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Financial and Economic Consequences of the War for Ukraine

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Purpose. The article explores the financial and economic consequences of the war with the Russian Federation for Ukraine. The focus is on assessing how businesses, government and other international stakeholders have responded to the various challenges posed by the war. **Design / Method / Approach**. According to the World Bank's RDNA3 methodology, damage is the direct costs of destroyed or damaged physical assets and infrastructure, valued in monetary terms. **Findings**. Businesses note the shortage of labor, rising wages in the market and the overall economic prospects of Ukraine as significant risks to their recovery. They identify the priorities related to government policy and the business ecosystem. **Theoretical Implications**. Companies demonstrate a cautious view of the country's economic outlook and prospects, explaining this by the unpredictable situation, insufficient demand, and labor shortages. Most of the companies that have already optimized their staff do not intend to reduce it further, seeing human resources as a prerequisite for a gradual economic recovery. **Practical Implications**. Most of the Ukrainian companies focus on the domestic market, with a limited presence on foreign markets. They report losses of up to 100 USD thousand. The scale of financial losses varies across sectors, with the construction sector suffering the most and the least, agriculture, telecommunications, marketing, consulting and design services. **Originality / Value**. Despite unprecedented losses and challenges due to the war, Ukraine has managed to maintain relative macroeconomic and price stability and overcome significant production difficulties and the negative effects of labor outflows and labor migration. **Research Limitations / Future Research**. Future significant research must be focused on rebuilding a critical infrastructure damaged by the hostilities and enabled a comprehensive reconstruction in Ukraine. **Paper Type**. Analytical Paper.

Keywords:

financial and economic consequences, war, infrastructure, business, economic recovery, negative effect, migration

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The Ukrainian economy has remained resilient due to the joint efforts of the government, business, the rapid recovery of destroyed and damaged critical infrastructure, and continued financial support from international support from international partners.

Despite the devastating impact of the war, economy demonstrated exceptional resilience. Shortly after the shock of the Russian invasion, businesses began to adapt to the new economic situation. Since the start of the full-scale invasion, 64 percent of businesses have temporarily suspended or curtailed their operations. However, the vast majority have resumed their operations. In October 2023 only 9.6 percent of companies that suspended their operations were at risk of ceasing operations entirely (World Bank, 2024a).

Companies demonstrated a cautious view of the country's economic outlook and prospects, explaining this by the unpredictable situation, insufficient demand, and labor shortages. The majority of the companies that have already optimized their staff did not intend to reduce it further, seeing human resources as a prerequisite for a gradual economic recovery in 2024. Most of the companies have significant unused capacity, which planned to start gradually utilizing them in 2024. Despite the ongoing war, businesses have successfully adapted to the situation and maintained financial stability. Although, companies needed additional funding, they were cautious about attracting new investments due to the unpredictability of further developments.

The security situation was recognized as the main factor influencing the decision to relocate. Business owners and managers expected a quick return to the abandoned regions after the end of the war. There were significant regional differences in the impact of the war on the companies. Enterprises in the eastern and southern regions of Ukraine suffered losses about 1.5 times more than in the west of the country. Despite this, businesses in eastern Ukraine expressed optimism and positive expectations about their prospects for recovery in 2024. Most of the companies focused on the domestic market, with limited presence on foreign markets. They reported losses of up to 100 USD thousand. The scale of financial losses varied across sectors, with the construction sector suffering the most and the least, agriculture, telecommunications, marketing, consulting and design services (World Bank, 2024a).

Businesses noted the shortage of labor, rising wages in the market and the overall economic prospects of Ukraine as significant risks to their recovery. They identified the following priorities related to government policy and the business ecosystem: improving the legal and regulatory framework, expanding access to finance and markets, and harmonizing legislation and standards with the European Union, addressing the root causes of low economic development and promoting entrepreneurship.

Objective and Tasks

The article explores how the consequences of the war have affected the activities of micro, small and medium-sized businesses in Ukraine, as well as their status at the end of 2024. In addition, the assessment provides important information about the financial and economic consequences of the war in the context of their regional presence, given that the regions of Ukraine have been affected by the hostilities to varying degrees. The focus of the article was on assessing how businesses, government and other international stakeholders have responded to the various challenges posed by the war, including disruptions in logistics chains, forced displacement of people, changes in trade and transportation routes, etc.

The assessment highlights the main obstacles, problems and risks that hinder business development. It also analyzes the effectiveness of government programs aimed at stimulating the economy from the perspective of a business, as well as the needs and priorities of businesses for the post-war recovery of Ukraine, which can have a significant impact on the society as a whole.

Materials and Methods

According to the World Bank's Rapid Damage and Needs Assessments (RDNA3) methodology, damage is the direct cost of destroyed or damaged physical assets and infrastructure, valued in monetary terms. Costs are estimated based on replacing or repairing physical assets and infrastructure, considering the replacement price prevailing before the war. The data cut-off for RDNA3 was on December 31, 2023. The loss is a change in economic flows resulting from the war, valued in monetary terms. Examples include increased operating costs and loss of revenue for authorities and private sector (World Bank, 2024a).

According to the RDNA3 methodology, needs are the value associated with the resumption of prewar normality through activities, such as: repair and restoration, including a premium linked to build back better principles. They included improved energy efficiency, modernization efforts, and sustainability standards — as well as factors such as global inflation, surge pricing due to volume of construction, higher insurance, and so forth. Needs are expressed in monetary terms according to market prices prevailing as of December 31, 2023. Needs did not equal the sum of damage and losses. Needs met were discounted as relevant.

As for the recovery and reconstruction financing priorities for 2024, they refer to recovery and reconstruction needs identified by GoU line ministries that are considered highest priority for urgent delivery and require funding in 2024. Investment priorities account for both capital and current expenditures and consider expenditures that would be made by central and local governments, by state-owned enterprises (SOEs), by the private sector (including households), or by other actors (e.g., development partners).

The RDNA3 also includes short-term priorities identified by Ukrainian line ministries that need financing in 2024. These priorities have been defined by line ministries through an ongoing process of project development and monitoring and involving extensive consultations with development partners. Sectoral priorities, to be monitored and refined over time, are intended to inform investment planning, mobilization of resources, and implementation. The RDNA3 also includes an overview of key requirements to facilitate more effective and efficient recovery and reconstruction planning and implementation (World Bank, 2024a).

Some institutional and policy reforms have been implemented to support the recovery and reconstruction process. The Ministry for Communities, Territories and Infrastructure Development (MCTID or Ministry of Recovery) facilitates coordination and efficient reconstruction of war-affected regions.

Territorial communities are responsible for developing planning documents, establishing communication with international partners, and implementing restoration projects in their respective territories. The European Commission proposed a multi-annual instrument to support Ukraine between 2024 and 2027. This was the Ukraine Facility, which aimed at supporting the state's basic needs as well as Ukraine's recovery, reconstruction, and modernization, in part through catalyzing of private sector investment tied closely to Ukraine's EU path (European Commission, 2023).

The UN had a strong focus on supporting the inclusion of marginalized groups and seeks to ensure that the recovery process benefits those farthest behind, reduces inequalities, and promotes social cohesion and livelihoods. In collaboration with the GoU and MCTID, the UN in Ukraine has established a flexible Ukraine Community Recovery Fund. The fund supported communities that are driving their own recovery efforts in targeted communities to reduce current and prevent future humanitarian needs; to rebuild the social and economic fabric; and to provide the conditions for people to voluntarily return to their homes and rebuild their lives. These community-focused early recovery efforts set in the nexus of humanitarian, recovery, and social cohesion interventions (United Nations in Ukraine, 2023).

In December 2022, the Ukraine Relief, Recovery, Reconstruction and Reform Trust Fund (URTF) was set up by the World Bank to channel donor support. The URTF provides a coordinated financing and support mechanism that helps the GoU sustain its administrative and service delivery capacity, conduct relief efforts, and plan and implement Ukraine's reconstruction and reform agenda.

The URTF was financing projects with a focus on repairing damaged infrastructure, restoring public services, and sustaining economic activities in the areas of health care, energy, logistics, agriculture, and housing. As of January 2024, URTF was over 1.5 USD billion in contributions from 14 donor countries, making grants to support early recovery and administrative capacity of the government The multisectoral support provided by the World Bank during the war built on a decades-long development partnership and set the stage for resilient reconstruction when peace returns.

It is important for us to pay attention to the national peculiarities of the codification of collective memory through individual experience and life stories during the full-scale military aggression against Ukraine, and to show the newest forms of presenting the evidence of war (Hudoshnyk & Krupskyi, 2023).

Results

Despite unprecedented losses and challenges due to the war, Ukraine managed to maintain relative macroeconomic and price stability and overcome significant production difficulties and the negative effects of labor outflows and labor migration. According to preliminary data from the Ministry of Economy of Ukraine, overall GDP growth in 2023 was estimated at around 5 percent, which was a significant improvement compared to the 28.8 percent decline in 2022. Several factors, such as: improvements in the energy sector and external financial assistance from international partners were contributing to the GDP recovery (Government Portal, 2022).

The fastest recovery rates were observed in the following sectors as: construction, agriculture, domestic trade, and manufacturing industry. As for the construction, significant funding has been allocated to rebuild a critical infrastructure damaged by the hostilities and enable a comprehensive reconstruction. According to the State Statistics Service, the construction sector experienced a significant growth, increasing by 20.9 percent in the first nine months of 2023 compared to the same period in 2022.

As for the domestic trade, it demonstrated an increase in consumer demand and supply of goods and the retail trade turnover increased by 11.6 percent. As for agriculture, favorable weather conditions contributed to an increase in yields and harvested areas of almost all crops. In addition, the partial recovery of exports in this sector was facilitated by the opening of trade routes. According to the Ministry of Agrarian Policy and Food of Ukraine, the grain harvest as of January 11, 2024, was 15% higher than in the corresponding period of 2023 (World Bank, 2024b).

As for the manufacturing industry, its recovery was explained by growing demand for engineering and construction materials. There was an increase in the raw material base of agriculture, in particular, the production of food, beverages, and tobacco products, as well as demand from related activities. In general, industrial production grew by 2.4 percent and in the manufacturing by 8 percent. In the manufacturing industry, the highest growth rates were observed in machine building products (15.3 percent); production of furniture and other products (15.2 percent); rubber and plastic and other non-metallic mineral products (16.4 percent); food, beverages and tobacco products (11.6 percent) and chemical products (12.2 percent).

The growth in food prices accelerated sharply in August 2024, as prices for raw foods started to grow again amid reduced food supply caused by unfavorable weather conditions. Prices for processed foods also rose at a faster pace, both due to the second-round effects of higher costs of raw food inputs and further increase in businesses' costs for energy and labor. The growth in prices for most nonfood products accelerated, largely driven by the exchange rate factor. Meanwhile, clothing and footwear prices declined faster, likely due to growing competition between imports and products made in Ukraine. The growth in prices for services picked up slightly, being under pressure from business production costs (World Bank, 2024b).

In the first half of 2024, Ukraine's economy demonstrated a significant adaptability. It didn't only withstand the unprecedented challenges of war and electricity shortages, but also continued to recover. The macrofinancial stability ensured by the NBU and government decisions and significant international support was the basis for adaptation. Thus, inflation fell to 3.2% in March 2024 and has remained moderate since then, despite accelerating. Underlying inflationary pressures also intensified in August 2024. Core inflation accelerated to 6.5% yoy, up from 5.7% yoy in July. These dynamics were slightly ahead of the trajectory in the NBU's July forecast, caused primarily by a faster rise in the prices of processed foods due to the second-round effects of higher raw material prices and production costs, including for energy and labor. However, inflation expectations remained generally stable (World Bank, 2023).

According to NBU's estimates, inflation accelerated further in September 2024. The budget deficit has been financed without any hryvnia issuance, and international reserves were at sufficient levels. However, the war was ongoing, which means that risks and challenges remained.

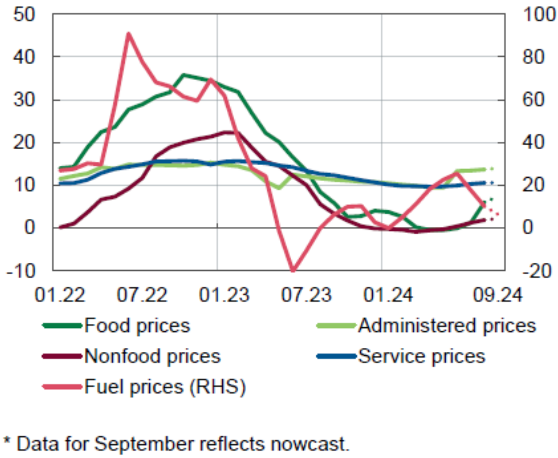
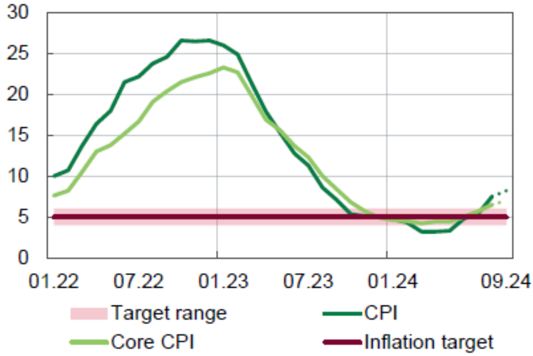


Figure 1 – CPI components*, % yoy (SSSU, NBU)

The state budget deficit (excluding grants in revenues) decreased somewhat compared to the previous months 2024 but remained, expectedly, quite significant. In September 2024, the budgetary needs were financed mainly using accumulated funds from the substantial international aid received in August 2024. Meanwhile, the domestic debt market revived in September. Placements of domestic government securities in both national and foreign currencies were the largest since the beginning of the year, supported by NBU`s additional measures to stimulate investments in government securities and a moderate increase in their yields. The total rollover of domestic government securities in nine months was around 160 percent (United Nations in Ukraine, 2023).

The NBU assumed a gradual normalization of economic conditions. However, the risks associated with the course of the war were crucial to our forecast. A prolonged, high-intensity war would limit economic potential, put pressure on prices, and result in higher budgetary needs. This would increase uncertainty and risks. The destruction of housing infrastructure, children's hospitals, and energy terror all seemed impossible (National Bank of Ukraine, 2024).



* Data for September reflects nowcast.

Figure 2 – Inflation* and inflation target, % yoy (SSSU, NBU)

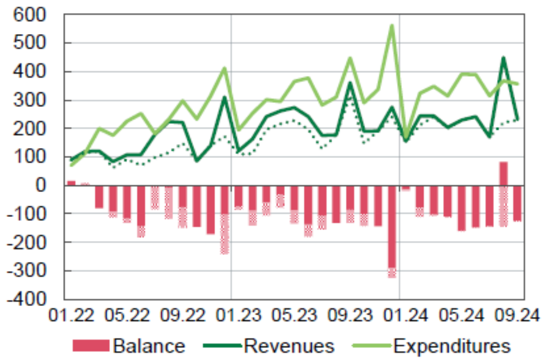


Figure 3 – Main state budget indicators (monthly), UAH billions (SSSU, MFU, NBU)

According to the NBU, the second assumption of the forecast was that international assistance would continue. Ukraine remained dependent on it. On the contrary, Ukraine exceeded expectations in terms of consolidating its capabilities, implementing reforms, and fulfilling its commitments. Funding needs were determined by the war unleashed by the Russian Federation. It led to a huge increase in budget expenditure. It would be very difficult to cover a significant part of 2024 year's deficit (about 38 USD billion) without external financial assistance, despite the successes in revitalizing the domestic debt market, increasing the tax base and the accumulated safety margin. And Ukrainian government was grateful to the EU, the US, the IMF and other partners for the already approved support programs. It was crucial for Ukraine to receive at least 31 USD billion and 21 USD billion in 2025 and 2026, respectively.

Unfortunately, due to bureaucratic compliance with lending principles, procedures, and requirements (project objective, co-financing requirements, technical expertise, procurement procedures, complex and time-consuming procedures for entering into loan agreements, etc.), the aid that came to Ukraine was uneven in time and does not match the level of stated needs (Kurnosenko, 2022).

The key risks of economic development and financial and investment processes in Ukraine are as follows: slow economic recovery due to the destruction of energy, industrial, socio-economic infrastructure, loss of part of the production and labor potential, high unemployment, low and distorted consumer demand, aggravation of crisis trends in the global economy, in particular in the energy sector and financial markets, which together affect the amount of international financial support for Ukraine; tight domestic monetary policy and a narrowing of bank lending to businesses; cuts in government support programs and a drop in tax revenues; deterioration in the fiscal sustainability of public finances and the high cost of domestic government borrowing, and man-made disasters (Близнюк & Іванюта, 2023). Otherwise, the financial mechanisms for recovering from military conflicts and stimulating competitive economic development are determined by a set of strategic instruments. In this context, the main factors are the efficient use of public and private financial resources, the introduction of innovative financial instruments, and the development of transparent governance mechanisms. In addition, promoting social inclusion, sustainable development, and attracting international investment are key to a successful path to recovery and competitive economic growth.

In addition, an important component of the fiscal mechanism is the development of effective social protection and education programs aimed at restoring and developing human capital. Creating a favorable investment environment and improving financial legislation can help make the country more attractive to foreign investors. In addition, it is important that the government, business, and civil society actively cooperate to jointly implement recovery and development strategies (Borovkov, 2023).

The forms of implementation of the regional development strategy are the adoption of an investment program (a set of interrelated tasks and measures of a short-, medium-, and long-term nature to achieve certain goals) and an investment project (an official document that defines the actions of its participants and the resources necessary to achieve its goals within the established timeframe). The requirements for the compliance of the mechanisms of financing the state regional policy with the requirements of the Budget and Tax Codes of Ukraine are: transfers to local budgets from the state budget; public-private partnership, etc. (Kosova, 2023).

Moreover, the following steps will help to create a more secure, efficient, and resilient financial environment that takes into account the challenges and opportunities brought by digital innovations after the war (Lytvyn et al., 2024), as:

1. Develop and implement clear regulations to safeguard data confidentiality and ensure cybersecurity.

2. Participate in international initiatives and collaborate with other countries to develop standards.

3. Promote the development of technical skills and scientific research to ensure competitiveness in the digital era.

4. Ensure equal access to fintech tools and technologies in all regions.
5. Engage in dialogue with international and local regulators to develop flexible rules that consider the innovative nature of fintech projects.

As part of the sustainable development, post-war companies should increase their activities in the field of renewable energy and ecology, as well as support environmental projects in any way possible, thus contributing to the achievement of the 6th, 7th and 13th Global Goals for Sustainable Development, which the United Nations has set for 2015. Ukrainian companies should be aware of their environmental impact and strive to reduce it by developing their sustainability orientation, including sustainable business and sustainable management (Lytvyn et al., 2023).

Nowadays, companies and individuals who want to start or support sustainable projects in Ukraine face two major challenges: lack of support from local and state authorities; and inefficient and ineffective legal framework and policies, e.g. lack of laws and regulations on environmental protection, lack of fiscal, economic and industrial policies in the field that would facilitate the implementation and operation of green initiatives. In addition to the war, businesses face problems in attracting investment, corporate, tax and intellectual property issues. Despite these problems, business should support the following sectors: renewable energy, low-carbon transportation, low-carbon buildings, sustainable water and waste management, sustainable land use, and climate change. In our opinion, Ukraine will need 5-7 years to recover the potential lost during the war (Lytvyn et al., 2023).

Conclusions

Two-thirds of Ukrainian small and medium-sized enterprises were forced to fully or partially cease operations during the full-scale invasion. At the same time, 36.5 percent of businesses managed to continue working without interruption, and 6 percent were forced to stop for a year or more. Enterprises currently have significant unused capacity, which were planned to start using in 2024. Despite the ongoing war, the business community adapted to the situation, ensuring financial stability. There has been no massive relocation of businesses from the war-affected areas to other regions of Ukraine. Entrepreneurs considered security as the main factor for relocation. Therefore, they expected a quick return to the de-occupied territories after the war ended. Despite the security uncertainty, Ukraine has the potential to accelerate its development by improving the efficiency of the existing level of its economy, reducing the size of the shadow economy and creating favorable conditions for doing business. The planned integration with the EU could also accelerate the convergence of income levels with those of EU member states by 2030 – 2050, creating significant incentives for economic development.

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