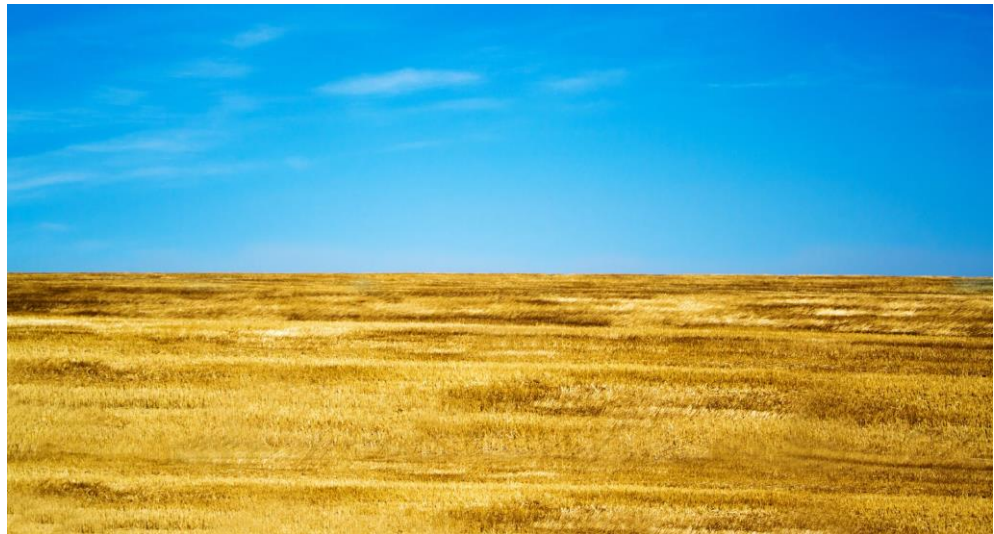




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Wilton Park



Report

The role of the private sector in Ukraine's recovery and reconstruction

Tuesday 29 November – Friday 2 December 2022 | WP3177

Held in Warsaw, Poland

In partnership with

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Introduction

Despite ongoing fighting and a recent increase in Russian attacks to Ukraine's energy and other critical infrastructure, early planning for reconstruction is essential. Given the resources required, the international private sector must play a central role in supporting Ukraine's National Recovery Plan. This event, convened in Warsaw, Poland explored the actions, changes and conditions needed to facilitate sustainable reconstruction and support Ukraine's economic future.

The three-day Wilton Park dialogue, hosted in partnership with Washington DC based think tank the Center for Strategic and International Studies (CSIS) brought together a diverse set of participants from a range of sectors including: international finance institutions, Ukrainian and international private sector companies, Ukraine's national government, leading partner governments and the EU. It sought to identify the key actions required to enable private sector investment and assistance to Ukraine, feeding into wider international coordination and reconstruction efforts including next year's Ukraine Recovery Conference (URC23) in London. Discussions ranged from identifying immediate 'quick wins' that can foster a more effective business enabling environment, to longer term structural changes including EU and OECD accession processes that can further attract private sector investment.

"Ukraine is a bulwark against Russian aggression, so it is really important that we ensure that it is successful, economically developed and economically stable enough to fund its own defence"

Executive Summary

- The impact of Russia's illegal and brutal invasion of Ukraine has been devastating, leading to significant loss of life and destruction of essential infrastructure, including energy, housing, hospitals, and schools. This destruction has caused the economy to contract significantly. The cost of Ukraine's reconstruction will be immense, and donors, International Finance Institutions (IFIs), Development Finance Institutions (DFIs), and EU and G7 allied governments will not have enough capital to cover the costs. Therefore, the private sector will play a critical role in Ukraine's reconstruction.
- However, the global private sector is currently unwilling to take on the risks associated with investing in Ukraine, due to the continuing conflict and concerns about corruption, rule of law, governance, and oligarchy in Ukraine that predated the war.
- While important progress has already been achieved, the Ukrainian government must make significant further reforms on transparency and accountability to create a strong business enabling environment for attracting private sector investment. Ukraine's strong civil society can be crucial in monitoring the reform process and providing accountability.
- The EU (and OECD) accession process will greatly motivate necessary governance reforms. The accession process will require Ukraine to implement

procurement, financial management, technical regulation, and standards, all of which will help attract private sector investment.

- Multilateral and bilateral finance institutions will also play a key role in attracting private sector investment to Ukraine through myriad financial instruments including blended finance, guarantees, first loss coverage, risk insurance, and trade facilitation.
- Although the task is immense, there are small reconstruction projects the international community can start now to create investor confidence and can scale up during later reconstruction phases. There is tremendous potential in the digital sector, which has proven its resilience throughout the conflict and can be used to build capacity for Ukraine's skilled workforce.
- The organisers for the upcoming Ukraine Recovery Conference in the United Kingdom and any other Ukraine reconstruction conferences the Swedish, Spanish, or Japanese governments host as part of their respective EU and G7 presidencies should aim to find actionable solutions for one or two of the challenges listed above to support Ukraine's reconstruction.
- A successful reconstruction process will end in a Ukraine firmly embedded in the Euro-Atlantic community, a green, modern, innovative, and inclusive economy, and a thriving civil society and private sector.

“Many production facilities have been partially or completely physically destroyed while supply chains have been broken in many ways”

Current Needs and Situation in Ukraine

1. With the continuing Russian attacks on Ukraine, there are immediate emergencies that need to be addressed. However, it is critical that Ukraine and its partners build early-phase reconstruction projects into current efforts and that medium and long-term reconstruction planning begins now.
2. As of September, the World Bank estimated the cost of rebuilding Ukraine to be \$350 billion. Small and Medium-Sized Enterprises (SMEs) losses are over \$103 billion, and experts predict Ukraine's GDP will contract by 30 percent.
3. The most significant challenges facing the private sector are access to finance and the logistics of exporting goods.
4. The Ukrainian people have shown immense resilience throughout the conflict. Only 11 percent of business owners have decided to shut down, and 85 percent of companies have announced they are ready to join reconstruction efforts. Ukrainians also have immense technical knowledge, which will support reconstruction efforts.

A Successful Reconstruction of Ukraine

5. All recovery efforts should be carried out with the goal to build back better and create a modern, green, innovative, and inclusive Ukrainian economy.
6. Ukraine and its allies should link reconstruction to EU and OECD Accession. Governance, trade, and business enabling environment reforms must comply with EU standards, which will help connect Ukraine to the global private sector and create a Ukraine firmly embedded in the Euro-Atlantic community.
7. Building social infrastructure such as schools, hospitals, and housing will be key to attracting Ukrainian refugees back, who will play an essential role in stimulating economic growth.

8. Ukraine's strong civil society will play a critical role in reconstruction efforts. Civil society has already been essential during the war, working with the private sector and government to provide urgent humanitarian aid. During reconstruction, they can support local capacity, which will be a critical piece of government decentralisation. Before the war started, Ukrainian civil society monitored government reforms. It will need to continue to do so as Ukraine moves towards implementing the standards and regulations of EU accession.
9. The reconstruction of Ukraine will likely need to be carried out in phases:
10. ***In the short term***, the international community should focus on providing immediate assistance and rebuilding critical structures in Western Ukraine and recently liberated territories. Some of these projects, especially in Lviv, have already started. In the short term, the international community can also support the capacity building of the Ukrainian workforce, especially in implementing the standards required for EU Accession and trade facilitation. Given that Russia's recent attacks have been focused primarily on the energy sector, Ukraine and its partners must create alternative sources. One way to do this is to create an energy grid service warehouse in Poland to store critical equipment necessary for rebuilding the sector. The Ukrainian government can take steps toward governance reforms in the short term. One possibility to do this is to create a de-oligarchization pilot program in either gas or electricity distribution.
11. ***In the medium term***, the Ukrainian government can move to expand the de-oligarchization pilot program. In the energy sector, any rebuilding efforts must consider market standards, capacity, and security considerations to ensure sustainability moving forward. Medium-term reconstruction should also focus on developing public-private partnerships that can spur investment. The government should begin as well to resolve trade and tariff issues to ensure that any private investors who want to come in do not face unnecessary barriers.
12. ***In the long term***, the government should do a national rollout of privatisation based on the de-oligarchization pilot program. The Ukrainian government and its partners should also develop a long-term reconstruction strategy, for which planning has already started, that is based on energy security, resilience, and balance. The design should include coordination mechanisms and multistakeholder dialogue. Continued IFI support in project preparation and de-risking efforts will be critical in long-term reconstruction. Finally, the government must be transparent in all reconstruction efforts to create investor confidence. Long-term planning also requires some form of security guarantee from Russian attacks that makes infrastructure investments possible.

Key Sectors for Reconstruction

13. ***Energy***: Russia's attacks have focused primarily on Ukraine's energy infrastructure. The damage has been immense, with estimates of current destruction at \$8 billion. In the case of energy, significant immediate needs include generators, gas, transformers, and heaters to help Ukrainians survive the winter. However, there will also be immense opportunities for the private sector to invest in helping to rebuild Ukraine's energy sector. For example, licensing auctions for gas production are already taking place.
14. ***Agriculture***: Before the war, agriculture was one of the Ukrainian economy's key sectors, accounting for 41 percent of exports. In 2022, half of all agricultural producers could not produce crops to sell the following year. Agricultural producers' inability to export will significantly impact Ukraine's economy, worldwide food supply chains, and the cost of food. The current challenges facing the sector are a lack of transportation options, both rail within Ukraine and ports for exports, a reduction in the energy supply necessary for production, and the destruction and inoperability of storage. Given its centrality to the Ukrainian economy and world food supply, agriculture will be a central piece of reconstruction.

“Ukraine’s long-term vision needs to be not to rebuild what was before; we need to rebuild based on new technologies, based on new innovations”

“Linking Ukraine to the European Union needs to be the North Star for all Ukraine’s reconstruction”

15. **Digital:** The digital sector is unique in its resilience and immense potential throughout the war. Since the start of the war, it has grown and, during the war, has been utilised to provide employment and capacity-building training to address rising unemployment concerns—the Diia.App is an important example of the sector’s resilience. Ukrainian Internally Displaced Persons (IDPs) can use it to update their residency information, and refugees in Poland can also use it for identification purposes. Digital technology has the potential to be an enabler behind a modern reconstruction of all other sectors. Digital can also be an early sector for the private sector to invest in, given its smaller physical footprint and lower risk. These early investments will create broader comfort for potential investors in Ukraine. Ensuring that Intellectual Property protections are in place will also be critical to attracting investment. Finally, the digitalisation of government documents will help provide accountability mechanisms for civil society over the ongoing reform efforts.
16. **Social Infrastructure:** Rebuilding houses, schools, and hospitals will be a critical piece in attracting the Ukrainian workforce back, which will play a key role in promoting economic growth. Beyond these physical pieces, reconstruction efforts will also require a particular focus on creating social cohesion and providing mental health support.

EU Accession

17. A prosperous Ukraine is one firmly embedded in the Euro-Atlantic community. EU Accession will play a critical role in solidifying this move.
18. The trade and economic benefits of joining the EU will also be an important motivator for Ukraine to make the reforms it needs to attract private-sector investment. Therefore, any conditionality for aid the international community places on Ukraine should be aligned with the requirements associated with EU accession.
19. EU standards are important for creating a stable and successful economy. They include open and transparent government procurement, public financial management, liberalisation of the economy, sustainable climate requirements, customs conventions, and technical regulation requirements.

Coordination Among Donor Governments, IFI’s, and DFI’s

20. The US, EU, other G7 governments, Development Finance Institutions, International Finance Institutions, and the private sector will all need to be involved in addressing the immense challenge of reconstructing Ukraine. On the donor side, there must be coordination to ensure there is no duplication of efforts and that the international community uses the limited available resources effectively in order to maximize impact.
21. Although some coordination is already taking place, there should be an official structure. There are a number of organisational structures that coordination efforts could take:
 - (a) A secretariat at the G7 level, with significant input or co-ownership on the part of the Ukrainian government and its reconstruction plans.
 - (b) A Global Fund for Reconstruction: this fund could have shared ownership between Western governments, Ukraine, and the private sector. Private investors could buy an equity stake and the fund would eventually end up in Ukrainian hands.
 - (c) A Ministry for Reconstruction, Recovery, and Modernisation in the Ukrainian government.
22. Each option should have clear leadership and involvement from the Ukrainian government and its vision for reconstruction.

“We need to ensure that there is some agency or champion for Ukraine to sustain the support after the conflict ends and to ensure successful reconstruction”

Government Accountability and a Strong Business Enabling Environment

23. A critical piece for Ukraine to attract private sector investment will be implementing judicial, rule of law, institutional, and governance reforms to create a strong business enabling environment. These reforms should align with the requirements for EU Accession, and the government can accomplish them through transparency, simplification, and digitalisation.
24. Rule of law will be one of the most critical elements for Ukraine to succeed in its governance reforms. Starting in 2014, Ukraine made substantial progress by changing judges and creating new chambers within the Supreme Court. However, the government put many of these reforms on hold during the conflict. Ukraine must continue to make reforms to the judicial system in a manner that will provide investors with confidence that effective, fair litigation measures are in place to protect their assets. Currently, only three percent of business-related investigations end up in trial, and one percent in convictions. During reconstruction, the bodies that dismiss or appoint new judges must continue. The government's reforms to the Supreme Court before the war must also trickle down to appeals courts as part of the reconstruction.
25. Ukraine can also attract private sector investors and address its budget deficit through tax and regulatory reforms. International investors need stability, simplicity, and predictability through strong laws in Ukraine. One way this can be accomplished in the medium term is for Ukraine to come to a special international agreement that protects foreign investors and gives an attractive tax rate to foreign investors.
26. Another crucial part of reforms will be privatisation. Currently, Ukraine has 3000 State-Owned-Enterprises (SOEs), while Germany only has ten. This causes concern for potential investors over preferential treatment for SOEs in government auctions or judicial proceedings. Four of Ukraine's five top banks are also state-owned. Organisations such as The World Bank Group's International Finance Corporation (IFC) rarely work with national banks, making addressing access to financing options for SMEs complex. Efforts to privatise banks before the war must be continued as part of reconstruction.
27. Oligarchs and vested interests present another significant challenge for attracting private sector investors because of their preferential treatment. To address these issues, Ukraine must deal with the underlying causes, including the opportunities for big businesses to distort the playing field. Creating a truly level playing field for the whole private sector is important to attracting investment for reconstruction.
28. To attract international investment, Ukraine must become a functioning and stable market economy with strong capital markets and rule of law. The reforms required to attract investment can be accomplished by adopting the standards required by EU Accession. The Ukrainian government and people want to become a member of the EU and are already taking steps to implement those standards and regulations.

Instruments Available to the IFIs and Donor Community

29. One of the most significant challenges to Ukraine's reconstruction will be access to finance, given the high levels of risk associated with active conflict and corruption concerns. IFIs, DFIs, and aid agencies will play a critical role in providing initial financing to the Ukrainian private sector and creating investor confidence for the global private sector to invest in Ukraine. They have several tools available, including but not limited to the following:

30. **Guarantees** are a legally binding agreement that requires the guarantor to cover an agreed amount of a loan if non-payment occurs. Bilateral and multilateral development agencies can use them to reduce an investor's exposure and risk, thereby increasing capital flowing into Ukraine. Guarantees provide risk coverage so they can help spur investment.
31. **Risk Insurance** provides coverage to investors, financial institutions, and businesses against various risks, including adverse government actions, war, and sovereign payment defaults. The World Bank's Multilateral Investment Guarantee Agency (MIGA) can provide political risk insurance through guarantees, resolving disputes, and deterring harmful actions as part of its membership in the World Bank Group. However, MIGA has a limited budget available, so insurance would be an area for the private sector to step in, but there are only a few companies with an appetite for this type of risk. One outlier is Lloyds of London in the UK, which helped provide insurance to the UN grain export deal. However, this is a unique situation because the ships did not spend much time in Ukraine and the international community was able to provide enough intelligence to lower risk. Perhaps this type of agreement can be extended on a case-by-case basis.
32. **First Loss Coverage** enables multilateral institutions, including the World Bank, to enhance credit by agreeing to cover part of an investor's financial loss. This type of coverage helps investors take on more risk than they are comfortable with and is critical to enabling private sector engagement in Ukraine to build confidence throughout the reconstruction process.
33. **Blended Finance** is the strategic use of development finance to help mobilise funds, including private resources, and consists of concessional financing from donors, the institution's capital, and financing from investors. Using blended finance in Ukraine will help bilateral and multilateral institutions multiply their limited capital.
34. Although all of these development finance tools will play a critical role in Ukraine's reconstruction, there are a number of challenges facing the IFIs and DFIs hoping to use them. First, organisations such as the IFC and EBRD currently have a triple-A rating and are, therefore, unwilling to take such high levels of risk that would jeopardise this rating. The second challenge is that they only have limited access to capital and guarantees and cannot address the immense needs of Ukraine alone.

Immediate Wins – What can be done now

35. Ukraine's reconstruction will be an immense task, but efforts must start as soon as possible, even if they are small. Identifying lower-cost projects that face less risk of destruction will be critical, especially for IFIs and DFIs. The success of these smaller projects will make a difference to Ukrainians now and constitute an important signal to the private sector. These projects can also be scaled up at later stages of reconstruction.
36. Capacity building is another vital part of reconstruction that can be completed now. The international community can provide training through digital mechanisms to help the Ukrainian workforce prepare for reconstruction. Project management skills will be a critical need given the vast scale of reconstruction.
37. The international community can also remove tariffs on Ukrainian exports, making it easier for businesses to export their goods. The Ukrainian government and its European partners can make improvements now on various customs conventions. Export licensing know how within both government and businesses could constitute another important area for capacity building.
38. At a time when the Ukrainian government is facing a huge budget deficit, tax revenues will be critical. Therefore, the government should create a Diia.City type tax regime that digitalises the process and simplifies reporting.

39. The Ukrainian government must communicate transparently with the international community and the global private sector, which will build participant confidence and make opportunities for investment clear.

Janina Staguhn

Wilton Park | 16 December 2022

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