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What Should Be the Economic Priorities in Post-war Ukraine?

It has been one year since Russia launched an unprovoked and brutal assault on the independent sovereign nation of Ukraine. During this time, the hollowness of Russia's great power pretensions has been exposed, with its military performing in away which vindicates late US Senator John McCain's assertion that Russia is a "gas station masquerading as a country." More interestingly, the war has also shown the resilience of Ukraine and Ukrainian society (Alshamy et al. 2023), an almost-unthinkable outcome when seen from the vantage point of the first Russian invasion of Ukraine in 2014. The reforms undertaken since the protests on Maidan ousted Russian-backed Viktor Yanukovich have paid off handsomely in enabling Ukraine to resist the Russian war machine.

However, there is much to be done if Ukraine is to win the peace in a post-war era, no matter what shape it takes. Maidan represented a long-delayed starting point for a country which had fallen far behind its western neighbors in transitioning to a market economy (Åslund 2009), retaining too many institutions from its communist past and standing in the way of the fundamental economic institutions required of free markets, including rule of law and protection of private property (Hartwell 2016). The actions of the Ukrainian government post-2014, catalyzed by the existential threat from a Russia which had already seized Crimea and was occupying portions of the country's east, finally put an end to much of the start-stop reforms which characterized the 1990s. But they did not go far enough.

The purpose of this policy brief is to outline the crucial priorities for Ukraine in any post-war reconstruction, focusing on the needed economic institutions first and foremost. Coming out of a joint Ukrainian-Polish-Swiss project, our efforts have been directed to highlight the most important reforms for the Ukrainian government, so as to have a blueprint ready to go when the Russians retreat. Unlike the 1990s and 2000s, Ukraine does not have the luxury of giving in to corruption, an intrusive state, and a Russian-inspired economic system. If the country is to truly break away from any form of Russian influence, it needs to accelerate and deepen its reforms, and this brief gives a sense of where its efforts should be targeted. In particular, we emphasize the areas of building fundamental economic institutions on the path to Euro-integration. These will be taken in turn.

KEY MESSAGES

- **Ukraine must first win the war. But if it can successfully expel Russia from all of its territories, it needs to accelerate its post-Maidan, pre-war tempo of reforms**
- **Ukraine must build what it has long been lacking: the rule of law. In order to do this, it must build the rule of law from scratch, reforming its judiciary, unabashedly protecting property rights, and continuing its highly successful decentralization reforms**
- **During the transition from war economy to market economy, simplification of nearly every facet of interaction with the government should be undertaken – and kept in place. This will encourage not just hanging on to foreign charity, but also encourage investments needed for growth**
- **These steps will help Ukraine move towards Europe and continue its march towards Euro-integration even if (and especially if) accession to the European Union is a longer-term goal**
- **Ukraine's survival after the war is dependent on making policy reversals incredibly difficult to implement. This requires substantial political will**

BUILDING FUNDAMENTAL INSTITUTIONS

Within the myriad of economic institutions which will require attention in the post-war world, rule of law stands heads and shoulders above the rest. However, "rule of law" is a concept rather than a policy goal (Krygier 2016). Substantively building the rule of law in Ukraine in the post-war environment will require a complex set of actions focused on the judiciary and reducing the power of the state. In the first



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instance, Zelenskyy's government will need to be serious about the rule of law and especially the fight against corruption. Decades of shelving the issue of rule of law (De Waal 2016) translated into a decision to create a proxy system of anti-corruption bodies (thus acknowledging the inability of existing institutions to wipe away the scourge of corruption). However, the prescriptions for reform of the judicial and law enforcement systems have already been drawn up by international financial institutions (IFIs) in collaboration with Ukrainian civil society, and should be seriously considered:

- The Constitutional Court of Ukraine (CCU) should be rebooted without political influence under the supervision of independent international experts and representatives of civil society.
- The High Council of Justice (HCJ) and the High Qualification Commission of Justice (HQCJ) should be restarted under the supervision of international experts and civil society (implementation in progress), and as soon as the bodies are staffed, they should revise the entire judicial system (courts of first instance and appeal courts).
- Similarly, the Security Service of Ukraine (Sluzhba Bezpeki Ukrainy or SBU) should be stripped of its power to investigate economic and corruption crimes.
- Finally, the overhaul of operative and detective units of the police (which remained untouched in 2015), as well as the prosecutor's office (suspended in 2020) are also critical for the reform of the law enforcement system.

The abovementioned measures remain necessary but are not sufficient conditions in themselves for the successful establishment of rule of law, as rule of law is not just the passing of better legislation or even tweaking existing institutions (Krygier 2016). Indeed, in the broken atmosphere of Ukraine, which has neglected rule of law for too long, better laws will have little impact. Against this backdrop, there is a need for more sophisticated digitized metrics for measuring the progress of changes in the area of law enforcement and the judicial system, providing evidence for the (lack of) progress in the post-war era. Some basic monitoring already exists, such as the tracking of changes to court decisions in courts of appeal and the Supreme Court. Also, civil activists can analyze court decisions via an electronic judiciary system. However, further development of both data collection and the system of indicators is needed. With a system of quantitative metrics, based on sound methodologies (Skaaning 2010), Ukraine could evaluate progress in establishing rule of law.¹ Progress in

¹ For instance, the fraction of supportive decisions in favor of the state in litigations between tax authorities and taxpayers, comparative statistics on judges whose decisions were canceled by a court of appeal or the Supreme Court, and a more sophisticated (digitalized) monitoring system for the actions of law enforcement bodies at the stage of pre-trial investigation and litigations, etc.

establishing rule of law should also be directly linked to financing the post-war recovery. International partners need to make it absolutely clear that rule of law will be required and there will be no flexibility enabling the bypassing of this requirement.

Judicial institutions are only a first step, and corruption has flourished in Ukraine namely because the state has far too much power with which to demand rents. With fewer interactions between the state and citizen, there are less opportunities for corruption to arise.² Moreover, lack of rule of law has a domino effect with other institutional mechanisms: Because of the dysfunctional law enforcement system in Ukraine, it was impossible for the authorities to effectively collect taxes, as law enforcement bodies were unlikely to trace and punish evaders. As a workaround, the Ministry of Finance and tax authorities developed a tax collection system based on the presumption of taxpayer (tax agents) guilt, making businesses responsible for proving their innocence on a daily basis. Presuming taxpayers (tax agents) to be guilty is perhaps a helpful tool (in the short term) for fiscal consolidation but constitutes a very counterproductive instrument for generating economic growth in the country.

A state which a) has too much power and b) presumes that every transaction is illicit is also a state which has no love for property rights protection. This has been demonstrated through the aggregation of land rights to the government and away from individuals. Since 2001, a "temporary" moratorium on the sale of agricultural land was in place (Kostyashkin et al. 2020), finally lifted only in July 2021. Due to fierce political resistance, the reform was far less comprehensive than it could have been and was passed with multiple limitations: for example, until 2024, only individuals are allowed to buy land plots, with a cap of 100 hectares for any individual. Legal entities will be allowed to buy land from 2024, subject to a cap of 10,000 hectares for any one entity. State-owned and community land will not be for sale at all at present, while foreigners will be able to buy land only after a national referendum, which should be arranged (theoretically) in the not-too-distant future. Despite many fears connected with land reform, the first year of land market operations passed smoothly, with only technical difficulties reported (such as the need to streamline certain procedures for the easier closing of deals). Most importantly, banks have already started treating land plots as a source of collateral for new loans. In the post-war realm, Ukraine will have to go even farther with its land reforms, opening its market to non-residents to speed up the modernization and business of agriculture and its integration with international markets. As a more important objective, state and municipal land should be the subject

² One of the authors made this point while serving on a US-AID-funded project in Armenia in the early 2000s, only to have this assertion waved away as wishful thinking. It was decided it was better to spend more on anti-corruption campaigns than do something as fanciful as reduce the opportunities for corruption.

of sale and privatization according to a transparent procedure, developing alongside the procedures for rule of law.

Last but not least, Ukraine needs to not only address some of the gaps in its institutional framework but also build on the successes which it has had. Decentralization stands paramount among these, as the resilience of local communities during the Russian aggression is partly attributable to the decentralization reforms which began in 2014. An important part of this was the creation of its best-known aspect, the Amalgamated Territorial Communities (ATCs) or *hromadas* (1,469 ATCs were created by 2021). Some degree of fiscal decentralization, mainly related to education and health care, has also been implemented. However, this reform can still go farther, and will complement the withdrawal of the state from every facet of economic life. After the way, policymakers need to expand the fiscal autonomy of lower-level governments, while re-opening the draft constitutional changes intended for opening the way to genuine local and regional self-government but which were blocked by parliament in 2015. As with many Eastern European countries, Ukraine faces a challenge in understanding how funding between the center and the regions can be shared, and a key challenge will be understanding the mismatch between available funding and responsibilities allocated to local communities. A renewed decentralization effort, acknowledging the role that the regions played in keeping Ukraine alive, would be a welcome policy course.

EURO-INTEGRATION, WITH OR WITHOUT THE EU

These institutional reforms are a crucial step on the way towards accession to the European Union but are also independent of the often-belabored accession process. The process of European integration in Ukraine started in 1994, when the country signed a Partnership and Cooperation Agreement with the EU and established a special European integration department within the Cabinet of Ministers. Cooperation with the EU accelerated after 2009, when Ukraine became one of the EU's geopolitical partners under the Eastern Partnership Initiative. The signing of an Association Agreement (AA) in the spring of 2014 further deepened cooperation, bringing it to the level of strategic partnership and potentially opened the prospect of EU membership for the country.

However, from a political point of view, the EU did not even dare, at the time, to bring up official prospects of membership despite the unprecedented commitments taken by Ukraine under the AA to approximate the regulatory environment of the European Union. A poorly attended advisory Dutch Referendum on the EU-Ukraine Association Agreement was held in April 2016, showing that Dutch voters were not quite ready to give Ukraine the prospect of EU membership (Jacobs 2018). Despite ratification

of the Association Agreement by EU Member States, the referendum made any promise of EU accession to Ukraine at that juncture politically impossible.

In reality, the EU-Ukraine Association Agreement had a significant impact on government policy, as key reforms began to set in motion the gradual modernization of the country (Králiková 2022). Certain fundamental changes – such as decentralization, reform of the civil service, and judiciary reform – were expected from Ukraine under the terms of the AA, and they were to serve as the basis for broader reforms and the further implementation of broad, sector-based transformations. In fact, Ukraine's greatest successes post-2014 were achieved in the “trade sections” of the Agreement, which aimed at reducing customs duties and removing non-tariff barriers to Ukrainian exports to EU markets. Changes in the “sector-based” part of the Agreement, which involved steps in specific areas from energy to education, reached varying degrees of progress, from “ready-to-be-integrated into the EU Single Market” sectors like public procurement or technical regulation, to “unpopular sectors” like education or postal services. A government assessment³ of the implementation of the AA Action Plan for 2014-2024 arrived at an implementation rate of 66 percent as of November 2022, while an independent assessment⁴ by the Ukrainian Centre for European Policy was less optimistic, showing that overall progress stood at 49 percent as of the first half of 2021, which included both fully completed commitments and interim results.

In June 2022, Ukraine was granted candidate status for EU membership through an extraordinarily quick decision of the European Council, taken when the country was resisting Russia's full-scale invasion. An unprecedented decision (the EU had never granted candidate status to a country at war before), Ukraine skipped several steps of the accession process as mandated by the Treaty on the European Union. Under normal conditions, Ukraine would have had to fully implement all the commitments under the Association Agreement, demonstrate and convince EU members that the country had fully implemented them, and only then submit a membership application: the base scenario for tendering an application was originally scheduled for 2035. Therefore, preserving the progress within the framework of AA implementation has become an important prerequisite for accession negotiations.

While much has been achieved since 2014, obstacles remain that hold the country back. “Frozen” progress – in particular in establishing rule of law, the continuing weakness of the civil service and extensive reach of the state and, in particular, the political interference that this allows – remains the most significant

³ See the Ukrainian Government website, “Pulse of the Agreement,” available at <https://pulse.kmu.gov.ua/ua/a/year/all>.

⁴ Shown on the website of “Europaiska Pravda” (a project of newspaper Ukrainianska Pravda) at <https://navigator.eurointegration.com.ua/>.

of these issues. This reality means that some commitments made by Ukraine during this process will have to be resolved, including the complex set of political and regulatory decisions (covering anti-oligarch legislation, the implementation of anti-monopoly rules, and a better investment climate and access to finance for reconstruction). For example, the harmonization of European environmental law concerning GHG emissions (e.g., requirements of the Large Combustion Plant Directive for air pollution limits by large power plants)⁵ will require substantial investment and, in fact, a complete overhaul of the country's old and badly deteriorated domestic power generation system. Such issues also clash with the interests of the business groups that own the power plants responsible for the greatest pollution and are opposed to such restrictions.

Not all issues come from the Ukrainian side, however, and the EU also has policy avenues that it needs to explore to hasten the process of accession. First, an accelerated and complete elimination of customs duties, tariff quotas and other pricing restrictions for Ukrainian agricultural goods would function as a measure to support the country's economy and is a political measure that the EU could (in theory) do quickly. Second, signing the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), which allows the EU to recognize Ukraine's National Quality Infrastructure and conformity assessment to ensure supplies of industrial goods to the EU internal market without additional certification. These issues are currently in the verification phase, and fast-tracked signing of the three agreements in the first three industrial sectors (electrical equipment, pressurized vessels, electromagnetic compatibility) would be a major step of support on the part of the EU.

POLICY CONCLUSIONS

As this brief shows, opportunities abound for Ukraine in a post-war scenario to continue the reforms begun in earnest in 2014 after years of neglect. However, the chance must be seized and the reforms instituted rapidly; as former Polish Deputy Prime Minister/Central Bank Governor/Finance Minister Leszek Balcerowicz (1995) noted, after a great victory (over communism or Russia) there is a period of "extraordinary politics" where radical and necessary reforms can be implemented. This window of opportunity closes fast, however, and so must be used to its maximum. The immediate post-war period would be such a time. In reality, EU accession is still a long-term goal for Ukraine and, as the accession of Central European states such as Poland and Hungary showed, attaining EU Member State status is not a panacea for all institutional woes. Indeed, as one of us have argued

⁵ Directive 2001/80/EC of the European Parliament and of the Council of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants.

elsewhere (Hartwell, 2013), the EU actually froze in place the institutional experimentation that was underway after the end of communism, a stasis which has led to some of the issues seen today in backsliding countries such as Poland (e.g., with regard to the judiciary). With Ukraine attempting to approximate EU legislation, it should take advantage of being outside of the EU formally to push for innovative and extensive institutional reforms, implemented quickly. For example, in light of the multiple institutional problems within the country, the European Commission also outlined seven post-candidacy conditions for Ukraine which should be implemented before the accession negotiation process starts, including requirements on reforming the Constitutional Court, judicial reform, combatting corruption, combating money-laundering, implementing anti-oligarch legislation, harmonizing legislation on media, and amending legislation on national minorities. These are all issues which Ukraine should be moving on even without EU accession, and this should be the emphasis: becoming a European state, with an emphasis on core European values related to rule of law and free trade, even if the process of accession takes years.

The reality, however, which may trip up such a plan, is that Zelenskyy is not and was not a natural reformer. His movements regarding anti-corruption before the war were not encouraging, and his pre-war association with oligarchs was troubling. It remains to be seen if his wartime resolve translates into a desire to push the reforms that he was reluctant to tackle previously, although the extensive anti-corruption investigations and firings occurring in January 2023 are a good signal.

Finally, when discussing the myriad of reforms that Ukraine needs in the post-war world, it is crucial to remember that Ukraine needs to win the war first. Inordinate amounts of effort, borne by the Ukrainian people but with the support of NATO and the West, need to be expended to uphold the liberal international order and repel Russian aggression. Anything short of forcing Russia to retreat will leave a continuing potential threat to the country's sovereignty. For our purposes, anything less than unqualified victory will also have negative consequences for the country's reform path, as current leaders will be seen as ineffective and other avenues may be sought. It is thus imperative that Ukraine wins the war first. Only then can it work on post-war reconstruction – but this reconstruction, as we have shown, will be just as crucial for breaking out of *Russskiy Mir*.

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