costs will increase further as the violence and destruction continues.⁷

Second, the World Bank, European Commission and Ukrainian Government assessed the direct damage from the war that occurred between 24 February and 1 June 2022 at USD 97bn, with housing, transport and industry the worst-affected sectors. However, as of 1 June 2022, reconstruction and recovery needs were put at USD 349bn. Recovery needs are defined as the value associated with the resumption of pre-war normality through activities such as repair and restoration, including a premium linked to 'building back better' principles (e.g. improved energy efficiency, modernisation efforts). The experts who took part in this investigation emphasise that their findings are preliminary and refer to the specified date range; the estimates for damage, loss and need should be regarded as minimums.⁸

Third, in April 2022, the authors of *A Blueprint for the Reconstruction of Ukraine* concluded: 'Preliminary estimates and examples suggest that the cost of reconstruction aid to Ukraine ranges from €200 billion to €500 billion.'⁹ One of their methods relied on the World Bank's estimate of Ukraine's produced capital stock of USD 1.1 trillion. Assuming 40% destruction, the authors put the cost of reconstruction at USD 440bn. They stressed that this estimate does not include: (i) less tangible values (such as higher uncertainty for investments for years to come); (ii) immediate GDP losses; and (iii) the very high costs of human suffering and loss of life.

Our own scenario assumes that the war will last until the middle of 2023, but with declining intensity of destruction, so that the replacement costs of the assets destroyed will probably rise from USD 197.8bn to USD 270bn. However, in truth that amount could not be regarded as a benchmark for the total reconstruction needs, given the modernisation challenges that Ukraine faces in its preparations for EU membership. The country needs to take critical steps toward becoming a modern, low-carbon, climate-resilient and inclusive country.

⁷ Kyiv School of Economics (2021). Загальна сума прямих збитків інфраструктури зросла до \$114.5 млрд, мінімальні потреби у відновленні зруйнованих активів наближаються до \$200 млрд. <https://www.epravda.com.ua/publications/2021/04/6/685311/>

⁸ World Bank (2022). Ukraine Rapid Damage and Needs Assessment. Report jointly prepared by the World Bank, the Government of Ukraine and the European Commission (August). <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099445209072239810/p17884304837910630b9c6040ac12428d5c>

⁹ Becker, T., Eichengreen, B., Gorodnichenko, Y., Guriev, S., Johnson, S., Rogoff, K., Mylovannov, T., Weder di Mauro, B. (2022). A Blueprint for the Reconstruction of Ukraine. <https://voxeu.org/article/blueprint-reconstruction-ukraine>

A good starting point to derive a comprehensive estimate of the costs involved in bringing Ukraine more into line with EU standards is the European Bank for Reconstruction and Development's (EBRD) calculations of Ukraine's infrastructure investment needs for 2018-2022, which it put at 16.5% of GDP annually.¹⁰ Only a small part of this derived target for infrastructure investment has actually been achieved. Extrapolating a marginally lower value of investments for the next five years (15% of pre-war GDP), we obtain a figure of USD 150bn for upgrading the infrastructure in Ukraine, *had there been no military invasion*. However, it is reasonable to assume that this estimate of USD 150bn overlaps somewhat with the estimate of USD 270bn for reproduction costs to cover the assets destroyed in the war. Besides, a share of the country's investment needs should be financed from domestic sources. Therefore, the initial estimate of USD 150bn for upgrading Ukraine's infrastructure could be reduced to roughly USD 110bn. The main guiding principle for the reconstruction of Ukraine's infrastructure would be to 'build back better', which implies investment in green, resilient, inclusive and sustainable recovery and modernisation.

Moving on with our calculation of Ukraine's reconstruction costs, we should also take account of the environmental and economic competitiveness challenges, the development of rural areas, institutional reforms and the many other things that need to be addressed on the road to EU membership. This is the money needed to render Ukraine fit for EU integration. In order to achieve the greatest possible impact, clearly the quite significant amounts of EU transfers should be accompanied by strict conditions – only good institutional quality and governance standards would allow Ukraine to absorb efficiently the huge amounts of funding from the EU and other donors.

To calculate Ukraine's reconstruction costs, it is worth incorporating into the core formula the EU transfers component that is not associated with physical infrastructure. wiiw found that Central and Eastern European countries (CEE) received EU transfers equivalent to one third of their GDP over the period 2004-2018, with that figure rising to more than half for some of them.¹¹ However, in the case of Ukraine, a more appropriate benchmark would probably be the candidate and potential candidate countries of the Western Balkans. The Economic and Investment Plan for the Western Balkans that the EU adopted in 2020 is considered inadequate (a planned EUR 9bn), as it is equivalent to only 1% of the Western Balkans' collective GDP per year. Using this as a guide, EU transfers could be equivalent to roughly 12% of Ukraine's annual GDP over the period 2024-2030. In this way we come to a figure of EUR 30 bn of EU transfers to Ukraine as pre-accession assistance.

Finally, to derive a comprehensive estimate of aid-driven support for Ukraine's reconstruction needs, we have to sum up:

$$\text{USD 270bn} + 110\text{bn} + 30\text{bn} = \text{USD 410bn}$$

¹⁰ European Bank for Reconstruction and Development (2017). Transition Report 2017-18: Sustaining Growth. <https://www.ebrd.com/transition-report-2017-18>

¹¹ Ghodsi, M., Grieveson, R., Hanzl-Weiss, D., Holzner, M., Jovanović, B., Weiss, S. and Zavorská, Z. (2022). The long way round: Lessons from EU-CEE for improving integration and development in the Western Balkans. <https://wiiw.ac.at/the-long-way-round-lessons-from-eu-cee-for-improving-integration-and-development-in-the-western-balkans-p-6194.html>

We should note that this figure for development assistance towards Ukraine's reconstruction does not include security and defence costs; these could vary substantially, depending on the outcome of the war and the further security situation dependent on the political situation in the aggressor country.

3.3. How to fund the reconstruction

Without doubt, Ukraine will need considerable financial support from its Western partners on the road to post-war recovery and EU integration. Although the politics of the US, the EU and other Western partners are difficult to predict over a longer time horizon, at present all the key political actors are agreed on the need to support Ukraine.

Since the outbreak of the war, Ukraine has received a remarkable amount of foreign financing from the West; but the total is still insufficient to plug the country's big fiscal gaps. Ukraine urgently needs significant resources from abroad not only for future reconstruction, but to combat the aggressor country and maintain public services in time of war. Currently, the US plays the leading role among foreign donors: in 2022, it allocated the Ukrainian budget USD 8.5bn in grants. By contrast, the EU's contribution was rather modest: USD 2.9bn of total financing, including USD 0.1 bn in grants. Of the EU member states, contributions in excess of USD 0.1bn were made by Germany (USD 1.4bn in total financing, including grants of USD 1.1bn), France (loans of USD 0.3bn) and Italy (a grant of USD 0.3bn).

The EU authorities have already declared that, in the longer term, the EU will lead a major international financial effort to rebuild a free and democratic Ukraine – working with partners such as the G7 and international financial institutions, and in close coordination with Ukraine.¹² To support Ukraine's reconstruction, the EU Commission has proposed setting up a Ukraine Reconstruction platform, with a 'Rebuild Ukraine' Facility as the main instrument for the EU's involvement (through a mixture of grants and loans). The platform is expected to bring together the supporting partners and organisations, including EU member states, other bilateral and multilateral partners and international financial institutions.

These plans and declarations look good on paper, but no legally binding commitments for reconstruction are yet available and the sources of funding for the 'Rebuild Ukraine' Facility have not been settled. It is highly likely that the coordination of these arrangements by the EU member states and approval of the final documents will be a long and convoluted process. But we hope that the EU will stand by Ukraine over the long term and will adhere to its political commitments to be a leading donor in the international reconstruction efforts.

Ukraine's EU-oriented reconstruction must be seen by its Western partners not just as an act of charity, but as a pragmatic policy that is in the West's own interests. Currently, we can see that there is both widespread understanding at the highest political level of the need to rebuild Ukraine in a way that integrates it with the EU, and willingness to fund this effort.¹³ However, the EU must step up its financial efforts in both the short and the long term.

¹² European Commission (2022). Ukraine: Commission presents plans for the Union's immediate response to address Ukraine's financing gap and the longer-term reconstruction. https://www.eeas.europa.eu/delegations/ukraine/ukraine-commission-presents-plans-unions-immediate-response-address-ukraines_en?s=232

¹³ Sandbu, M. (2022). Ukraine's reconstruction plans are appropriately ambitious, Financial Times, 7 July.

The largest share of the total reconstruction and recovery costs is expected to come from public sources, both foreign and domestic. However, the reconstruction of private-sector assets and some categories of public assets in infrastructure sectors could be financed via private capital inflows and some combination of public and private capital. Private-sector inclusion – through some permutations of public-private partnerships – may be desirable in capital-intensive areas. As it seeks to attract private capital, government policy and any incentives for investors should focus on the stimulation of growth in a dynamic, competitive and technologically sophisticated economy and should build sustainable infrastructure in a way that is socially, environmentally and financially responsible.

It must be acknowledged, however, that any hope of attracting private capital will depend greatly on the military situation in eastern Ukraine. A total Ukrainian victory, followed by a peace agreement that is observed by Russia, would make it much easier to attract large-scale private capital in the early stages of reconstruction. However, it is far from clear whether these conditions will emerge. Accordingly, it makes sense to be cautious regarding any assumptions about private capital flows as part of the reconstruction.

Turning to the total of USD 410bn, we face an important question as to whether frozen Russian assets (the reserves of the central bank and the National Wealth Fund, as well as the assets of Russian oligarchs) can be seized to back Ukraine's reconstruction and offset the losses of victims of Russian crimes. As yet there is no clear answer to that question. Only once the judicial issues surrounding Russian asset liquidation are finally sorted out, can the total reconstruction costs in Ukraine start to be apportioned between Russian compensation and Western assistance.

4. CRITICISM OF THE DECENTRALISED APPROACH AND SECTORAL PRIORITIES

4.1. Decentralised approach

A key potential weakness of the Recovery Plan is its decentralised approach. The government's intention is for the National Recovery Plan to provide an overall guiding framework for regional recovery plans and projects. The plan is to concentrate recovery projects in specific regions, where they will be supported by specific international partners. For instance, the UK has agreed to take care of reconstruction in the Kyiv region; Denmark will focus its efforts on Mykolaiv; and Sweden is ready to assist Odesa.

In this regard, some experts have warned that very few people seem to understand how such a decentralised system is supposed to work across the whole country, and how resources from multi-donor funds will be distributed among different regions and different projects. In our opinion, decentralised management of the reconstruction process may perform well in certain elements of local infrastructure and housing, but not as a universal approach to country-wide reconstruction and tackling issues of nationwide importance. A significant proportion of the programmes that make up the Recovery Plan need to be devised and governed at the state level, in order to be effective across the country and encompass all eligible regions. Besides, many programmes have powerful regional spill-over effects that would justify the involvement of national bodies. Among such nationwide programmes, we would include support for the EU's zero-carbon energy transition, the development of value-adding sectors of the

economy, boosting the business environment, resolving logistical bottlenecks, and integration with the EU, including aligning Ukraine's legislation with the EU acquis.

4.2. Questionable priority sectors and flaws in sectoral policy initiatives

The list of priority (value-adding) sectors in the Recovery Plan is headed by steel production, machine building (including for defence needs), agricultural and wood processing, construction and IT. Within agriculture, the government is targeting the development of meat and milk production; the cultivation of vegetables, fruits, berries and seeds; and establishment of production facilities for starch, corn syrup, gluten, lecithin and protein in line with the EU Green Deal. Within metallurgy, we find such priorities as the production of coated steel, plates, rails and girders (up to 5m tonnes), and the construction of additional pelletising capacity for 7m tonnes of DR-grade pellets.

In our opinion, the selection of the priority sectors in the Recovery Plan is backward looking and relies on current business structures. While by no means covering all the priority sectors for development and investment in Ukraine, we would emphasise the good prospects for the digital sector (e-trade and e-commerce, e-governance and e-health, digital transport corridors and smart cities), renewable energy (hydrogen production, wind and solar energy generation)¹⁴ and machine-building (equipment for the energy sector, military machines and equipment, transport vehicles, etc.).

Within the framework of the Recovery Plan, the government estimates the financing needs for the development of the priority manufacturing sectors and agricultural production at USD 50bn. However, the programmes available do not specify the policy instruments that will be used to achieve the goals set; the agencies that will be responsible for implementation; the sources of funding for the sectoral initiatives; or the form that the capital inflows could take.

We can see only that the government plans to launch a programme to fund exporters (including through the mechanism of an export credit agency) and to enhance innovative activity (via financial inducements for producers to cooperate with research institutions, the introduction of a research tax credit and participation in EU programmes). There is no clear provision for the creation either of a structural transformation fund for the national economy or of a reconstruction and development bank (only the possibility is floated), and there is no financing planned for this.

The whole Recovery Plan proposes less than USD 0.1bn for a performance-based grants system for researchers (over the entire period of reconstruction) and less than USD 0.1bn for the creation of 'centres of excellence' (science parks) in cooperation with top international centres. The total amount constitutes only 0.007% of Ukrainian GDP annually. However, in reality the development of modern manufacturing is virtually impossible without significant financing of research, development and innovation (RDI) and technology. In 2020, Landesmann and Stöllinger revealed that within the framework of EU industrial policy, more than EUR 7bn is spent annually on RDI and technology at the EU level, and EUR 9bn at the level of the EU member states (0.11% of GDP annually).¹⁵

¹⁴ Dadabaev, T., Grieveson, R., Holzner, M. and others (2021). Support Facility for the Implementation of the EU-Japan Strategic Partnership Agreement (SPA) / EU Japan Joint Study on Connectivity Cooperation in the Western Balkans, Eastern Partnership Countries and Central Asia.

¹⁵ Landesmann, M. and Stöllinger, R. (2020). The European Union's Industrial Policy: What are the Main Challenges? wiiw Policy Notes and Reports 36. <https://wiiw.ac.at/the-european-union-s-industrial-policy-what-are-the-main-challenges-p-5211.html>

Some sectoral aspects of the National Recovery Plan also suffer from overlapping and poor coordination. As an illustration, so-called 'value-adding' sectors of the economy – agriculture and ferrous metallurgy – are eligible for a broad range of privileges. This approach is reflected in the programme 'economic recovery and development', which to some extent overlaps with the programme 'access to funding with a competitive cost of capital'.

In discussing Ukraine's National Recovery Plan, we should bear in mind the experience of the Balkan states, where underestimation of the role of the manufacturing sector in long-term economic development, lack of restructuring at the micro-level and a low level of support from foreign donors for national industries all served to dampen the whole reconstruction process (see Box 1).

Moreover, in the Ukrainian case, the massive destruction of production assets in the east (where industrial capacities were concentrated) and the fact that Ukraine's national industries anyway lag behind the West technologically highlight further the need to prioritise industrial development by targeting (and properly resourcing) the modernisation of industry.

BOX 1 / STRUCTURAL DEFICIENCIES OF THE RECONSTRUCTION PROGRAMMES AND NEGATIVE ECONOMIC OUTCOMES IN THE BALKAN STATES

In BiH, during the emergency period, the share of official development assistance in GNI was consistently above 20%, and the lion's share of this went on reconstructing war-damaged physical assets, encouraging millions of refugees and displaced persons to return home, and building an institutional framework for sustainable growth. However, less than 3% of development assistance was committed to the production sector. The lack of an industrial policy, the neglect of this issue by international donors and the poor-quality institutional environment in BiH resulted in the anaemic growth of industrial production, continued high unemployment, a growing informal sector, low domestic savings and huge external imbalances.¹⁶

In 1999, Gligorov et al. argued that in the long term, BiH reconstruction should seek to support industrial production and the spread of modern technology. The required sectoral approach to industrial restructuring should, they wrote, involve a strategic review of all sectors; support for viable companies, including the preparation of privatisation plans; training; the encouragement of industrial cooperation; and the development of industrial associations. They also argued that some form of support for the restructuring of large companies was necessary, alongside carefully designed donor programmes of financial assistance to enterprises, and particularly various credit lines.¹⁷

However, this did not happen, and as a consequence the reconstruction efforts in BiH and Kosovo were much less successful (in particular, donors were reluctant to provide finance for the purchase of equipment, and instead focused on small-scale loans towards working capital). In other Balkan countries, the implementation of association and stabilisation agreements with the EU placed them in a position of fierce competition with EU producers, while strong industrial policies and financial support for

¹⁶ Nedic, G. (2006). Financial and Technical Assistance in the Reconstruction and Development of Post-Conflict Bosnia and Herzegovina, wiiw Balkan Observatory, Working paper 073.

¹⁷ Gligorov, V., Kaldor, M. and Tsoukalis, L. (1999). Balkan Reconstruction and European Integration, wiiw Balkan Observatory, Working paper 001.

the development of industries were lacking. As a result, most of the Balkan states have failed to build serious industrial capacity and now run huge trade deficits with the EU and the rest of the world.

Since 2010, Montenegro's current account deficit has ranged from 9% to 26% of GDP; Albania's – from 7% to 13%; Kosovo's – from 4% to 13%; BiH's – from 2% to 9%; and Serbia's – from 3% to 11%. This has locked the Balkan states into a kind of dependency model that revolves around importing goods from the EU and exporting people to the EU core countries. In view of such negative experiences, Ukraine ought to take a balanced industrial policy route.

4.3. Distribution of general financing among sectors

Another area where the National Recovery Plan definitely requires improvement is in the distribution of general financing among the different programmes and the various sectors of the economy. In some cases, the distribution is not well specified and is poorly justified.

For instance, the financing of defence and security needs is put at USD 50bn, including the military assistance that Ukraine has received in 2022 from its allies to fight the war. We consider this estimate to be on the low side, given the intensity of the military conflict with the Russian army and Ukraine's high dependency on Western weapons during the war – to say nothing of the huge challenges the country will face in transforming its defence industry and modernising its armed forces in the post-war period.

Within the framework of the 'defence and security' element of the National Recovery Plan, the government intends to develop the aviation industry and armoured vehicle production; to start radar production and military shipbuilding; to pursue a programme of missile weapons development; and to undertake a comprehensive rearmament of the Ukrainian armed forces. The earlier experience of war-ravaged countries suggests that measures of this kind are costly and may exceed the amount of official development assistance.

In BiH, total disbursements of official development assistance approached USD 6.8bn from 1996 to 2004. Meanwhile, international support for the establishment and maintenance of security in BiH exceeded USD 18bn over the same period, with the bulk of the costs associated with the international military and police presence. US assistance for Iraq's reconstruction in 2013-2014 amounted to USD 60.6bn, 45% of which was directed toward national defence, including training and the technical upgrading of the Iraqi security forces.

Meanwhile, in contrast to its plans for defence and security, the National Recovery Plan assigns very large resources to such programmes as 'ensuring competitive access to funding' (USD 75bn) and 'developing culture and sport systems' (USD 15-20bn). The most significant components of the former programme are (i) developing covered financing to encourage mortgage lending, supported by international financial institutions (IFIs) with funding from institutional investors; and (ii) strengthening banking capital, i.e. bank recapitalisation to sustain lending growth. The government puts the funding needs for the first component at USD 40bn and the needs of the second component at USD 15-20bn.

In our opinion, the selection of mortgage lending promotion and bank recapitalisation by public funds as priorities for Ukraine's post-war reconstruction is dubious and inexplicable. Moreover, the amount of money planned for implementation of these projects is very large. Bank recapitalisation to the tune of USD 15-20bn would further boost the already-high share of state participation in the banking system. As of July 2022, the share of the four state-owned banks in the total net assets of Ukraine's banking system constituted 50.1%. The government has previously declared – on many occasions – its intention of privatising either partially or completely some of the state-owned banks, in order to improve the efficiency of financial intermediation.

The details of the mortgage lending scheme to be supported by IFIs and institutional investors are not clear from the plan, and nor is the structure of the USD 40bn package. But it is worth pointing out that USD 40bn is equivalent to one third of Ukraine's GDP forecast for 2022. Moreover, the plans for the influx of foreign capital to develop mortgage lending do not square with the volume of domestic resources allocated for this purpose (as of September 2022, the portfolio of mortgage lending by Ukrainian banks constituted the equivalent of only USD 3bn).

Clearly, in terms of efficiency considerations and the overall impact on Ukraine's economy, the recapitalisation of banks with public funds and a focus on less than transparent mortgage schemes are not the best options for the distribution of donor assistance.

5. OVERLAPS AND INCONSISTENCIES

In addition to the criticisms outlined in chapters 3 and 4, we also identify some contradictions and inconsistencies in the Recovery Plan that indicate a lack of harmonisation and poor coordination of the various vectors of reconstruction and related activities. We highlight five examples. Each of these shortcomings and drawbacks need to be eliminated, in order to make the National Recovery Plan consistent, comprehensive and as well suited as it can be to Ukraine's challenges, including the EU integration agenda.

First, we see an inconsistency between various laissez-faire measures and the plans for major economic restructuring and an active industrial policy. Targeted deregulation and the simplification of government–business relations to improve the business environment coexist with projected intervention to support large-scale economic restructuring and the development of high-value-added industries.

On the one hand, many laissez-faire measures are included in the plan (deregulation of business activities, cut in taxes, liberalisation of labour legislation, privatisation of state-owned enterprises, etc.). The government envisages launching large-scale deregulation, reviewing the different regulations, establishing a foundation for business self-regulation, and taking steps to enhance competition (p.10 of the economic recovery chapter of the plan in Ukrainian).

But on the other hand, the government is also planning for the rapid development of new private industrial production facilities within the framework of economic indicative planning. It is planning on the basis of available production capacities and raw materials, calculating the necessary new capacities and raw materials in the light of projected demand, and shaping a set of incentives and guarantees for

investors. Such measures, along with the creation of conditions conducive to the post-war reconstruction of the steel industry and other branch-related measures, have little in common with the declared objectives of business self-regulation (p.16 of the economic recovery chapter).

Second, the targeted reductions in the number and volume of tax exemptions (contained in the chapter on the financial sector) run counter to the huge tax exemptions contained in the chapter on economic development. One reform of the financial system consists in reducing the amount and scope of tax privileges and developing a unified state approach to their introduction and control (p.44 of the financial system chapter of the plan in Ukrainian). Meanwhile, the working group on economic recovery suggests: (i) cancelling import duties on raw materials and inventories that are not produced in Ukraine or that are produced in quantities significantly below those required by industry; (ii) providing tax and customs privileges for the recovery of destroyed/damaged industrial enterprises: channelling the income tax to rehabilitation projects, the cancellation of VAT and import duty on new foreign equipment and components (pp.11-12 of the economic recovery chapter of the plan in Ukrainian).

Third, there are potential inconsistencies between the desire for European integration and stated domestic policy measures that could come into conflict with that process. For example, the process of European integration and the alignment of national legislation with the EU acquis is combined with a ban on VAT reimbursements for exports of raw materials and large state support for Ukraine's industries (pp. 11-12 and 26 of the economic recovery chapter). Government fiscal initiatives omit the fact that the EU-Ukraine Association agreement and EU Council Directives require the harmonisation of indirect taxation between member states and the EU's partners (including VAT reimbursement), as well as the fulfilment of EU Directives on state aid and competition policy.

Fourth, plans to improve access to capital at affordable rates are a welcome inclusion, but need more thought. The programme 'providing access to funding with competitive cost of capital' is an important element of the Recovery Plan. It is laudable that the government is focusing its efforts on this powerful lever of economic recovery and sustainable development. However, the formulation of this programme is not perfect and the wording of some of the projects in the National Plan is strange. To illustrate the point, two of the seven core projects are phrased thus: 'consider a possibility to establish a development bank' and 'consider a systemic solution to clean up banks' balance sheets and resolve non-performing loans (including "bad bank" option)'. It is a well-known fact that when projects talk of 'considering possibilities', it is highly likely that their effectiveness and implementation will be close to zero.

One significant drawback of this programme is associated with its vague and weak components. In fact, little is proposed in relation to the stimulus measures that were employed prior to the war. For instance, attracting deposits to banks or strengthening bank capital (envisaged by the programme) is unlikely to result in the extension of bank loans to business. In the period 2017-2022, Ukrainian banks were overcapitalised and disposed of abundant liquidity, at the same time as the country had the lowest ratio of banking loans to GDP in Europe.

In addition, the introduction of war insurance for investment projects in the priority sectors and the improvement of the '5-7-9' programme¹⁸ for certain categories of borrowers are welcome elements of the National Recovery Plan. But these measures are unlikely to change substantially the situation

¹⁸ '5-7-9' is a nationwide crediting programme for Ukrainian SMEs, carried out by banks and subsidised by the Government in part of interest rates on released loans.

whereby business finds the cost of the loans too high (as was the case on the Ukrainian financial market both before and during the war). Moreover, as we emphasised above, the financial plans for some projects seem ill-founded (e.g. USD 40bn to encourage mortgage lending, supported by IFIs, or USD 15-20bn for bank recapitalisation).

Fifth and finally, we identify poor balancing of the different policy initiatives within the framework of the national budget and a disregard for the fiscal implications of some of the measures anticipated. To illustrate this point, one of the key reforms planned by the government within the economic recovery chapter is 'revivification of SMEs due to deregulation, reduced tax burden, increased access to knowledge...'. Activity 2.2.8 clearly prescribes a 'reduction of fiscal load upon businesses and population to the level that stimulates economic growth, namely no more than 30% of GDP'.

However, tax cuts for business are not compatible with huge investment in infrastructure, the reimbursement of war-driven losses for businesses and households or massive fiscal support for enterprises in priority sectors. Obviously, tax relief may be introduced as a short-term emergency measure in the extraordinary conditions. But the Recovery Plan is long term in nature and envisages profound structural reform. In that context, the rather moderate existing tax burden in Ukraine (as compared to other European countries) and the fiscal sustainability concerns (that appeared following the Russian aggression) render the planned tax-easing reform meaningless.

An expanding fiscal deficit driven by tax cuts is also at odds with the goal of reducing public debt, as set out in the National Recovery Plan. The chapter 'financial system functioning, reform and development' prescribes a gradual reduction in the ratio of total public debt and state-guaranteed debt to GDP to pre-war levels, with that target being reached by 2035.

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