Priorities and mechanisms of industrial recovery of Ukraine

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The war brought massive economic shocks

The Russian aggression has created severe challenges for Ukraine’s real sector, leading to the destruction of production facilities, loss of markets, fall in purchasing capacity, lack of supplies, non-performed external contracts, and personnel deficits.

Ukrainian industrial enterprises faced the following economic shocks:

1. destruction of production facilities
2. disrupted logistics
3. outflow of the workforce, changes in the regional distribution of workers
4. heavy war risks that scare off investors

The area fully occupied or under combat produced around 30% of Ukrainian industrial output before the war. Estimated damages to corporate assets of industry and business services as of November stand at USD 13 billion.¹

The most significant destruction has occurred in the metallurgical industry, where Ukraine lost its most prominent plants – Azovstal and the Metallurgical Plant Illicha in Mariupol in the east of Ukraine. The two plants produced 40% of the entire Ukrainian metallurgy industrial output in 2021.

Another critical loss concerns the oil industry – Russian aggressors destroyed the Kremenchuk Oil Refinery and significant oil reserves during several direct air assaults. In 2021, the refinery accounted for around 40% of gasoline, 15% of diesel, and nearly 60% of aviation kerosene in the country. The destruction has made Ukraine wholly dependent on the import of oil products across the western border.

According to the Ukrainian League of Industrialists and Entrepreneurs estimates, one-third of Ukrainian industry has halted work due to the war and the destruction of production facilities.

The war also disrupted logistics, preventing companies from receiving supplies and raw materials and exporting finished products. The blockade of seaports had the most significant impact since Ukraine transported 65% of its international commodity trade by sea before the war.

The massive outflow of the workforce (especially women) abroad also poses the risk that a significant segment of the population will not return to Ukraine. Many previously active workers joined the military. A decrease in the population and labour force will detrimentally impact the demand for and supply of products. The movement of people to safer western regions and away from the east and south further steered dramatic changes in the regional distribution of workers.

Heavy war risks scare off investors, and ongoing investment projects are frozen, postponed, or cancelled.

Ukraine will need many resources to rebuild its infrastructure and industrial enterprises.

¹ https://damaged.in.ua/damage-assessment
Recovery of industry will depend on the new after-war reality

The industry will face the following trends during its recovery:

1. Relocation of production facilities to western regions of Ukraine
2. Militarization of industry, growth of the state sector
3. Rebuilding under the principle “build back better”
4. EU accession process that will require industry compliance
5. Environmental and climate-change requirements

Relocation of production facilities started at the beginning of the war means that relocated businesses will remain at the new location. The relocation program for enterprises launched by the Ukrainian government has already helped (as of November 2022) to relocate 772 businesses – 605 have already resumed activities.2

The constant threat from Russia means that security concerns will gain importance. Businesses must ensure that their new projects comply with safety and protection requirements tailored to zones facing high risks of attacks. For example, they will have to build bomb shelters for employees, provide alternative energy sources, install electricity generators, and construct distributed storage facilities.

The growing defence sector will provide new business opportunities, especially for machinery producers. More companies will be able to participate in the production of military equipment and procurement at the Ministry of Defence and potentially become competitive in the global weapons market. The Ministry already reports an increased share of private companies in defence procurement.

The robust military sector will also boost Ukraine’s high-tech industry and IT development. Experts predict the rapid development of military tech. The first signs of these developments are already visible – the government announced a hackathon on drone technologies. Ukrainian military tech is actively developing robotics, software for the army, and AR/VR technologies. Ukrainian IT companies produce and operate drones, develop software like Kropyva, Delta, or Bronya that collect and analyze real-time information from the battlefield, and simulate different types of weapons and military equipment for training soldiers. We can expect some spillovers to the consumer market, and the business will adopt innovations developed for the military for public use.

The rebuilding process, which will start after the war’s conclusion, will create demand for construction goods and services, metallurgy, chemical industry, and machine building. The National Recovery Plan, presented by the Ukrainian government, envisages establishing a state production order of critical engineering products (construction equipment, agricultural, transport engineering, school buses, etc.) and provisions to meet the needs of the Armed Forces of Ukraine.

The recovery of the agricultural sector on a new, more industrialized basis and with a larger share of small and individual farms will create increased demand for machinery and equipment for farming, especially from small-sized entities.

In the short and medium term, Ukraine could witness a boost in demand for consumer goods due to the broad need to restore war losses and postponed demand. Over the long term, however, Ukraine will need to cope with its population loss caused directly by war casualties and refugee flows (some migrants will decide not to return to Ukraine). For example, the need for consumer goods, food, and electronics may consequently drop compared to pre-war levels.

During the recovery process, companies will need to abide by the requirements of Ukraine’s accession to the EU. These may include energy efficiency, energy savings obligations, environmental protection, sustainability standards, etc. Industrial producers must comply with European technical standards. The Ukraine-EU Association Agreement signed in 2014 requires Ukraine to adopt 5 000 harmonized and 24 000 European standards. Ukraine has, in fact, already made significant progress in adopting these standards.

The post-war industrial recovery should comply with environmental and climate-change requirements

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that Ukraine must implement as part of its EU accession process. This path calls for a considerably more ambitious transformation of the country. The war has caused significant damage to areas of eastern and south-eastern Ukraine, contributing significantly to the country’s industrial activity. Many production facilities in these heavily polluted areas lie in ruins and must be rebuilt from scratch. The economic recovery of these regions could become a turning point in the country’s green transition.

The Ukrainian government and the EU institutions should plan to rebuild Ukraine. Ukraine will not be able to rebuild alone as it will have no resources. Also, business participation will be crucial.

Recommendations for state authorities

In the short run, to eliminate transport delays and improve the connection of Ukraine, it is necessary to:

- Negotiate with the EU countries the allocation of additional locomotives for the transportation of goods to/from Ukraine
- Increase the capacity of transport networks and transshipment terminals
- Optimize customs operations and other checks with neighboring countries – Poland, Hungary, Romania, Slovakia, and Moldova
- Create conditions for the use of paperless technologies in transport
- Solve the problem of insurance of military risks for freight and passenger transportation

In the medium term, it is necessary to:

- Develop alternative routes for the main transport corridors with particular attention paid to “bottlenecks”
- Electrify the main railway corridors, introduce high-speed passenger, and freight transportation
- Restore the capacity of the sea and river ports of Ukraine, invest in their demining, deepening, clearing, repair, and modernization of port infrastructure
- Create conditions for fair competition in the transportation market. For example, implement the reform of Ukrzaliznytsia, allow private locomotives on the railway network
- Build railways with a European track width (1435 mm) to the largest cities of Ukraine

Recommendations for business

- Businesses must rethink their logistics routes disrupted by the war. The blockade of seaports for anything beyond food exports means that the companies that previously relied on maritime transportation must switch to railways or automotive deliveries. As a result, they must also absorb the inevitable increase in transportation costs and terms of delivery.
- Provide additional capacity for storing goods at the border
- Build multimodal terminals in the west and south of Ukraine for easy transition between different modes of transport
- Apply EU standards in the reconstruction and modernization of Ukrainian infrastructure (access for people with special needs and other low-mobility groups to passenger infrastructure, requirements for environmental protection and sanitary safety during the restoration of houses and engineering structures, the use of alternative energy sources, etc.)