

Ukraine: Resilient Spirit but Fragile Economy

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In 2014, Russia invaded Ukraine, occupied part of the eastern territories, and annexed Crimea. As a result, the country faced enormous challenges, with a substantial drop in Ukraine's GDP in 2014 and 2015. But, despite the war, Ukraine has managed to implement reforms, maintaining economic resilience. The electronic public procurement system Prozorro was created and received the World Procurement Award. Ukraine became one of the leaders in fiscal transparency. It also managed to reduce its debt-to-GDP ratio from 80% at the end of 2016 to 50% by the end of 2019 and kept it at that level throughout the COVID-19 pandemic years. The banking system became sound. The Ukrainian government also started many reforms in the SOE corporate governance, the energy market, and other areas. These reforms allowed Ukraine to remain resilient even after Russia started a full-scale invasion of the country on February 24, 2022. This gave time for international partners to make decisions and start strong international support for Ukraine while more extensive sanctions were introduced against Russia.

Moreover, reforms continued during the full-scale war, with their recognition culminating in the EU's decision to open accession negotiations. International assistance is currently provided according to the principle 'money for reforms'. As a result, according to the Government Reform Matrix, Ukraine has already more than 200 reforms, which correspond to over 400 actions to be fulfilled. This does not include 3,000 legislative and normative acts that Ukraine should harmonize with the EU acquis. These reforms aim to strengthen Ukraine and ensure robust economic recovery. Currently, despite a full-fledged war, Ukraine is on track with the implementation of reform plans.

However, Ukraine's economic situation remains challenging, and there is a high need for international defense and financial assistance.

- In 2023, Ukraine's real GDP grew by 5.3%, supported by a recovery in agriculture, increased manufacturing output, and the stabilization of consumer demand. Despite these positive trends, economic recovery remains fragile as war continues to disrupt key sectors. The energy sector, in particular, has been severely impacted by the loss of generation capacity, which constrains economic growth. According to the consensus forecast, GDP growth for 2024 is estimated at 3.5% and projected at 2.9% in 2025, driven by increased private consumption and investments (including contribution of the defense industry). However, **Ukraine's economy will remain almost 20% smaller than its pre-full-scale war** levels because of territorial losses, population displacement, damage of infrastructure, and destroyed businesses.
- **The economic situation is highly dependent on the situation on the battlefield as well as on the availability of air defense systems and munitions.** According to the IER business survey, the biggest impediments for business operations usually are 'danger to work' and 'lack of the access to electricity', which are the results of Russian missile and drone attacks. Therefore, there is a high need for more air defense systems to protect energy infrastructure, seaports, businesses, and civilians.
- **Ukraine's energy sector remains under severe strain, exacerbated by repeated Russian attacks on power generation and transmission facilities.** The loss of over 9 GW of power generation capacity has affected both households and small, medium and large companies, particularly in energy-intensive sectors such as metallurgy and manufacturing. As of October 2024, imports and emergency repairs have alleviated some pressure, but the industry remains highly vulnerable to further disruptions. Ukraine will need substantial investments to rebuild its energy infrastructure and secure reliable power supplies. The government has allocated about USD 250 m for infrastructure protection and launched support schemes

for setting up new generation, which will only partially address the existing gaps. The coming winter will bring further challenges, including potential outages due to deficit and continued dependence on electricity imports from neighboring countries. Therefore, international support with all possible means is urgently required. This includes provision of both financing and in-kind assistance (spare parts for repairs of damaged energy networks and plants, gas peakers, cogeneration units, etc.).

- **Ukraine's fiscal challenges remain acute, with almost half of central expenditures financed by international assistance.** This is due to an urgent need to increase defense and security fiscal spending, which account for more than half of government spending. The delay in international assistance at the beginning of 2024 was detrimental to the fiscal situation overall and defense financing in particular.
- **The fiscal gap is close to USD 40 bn for 2024 and 2025.** The EU's Ukraine Facility, which has provided EUR 50 bn over four years, is crucial but insufficient to meet all of Ukraine's needs. While the IMF's current program allows Ukraine to refinance previous debts, it offers limited new funding. However, the program is crucial as it is essential to a broader international assistance package. The US approved the decision to provide Ukraine with USD 7.2 bn in 2024, with only USD 3.8 bn provided so far. As of October 2024, grants and concessional loans from the US and EU continue to support the budget, but additional commitments—particularly from the US—are necessary to ensure fiscal sustainability.
- **The fiscal situation for 2025 remains challenging.** Ukraine's government has submitted a draft budget, which anticipates an external financing requirement at over USD 38 bn. This funding is expected to come from international donors and financial institutions, though uncertainty persists about the scale and timing of such support. Public debt is forecasted to exceed 100% of GDP by the end of 2025. The government is working to increase revenues through reforms in tax policy and by improving fiscal governance.
- **Ukraine's economic recovery depends on continued international defense and financial assistance, particularly from the US, EU, and other G7 countries.** The USD 50 bn G7 financial package, expected to be repaid using proceeds from seized Russian assets, is critical in addressing Ukraine's fiscal needs. The EU Council has approved a decision to provide EUR 35 bn within this larger G7 package. The money is to be provided in 2025, while the government of Ukraine will have to make savings for 2026 when the need for international assistance remains high and there are no substantial pledges of support. There is a risk that military support might be reduced considering that the EU allows Ukraine to use pledged EUR 35 bn for military and civilian expenditures. This would create a risk of a higher fiscal gap.

Therefore, it is essential that Ukraine's international partners continue to provide military, economic, and technical support to ensure that the country remains resilient. In its turn, Ukraine has remained committed to its reform agenda even during the full-scale war. Reforms in the energy sector, particularly in energy efficiency and renewable energy, will be crucial for the country's long-term sustainability. Additionally, efforts to increase the efficiency of public finance, streamline corporate governance, improve labor market conditions, and enhance public administration will support Ukraine's path toward EU accession. The IMF-supported program and the EU enlargement agenda will continue to provide critical guidance in these reform areas.

RRR4U Consortium (Resilience, Reconstruction and Relief for Ukraine) is comprised of four Ukraine's CSOs – DiXi Group, Institute for Economic Research and Policy Consulting, Center for Economic Strategy, Institute for Analysis and Advocacy. The activities of RRR4U are supported by the International Renaissance Foundation. RRR4U materials are available at <https://rrr4u.org/>