

ANDERS ÅSLUND & ANDRIUS KUBILIUS

RECONSTRUCTION, REFORM, AND EU ACCESSION FOR UKRAINE



Reconstruction, Reform,
and EU Accession for Ukraine

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Foreword

“Peace belongs to the free man and to no one else”

These are the words of Wilhelm Moberg, one of the greatest Swedish authors in modern times, taken from his historical novel book *Rid i natt!* (‘Ride this Night!’) written during war-time in 1941.

Moberg wrote his book during the Second World War, providing an allegory of Swedish peasants in the 17th century standing up to a nobleman of German origin who, in order to impose feudal rule, tried to take away their inherited freedom. The book was written as a wake-up call about the need in the 1940s to unite against dictatorship. However, it could have been written today as a tribute to the Ukrainian people who demonstrate every day that there is no peace without freedom.

In addition, Moberg’s book serves as a reminder to all of us of the need to unite in the fight against tyranny. Ukraine will have no peace without freedom, but Ukraine will not get peace until Russia is defeated. That is a victory crucial not only for Ukraine but also for Europe.

The Ukrainians are fighting a war for all of us. It is a war against Russian dictatorship, but it is also a war that is being fought for the sake of Europe’s freedom and security. The Ukrainian cause is our cause. Europe has to understand that our efforts for Ukraine by no means match the effort and sacrifice that Ukraine is making for us. The sacrifice of Ukraine is truly ours; we owe them our support. Once Russia has been defeated, Europe must support the reconstruction of Ukraine.

A strong and prosperous Ukraine, rebuilding its cities, towns and villages, restoring its economy and industrial capacity, regaining the confidence of an innovative and growing econ-

omy, will be a benefit to us all. Winning peace in Ukraine is a win for the whole of Europe.

Establishing hope today for the future is one of the means to support Ukraine during the war, and to eliminate any Russian ambitions to control Ukraine in the future. In order to defeat Russia, Ukraine needs weapons, financial support and hope. And that hope is what this book is about.

For Stockholm Free World Forum, it is an honor to present this plan for how to rebuild Ukraine with European and international support after the war. We want it to be a part of a plan that forms hope for the future but also offers a road map for commitments in the present, making those hopes concrete and credible.

It is written by two experts. Anders Åslund, senior fellow at Stockholm Free World Forum, is a leading international economist with unique academic expertise on reforming regulated and dysfunctional economies into dynamic societies. He has served as an advisor when market economy reforms were on the agenda in Russia and during the ongoing process of transforming Ukraine into a market economy and a European democracy. Andrius Kubilius, a Member of European Parliament and a friend to Stockholm Free World Forum, is an experienced practitioner with a strong belief in free and open markets. As one of the leading persons in the independence movement Sajūdis, he took part in turning Lithuania into a free European nation; transforming it from a Soviet dictatorship with a planned economy into a democratic European nation with the rule of law and market economy. He has served twice as Lithuania's Prime Minister. During the financial crisis of 2008-09, Kubilius was responsible for one of the strongest recoveries in Europe.

Åslund and Kubilius's road map for rebuilding Ukraine and their proposals for how the West could and should support Ukraine after the war should be read by anyone who is committed to the project of winning the peace.

Here is the foundation for our future common cause. And there, in the future, we need to remember, as Pericles once

remarked: “Freedom is the sure possession of those alone who have the courage to defend it.” That is what rebuilding Ukraine is about.

Gunnar Hökmark

Chairman Stockholm Free World Forum.

1. Introduction

Ukraine has developed greatly since it became independent on August 24, 1991. Its development has not been easy, because in Soviet times it suffered badly from repression and isolation. The KGB was always particularly focused on Ukrainian nationalism, which it correctly saw as the greatest threat to the persistence of the Soviet Union. Therefore, repression in Ukraine was arguably worse than in any other European Soviet republic. It has taken time to overcome the isolation imposed by the Soviets, but Ukraine's democratic and economic institutions have evolved successfully.

Unfortunately, also after its independence, Ukraine has suffered severely from Russian aggression. For the first two decades, the Russian interference took the form of non-market energy deals that promoted corruption. In 2014, Russia launched open warfare. After eight years of low-intensity war in which 14,000 Ukrainians are considered to have died, Russia opted for full-scale warfare on February 24, 2022.

The Ukrainian people have bravely stood in defense of their nation and they have done so with impressive success, astounding the world. Russia's assault on Ukraine has convinced the Ukrainians that they are one nation and that Russia is not ready to pursue peaceful cooperation with Ukraine but desires its annihilation. The European Union has drawn the same conclusion. Today, a large Ukrainian majority wants their country to become a full member of both the EU and NATO, and the EU has been greatly impressed by the Ukrainians' commitment to European values. Therefore, realizing that Ukraine is a fully-fledged European country, the EU welcomes Ukraine. Ukraine and the EU have come to the same conclusion: they aspire to far-reaching integration with Ukraine becoming a full member of the EU.

The EU and Ukraine negotiated their Association Agreement, including a Deep and Comprehensive Free Trade Area (DCFTA) between 2007 and 2011, and they signed on March 21 and June 27, 2014.¹ Ukraine has adopted broad-based reforms in line with this agreement. The Association Agreement with the DCFTA came into force in 2017. In the same year, the EU granted Ukrainians visa freedom. In June 2022, the EU took the next big step: offering Ukraine both membership perspective and to become a candidate for EU membership. The ensuing step is to start membership negotiations. These comprise a lengthy process because they involve substantial institutional reforms to the benefit of the Ukrainian nation. Therefore, on November 23, 2022, the European Parliament adopted a resolution on the new EU enlargement strategy, which demanded that the EU “establish clear deadlines for concluding negotiations with the accession countries by the end of the current decade at the latest”.²

Ukraine needs to rebuild after the destruction caused by the Russian invasion. This requires substantial financing. Ideally, Russia should be forced to pay war reparations for all the damage it has caused in Ukraine. The best way of doing so is that the Western countries that have frozen a total of \$300 billion of Russian Central Bank reserves confiscate them and use them as Russian war reparations for Ukraine. In any case, the West and international financial institutions also need to make substantial contributions. Hopefully, Ukraine’s further development will also attract major private investment.

At present, there is much talk about a Marshall Plan for Ukraine, which appears appropriate given the size of the under-

1 Association Agreement between the European Union and its Member States, of the one part, and Ukraine of the other part (2014, OJ L161/3).

2 European Parliament, “European Parliament recommendation of 23 November 2022 to the Council, the Commission and the Vice-President of the Commission / High Representative of the Union for Foreign Affairs and Security Policy concerning the new EU strategy for enlargement,” November 23, 2022. https://www.europarl.europa.eu/doceo/document/TA-9-2022-0406_EN.pdf

taking and the financing needed. Since the funds required are large, it is vital that an independent international authority is set up to manage these funds in a transparent fashion because Ukraine's foremost problems have been corruption and insecure private property rights.

Our hope is that Ukraine, and the collective West, will combine and cooperate in these three processes: reconstruction, EU accession, and the completion of Ukraine's reforms. While we hope that the EU will be able to take a lead in this process, it is important that the United States, the United Kingdom, Canada, Japan, and other democratic countries participate. Since this is a major long-term project, we must get it right.

Ukraine is a European Country

Article 49 of the Treaty on European Union states unequivocally: "Any European State which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union".³ Article 2 spells out standard democratic values and the rule of law: the union "is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail".⁴

For a long time, the Ukrainian nation did not have a clear view of the EU. However, since 2014 a large majority of the Ukrainian people desires that their country becomes a member of the EU. Since the start of Russia's war on Ukraine, more than 80 percent of Ukrainians favor full EU membership in numerous opinion polls. Through repeated democratic elections and democratic transfers of power, the Ukrainian nation has shown that it

3 Treaty on European Union (2012, OJ C326/13).

4 Ibid.

embraces the universal values of the EU in practice as reflected in the extensive Association Agreement.

Ukraine has fought valiantly and bravely for its national sovereignty and territorial integrity against the unprovoked Russian military aggression. While doing so, it has also fought for Europe, which owes Ukraine a great debt of gratitude. Ukrainian EU membership is not only a political and economic issue. It is also a matter of European security. Ukraine is an intrinsic part of the EU security and defense policy. Ukrainian membership of the EU is needed not only for Ukraine, but also for the EU. Only through Ukraine's integration into the EU can Ukraine become successful. There is no single example of a post-Soviet country becoming successful without being integrated into the EU. Ukraine's success can become a powerful example and source of inspiration for Russians to follow the Ukrainian path of democratization and reforms. This is what the Kremlin is terribly afraid of and probably it is the main reason why Putin started the war against Ukraine. Therefore, Ukraine's membership of the EU is vital also for the EU.

Economically, Ukraine offers a great potential for the EU. The Union has thrived on its many expansions. The newest EU members have usually benefited from the highest economic growth rates, since the single European market breeds economic convergence. But the previous EU members have profited from the expansion of their markets and supplies. Thanks to its existing Deep and Comprehensive Free Trade Area, Ukraine has already started becoming a part of the European supply chain, but this development should go much further.

Ukraine is bringing a new momentum to the development of the EU. Its EU membership will signify that Europe is becoming free and whole, though it will not be in peace until Russia has been defeated. Russia's assault on Ukraine has defined the borders of Europe for some time. Through its aggression, and control over Belarus, Russia has made clear that Russia and Belarus do not belong to the Europe of civilization until they have undergone a profound regime change, while Ukraine and

Moldova do. A natural consequence of this acceleration of European integration is that the EU accession process in the Western Balkans has been sped up with the EU starting accession negotiations with Albania and North Macedonia.

As this is being written, Russia's illegitimate military aggression against Ukraine persists. Without presuming exactly how the war will end, we make three assumptions. First, we assume that Ukraine will remain an independent, sovereign, and democratic state. Second, we assume that the war will slow down within 2023 after the Ukrainian government has recovered its full sovereignty and territorial integrity as before February 2014. Third, we trust that the EU and the rest of the West will maintain their political, military, and financial support for Ukraine, and that Ukraine eventually will become a full member of the EU. These three assumptions naturally lead to a call for a Marshall Plan for Ukraine, which should combine three important processes: reconstruction, reform, and EU accession.

This book has five primary aims. First, it aims to clarify why Ukraine and the EU belong together. Second, it suggests a structure for how EU accession, reconstruction, reform, and development can be combined. Third, it discusses how this major undertaking can be financed. Fourth, it considers how this international project may be managed. Finally, it singles out some of the most important reforms. Naturally, this endeavor is non-partisan. We favor cooperation with any government in Ukraine that honors EU values. The aim of this book is not to produce a comprehensive study but to focus on key aspects.

Our hope is that Ukraine will achieve a growth of 7-8 percent a year for a decade or more after the war is over. Many countries have achieved such a growth boost and Ukraine should draw on their experiences. They have had several features in common: national security, strong property rights based on the rule of law, macroeconomic stability, great economic freedom, limited state burden, and substantial market access leading to expansive foreign trade. The EU can assist in all these matters, and it is willing to do so.

Our focus is economic. We are not discussing the war or military assistance, only the economic cost of the war; although we favor large supplies of advanced military equipment and Ukraine's membership of NATO. Nor are we discussing sanctions against Russia in this volume, as we have done so elsewhere. Our aim is to support Ukraine as a nation.

Ukraine of Today

Ukraine has come a long way since it regained its independence in 1991, but this process has not been easy. In 1990, Ukraine and Poland were at similar economic levels, but now Poland is about three times wealthier because of its far better economic policy. At that time, the apparent similarity between the two nations was reflected in an optimistic report by Deutsche Bank. These two large countries had very similar size and economic structures with many mines, steelworks, and machine building as well as agriculture. Their level of education was also very similar. Therefore, they could take off in parallel. No conclusion could be more flawed, because the qualitative conditions were completely different.⁵

What was different? Four factors stand out: domestic institutions, economic policy, public understanding, and international engagement. First, Poland was an independent state with all relevant national institutions, such as a central bank and a ministry of finance, while Ukraine had to build most national institutions from scratch with minimal knowledge. Although Poland had a socialist economy, it had a large private sector and institutions for its regulation, relevant state institutions, and functioning courts.

Second, Poland had a corps of free market economist reformers around its great reform leader, Leszek Balcerowicz, while Ukraine had few significant market economic reformers in 1991

5 Christopher A. Hartwell, *Two Roads Diverge: The Transition Experience of Poland and Ukraine* (Cambridge: Cambridge University Press, 2016).

and none with high government positions. The Ukrainian decisionmakers did not know how to proceed with economic policy until 1994. As a consequence, the economic policies were quite different. Poland opted for radical market economic reforms and swift macroeconomic stabilization, while Ukraine continued Soviet state regulation, minimal privatization, and suffered from horrendous hyperinflation.

Poland had the necessary human capital for systemic change, and many intellectuals and officials who spoke English and were part of Western discussions. By contrast, few official Ukrainians spoke English and those who did were usually KGB agents. Millions of Poles had spent months abroad in the West in the 1980s as tourists, students, or temporary workers, having learned how the West worked. They were happy to return home and transfer that knowledge to their home country.

Poland had rejoined the International Monetary Fund (IMF) and the World Bank in 1986. Therefore, the IMF was ready to support Poland from the outset of its reforms in 1989. The West thought that it was worth supporting Poland financially, so it provided the country with sufficient funds from the outset in January 1990. A vital difference between the development of Poland and the whole of Central Europe, including Baltic States, and Ukraine, is that between 1994 and 1995 the Central European nations and Baltic States received Association Agreements with the EU, and somewhat later became a candidate towards EU membership status. Ukraine, by contrast, did not get such benefits in the 1990s.⁶

Today, Ukraine has caught up qualitatively in all these regards, and since 1991 it has held regular democratic elections for president, parliament, and local authorities. It has repeatedly gone through democratic change of power and has proven itself as an established democracy with a multi-party system, free media, and the freedom of assembly.

6 Anders Åslund, *How Ukraine Became a Market Economy and Democracy* (Washington, DC: Peterson Institute for International Economics, 2009).

Since 1992, Ukraine has established fruitful cooperation with the IMF, the World Bank, and the European Bank for Reconstruction and Development. Together with them, Ukraine has built a strong central bank, and a ministry of finance and fiscal service, which before the war had led to a sound macroeconomic policy, with orderly state finances, low inflation, and a relatively stable floating exchange rate based on inflation targeting. The Ukrainian nation has become integrated with the West.

Ukraine has numerous qualified professionals of all kinds. Tens of thousands of Ukrainians have been educated abroad and spent a long time there. They speak good English and other foreign languages, and they have learned how the West works. Today, Ukraine is united as a nation and ready for a breakthrough.

A seldom acknowledged fact is how well Ukraine has functioned after the Russian assault. Although Russia occupies 17 percent of Ukraine's territory and slashed its GDP in 2022 by 30 percent, Ukraine's infrastructure continued to operate surprisingly well even after Russia targeted it in October 2022. The Ukrainian state has turned out to function better than widely expected, and Ukraine's private enterprises have been highly patriotic. Apart from the places most exposed to Russia's warfare, Ukraine had functioning electricity, telecommunications, internet, radio, television, gas, water, sewage, roads, railways, and banks. The shops are full of goods and no rationing is needed. The vast majority of enterprises continue to work, although the Russians have devastated some parts of the country. The Ukrainian railways have surprised everybody by continuing to work normally.

Needless to say, nobody dares to fly over Ukraine because of the danger of being shot down by lawless Russia, and, even before the war in February 2022, Russia blocked the Ukrainian Black Sea ports and bombed civilian cargo ships. The Ukrainian state and society have proven tenacity and integrity that few had expected.

With Russia's assault on Ukraine in 2022, the collective West realized that Ukraine deserves its strong support, and the EU is happy to embrace Ukraine. The war has changed Ukraine profoundly. The material and human destruction has been horrendous. Great reconstruction and healing are necessary and will take many years. Because of the war, most Europeans realized that it makes no sense to continue with the wrong strategic attitude of "let's not provoke Putin", even when it is connected with the EU enlargement towards Ukraine. As High Representative of the European Union for Foreign Affairs and Security Policy, Josep Borrell, stated in the European Parliament: "Before the war the EU had no policy towards Russia, because the EU was too dependent on Russian gas; nor did the EU have any policy towards Ukraine, because policy towards Ukraine was subordinated towards the policy to Russia".

The relationship of Ukraine and the West with Russia is likely to be poor and minimal for years, while Ukraine's accession to the EU has not only become feasible but must be sped up. The future borders of the EU have become discernable. At present, the collective West is supporting Ukraine more than ever. It is vital to utilize and cement this Western support for future institutional development and for financing of such a development.

To begin with, Russia's aggression must be stopped, which is very costly and nobody knows how long it will take. If Ukraine wins the war against Russia and recovers its territory, a completely different process needs to start.

The common aim of Ukraine and the West should be to combine three goals: reconstruction, reform, and EU accession. These three objectives naturally form a whole without contradictions, turning Ukraine into a free and modern state with democracy, the rule of law, and a free market economy. The first and most obvious issue is to rebuild Ukraine. The second is to complete its post-communist reforms. The third is accession to the EU. These three combined processes require substantial financial support. The Western world has supported Ukraine, but it needs to do much more for Ukraine's future.

2. Ukraine's Road from Russia to the European Union

Ukraine's foreign policy and international integration have developed in fits and starts, as the Ukrainian nation has found its form, but over the three decades since Ukraine became independent its move from Russia to Europe has been gradual. Russia's increasingly hostile policy towards Ukraine under President Vladimir Putin has been the driving force. Conversely, the EU has gradually realized that Ukraine is a part of Europe and should become a member of the EU.

Soviet Ukraine was a member of the United Nations, but only formally. It suffered from severe international isolation imposed by Moscow. Therefore, in 1991 it was poorly prepared for independence in terms of relevant institutions and human skills, and it took Ukraine time to develop relevant skills for independent government policy, though some policies were obvious from the outset, notably national sovereignty and territorial integrity. With the sole exception of the Soviet naval base in Sevastopol in Crimea, all previous Soviet property in Ukraine was recognized by Russia as Ukrainian.

Ukraine's Road from Russia

Today, Ukraine's main problem is Russia's military aggression, but this has not always been the case. The relationship between Ukraine and Russia was more positive in the 1990s, when Boris Yeltsin was president of Russia.⁷

7 Åslund, *How Ukraine Became a Market Economy and Democracy*; Steven Pifer, *The Eagle and the Trident: U.S.-Ukraine Relations in Turbulent Times* (Washington, DC: Brookings, 2017).

In December 1991, the presidents of Russia, Ukraine, and Belarus agreed to dissolve the Soviet Union. Yeltsin committed to respect the territorial integrity of all the former Soviet republics within the existing borders. The Soviet Union collapsed, but peacefully so, and that remained true of the relationship between Russia and Ukraine. Both Russia and Ukraine attempted to accommodate one another in the 1990s. They concluded a large number of important agreements, with disputes mainly of a financial or commercial nature.

From the outset, Ukraine declared a “multi-vector” foreign policy, which implied its intention to maintain good relations with Russia, while developing more relations with the West. It joined all relevant international organizations, such as the IMF and the World Bank. It participated in the loose Russia-led Commonwealth of Independent States, but it never ratified its statute. It participated in the CIS multilateral free trade agreement, which was never fully ratified, but it never joined the Eurasian Economic Union - Russia’s attempt to ape the EU - or the Collective Security Treaty Organization - Russia’s response to NATO. Ukraine was a neutral country and it has remained so.

Although the Russian government recognized Ukraine’s sovereignty and territorial integrity from December 1991, Ukraine’s relationship with Russia remained complicated. A substantial political group of communists and nationalists in Russia, led by Moscow Mayor Yuri Luzhkov, agitated for Crimea being transferred to Russia, but this did not become Russian government policy at that time.

After Ukraine had become independent, the primary concern of the US government was to make sure that Ukraine, Kazakhstan and Belarus did not remain states with nuclear arms.⁸ At the time of its independence, Ukraine had the third largest nuclear force in the world. Needless to say, these US concerns

8 James M. Goldgeier and Michael McFaul, *Power and Purpose: U.S. Policy Toward Russia after the Cold War* (Washington, DC: Brookings Institution, 2003).

suiting Russia. In December 1994, the US, the UK, the Russian Federation, and Ukraine concluded the Budapest Memorandum, in which Ukraine agreed to give up all its nuclear arms to Russia in return for security assurances from the US, the UK and Russia. Ukraine lived up to its commitment and delivered all its nuclear arms and missiles to Russia by 1996 as promised, and it signed and ratified the Nuclear Nonproliferation Treaty.

In 1996, Yeltsin was re-elected, receiving a new stronger political mandate. Both he and Ukrainian President Leonid Kuchma aspired to friendly bilateral relations. As the mutual relations between Ukraine and Russia were better than ever, they concluded several important bilateral agreements. The most significant was the 1997 Treaty on Friendship, Cooperation, and Partnership between Ukraine and the Russian Federation, which established the principle of strategic partnership, the recognition of the inviolability of existing borders, and the mutual respect for territorial integrity.

In 1997, Russia and Ukraine concluded three important bilateral treaties about the Status and Conditions of the Black Sea Fleet. They divided the old Soviet Black Sea Fleet into two independent national fleets. Ukraine agreed to lease Crimean naval facilities to Russia for 20 years until 2017 with Russia paying Ukraine \$98 million annually for leasing Crimean bases. This payment was deducted from the cost of Russian gas provided and billed to Ukraine. Russia was bound to “respect the sovereignty of Ukraine, honor its legislation and preclude interference in the internal affairs of Ukraine” and, furthermore, Russian military personnel had to show their “military identification cards” when crossing the Ukrainian-Russian border; Russian forces could operate “beyond their deployment sites” only after “coordination with the competent agencies of Ukraine”. In 1998, Russia and Ukraine also concluded an important bilateral investment treaty with international arbitration. The years 1997-98, when Yeltsin was president of Russia, mark the most positive period for Russian-Ukrainian relations. In the late 1990s conflicts were of a rather mundane nature. In the early

1990s, Russia complained that Ukraine extracted too large credits from Russia and did not pay them back. Russia's gas trade with Ukraine was always controversial. Russia set the prices in an arbitrary fashion, and it complained that Ukraine did not pay but ran up large arrears, but Russia tried to seize Ukrainian assets, especially the gas pipeline system, in return. Both sides accused one another of larceny, probably on good grounds.⁹

Another area of conflict was trade. Ukraine's main exports to Russia were arms, steel, agricultural goods, and chemicals, but Russia was also a major exporter of steel, food, and chemicals, so they were competitors. Russia imposed anti-dumping measures whenever Ukraine successfully exported significant amounts of steel pipes, sugar, or vodka to Russia. Officially, free trade ruled, but the CIS free-trade agreement was never ratified and it offered no protection to Ukraine against Russian anti-dumping actions. These financial and commercial conflicts were prominent irritants, but they never rose to the threat of war.¹⁰

After Vladimir Putin became the Russian president in 2000, the relationship between Russia and Ukraine deteriorated. During his first term (2000-04), Putin paid initially little attention to Ukraine, but in 2004 he engaged intensely with Ukraine, seeing President Leonid Kuchma every month. He even went to Ukraine to campaign publicly for the pro-Russian candidate, Viktor Yanukovich, in the presidential elections in the fall of 2004.

Initially, Yanukovich recorded victory in the elections but only because of blatant forgery. Peaceful popular protests known as the Orange Revolution broke out on a massive scale, gathering up to one million people in Kyiv. Eventually, a compromise was reached to repeat the elections, which led to the

9 Anders Åslund, *Ukraine: What Went Wrong and How to Fix It* (Washington, DC: Peterson Institute for International Economics, 2015), 67.

10 Åslund, *How Ukraine Became a Market Economy and Democracy*.

victory of Viktor Yushchenko.¹¹ The main mediators were the EU High Representative for Foreign Policy, Javier Solana, and Poland's President, Alexander Kwaśniewski.¹²

The Orange Revolution appears to have been a horrendous shock for Putin. He was obviously furious but seemed rather lost, apparently not ready for external aggression. Clearly, he saw the Orange Revolution as a democratic threat to his increasingly authoritarian rule. Rather than attacking Ukraine at that time, he closed down democracy in Russia. In 2005, he promulgated several laws that stifled civil society, media, and political parties. These laws mark Russia's transition to authoritarianism.

Having established dictatorship at home, Putin proceeded to declare his novel anti-Western and anti-American views in his big speech at the Munich Security Forum in February 2007.¹³ He focused on complicating Russia's export of gas to and through Ukraine. In January 2006, Russia cut the gas flow to and through Ukraine for four days over a price dispute. In January 2009, Russia stopped the gas flow to no less than sixteen European countries for two weeks in the midst of a very cold winter.

President Yushchenko wanted Ukraine to join NATO. Belatedly, US President George W. Bush had decided that he wanted to admit Ukraine and Georgia into NATO, but Germany and France opposed. It all came to a crunch at the NATO summit in Bucharest in April 2008. The awkward compromise was that the summit agreed that Ukraine and Georgia should become members of NATO, but they did not say how that should be done.¹⁴

11 Anders Åslund and Michael McFaul, eds., *Revolution in Orange: The Origins of Ukraine's Democratic Breakthrough* (Washington, DC: Carnegie Endowment for International Peace, 2006).

12 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 69.

13 Vladimir V. Putin, Speech and the Following Discussion at the Munich Conference on Security Policy, February 10, 2007. <http://en.kremlin.ru/events/president/transcripts/copy/24034>

14 Åslund, *How Ukraine Became a Market Economy and Democracy*.

Strangely, Putin had been invited to this summit, and he made a speech in the closed session insisting that Ukraine was not a real country - a point that he has repeated many times later.¹⁵ Strangely, Western leaders did not realize what he was saying. In August 2008, Russia pursued a five-day war in Georgia, capturing one-fifth of its territory. The West protested, but it did not even impose sanctions, and many Westerners blamed Georgia.

In February 2010, Putin finally got his victory in Ukraine. Yanukovich was elected president of Ukraine not least thanks to massive Russian financing and media support. Yanukovich's big idea was to prolong Russia's lease of the Sevastopol base in exchange for lower gas prices. In April 2010, Yanukovich concluded such a deal with Russia, the so-called Kharkiv Pact. It extended the Russian lease of the Sevastopol base until 2042 in exchange for a multi-year discounted contract to provide Ukraine with Russian natural gas. In reality, Ukraine appears to have benefited little from this.¹⁶

Ukraine's Road towards Europe

In the 1990s, contact between Ukraine and the EU was surprisingly limited. Most Western countries established embassies in Kyiv early on, but little interaction or trade evolved. The first significant EU agreement with Ukraine was the EU Partnership and Cooperation Agreement that was concluded in June 1995. The EU concluded such an agreement with all CIS countries apart from Tajikistan, but it meant little: it involved no trade liberalization beyond the World Trade Organization Most Favored Nation. Ukraine and other former Soviet countries were set to wait while the EU concluded its lengthy negotiations with fifteen new EU members between 1995 and 2007.

15 "What Precisely Vladimir Putin Said at Bucharest," *Zerkalo nedeli*, April 19, 2008.

16 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 82-83.

In 2003, the EU finally felt ready to take a first step, launching its European Neighborhood Policy. It had “the objective of avoiding the emergence of new dividing lines between the enlarged EU and its neighbors and instead strengthening the prosperity, stability and security of all. It is based on the values of democracy, rule of law and respect of human rights.” It was broad, including sixteen countries in the EU neighborhood - in Eastern Europe, Northern Africa and the Middle East. The EU opened its door to the neighborhood, but little more. Yet, the EU mentioned the possibility of starting the negotiation of bilateral Association Agreements, and Ukraine was among the first countries to jump on the band wagon in 2007.¹⁷

The EU engagement with Eastern Europe assumed a firmer form in 2009, when the EU launched its Eastern Partnership. It focused on six countries - Ukraine, Moldova, Georgia, Armenia, Azerbaijan and Belarus. Russia had rejected participation early on. Azerbaijan and Belarus were instantly dropped because of their lack of democracy, but the EU pursued negotiations on substantial Association Agreements with Ukraine, Moldova, Georgia, and Armenia. These Association Agreements were quite similar. Their main content was a Deep and Comprehensive Free Trade Area of nearly 2,000 pages and a reform program of a few hundred pages.¹⁸ The Central European and Baltic countries had concluded such Association Agreements between 1992 and 1995, and had become EU members in 2004.

Ukraine had pioneered the negotiation of an Association Agreement with the EU in 2007, and in 2013 actual negotiations were finished. Traditionally, the Kremlin had paid little attention to the EU, but suddenly in June 2013 it came out strongly in opposition to the Association Agreement that not only Ukraine but also Moldova, Georgia, and Armenia had negotiated. In early September 2013, Putin forced Armenia to abandon its

17 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 16.

18 Association Agreement between the European Union and its Member States, of the one part, and Ukraine of the other part (2014, OJ L 161/3).

EU Association Agreement, apparently on national security grounds, while the other three held firm.¹⁹

In November 2013, Yanukovich refused to concede to the last two EU conditions - the release of political prisoners (notably former Prime Minister Yulia Tymoshenko) and the adoption of a law on prosecution - and did not sign the Association Agreement during the Eastern Partnership Summit in Vilnius in November 2013. As a consequence, the Ukrainian people stood up in protest once again. On November 21, 2013, large peaceful popular protests erupted in Kyiv. On January 16, 2014, Yanukovich forced the parliament to adopt the so-called dictatorship laws, which corresponded to laws Putin had promulgated in Russia in 2005 to prohibit almost all opposition activity. Yanukovich escalated and let his riot police shoot, killing more than one hundred protesters. In response to his violence, parliamentary support for Yanukovich disappeared; he lost his parliamentary majority and was ousted with a two-thirds majority. He fled Ukraine and went to Russia.²⁰

Russia's Break with Ukraine

Putin has repeatedly insisted that Ukraine is not a real state since his appearance in Bucharest in 2008, and he has become ever more aggressive. On February 21, 2014, when Yanukovich fled, Putin started a special operation in Crimea without any public declaration.

Russian special forces, without insignia, swiftly captured the whole peninsula. Everybody was surprised, and the Ukrainian armed forces were not prepared to offer resistance, so Russia seized Crimea almost without bloodshed. Putin insisted that this was a spontaneous movement of the people in Crimea. Only long afterwards did he acknowledge that Russian troops had participated. On March 16, a fake referendum calling for

19 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 44.

20 *Ibid.*

Crimea's accession to the Russian Federation was held; on March 18, the Russian Federation Council annexed Crimea. Only three Russian allies have recognized the Russian annexation of Crimea, and the West imposed strict sanctions on Crimea and the culprits behind its occupation.

On April 17, 2014, Putin held a major speech calling for “*Novorossiia*” (New Russia) to join Russia.²¹ By this he meant the eastern and southern half of Ukraine that Catherine II had conquered for Russia in the late eighteenth century. Soon after his speech, Russian special forces, without insignia, popped up in these regions of Ukraine and tried to instigate popular uprisings. By and large, these attempts failed except in parts of the two eastern-most regions - Donetsk and Luhansk - where Russians set up fake republics under Kremlin dictatorship.²²

Ukraine organized voluntary troops at a surprising speed, and, in the summer of 2014, the Ukrainian troops recovered substantial territory in the Donetsk and Luhansk regions. In July, the Kremlin sent in its special forces, which made substantial headway in July and August. A ceasefire agreement was reached in Minsk on September 5 between Russia and Ukraine, with the mediation of Germany and France in the presence of Belarus. After the Russians violated this agreement, seemingly to improve its strategic position, a second Minsk agreement was reached in February 2015. Yet, the Russian forces never maintained the ceasefires it proclaimed in Minsk, and trench warfare persisted until Russia launched its major onslaught on February 24, 2022.

After his seizure of Crimea, Putin cancelled most international agreements with Ukraine. On March 28, 2014, Putin submitted proposals to the State Duma to terminate all bilateral Russia-Ukraine agreements, including the Friendship Pact, the Bilateral Investment Treaty, the Black Sea Fleet partition treaty

21 Vladimir Putin, “Direct Line with Vladimir Putin,” April 17, 2014. <http://en.kremlin.ru/events/president/news/20796>

22 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 20.

and the Kharkiv Pact. The State Duma approved the abrogation of these Russian-Ukrainian agreements unanimously by 433 members of parliament. Thus, Ukraine and Russia no longer had any relevant or valid bilateral agreements.²³

After having annexed Crimea in 2014, the Kremlin treated Crimea as a fully Russian territory, while its position on its occupied territories in the Donetsk and Luhansk regions was confused. They were effectively ruled by Russian officials and commanded by Russian generals, but implausibly the Kremlin claimed that they were independent people's republics. The Russian government offered them minimal financing, leaving them as criminalized gang lands. Half of their populations fled - two-thirds to Ukraine, and one-third to Russia - leaving behind mainly pensioners, soldiers, and bandits. Their economies remained devastated. The Ukrainian-owned assets were gradually confiscated without any legal provisions. Only when forced to do so, the Russian government has provided financing to this area.

Putin is obsessed with Ukraine - or, rather, with pretending that Ukraine does not exist. In his annual call-in show on June 30, 2021, he claimed that "Ukrainians and Russians are a single people". He proceeded: "The main issues concerning Ukraine's functioning are not decided in Kyiv, but in Washington and, partly, in Berlin and Paris".²⁴

On July 12, 2021, Putin strengthened his resolve. Untypically, he published a long article on his own website, denying the very existence of the Ukrainian nation.

"I am confident that true sovereignty of Ukraine is possible only in partnership with Russia. Our spiritual, human and civilizational ties formed for centuries and have their origins in the same sources, they have been hardened by

23 Åslund, *Ukraine: What Went Wrong and How to Fix It*.

24 Vladimir Putin, "Direct Line with Vladimir Putin," June 30, 2021. <http://en.kremlin.ru/events/president/news/65973>

common trials, achievements and victories. Our kinship has been transmitted from generation to generation. It is in the hearts and the memory of people living in modern Russia and Ukraine, in the blood ties that unite millions of our families. Together we have always been and will be many times stronger and more successful. For we are one people.”²⁵

On February 21, 2022, three days before his assault on Ukraine, Putin held his most anti-Ukrainian speech to his Security Council. Since this speech contained his most extensive and immediate complaints about Ukraine, it is worth citing at length. Putin started and ended with Donbass: “The situation in Donbass has reached a critical, acute stage.” He claimed that “Presidents and Rada deputies come and go, but deep down the aggressive and nationalistic regime that seized power in Kiev remains unchanged. It is entirely a product of the 2014 coup, and those who then embarked on the path of violence, bloodshed and lawlessness did not recognize then and do not recognize now any solution to the Donbass issue other than a military one.” He accused the Ukrainian authorities of having elevated “the Neanderthal and aggressive nationalism and neo-Nazism ... to the rank of national policy,” while people in Donbass were “fighting for their elementary right to live on their own land, to speak their own language, and to preserve their culture and traditions.” Putin concluded: “I consider it necessary to take a long overdue decision and to immediately recognize the independence and sovereignty of the Donetsk People’s Republic and the Lugansk People’s Republic.”²⁶

Second, he condemned all Ukrainian state institutions and its foreign policy:

25 Vladimir Putin, “On the Historical Unity of Russians and Ukrainians,” July 12, 2021. <http://en.kremlin.ru/events/president/news/66181>

26 Vladimir Putin, “Address by the President of the Russian Federation, February 21, 2022. <http://en.kremlin.ru/events/president/news/67828>

“Ukraine is not just a neighboring country for us. It is an inalienable part of our own history, culture and spiritual space ... Ukrainian society was faced with the rise of far-right nationalism, which rapidly developed into aggressive Russophobia and neo-Nazism ... A stable statehood has never developed in Ukraine; its electoral and other political procedures just serve as a cover, a screen for the redistribution of power and property between various oligarchic clans. Corruption, which is certainly a challenge and a problem for many countries, including Russia, has gone beyond the usual scope in Ukraine. It has literally permeated and corroded Ukrainian statehood, the entire system, and all branches of power. The nationalists who have seized power have unleashed a persecution, a real terror campaign against those who opposed their anti-constitutional actions ... Under the laws on education and the Ukrainian language as a state language, the Russian language has no place in schools or public spaces ... Kiev continues to prepare the destruction of the Ukrainian Orthodox Church of the Moscow Patriarchate.”²⁷

A third part of the speech condemned Ukraine’s cooperation with the US and NATO: “Ukraine joining NATO is a direct threat to Russia’s security”;

“NATO documents officially declare our country to be the main threat to Euro-Atlantic security. Ukraine will serve as an advanced bridgehead for such a strike”; “The Ukrainian troop control system has already been integrated into NATO. This means that NATO headquarters can issue direct commands to the Ukrainian armed forces ... Ukraine intends to create its own nuclear weapons”.

Putin even accused the US of having combat corruption in Ukraine:

27 Ibid.

“the United States directly controls the National Agency on Corruption Prevention, the National Anti-Corruption Bureau, the Specialized Anti-Corruption Prosecutor’s Office and the High Anti-Corruption Court”.²⁸

Putin repeated Russia’s three core proposals to the US and NATO from December 2021:

“First, to prevent further NATO expansion. Second, to have the Alliance refrain from deploying assault weapon systems on Russian borders. And finally, rolling back the bloc’s military capability and infrastructure in Europe to where they were in 1997, when the NATO-Russia Founding Act was signed”.²⁹ Each of these three points sounded like a declaration of war to Ukraine.

In 1991, Russia had recognized the independence and territorial integrity of Ukraine, but Putin ignored that. When Russia started its full-fledged war against Ukraine in both 2014 and 2022, it did so without any legitimate ground. Meanwhile, Ukraine pursued no aggression against Russia; it has only defended itself against Russia’s war of aggression.

With its warfare against Ukraine since 2014, Russia has violated numerous international agreements, notably the UN Charter, the Helsinki Final Act of 1975, the Organization for Security and Co-operation in Europe Charter of Paris for a New Europe of 1990, the Organization for Security and Co-operation in Europe Istanbul Document of 1999, and its purported Friendship Treaty with Ukraine of 1997. This list could be made much longer, for example, including Russia’s violation of the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on their Destruction. Russia has revealed a horrendous lack of respect for international law.

28 Ibid.

29 Ibid.

After the war started, the UN General Assembly condemned Russia's aggression against Ukraine with overwhelming majority no less than three times in the course of 2022. As early as March 2, UNGA adopted a resolution that deplored "in the strongest terms the aggression by the Russian Federation against Ukraine in violation of Article 2 (4) of the Charter", and demanded that Russia "immediately, completely and unconditionally withdraw all of its military forces from the territory of Ukraine within its internationally recognized borders". It was adopted with an overwhelming majority of 141 out of the 193 UN member countries; only five countries voted against, and 35 abstained.³⁰

On October 12, UNGA passed another resolution calling for countries not to recognize the four regions of Ukraine which Russia had claimed following the so-called referendums, and demanded that Moscow reverse course on its "attempted illegal annexation". The resolution was adopted with 143 member states in favor, five against, and 35 abstentions. In these two votes, the only countries that opposed were Belarus, the Democratic People's Republic of Korea, Nicaragua, Russia and Syria; that is, Russia's closest allies, showing how isolated Russia has become.³¹

The EU Welcomes Ukraine

While Russia has repelled and assaulted Ukraine, the EU has welcomed Ukraine. After the Euromaidan, a large majority of Ukrainians wanted to join the EU and a somewhat smaller majority also favored NATO membership. After Russia's assault in 2022, few Ukrainians saw any other option than the EU and

30 UN, "General Assembly resolution demands end to Russian offensive in Ukraine," *UN News*, March 2, 2022. <https://news.un.org/en/story/2022/03/1113152>

31 UN, "Ukraine: UN General Assembly demands Russia reverse course on 'attempted illegal annexation'," *UN News*, October 12, 2022. <https://news.un.org/en/story/2022/10/1129492>

NATO. Since NATO membership did not appear realistic, the EU became the all-dominant issue.

In May 2014, Petro Poroshenko was elected president, and he was all for the EU and so was his government. Soon after Euro-maidan, Ukraine fulfilled the outstanding conditions so that the EU and Ukraine could conclude the important Association Agreement, which contains a substantial Deep and Comprehensive Free Trade Area. It came into force on September 1, 2017. Yet, this Agreement did not stipulate completely free trade, as it maintained 36 import quotas for Ukraine's main export items: agricultural goods, and steel. These quotas have gradually expanded and been eased, but as late as 2021, the EU still accounted for only 39.5 percent of Ukraine's foreign trade.³²

In 2017, the EU introduced visa freedom for Ukrainian citizens. It allows a Ukrainian to spend 90 days in the EU in a row without having to apply for any particular permit. This is greatly appreciated among Ukrainians, and millions of Ukrainians are usually present in the EU. In addition, several EU countries have facilitated Ukrainians opportunities to receive residence and work permits or study abroad.

The Association Agreement, together with the demands of the international financial institutions (IFIs), have spearheaded many structural reforms. Ukraine has made great headway in several areas, notably in its military, macroeconomic policy (central bank, ministry of finance, and tax administration) and decentralization. Other reforms have been lagging, and the EU accession is a great opportunity to facilitate and complete these reforms.

Russia's invasion of Ukraine on February 24, 2022, came as a major shock to Europe, which united as never before. Not only Europe, but the whole of the collective West united: the EU, the

32 European Commission, "Ukraine: EU trade relations with Ukraine. Facts, figures and latest developments," https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/ukraine_en

US, the UK, Canada, Japan, South Korea, Australia, and New Zealand.

The West united around three ideas - to isolate Russia through sanctions, to arm Ukraine, and to provide financial and humanitarian support to Ukraine. While the policy change was sudden, the West has pursued a gradual escalation. The sanctions against Russia have gone far to isolate Russia and degrade the Russian economy. To general surprise, the West froze half of the currency reserves of Russia's Central Bank that were held in Western central banks. Russia is, to a large extent, cut off from global finance; most of its prior imports of technology are no longer available, more than one thousand foreign companies have stopped trading with Russia, much of the transport and insurance sectors have also been eliminated.³³ Russia's economy is set to plummet. President Vladimir Putin has responded with state regulation and nationalization, which are bound to further aggravate the Russian economy. In addition, about 1,800 top Russian officials and oligarchs with families have been sanctioned by the West.³⁴ The united West has isolated Russia to a greater extent than anybody had expected.

Sensibly, the EU also decided to further enhance Ukraine's access to its market. However, in June 2022, the EU adopted a regulation that allowed for temporary full trade liberalization until June 2023. Thus, the EU has temporarily abolished all these import quotas and facilitated border and customs procedures. Due to a near total boycott by Russia and its blockade of Ukraine's Black Sea ports, the EU share of Ukraine's foreign trade is set to rise fast.³⁵

33 Jeffrey Sonnenfeld, "Over 1,000 Companies Have Curtailed Operations in Russia—But Some Remain," Yale School of Management, January 28, 2023. <https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain>

34 The International Working Group on Russian Sanctions, "Individual Sanctions Roadmap: Recommendations for Sanctions against the Russian Federation," Stanford University, Working Paper #3, June 14, 2022.

35 Ibid.

Many would have desired a faster and earlier armament of Ukraine to save Ukrainian lives, but Ukraine has received ample effective modern arms. In the first round, Ukraine needed anti-tank weapons (Javelins), anti-aircraft weapons (Stingers), and stronger air defense. In the second phase of the war, precise long-distance artillery and missiles, notably American HIMARS, have become crucial, and the US along with other Western countries are now delivering them. In late January 2023, several Western countries finally agreed to deliver modern battle tanks. The next big issue is modern Western fighter planes, such as F-16, French Rafale or Swedish Gripen. Furthermore, Ukraine needs a steady stream of ammunition.

The EU has changed internally. It has developed a more extensive common foreign policy. No former European Commission has been so committed to Ukraine. The cabinet of Ursula von der Leyen, the President of the European Commission, has coordinated the impressive sanctions policy. Together with Charles Michel, the President of the European Council, von der Leyen has become the face of the common EU foreign policy.

Countries with weak defenses, notably Germany and Sweden, decided to raise their defense expenditures to 2 percent of GDP as NATO has long demanded. Finland and Sweden have been admitted to membership of NATO, which facilitates cooperation between the EU and NATO. The only EU members not to have applied for NATO membership yet are Austria and Ireland.

Ukraine has asked for membership perspective and the status of candidate for EU membership for many years. In June 2022, the EU granted Ukraine both membership perspective and made it a candidate for EU membership. The next step for the EU is to formulate a negotiation mandate and start membership negotiations. On February 3, 2023, von der Leyen led a delegation of 15 EU commissioners to Kyiv for an EU-Ukraine summit.³⁶

36 “EU officials praise Ukraine for anti-graft raids,” *Financial Times*, February 2, 2023. <https://www.ft.com/content/53d688ca-482f-41e4-b6a7-7d24a416a9f4>

The EU and Ukraine issued a strong Joint Statement. The EU repeated its commitment to Ukraine: “The EU recalled the decision by the European Council to recognise Ukraine’s European perspective and grant to Ukraine the status of a candidate country. The EU reiterated its commitment to support Ukraine’s further European integration.” Yet, the EU insisted: “The EU will decide on further steps once all conditions specified in the Commission’s opinion are fully met.” Fortunately, “Ukraine underlined its determination to meet the necessary requirements in order to start accession negotiations as soon as possible.”³⁷

The EU offered a positive conclusion: “The EU acknowledged the considerable efforts that Ukraine demonstrated in the recent months towards meeting the objectives underpinning its candidate status for EU membership, welcomed Ukraine’s reform efforts in such difficult times, and encouraged the country to continue on this path and to fulfil the conditions specified in the Commission’s opinion on its membership application in order to advance towards future EU membership.”³⁸

The Joint Statement rightly focused on the most important judicial reforms: “We reaffirmed that comprehensive and consistent implementation of judicial reforms, in line with the recommendations of the Venice Commission, including the reform of the Constitutional Court and the selection procedure of politically independent and qualified constitutional judges, remains vital for strengthening Ukraine’s resilience and for progress on the enlargement process.”³⁹

37 European Council, “Joint statement following the 24th EU-Ukraine Summit,” February 3, 2023. <https://www.consilium.europa.eu/en/press/press-releases/2023/02/03/joint-statement-following-the-24th-eu-ukraine-summit/#:~:text=The%20EU%20will%20support%20Ukraine,of%20candidate%20country%20to%20Ukraine.>

38 Ibid.

39 Ibid.

3. The Costs of Russia's War on Ukraine

Ukraine has suffered enormously from Russia's ruthless and unjustified aggression, and it is suffering ever more. In 2014-15, Russia seized 7 percent of Ukraine's territory and caused the latter a loss of 17 percent of its gross domestic product (GDP), since it occupied part of the highly industrial eastern Donbass region. In his famous book, *Capital in the Twenty-First Century*, economist Thomas Piketty estimated that the total value of assets has averaged slightly more than four times GDP for Europe over the last 140 years.⁴⁰ The simple, broad measure of the losses Ukraine suffered in 2014-15 because of Russia's warfare is, therefore, the occupied territories' share of GDP times four. Since the Donbas was the source of 10 percent of Ukraine's GDP and Crimea 3.7 percent at that time. The IMF assessed Ukraine's GDP in the pre-crisis year of 2013 at \$179.6 billion, the total asset value of Crimea and Donbas would amount to 13.7 percent of \$179.6 billion multiplied by four, or \$98.4 billion. This roughly represents the value lost by Ukraine if it loses these territories forever.⁴¹

In February 2022, Russia started a far greater military campaign. This time, Russia seized more land, but, apart from Mariupol, these territories were not very industrialized. As of February 2023, Russia occupies 17 percent of Ukraine's territory, in the south and the east (Crimea, almost the whole of Luhansk oblast, half of Donetsk oblast, much of Zaporizhze oblast but not

40 Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Belknap, 2013), 165.

41 Anders Åslund, "Kremlin Aggression in Ukraine: The Price Tag," *Atlantic Council*, March 2018.

the city Zaporizhe, and much of Kherson oblast, but no longer the city of Kherson). Russia lost its parts of Kharkiv oblast in September 2022 and the city of Kherson in November. In early February 2023, both countries fight in Donbas, where the front-line has changed minimally for months. Intermittently, Russia sends missiles from submarines in the Black Sea, and bases in Belarus and Russia, against any part of Ukraine. These Russian attacks, primarily directed against civilian targets across the whole of Ukraine, are highly disruptive. Since October 2022, Russia has focused its missiles on the civilian electricity system, first the grid and later the thermos-power stations.

The government of Ukraine, the World Bank, and the European Commission have launched a joint Rapid Damage and Needs Assessment. The World Bank published a first version in August 2022.⁴² This is a thorough assessment, comprising 242 pages. The material and human losses from the Russian aggression are very substantial. As of June 1, 2022, the World Bank recorded direct damage of more than \$97 billion. By November 1, both the Ukrainian government and the private Kyiv School of Economics that maintain these databases had recorded losses of more than \$120 billion. This is based on original cost. With realistic assessment of the reconstruction cost, the amount is likely to nearly double to some \$200 billion. Most of the losses are buildings and infrastructure. The cities of Mariupol and Chernyhiv have been devastated. The World Bank assessed the total recovery and reconstruction costs as of June 1 at \$349 billion. It has later arrived at almost twice as high a number. World Bank Vice President for Europe and Central Asia Anna Bjerde told Austrian newspaper *Die Presse* that the cost of rebuilding Ukraine's infrastructure damaged or completely destroyed by Russia will cost from 500 to 600 billion Euros.⁴³

42 World Bank, "Ukraine: Rapid Damage and Needs Assessment" (Washington, DC: World Bank, 2022), 11.

43 "World Bank: Ukraine's post-war reconstruction to cost up to 600 billion euros," Kyiv Independent, December 4, 2022.

The Russians have killed tens of thousands of civilian Ukrainians and presumably three times as many have been injured. After Libyan officers planted a bomb on an airplane that blew up over Lockerbie in Scotland in 1998, Libya eventually agreed to pay \$2.7 billion in compensation to the 270 victims' families, that is, \$10 million per victim.⁴⁴ If Russia has killed 50,000 Ukrainians, it would have to pay \$500 billion by the same standard.

To this comes the current Russian devastation of the Ukrainian economy. Ukraine's GDP appears to have declined by 30 percent in 2022. Since Ukraine's 2021 GDP was \$200 billion, that would mean a loss for Ukraine of \$60 billion in a year. As long as the war continues, nobody is predicting a fast recovery of the Ukrainian economy and we do not know as yet how large a share Russia is likely to keep, making it impossible to predict Ukraine's total losses.

Russia caused multiple damages to Ukraine's economy. From early February, Russia blockaded all Ukraine's Black Sea ports, which handled most of its foreign trade. Russia itself minimized its trade with Ukraine through sanctions and discretionary state decisions. Ukraine had to try to adjust by trading with Europe instead, but the infrastructure was insufficient. The World Bank assesses that: "Disruptions to economic flows and production, as well as additional expenses associated with the war, are collectively measured as losses and amount to some \$252 billion".⁴⁵

Russia's war has also caused major movements of population. In the last Soviet census in 1989, Ukraine had 52 million inhabitants. As elsewhere in Eastern Europe, the population has declined because of substantial emigration and low birth rates. There is no authoritative tally, but before the war in 2014, Ukraine had at most 42 million inhabitants, and 5-6 million of them spent substantial time abroad, primarily in Europe.

44 "Lockerbie Compensation: Libyan officials Acquitted," *BBC*, June 17, 2013. <https://www.bbc.com/news/world-africa-22936678>

45 World Bank, "Ukraine: Rapid Damage and Needs Assessment," 11.

In February-March 2014, Russia conquered Crimea with a population of 2.3 million. The occupied territory of its two quasi-states in Donetsk and Luhansk oblast had barely 5 million inhabitants before the war of 2014. Of those, 1.7 million fled to Ukraine and probably 0.8 million to Russia, leaving about 2.5 million inhabitants, to a large extent old-age pensioners.

After Russia's attack on February 24, 2022, the demographic situation changed dramatically. Observations are complicated by Ukrainians having emigrated and returned in vast numbers and often very fast. No less than 7.5 million people fled to the EU, while almost as many Ukrainians, probably 7 million, were internally displaced. Almost half of the refugees, about 3 million, appear to have stayed in Poland. Other major recipients of Ukrainian refugees have been other Central European countries and Germany. Assessments are difficult because Ukrainians are allowed to travel around without visa or registration in the EU, and many Ukrainians move back and forth from Ukraine. Fortunately, all countries have received Ukrainian refugees with open arms, as most Europeans have greatly sympathized with their hardship and cause.

Initially, most refugees appear to have found private housing, but these conditions are largely temporary. The costs of the refugees have been covered by the host countries with surprisingly few complaints. Over time, however, the hosts' welcome is likely to wear out. Given that most of the refugees are women, children and old-age pensioners, many of them are likely to return to their homeland to reunite with their men. Many refugees have already returned to western and central parts of Ukraine, such as Kyiv. Yet, the longer the war lasts, the more refugees are likely to stay abroad, and the greater the tensions and costs will be.

4. Russia Must Pay War Reparations

Russia has caused Ukraine great costs for no permissible reason, as discussed above. Ukraine's Western allies need to go after the culprit - Russia - and make it pay substantial war reparations to Ukraine. The Putin regime will not agree to pay any reparations, but the beauty of the current situation is that Russia does not need to agree because the West has already frozen the international currency reserves of the Central Bank of Russia that are being held in seven Western countries. Immediately after Russia invaded Ukraine, the G-7 decided to freeze the international currency reserves of the Central Bank of Russia held in Western countries.⁴⁶ These funds are very large. According to the public statistics of the Central Bank of Russia, on January 1, 2022, they amounted to \$316 billion. Germany held \$96 billion, France \$61 billion, Japan \$57 billion, the USA \$39 billion, the UK \$31 billion, Canada \$17 billion, and Austria \$15 billion.⁴⁷

These reserves are being held at the central bank of each of these countries. The central bank reserves have many advantages. They are the indisputable property of the Russian Federation, which is directly responsible for the war crimes in Ukraine. They are perfectly liquid, and require a minimum of administrative and legal work. The countries that hold and have frozen these funds should confiscate them through national

46 Nate DiCamillo, "The G-7 has frozen all of Russia's reserve assets in their countries," *Quartz*, February 28, 2022. <https://qz.com/2135316/the-g-7-froze-all-of-russias-reserve-assets-in-their-countries>

47 Gary Clyde Hufbauer and Jeffrey J. Schott, "The United States Should Seize Russian Assets for Ukraine's Reconstruction," Peterson Institute for International Economics, April 21, 2022.

legislation on the basis of Putin's unprovoked war of aggression against Ukraine and his gross violations of international law.

The most obvious international authority to authorize such a seizure is the UN Security Council, but given that Russia is a permanent member of that body and can veto any decision, the UN Security Council is of little use, but the UN system offers other possibilities for the arranging of an international tribunal and the extraction of war reparations. While the UN General Assembly has less power, as mentioned above, on March 2, it demanded that Russia "immediately, completely and unconditionally withdraw all of its military forces from the territory of Ukraine within its internationally recognized borders" in a vote of 141 for and five against.⁴⁸

On November 14, the UNGA adopted a third strong resolution with 94 votes against 14 with 73 abstentions. This resolution went further to hold Russia accountable and compel it to pay war reparations to Ukraine.⁴⁹ It is quite strong and potentially operative. It "recognizes that the Russian Federation must be held to account for any violations of international law in or against Ukraine, including its aggression in violation of the Charter of the United Nations, as well as any violations of international humanitarian law and international human rights law, and that it must bear the legal consequences of all of its internationally wrongful acts, including making reparation for the injury, including any damage, caused by such acts".⁵⁰ It can form the basis for an international tribunal against Russia and help Ukraine to extract war reparations from Russia.

48 "General Assembly resolution demands end to Russian offensive in Ukraine," *UN News*, March 2, 2022.

49 UN, "General Assembly adopts resolution on Russian reparations for Ukraine," *UN News*, November 14, 2022. <https://news.un.org/en/story/2022/11/1130587>

50 UN, "Furtherance of remedy and reparation for aggression against Ukraine: resolution," November, 14, 2022, <https://digitallibrary.un.org/record/3994052>

The main legal authority of the UN is the International Court of Justice (ICJ) in The Hague. Since it is the highest UN court, its decisions are final and not subject to appeal. On March 16, the ICJ ruled in a vote of thirteen to two (the Russian and Chinese justices), that Russia “shall immediately suspend the military operations that it commenced on 24 February”. Russia did not comply. This is a good legal grounding for the Western countries in question to confiscate Russian funds.⁵¹ The ultimate verdict of the ICJ that is yet to come should provide a sufficient basis in international law for any Western country to confiscate Russian funds.

Historically, war reparations have been standard. Iraq’s unprovoked invasion and attempted annexation of Kuwait in 1990 is reminiscent of Russia’s invasion of Ukraine. Afterwards, Iraq was forced to pay substantial reparations to Kuwait. In February 2022, the UN Compensation Commission, which had been created to handle the restitution to Kuwait, announced that it had processed its final claim, concluding a total of \$52.4 billion of war reparations.⁵² Ideally, Russia should be forced to pay war reparations after this war has ended for all the damage it has caused Ukraine.

Gary Hufbauer and Jeffrey Schott of the Peterson Institute for International Economics have noted that the US has two powerful laws for seizing foreign assets: the Trading with the Enemy Act of 1917 and the International Emergency Economic Powers Act of 1977. Both these laws focused on the freezing of foreign assets. The USA Patriot Act of 2001 gave the US government additional powers to seize assets of belligerent countries as well as to dispose of them as the president sees fit. President George W. Bush used the revised International Emergency Economic

51 “International Court Orders Russia to ‘Immediately Suspend’ Military Operations in Ukraine,” *UN News*, March 16, 2022. <https://news.un.org/en/story/2022/03/1114052>

52 “Iraq Makes Final Reparation Payment to Kuwait for 1990 Invasion,” *UN News*, February 9, 2022. <https://news.un.org/en/story/2022/02/1111632>

Powers Act to use Iraqi assets for humanitarian and reconstruction needs in Iraq. President Biden invoked the same law to pass on \$3.5 billion of the Afghan central bank's reserves for humanitarian purposes. The problem with regard to Russia, as Hufbauer and Schott point out, is that Russia has not attacked the US. Therefore, they argue that "President Biden might well prefer fresh authorization from the Congress".⁵³

Harvard Law Professor, Lawrence Tribe, and his co-author, Jeremy Lewin, have developed these arguments further, claiming that "Mr. Biden already has ample statutory authority to liquidate Russian assets under a section of the International Emergency Economic Powers Act". They continued: "Since the reserves in question are Russian state property - unlike the assets of oligarchs - they are not shielded by the usual protections our legal system affords private property. The Fifth Amendment's guarantee against government seizure of property "without due process of law" applies only to "persons" - not foreign governments - as the Supreme Court suggested in 1992 and multiple federal courts have since held. Protections against the "taking" of property without "just compensation" likewise apply only to "*private* property", a category that clearly excludes Russia's sovereign reserves, even if they are conveniently parked within the US and in dollars."⁵⁴

Their arguments should also matter to other Western countries that have defense of private property rights in their constitutions. Central Bank reserves are not private but state property, and our concern is that the Russian state has violated multiple international laws.

In connection with the Lugano conference, Ursula von der Leyen, the President of the European Commission stated,

53 Hufbauer and Schott, "The United States Should Seize Russian Assets for Ukraine's Reconstruction."

54 Lawrence Tribe and Jeremy Lewin, "\$100 Billion. Russia's Treasure in the U.S. Should Be Turned Against Putin," *New York Times*, April 15, 2022. <https://www.nytimes.com/2022/04/15/opinion/russia-war-currency-reserves.html?searchResultPosition=1>

“We are working on the legal framework so that the assets of Russia and partly the assets of oligarchs can be used to restore Ukraine”.⁵⁵ But so far, the EU has not adopted any such law.

The principle is clear: Russia ought to pay substantial reparations to Ukraine after the war.⁵⁶ Sticking to international law, the G-7 should confiscate Russian state funds in Western countries. The G-7 should announce their intention to do so now and tell the Kremlin that it will have to pay for everything that it destroys in Ukraine. The more damage Russia inflicts on Ukraine, the larger the funds that will be confiscated.

Moreover, as former top US diplomat Robert Zoellick has noticed, “Countries win wars through economic resilience, not by force of arms alone”.⁵⁷ Ukraine needs far more budget financing now because of the immense costs of the war that Russia has imposed. The West holds Russia’s cash frozen. It should be used before Ukraine ends up in default, high inflation and great poverty.

Canada has taken the lead in adopting a law in late June 2022, to confiscate the assets of both individuals and states that are linked to violations of international peace and security, as well as gross violations of human rights. Canadian legislation could serve as a useful model for other countries currently holding Central Bank of Russia reserves. At the end of December 2022, the US adopted a law on the confiscation of frozen assets of sanctioned Russian oligarchs, but it does not apply to the far more important Central Bank reserves.

As discussed above, Russia does not need to agree, because the West already controls liquid Russian state assets. Putin

55 “EC preparing legal framework for confiscation of Russian assets in favor of Ukraine - von der Leyen” *Kyiv Post*, July 6, 2022.

56 Anders Åslund, “Russia Must Pay Reparations,” *Project Syndicate*, March 24, 2022.

57 Robert B. Zoellick, “Russian Cash Can Keep Ukraine Alive This Winter,” *Wall Street Journal*, October 26, 2022. https://www.wsj.com/articles/russian-cash-can-keep-kyiv-alive-putin-war-of-aggression-frozen-reserves-group-of-seven-negotiations-europe-11666790591?mod=hp_opin_pos_4#cxrecs_s

has already responded by complaining that, by the “illegitimate freezing of some of the currency reserves of the Bank of Russia[,] ... the US and the EU have defaulted on their obligations to Russia”.⁵⁸ This is a weak argument for a man who has launched a war of aggression with thousands of unjustified murders and crimes against humanity.

Unfortunately, it appears as if the Western central banks are stalling any action to confiscate the currency reserves of the Central Bank of Russia. They appear to think that it would be bad for their reputation which is the weakest of arguments. The simple truth is that there is no viable argument against the confiscation of these reserves and without doing so the West will hardly be able to force Russia to pay war reparations to Ukraine and it will turn out to be impossible to finance the Ukrainian reconstruction.

Another potential source of financing for Ukraine’s reconstruction are assets of sanctioned Russian oligarchs that have been frozen abroad, because of their assistance to Putin’s criminal regime. However, it is unlikely to offer much financing within reasonable time because the legal obstacles will probably be insurmountable. Total Russian private financial assets abroad are assessed at more than \$1 trillion on the basis of the total net capital flight from Russia since 1990.⁵⁹ A fair guess is that the assets that should be frozen amount to about \$500 billion, but information about how much has been frozen is accidental and lacks detail.

The most authoritative EU information comes from EU Justice Commissioner, Didier Reynders, who said in an interview published on October 29, that the EU had frozen Russian assets

58 “Meeting on socioeconomic support for regions,” March 16, 2022.

<http://en.kremlin.ru/events/president/news/67996>

59 Filip Novokmet, Thomas Piketty, and Gabriel Zucman, *From Soviets to Oligarchs: Inequality and Property in Russia, 1905-2016*. NBER Working Paper no. 23712. (Cambridge, MA: National Bureau of Economic Research, 2017); Anders Åslund, *Russia’s Crony Capitalism: From Market Economy to Kleptocracy* (New Haven: Yale University Press, 2019), 165-9.

worth around \$16.9 billion since Moscow invaded Ukraine, of which roughly \$13.8 billion came “from oligarchs and other entities”.⁶⁰ On November 10, the UK announced to general surprise that it had frozen \$21.5 billion of Russian assets without any specifications.⁶¹ In May, the Swiss government reported \$6.3 billion worth of Russian assets frozen under sanctions, but this was a drop from early April as \$3.4 billion in provisionally blocked assets were released.⁶² The Cayman Islands has reported that it has frozen \$8.7 billion of Russian assets.⁶³ The British channel island Jersey froze \$7 billion associated with Roman Abramovich.⁶⁴ Strangely, the US has said nothing, so it does not appear to have frozen much. By the end of June 2022, the US Department of Justice stated that the US and its allies had frozen more than \$30 billion of Russian oligarch assets.⁶⁵ Considering how much the allies had frozen, this suggests that the US has hardly frozen any Russian assets. If we add up the amounts above, presuming no assets in the US, we arrive at \$60 billion, which might be 12 percent of half a trillion that should be eligible for freezing. None of it is Central Bank reserves Needless to say, the Western

60 “EU commissioner says 17 billion euros in Russian assets frozen,” *Le Monde*, October 29, 2022. https://www.lemonde.fr/en/international/article/2022/10/29/eu-has-frozen-17-billion-euros-in-russian-assets_6002233_4.html

61 HM Treasury, “OFSI Annual Review,” April 2021-August 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1116689/OFSI_Annual_Review_2021-22_10.11.22.pdf

62 Brenna Hughes Neghaiwi and Silke Koltowitz, “Swiss release some frozen Russian assets,” *Reuters*, May 12, 2022. <https://www.reuters.com/business/finance/swiss-release-some-frozen-russian-assets-2022-05-12/>

63 “Cayman freezes US \$8.7 billion in Russian assets,” *Cayman News*, July 12, 2022. <https://caymannewsservice.com/2022/07/cayman-freezes-us8-7-billion-in-russian-assets/>

64 “Jersey freezes \$7-billion worth of assets linked to Roman Abramovich,” *Financial Post*, April 13, 2022. <https://financialpost.com/fp-finance/jersey-freezes-7-billion-worth-of-assets-linked-to-roman-abramovich>

65 Thomas Franck, “DOJ says the U.S. and allies have frozen \$30 billion of Russian elites’ assets,” *CNBC*, June 29, 2022. <https://www.cnbc.com/2022/06/29/doj-says-allies-have-frozen-30-billion-of-russian-oligarch-assets.html>

countries need to start taking the tracing and freezing of sanctioned Russian assets seriously.

Unfortunately, it will be extremely difficult to collect any of these oligarchic assets. The culpability of various oligarchs will be hard to assess and they will defend themselves vigorously in court with the best lawyers in the world. They are now defending themselves against having been sanctioned. While their legal cases may be weak, their legal resources are far greater than those of Western governments. Their actual ownership is often hidden in layers of 20-30 anonymous shell companies registered in a dozen secretive offshore tax havens, and the real owners are doing whatever they can to transfer property to ever more obscure owners. The assets that have been frozen were so in the first days after sanctions were imposed, and many of them seem to have disappeared. By and large, these assets are not liquid. The prices of superyachts and palaces are likely to be very low at executive auctions, as the former owners might sue to retrieve them. Moreover, debts are often tied to them. Since the legal hazards will be enormous, oligarch assets are likely to generate little if any money, and if they do, only after a long time. The public focus on oligarchs is clearly driven by a populist desire for vengeance, but our main intention should be to finance Ukraine.

Instead, each country that holds Russian Central Bank reserves should adopt a special law for the confiscation of such assets and their transfer to Ukrainian reconstruction. Canada has already adopted such a law. The US Congress and the European Parliament have discussed such bills, but so far they seem unduly focused on the confiscation of frozen oligarch assets. Strangely, none of the Western countries holding Russian Central Bank reserves has publicly announced that it does or how large the Russian funds are that it holds. Each of the countries that hold such funds should declare how much it holds.⁶⁶

66 The International Working Group on Russian Sanctions, “Why and How to Confiscate Russia’s Sovereign Assets to Help Rebuild Ukraine,” Stanford University, Working Paper #6, October 11, 2022.

Other alternative legal approaches exist, and they can be pursued in parallel. They should be attempted, but they are unlikely to yield significant revenues in the next several years, and Ukraine needs vast amounts as soon as possible.

About ten Ukrainian company groups have presented their claims in the Permanent Court of Arbitration in The Hague. They base their claims on the 1998 Russian-Ukrainian Bilateral Investment Treaty. The Russian Federation claims that Crimea is Russian territory and these assets have been officially confiscated with Russian state decrees. Russia has revoked the Bilateral Investment Treaty, but it did so after it had confiscated these assets. These claims exceed \$13 billion. A first group of Ukrainian companies won an award of \$188 million. The most important case involves Naftogaz, which has won its case and it appears set to gain about \$10 billion from Russia. A few other claims are in the order of \$1 billion. They are from DTEK for Krymenergo, and the two state banks Oschadbank and Privatbank.⁶⁷ So far, however, even eight years after the Russian confiscation, no Ukrainian entity has received any compensation from Russia.

Moscow refuses to accept The Hague arbitration court's jurisdiction, but it has not been able to put up any credible resistance. If a Ukrainian entity wins in an international arbitration court, it can raise claims against the Russian Federation in other jurisdictions than Russia where Russian assets are present, utilizing the New York Convention on the Recognition and Enforcement of Foreign Arbitral Award of 1958. Naftogaz has already done so successfully for a major victory it won at the Stockholm arbitration court.

An alternative international tribunal is the European Court of Human Rights (ECHR), which is attached to the Council of Europe in Strasbourg. The Ukrainian Ministry of Justice has repeatedly stated that it would go to the ECHR to seek compen-

67 Anders Åslund, "Kremlin Aggression in Ukraine: The Price Tag," *Atlantic Council*, March 2018.

sation from Russia for its economic losses in Crimea. In December 2015, however, the Russian State Duma promulgated a law allowing Russia to overrule verdicts by the ECHR, so the Kremlin is not likely to recognize any verdict by this court. Moreover, in March 2022, Russia left the Council of Europe and claimed to leave the ECHR even retroactively, but the New York convention still allows successful claimants to collect Russian property outside of Russia.

Ukraine's wealthiest man, Rinat Akhmetov, has announced that he is suing the Russian Federation in the ECHR for compensation of \$17 billion for his two giant steelworks, Azovstal and MMK Illich, in Mariupol that were completely demolished by the Russian army.⁶⁸ All these are claims on the Russian Federation.

In practical terms, the confiscation of the \$316 billion of Russian Central Bank currency reserves appears the only attractive short-term option, and its legal viability should be tried. There is no other way in which Russia can be forced to finance war reparations to Ukraine in the short term.

On November 23, 2022, the European Parliament adopted a resolution that recognized the Russian Federation as a "state sponsor of terrorism" with the overwhelming vote of 494 in favor and only 58 against with 44 abstentions. It called on "the EU and its Member States to develop an EU legal framework for the designation of states as sponsors of terrorism".⁶⁹ Several EU countries have already declared Russia a state that supports terrorism, notably, Lithuania, Latvia, Estonia, Poland, and

68 Max Hunder, "Ukraine's richest man sues Russia at Europe's top human rights court," *Reuters*, June 27, 2022.

69 European Parliament, "Recognizing the Russian Federation as a state sponsor of terrorism," November 23, 2022. https://www.europarl.europa.eu/doceo/document/TA-9-2022-0405_EN.pdf; European Parliament, "European Parliament declares Russia to be a state sponsor of terrorism," *Press Release*, November 23, 2022. <https://www.europarl.europa.eu/news/en/press-room/20221118IPR55707/european-parliament-declares-russia-to-be-a-state-sponsor-of-terrorism>

the Czech Republic, but it has had little impact because of the absence of such legislation.

The US has such legislation and has declared several states - Cuba, Iran, North Korea, and Syria - state sponsors of terrorism. So far, the US has refused to declare Russia a state sponsor of terrorism, since that would force a further cut in official relations than the US administration currently desires.

However, if the EU adopts appropriate legislation on state sponsor of terrorism and the US designates Russia as a state sponsor of terrorism, that would allow the removal of the international legal immunity from Russia's state property, which would facilitate the confiscation of Russia's frozen state assets. Such a designation could also facilitate the establishment of an ad hoc international tribunal on crime of war aggression.

5. The Short Term: How to Provide Macroeconomic Stability, 2022–23

The world is justly impressed by the victories of Ukraine’s armed forces against Russia, and the collective West has provided Ukraine with plenty of modern arms. However, arms alone are not enough. As economic historian, Niall Ferguson, has pointed out: “*The Ukrainian army may be winning. The Ukrainian economy is losing*”.⁷⁰

In April 2022, eight economists from the respected Centre for Economic Policy Research (CEPR) published a substantial and useful report: “A Blueprint for the Reconstruction of Ukraine”. Their report on Ukraine’s reconstruction distinguished between three stages of reconstruction. At the Ukraine Recovery Conference in Lugano, July 4-5, 2022, the Ukrainian government presented a similar periodization in a detailed, ambitious reconstruction plan for 2022-32:

- A. Emergency response, while the war continues, 2022-23
- B. Reconstruction for 2023-25
- C. Development and modernization, 2026-32.

Each of these stages has different objectives. The emergency response aims to reestablish elementary state functions. The second stage aims to revive the basic functions of the economy. The third stage is meant to put the country on a rapid, sustained growth trajectory.⁷¹ This is a useful periodization, and others, including the Ukrainian government and the World Bank, have

70 Niall Ferguson, “Ukraine’s Army Is Winning But Its Economy Is Losing,” *Bloomberg*, September 12, 2022.

71 Torbjörn Becker et al. “A Blueprint for the Reconstruction of Ukraine,” *Centre for European Policy Research*, 6 April 2022.

followed it. There is no sharp division between them since reconstruction can start in some peaceful parts of Ukraine, while other parts remain in war.

Characteristics of the Emergency Phase

The key feature of the emergency phase is that the hot war is continuing. It is impossible to guess what damage the Russian troops will cause next. Rather than focusing on real warfare, they have bombed infrastructure in the whole country and bombed hospitals, schools and residential housing with obvious intention. The government's top priority is to win the war, which means that the supply of arms is vital. Yet, the government machinery and the national economy must somehow be kept afloat.

In early 2023, at the time of writing, it is impossible to guess for how long the war will last. Sheer attrition suggests that it will be less intensive in 2023. Neither side has sufficient munitions, while both have plenty of soldiers. Yet, both sides have mobilized their forces for a major offensive for months. If neither side gains upper hand, the hot war may recede into a limited trench warfare as was the case in 2016-21. Tentatively, though, the current emergency phase appears likely to last through most of 2023.

In the early emergency phase, little coordination among donors was possible. Ukraine needed to urgently receive as much humanitarian and military assistance as possible and as fast as possible. This is best done by individual countries and international organizations on an ad hoc basis. The initial donations to Ukraine have been spontaneous as speed has been essential. Multiple governments have rightly made ad hoc decisions to help Ukraine. Non-governmental organizations have played an important role, and they have tended to go to the front. Trust funds have proliferated.

The aid Ukraine currently receives is usually divided into three categories: military aid (the largest element), budget sup-

port (which is cash funding to the state budget), and humanitarian aid (in many forms through many channels). These three forms of aid vary in many regards. The military aid is predominantly delivered in kind, military hardware and training, and some aspects of the military support are secret. The budget support, by contrast, comes in cash to the Ukrainian Ministry of Finance, and it is as transparent as possible. The humanitarian assistance is a mixed bag. Some is delivered in kind and some as funds. The donors are many, including states and non-governmental organizations. In this book, we focus entirely on the budget support.

From April 2022, the Western defense support was coordinated in monthly “Ramstein” meetings of the Ukraine Defense Contact Group, which included about 50 countries that contributed military support to Ukraine.⁷² From the outset, US Secretary of Defense Lloyd Austin has chaired these Ramstein meetings, and they have been highly productive and contributed to good coordination of Western military support to Ukraine.

The Kiel Institute for the World Economy in Germany publishes a very helpful summary of international support for Ukraine online. For the period, January 24-November 20, 2022, the US made the greatest commitment to support Ukraine at €47.9 billion, followed by EU countries and EU institutions at €35.0 billion and €12.3 billion, respectively, which means that the US accounted for just over half of the total recorded commitments.⁷³ At this time, the euro and the US dollar were close to parity, so the numbers in dollars and euro are about the same.

72 Karen DeYoung and Annabelle Timsit, “‘Putin never imagined’ global rally of Ukraine support, defense secretary says”. *Washington Post*, April 26, 2022. <https://www.washingtonpost.com/world/2022/04/26/austin-putin-ukraine-support-military-russia/>

73 Arianna Antezza et al. “Ukrainian Support Tracker,” Kiel Institute for the World Economy, December 7, 2022; Arianna Antezza et al. “The Ukrainian Support Tracker,” Kiel Institute for the World Economy, Working Paper, August 2022 <https://www.ifw-kiel.de/topics/war-against-ukraine/ukraine-support-tracker/>

Of the US commitments of support for Ukraine, military assistance accounted for €22.9 billion, budget support for €15.1 billion, and humanitarian support for €9.9 billion. The US Congress has adopted three laws allocating a total of \$68 billion to Ukraine in 2022, which happens to correspond to the official Russian defense budget, and it has adopted a law allocating \$45 billion of more support for Ukraine until the end September 2023. The US has taken the lead not only in military support, but also with regard to budget support and humanitarian aid. Initially, the international financial institutions have played a remarkably small role, which is likely to change in the medium term. The US support has mainly consisted of grants, while almost all the EU support comprises credit. So far, the US has disbursed its commitments much faster than the EU. An rising concern is that Americans will not accept that they are paying more for Ukraine than Europeans. A worse concern is that some Trumpists in the House of Representatives oppose support to Ukraine because they appear to prefer Putin and Russia over Ukraine. Therefore, US support for Ukraine might come to an end in late 2023.⁷⁴

Proportionally, the greatest supporters of Ukraine are the nearby East European countries. Estonia and Latvia have committed the largest contributions as a share of GDP, both donating about 1 percent of their 2022 GDP. They are followed by Poland, Lithuania, and Slovakia. The big countries in the Western alliances, the US, the UK, Germany, France, and Italy have each committed 0.2-0.3 percent of their GDP.⁷⁵

Short-Term Financing

In the spring of 2022, the Ukrainian government and the International Monetary Fund assessed that it needed emergency budget funding of \$60-65 billion or \$5 billion a month for 2022

74 Ferguson, “Ukraine’s Army Is Winning But Its Economy Is Losing,”

75 Antezza et al. “Ukrainian Support Tracker.”

to cover the budget deficit caused by reduced tax revenues, because of GDP was expected to fall by about 35 percent. This amount does not include military support, which falls outside of our discussion. Public expenditures have been slashed to the bare minimum. Capital investment has virtually ceased, so the public expenditures are focused on the basis of government activity: public wages, pensions, medical care, education, and basic social benefits.

Given a need for \$5 billion a month, Ukraine would have needed \$50 billion for the nine months between March and December, 2022. After severe budget cuts, the Ukrainian ministry of finance reduced the budget deficit to a total of \$51 billion for 2022, but the total pledges for 2022 reached only \$33.6 billion and only \$32.2 billion had been disbursed by the end of 2022, leaving the Ukrainian government with a shortfall of \$18 billion. The government felt compelled to resort to monetary financing, that is, printing money. As a result, inflation rose steadily - to 26.6 percent in October. Fortunately, inflation appears to have stabilized at this high level after larger Western budget contributions, and continued Ukrainian austerity.⁷⁶

76 Dragon Capital, *The Dragon Daily*, October 3, 2022.

Budget Support Pledged and Disbursed to Ukraine from March–December 2022 (Billion USD)

Partner	Pledged by 19-Oct	Incl. Grants	Disbursed by 22-Nov	Dec	Nov	Oct	Sep	August	July	Mar–June 2022
USA	13	13	12	3,5	0	0	1,5	3	1,7	2,3
EU	8	0,7	8	0,5	2,6	2	0,5	1	0	1,3
IMF	2,7	0	2,7	0	0	1,3	0	0	0	1,4
Canada	1,9	0	1,9	0,4	0	0	0	0,4	0	1,2
World Bank	1,8	0,1	1,8	0,4	0,1	0	0	0,1	0	0,7
EIB	1,8	0	1,8	0	0	0,6	0,5	0	0	0,6
Germany	1,5	1	1,5	0,2	0	0	0	0	1	0,4
UK	1,1	0,1	1,1	0	0	0,5	0	0	0	0,5
Others	1,7	0,2	1,7	0,3	0	0	0	0,2	0	1,1
Total	33,6	15,3	32,2	5,4	2,7	4,4	2,5	4,7	2,7	9,6
Incl grants	15,5		14,2	3,7	0	0	2	3	2,7	2,7

Source: Dragon Capital, The Dragon Daily, January 3, 2023, 2.

The Table shows all the budget support that has been firmly pledged and disbursed in 2022. For short-term budget financing, the two major sources are the US and the EU, though other contributions are also significant. Since July 2022, the US is regularly disbursing at least \$1.5 billion a month; all the US money is in grants, so the US is fulfilling its part of the bargain.

The EU has lagged behind, but it is catching up. It disbursed a first package of €1.2 billion of macro-financial assistance in the first half of 2022. In May, it committed to a second much larger package of €9 billion, but it has encountered bureaucratic problems so the first €1 billion was disbursed only in early August.⁷⁷ In October, it disbursed €2 billion, and it paid out €3 billion in November and December 2022, but its total stops at only €6 billion out of the €9 billion the EU committed last May.

However, the European Commission remains fully committed to Ukraine's cause. Valdis Dombrovskis, the European Commission's Executive Vice-President, stated:

“This €1 billion payment is a first part of our €9 billion macro-financial assistance package to help Ukraine meet its emergency financial needs caused by Russia's brutal war. At the same time, we are working closely with EU Member States and our international partners on the next steps to rebuild Ukraine for the longer term. The EU will provide all political, financial, military and humanitarian support required to assist Ukraine and its people in the face of Russia's continued illegal aggression - for as long as it takes”.⁷⁸

In the end, it is the European Council that decides actual disbursements, and Germany has persistently protested about the financing, since it opposes further EU mutual indebtedness,

77 “EU releases first tranche of new €1 billion macro-financial assistance for Ukraine,” *EU Neighbours East*, August 1, 2022. <https://euneighbourseast.eu/news/latest-news/eu-releases-first-tranche-of-new-e1-billion-macro-financial-assistance-for-ukraine/>

78 Ibid.

which has nothing to do with Ukraine. These problems are of an internal EU nature and the EU appears to be resolving them.

Traditionally, EU macro-financial assistance comes in the form of loans, but Ukraine can hardly afford to accept more loans, because the debt burden will become excessive with the smaller GDP and will force Ukraine into debt restructuring. The EU set up the Next Generation EU funding program of €750 billion in response to the Covid crisis.⁷⁹ Half of it was grants and half credits.

Contributions from individual EU members have not compensated for the shortfall from the EU itself. Until the end of September 2022, such contributions amounted to only €2 billion. Half of it was a grant from Germany.

The Ukrainian government has specified its needs for 2023, presuming that the war continues with the current lower intensity. In October, President Volodymyr Zelensky stated that Ukraine would need \$55 billion of foreign support 2023 including \$38 billion for the budget and \$17 billion for the rebuilding of critical infrastructure. He expected an IMF program of some \$20 billion.⁸⁰

The two dominant donors to the Ukrainian budget remain the US and the EU. Hopefully, each will offer \$1.5 billion a month in 2023, which should suffice if their disbursements occur on time.

The Biden administration has declared its intent to continue with its budget support of \$1.5 billion a month until the end of the fiscal year in September 2023. This support was included in the administration's request for \$38 billion for 2023 that the congressional lame-duck session boosted to \$45 billion.

79 Laurence Boone, "Europe Must Become a Global Political Actor," *Financial Times*, August 26, 2022.

80 Andrea Shalal and David Lawder, "Ukraine's Zelenskiy appeals for \$55 bln to cover budget gap and reconstruction," *Reuters*, October 12, 2022. <https://www.reuters.com/world/europe/ukraine-needs-3-4-bln-external-financing-per-month-next-year-imf-chief-2022-10-12/>

The European Commission is also strongly in favor of Ukraine and it attempts to catch up to match the US financial support, though with highly subsidized credits rather than grants. On November 9, the Commission formally proposed a package of €18 billion macro-financial assistance for 2023. The European Parliament concurred and approved this package on November 24. In spite of an initial veto from Hungary, the European Council of 27 ministers of finance passed the final approval in December 2022.⁸¹

It thus appears as if the US and EU are guaranteeing Ukraine \$3 billion a month in budget support at least until the end of September 2023. This should be sufficient to keep the inflation from rising, but Ukraine is likely to need more funding. In early February 2023, Ukraine's Finance Minister Serhiy Marchenko saw an unfinanced budget deficit of \$10 billion in 2023 mainly because of the need for reconstruction of destroyed infrastructure.

The big financial player that has strangely stayed out of the Ukrainian drama so far is the IMF. Hopefully, the IMF will come around to offering a substantial macroeconomic financial stabilization program with major financing soon.

Macroeconomic Policy: How to Control Inflation

The war proceeds, but as Western budget support remains insufficient, the risk of high inflation rises. The ultimate Western aim today is that Ukraine wins the war both militarily and economically. The military expenditures cannot be cut, and the other public expenditures have been slimmed down to an utter minimum. The government has limited capacity to raise tax expenditures in the middle of a hot war.

Hyperinflation is all too common in or after wars. At the end of Communism, most of the formerly Communist countries

81 Dragon Capital, *The Dragon Daily*, November 25, 2022, and January 3, 2023.

were hit by hyperinflation, defined as at least 50 percent inflation a month. Hyperinflation inevitably undermines all public trust in the state and usually results in authoritarian rule, as we have seen in the former Soviet Union. We cannot allow Ukraine to fail financially for no fault of its own because the EU is too preoccupied with its bureaucratic rules.

The best solution, as argued above, would be a swift Western confiscation of the Russian Central Bank reserves and their transfer to Ukraine as war reparations. The West should not be compelled to pay for the damage that the Kremlin has intentionally caused.

The CEPR has produced a report going through all the options. It recommends that the government raise tax revenue and sell domestic debt rather than monetize it through the central bank, but that will hardly change much during the war. However, it is important that the government does not give in to voluntaristic ideas of sharp tax cuts in the middle of the war. In order to save its international currency reserves, Ukraine has introduced strict and necessary currency and capital controls. It has hiked the interest rate to 25 percent close to the level of inflation. It has fixed the exchange rate and devalued once by 25 percent, but it needs to devalue more given that an alternative market rate has evolved. Remarkably, Ukraine has gone through the war without a single bank crash. Banks and ATM machines continue to operate even if due caution is maintained.⁸²

Another concern is public debt sustainability. At the end of 2021, Ukraine public debt stood at 49 percent of GDP. Then its GDP was \$200 billion, but it is likely to fall to about \$130 billion in 2022, while the public debt has increased. According to Dragon Capital, Ukraine's public debt reached \$111 billion at the

82 Torbjörn Becker, B. Eichengreen, Y. Gorodnichenko, S. Guriev, S. Johnson, T. Mylovanov, K. Rogoff and B. Weder di Mauro, "Macroeconomic policies for wartime Ukraine," Centre for European Policy Research (CEPR), 12 August 2022.

end of 2022, or 86 percent of GDP which is barely sustainable.⁸³ Therefore, it is important that Ukraine primarily receives grants and not loans for its financing.

Usually, the IMF takes the lead in a macroeconomic crisis, but it has been the missing actor in the current Ukrainian financial drama. After Russia attacked Ukraine in February 2014, the IMF played a major and honorable role. As early as in March 2014, the IMF concluded a two-year Stand-by Agreement with a total financial support of \$33 billion, of which the IMF itself would contribute \$17 billion.⁸⁴ As the impact of the war became known, the IMF adopted a four-year program in March 2015. The IMF action was highly successful and should be repeated.

President Zelensky and the Ukrainian government have repeatedly appealed to IMF Managing Director, Kristalina Georgieva, for an IMF program, but she appears to do whatever she can to avoid adopting a normal financial stabilization program for Ukraine. After nine months of Russian aggression against Ukraine, the IMF has only provided \$2.7 billion of ad hoc emergency financing.⁸⁵

In order to minimize its financing to Ukraine, the IMF has developed a new monitoring instrument, a Program Monitoring with Board Involvement (PMB). It aims to establish a macroeconomic framework without financing. On November 23, the IMF announced that it had concluded such a staff-level program after virtual discussions, but without any financing.⁸⁶

Speaking at the International Conference on the Recovery, Reconstruction and Modernization of Ukraine in Berlin on

83 Dragon Capital, *The Dragon Daily*, January 30, 2023.

84 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 159.

85 IMF, "Remarks of the Managing Director at the International Expert Conference on the Recovery, Reconstruction and Modernization of Ukraine," October 25, 2022. <https://www.imf.org/en/News/Articles/2022/10/25/sp-md-remarks-at-the-international-expert-conference-on-recovery-of-ukraine>

86 IMF, "IMF and Ukrainian Authorities Reach Staff Level Agreement on Program Monitoring with Board Involvement," November 23, 2022. <https://www.imf.org/en/News/Articles/2022/11/23/pr22407-imf-and-ukraine-reach-staff-level-agreement>

October 25, Georgieva stated that the “PMB would help catalyze urgently needed support from donors and pave the way for eventually moving to a full-fledged IMF program”.⁸⁷ Neither there nor elsewhere does Georgieva appear to have uttered a word to explain the IMF’s neglect of its primary duty, to help a member country in a severe macroeconomic crisis with emergency financing.

Fortunately, Ukraine’s allies in the IMF have put the organization under pressure to help Ukraine and they hold the majority in the IMF. In early 2023, discussion is under way on a four-year IMF package of \$14 billion - \$16 billion, which may be decided in the spring of 2023.⁸⁸ That would put Ukraine’s finances on a steadier keel, and an IMF program is often facilitating other financing as well.

87 IMF, “Remarks of the Managing Director at the International Expert Conference on the Recovery, Reconstruction and Modernization of Ukraine,” October 25, 2022. <https://www.imf.org/en/News/Articles/2022/10/25/sp-md-remarks-at-the-international-expert-conference-on-recovery-of-ukraine>

88 Sam Fleming, Colby Smith, and Alice Hancock, “Ukraine’s allies push IMF to approve \$14bn-\$16bn loan,” *Financial Times*, February 3, 2023.

6. Ukraine's Reconstruction

When the war ends, or slows down, the emergency phase gradually ends, and a second phase of reconstruction - presumably the three years 2023-25 - begins. It should be very different. The amounts involved are vast, which requires substantial coordination, transparency, and good governance. Unless the governance is sufficiently good, funds might not be forthcoming. At that stage, private investments are unlikely because of excessive risks, so the financing needs to come from governments or inter-governmental organizations, while private contractors would be desirable.

After the West has spent trillions of US dollars on Afghanistan and Iraq, a smaller payment to Ukraine should be possible, in particular as Ukrainians are fighting and no foreign governments have provided soldiers. Since so many Westerners have worked with Afghanistan and Iraq, it is necessary to underscore that Ukraine is very different from those two countries. Therefore, everybody should be very careful not to carelessly transfer any lessons from Afghanistan or Iraq to Ukraine.

Ukraine has many advantages. It has already become a democracy and it has a functioning state administration. It has proven itself as a cohesive nation. In its defense against Russia's invasion, it has stood up not only for itself but also in the defense of the West. Today, Ukraine has the biggest and strongest army in Europe of 1 million men and women under arms. The Ukrainian population is highly educated and possesses considerable international experience. Moreover, Ukraine is a part of Europe. It has an Association Agreement with the EU, which includes a Deep and Comprehensive Free Trade Area, and it enjoys visa-free travel around Europe.

Principles of Reconstruction

The April 2022 CEPR report formulated nine pertinent principles for the international aid for the reconstruction, which are worth quoting ad verbatim, because they have become widely accepted:

1. “Aid should be rapid but conditional: Speed is critical for arresting a humanitarian catastrophe in Ukraine. Aid should be front-loaded to ensure that Ukraine receives support in the critical early post-war period when Ukraine does not have its own resources. Reasonable conditionality (accountability, milestones, etc.) will ensure that international aid is well spent and Ukraine makes progress in fighting corruption. Administrators of aid will monitor the use of funds, and Ukraine provides the transparency necessary to sustain international support for its reconstruction. Conditionality should be based on measurable, verifiable outcomes.”
2. “Grants rather than loans. The country destroyed by the war will unlikely be able to service and repay additional debts in the short run. A focus on loans (which is the main type of funding for WB, EBRD, EIB, etc.) will increase the risk of a debt crisis in the future. Grants accounted for 90% of Marshall Plan disbursements.”
3. “Coordination: Given the multitude of aid sources, close coordination across funding sources and with the recipient will minimize waste and delays.”
4. “Administration. Aid should be administered by a self-standing EU-affiliated or authorized agency independent of but accountable to multilateral, bilateral, and non-governmental donors. However, this agency should sunset when Ukraine joins the EU, to avoid the creation of a permanent bureaucracy with perverse incentives.”
5. “Ukraine must ‘own’ the reconstruction: Ukraine will utilize the aid most effectively when the aid is consistent

with Ukraine's interests. Aid programs should be aligned with the ultimate objectives of Ukraine (e.g. close the per capita GDP gap vis-a-vis successful EU accession economies, become a member of the EU, and build a carbon-free economy). Aid should reinforce national success via national institutions. Ukrainians should be able to scrutinize reconstruction efforts consistently, in line with best practice of EU transparency. Ukraine should be able to sustain projects funded by reconstruction aid after the aid is withdrawn."

6. "EU integration: Aid should create incentives for Ukraine to align its regulatory/legal environment to the EU standards (including anti-corruption frameworks), to promote free trade, and to attract foreign direct investment (FDI). The success of aid will critically depend on Ukraine's ability to export to the EU and other markets. The aid should direct Ukraine to become a member of the EU. Just like the Marshall Plan and the impetus it provided for regional integration (through the Organization for European Economic Cooperation) were instrumental in building confidence about the future of post-WWII Europe, EU integration would send a vital signal about a long-term commitment to market-based democracy in Ukraine."

7. "Modernization: Reconstruction offers a unique opportunity to radically upgrade Ukraine's productive capacity to bring it close to the technological frontier, lay foundations for long-term growth, and integrate Ukraine even more tightly into the global economy. Aid should be focused on increasing the productivity ,... [the] capacity of the economy and stimulating a high investment rate (e.g. on new machinery/equipment, infrastructure, training/human capital, technical assistance, etc.), as well as through strengthening human capital. The Russian invasion has damaged education for many young people, and this needs to be addressed as a top priority."

8. “Government intervention: Markets are unlikely to function smoothly in a war-torn economy. With scarce resources and dysfunctional markets, government will need to intervene in the allocation of resources producing ‘coordinated capitalism’ at least in the early stages of reconstruction. Ukraine will reduce government intervention in the medium-to-longer run, in line with EU accession.”

9. “Reduction of corruption: Putting in place mechanisms for the efficient utilization of aid (strengthening public procurement practices), together with mechanisms for monitoring the results, offers an opportunity to address complaints about clientelism and corruption, and, in doing so, to set the stage for attracting additional foreign direct investment. Again, following best practice for the EU seems to provide the best path.”

All these principles make perfect sense, and the Ukrainian government as well as the international community have largely adopted them. The question is how to apply all these principles. We would like to summarize these endeavors into three over-grasping actions: reconstruction, EU accession, and completion of reforms.

Management: A New Executive Agency?

The task of rebuilding and reforming Ukraine while facilitating its accession to the EU is a major European and collective Western undertaking for this decade. This task will determine the future of Europe. This task must not be allowed to go wrong. The amounts involved will hopefully be huge. It must be done well. The accounts must be transparent and the procurement competitive, but the execution must also be swift. At present, there is much talk about a Marshall Plan for Ukraine, which

appears appropriate given the size of the undertaking and the financing needed.⁸⁹

A first requirement is that, since the funds required are large, these funds are managed in a transparent fashion. A second requirement is sensible coordination of Ukraine's reconstruction, reform, and EU accession. Third, a coordinating agency needs to give the donors majority over disbursement of Western-controlled funds. Otherwise, the donors are unlikely to provide funds, but it must also guarantee the Ukrainian government ownership of the programs. A fourth requirement is that the reconstruction authority becomes fast and effective so that it does not become a slow bureaucracy. Fifth, Ukraine will need a completely new infrastructure that is focusing on European, rather than Russian, integration. It needs to be modern and green. That requires central government planning. Sixth, Ukraine requires reforms to fulfill its EU accession criteria, and the widely-held views of necessary reforms. Finally, the coordinating agency must involve the whole collective West. All significant donors must feel welcome.

Our hope is that Ukraine, and the collective West, will combine and cooperate in these three processes: reconstruction, EU accession, and the completion of Ukraine's reforms. While we hope that the EU will be able to take a lead in this process, it is important that the US, the UK, Canada, Japan, and other democratic countries participate. Since this is a major long-term project, we must get it right.

Various ideas have already been put forward. Europe has an outstanding model of successful governance that could be

89 Andrius Kubilius, "Ukraine: Our Next Steps," *Vilnius*, July 6, 2022. <https://elpnariai.lt/en/a-kubilius-ukraine-our-next-steps/>; Ronja Ganster, Jacob Kirkegaard, Thomas Kleine Brockhoff, and Bruce Stokes, "Designing Ukraine's Recovery in the Spirit of the Marshall Plan," German Marshall Fund, September 2022; Philip Zelikow and Simon Johnson, "How Ukraine Can Build Back Better," *Foreign Affairs*, April 19, 2022; Aleksandr Vindman and Dominic Cruz Bustillos, "Build Ukraine Back Better," *Foreign Affairs*, July 18, 2022; "Build Ukraine Back Better," Editorial, *Washington Post*, October 21, 2022.

repeated: the Organization for European Economic Cooperation (OEEC), which was founded in 1948 to manage the Marshall Plan. It was managed from Hotel Talleyrand at Rue de Rivoli in the center of Paris.⁹⁰

This precedence suggests that the best way of taking care of this important task is to establish a new strong institution for Western support of Ukraine. A neutral name of such a new agency would be the Ukrainian Development Authority. It should include all the donors as well as Ukraine. Its governing body should have a majority of donors, while the minority should be Ukrainian state representatives. The two dominant powers in the new Ukrainian Development Authority should be the main donors, the EU and the US, joined by the next three - Japan, the UK, and Canada - but all other major donors should be invited to participate. It is vital that the Ukrainian government feels ownership of the process.

In order to achieve this, an early agreement needs to be concluded between these parties and the Ukrainian government, so that an international institution exists to which reconstruction funds can be provided. A summit of interested parties should be convened as soon as a tentative agreement on the financing has been reached. The Ukrainian Development Authority should be given substantial executive powers so that it does not have to wait for others to disburse its funds. In order to be effective, it needs to have a strong chief executive with real power.

The argument against such an option is that it may take too long time to form such a body and it should preferably start working in early 2023.⁹¹ The Western countries that are not members of the EU are afraid of excessive dependence on the EU, which is being perceived as too slow and bureaucratic in its decision-making.

90 Michel J. Hogan, *The Marshall Plan* (Cambridge: Cambridge University Press, 1987).

91 Ganster, Kirkegaard, Brockhoff, and Stokes, "Designing Ukraine's Recovery in the Spirit of the Marshall Plan."

The Lugano conference for Ukraine's reconstruction, July 4-5 2022 was quite disappointing. The Ukrainian government presented a detailed reconstruction program but the Western donors only listened, and the US was barely represented, since the Swiss had not very sensitively organized the meeting on the US national Day. The next conference on Ukraine's reconstruction was held in Berlin on October 25, but it was primarily devoted to presentations by experts and non-governmental organizations. Once again, the US government was almost absent. The EU clearly wanted to take the lead and put the focus on EU accession, while not only the US but also the other non-EU G-7 countries appeared to stand aloof. The US had organized the successful monthly Ramstein process for defense support from April 2022, while no international coordination of financial support for Ukraine had been established.

Presumably for good, after these two not very operative Ukraine conferences, the driving force of Western support for Ukraine has become the informal G-7, which also includes the EU. On November 4 2022, the G-7 foreign ministers announced the establishment of a "coordination mechanism" to help Ukraine "repair, restore and defend its critical energy and water infrastructure".⁹² Such a body needs some administration. The European Union has offered to set up such an administration in Brussels, but independently from the European Commission to make sure that it does not become too slow and bureaucratic. A moot point is to what extent EU accession and reconstruction will be coordinated.⁹³ The World Bank has also offered to set up such a secretariat. Fortunately, the G-7 has moved ahead quite speedily. On December 12 2022, The G-7 leaders held a virtual meeting under the chairmanship of the UK. They agreed

92 John Hudson and Dan Lamothe, "G-7 Agrees to Repair, Defend Ukraine's Infrastructure amid Russian Attacks," *Washington Post*, November 5, 2022.

93 T. Becker, "A Blueprint for the Reconstruction of Ukraine;" Philip Zelikow, Philip Johnson, and Simon Johnson, "How Ukraine Can Build Back Better," *Foreign Affairs*, 19 April 2022; Ganster et al., "Designing Ukraine's Recovery in the Spirit of the Marshall Plan."

to “establish a multi-agency Donor Coordination Platform. Through this platform, we will coordinate existing mechanisms to provide ongoing short- and long-term support - with particular responsibility by the Finance Track for short term support - coordinate further international funding and expertise, and encourage Ukraine’s reform agenda as well as private sector led growth. We will also set up a Secretariat for the Platform. We will each designate a senior government representative to oversee the set-up of the platform and ongoing coordination efforts, and ask them to convene as soon as possible in January 2023.”⁹⁴

The G-7 leaders had made clear that it would lead the coordination of financial support for Ukraine and they made the operative decisions to proceed speedily. The two most important decisions were made - the establishment of a broad Donor Coordination Platform and of a Secretariat.

In late January 2023, the G-7 designated representatives met and made several important operative decisions. They agreed on the governance of the coordination platform. They appointed a steering committee consisting of a triumvirate of US Deputy National Security Advisor for International Economics Mike Pyle, Ukrainian Finance Minister Serhiy Marchenko, and European Commission Director General Gert Jan Koopman. It made perfect sense to have the US, the EU and Ukraine represented, though some complained that the US and EU representatives did not have higher rank. Nor was any strong executive appointed, which should be done in the future.

The G-7 representatives agreed to set up a Secretariat at the EU in Brussels with an additional office in Kyiv, which makes sense. The US wanted to minimize the size of the secretariat, which makes little sense since this is supposed to be a major undertaking. On the positive side, the G-7 has been highly inclusive. The relevant international financial institutions - the World

94 The Government of the UK, “G7 Leaders’ Statement: 12 December 2022,” December 12, 2022. <https://www.gov.uk/government/news/g7-leaders-statement-12-december-2022>

Bank, the IMF, the European Investment Bank, the European Bank for Reconstruction and Development, and the Council of Europe Development Bank have been included. It appears to be the required big tent. It is important to include countries neither belonging to the EU nor the G-7, such as Norway, Switzerland, Australia, South Korea, and New Zealand as well.⁹⁵

The development of Ukraine must not fail. The best way of assuring success is to impose strict conditions, which are supported by domestic reformers, of whom Ukraine has many. The IMF is famous for few but strict conditions, which are linked to substantial financing. Therefore, most countries in the world have complied with its conditions and built strong macroeconomic institutions, as has Ukraine. The EU has been similarly effective in its accession of new members, but it has been far too slow in the Western Balkans.⁹⁶ Hopefully, it can be more successful with Ukraine given all the experience it has gained of what works and what does not work in accessions, and if the discussed funding is really forthcoming, it should be a convincing argument for the Ukrainian government to adopt the right policies. It is promising that the EU is devoting great attention to Ukraine, and that it has set seven key conditions for its EU candidate status.

Good Governance and Transparency are Vital

Ukraine's governance is a major concern. Like all other post-Soviet countries, Ukraine has suffered from substantial corruption. The independent non-governmental organization, Transparency International, produces an annual corruption perception index. Currently, it ranks Ukraine 116 among 180

95 Thomas Kleine-Brockhoff, January 29, 2022. <https://twitter.com/Kleine-Brockhoff/status/1619791160192700416>

96 "The Balkan Turtle Race: A Warning for Ukraine," *European Stability Initiative*, July 13, 2022.

countries, with the thoroughly corrupt Russia at 137.⁹⁷ Ukraine has improved substantially since 2014, but much more needs to be done. All international institutions engaged in Ukraine focus on governance.

Unless Western donors are convinced of transparency and good governance, they will hold back funding from their state budgets. It is in Ukraine's national interest that donors are convinced that the funds they dedicate to Ukraine are being used to the benefit of Ukraine's national interest. The same is true for the confiscation of Russian assets. The seven countries that hold the Russian Central Bank reserves must be convinced that the money will be properly supervised and well used. Otherwise, their parliaments will protest and they are not likely to go ahead with any confiscation.

Disbursement systems may be seen as a technical issue but it is crucial. They must be fast, transparent, and well controlled. The IFIs are useful because they are used to working in all kinds of countries and situations. Tellingly, the US is disbursing its fast assistance to the Ukrainian state budget through a World Bank trust fund, because the World Bank can make sure that the money goes to specific purposes, such as pensions and health-care. The system of disbursement needs to be scrutinized and evaluated for the future Ukrainian Development Authority. A trap that must be avoided is a proliferation of trust funds that compete over the same funds, which easily results in donors becoming suspicious and holding back their support.

Given that the amounts of funding are expected to be very substantial, the risk of corruption is great. An early corruption scandal could easily sabotage the whole effort. The US and the West have been badly burnt by their experiences in Afghanistan and Iraq, where large amounts of money were spent, but they appear to have resulted in more corruption than development. Without comparing Ukraine with Afghanistan and Iraq, it is

97 Transparency International, "Corruption Perceptions Index," 2022. <http://transparency.org/en/cpi/2022>

obvious that the West will insist that safeguards against corruption are solid.

Ukraine stands out as a country with a very strong civil society. It has woken up time and again, first when Ukraine became independent in 1991; then in the Orange Revolution in late 2004, which was a protest against a stolen presidential election and engaged one million protesters in Kyiv.⁹⁸ An even greater mobilization of civil society occurred in Euromaidan between November 2013 and February 2014, when more than 100 protesters were shot dead. At no other time have so many people died for the sake of the EU.

Ukraine has impressive free, investigative media and anti-corruption non-governmental organizations. Ukraine's anticorruption activists and investigative journalists stand out for being sophisticated in all regards. They know what is going on and frequently cause well-justified corruption scandals with their revelations that have brought down many politicians. Rather than being absolutists, they are pragmatists who know how to focus on what really matters to cleanse Ukraine from corruption step by step. Since its Revolution of Dignity in 2014, Ukraine has carried out substantial reforms on the guidance of its civil society to improve its governance. Often, the international community has based their conditionality on the insights of Ukraine's civil society, though sometimes the civil activists complain that the foreign conditions are too soft.

Some of the most important reforms involve transparency. Ukraine has developed a transparent, electronic system for public procurement, sales and privatization called ProZorro, which has proven excellent, although it is not well suited for some purchases, such as quality consultation. Around one million public employees are compelled to register their incomes and assets in a public electronic database. While few have been prosecuted for violating these rules, the very transparency has shamed many violators. Ukraine has developed a full system

98 Åslund and McFaul, eds., *Revolution in Orange*.

of anti-corruption agencies that has now come into full force. Ukraine's fiscal system functions well. One of the most successful reforms has been decentralization of powers and finances to municipalities, which has rendered local authorities responsible to their communities. Even if Ukraine has too many state companies, the private sector dominates the economy. While judicial reform has not been completed, it is at the top of each reform agenda for Ukraine.

Good governance has to be enforced, that is, through the rule of law, transparency, and open competitive procurement. Both the in-flow of funds and the expenditures must be meticulously transparent. If any suspicion of inappropriate usage of the funds arises, the flow might easily be stopped by Western governments that transfer confiscated Russian, or their own funds, to Ukraine's support. Ukraine should learn from other Eastern Partnership countries, especially Georgia and Armenia, which during the last decades have made huge progress in the Transparency International Corruption Perception index, now ranked at 41 for Georgia and 63 for Armenia. By contrast, Ukraine has only advanced from rank 142 in 2014 to 116 at present. It could do much better following the examples of Georgia under President Mikheil Saakashvili and Armenia under Prime Minister Nikol Pashinian.⁹⁹

Medium-Term Financing, 2023–25

The second reconstruction phase should cover the three years 2023–25, for which the Ukrainian government request is \$300 billion. This is a lot of money, but it is not unreasonable given the damage Russia has caused Ukraine. Ideally, all of it would be covered by confiscated Russian Central Bank reserves as discussed above.

When the war starts winding down, the West needs to decide on medium-term financing for Ukraine's reconstruction. At that

99 "Corruption Perceptions Index."

time, the macroeconomic situation should have become sufficiently clear so that the IMF can conclude a multi-year Extended Fund Facility (EFF) or a similar agreement with the Ukrainian government, which should be given maximum financing. An EFF program is usually conditioned on substantial structural reforms, which Ukraine needs in order to complete its reforms and move towards high economic growth.

Considering the nature of Russia's war damage, the vast majority of the funding should be grants rather than loans. If this is not the case, the dominant source would have to be bilateral funding, primarily from the EU and the US. The EU has already committed \$100 billion to Ukraine and the US has committed \$113 billion for 2022-23, but that includes mainly military support. Other major Western countries - such as the UK, Japan, Canada, Norway, and Switzerland - should be encouraged to provide matching funds of another \$100 billion. Ideally, this amount of combined bilateral assistance should reach \$300 billion.

In order to achieve this, the EU needs to establish a special program of financing for Ukraine. The EU budget is small and inert set for seven years, allowing for few exceptional expenditures. The EU traditionally uses the EIB for major investment. To deliver financing of \$100 billion, the EIB would need a substantial capital infusion, which is possible, but the EIB provides loans rather than grants, which will put Ukraine in default and prompt a restructuring of its public debt. The EIB is suitable as an agency for a large-scale Ukrainian reconstruction program of infrastructure, but Ukraine cannot afford to take such large loans.

In May 2022, the European Commission therefore proposed a "RebuildUkraine" Facility, a new EU-funded instrument specifically dedicated to finance the reconstruction effort and the alignment of Ukraine's economy to the EU". This facility "would be the main legal instrument for the European Union's support, through a mix of grants and loans"; it "would have a specific

governance structure ensuring full ownership by Ukraine”.¹⁰⁰ Evidently, this is up for negotiations with other Western donors, such as the G-7 and especially the US, but this is the EU’s starting point.

Traditionally, the international financial institutions (IFIs) – the IMF, the World Bank, the EBRD and the EIB – have taken the lead in financial assistance. Their shortcoming is that they provide more loans than grants, and the amounts they can offer are too small, which means that they will probably play a less important role than usual. Yet, they will remain important because of their institutional and personal skills.

The World Bank seems well suited for Ukraine’s current needs. It was set up for the purpose of reconstruction after the Second World War, and it has all the tools and skills required. Tellingly, the US’ bilateral assistance to Ukraine’s government is being disbursed through a World Bank trust fund, because the World Bank has routines for ascertaining such disbursement with all the necessary safeguards. Therefore, the World Bank has come to pay a major role in the current financial support for Ukraine.

No macroeconomic stabilization takes place without the IMF. The strengths of the IMF are its highly-competent staff, a clear focus on macroeconomic essentials, the access to vast funds of credits, ability to act very fast and a clear focus on a few key conditions. The main problem in the current situation is that IMF management does not seem very interested. Also the IMF offers loans, admittedly on preferential conditions, but they are supposed to be paid back rather soon. The presence of an IMF program facilitates the engagement of other donors.

The EIB and the EBRD should also play major roles in the Ukrainian reconstruction. They have a prominent presence there for many years. The EIB is best seen as the EU arm for

100 European Commission, “Communication from the Commission ... Ukraine Relief and Reconstruction,” May 18, 2022. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022DC0233&print=true>

large-scale infrastructure investment. It offers large loans at preferential interest rates to governments and corporations. It is important that it is given a wide frame of investment credits for Ukraine. It is also important that it continues to finance both the public and private sector. The EIB should expand its financing for Ukraine as far as possible.

The EBRD has traditionally been the largest investor in Ukraine, both in equity and credits, in private as well as public enterprises. The EBRD has an important role to play when the private sector is feeble or uncertain, and that is what is to be expected after the war. It has been particularly effective in supporting corporate governance and protecting private property rights.

Not Only Reconstruction But Renewal

The post-war rebuilding of Ukraine must not be seen as a mechanical reconstruction. The reconstruction funding should be an insurance covering the losses made. It should primarily go to the owners of assets that have been destroyed by Russian warfare, which will lead to a natural decentralization.

With regard to the old infrastructure, the aim should be to build new modern structures. Modernization is always needed, but Ukraine needs strategic changes. Previously, Ukraine traded primarily with Russia, whereas Europe is now its dominant market, so the Ukrainian transportation system needs to be reoriented from Russia toward Europe. Central government policies should reorientate the transportation networks - highways, railways, pipelines, and the energy grid - to Europe. Obviously, Ukraine should build highways to Europe, but should it switch from the Soviet broad gauge of 1520 mm rails to the European 1435 mm rails? This major policy and security question involves vast costs, but also great new economic possibilities and better national security. Such choices require substantial analysis and centralized government decisions. The Black Sea

ports need to be further developed for international shipping to facilitate Ukraine's export of grain and iron ore.

The energy sector is a prime example of how Ukraine should move from Soviet to EU standards. As a member of the European Energy Community since 2011, Ukraine has already adopted and legislated the Third EU Energy Package of 2009 with its marketization and unbundling of energy assets. In 2021, Ukraine adopted laws on market pricing for gas and electricity. In March 2022, after Russia has started its new assault on the country, Ukraine harmonized its electricity grid with Central Europe, by transitioning from the Soviet electricity grid to ENTSO-E, which has provided Ukraine with new possibilities to export electricity to Europe, while Ukraine can import electricity from Europe at times of scarcity. Until the Russian bombings of Ukraine's electricity assets in October 2022, Ukraine had substantial overcapacity of electricity production, which could have been a boon to Europe and helped Europe to reduce its excessive electricity prices. Since October 2022, when Russia started bombing Ukraine's electricity network, Ukraine has instead been able to import substantial volumes of electricity from the EU.

No country in the EU has larger conventional gas reserves than Ukraine. It should finally increase its production of gas so that it can export gas to Europe to mutual benefit. When Ukraine regains the Donbass and Crimea, it should greatly increase its production of natural gas, which could replace some of the prior Russian exports on the European markets. The government should provide incentives to promote renewable energy and energy saving.

Ukraine has been at the forefront of developing green energy, both wind and solar energy. In early 2023, most of these assets are in the occupied south of Ukraine, that Ukraine will hopefully regain. The energy policy should incorporate the ideas of green energy, energy saving and European integration. The construction of buildings should aim at energy conservation

and more green energy. Ukraine could become a major asset to EU energy policy.

The United for Ukraine Network, of which the current authors are members, has proposed a Green Marshall Plan for Ukraine with generous European support. Ukraine has the largest potential for solar and wind energy in Europe. With the right technology and investments, it can rapidly expand its renewable energy sector and become a major producer and supplier of green energy to Europe, thus replacing Russian fossil energy.¹⁰¹

A budding internal Ukrainian dispute is whether reconstruction funding should be centralized or decentralized, but this dispute is artificial because the reconstruction has to combine both. As in any country, major infrastructure investments, such as highways and railways, must be decided at the highest national level. If reconstruction financing is based on the principles of insurance, it solves many of these disputes. A private family that has lost their house because of Russian warfare, should be allowed to claim restitution from the reconstruction fund and be allowed to use those funds as they desire. The same should be true of a private or public company. Any municipality or region should be allowed to claim funds for damages caused to them and use them as they find appropriate.

101 “A sustainable Future for Ukraine - the New Marshall Plan,” *Euroactiv*, November 10, 2022. <https://www.euractiv.com/section/energy-environment/opinion/a-sustainable-future-for-ukraine-the-new-marshall-plan/>

7. Reforming Ukraine through EU Accession

The EU accession should be an engine of reform in Ukraine. An early big step should be Ukraine's integration into the European Single Market, which is likely to kickstart Ukraine's economic growth. Most important for the country's future development is its institutional transformation, the development of a free democratic society with free information and a strong rule of law that can guarantee private property rights. A strong public consensus demands that Ukraine catches up economically and converges with the EU. Ukraine's EU accession should serve as an effective instrument to accomplish that. It should also help the EU to improve its own functioning.

Ukraine's Steps towards EU Accession

Russia's invasion of Ukraine on February 24, 2022, has brought Ukraine and the EU closer than ever before. The invasion united the EU in strong support of Ukraine. Millions of Westerners are grateful to Ukraine for standing up in defense of the whole West against Russia.

The Ukrainian government has consistently made clear that EU accession is a top priority. On February 28, 2022, five days after Russia had launched its full-scale, unprovoked and unjustified war of aggression, Ukraine submitted its application for membership of the EU. On March 7, the Council of the European Union requested the European Commission to submit its opinion on this application.¹⁰² After Russia's attack, most EU leaders

102 European Commission, "Commission Opinion on Ukraine's application for membership of the European Union," June 17, 2022, 2.

have visited Ukraine. The EU instantly imposed severe sanctions on Russia, and it has provided substantial financial assistance to Ukraine. The EU has responded positively to Ukraine's requests to become a member of the EU.

On April 8, 2022, the President of the European Commission, Ursula von der Leyen, and the High Representative for Foreign Affairs, Josep Borrell, visited Kyiv. They were received by President Zelensky and Ukrainian Prime Minister, Denys Shmyhal. At their joint press conference, von der Leyen offered Zelensky the necessary documents to complete his application for EU membership and she explained that this was an important step towards the EU. The Ukrainian government acted fast, responding to all the EU questions in writing within a couple of weeks.

As early as June 17, the European Commission recommended to the European Council that Ukraine be given the perspective to become a member of the EU. At the same time, the Commission took the important step, recommending that Ukraine be granted candidate status. The European Council decided accordingly.

The introduction to the Commission's opinion reflects the current positive EU thinking about Ukraine and is worth quoting ad verbatim:

“The aspiration to belong to the European Union has for many years been an important priority for Ukraine, its governments and citizens. It has been an underlying motive for democratic changes over the past decade and a driver of a number of key reforms founded on European values. The decision in late 2013, of the then-President not to sign, the EU-Ukraine Association Agreement, which symbolised for many Ukrainians a path towards the European Union, led to large-scale protests against the authorities. Subsequently, the Russian Federation moved against Ukraine, not accepting the independent choice of the Ukrainian people. While losing control over part of its territory and suffering human and economic losses because of the con-

flict in the eastern part of the country, Ukraine continued throughout the years as a resilient democracy moving closer to the European Union and gradually aligning with the acquis.”¹⁰³

The EU recommendation that Ukraine become a member is based on Ukraine fulfilling a number of conditions:

“the Commission assesses Ukraine’s application on the basis of its capacity to meet the criteria set by the European Council in Copenhagen in 1993, as well as in Madrid in 1995, notably regarding the country’s administrative capacity. The Opinion also takes into account Ukraine’s efforts in implementing its obligations under the Association Agreement (AA) and Deep and Comprehensive Free Trade Area (DCFTA), which entered into force on 1 September 2017”.

Key EU Conditions

The accession criteria, the so-called Copenhagen Criteria (after the European Council in Copenhagen in 1993, which defined them), are the essential conditions that all candidate countries must satisfy to become a member state. They are few but fundamental and pretty straightforward:

- “political criteria: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- economic criteria: a functioning market economy and the capacity to cope with competition and market forces;

103 Ibid.

- administrative and institutional capacity to effectively implement the *acquis* and ability to take on the obligations of membership”.¹⁰⁴

The European Commission offered a brief preliminary assessment on each point. “Overall, as regards the political criteria, Ukraine is well advanced in reaching the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities”.¹⁰⁵

The Commission delved a bit further on the economic criteria, raising more concerns, while still passing a positive verdict:

“Concerning the economic criteria, Ukraine has continued its strong macro-economic record, demonstrating a noteworthy resilience with macroeconomic and financial stability ensured also after Russia’s invasion in February 2022. This reflects not only a very strong political determination, but also relatively well-functioning institutions. At the same time, ambitious structural reforms to remove corruption, reduce the State footprint and the persistent influence of oligarchs, strengthen private property rights and enhance labour market flexibility need to continue in Ukraine to improve the functioning of its market economy. The capacity of the country to cope with the competitive pressure in the EU will depend crucially on how post-war investments in Ukraine are designed and sequenced in order to upgrade its physical capital, improve educational outcomes and spur innovation.”¹⁰⁶

With regard to its capacity to fulfil the obligations of membership, the Commission was particularly respectful:

104 European Commission, “Accession criteria: European Commission - Enlargement - Accession criteria,” n.d. https://ec.europa.eu/neighbourhood-enlargement/enlargement-policy/glossary/accession-criteria_en

105 “Commission opinion on the EU membership application by Ukraine.”

106 *Ibid.*

“Ukraine has worked since 2016 on the implementation of the EU-Ukraine Association Agreement, including a Deep and Comprehensive Free Trade Area (AA/DFCTA). These agreements already capture an unprecedented amount of the EU acquis. Ukraine has gradually approximated to substantial elements of the EU acquis across many chapters. It has an overall satisfactory track record of implementation, while in some sectors the country is more advanced than in others.”¹⁰⁷

This statement reflects that Ukraine has adopted a substantial amount of legislation in line with the requirements of the Association Agreement on matters such as the EU energy policy, which the Ukrainian government is keen to emphasize. These are important achievements, though not very visible to the public.

While the Commission and the Council accepted Ukraine as an EU candidate, it did so with seven conditions, and the Commission will monitor Ukraine’s progress in fulfilling these steps and report on them, together with a detailed assessment of the country, by the end of 2022. They are quoted ad verbatim:

1. enact and implement legislation on a selection procedure for judges of the Constitutional Court of Ukraine, including a pre-selection process based on evaluation of their integrity and professional skills, in line with Venice Commission recommendations;
2. finalise the integrity vetting of the candidates for the High Council of Justice members by the Ethics Council and the selection of candidate to establish the High Qualification Commission of Judges of Ukraine;
3. further strengthen the fight against corruption, in particular at high level, through proactive and efficient investi-

107 Ibid.

- gations, and a credible track record of prosecutions and convictions;
4. complete the appointment of a new head of the Specialised Anti-Corruption Prosecutor's Office through certifying the identified winner of the competition and launch and complete the selection process and appointment for a new Director of the National Anti-Corruption Bureau of Ukraine; ensure that anti-money laundering legislation is in compliance with the standards of the Financial Action Task Force (FATF); adopt an overarching strategic plan for the reform of the entire law enforcement sector as part of Ukraine's security environment;
 5. implement the Anti-Oligarch law to limit the excessive influence of oligarchs in economic, political, and public life; this should be done in a legally sound manner, taking into account the forthcoming opinion of the Venice Commission on the relevant legislation;
 6. tackle the influence of vested interests by adopting a media law that aligns Ukraine's legislation with the EU audio-visual media services directive and empowers the independent media regulator;
 7. finalise the reform of the legal framework for national minorities currently under preparation as recommended by the Venice Commission, and adopt immediate and effective implementation mechanisms.¹⁰⁸

This is a concrete list of measures that will reflect the political will of the Ukrainian government, because it can implement them with minimal budgetary cost. Their concreteness makes it easy for the Commission to assess Ukraine's progress. Illustratively, the four first EU conditions are legal, while the three others are democratic principles.

By putting the four conditions on the building of the rule of law first, the European Commission has clarified that the rule

108 Ibid.

of law has top priority. The Constitutional Court is the pinnacle of the Ukrainian judicial system, but its current majority of justices has repeatedly voted in favor of corrupt actions, showing that it needs a renewal based on personal integrity. Yet, such an important change must be carried out in a constitutionally acceptable way. The Venice Commission of the Council of Europe is supposed to vouch for that.

The situation is similar with the High Council of Justice and the High Qualification Commission of Judges, which are responsible for the nomination of judges, but they have so far failed to protect the integrity of judges. Ukraine has proper laws against corruption and top-level corruption remains a serious concern, but no high official still in office has been prosecuted or sentenced for corruption. The EU wants to see some change in this regard.

A long-standing EU demand has been the appointment of a new anti-corruption prosecutor. Fortunately, the experienced investigator, Oleksandr Klymenko, who was internationally verified, was appointed as head of the Specialized Anti-Corruption Prosecutor's Office at the end of July, 2022.

EU-Ukraine Cooperation

The EU-Ukraine Association Agreement provides the two parties with a comprehensive institutional set-up for bilateral dialogue and monitoring of the process of Ukraine's adoption and implementation of the EU acquis.¹⁰⁹ The EU is known for its intensive bureaucratic interaction with multiple working groups. Ukraine is now part of these activities. At the top, the EU and Ukraine hold annual summit meetings, but there are also an Association Council and Association Committees with a variety of sub-commissions.

109 "Commission Opinion on Ukraine's application for membership of the European Union," 16.

Ukraine has shown a strong commitment to the implementation of the Association Agreement and the Deep and Comprehensive Free Trade Agreement. It has a deputy prime minister for EU and Euro-Atlantic Integration, who has been able to coordinate EU integration at the Cabinet of Ministers, superior to ordinary ministers. The result has been good bilateral cooperation and gradual economic integration with the EU across a wide range of sectors. The EU has provided a large EU Advisory Mission, which has offered several advisors to all Ukrainian ministries. Since 2016, Ukraine's implementation of the EU acquis has been documented in the EU's annual 'Association Implementation Reports'. In August 2022, the Ukrainian government assessed that it had impressively adopted 70 percent of the legislation required in the Association Agreement.

The cooperation between the EU and Ukraine is not limited only by the government. An EU-Ukraine Parliamentary Association Committee works with the European Parliament and the Ukrainian Parliament on the implementation of the Association Agreement. An EU-Ukrainian Civil Society Platform has been established for the engagement of civil society as well.

We shall not enumerate all the many EU-Ukraine bodies, which might appear too many at first sight, but cooperation and interaction is broad and deep. Ministers of all specialisms meet every so often to discuss their specific concerns, exchanging and benefiting from the experiences of their peers.

Benefits of EU Accession

EU countries have benefited greatly from their EU membership in many ways. The first great advantage is the opening of the large European Single Market to candidates. The EU has already opened its market to Ukraine through the Deep and Comprehensive Free Trade Area (DCFTA), but Ukraine has not been fully integrated into the Single Market as yet. Ukraine has already started its integration into the European supply chain,

which should be a major engine for the country's economic growth.

A problem with Ukraine's DCFTA is that it contains 36 import quotas for Ukraine's main exports, notably agricultural products and steel. Fortunately, the EU has suspended all these quotas until the end of June 2023, but that would be a good time to integrate Ukraine fully into the EU Single Market. That would offer foreign investors in Ukraine certainty that they will not face any EU trade barriers in the future. Executive Vice President of the European Commission Valdis Dombrovskis has proposed Ukraine's early inclusion in the Single Market in 2023.¹¹⁰

Most important is the adoption of EU-conforming institutions for the sake of justice and social standards. The EU impose the rule of law through the superiority of the European Court of Justice. Sensibly, the EU has now focused its conditions for Ukraine's EU candidacy on the rule of law. Through its practice, the EU has proven that it knows how to build strong democratic institutions in its member countries. Thanks to its Association Agreement with the EU, Ukraine has already adopted a large part of 'acquis communautaire'. The Ukrainian government claims two-thirds of the necessary legislation, which should facilitate Ukraine's EU accession.

EU membership is also financially beneficial. A final benefit is substantial EU grants to new members. Recent EU members have typically received a net inflow of EU grants in the order of 3-4 percent of GDP after they have become members. This is being paid by the richer EU members, who are usually happy to be net contributors because the EU offers them a large and sophisticated market.

The EU is also a monetary community. Twenty of its current twenty-seven members belong to the eurozone, which means

110 Galina Ermolenko, "Ukraine expects to continue duty-free trade with the EU until the end of 2024," *GMK Center*, February 3, 2023. <https://gmk.center/en/news/ukraine-expects-to-continue-duty-free-trade-with-the-eu-until-the-end-of-2024/>

that they have the common euro currency and benefit from the stable euro and the services of the European Central Bank.¹¹¹ They are also members of the European banking union and the steadily evolving European capital market. As a new member, Ukraine would eventually be required to adopt the euro, when it has fulfilled the necessary conditions.

Certain EU regulations are both extensive and complex, and not necessarily beneficial to Ukraine at this stage of its development. The EU can make exceptions. When Poland became a member of the EU, it was relieved from a few of the EU chapters, notably environment, agriculture, and fishery. The EU should adopt a similar approach to Ukraine, allowing it longer time to the very expensive adoption of EU environmental rules.

Possibly the best EU assistance in the accession of countries to the EU has been ‘twinning’: a European country is twinned with a state agency in an accession country and its corresponding agency takes care of reform, modernization, and training of the staff at that agency. This is swift, fast, unbureaucratic, and effective. Ukraine started with some twinning under President Yanukovich, but that was not the right time so it fell off the rails.

How Fast Can Ukraine Join the EU?

The standard Ukrainian question is how fast Ukraine can join the EU, but there is no standard answer. Albania and North Macedonia had to wait many years between the declaration as candidates and the beginnings of membership negotiation. Albania applied for EU membership in April 2009. Since June 2014, it has been an official candidate for accession. In March 2020, the EU Council decided to open accession negotiations with Albania, but only in June 2022 did that actually happen. Similarly, in March 2004, North Macedonia submitted its application for EU membership. In December 2005, the European Council granted North Macedonia candidate status, but only in

111 The latest country to join the eurozone is Croatia on January 1, 2023.

June 2022 did the EU declare itself ready to start accession negotiations.

The timing depends on the candidate country, the European Commission, and the EU members, who must all agree. The candidate country tries to comply with the demands by the European Commission, while all the EU members must ultimately pass their political verdict with consensus. Any EU member can veto an accession country. Albania and North Macedonia show how complicated and slow it can be, and how it must not be done. North Macedonia has suffered from a series of single-country vetoes by Greece, France, and Bulgaria, for no fault of its own.¹¹²

An EU accession process usually takes a decade, but it can be sped up. One of us, former Lithuanian Prime Minister and now MEP, Andrius Kubilius, has published an article about how Ukrainian EU integration can evolve, arguing that in the very best case, Ukraine could join the EU in 2029. This article draws on two of the most successful prior experiences of EU accession: Poland and Lithuania.¹¹³ It distinguishes the different steps on the road to EU membership and advises how they can be minimized.

In June 2022, the EU made the historical decision to grant Ukraine the status candidate country. In the next step, the European Commission is supposed to deliver a positive assessment of Ukraine at the end of 2022. The Commission can only do so, if Ukraine can demonstrate that it has met all the seven conditions indicated in the Opinion quoted above. After that, the European Council can approve the Enlargement Report for Ukraine and decide on further steps, including the beginning of negotiations with Ukraine. It needs to set the terms for these negotiations. A

112 “The Balkan Turtle Race: A Warning for Ukraine,” *European Stability Initiative*, July 13, 2022.

113 Andrius Kubilius, “Ukraine: Our Next Steps,” *Vilnius*, July 6, 2022. <https://elpnariai.lt/en/a-kubilius-ukraine-our-next-steps/>

total of thirty-three chapters has to be opened for negotiations, and the EU tends not to open all at once.

Thus, ideally the EU and Ukraine could start membership negotiations in the first half of 2023. In the best cases, these negotiations have taken only three years (Lithuania) or four years (Poland). If Ukraine could follow this optimal path, it could complete its accession negotiations in 2027. Then, it would take about two years to prepare and ratify the treaty, which has to be ratified by all the EU member states.

If this is to be possible, the EU needs to change its accession negotiations to speed them up. The EU requirements are pretty clear in substance. While they are extensive, all the necessary legislation and administrative procedures can be adopted within three years, as per the Baltic States. The faster an accession country adopts all the required laws in an acceptable form, the sooner a country can join the EU. Speedy negotiations do not aggravate the quality but, as the Baltic countries show probably improve it.

The EU should return to its more effective enlargement of the period 1994-2004. The EU should reform itself so that it can make decisions faster, and EU member states should not be entitled to block EU enlargement to their immediate neighbors with whom they have historical problems (for example, Greek and Bulgarian objections to North Macedonia). The EU must regain its 'hunger for enlargement', as Ukraine's membership will strengthen the EU, not weaken it, and Ukraine's geopolitical weight will propel the whole EU enlargement process forward. This will also benefit Moldova and Georgia, as well as the Western Balkans, whose integration process so far has been stalling. Ukraine's membership would significantly strengthen the economic power of the EU.¹¹⁴

A common EU view is that the accessions of Bulgaria and Romania were too quick, as their rule of law remains unsatisfactory, but an alternative viewpoint is that the EU was not suffi-

114 Ibid.

ciently effective in their accession process. The EU should have imposed stricter conditions early on. It needs to learn from these experiences how to work more effectively on accession.

There are many reasons to believe that Ukraine will become far more serious about profound reforms after the war. It is ripe for reform. It has gained the needed human capital. Politically, Ukraine has attained a new national consensus about being part of Europe, and the president, parliament and cabinet of ministers all reflect this consensus. The cost of not having reformed the country earlier will be all too obvious and great.

The EU has strong incentives to support Ukraine as well. Ultimately, the Russian war against Ukraine is a war against Europe. Therefore, the Western political engagement in Ukraine will remain strong, and the financial resources available will be far greater than before. Ultimately, as long as the Russian military threat against Ukraine and Europe persists, all have a strong incentive to resolve the necessary issues fast and well.

In November 2022, the European Parliament took the logical step to recommend a New Enlargement Strategy, which declares that the EU enlargement to include Ukraine, Moldova, Georgia, and Western Balkans should be concluded before 2030.¹¹⁵ In his programmatic speech in Prague in August 2022, German Chancellor, Olaf Scholz, stated that he was “committed to the enlargement of the European Union to include the countries of the Western Balkans, as well as Ukraine, Moldova and, down the line, also Georgia”.¹¹⁶ The strong EU engagement for Ukraine’s accession to the EU has not impeded the accessions of other countries, but on the contrary, given them a new impetus.

115 “European Parliament recommendation ... concerning the new EU strategy for enlargement”.

116 “Speech by Federal Chancellor Olaf Scholz at the Charles University in Prague,” August 29, 2022. <https://www.bundesregierung.de/breg-en/search/scholz-speech-prague-charles-university-2080752>

8. Structural Reforms

At present, a broad and clear understanding has arisen about what major reforms Ukraine requires. This is also true of the Western community, including the G-7, the EU, the US, the IMF, the World Bank, and the EBRD. They have coalesced around a broad reform consensus.¹¹⁷

Ukraine has already come far in its reforms. All recent governments have embraced sound macroeconomic policies as reflected in the National Bank of Ukraine (NBU), the Ministry of Finance, and the State Fiscal Service. This has meant a limited budget deficit, limited public debt, low inflation thanks to inflation targeting, floating exchange rate, increasingly broader tax bases, reasonably low tax rates, and a far-reaching computerization of the tax system.

Yet, in practice, economic freedom has been little appreciated by any Ukrainian government, which is a major reason for the excessive corruption in Ukraine. Some relaxation of outmoded Soviet regulations has occurred, but too little and too slowly. All too often, the economic thinking of the government and parliament lapses into a Soviet state-oriented thinking, typically suggesting that a new state agency or company be established to resolve one problem or the other, or that the government should subsidize certain enterprises or activities. Price controls have persisted far too often, and the government maintains all

117 This chapter draws extensively on European Commission, “Commission Opinion on Ukraine’s application for membership of the European Union,” June 17, 2022. The Centre for Economic Policy Research published a book, “Rebuilding Ukraine: Principles and Policies,” edited by Yuriy Gorodnichenko, Iлона Sologoub, and Beatrice Weder di Mauro, in January 2023. It discusses Ukraine’s EU accession, reconstruction, and reforms at length. It draws on the mainstream of economic transition literature and previous Ukrainian experiences.

kinds of restrictions and regulations that cannot be understood. In wartime, it is understandable that various regulations have been imposed, but also, before the war, the many government interventions have been characterized by voluntarism rather than any principles. Ukraine needs far more economic liberalization.

Many, but not all, new EU members have excelled with eminent growth rates soon after they became members. In the 1990s, Ireland and Poland were the stars. In the 2000s, Estonia, Latvia, and Lithuania stood out. In recent years, Romania has excelled. These countries have shown that it is possible to sustain growth rates of 7-8 percent a year for a decade or more. But nothing comes automatically, and other countries have failed. In hindsight, the reasons for success are clear. Those countries have carried out proper reforms on a broad front, notably they have reformed their state administration and secured the rule of law. They have pursued conservative fiscal and monetary policies, not allowing public expenditure to grow larger than the economy can bear, and they have privatized state enterprises.

If Ukraine is to succeed, it will need to draw the right lessons from these many examples. It has already carried out many reforms, but much remains to be done. First of all, Ukraine needs to render its state administration more efficient. Second and most important, the rule of law needs to be established so that private property rights become credible. Third, the government needs to combat corruption more effectively, including abandoning a lot of excessive regulations. Fourth, Ukraine has a market economy, but the market reforms need to be completed. The market needs to be opened up with a sound competition policy. Fifth, Ukraine has still far too many state-owned enterprises that are neither innovative nor productive. Most of them should be sold off as fast as possible. A far-reaching privatization is needed. Finally, corporate governance of the remaining state-owned enterprises needs to be reinforced.

Interestingly, in July 2022, First Deputy Prime Minister and Minister of Economy, Yuliya Svyrydenko, published an article

advocating for “the philosophy of the three steps”. She sensibly called for 7 percent growth a year for the next decade by cutting the tax burden from 45 percent of GDP to 30 percent of GDP, by radically liberalizing the economy, and by imposing the rule of law.¹¹⁸ This was clear policy advice in line with what has worked in the recent winners in the EU, but it remains to be seen what policy will win.

Reform of the State Administration

Ukraine has carried out substantial reform of its state administration since 2014. It has a reasonable number of ministries and their areas of competence make sense. The legal framework for a modern public administration is largely in place, but its functioning is problematic.

The finest success has been the decentralization reform, which has advanced greatly since 2014. More than 10,000 small and dispersed local entities were merged into 1,470 larger municipalities, gaining administrative and economic capacity, and becoming able to manage their responsibilities more effectively. Democratic elections of mayors and local councils have strengthened the municipalities politically. A country-wide network of local ‘one-stop shop’ administrative service centers provide quality services to citizens and businesses. The reform was reinforced by fiscal decentralization so that the municipalities have stable financial resources necessary for the exercise of their new tasks of local self-government. They have also benefited from transfer of property and gained opportunities to regulate land trade on their territory. Therefore, the municipalities have now become crucial enablers of social and economic development. The war has proven the legitimacy and efficacy of the municipalities.

118 Yuliia Svyrydenko, “Kakuyu ekonomiku my stroim? (Vad för slags ekonomi bygger vi)?” *Ukrainskaya pravda*, July 8, 2022.

Another major achievement is that Ukraine has established an advanced e-government. It has computerized and digitized many public services through its DIA service, so that citizens can obtain many standard public services without having to talk to an official. Digital governance has improved the efficiency and transparency of the government.

Currently, the main problem of the Ukrainian state administration appears to be the functioning of the central state administration. Ministers are given far too short tenures, often only half a year, and acting ministers with limited authority are frequently keeping the government going. Ukraine has a new law on civil service that came into force in 2016. It lay the foundation for a modern professional and merit-based civil service, but it has been largely ignored. Staff are frequently changed on the basis on personal loyalty to superiors rather than professional merits.

The Ukrainian Constitution allocates most economic powers to the Cabinet of Ministers that is supposed to operate like a collective decision-making body. Alas, far too many decisions appear to be inspired by telephone calls from the presidential office. Such calls are not recorded or scrutinized, which dilutes personal accountability. Moreover, far too many issues have to be discussed and approved consecutively by half a dozen ministries, which can take years. For foreign businessmen, these tedious delays often raise prohibitive obstacles against investments in Ukraine.

The Ukrainian government needs to speed up and coordinate its decision-making, so that it stops being the main blockage to foreign investment. The government needs to impose strict deadlines for how long issues can be discussed before a decision is being reached.

The Ukrainian state administration is overextended. It needs to reduce its attempts to regulation to what is absolutely necessary and abolish many inspection agencies or trim both their sizes or authorities so that they protect society rather than hindering legitimate business activities. Many East European coun-

tries offer good examples, notably the three Baltic States but also Georgia under Saakashvili, and Armenia under Pashinian. Ukraine cannot afford to continue with its current cumbersome and harmful state regulations.

Ukraine also needs to switch to public funding of political parties combined with outright prohibition of private donations. Lithuania did so in 2011, and it really works. It is vital to get private business money out of politics. Similarly, lobbying activities must be regulated. Businessmen should not be allowed to purchase the services of government servants.

Ukraine has already done a great deal to increase public transparency, but it needs a full-fledged freedom of information act, which should make it possible for citizens and journalists to gain access to all state and government files that are not restricted for reasons of national security or personal integrity. The Nordic countries adopted such freedom of information acts in the eighteenth century and they have persisted. They are the main reason why they Nordic countries have minimal corruption.

Rule of Law Is the Foundation of Everything

Ukraine's fundamental problem is the malfunctioning of its judicial system. Like the rest of the former Soviet Union, Ukraine has still not succeeded in establishing real private property rights because of a weak judicial system. Temporary government officials can all too easily relocate the control of purportedly private assets.

Unfortunately, most formerly communist countries initially devoted little attention to the building of the rule of law because few prominent reformers were lawyers. Three positive exceptions stood out: East Germany, Estonia, and Georgia after Mikheil Saakashvili was elected president. These countries carried out radical judicial reforms from the top down, essentially sacking judges and prosecutors, and hiring new staff from a broader circle of legal professionals on the basis of professional

merit and ethical standards, which were assessed by external experts.¹¹⁹ No judicial system can be just, if its top officials are suspected of corruption or other ethical violations. Ukraine has partially started this process, notably with the Supreme Court and the new anti-corruption agencies, but it needs to be completed with rigor.

According to the Ukrainian Constitution, the only body that may interpret the Constitution and determine whether legislation conforms to it, is the Constitutional Court of Ukraine. However, it is in urgent need of reform, because it tends not to defend the Constitution. Most of its justices need to be exchanged. A credible and transparent selection procedure for appointments of judges to the Constitutional Court, including a proper integrity check, is needed. Relevant legislation is pending in the Parliament and it needs to be adopted before the end of 2022 in line with the EU requirements for candidate status. As the European Commission observed:

“Since the Revolution of Dignity in 2014, Ukraine undertook two rounds of judicial and anticorruption reforms (in 2014–2016 and in 2020–21) to align the judicial system with the principles of the rule of law, to strengthen judicial independence and accountability and to set up independent anti-corruption bodies. These reforms also had the aim of making the system more efficient and transparent. This need for reforms arose against the background of insufficient independence of the judiciary from the executive and legislative branches, low accountability, high levels of corruption and strong influence of oligarchic interests.”¹²⁰

The key to the judicial system is the High Judicial Council, which is the main body responsible for the self-government of the judiciary. The Constitution is supposed to guarantee the indepen-

119 Åslund, *Ukraine: What Went Wrong and How to Fix It*, 139–43.

120 “Commission Opinion on Ukraine’s application for membership of the European Union.”

dence of the judiciary, but that is only meaningful if the judges possess high integrity. Ukraine has codes of ethics for judges and prosecutors, and the appointment of judges and prosecutors is supposed to be based on merits and ethical standards, following public competitions. However, attempts of undue internal and external interference on the judiciary remain an issue of concern.

A first round of judicial reforms in 2016 succeeded in streamlining the court system and imposing new integrity examinations on all sitting judges. More than one quarter of the judges - *c.* 2,000 judges - resigned. Judicial appointments were opened to the entire legal profession and a more transparent judicial selection system was introduced. New Supreme Court members were nominated in a transparent manner, but unfortunately some judges with questionable integrity were appointed. The judiciary continues to be regarded as one of the least trusted institutions. When the war broke out, Ukraine was about to implement a fundamental judicial reform (2020-22) that was supposed to lead to systemic changes. Yet, the standard advice to any decent businessman is to avoid the Ukrainian courts.

In July 2021, Ukraine adopted new legislation on integrity and professional ethics checks for the two key judicial governance bodies (the High Council of Justice, which appoints and dismisses judges, and the High Qualification Commission of Judges, which conducts the selection procedures for new judges), in line with Venice Commission recommendations. The bodies tasked with doing the integrity checks had been established and started their work. After the integrity check of current High Council of Justice members was finalized on May 7, 2022, only three out of twenty-one High Council of Justice members remained. The aim of these reforms is to reduce corruption and enhance integrity of the top judicial governance bodies.

At the end of 2019, an ambitious reform of the prosecution service was launched. All the 11,700 prosecutors were vetted on the basis of professionalism and integrity: 30 percent of the prosecutors failed the attestation and had to leave the service.

Some 2,000 court cases challenging the outcome of the individual attestation were opened. In most of these cases, the court proceedings are pending. In 2021, the Prosecutor General's Office was searching for a new procedure for a transparent and merit-based selection of prosecutors, but the outcome remains uncertain.

Anti-Corruption Reforms: An Important Complement

Due to the pervasive larceny of the Yanukovich regime, prevention and combat of corruption became a major topic after the Revolution of Dignity in 2014. Many important measures have been undertaken. Ukraine's first important step was to opt for far-reaching transparency. Hundreds of thousands of government officials were compelled, under criminal liability, to declare their assets and incomes in a publicly accessible database, which came into operation in 2016. By and large, officials have done so and their revelations have been widely publicized. While inaccurate information has rarely led to criminal cases, many officials and politicians have lost their public standing because of their truthful but inconvenient revelations.

The most important anti-corruption measure has been the introduction of an electronic system for public procurement: Pro-Zorro. It boosted transparency in previously opaque procurement processes. The government assesses that this system has generated savings of at least 1 percent of GDP and will continue to do so. Similar systems have been introduced for sales of public assets and for privatization. A concern, however, is that the government agencies sometimes avoid this open public procurement. Another problem is that Pro-Zorro deals often fail or are delayed because of complaints to courts. Moreover, qualitative procurements, such as appointments of consultants, are not well suited for this system, which requires certain improvements.

Ukraine has also adopted various preventive measures. All forms of corruption, including illicit enrichment, have been criminalized, and the laws were adopted that regulate conflict of interest, protect whistle-blowers and ensure transparent public party financing. Integrity plans and code of ethics have been promulgated for key parts of the public administration and judiciary. Yet, the adoption by the parliament of a national anti-corruption strategy is still pending, and the enforcement of these ethical rules leave much to be desired.

After the Revolution of Dignity, Ukrainian civil society and the international community demanded that the Ukrainian government instituted a set of four specialized anti-corruption institutions: the National Anti-Corruption Bureau (NABU), the Specialized Anti-Corruption Prosecution Office (SAPO), the National Agency for Prevention of Corruption (NAPC), and the High Anti-Corruption Court (HACC). Legislation was adopted, and these institutions have received comprehensive mandates and are supposed to operate independently. Their heads were supposed to be selected in transparent competitions, checking their competence and integrity.

Yet, for years only one of these four bodies, NABU (the investigative arm), functioned as intended. In the absence of a credible anti-corruption prosecutor and anti-corruption court, NABU could not reach any verdicts. Other law enforcement agencies, mainly the State Security Service (SBU, the old KGB) remained unreformed and tried to hinder NABU's work. Yet, the publication of its investigations in free media has shamed the purported culprits.

In 2019, the HACC was finally established, and it has passed dozens of convictions. In July 2022, an anti-corruption prosecutor, whose integrity had been verified by international jurists and civil society, was finally confirmed. NAPC, which is mandated to check conflicts of interest, verify declared assets, and audit the spending of political parties, remains a concern. Its preventive functions are not being fulfilled, but they are badly needed.

The Ukrainian anti-corruption agencies have continued operating freely during the war. At the end of January 2023, several top Ukrainian officials, mainly deputy ministers, were exposed for corruption and dismissed. A couple were arrested immediately.¹²¹ These firm actions show the commitment of the Ukrainian government to its combat of corruption.

For Ukraine's successful securing of private property rights, it is vital that all the anti-corruption agencies function properly. In the last decade, Romania has proven how useful effective anti-corruption bodies can be when fully enforced. Not least because of this reason, Romania has excelled with the highest growth rate within the EU most recently.

Market Reforms Must Be Completed

Since 2014, the Ukrainian government has been broadly successful in carrying out sound macroeconomic policies. The government managed to get the budget deficit under control as well as the public debt. The National Bank of Ukraine (NBU) has been greatly strengthened and gained independence. It has adopted inflation targeting, stabilized the exchange rate, and built up Ukraine's international currency reserves. The NBU has cleaned up the banking system; though a negative effect has been that the four biggest banks are now state-owned and they hold about 60 percent of all banking assets. The share of non-performing loans has fallen, but it is still very high, and banking loans compose a remarkably small share of GDP. The interest rates remain by necessity high, since it is difficult to collect collateral. These generally successful macroeconomic reforms have been carried out in close collaboration with the IMF.¹²²

121 James Waterhouse and Phelan Chatterjee, "Top Ukrainian officials quit in anti-corruption drive," BBC, January 24, 2023. <https://www.bbc.com/news/world-europe-64383388>

122 Torbjörn Becker et al., "Macroeconomic Policies for Wartime Ukraine."

Yet, Ukraine's economy is not developing well. According to IMF statistics, Ukraine had the lowest GDP per capita in US dollars before Russia began its most recent assault. The Russian attack in 2014 was a major blow, slashing 17 percent of Ukraine's GDP, but the ensuing annual growth has only been c.2.5 percent. The problems are multiple, but they have to be solved. As mentioned, Ukraine's investment ratio is persistently low, because the business environment remains poor. In 2019, Ukraine ranked 85th in the global competitiveness index of the World Economic Forum, primarily because of weak institutions, the high prevalence of market dominance, and ineffective anti-monopoly policy. A steady complaint has been the malfunctioning of the Ukrainian market.

The steady public complaint is that the oligarchs dominate the Ukrainian economy, but you have to be an oligarch - that is, a very wealthy and well-connected person - to be able to defend your property against predatory state officials. A radical judicial reform is obviously needed to reinforce private property rights, but that is far from enough. Ukraine also needs to adopt an effective competition policy. Many call for a stronger anti-trust policy, but by international standards, Ukrainian companies are pretty small. Rather than anti-trust, Ukraine needs de-politicization of its economy and more international competition.

The most effective means of competition policy is the opening of the Ukrainian market to more international competition, which is what EU trade and competition policy provides. One of the EU's greatest achievements is its single market. The EU has sensibly suspended the 36 import quotas for Ukraine in the DCFTA until the end of June 2023. In the next step, the EU should offer Ukraine full membership of the Single Market from July 2023, including the four famous freedoms: the free movement of goods, people, services, and capital.¹²³

123 "Offer the Four Freedoms to the Balkans, Ukraine, and Moldova," *European Stability Initiative*, June 16, 2022.

The internal market cluster in the Association Agreement includes key chapters of the EU *acquis*: free movement of goods, workers, services, capital, company law, intellectual property law, competition policy, financial services, and consumer and health protection. Ukraine has made good progress in free movement of goods and technical barriers to trade, competition, and anti-trust, while the protection of intellectual property rights continues to arouse concerns. With regard to state aids, or state subsidies, Ukraine has made progress, but it is not sufficient.¹²⁴

By and large, Ukraine has adopted substantial and good legislation in line with EU standards, but the politically most sensitive legislation, such as protection of intellectual property rights, is often delayed, and a general concern is insufficient implementation of already adopted legislation. All too often, seemingly arbitrary executive decisions by the Ukrainian government have violated the law, while little has been done to implement the law. The victims of such government negligence are businessmen, who reduce their investment or activities in response to government actions.

Privatization Must Be Sped up

A lasting concern is the persistence of a large, inefficient, and corrupt sector of state-owned enterprises. At the central level, Ukraine has more than 3,500 state companies. They account for about one-tenth of GDP and about 18 percent of employment, but leaving Naftogaz aside, they hardly make any profits.¹²⁵ About half of these enterprises are little but ruins that should be auctioned off as real estate. Most of the remaining state assets should be auctioned off as fast as possible, while the 100 or so biggest and most strategic companies should be properly corpo-

124 “Commission Opinion on Ukraine’s application for membership of the European Union,” 17.

125 *Ibid.*

ratized and become subject to proper corporate governance or profitable sales. The government and parliament should make a clear list of those 100 strategically-important companies. Everything else should be privatized, and the remaining state-owned companies should all be subject to rigorous corporate governance.

For many years, a majority of the Ukrainian parliament prohibited the privatization of *c.*2,000 state companies, purportedly for ideological or national security reasons, but these problems have now been resolved. In reality, the incumbent state managers tended to benefit mightily from these enterprises, far beyond their official salaries.

Another problem has been that governments have focused on generating maximum revenues from privatization, singling out the biggest and most valuable companies for privatization, but they have also been the most complicated to privatize with large and undefined liens to dubious businessmen, rendering the assessment of the company's value difficult. What do these companies actually own? They have regularly been contested by several of the richest businessmen in Ukraine, who used all kinds of means of combat. As a consequence, foreign investors stayed out and the prices often fell below the permissible level. Outstanding examples are the multiple failed attempts to privatize the Odesa Portside Plant, a major producer of nitrogen fertilizers, or Centrenergo, the last remaining state-owned, coal-fired power station.

In recent years, the government has opted for a more propitious strategy that should be continued, selling off cheap and uncontested assets through Pro-Zorro. The revenues have not been large, but hundreds of small state assets have been successfully privatized without controversies through electronic sales.

Corporate Governance of State-Owned Companies Needs Improvement

The large state-owned enterprises cannot be privatized quickly, and some strategic companies should not be privatized for the sake of national security. The old-Soviet-style ‘unitary’ enterprises should be properly corporatized and their property defined.

All the remaining state-owned enterprises should be professionally audited and given sound corporate governance with supervisory boards, with a majority of independent directors who are paid market salaries in accordance with good OECD practice. Over time, the valuable state-owned enterprises, that do not have to stay state-owned for the sake of national security, should be sold off through initial public offerings, direct sales or auctions depending on the type of asset. The remaining state-owned enterprises should sell off non-core assets that abound in the old companies, and they should pursue unbundling, as Naftogaz has done.

Since 2016, Ukraine has made substantial advances with corporate governance. The four big state banks and nine big state-owned companies have been given professional supervisory boards, with a majority of independent directors, while the minority has been appointed by the Ukrainian government. The supervisory boards have been appointed by joint committees consisting of the Ukrainian government and the donor community. They have been transparent and competitive, though often too slow.

The supervisory boards have been supposed to appoint the CEO and the management board in each company, but these selections have usually been contentious and subject to government interference. The supervisory boards should also adopt a company’s strategic and financial plans, but the cabinet of ministers tends to make these decisions for the big state companies. The powers of the existing supervisory boards need to be strengthened, and all the big state-owned companies should be

given supervisory boards with a majority of independent directors to reassure the full independence of each state company. Alas, so far, the vast state sector, with the occasional exception of Naftogaz, hardly generates any official profit.

The ultimate aim of government policy should be to reduce the state enterprise sector to a normal size, to improve corporate governance and efficiency of remaining state-owned enterprises, and to prepare most of the big state-owned enterprises for privatization.

9. Sectoral Reforms

Certain sectors of the Ukrainian economy offer great promises for EU cooperation and integration. Some industries stand out: trade, transportation, energy, hi-tech, services, machine-building, agriculture, metallurgy, and mining. Each industry requires special conditions, standards, and legislation for successful integration, but these sectors are predominantly private and should remain so. Yet, for this integration to succeed, the EU and Ukraine must together develop sound trade policy and good transportation.

Trade Policy: As Close as Possible to the EU

Ukraine has an open economy. It is a major exporter of agricultural commodities, iron ore, and steel, that have traditionally accounted for three-quarters of Ukraine's goods exports. Currently, agricultural products have surged to almost half of Ukraine's goods exports, while iron ore and steel have declined because of the war. Chemicals, primarily fertilizers, used to be important export products, but most of the Ukrainian fertilizer factories have been destroyed by the Russians. Ukraine is now suffering from such high gas prices that it might not be competitive.

For agricultural goods, Ukraine benefits from vast open markets in China, the Middle East, Asia, and Africa. Hopefully, these markets will remain open. A major market for iron ore has traditionally been China. Steel and steel pipes have been sold to Russia, the EU, and the US, but they encountered extensive protectionism, as all these countries have imposed import quotas or anti-dumping tariffs from time to time.

For the future, the EU should offer a large market. The basis is Ukraine's Deep and Comprehensive Free Trade Area with the

EU, in which the import quotas have temporarily been abolished during the war. The Central European and Baltic States swiftly raised their exports to the EU to two-thirds of their total exports by 1995,¹²⁶ but in 2021 Ukraine still only had 40 percent of its exports going to the EU. Partially, this is because so much of Ukraine's exports consist of food, of which the EU does not need to import all that much, partially because of transportation issues, but there are many other problems. In 2022, the EU share of Ukraine's exports rose above 60 percent, but it remains to be seen whether this trend will hold after the war.

In recent months, trucks and railcars have waited for several weeks to cross from Ukraine into EU countries, such as Poland and Romania. The problems have been both logistical and bureaucratic. The customs procedures on both sides of the border have been complex, and staffing has been insufficient for the increased traffic after the Russian traffic and the Black Sea shipping disappeared. The physical facilities need to improve, but the main bottlenecks appear to have been bureaucracy in both EU countries and Ukraine.

The Ukrainian parliament has taken an important step, by adopting a law on Customs Visa Exemption. It provides for the accession of Ukraine to the Convention on the Procedure of Common Transit with the EU (NCTS) countries. It will allow Ukrainian businesses to take advantage of the following simplifications: one transit declaration and one guarantee for moving goods between 36 countries (with EU countries and Great Britain, Turkey, Serbia, North Macedonia, Iceland, Norway, Liechtenstein, and Switzerland). Authorized enterprises will be able to send and receive goods at their enterprise rather than having to go to customs terminals. Ukrainian financial guarantees will operate in another 35 countries of the world.

126 Anders Åslund and Andrew Warner, "The Enlargement of the European Union: Consequences for the CIS Countries," Working Paper no. 36, *Carnegie Endowment for International Peace*, April 2003.

Energetic Transportation Integration

Transportation requires massive investments, which are usually predominantly public. Ukraine's transportation infrastructure called for large-scale investment before the war, and all the more so now. It requires strategic changes.

First of all, the direction of the transportation network needs to change. Previously, Ukraine traded primarily with Russia, but now Europe has become its dominant market, while much of the bulk goods are shipped through the large Black Sea ports. Thus, the Ukrainian transportation system needs to be reoriented from Russia toward European integration. Central government policies are required to make sure that the transportation networks - highways, railways, pipelines, and the energy grid - are re-oriented to the EU-oriented fashion. It is obvious that Ukraine should build highways to Europe, but should it switch from the Soviet broad gauge of 1520mm rails to the European 1435mm rails? That is a major policy question that would involve vast costs, but also great benefits in terms of new economic possibilities and better national security. Such choices require substantial analysis. In any case, the border passages to Poland, Slovakia, Hungary, and Romania are major bottlenecks that will have to greatly improve. The Black Sea ports need to be further developed for international shipping to facilitate Ukraine's export of grain and iron ore.

Second, the quality of the transportation network must improve and be modernized. In the recent decade, Ukraine has built some good highways, but much more is required, and that involves vast, long-term investment. The Ukrainian railways have done very well during the war, but often these are successes that they cannot build on in the future. Ukraine has a too-large rail network, but that is an advantage in wartime when trains can choose alternative routes. The railroads are heavily overstaffed, which is also an advantage during a war. Too few of the Ukrainian railroads are electrified, but diesel engines are less vulnerable to war damage than electrical engines. Con-

tainer transportation has been quite limited in Ukraine, because bulk goods such as grain and iron ore have dominated. After the war, Ukraine needs to proceed with the modernization of its railways.

Infrastructure developments, notably highways and airports, are major recipients of EU structural funds and EIB financing. An obvious focus of EU long-term investment should be to improve the transportation infrastructure between Ukraine and the EU.

The interaction between the EU and Ukraine has been much less in the transportation sector than in the energy sector (see below). Currently, the European Commission assesses that only one-third of the relevant EU acquis has been implemented. One reason is that no joint authority, such as the Energy Community, has existed. Another is that, in Ukraine, the transportation sector is dominated by large state-owned enterprises, such as the state railways, that tend to be the last to reform. Furthermore, Ukrainian transportation companies have adhered to old Soviet standards, and the investment requirements in this area are huge. The EU needs to tilt the balance by offering substantial investment funds.

Energy: A Great Promise

Arguably, the energy sector offers Ukraine the greatest early opportunities from EU integration. Ukraine has enthusiastically embraced the EU energy policy and achieved good results with regard to the development of green energy and marketization of the gas and electricity sectors. As discussed above, Ukraine should become a major producer of green energy and export it to the EU.

Ukraine has legislated structural transformation of its electricity and gas sectors based on the EU rules of the Third Energy Package of 2009. These reforms have been greatly facilitated and well prepared through Ukraine's membership of the European Energy Community since January 2011. Ukraine has car-

ried out the unbundling of production and transportation in both sectors. On July 1, 2021, Ukraine introduced market pricing for both the electricity and gas sectors, though this has not been fully implemented. In both sectors, multiple regulated prices persist. A further liberalization of these prices is needed, while negative social effects can be countered with government cash subsidies if required.

In the midst of the war with Russia, in March 2022, Ukraine successfully connected to the EU's electricity grid, ENTSO-E, and Ukraine has started exporting electricity to Central Europe. This is beneficial for both Ukraine, which usually has a large surplus of electricity, and Central Europe, which suffers from very high prices; this trade needs to expand. If Ukraine suffers from a shortage of electricity, as it has done since October 2022, because of Russian bombing of Ukraine's power infrastructure, it can import from Central Europe.

The current gas crisis has shown Europe's great need for gas storage. Fortunately, Ukraine has vast gas storage of 36 billion cubic meters in the west of the country, which is underutilized because of Russia's capricious gas policies. These large gas stores should be fully utilized by European countries to the benefit of all.

Ukraine possesses the largest reserves of natural gas in Europe, but its production has been stagnant at about 20 billion cubic meters a year for the last thirty years. State-owned Naftogaz accounts for 80 percent of the production, and four private Ukrainian producers account for most of the rest. Ukraine can produce much more gas, but the gas sector is a nightmare of red tape. Gas producers need licenses and permissions from multiple state agencies that do not cooperate. These state institutions need to be streamlined. Since the state has failed to increase its production during this time, it appears beneficial to privatize most of it. Major Western energy companies, such as Shell, Chevron, and Exxon, have attempted to produce gas in Ukraine, but for various reasons, they have all given up, leaving no significant foreign company operating in Ukraine. The gov-

ernment needs to establish a streamlined administrative process and reasonable legal conditions so that bona fide foreign companies can and want to invest in Ukrainian gas production. In that case, Ukraine can become a major gas exporter to Central Europe.

Ukraine has also enthusiastically subscribed to the Paris Agreement and the European Green Deal. Ukraine has a huge potential for producing renewable energy and developing green hydrogen. Thanks to a very favorable green tariff, wind and solar energy were the main recipients of foreign direct investment between 2016 and 2019. Unfortunately, this came to an end in 2020, when the Ukrainian government reacted against the high green tariffs and first refused to pay them and then insisted on them being reduced. This conflict has persisted and needs to be resolved. In 2022, Russian troops occupied the territories that harbored most of the solar and wind energy in southern Ukraine, which stopped most of their production. Yet, Ukraine is committed to reducing its dependence on Russian fossil fuels in line with REPowerEU.¹²⁷ In 2021, the EU and Ukraine established a strategic high-level dialogue on the European Green Deal and the Ukrainian green transition.

The joint aim of the EU and Ukraine should be to make Ukraine a major exporter to the EU of green electricity, green hydrogen, and natural gas.

Hi-Tech, Services, and Machine-Building: Let Them Develop!

Surprisingly little is being said about hi-tech, machine-building, and services, but this is actually a good sign, because these are the freest and most market-driven sectors. Rather than develop-

127 European Commission, “Communication from the Commission... REPowerEU Plan,” May 18, 2022. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A230%3AFIN>

ing any government policy towards these sectors, the government should let them be free.

In the last decade, hi-tech, primarily computer programming, has been a great success in Ukraine. The Ukrainian hi-tech companies are concentrated in Kyiv, Kharkiv, and Lviv. They draw on Ukraine's outstanding mathematical and engineering skills. These companies tend to be start-ups working for foreign companies, primarily American companies. There are four reasons for their success: good mathematical and engineering knowledge, minimal state regulation, little taxation, and good connections with the chief hi-tech companies in the world. In this sector, the main ambition of the government should not be to rock the boat but allow them to continue developing.

The service sector is, surprisingly, economically similar to the hi-tech sector. It consists of myriad new enterprises that have popped up all over and have proven themselves impressively innovative and swiftly improved their quality. Restaurants, bars, hotels, and calling services thrive all over. Ukraine benefits from the relevant human skills, good telecommunications, and internet services, and free trade with the EU. This sector does not require much government policy but freedom and stable legal conditions.

Traditionally, Ukraine had an outstanding machine building sector. It was considered better than anywhere else in the Soviet Union, but it suffered from two problems. The first was that it was Soviet and therefore became ever more backward with the isolation of the Soviet Union. The other problem was that a substantial part of the Ukrainian machine building sector was a part of the Soviet military-industrial sector. It fell on hard times with the collapse of the Soviet Union, and it was completely cut off from its Russian contractors in 2014, to whom many Ukrainian armaments factories had delivered sophisticated parts. A complete renewal is needed. Ukraine produces some outstanding arms, such as the Neptune missiles from Luch in Kyiv, which allegedly sank the Russian flagship Moskva. Yet, the total employment of Ukroboronprom, the state arms holding com-

pany, has fallen to 70,000 people. Some of this may be revived, but most of the armaments industry remains in tatters.

Instead, in recent years Ukraine has attracted mainly German and Japanese investments from car parts producers in western Ukraine. Thus, Ukraine is being integrated into the European supply chain, in which the German car industry has been the driving force. The whole of Central Europe has become profitably integrated into the European supply chain and now it is time for Ukraine to become so too.

Agriculture Is Flourishing

In the Russian Empire, Ukraine was the granary of the whole of Europe. After the general privatization of land in 2000, Ukraine has become so once again. About one-third of Ukraine's rich black earth land is being cultivated by large agroholdings of typically 10,000 hectares or more. The agroholdings do not own the land, but lease it en masse from peasants who own 4-5 hectares each. The new big farmers have invested heavily in modern farm equipment, infrastructure, seeds, and fertilizers.

Ukraine's grain production has surged impressively over the last two decades. The farmers have deftly turned to modern grains, notably corn, soy, wheat, sunflower oil, and rapeseed, and they have found new markets for Ukraine's ample new products all over. The Ukrainian farmers usually transport their grains themselves to the Black Sea ports, where they sell to the big international grain traders (for example, Cargill, Bunge, ADM and Louis Dreyfuss). To begin with, their big concern was how to store their grain, but most have built impressive elevators. In recent years, they have mainly complained about slow rail transportation to the Black Sea ports and slow operation of these ports. Yet, these problems are a reflection of the tremendous success of Ukraine's grain production and exports, which in 2021 rose to almost half of Ukraine's goods exports.

Russia's war has caused major problems for Ukraine's grain exports, because Russia blocked all Ukraine's Black Sea ports

from before the war in early February 2022.¹²⁸ Ukraine has tried to export more grain through alternative roads, such as by rail to Poland and to Lithuania's Baltic Sea ports, or to Romania and its Danube or Black Sea ports, but the capacity of the railroads, roads, and ports have not sufficed. From August 2022, the UN and Turkey succeeded in persuading Russia to allow substantial exports from three Ukrainian Black Sea ports around Odesa, but it remains to be seen if this will hold.

Metallurgy and Mining Need Modernization

Ukraine has magnificent preconditions for mining and metallurgy. It possesses substantial known quantities of major ores, such as iron and titanium, as well as coal. It has had a strong and manifold metallurgical industry since the nineteenth century, with big metallurgical factories, excellent engineering schools, and outstanding engineers. Fortuitously, these assets are located on the shores of the Black Sea and Dnipro, facilitating cheap bulk shipping. After the war, Ukraine is likely to once again have access to cheap energy.

During the war, however, Russia has destroyed at least two of Ukraine's largest steelworks, Azovstal and MMK Ilicha, in Mariupol. With the exception of Interpipe Steel in Dnipro, all the metallurgical factories in Ukraine pertain to Soviet times, even if most have all undergone substantial modernization. The reconstruction should be an opportunity for Ukrainian businessmen to rethink the metallurgical industry and give them an opportunity to move to the greatest modernity, if that is profitable. This is hardly a job for the government, but it is important that reconstruction funds, which should be paid out as insurance, can be used for a thorough modernization also in the private sector, where that makes sense.

128 Anders Åslund, "Russia's War on Global Food Security," *Atlantic Council*, June 2022.

10. Ukraine's Long-Term Development

Ukraine's long-term development - the third phase, 2026-32 - should be quite different, and it is too early to discuss this stage in detail. Ukraine should have carried out sufficient judicial reforms and reinforced property rights so that it can attract foreign private financing. Yet, the West should facilitate investment in Ukraine by offering beneficial political risk insurance.

For this development phase, the Ukrainians foresee international inflows of \$400 billion. Needless to say, these are very tentative numbers. In the long term, both the sources and nature of financing should change. Governments and inter-governmental organizations should continue their financing, but the share of credits and private investment should increase. Ukraine should prove the quality of its reforms of the business environment by attracting substantial foreign investment, and the private sector should gradually replace governments in financing Ukraine.

Traditionally, Ukraine has had a low investment ratio at 15-20 percent of GDP. It should aim at raising its investment ratio to 30 percent of GDP, which is normal for a rapidly developing country requiring substantial infrastructure construction. To accomplish this, Ukraine needs to attract both domestic and foreign private investment. The attraction of private investment both from Ukrainians and foreigners will be an important indication of the success of Ukraine's reforms.

To reach a substantial investment ratio, a country needs to convince domestic and foreign investors about its national security and reliable property rights. Because of the war and many years of poor property rights, it will be difficult to attract private capital for years. The best solution is obviously that Ukraine wins the war, but even if that is the case, uncertainty about security will prevail.

International Public Investors Should Be Pioneers

During a war, no private financing is possible, since the risks are excessive. Even the international financial institutions (IFIs) usually stay away in the midst of a war, while they are of crucial importance in the immediate aftermath. Their key task is to provide financing before private investors are ready to do so. However noble private donors may be, their financial resources are limited in relation to what a country at war requires. We must all remember that Ukraine fights not only for its national sovereignty and territorial integrity, but in defense of Europe.

In the early development stage, international public and semi-public investment vehicles should play a major role. The World Bank and the EIB are the natural backbones of public and private infrastructure investment. The EBRD, the International Finance Corporation, and public private equity funds should be important investors before purely private investors enter the stage. Ukraine has far too long been dominated by state enterprises, and it is important that the foreign investors do not give undue preference to public companies.

As early as possible, opportunities should be offered to private investors. They are not easily attracted after a war, and short-term financial speculators should not be the target group. IFIs, such as MIGA, or bilateral export credit institutions that offer both political risk insurance and export credits, should facilitate attractive financial conditions for serious, long-term private investors to enter Ukraine after the war.

Long Term Goals: Promotion of Private Investment

The Ukrainian authorities must not harbor any illusion about early, large private investments. Foreign investors are by nature risk adverse and cowardly facing a war. Many people might start small enterprises even during the war, which is valuable, but few will invest significant amounts until they trust peace and

the sanctity of property rights. To try to promote major private investment just after a war is a fool's errand.

The foreign investors in wind and solar energy on the Black Sea coast will not be easy to convince for renewed investment. First, they were not paid the tariffs they were promised by the Ukrainian government before the war. Next, the Ukrainian government refused to pay their debts to the green investors. As a grand finale, Russia seized most of the green investments and moved some of them to Russia.

The best security guarantee would be that Ukraine becomes a member of NATO, so that it becomes covered by the security guarantees of Article 5 of the NATO Charter. Bulgaria and Romania became members of NATO in 2004, and they acceded to the EU in 2007. Tellingly, foreign direct investment took off in both countries in 2004, when they joined NATO. Apparently, even in those countries in a peaceful time, foreign investors looked to NATO for security protection of their investments.

Capital also needs domestic security, that is, strong property rights protection. Therefore, Ukraine needs to build up a strong judicial system from the top down. Both domestic and foreign businessmen must be reassured that Ukraine has been able to stop the pernicious practice of 'corporate raiding'; that is, the theft of successful enterprises by well-connected individuals with support of law enforcement agencies and courts.

After a war, private insurance companies are reluctant to operate, and if they do they charge excessively high fees. In their place, Western donor governments and IFIs need to step in. They have several related instruments to promote investments in countries in peril, notably export guarantees, investment guarantees, and credit risk insurance. These facilities should be provided to Ukraine at an early stage to encourage the private sector in Ukraine, especially as the natural effect of a war is that the state sector expands greatly.

Large bilateral government funds should continue to be forthcoming, primarily from the EU, the US, the UK, and Canada, but also other bilateral donors.

11. Conclusions

The reconstruction, reform, and EU accession of Ukraine will be the most important EU projects of the 2020s. It has to be done in the right way. We have written this brief book with the aim to assist and guide this process. Our fundamental idea is that Ukraine's reconstruction, reform, and EU accession need to be combined into one process. We hope that it will engage all members of the collective West. We have discussed Ukraine's evolution and its embracement of Europe, and Europe's embracement of Ukraine, at some length to clarify that this is not a temporary but a steady development. Ukraine and Europe belong together.

It is too early to assess the costs of Russia's destruction in Ukraine, but we can already state that only the cost of destruction amounts to more than \$250 billion and it is likely to rise.¹²⁹ The Ukrainian government has requested \$750 billion in financing for the next decade.¹³⁰ Whatever the exact numbers will be, they are big. How can Ukraine's reconstruction be financed? Our key suggestion is that the seven Western countries that host some \$300 billion currency reserves of the Central Bank of Russia confiscate them as war reparations to finance the damage Russia has caused.¹³¹ In addition, the EU and the US should take the lead in matching funds in the order of \$100 bil-

129 World Bank, "Relief, Recovery and Resilient Reconstruction: Supporting Ukraine's Immediate and Medium-Term Economic Needs," *World Bank*, April 2022.

130 "Ukraine's National Recovery Council, Ukraine's National Recovery Plan," July 2022. <https://www.urc2022.com/urc2022-recovery-plan>

131 The International Working Group on Russian Sanctions, "Why and How to Confiscate Russia's Sovereign Assets to Help Rebuild Ukraine," *Stanford Working Group Paper #6*, October 11, 2022. <https://fsi.stanford.edu/working-group-sanctions>

lion each for the medium term, and other donors can hopefully come up with a similar amount.

In order to raise such funding, the governance of the funds must be perfect and absolutely transparent. Our suggestion is to set up a new executive agency based on a partnership between the EU and the US. It should be dominated by the donors. Otherwise, they will not provide the necessary funding, but the Ukrainian government should have a strong voice in how the funding should be used. The compensation for the material losses should take the form of insurance, encouraging modernization, and new investment, rather than literal reconstruction.

We see Ukraine's EU accession as crucial for Europe's security, Ukraine's reforms, and EU revitalization. This should be the EU project of the 2020s. Therefore, we encourage both the EU and Ukraine to do whatever they can to get this right. Without going into detail, we want to highlight six structural reforms: of the state administration, of the judiciary, anti-corruption reforms, market reforms, privatization, and corporate government of state-owned enterprises. We see these six reforms as vital for the success of the Ukrainian economy. Similarly, we are highlighting the reforms of six sectors that we see as strategic or particularly propitious. Through its trade policy, Ukraine needs to fully integrate into the EU single market. But trade integration requires massive transportation investment, which is one of the strengths of the EU accession process. Ukraine has vast energy resources. They should be fully integrated into the EU for mutual benefit. Ukraine would thrive from greater exports, while the EU would gain from more energy supplies. Ukraine's hi-tech, services, and machine-building sectors are already prospering from the European supply chain, which did so much for the welfare of Central Europe. In the last decade, Ukraine's agriculture has developed marvelously, and this development can only be appreciated. Ukraine has had strong metallurgy and mining for two centuries. These industries will continue to thrive, but first they need to be reconstructed and modernized after the end of the war's destruction.

The reconstruction, reform, and EU accession of Ukraine will be the most important EU projects of the 2020s. This brief book aims to assist and guide this process. Our fundamental idea is that Ukraine's reconstruction, reform, and EU accession need to be combined into one process. It is our hope that it will engage all members of the collective West. Ukraine's EU accession is crucial for Europe's security, Ukraine's reforms, and EU revitalization.

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