Ukraine’s Future Depends on a Vibrant Private Sector

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The private sector is the main motor of growth of any functioning market economy, creating jobs; introducing new products, services, and processes; and transferring technology and know-how. In particular, small and medium-sized enterprises (SMEs) represent 90 percent of all business activity worldwide and contribute over 50 percent of global employment. Companies are also major sources of tax revenue for governments, helping fund public services. This is the case in Ukraine, where the private sector—comprising approximately 1.6 million individual entrepreneurs, 400,000 SMEs, and 500 large enterprises—contributes significantly to the economy and society at large.

Unfortunately, the war has affected businesses across sectors of the Ukrainian economy, damaging facilities and logistics routes and disrupting supply chains, leading to sales losses and unemployment. Ukraine is fighting as much a military war against Russia as an economic war. The enemy is trying not only to occupy land, wipe out physical infrastructure, and inflict mass civilian casualties but also to cripple the economy, targeting critical industries including transport and logistics, agriculture, energy, digital, and the defense industrial base. Ukraine’s future depends on the outcomes on the battlefield as much as on the economic front.

Despite the war, the private sector has exhibited remarkable resilience. According to the American Chamber of Commerce’s September 2023 Ukraine survey, even one and a half years into the conflict, 98 percent of its member companies were still operational in Ukraine. Although GDP fell by nearly 30 percent in 2022, it is forecast to grow by 3.5 percent in 2023, partly due to the resilient information technology (IT) sector and the rerouting of exports. Since the war started, Ukraine attracted more than $500 million in new investments, according to data by UkraineInvest, the country’s investment promotion agency. These new investments are taking place in regions that are not under active combat, such as the western and central parts of the country. A large portion of Ukraine—close to 85 percent of its territory—is
unoccupied, where businesses can operate and grow. The Global Business for Ukraine’s investment map showcases 146 investment-ready projects totaling $4.9 billion.\(^7\) On the other hand, large reconstruction projects in the east and southeast of Ukraine (regions that have been heavily destroyed) will probably have to wait until the war is over.

Ukraine’s allies and partners are supporting Ukraine’s right to defend itself by providing military aid. Through humanitarian and budgetary assistance—which pays the salaries of soldiers, pensioners, and teachers and finances essential public services—they are also helping the economy stay afloat. However, only a small part of this aid is being directed to help current businesses and attract new investors. Moreover, the war continues, and a political settlement is unlikely anytime soon. This complicates the situation of the private sector. Donor countries will continue supporting Ukraine, but these amounts will likely decline over time and fulfill only part of the country’s financial needs. The international community needs to work with the government of Ukraine to spur business and attract new investments into the country so they can create jobs and generate tax revenues. International financial institutions (IFIs) and development finance institutions (DFIs) could do more in this area, even amid the war.

Ukrainian businesses have many financing needs at the moment, in particular equity investments. The capital needs are immense. The destruction of manufacturing facilities, logistical lines, and supply chains has forced some companies to rebuild their business models from scratch. Some companies were able to adapt to the war, but in many cases they require capital. The impact that new capital can produce in this environment is enormous.

IFIs and donors are exploring new finance mechanisms to support the private sector in Ukraine.\(^8\) They are also providing technical and legal advice on how to reform laws (e.g., the public-private partnership law) and important institutions so Ukraine can become “investor-ready.” However, as they approach operations in Ukraine, they need to be more creative, coordinated, and willing to take risks. They must devise new instruments to leverage private capital for smaller projects that could provide demonstration effects for other investors. Although these institutions are doing incredible work to support the economy, they have not adapted their business model to operate more creatively in a war zone.

IFIs and DFIs could set up new finance vehicles, such as investment funds where donors would provide a first-loss tranche to attract other investors. These funds could potentially be funded by using frozen Russian central bank assets worth $300 billion, or the interest proceeds, which in Europe amount to $3 billion a year. In addition, DFIs could ramp up existing risk mitigation mechanisms such as loan portfolio guarantees, which would help existing businesses access finance at reasonable rates. One example is the support that the U.S. International Development Finance Corporation (DFC) is lending to the Bank Lviv. Although these amounts are small, this instrument could be expanded. Additionally, a more coordinated and scalable political risk (or war risk) insurance mechanism may create the confidence needed for private sector investments to flow into Ukraine. The European Bank for Reconstruction and Development (EBRD) is working on such a scheme, but it is still not operational.

Investors also want to see more significant governance and economic reforms in Ukraine to improve the business climate in the country. This includes turbocharging anti-corruption efforts, devising a clear strategy to restructure state-owned enterprises and inefficient businesses, and de-oligarchizing the economy. This reform agenda must align with the conditions under Ukraine’s EU accession process to ensure harmonization with EU laws and standards.

Fighting corruption is paramount if Ukraine wants to attract investments and join the European family. Society at large considers corruption as the number two problem in the country after the war, according to a recent survey.\(^9\) The latest edition of Transparency International’s Corruption Perception Index shows that Ukraine still scores poorly at 36 points out of 100 (half of France’s score and 18 points behind Poland).\(^10\) However, Ukraine has made strong inroads in the fight against corruption, including increased criminal proceedings against suspected
perpetrators, judiciary reforms, a competitive selection process for the heads of the main anti-corruption agencies, and improvements in public procurement. This is an area where the international community can play a critical role, providing both advice and pressure for reforms. Ukrainian civil society and independent journalists are important allies in this fight. Ukraine still has a long road ahead but must keep this momentum.

Ukraine’s future membership in the European Union is also a big incentive for investors. Ukraine’s entry into the European Union will provide companies with enough confidence that there is a level playing field for doing business in the country. Moreover, it will give companies access to more than 40 million consumers in Ukraine, with an added 450 million consumers in the European Union. Recent investor surveys point out that access to the EU market and EU product quality and standards are key to future business opportunities in Ukraine.\textsuperscript{11}

Ukraine has huge investment potential given its low-cost skilled labor, a market size of more than 40 million consumers, and proximity to the EU market. There are many business opportunities in sectors such as oil and gas, strategic minerals, IT, and agriculture.\textsuperscript{12} Ukraine also has the potential to become a manufacturing hub for its neighborhood, reaching more than 800 million consumers.

As Ukraine moves away from its Soviet past and looks toward a bright economic future, developing a strong and vibrant private sector will provide tax revenues, jobs, and economic security. The international community can help provide more predictability and stability for companies operating in Ukraine and create innovative mechanisms to attract private capital. It might be risky to invest in Ukraine during wartime, but not investing is a larger missed opportunity. Ukrainians cannot wait until a peace settlement is reached. With the prospect that economic assistance will not last forever, the international community needs to find ways to make the economy more self-sufficient. The time to act is now.

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