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Ukraine's Post-War Reconstruction Strategy: Breaking Free of the Soviet Economic Legacy

Max Primorac

KEY TAKEAWAYS

The United States has a strategic interest in seeing Ukraine become a successful economic barrier to Russian aggression.

Post-war reconstruction will offer Kyiv a historic opportunity to make a radical break from its Soviet economic legacy.

Private investment and wealth creation, not dependence on the government and outside aid, should be at the center of Ukraine's reconstruction strategy.

Next month, Germany will host a conference to respond to Ukraine's request for $349 billion in reconstruction and recovery support.[1] At a time when Ukraine's recent military successes have created new hope that the war might soon end and the difficult task of post-war rebuilding begin, the conference affords Ukraine a historic opportunity to break with its Soviet economic legacy and revitalize a moribund Europe by placing private investment and wealth creation, not dependence on the government and outside aid, at the center of its reconstruction strategy.

Avoiding the Aid Trap

The wartime Ukrainian government is under severe financial distress, needing billions in monthly funding just to keep functioning and billions more to revive flattened cities, restore basic infrastructure, rebuild a ruined industrial base, and care for millions of displaced persons.[2] The country's gross domestic product (GDP) is projected to drop this year by 30 percent. However, as the United States and Europe suffer their worst economic crisis since the 2008 global financial meltdown, asking Western taxpayers to provide hundreds of billions more for reconstruction aid is unrealistic. It would also be self-defeating.

No country that has transitioned from poverty to economic prosperity has done so through foreign aid; it has done it by implementing pro-growth, free-market policies that unleashed the entrepreneurial zeal of its own people and drew in billions of dollars in foreign investment. The much-touted post–World War II Marshall Plan was a limited aid program centered on reviving the private sector.[3] The largest recipients of reconstruction aid over the past decades—countries like Afghanistan, Iraq, and Bosnia-Herzegovina—have all failed as states.

Over the long term, more aid equals more poverty.[4] Donors have tried the same aid-centered approach again and again with the same negative outcomes: It just does not work.[5] In addition, failed reconstruction would leave both Ukraine and Europe vulnerable to another round of Russian aggression. Ukraine and its supporters must therefore take another approach to reconstruction.

The funding that Kyiv seeks to help it rebuild is not to be found in other government coffers, but in the massive global capital that is readily available. Last year, total global equity alone grew to $124 trillion.[6] Capital flows into countries that allow it to make a profit and, in the process, create wealth. Countries that erect barriers to capital see little investment but more debt, instability, and poverty. To access capital, Kyiv must dump its long-standing statist and centralized approach to economic governance and instead adopt the wealth strategies of success stories in Europe, East Asia, and elsewhere.

Winning the Battle Against the Soviet Economic Legacy

Ukraine must make a radical break from its Soviet economic legacy that assigns the lead task of economic growth to the state not as an enabler, but as its director. From 1992 until the February 2022 invasion, Kyiv received a substantial amount of aid from the West to help it make this transition: more than $30 billion from the European Union,[7] more than $8 billion from the United States,[8] more than $23 billion in soft loans from the International Monetary Fund,[9] and billions more from other donors.

What has been the outcome of this aid?

The Heritage Foundation's *Index of Economic Freedom* ranks Ukraine 130th of 177 countries surveyed, behind Nigeria, Papua New Guinea, and Nicaragua, and 44th freest of 45 European countries surveyed, behind Russia.[10] Transparency International's *Corruption Perceptions Index* ranks Ukraine as the second most corrupt country in Europe, with Russia the worst, and 122nd among 180 countries globally.[11] Yet neighboring Poland, which shares a long border and close historical, cultural, and linguistic ties to Ukraine as well as decades of past Russian domination, ranks 39th freest in the *Index of Economic Freedom*[12] and 42nd among 180 countries surveyed by Transparency International.[13] Former Soviet states Estonia, Latvia, and Lithuania rank even better. Economic transition is clearly doable, but it demands political resolve that successive Ukrainian governments have failed to demonstrate.

Ukraine is bravely throwing off the heavy yolk of Russian political and military subjugation. That is the hard part. Now it must liberate itself from the same Russia-dominated command mentality that has characterized its economic approach since independence: budget-draining state-owned companies, graft-ridden and bloated bureaucracies, stifling red tape, and a model of governance that places the needs of the state apparatus above those of the citizen. As Ukraine President Volodymyr Zelenskyy has aptly stated, "We've shown that we know how to win on the battlefield. Another important task for us is to achieve victory in the economy as well. And to be an attractive country for investors."[14]

Yet current aid discussions center on setting up a massive Reconstruction Fund "for both public and private investors to participate in reconstructing and rejuvenating the market economy in Ukraine"[15] and arguing over whether it should be led by the Ukrainian government to ensure country ownership of reconstruction or by donor officials as a wall against Ukraine's endemic corruption.[16] A donor-financed fund, however, will crush inducements for policy prescriptions that the Ukrainian government must adopt if it wishes to create an investment climate that will attract large-scale private capital.

Moreover, global capital markets are not likely to finance a government-managed fund, especially as Ukraine's National Recovery Plan places the state, not the private sector, at the center of economic revival.[17] Kyiv's desperate need for financing makes it more amenable now to making the tough economic choices it has repeatedly promised but failed to deliver during the past 30 years. Setting up a government-managed fund will lessen that pressure.

Post-War Recovery Focused on the Private Sector

The G7 group of Western democracies, having financed Ukraine these past decades, should use the occasion of the Berlin conference to set up a reconstruction framework that places the private sector—Ukrainian, regional, and global—solidly at the center of any reconstruction support plan. The private sector (as famous American bank robber Willie Sutton once famously quipped when asked why he robbed banks) is "where the money is." What would that framework look like?

First, and most important, Ukraine must eliminate all obstacles to the operations of its small and medium-size businesses.[18] Billions of dollars of capital are held by Ukrainian citizens who are ready to restart family to middle-size businesses. Many are already doing so and showing extraordinary resilience in the face of adversity.[19] This favors the emergence of a bourgeoning private sector and middle class poised for rapid economic recovery. In 2021, Ukraine realized $18 billion in remittances.[20] Small-scale enterprises are the true engine of quick and sustainable job creation, as well as the rebuilding of a tax base, and serve as feeder enterprises for a massive construction-led boom.

In Prague, a former conservative leader acquaintance described Ukrainians "as the backbone of the construction industry in the Czech Republic." A Croatian friend of the ruling conservative government described Ukrainian refugees in similar terms: "[T]hey get a job, work hard, and contribute immediately."[21] Either Ukrainians will create wealth within Ukraine or they will create it elsewhere. Unfortunately, at present, starting a business in Ukraine is cumbersome, expensive, and frustrating: Ukraine ranked 64th in the World Bank's Ease of Doing Business index in 2019 (the most recent year for which World Bank Doing Business data are available).[22] This must change and change swiftly.

Second, regional economic integration is the strategic response to the question of how to cut Ukraine's dependence on Russia once and for all by reorienting its economy westward. This is true for several reasons. For example:

- Eastern European companies have been operating in Ukraine for many years and are most likely to be the source of a first wave of substantial foreign investment in Ukraine.

- Russia's naval blockade forced Ukraine and its neighbors to seek alternative export routes through Poland, Romania, and Bulgaria, exposing the need for more regional infrastructure.

- Ukraine's population of 45 million people represents a large educated market in an otherwise demographically challenged Europe.

- For the United States, Ukraine's integration into Europe moves the continent's political center of gravity eastward away from moribund Brussels and toward more security-minded countries of Central and Eastern Europe that are more willing to spend on their defense.[23]

Significantly, in June, Ukraine obtained candidate status to join the European Union, which would bring with it many trade and investment advantages.[24] It also provides a well-tested road map for integration and economic reform. Regional companies that stand to gain from accession, however, complain of corruption, bureaucracy, and a poor legal environment in Ukraine.[25] Laws and regulations for market liberalization, judicial, and other reforms languish for years waiting for the Ukraine Parliament to approve them and the government to execute them.

Ukraine's Western neighbors are best positioned to advise it on the transition process, knowing full well the difficult path away from socialist governance toward market-based wealth generation having themselves lived under and dismantled a Soviet-style command economy. Kyiv would therefore be well advised to take advice on economic revival and transition from Warsaw, Tallin, and Prague rather than from Brussels, Paris, or Rome.

Third, large infrastructure and industrial-size projects can be financed by global capital through privatization, design-build-operate agreements, corporate financing, and co-investment through joint venture contracts.[26] U.S. investment company Blackrock, for example, manages $8.5 trillion in global assets, dwarfing Ukraine's reconstruction needs. Ukraine is already a critical energy hub with massive stores of natural gas, coal, hydropower, and nuclear power that could end Europe's reliance on Russian oil and gas exports.[27] The world now also understands Ukraine's critical role as a major global supplier of grains and the need to expand regional ports, road, and rail as well as a competitive agro-industrial sector.

Kyiv could attract tens of billions of dollars in private funds given these large-scale opportunities, but to do so, it must be willing to cede government control of major sectors of the economy and the political patronage opportunities that accompany it. This will invariably require Kyiv to shut down or sell off its 3,300 money-losing, state-owned enterprises, many of which have been destroyed during the war and should not be revived.[28] However, it appears that Kyiv is instead moving in the wrong direction with respect to ending reliance on state companies.[29]

Ukraine's Economic Recovery: An America Strategic Imperative

The United States has a strategic national interest in seeing Ukraine transform itself into a strong economic barrier to future Russian imperialist threats to Europe and efforts by Communist China to exploit Ukraine's current situation. The wealth generated from transition would help to finance Ukraine's defense. Its westward integration, anchored by its Eastern European neighbors, would align with U.S. demands that Europe spend more on its defense; deter future Russia belligerence; and, most importantly, help Europe to become a more robust strategic partner against Beijing's machinations.

As for more U.S. assistance to Ukraine, our military has shown unparalleled skill in mobilizing a global logistics network to support our allies—a capability that no other country possesses.[30] Therefore, military aid must remain a U.S. lead in view of Europe's political fragmentation, weak arms industry, and diminished defense capabilities.

Contrarily, America's record of civilian foreign aid in general and reconstruction aid in particular has been one of utter failure.[31] Even current multibillion-dollar U.S. humanitarian efforts have come under severe congressional attack for "not being properly and swiftly used to help Ukraine."[32] Moreover, for 30 years, the European Union has encouraged new entrants to adopt Western laws, regulations, and norms. European nations, not the U.S., should therefore lead reconstruction efforts.

The U.S. government still has a major role to play in galvanizing American capital to rebuild Ukraine, especially in the energy, agro-industrial, construction, and technology sectors, through business-promotion programs provided by the U.S. International Development Finance Corporation[33] and the U.S. Department of Commerce's International Trade Administration. The U.S. government's convening power can be used to promote commercial diplomacy in favor of American companies as well as to induce Kyiv to reform its laws. As Ukraine is a major global food exporter and Europe will take the lead on development, there is little need for further relief and technical programs funded by the U.S. Agency for International Development (USAID).

What the U.S. Should Do

The United States and its European allies should encourage Ukraine to transition from a state-centric, foreign aid post-war reconstruction framework toward a framework that places Ukraine's private sector at the middle of its efforts and sees global private investment as the driver in rebuilding Ukraine.

Given Ukraine's eventual accession to the European Union, the Biden Administration should refrain from sending additional food and development aid and focus instead on promoting U.S. trade and investment with Ukraine.

The U.S. enjoys substantial influence at global financial institutions, which it funds, such as the World Bank and International Monetary Fund. It should use that influence and, if necessary, its veto power to encourage Kyiv to enact economic reforms that it previously promised to adopt, liquidate all of its state-owned enterprises, and privatize key sectors of its national economy. The U.S. should also prevent reconstruction aid from going to Chinese state-owned companies.

Conclusion

The October 25 Berlin Conference on Ukraine's reconstruction presents not only Ukraine, but also Europe and the United States with a stark and historic choice: Either follow the failed aid models of the past and achieve the same results or count on the true and tested engine of wealth creation—the private sector. The choice that these government make could indeed determine the future security and prosperity of the Western democracies.

Max Primorac is Director of the Douglas and Sarah Allison Center for Foreign Policy Studies at The Heritage Foundation.

Endnotes

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