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

BertelsmannStiftung

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Study: Ukraine’s economy has great potential

Six sectors could help Ukraine to succeed economically after the end of the war: renewable energy, rare raw materials, metal processing, mechanical engineering, the food industry, and IT

The reconstruction of Ukraine should be based on the principle of ‘Build Back Better’ as well as the green and digital transformation of its economy. This is the main recommendation of a new study by the Vienna Institute for International Economic Studies (wiiw) and the Bertelsmann Stiftung. Six areas of the Ukrainian economy, in particular, harbour great potential for success and could be of interest to investors: renewable energy, rare raw materials, metal processing, mechanical engineering, the food industry, and IT.

Focusing on these sectors should enable Ukraine to leapfrog in terms of economic development and establish technologically advanced sectors with higher added value. It could also significantly advance the country’s integration into the EU single market even before accession. *‘However, this will require institutional reforms in the areas of the rule of law and anti-corruption, which must be combined with industrial policy and a strategy to attract foreign direct investment,’* says Olga Pindyuk, an expert on Ukraine at wiiw and co-author of the study. In addition, the study’s authors also find that Ukraine should improve its education system.

Policy recommendations for the EU

The study recommends three policies for the EU. *‘In view of the fact that Brussels has a leading role due to its coordination of the EU accession process, it should also fulfil this role in reconstruction,’* emphasises Miriam Kosmehl, Senior Expert for Eastern Europe and EU Neighbourhood at the Bertelsmann Stiftung. *‘If Ukraine and the EU manage this consistently from the outset, the costs of reconstruction and economic modernisation need not be incurred twice.’*

First, the EU should help Ukraine to overcome its weakness in attracting foreign direct investment (FDI), which has been made even more difficult by Russia’s full-scale war of aggression. Nevertheless, focusing on Ukraine’s strengths offers opportunities because it is in line with the EU’s own transformation goals as well as its evolving industrial policy and the Green Deal. A sustainable model for attracting FDI should go beyond low wages and low taxes. *‘To this end, the EU must promote the improvement of labour productivity through the full integration of Ukraine into European education, research and development, and industrial policy programmes as well as better institutions in Ukraine,’* Pindyuk explains.

Second, the EU should improve Ukraine’s access to the internal market and integration into EU value chains in order to achieve greater regulatory harmonisation with EU standards, for example through direct and early involvement in EU initiatives in trade, the Green Deal, and the digital market as well as in terms of infrastructure and connectivity. Temporary trade facilitations should be made permanent instead of giving in to protectionist reflexes, as is currently the case in agriculture and industry, for example. *‘By utilising Ukraine’s comparative* *advantages, the EU's economic independence – for example, in critical raw materials or renewable energy – could also be facilitated,'* Miriam Kosmehl says.

Third, the study calls for close cooperation between the EU and Ukraine in order to develop the latter's industrial policy and align reconstruction efforts with existing economic strengths and promising niches – ideally already during the war.

Foreign direct investment is the key

Attracting FDI will be crucial to Ukraine's success. Private funds have an important role to play in reconstruction, as they can be used more flexibly and in more diverse ways than funds from public and state donors, even though the latter can provide an initial boost. In addition, since FDI is generally accompanied by a transfer of technology and greater integration into global value chains, it could make a huge contribution to Ukraine's integration into the EU single market and the global economy.

Since gaining its independence, Ukraine has faced challenges in its efforts to attract significant amounts of FDI. In fact, with a per capita stock of only around 1,100 euros, Ukraine has one of the lowest FDI stocks among European countries. *'Military security guarantees from the West as well as institutional reforms in the areas of the rule of law and property rights are the necessary prerequisites for the inflow of foreign direct investment on a large scale,'* Pindyuk emphasises.

In recent years, Ukraine has already passed several important laws to promote FDI. In May, the central bank also opened the door even more to private investors by starting to ease foreign exchange restrictions. In what represents a major relief to investors, they are now allowed, within certain limits, to export dividends and pay loans, leases and rents abroad.

Promising IT sector

The information technology (IT) sector offers enormous potential for FDI, has proved to be particularly resilient during the war, and is one of the most promising industries for the future worldwide. Ukraine is well positioned in this field. *'Over the last 10 years, the IT sector has developed into one of the most dynamic sectors in Ukraine, with solid export-oriented growth and a share of around 4 per cent of total value added in 2021,'* Pindyuk notes.

'Before the Russian invasion, the sector employed almost 300,000 people, and the education system also produces significantly more IT graduates each year than in neighbouring countries in Central and Eastern Europe – namely, 68 graduates per 100,000 inhabitants in Ukraine compared to 23 in Poland, 46 in Hungary, and 54 in Estonia,' Pindyuk continues, summing up: *'If Ukraine manages to fully exploit its potential, it could become a major IT power and develop this sector into one of the main pillars of its economy.'*

The study ***Ukraine's Future Competitiveness*** was prepared by the Vienna Institute for International Economic Studies (wiiw) and the Bertelsmann Stiftung and **is available for download here**.

About the Vienna Institute for International Economic Studies (wiiw)

For more than 50 years, wiiw has been an economic think tank that produces economic analyses and forecasts for 23 countries in Central, Eastern, and Southeastern Europe. In addition, wiiw conducts research in the areas of macroeconomics, trade, competitiveness, investment, the European integration process, regional development, labour markets, migration, and income distribution.
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