



A BLUEPRINT FOR REFORM

Economic priorities in post-war Ukraine

Lead Author: **Dmytro Boyarchuk**
Executive Director CASE Ukraine



CASE – Centrum Analiz Społeczno-Ekonomicznych
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The Report was initiated by the Polish-American Freedom Foundation
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Contributors

Prof. Dr. Christopher A. Hartwell, ZHAW School of Management and Law (Switzerland) and Kozminski University (Poland)

Dr. Marek Dabrowski, Non-Resident Fellow at Bruegel, Fellow at CASE – Center for Social and Economic Research, Visiting Professor at the Central European University

Dmytro Boyarchuk, Executive Director CASE Ukraine

Lyubov Akulenko, Executive Director of Ukrainian Centre for European Policy

Dmytro Naumenko, Senior Analyst at Ukrainian Centre for European Policy

Olena Pavlenko, President of DiXi Group

Volodymyr Dubrovskiy, Senior Economist, CASE Ukraine

Andriy Savarets, Legal Expert, CASE Ukraine

Andriy Boytsun, CEO, Boytsun Governance Architects

Dmytro Yablonovskyi, Senior Expert, Boytsun Governance Architects

Dr. Yvonne Hegele, Public Administration Researcher, ZHAW School of Management and Law (Switzerland)

Jana Machljankin, Public Administration Researcher, ZHAW School of Management and Law (Switzerland)

Yuriy Ganushchak, Director of the Institute of Territorial Development

Natalia Leshchenko, Senior Economist, CASE Ukraine



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Executive summary

Over 30 years of independence, Ukraine has launched almost all of the necessary critical reforms to build and develop a market economy. Before the invasion, it had been making progress in institutional reforms but still had far to go. The greater part of state-owned enterprises had passed into private hands, although in many cases they were controlled by powerful oligarchs. After 2014 there was substantial progress in the area of strengthening corporate governance. Price liberalization had almost been completed by 2020 before global inflation, driven by monetary policies in the advanced economies, increased substantially in 2021. A simplified taxation system helped tackle the problem of administrative discretion. The National Bank of Ukraine moved to inflation targeting, thus strengthening the macroeconomic system's resilience to shocks. A world-famous online public procurement system, Prozorro, was created. Decentralization reform was successfully implemented, although additional support is required. And an agricultural land market was finally allowed to develop.

Ukraine joined the WTO in 2008. Most importantly, in 2014 Ukraine signed the EU-Ukraine Association Agreement, and substantial progress has been demonstrated since then. From 2014 the EU became the main trading partner of Ukraine (36% of commodity exports went to EU countries in 2021). However, by 2021 the candidacy prospects still remained rather distant. Unprovoked Russian aggression in 2022 and the resilience displayed by Ukrainians in the war radically changed the perception of Ukraine in the European Union.

Reconstruction and the post-war landscape will highlight the reality that the full-fledged Russian invasion has seriously damaged the Ukrainian economy. Because of the war, Ukraine will have a unique opportunity to leap ahead in the European

integration process. In June 2022, Ukraine was granted candidate status for EU membership with seven post-candidacy conditions. However, the accession model for the country is still unclear and needs to be defined.

Regarding the organization of cooperation between Ukraine and the West beyond the EU integration process, Ukraine is already receiving urgent support from Western partners. The funding for reconstruction (rebuilding or repairing damaged buildings and infrastructure) and recovery (economic reforms and institutional changes) should go via a centralized body created jointly by G-7 countries and Ukraine, with the European Commission playing the central role as the main institution coordinating efforts towards Ukraine's European integration. Decision-makers might consider creating a "Recovery Fund," not only as an instrument of managing funds for rebuilding the country but also as a tool capable of facilitating the inflow of foreign investments. The Recovery Fund, overseen by donors, could serve as a guarantor of decisions of foreign courts being enforced not only for private entities but also for Ukrainian state bodies. This might serve as a proxy judicial and law enforcement system for the period while the national rule of law is being reinstated. For the recovery stage, Russia—the aggressor—should pay regardless of whether it complies voluntarily or if this needs to be enforced. Frozen Russian assets—with \$316 billion of Russia's foreign exchange reserves as the main source—should be used to cover the needs of Ukraine's recovery.

In terms of priorities for reform in post-war Ukraine, establishing the rule of law should be the main priority of post-war institutional change. The law enforcement and judicial systems should be rebooted energetically from the top down, and numerical metrics should be created for evaluating progress in establishing the rule of law. For the post-war transformation period, while the rule of law is still being

created, the authorities should apply simplified tools of economic policies to boost economic growth. Progress in establishing rule of law should be directly linked to financing Ukraine's recovery.

In the area of public administration, there needs to be a return to transparent and competitive recruitment of civil servants and a halt to hiring policy based on personal links and loyalty, together with the completion of the reform of civil service pay scales and incentives. Administrative capacities of state bodies are an overarching requirement of the European Commission for acceding countries, meaning that the full-fledged reform of the civil service will be an indispensable part of the future integration process. Similarly, anti-corruption initiatives need emphasizing, with a transparent competition for the Head of the National Anti-Corruption Bureau of Ukraine and increased digitalization of the anti-corruption process. Given its successes since 2014, the decentralization reform needs to be continued after the war, including through the clear allocation of competences between central government, regions, and local government units, as well as an increase in local fiscal autonomy.

Macroeconomic policy also needs tending to, and tax and customs procedures should be streamlined in line with EU practices once the rule of law has been established. For the period when law enforcement and the judicial system are being established, Ukrainian authorities should consider simplified instruments in the tax and customs administration to reduce the adverse impact of non-functional rule of law on economic development. Ukraine's authorities also should immediately abstain from administrative practices based on presumption of the taxpayers' (tax agents') guilt.

Further market liberalization is crucial for Ukraine to complete its oft-delayed transition. Deregulation should be a priority, with better assessments of the regulatory impact of new initiatives and concomitant institutional capacity building (i.e. the State Regulatory Service) to undertake these assessments. The anti-monopoly policy

should also strengthen the institutional capacity of the Anti-Monopoly Committee of Ukraine, while the energy sector requires further deregulation and de-monopolization of the gas and electricity markets and integration with European energy markets. As a final point under this heading, labor relations require liberalization, with labor contracts becoming the primary mechanism of labor relations, while the outdated Labor Code should be revised in line with the market realities.

Property relations have been a long-neglected part of Ukraine's transition, but no post-war recovery will be possible without the finalization of land reform, including opening the agricultural land market to non-residents to speed up the modernization of agricultural businesses and the privatizing of state and municipal land. Overall, the corporate governance of SOEs (State Owned Enterprises) needs to be attended to, with privatization intensified after the war ends. A centralized ownership entity, the National Wealth Fund, which would manage state-owned enterprises/assets, should be established.

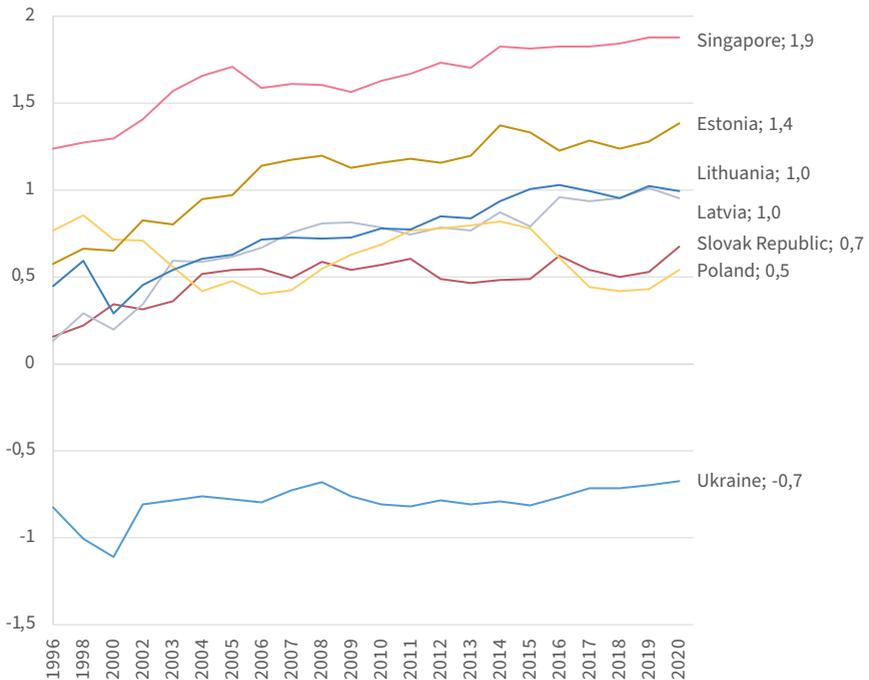
Finally, social reforms need to be examined for their long-term ramifications and drain on the state budget. The unsustainable pay-as-you-go pension system should be reformed, while policies in social assistance, health care, and education should all be properly adjusted to meet the new reality of the post-war period.

1 Reform achievements and failures

The path of reforms in Ukraine after the fall of the Soviet Union has been characterized by numerous reversals. By the 30th anniversary of independence in 2021, critical institutional reforms were finally emerging from stasis and moving in the right direction, but Ukraine remained a fragile market economy. Before Russia started its full-fledged aggression, Ukraine's economic system was still distorted by oligarchization and far too high levels of state intervention, especially when compared to its neighbors to the west.

Despite this reality, one should not downplay the key achievements, in particular those following the Maidan revolution in 2014. In the first instance, Ukraine made substantial progress in international integration. In 2008, the country joined the World Trade Organization (WTO), four years ahead of Russia, and in 2014 Ukraine signed the Association Agreement with the European Union (EU), embracing a Deep and Comprehensive Free Trade Area (DCFTA). The free trade area with the EU, coupled with Russia's unilateral revoking of the previous bilateral free trade agreement on January 1, 2016, led to the radical reorientation of Ukrainian trade towards the EU. The role of the EU in Ukrainian commodity exports increased from 23.6% in 2013 to 36.2% in 2021. Noticeable progress in the implementation of the Association Agreement Action Plan made it possible to grant EU candidate status to Ukraine in June 2022, although the main trigger for granting this status to Ukraine was the dramatic geopolitical developments and in particular the Russian invasion.

Figure 1. Rule of Law Index (World Governance Indicators), max 2.5, min -2.5



Source: <https://databank.worldbank.org/>

Note: Rule of Law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. Estimates give a country's score on the aggregate indicator, in units of a standard normal distribution, i.e. ranging from approximately -2.5 to 2.5.

Internally, the most important reform that Ukraine has started is of its **law enforcement bodies** and **judicial system**. The absence of rule of law is one of the biggest failures of independent Ukraine. The Rule of Law index (a component of the World Bank's World Governance Indicators) perfectly demonstrates this failure. As shown in the Figure 1., even 30 years after independence Ukraine was unable to reach the quality of judicial and law enforcement systems that Poland, the Slovak Republic, and the Baltic States already had in the early 1990s, when they started their market reforms. In this area, only partial progress may be reported with the total overhaul of

the police in 2015 and reform of the Supreme Court in 2017. There was also an attempt to strip law enforcement bodies of the leverage to put pressure on businesses by transferring the power to investigate “economic crimes” to the newly created Economic Security Bureau of Ukraine (ESBU). Quite naturally, reforming only selected parts of the system did not bring comprehensive results, and in many areas reform is still in progress: for example concerning the High Council of Justice (HCJ), the body that appoints and dismisses judges, and the High Qualification Commission of Justice (HQCJ), the body that selects candidates for vacant positions and checks the qualification of judges under the supervision of reputable international experts.

The dysfunctional law enforcement bodies and judicial system triggered the creation of a special **anti-corruption system** as a proxy law enforcement system to fight top-level corruption. The system included the National Anti-Corruption Bureau (NABU), the Special Anti-Corruption Prosecutors Office (SAPO), the Agency for Investigation and Management of Assets (ARMA), the National Agency on Corruption Prevention (NACP), and the High Anti-Corruption Court (HACC). A State Bureau of Investigation (SBI) was also established, although its functions clearly overlapped with the NABU (and the NABU was independent of the President’s Office). The anti-corruption system was finalized only in 2019, after the HACC was launched. However, the anti-corruption bodies faced obstacles at every step of their work, and the more active processing of filed cases only commenced after the outbreak of war, when the fight against corruption appeared in the spotlight of foreign aid provision.

Decentralization is one of the best-known fundamental reforms that Ukraine has undertaken. The reform was launched in 2014 and did not attract much public attention. However, the process of creating Amalgamated Territorial Communities (ATCs) moved ahead gradually, and the process of consolidating territorial communities was completed by 2020. ATCs benefitted substantially from extra own tax collections and additional transfers and subsidies from the central budget. Through the years of reform, ATCs managed to improve their social infrastructure and strengthened the

capacities of their communities' institutions. The resilience of the ATCs during the Russian invasion was one of the most impressive demonstrations of how important and successful the decentralization reform was. Despite this reform being one of the most impressive success stories, the central government is permanently revisiting the rules, with a tendency to trim the financial independence of local communities. The war, as was to be expected, strengthened the trend for centralizing power, though hopefully only temporarily.

Pivotal reforms also included the introduction of the online **public procurement system, Prozorro**. The public procurement process in Ukraine was famously plagued with corruption and was highly opaque. Starting from 2016, when the online system Prozorro was created, the rules in this area drastically changed, bringing transparency and noticeable efficiency to the realm of public procurement. The system itself is not perfect, showing the dangers of relying on technology for procedural issues, and users often report loopholes. However, the creation of Prozorro helped overcome many of the corruption issues in public procurement in Ukraine, and it is often touted as a case study for other countries to follow. Unfortunately, even before the war, the Ukrainian authorities had begun removing certain large infrastructure projects from Prozorro and, as the war started, the role of Prozorro narrowed even further.

Table 1. Ukraine: fundamental macroeconomic indicators, 2013-2021

Variable	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP, constant prices, % change	0.0	-6.6	-9.8	2.4	2.4	3.5	3.2	-3.8	3.4a
Inflation, end of period, %	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0
GG net lending/borrowing, % of GDP	-4.8	-4.5	-1.2	-2.2	-2.3	-2.2	-2.0	-6.0	-4.0
GG gross debt, % of GDP	40.5	70.3	79.5	79.5	71.6	60.4	50.5	61.0	49.0
Current account balance, % of GDP	-9.2	-3.9	1.7	-1.5	-2.2	-3.3	-2.7	3.3	-1.1a

Note: a – IMF staff estimates

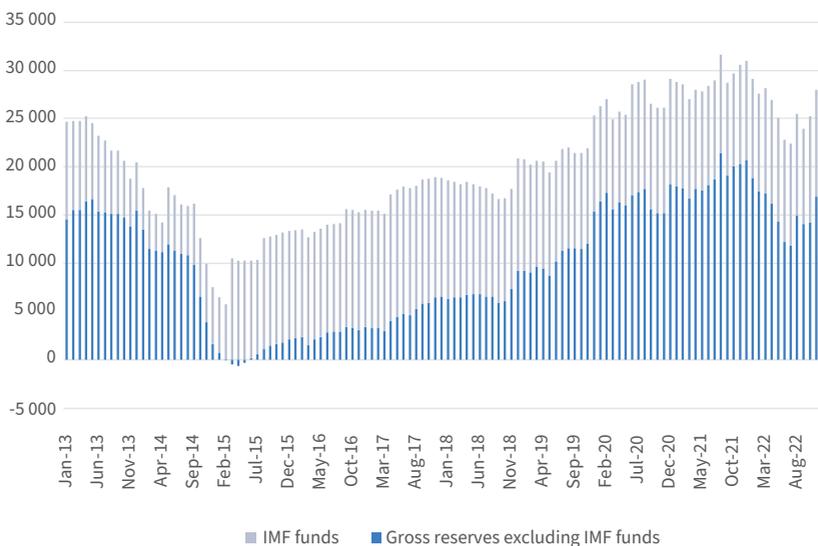
Source: IMF World Economic Outlook database, April 2022

Beyond these administrative changes, the **macro-stabilization** of the Ukrainian economy after Russia's annexation of Crimea and proxy invasion of Donbas in 2014 was among the critical pre-conditions for establishing a basis for the country's future development. For the past eight years, even while at war, Ukraine has managed to avoid a debt crisis, stabilizing the balance of payments and returning to moderate growth from 2016. During the same period, the general government (GG) deficit and gross debt to GDP were reduced, the NBU gross international reserves increased, the hryvnia's exchange rate stabilized, and inflation decreased.

A serious **upgrade in the National Bank of Ukraine's (NBU) institutional capacity** (2015), with a streamlined organizational structure and emphasis on transparency, as well as the wholesale restructuring of the banking sector, were among the most successful examples of reform after the Revolution of Dignity in 2013 and 2014. Since 2014, the NBU has closed more than 100 banks, with the emergency nationalization of the largest Ukrainian bank—PrivatBank, owned by politically influential

businessmen—the most spectacular step in this process.¹ The phenomenon was an entirely new process for Ukraine, as the banking system was intimately connected with powerful oligarchs who used banks as a way to transfer public funds to their own accounts. Reform in the financial sector threatened this reality and enabled some de-concentration of the Ukrainian economy.

Figure 2. NBU official reserve assets, USD millions, 2013-2022



Source: https://bank.gov.ua/files/SDDS/IREZ_en.xlsx

A move away from a fixed exchange rate regime to **inflation targeting** in 2016 was another important step towards building the fundamentals for sustainable economic growth. Previously, the fixed exchange rate was not only an instrument of exchange rate policy but was also used as a politically sensitive anchor. Political commitments

1 PrivatBank was highly undercapitalized as a result of politically connected lending and other unhealthy banking practices, and was a major threat to the stability of the Ukrainian financial system. Its nationalization was, as noted in the text, an emergency measure, and we are not suggesting that additional nationalizations should take place.

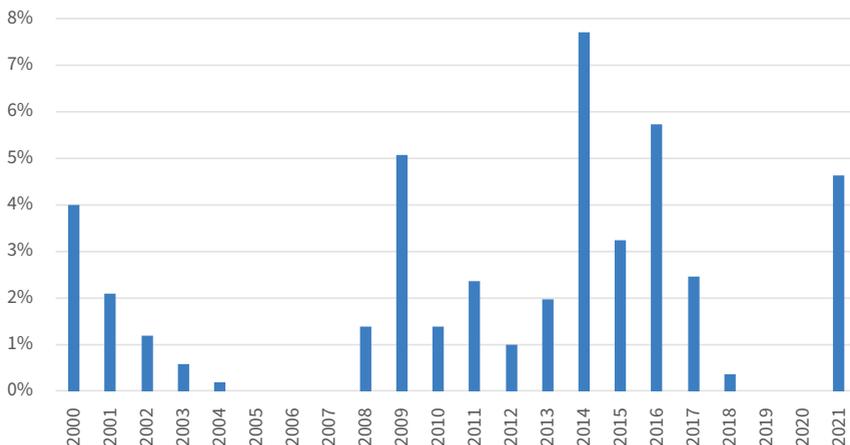
to the stability of the national currency led to short-sighted decisions that focused on currency as a political anchor rather than supporting long-term and sustainable growth. The shift to the inflation-targeting regime made the Ukrainian economic system more resilient to shocks and more flexible in terms of adjustment to new market realities. When the war started, the NBU switched to a mixed regime, attempting to minimize exchange rate fluctuations (the exchange rate was fixed as the aggression started and was later adjusted), though still staying committed to the priority of inflation targeting.

Price liberalization was another painful undertaking that was close to being completed just on the brink of the war. Heating, natural gas, and electricity tariffs for households were the main stumbling block to price liberalization, as subsidized tariffs for households distorted incentives, created large quasi-fiscal deficits for public finances, and boosted energy imports with subsequent impacts on external accounts and currency stability. By 2020, heating tariffs and natural gas prices were already close to market levels, removing quasi-fiscal problems and pressure on external accounts (in 2021 the situation changed with the rapid increase in global inflation). Electricity tariffs for households remained subsidized, which was reflected in meager investments in improvements of national electricity grids. The Russian invasion reignited the problem of subsidized utility tariffs amid ballooning energy prices and the political reluctance to charge market prices to Ukrainians, who were experiencing a dramatic fall in real income as a result of the Russian aggression.

Simplification of the tax system was another pivotal reform but one that was begun early (1998), opening the way for the development of micro- and small entrepreneurship. The key idea was to protect entrepreneurs from too much interaction with law enforcement and taxation bodies, and the system helped facilitate a business-friendly and politically active middle class in Ukraine; as evidence of this, micro-entrepreneurs played an important role in both the Orange Revolution (2004) and the Revolution of Dignity (2013-2014). The simplified taxation system

has been, however, heavily abused and requires proper tailoring to adjust to reality. Nevertheless, the system proved beneficial for the Ukrainian economy as an instrument for people to make a living by their own hand instead of relying on government handouts or public funds.

Figure 3. Quasi-fiscal deficit, % of GDP, 2000-2021



Source: Ministry of Finance, NBU, IMF, World Bank

Some tentative progress has also been made in key institutional reforms related to property, as just on the eve of the war Ukraine finally launched a long-awaited **land market reform**. A moratorium on the sale of agricultural land had been in place since 1992. Despite the ban on land sales, illegal trade in land plots was active and was accompanied by large-scale abuse. Finally, this vestige of the Soviet era was removed on July 1, 2021, allowing landowners to dispose of their property. Little time has passed since the launch of the land market, but provisional reports confirm that the market has been operating without major problems. Ukrainians are continuing

to buy and sell land even despite Russia's large-scale aggression. The opening of the land market for legal entities in 2024, and the further opening of access for foreign investors, are reforms that remain to be undertaken.

In a similar but distinct vein, **privatization** was the first critical reform. It was started in the 1990s and took a controversial path with voucher-based privatization, leaving perceptions (right or wrong) of societal unfairness. In any case, the process transferred the lion's share of enterprises into private hands. Unfortunately, the state remains far too involved in the economy and is one of the largest owners controlling enterprises in the energy sector, transportation and infrastructure, and further privatization is badly needed. The war has strengthened the role of the government and state-owned enterprises, with the government even seizing shares in some private companies under martial law.

Along these lines, substantial progress in strengthening **corporate governance** in state-owned enterprises (SOEs) and state-owned banks (SOBs) only took place after the Revolution of Dignity of 2014. More transparency was introduced, and independent directors entered the Boards of the SOEs and SOBs. The high salaries for top management of SOEs and SOBs became a sensitive issue for society and politicians, but the quality of management in the state-owned companies improved substantially. The victory of Naftogaz over Gazprom in a Stockholm arbitration court in 2018 is an excellent example of the shift in incentives at the SOE level.²

Finally, many important reforms took place in other areas, such as **education, health care, and social assistance**. Taken together, all such efforts contributed to a better quality of public services and brought greater efficiency to the use of taxpayers' money. For instance, the system of independent external evaluation was introduced,

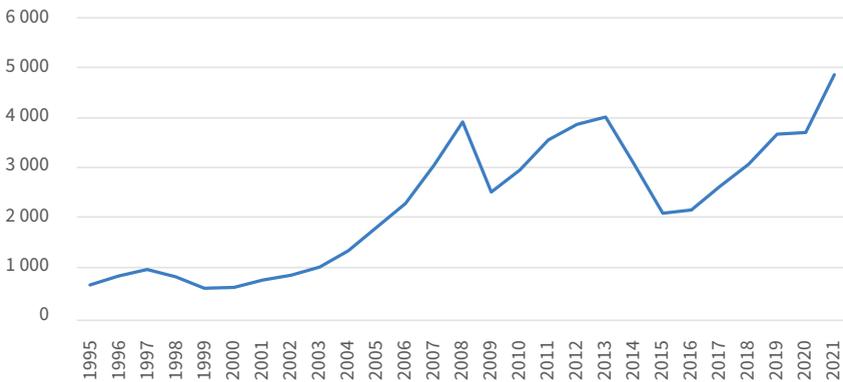
² It was for the first time in the history of Naftogaz that management of the company was defending national interests of Ukraine rather than reaching undercover agreements with Gazprom.

improving access to higher education for talented young people. The primary level of the health-care system was rebooted, establishing the institution of family doctors. A lot remains to be done, but the progress already made has been substantial.

What was wrong, and why does Ukraine remain economically backward despite all the reforms delivered over the 30 years of independence? We see three key reasons why Ukraine retained a distorted economic system following the collapse of the Soviet Union.

The first reason is that critical reforms were stretched out over time, taking three decades to be implemented. For instance, the agricultural land market was only legalized in 2021. The Soviet institutional legacy was allowed to exert an influence precisely because many of its features were not addressed promptly. And when critical

Figure 4. GDP per capita in Ukraine, US dollars, purchasing power parity (PPP)



Source: State Statistics Office of Ukraine, World Bank

reforms were undertaken, they were done inconsistently and only implemented after the Revolution of Dignity. In reality, the effects from the last stage of transformation began to manifest themselves just before the start of the war.

The second reason for Ukraine's economic backwardness was the recurring macroeconomic destabilizations, some created internally but others coming exogenously. Initially, the macroeconomic crisis was triggered by the fall of the USSR, but pendulum swings by the authorities and the preponderance of communists in parliament meant that it took a decade for the situation to be stabilized. After the Orange Revolution (2004), Russia made an attempt to induce an energy shock; however, booming resource prices on global markets in 2004-2007 meant that it went unnoticed. The global financial crisis reversed this trend, and the economy collapsed in 2008 with a 14.8% y/y GDP fall in 2009, exacerbated by short-sighted regulatory policies of the NBU which disregarded exchange rate risks³ and multiple internal imbalances. Four years later, in 2014, Russia's occupation of Crimea and Donbas began. It took three years to stabilize the country during wartime and the economy only returned to normal in 2016. Four years later, in 2020, COVID-19 hit the global economy, and in 2022 a large-scale Russian invasion began. From 2000 to 2021 Ukraine's average GDP growth was only 2.3% y/y. Internal reforms were slow, but external blows hitting the country were intensive to say the least.

The third reason for the backwardness is the acknowledged failure to establish rule of law. Problems with the investment climate, large-scale smuggling, widespread tax evasion and corruption, and the arbitrary application of law are consequences of a dysfunctional law-enforcement system. All macro-stabilization programs for Ukraine concentrated on external accounts and fiscal consolidation and continued to push institutional reforms further. Among these, the creation of a functional law enforcement system was ostensibly on the agenda but, apparently, was not

3 The regulator ignored large-scale foreign currency loans of banks to borrowers who had earnings in the national currency.

a priority, as the judicial and law enforcement systems were treated as weak but still operational. Unfortunately, this estimation of affairs in the judicial sector did not reflect reality, and the law enforcement system in Ukraine is unreliable and unusable for building sustainable economic policies. The creation of proxy systems such as anti-corruption bodies is a clear indication that the rule of law in Ukraine is a real challenge.

2 Reconstruction, EU accession, and completing reforms

The ongoing war has led to the rollback of many institutional achievements of the pre-war reforms. Power has been centralized and transparency reduced, while the logic of market efficiency is yielding to war-time expediency. Until the end of military actions and the expulsion of Russian forces from Ukrainian soil, there is little hope of institutional reform. However, as the recovery stage gets underway, the reversals of wartime should be abolished, and further institutional reforms should be promptly implemented.

Paramount among these is continued integration with the European Union. The process of European integration in Ukraine started in 1994 when the country signed a Partnership and Cooperation Agreement with the EU and established a special European integration department within the Cabinet of Ministers. Cooperation with the EU really gained pace after 2009, when Ukraine became one of the EU's geopolitical partners under the Eastern Partnership Initiative. The signing of the Association Agreement (AA) in the spring of 2014 deepened cooperation to the level of strategic partnership, which potentially opened the prospect of EU membership for Ukraine.

However, from a political point of view, the EU did not even dare, at the time, to bring up official prospects of membership despite the unprecedented commitments to approximate the regulatory environment of the European Union that Ukraine took upon signing the Association Agreement. A poorly attended advisory Dutch Referendum on the EU-Ukraine Association Agreement was held in April

2016, showing that Dutch voters were not quite ready to give Ukraine the prospect of EU membership. Despite ratification of the Association Agreement by EU Member States, the referendum made any promise of EU accession to Ukraine politically impossible.

Meanwhile, the EU–Ukraine Association Agreement had a significant impact on government policy as key reforms began to set in motion the gradual modernization of the country. The impact was multidirectional since certain fundamental changes—such as decentralization, reform of the civil service, and judiciary reform—were expected from Ukraine. These were to serve as the basis for broader reforms and the further implementation of broad sector-based transformations. In fact, Ukraine’s greatest successes were achieved in the “trade sections” of the Agreement, which aimed at reducing customs duties and removing non-tariff barriers to Ukrainian exports to EU markets. Changes in the “sector-based” part of the Agreement, which involved steps in specific areas from energy to education, reached varying degrees of progress, from “ready-to-be-integrated into the EU Single Market” sectors like public procurement or technical regulation, to “unpopular sectors” like education or postal services.

A government assessment⁴ of the implementation of the AA Action Plan for 2014–2024 arrived at an implementation rate of 66% as of November 2022. According to an independent assessment⁵ by the Ukrainian Centre for European Policy, overall progress stood at 49% as of the first half of 2021, which included both fully completed commitments and interim results. Public monitoring assessed net complete progress at 25.6% of the commitments envisioned by the Agreement (the same date of assessment).

4 Pulse of the Agreement: <https://pulse.kmu.gov.ua/ua/a/year/all>

5 AA Navigator: <https://navigator.eurointegration.com.ua/>

The detailed analysis of AA implementation demonstrated that public procurement and the energy sector were the leaders in terms of the number of commitments fulfilled. Ukraine successfully implemented a set of necessary steps in the trade part of the Agreement. The Deep and Comprehensive Free-Trade Area (DCFTA) brought quick benefits to the domestic economy and exporters, especially of agricultural products. The reform of non-tariff barriers to trade (technical barriers to trade, or TBT) demonstrated impressive progress in harmonizing the regulation concerned with national quality infrastructure and standards. This brought Ukraine very close to the barrier-free export of its industrial goods to EU markets. Other sectoral changes showed both significant achievements with certain sets of commitments and complications in the adaptation of others. One example can be found in customs reform:

- On the positive side, preparations were made to join the Convention on a Common Transit Procedure (NCTS). A mechanism for the protection of intellectual property during the movement of goods across the customs border was also brought into line with EU requirements.
- Progress was rather limited with other commitments. The EU's Customs Code provisions were only partly implemented and covered a limited range of issues. For instance, the Institute of Authorized Economic Operators has been implemented but has yet to gain popularity with businesses.
- Within the prospects of preparations for membership, Ukraine will have to do a lot to develop the institutional capacity of its customs authorities. This will involve the development of customs infrastructure (buildings, checkpoints, technical equipment, and so on), IT solutions for customs, and the retraining of personnel to establish a unified, efficient system of customs rules.

In June 2022, Ukraine was granted candidate status for EU membership through an extraordinarily quick decision of the European Council, taken at a time when the country was resisting full-scale invasion by Russia. Preserving the status quo within the framework of AA implementation became an important prerequisite for accession negotiations. While much has been achieved in 8 years, obstacles remain that hold the country back. “Frozen” progress—in particular in establishing rule of law, the continuing weakness of the civil service and extensive reach of the state and, in particular, the political interference that this allows—remains the most significant of these issues.

Some commitments made by Ukraine during this process will have to be resolved, including the complex set of political and regulatory decisions (covering anti-oligarch legislation, the implementation of anti-monopoly rules, and a better investment climate and access to finance for reconstruction). For example, the harmonization of European environmental law concerning GHG emissions (e.g., requirements of the Large Combustion Plant Directive for air pollution limits by large power plants)⁶ will require substantial investment and, in fact, a complete overhaul of the country’s old and badly deteriorated domestic power generation system. Such issues also clash with the interests of the business groups that own the power plants responsible for the greatest pollution and are opposed to such restrictions.

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

2.1 Key issues

A unique “candidacy” window of opportunity that should be exploited from the very start to move to the accession stage

- The EU accession process is defined in Article 49 of the Treaty on the European Union as follows: “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.” Within the EU legal framework, the accession process goes sequentially through nine political and administrative stages. There is no fixed timetable, but there are many examples showing that a decade or more can pass between when a country submits its application and when it fully accedes.
- Thus far, Ukraine has skipped several steps of this stage. Under normal conditions, Ukraine would have had to fully implement all the commitments under the Association Agreement, demonstrate and convince EU members that the country had fully implemented them, and only then submit a membership application: the base scenario for tendering an application was originally scheduled for 2035.
- The EU has never before granted candidate status to a country at war. Therefore, Ukraine—caught up in the largest war of the last 50 years—is in a unique position today and has been given a window of opportunity to enter accession negotiations within the next few years.

The significant geopolitical and security impact of candidate status

- The EU's motivation for granting Ukraine candidate status was not a reflection of enthusiasm for the country's implementation of reforms, but rather of urgent geopolitical and security considerations. The EU finally dared to declare Ukraine its geopolitical partner in opposition to Russia, which does not see Ukraine as a European nation.
- Ukraine can count on cooperation with the EU, which will grow even stronger in the future: this support is logical and necessary in light of the current protracted war of attrition.
- The status of a candidate to the EU allows Ukraine to participate in various European structures where a physical presence and involvement in discussions is of great importance. The country needs to leverage efforts to integrate into various EU structures in order to gain greater support within the EU.

Pre-accession assistance to Ukraine in critical areas

- Candidate status can open the way to pre-accession support, which would mainly be:
 - a. financing purchases of weapons made by European companies and coordinating joint manufacturing with European companies;
 - b. macro-financial assistance to balance the national budget that has been suffering huge economic losses;
 - c. sector-based investment (loans and grants) in rebuilding destroyed critical infrastructure and more;
 - d. financial and technical assistance in economic and structural sectoral reforms.

- The EU has expressed its intention to invest in Ukraine's post-war recovery. The Cabinet of Ministers, together with the Government Office for the Coordination of European and Euro-Atlantic Integration, has developed a Recovery Plan and presented it at the Ukraine Recovery Conference in Lugano.
- The availability of investments could possibly be resolved in the post-war period by using confiscated Russian assets to finance Ukraine's reconstruction. Although history has seen no precedent of a comparable scale, international courts and organizations could assist in arranging this.

Trade barriers with the EU that still need serious solutions

- First, an accelerated and complete elimination of **customs duties, tariff quotas and other pricing restrictions** for Ukrainian agricultural goods would function as a measure to support the country's economy.
- Secondly, signing the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), allowing the EU to recognize Ukraine's National Quality Infrastructure and conformity assessment to ensure supplies of industrial goods to the EU internal market without additional certification. These issues are currently in the verification phase, and fast-tracked signing of three agreements in the first three industrial sectors (electrical equipment, pressurized vessels, electromagnetic compatibility) would be a major step of support on the part of the EU.
- Thirdly, Ukraine needs to work on harmonizing tax regimes, developing a road map for bringing Ukraine's tax legislation into line with EU tax legislation, and determining the provision of EC Directive 112 on the common system of value added tax.

- Fourthly, customs rules need to be harmonized and steps taken towards a de facto common customs area with the EU (including the longer-term goals of harmonized VAT legislation, common external trade policy or at least understandings/exemptions, and any necessary revenue sharing mechanisms).

These four steps will finally liberalize trade with the EU and remove barriers to cross-border business operations, together with the unimpeded movement of goods across borders.

Seven sets of reforms identified by the European Commission⁷ as post-candidate conditions

To seize the moment, Ukraine was granted candidate status for EU membership unconditionally, an approach that was widely supported by Ukrainian civil society. However, in light of multiple institutional problems within the country, the European Commission outlined seven post-candidacy conditions for Ukraine which should be implemented before the accession negotiation process starts. The pre-conditions are predominantly related to the rule of law and include requirements on reforming the Constitutional Court, judicial reform, combatting corruption, combating money-laundering, implementing anti-oligarch legislation, harmonizing legislation on media, and amending legislation on national minorities.

The European Commission typically exercises strict control and monitors progress in the fulfillment of such commitments. Ukraine will need not only to fulfill them, but also to convince the EU Member States to acknowledge the outcomes and to

⁷ https://www.eeas.europa.eu/delegations/ukraine/eu-commissions-recommendations-ukraines-eu-candidate-status_en

demonstrate cases functioning in practice. This should help remove the political barrier of skepticism in certain individual EU Member States, and give a signal to continue with the accession process with the launch of accession talks.

Uncertainty regarding further accession prospects

- Although having been granted candidate status in advance, given Ukraine's incomplete implementation of the Association Agreement, full EU membership will not happen soon. The current EU enlargement policy is slowed down by, among other things, limited capacity of the Union's institutions to absorb new members. One of the key questions in this regard is whether Ukraine will receive an accession option tailored to its national specifics and the ongoing war, or the accession process will unfold within the existing accession model for candidate countries.
- In 2020, the European Union updated its accession methodology for new candidates, so it already has an updated vision of its own enlargement capacity.
 - One option for the accession process is the Western-Balkan scenario. Serbia and Montenegro have been negotiating their accession to the EU for quite some time, while Albania and North Macedonia have only just started. These candidate countries have had to implement provisions of certain sections of EU legislation in a cluster format, complete with goals or benchmark-setting by the European Commission, ongoing monitoring or screening of performance, and the closure of these sections after all EU Member States provide positive assessments.
 - Being a candidate country, Ukraine can also negotiate with the EU for step-by-step accession, also known as a staged sector-based accession, in which progress in a given sector allows the candidate to de facto claim integration into the EU market in this sector.

- Another approach involves designing a procedure specific to Ukraine that would effectively be a concessional accession with transition periods. Given the ongoing war, some EU commitments cannot easily be implemented in a “business-as-usual” manner, so Ukraine might be able to agree with the EU to set transition periods in certain sectors that cannot otherwise be implemented in the short term.

2.2 Post-War Recommendations

Focus on key fundamental reforms.

- Countries that are candidates for EU membership have to implement Chapters 23 and 24 of the European acquis, which require reforms in justice and the protection of basic human rights, as well as an effective working judiciary, including courts, anti-corruption agencies, and political institutions. Ukraine was tasked with this as part of its candidacy conditions, and it is a key requirement to be fulfilled for further progress in accession.
- Ukraine’s modern history has noted many examples of good laws being adopted, such as gas market reforms or the reform of corporate governance in government-owned companies, but weak government institutions or undue political influence distorting their implementation are effectively stalling progress. The absence of rule of law and transparency of political machinery coupled with the penetration of interest groups can slow down and distort fundamental sectoral changes.

- Administrative reform, with its complexity and importance, is a separate issue involving changes in administrative structures and the mechanisms of political machinery (see below in Section 5.2). If this is successfully completed, it will play a decisive role in the allocation of substantial funds for Ukraine's post-war recovery.
- In general, Ukraine needs to aim towards complete compliance with EU pre-conditions and strengthen the capacity of its own institutions.

Improve the performance of units of European integration in the Government and Verkhovna Rada.

- Most regulations that Ukraine needs to adopt for further integration are blocked at the stage of reviewing and voting. The country's units of European integration need to be shored up to properly generate qualitative changes to legislation and prevent further interference and distortion.
- Effective interconnectivity and coordination between the Government and Verkhovna Rada is of critical importance for the progress of EU accession. One example here is Poland and Eastern European countries' experience in their pre-accession stages; their governments were ready to design qualitative amendments to legislation and their legislatures were properly prepared for adopting such changes.
- Obtain from the EU a clear understanding of Ukraine's accession pathway.

The hardships and uncertainties Ukraine has to go through because of the war, as well as the absence of a clear vision on the part of the EU as to how the Union might look once Ukraine accedes, mean that the country may require a set of specific accession conditionalities and exceptions reflecting both the progress made under the

AA, which will be an asset during accession talks, and the urgent need for support today. At the very least, Ukraine has to survive the war with Russia in order to move further towards the EU and afterwards to pass through the stages of the revised version of the new (2020) EU enlargement methodology, with exceptions related to the country's specific and post-war conditionalities with a special focus on reform in the rule of law.

Draw up a realistic plan for key European integration reforms with targeted support from the EU.

If the EU opts for the “concessional” accession model with transition periods, then a joint road map of reforms will be necessary: a clearly defined action plan drawing appropriate targeted support from the EU on a permanent basis as a candidate country, with properly projected needs and properly defined resources to meet them.

Undertake effective political advocacy among key EU Member States regarding political and structural reforms and expand support.

The European Commission is a technocratic institution that, in terms of EU enlargement, is mostly busy balancing the political and economic interests of individual Member States while technically evaluating reforms. As all key decisions regarding the future development of the EU are the product of consensus-building among Member States (and enlargement requires unanimity), Ukraine has to boost its influence, work with the skeptics to demonstrate the benefits of closer relations, and show its commitment to reform via sustained progress. Without this kind of effort, the country will not be able to build enough political support to properly pass through the stages of accession talks.

3 Organizing cooperation between Ukraine and the West

Post-war policy should also include two parts in addition to Euro-integration: post-war reconstruction, and the speeding up of institutional reforms as part of the recovery. While military operations are in full swing, Ukraine is receiving (and should continue to receive) support without strict conditionality on institutional changes. However, once Ukraine moves into the recovery stage financing needs to be linked to the progress of reforms.

In the first instance, the funding of reconstruction and recovery requires a centralized institution to avoid overlap and minimize inefficiency. On December 12, 2022, G7 Leaders made a statement on establishing a multi-agency Donor Coordination Platform in close coordination with relevant International Organizations and International Financial Institutions, which seems to be the first step towards the potential creation of a centralized body responsible for managing funds for Ukrainian reconstruction. The platform will be used to “coordinate existing mechanisms to provide ongoing short- and long-term support – with particular responsibility of the Finance Track for short-term financial support –, coordinate further international funding and expertise, and encourage Ukraine’s reform agenda as well as private sector led growth.”⁸ The G7 countries also plan to create a Secretariat for the Platform, with a senior government representative designated from each member to oversee the setup of the platform and ongoing coordination efforts.

8 <https://bit.ly/3VYyYcm>.

The G-7 countries are the holders of a frozen \$316 billion of Russia's foreign exchange reserves and should naturally retain the leading role in monitoring any proposed use of these funds. The European Commission should take the central role in the work of the Platform (and potentially in creating a "Recovery Fund"; more on this below) as the main institution that will be coordinating Ukraine's efforts on its path to European integration.

Ukrainian authorities should play the leading role in defining the needs and prioritizing the projects that require financing. The involvement of Ukraine in decision-making is crucial for securing ownership of the projects that the Recovery Fund will be supporting. The approval and supervision of the projects should be the responsibility of the executive secretariat of the fund, with the active engagement of Ukrainian civil society since the financing should be closely linked to the monitoring of progress in institutional reform.

The funding mechanism should be project-based, with the Recovery Fund approving financing after a thorough review of project proposals. Ukrainian authorities should decide, following consultations with civil society, which projects require funding and are of priority. The voice of civil society at the stage of defining needs and prioritizing projects should be an integral part of the quality check on funding requests. The managing body of the Recovery Fund should be responsible for project review through the prism of efficiency in the use of potential funds and compliance with the criterion of good value for money. The monitoring of spending and progress of project implementation should be built on the capacities of Ukrainian state institutions (such as the Prozorro online procurement system and the Accounting Chamber of Ukraine) and on the capacities of Ukrainian watchdogs. The managing body of the Recovery Fund should run high-level general monitoring of the process addressing issues that might require special attention.

4 Needs and sources of financing

The Russian aggression has damaged and continues to seriously damage the Ukrainian economy. The NBU projects a 31.5% y/y GDP fall in 2022. The UN reports 7.8 million⁹ refugees leaving the country, while Ukrainian authorities report 4.9 million internally displaced people (IDPs).¹⁰ The damage caused by the Russian invasion is estimated at \$127 billion as of September 1, 2022, according to the “Russia will pay”¹¹ project.

In July 2022, at the international Ukraine Recovery Conference in Lugano, Ukrainian authorities defined a requirement of almost \$750 billion for rebuilding the country (this figure also includes private investments). The government defined three stages of funding needs: stability or rapid response funds (2022), recovery (2023-2025) and modernization and European integration (2026-2032). For the short-term perspective (stability stage, 2022) Ukrainian authorities outlined needs of up to \$65 billion in financing for covering urgent needs in war operations and for paying social benefits as well as financing emergency repairs of critical infrastructure. For the recovery stage (2023-2025), the Ukrainian leadership determined more than \$300 billion in financing needs for covering the reconstruction of destroyed facilities and apartment blocks, the rebuilding and modernization of infrastructure, energy projects, support for the financial system, and projects in the area of defense, and so on. For the European integration (modernization) stage (2026-2032), financial needs of up to \$400 billion were defined in the official Ukraine Recovery Plan. The estimates are

9 <https://data.unhcr.org/en/situations/ukraine>.

10 <https://www.ukrinform.ua/rubric-society/3632525-v-ukraini-zareestrovani-majze-49-miljona-pereselenciv.html>

11 <https://damaged.in.ua/>

very provisional and other institutions give alternative numbers (the World Bank estimated recovery needs at the level of \$350 billion in August 2022) but it is clear that the scale of funding needs is extraordinary.

Since the outbreak of war, Ukraine has already received \$30.8 billion¹² of support (without counting military assistance) in loans and grants, though less than Ukrainian authorities requested. For 2023 the US has already committed \$1.5 billion in monthly support. The EU has also made a commitment to provide €1.5 billion per month in 2023. Even so, these funds are barely enough to cover the country's ongoing military requirement in the war. The funds are barely enough to cover the costs of the country's ongoing requirements, especially during wartime.

Frozen Russian assets—with \$316 billion of Russia's foreign exchange reserves as the main source—should be used to cover Ukraine's recovery needs, no matter whether Russia complies with this demand voluntarily or it should be enforced.

As noted, Ukraine is receiving substantial support from the West for waging the war and maintaining the country's basic needs and functions. However, for the post-war recovery Ukraine will need hundreds of billions both in grant support and in private foreign investments to rebuild from the destruction caused by Russia and also to help finance the reforms. And if there is a shifting view concerning where some of the funds for rebuilding damaged infrastructure might come from (the frozen \$316 billion of Russia's foreign exchange reserves), there is no clear solution about how to attract private foreign investments into a war-torn country also suffering from non-functional rule of law.

¹² As of December 21, 2022

In this regard, Ukrainian authorities and Western partners might consider the Recovery Fund not only as an instrument in managing funds for rebuilding the country, but also as a tool capable of facilitating the inflow of foreign investments into Ukraine.

Even before the war, poorly performing law enforcement and judicial systems had led the Ukrainian authorities to search for alternatives that might help attract foreign capital to the country, despite the weak rule of law. Among the most popular ideas is that of applying British law in selected cases (such as privatization contracts); however, the key problem with such a proxy judicial system is that it might work well for relations between private entities, but it does not protect investors from the actions of law enforcement bodies or certain other representatives of the state. The absence of leverage to enforce Ukrainian state bodies to comply with the decisions of foreign courts is a stumbling block.

The launch of a Recovery Fund, overseen by donors, could solve this problem by having British law apply to representatives of the Ukrainian state. The funds and assets for recovery could serve as a guarantor that a decision by a foreign court will not be ignored—and, most importantly, that damage to private investors caused by the state will be secured for compensation at the expense of the Recovery Fund. In this form, a proxy judicial system in Ukraine based on British law might be temporarily created to facilitate foreign investments while the Ukrainian judicial and law enforcement systems mature, creating the incentives for the Ukrainian judicial system to become more like Western best practice.

Centralized accumulation of funds will be the backbone of such an experimental system. To create a proxy judicial system based on British law it is important to ensure that potential investors are prepared to rely on this experimental approach. The accumulation of confiscated Russian funds and assets (or any other resources to be used for recovery) in one place in foreign jurisdictions, under the supervision of the

Recovery Fund, will secure the creation of a bank with hefty collateral for boosting investors' confidence. Centralized supervision will secure easy access to the funds for executing court decisions when foreign courts might rule to compensate for damage to investors.

Tripartite agreements between investors, the Ukrainian government, and the Recovery Fund will serve as a second pillar of the proxy judicial system while national law enforcement and the judicial system mature. At the tripartite agreements, the Ukrainian authorities will commit to assisting foreign investors in creating new production capacities in the country and will be obliged to comply with the decisions of the foreign courts. Investors would then commit to bringing foreign investments into the country and creating more jobs. The Recovery Fund commits to secure access to compensation at the expense of the accumulated funds in the case of disputes with representatives of the emerging Ukrainian authorities and foreign courts ruling in favor of the investors.

Compensation of damage at the expense of reconstruction projects will be the third important pillar of the potential proxy judicial system. The Recovery Fund will be accumulating resources dedicated to being spent on the needs of Ukraine. Risky actions by state officials may reduce the size of the accumulated funds, which would inevitably lead to the prompt investigation of these issues at the top political level in Ukraine, with personal decisions concerning those responsible for the funding cuts very likely. In this way an (informal) inevitability of punishment will be established, with incentives to prevent state officials from unfriendly actions against businesses; and this will stimulate the Ukrainian authorities to guard foreign investors from any local specifics.

The design described above will protect foreign investors from any surprises related to the malfunctioning rule of law, will stimulate the Ukrainian authorities to tune the behavior of the state's bureaucratic machine in a way not damaging the volume of

funding collected for recovery, and will push the Ukrainian leadership to establish rule of law in the fastest possible way if every new money transfer for recovery is conditional on progress in institutional reforms, with judiciary the main priority.

5 Crucial reforms to complete

The overall path of reform in post-war Ukraine will be within the context of European integration. Complying with the recommendations of the European Commission will be the best strategy for Ukrainian authorities to reach sensible results in rebuilding the nation in a sustainable and effective manner. This approach will help overcome some of the failings of the past, and provide a beacon for Ukrainians—scattered throughout Europe due to the war—to return to. However, in many aspects there is no need to wait for the accession model to be defined or for the guidelines for reform. Moreover, many states are free to decide for themselves how they want to address these or other issues. Below we have highlighted reforms that Ukraine will have to deal with in order to successfully complete its transition away from the failures of the past and the Russian-inspired system it followed for so long and towards being a viable and vibrant economy. In many cases, the implementation of the reforms has already started but needs to be completed in the right order, while for other areas the political will has been lacking. Regardless, these are the priorities for post-war Ukraine.

5.1 Rule of Law

5.1.1 Building the Rule of Law and Judicial Institutions

By the end of 2021, almost all major market reforms had been launched in Ukraine. Some of them required further tuning, while others still required more effort to bring the initiatives to completion. Nevertheless, on the eve of the war there were hardly any macro-economic misbalances threatening the country's sustainable economic growth (other than the pension system) to report. What was of concern was the suppressed performance of businesses, the meager inflow of foreign investments (partly

due to the high geopolitical risk), and, as a consequence, economic growth that had been systemically underperforming for decades. In other words, over the course of thirty years of independence Ukraine had learned how to survive and stabilize but had failed to become capable of rapid growth and development.

The dysfunctional law enforcement and judicial systems are to blame for the country's poor investment appeal, the inefficient use of public funds (requiring higher levels of taxation), and at the same time large-scale tax evasion (the latter a consequence of the former). Decades of shelving the problem of rule of law translated into the decision to create a proxy system of anti-corruption bodies, thus recognizing the unsuitability of institutions existing in name alone. Because of the dysfunctional law enforcement system, it was impossible for the authorities to collect taxes; the lack of inevitability of punishment, coupled with the inability of tax authorities to trace taxes successfully, meant there was little incentive to comply. The Ministry of Finance and tax authorities therefore developed a tax collection system based on the presumption of taxpayers' (tax agents') guilt, making businesses responsible for proving their innocence on a daily basis. Presuming taxpayers (tax agents) to be guilty is perhaps a helpful tool (in the short term) for fiscal consolidation but constitutes a very counterproductive instrument for generating economic growth in the country.

The prescriptions for reform of the judicial and law enforcement systems have already been drawn up by IFIs in collaboration with Ukrainian civil society. The Constitutional Court of Ukraine (CCU) should be rebooted without political influence under the supervision of independent international experts and representatives of civil society. The High Council of Justice (HCJ) and the High Qualification Commission of Justice (HQCJ) should be restarted under the supervision of international experts and civil society (implementation in progress), and as soon as the bodies are staffed they should reboot the entire judicial system (courts of first instance and appeal courts). The ability of administrative courts to suspend the decisions of national state agencies should be examined and probably curtailed, with only the

highest courts having the function of reviewing the constitutionality of state decisions. The Security Service of Ukraine (Sluzhba Bezpeki Ukrainy) (SBU) should be stripped of its power to investigate economic and corruption crimes. The Economic Security Bureau of Ukraine (ESBU) should be restarted with closer attention paid to checking the integrity of candidates for positions at the ESBU. The rebooting of operative and detective units of the police (which remained untouched in 2015) as well as the prosecutor's office (not brought to completion in 2020) are also critical for the reform of the law enforcement system.

The abovementioned measures remain necessary but are not sufficient conditions in themselves for the successful establishment of rule of law. Legislative changes in the environment of dysfunctional law enforcement do not necessarily lead to the planned results. This is particularly the case if the changes affect the “business as usual” in the law enforcement system itself. Against this backdrop, there is a need for more sophisticated digitized metrics for measuring the progress of changes in the area of law enforcement and the judicial system. The Rule of Law index of the World Bank's World Governance Indicators is a good example of such metrics, but a more profound monitoring system is needed to accurately spot the causes of failures in the law enforcement and judicial systems. Some basic monitoring already exists, such as the tracking of changes to court decisions in courts of appeal and the Supreme Court. Also, civil activists can analyze court decisions via an electronic judiciary system. However, further development of both data collection and the system of indicators is needed.

A system of numerical metrics should be used for evaluating progress in establishing rule of law in Ukraine, not only via qualitative instruments such as whether or not a particular law has been approved, but also with quantitative measures.¹³

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

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

It would be highly desirable for the Ukrainian authorities to immediately address the problem of the absence of rule of law. However, the complexity of the reform as well as the scale of the required reboot in the judicial and law enforcement systems requires sufficient time for completing all the steps in the right order. This means that there will be a kind of “transitional period” when the new law enforcement and judicial systems will be under construction while rule of law is still non-functional. For attracting foreign investments and simplifying the business environment through the years of this transition (when law enforcement remains suboptimal), the authorities might be advised to consider simplified administration tools in economic policy, which for instance would not require a presumption of taxpayers’ (tax agents’) guilt and might give investors greater confidence for bringing money into the economy.

Importantly, the anti-corruption system does not solve the problem of general law enforcement and the judicial system. The anti-corruption system in place concentrates on top-level political corruption, which undoubtedly requires attention, but this does not address thousands of unjust court decisions and does not tackle the abuse of power by law enforcement bodies. The top cases might attract public attention and the media spotlight, which will serve as protection for aggrieved businesses or citizens. However, thousands of smaller cases will pass by unnoticed, completely under the power of the unreformed law enforcement bodies.

Rule of law will be one of the key requirements for Ukraine's accession to the EU. However, there is no need to wait until the advanced stage of EU accession negotiations, and the reform of law enforcement and the judiciary needs to be linked to recovery funding. The urgent need for financing will serve as a much stronger incentive than the European integration process, which will take several years.

5.1.2 **Anti-Corruption Policies**

The newly established anti-corruption chain of command was supposed to replace the non-performing law enforcement and judicial systems in regard to tracking, filing, and trying high-profile corruption cases. The system was completed in 2019 but became fully operational only in July 2022, when a new Special Anti-Corruption Prosecutor was appointed. Throughout 2021, only three proceedings were sent to court with indictments.¹⁴

In April 2022, the first term of the National Anti-Corruption Bureau Director expired and competitive selection for positions is currently underway. Rather ominously, the Verkhovna Rada Committee for the Organization of Government Authority recommended adopting a bill¹⁵ to abolish the requirement of political independence of future NABU directors and to simplify the procedure for dismissing them. There is desperate resistance in the establishment against the functioning of Ukraine's anti-corruption agencies. In addition, despite a fully functional Agency for Investigation and Management of Assets (ARMA), no effective system for tracking and reclaiming assets obtained through corruption has been set up.

14 https://old.gp.gov.ua/file_downloader.html?_m=fslib&_t=fsfile&_c=download&file_id=215627

15 <https://itd.rada.gov.ua/billInfo/Bills/Card/40215>

Post-War Recommendations

- Ensure compliance with Ukraine's international commitments to combat corruption, in particular those related to the process of European integration.
- Safeguard the independence and performance of anti-corruption agencies and strengthen their institutional capacity.
- Focus on increased digitalization of the anti-corruption process to enable both the tracking of corruption cases and an interface with the public.
- Organize transparent competition for key posts and appoint an authoritative, professional, and independent head of NABU.
- Organize transparent competition to select the head and safeguard the further institutional development of the Agency for Search and Management of Assets (ARMA).

5.1.3 Decentralization

Decentralization reform is considered one of the most important and successful achievements of the post-2014 period. The resilience of local communities during the Russian aggression is felt to be among the key factors behind the successful rebuff of Russia's invasion. Still, the reform was only partially implemented. An important part of this was the creation of its best-known aspect, the Amalgamated Territorial Communities (ATCs) or *hromadas* (1,469 ATCs were created by 2021). The amalgamation process was concluded by 2020. Additionally, the districts of Ukraine (*rayons*) were merged from 490 into 136 *rayons*¹⁶. Some degree of fiscal decentralization,

¹⁶ In 2021 Ukraine had 27 administrative units of the upper level which include 24 oblasts, temporarily occupied Crimea (Autonomous Republic of Crimea), Kyiv city and temporarily occupied Sevastopol city.

mainly related to education and health care, has been implemented. Nevertheless, the fiscal autonomy of lower-level governments remains limited. The draft constitutional changes intended for opening the way to genuine local and regional self-government were blocked by parliament in 2015.

Unclarity in the competencies and responsibilities between *hromadas* and central government, the high level of transfers from the central budget, the mismatch between available funding and responsibilities allocated to local communities, and the lack of cooperation and coordination between ATCs are the issues to be resolved.

Post-War Recommendations

- Constitutional reform to clarify the status of institutions at oblast and rayon levels:
 - After the war, the regional and local self-governments of all levels must be re-installed, and military war administrations must be disbanded.
 - Clarify the status and responsibilities of oblasts and rayons: it needs to be decided whether the oblasts and rayons are to remain deconcentrated from central government or are to be turned into truly decentralized levels of government, with the second option preferred.
 - Reduce political dependence of the governors (central government representatives at oblast level) by shifting the power to appoint governors from the President to the Cabinet of Ministers.

- Clarify the competences of levels of government through legislation (own tasks for local governments): in order to meaningfully strengthen local and regional self-government, tasks and responsibilities must be allocated to decentralized local and regional governments as own functions where

regulatory power is assigned within broad guidelines defined by central government to ensure comparability across the country. Each level of government must have their own competences to decide and administer.

- Increase local fiscal autonomy:
 - The share of taxes as a source of revenue for local governments should correspond to the competences transferred from state to local government. In the immediate and mid-term post-war era, the equalization scheme should equally consider the situation of local governments that have suffered destruction and those confronted with an influx of IDPs. In the long term, the equalization scheme should reduce disparities between local budgets deriving from their different fiscal capacity.
 - Local governments should be allowed to make their own choices on spending and should be empowered and enabled to determine and finance their own strategic policy priorities.

- Introduce mechanisms for vertical coordination between the executives of central government (and its deconcentrated agencies) and local and regional self-governments.

- Provide a system of state control over the legality of acts of local government through deconcentrated agencies.

- Strengthen and expand the Intermunicipal cooperation (IMC) of ATCs.

- Systematically digitalize public services at all levels of government, including a relaunch of the B2G (business-to-government) marketplace, and expand the DIIA public service app.

5.1.4 **Reforming the Accounting Chamber**

The Accounting Chamber is the highest auditing entity reporting to the Verkhovna Rada. This Chamber is an external auditing body independent of the government that routinely evaluates and argues the effectiveness and legality of state budget revenues, expenditures, and funding.¹⁷ Unfortunately, the institution lacks capacities, and has limited auditing powers for only some areas of the public sector. Extra-budgetary funds and local governments are outside its remit.

Post-War Recommendations

- Strengthen and expand the functions and powers of the Accounting Chamber to cover the entire public sector, including audits of efficiency and financial audits of local government budgets, as well as extra-budgetary funds such as the Social Insurance Fund and the Pension Fund.
- Amend the Law “On the Accounting Chamber” to allow the Accounting Chamber to conduct IT and compliance audits.
- Strengthen cyber security at the Accounting Chamber to protect the information it controls and operates with, and to prevent outside interference in its systems.
- Increase the institutional capacity of the Accounting Chamber to ensure that it can cope with its expanded remit.

¹⁷ <https://zakon.rada.gov.ua/laws/show/254%D0%BA/96-%D0%B2%D1%80#Text>.

5.2 The State, Public Administration, and Governance

5.2.1 Governance

After the Revolution of Dignity in 2014, Ukraine went through a series of political reforms, including amending the Constitution to transfer part of the president's power to parliament. The president was left with control over foreign policy and defense, while the rest of the Cabinet of Ministers (including the economic block) became accountable to the legislature. The president also retained control over law enforcement and central government representatives at the local level (so-called “governors”). The idea was to deconcentrate power and to strengthen checks and balances following the dramatic consequences of abuse of power by ex-president Viktor Yanukovich.

Later, in 2019, the electoral code was amended, reintroducing a proportional system (which had existed before 2012) based on partly open lists and multi-seat constituencies. The idea behind this was to fix the drawbacks of a mixed electoral system, which proved easy to abuse for groups of vested interests.

Despite a seemingly strengthened system of governance, the political system remained handicapped by the lack of a well-established party system or at least the articulation of platforms related to policy and ideology instead of personalities. The concentration of power after the 2019 elections revealed many weaknesses that could have been related mainly to the underdeveloped political culture rather than to political arrangement.

Post-War Recommendations

- Disband the system of military administration after the war ends.
- Strengthen the president's responsibility for non-compliance with the Constitution.
- Implement constitutional reform to clearly allocate competences between central government, regions, and local-government units (see the 'Decentralization' section for more details).
- Full transition to a parliamentary-cabinet system, with the president performing a mainly representative role (shift from semi-presidential to parliamentary system).
- Examine reform of the system of financing political parties (including possible subventions from the state budget proportional to results obtained in general elections).
- Examine ways of reforming the system of financing election campaigns.
- Introduce clear and transparent rules on the use of media (private and public) in election campaigns.

5.2.2 Public Administration

Essential public administration reform began in 2015. In 2016, the new Law "On Public Administration" came into force and a strategy for public administration reform was adopted for the years 2016-2021, with the aim of increasing efficiency and accountability across the board. Partial success was achieved, but simultaneously

the process of exempting certain civil services from the scope of newly adopted legislation commenced. Also, despite the requirements of the law, the practice of open competition for vacancies in state bodies did not last for long. Personal links and loyalty were the key criteria for selecting candidates for important state positions. Dismissals of civil servants are very often unrelated to performance in the post. And the practice of uneven financial remuneration for civil servants continues.

Post-War Recommendations

- Reimplement the transparent and competitive recruitment of civil servants:
 - Restore the government recruitment website (career.gov.ua) and make active use of it as part of a transparent and merit-based selection process.
 - Ensure that civil service HR departments establish high-quality recruitment commissions.
 - Restore directorates¹⁸ in all ministries in accordance with all areas of public policy for which they are responsible, and ensure that they are protected from political influence.

- Complete the reform of civil service remuneration and incentives:
 - Make remuneration and promotions predictable and transparent, linking them to the intensity and complexity of the work and responsibilities involved, and avoiding horizontal or vertical inequities.
 - Ensure that job classifications form the base for the civil service pay and incentive system.
 - Reform the variable elements of remuneration and link them to the intensity and complexity of work performed in a given post.

¹⁸ Directorates were created to ensure a strategic vision of policy formulation, and to guarantee a continuous path of reforms and policy continuity—even in the case of frequent and radical changes in government composition.

- Set the relationship between the fixed and variable parts of the salaries of civil servants in the law to ensure consistency, fairness and transparency throughout the civil service.
- Ensure advanced technical processes in the implementation of the Human Resource Management Information System (HRMIS).
- Audit the functions of central executive bodies (CEBs):
 - Comprehensively audit CEBs and analyze their structure and functions. This government audit has to be accompanied by an external public audit and the results widely disseminated to stimulate informed discussion.
 - Establish rules for analyzing major processes at government agencies and schedule such analyses regularly.
 - Clearly define the division of responsibilities for policy development and implementation. Clearly establish areas of competence and responsibility between the Cabinet of Ministers and other CEBs. Division of powers and responsibilities has to be based on the functional audit of each CEB (separate functions regulatory, managing, etc.).
 - Clearly define the mission of each CEB.
 - Bring all the activities of CEBs in line with the stated objectives. Eliminate functions that are harmful to the economy. Move all functions related to the management of state ownership to the State Property Fund (or National Wealth Fund if created) and ensure that the sector-based ministries are not involved in property management or other commercial activity, but remain focused on policy development and implementation in their designated sectors.

- Establish the order for all CEBs (ministries, agencies, services, inspections and so on) to report on their activities and achievements following Key Performance Indicators (KPIs) and strengthen responsibility for non-performance.
- Amend the Law “On Public Administration” to apply to all CEBs and the entire civil service.

5.2.3 Public Procurement

The electronic public procurement platform Prozorro is the calling card of the post-revolutionary reforms of 2014-2016. The system is presented as a case study in good practice that promotes cost reduction, transparency and fairness.¹⁹ Before the war, the Prozorro e-procurement system was expanding into new areas of public spending. However, with the COVID-19 pandemic and now the war, the Government decided to speed up the procurement process by restricting transparency and reducing competition. The Cabinet of Ministers²⁰ reverted to the old practice of allowing procuring agencies to purchase everything necessary through direct contracts. The only condition was to report on these procurement transactions, either immediately or after the war. Since then, tenders worth UAH 50,000 or more that are not directly related to defense, have been brought back under the Prozorro system.

Post-War Recommendations

- Ensure that resources for reconstructing destroyed social and transport infrastructure, restoring defense systems, and shoring up social services are spent effectively and efficiently to preserve the continuity and scale of donations flowing into the country after the war. For one thing, all procurement

¹⁹ <https://oecd-opsi.org/innovations/eprocurement-system-prozorro/>

²⁰ <https://tender.uub.com.ua/pro-prozorro/tendery-prozoro-u-vijsqkovyj-chas-na-majdanchyku-tender-uub-com-ua>

transactions must be handled through the competitive and transparent Prozorro system, ensuring that public procurement is monitored at all stages. Report on policy and decision-making, ensuring inclusiveness, transparency, and competitiveness.

- Apply economies of scale to recover from the massive destruction of standard social infrastructure objects. This offers an opportunity to standardize engineering and to ensure that all technologies are energy efficient. The government should consider ways to develop modular scalable design for social infrastructure.
- Amend the current public procurement system in line with the provisions of the EU acquis, Chapters 5 and 23.²¹ “The acquis on public procurement includes general principles of transparency, equal treatment, free competition and non-discrimination. In addition, specific EU rules apply to the coordination of the award of public contracts for works, services and supplies, for traditional contracting entities and for special sectors. The acquis also specifies rules on review procedures and the availability of remedies.”
- Work closely with the World Bank, which has already provided a report analyzing how Ukraine’s procurement system meets their requirements and where issues remain.
- Approach the post-war procurement strategy comprehensively and strategically to avoid three key procurement failures: low bidder interest, hold-ups, and risk allocation failures.²² Decisions should be grounded on evidence-based analysis of risks at all stages, from decision to acquisition.

21 https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/conditions-membership/chapters-acquis_en

22 <https://www.oecd.org/gov/infrastructure-governance/procurement-strategies/>

Make some proportion of post-war projects open to international competition only, which will help establish reference benchmarks to which Ukrainian providers could be compared. Systematic knowledge management will help ensure the dissemination of best practices to local industry.

- Involve civil society in procurement oversight, which is currently attracting many volunteers.
- Develop registers of qualified suppliers in various fields, so that customers do not need to check them every time and feel confident in their ability to quickly implement large-scale projects.
- Use a combination of financial and qualitative mechanisms to identify proposals offering the best value for money according to best international practice.²³

5.3 **Macroeconomic Policies**

5.3.1 **Streamlining Tax and Customs Procedures**

Viewed from a macro perspective, the taxation system of Ukraine as well as its customs practices resemble those of developed countries. However, the devil is in the details, which are usually ignored in monitoring reports. Due to the non-functional rule of law, the taxation system and customs procedures were built on the presumption of guilt of taxpayers (tax agents). This approach simplifies tax collection since the authorities have substantial room for maneuver for extracting money from businesses in line with their current needs. However, at the same time this approach

23 <https://www.oecd.org/gov/infrastructure-governance/procurement-strategies/>

suppresses economic activity, because tax authorities have plenty of instruments to intervene in business operations at their own discretion and without any limits, which also allows for the extraction of bribes.

Nominally, the key task that should be completed is the implementation of European practices in taxation and customs. The exchange of information on the flow of goods and services, and implementation of European customs legislation (in particular, the EU Customs Code), and so on, should theoretically strengthen the institutional capacities of tax and customs authorities for fighting smuggling and tax evasion.

However, in the environment of dysfunctional law enforcement and judicial systems there will be no protectors against the arbitrary application of sophisticated legislation in taxation and customs. In other words, further reforms in this area should be preceded by the establishing of rule of law in the country. As long as the law enforcement and judicial systems remain dysfunctional, the Ukrainian authorities might consider simplified instruments in tax and customs administration for the sake of reviving economic growth. The Ukrainian authorities should also abstain from administration practices based on the presumption of guilt of taxpayers (tax agents).

Post-War Recommendations

- Immediately abstain from the administrative practice based on the presumption of guilt of taxpayers (tax agents) and carry this approach over into the post-war period.
- Consider simplified instruments of tax and customs administration to reduce the adverse impact of the dysfunctional rule of law on economic development.

- Implement EC Directive No. 112 (Directive 2006/112/EC, of 28 November 2006, on the Common System of Value Added Tax) in the legislation of Ukraine.
- Adapt Ukraine's legislation to the requirements of Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations, and administrative provisions of the Member States concerning the manufacture, presentation, and sale of tobacco and related products and repealing Directive 2001/37/EC.
- Improve transfer pricing rules with due regard to OECD recommendations and international experience in taxation.
- Transform the structure of the domestic environmental taxation system and broaden the domestic environmental taxation system in line with EU classification standards.
- Implement international OECD standards on transparency and exchange of fiscal information.
- Connect the State Tax Service of Ukraine to the following IT platforms:
 - CCN/CSI special secured network, a joint IT platform for the exchange of tax information between the EU's competent authorities.
 - IT systems for automatic collection and exchange of tax information.
 - VIES (VAT information exchange system) to confirm VAT payer IDs of economic agents registered in the EU for transborder transactions.
 - E-commerce and One-Stop Shop (OSS).
 - VAT reimbursement.
 - System for monitoring the movement of excisable goods (EMCS).

- Implement Regulation (EU) No. 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code.
- Implement Council Regulation (EC) No 1186/2009 setting up a Community system of reliefs from customs duty.
- Implement Council Directive 2007/74/EC of 20 December 2007 on the exemption from value added tax and excise duty of goods imported by persons travelling from third countries.
- Implement an online exchange of preliminary customs information with EU Member States.
- Develop and improve IT solutions/IT infrastructure; harmonize with e-Customs and MASP-C.

5.4 Further Market Liberalization

5.4.1 Deregulation

By 2021, the problem of obtaining permissions and licenses, collecting supporting documents, and other regulatory obstacles to doing business moved to the back of the queue. The lion's share of the procedures had been digitalized and was later gathered together under the umbrella of the widely advertised DIIA applet.²⁴ Regulation problems remained predominantly in the areas where vested interests were preserved and where simple deregulation could not be applied without fundamental reform in adjacent areas. For instance, getting electricity access could not be simplified through only a revision of the procedures, permissions on trade in big cities

²⁴ The name of the applet that collects various digitalized state services under one umbrella. The applet was created and maintained by the Ministry of Digital Transformation of Ukraine.

could not be streamlined without revisiting the checks and balances on political and administrative arrangements, and the oppressive tax and customs administration could not be resolved without completion of law enforcement and judicial reform.

On the eve of the war the main complaints among businesses were related to various anti-COVID restrictions and requirements as well as to the over-complicated tax administration. **Even after the anti-COVID restrictions were lifted, the oppressive tax and customs administration still remained (and remains) difficult for businesses, linked to the inability of tax and customs authorities to trace tax evasion schemes. Instead of improving efficiency in spotting violators, the authorities responded with a general tightening of reporting procedures for all businesses, thereby increasing the costs of doing business for those complying and barely changing anything for those performing in the shadows.**

Post-War Recommendations

- Upgrade the status of the State Regulatory Service (SRS), its institutional capacity, and ensure its independence. Establish within the SRS instant feedback on the hottest business regulation issues and annual evaluation of the regulatory and tax policies based on business surveys (actual cost of doing business);
- Improve the a priori and a posteriori impact assessments for all kinds of business regulations. In particular, amend the Parliamentary procedure with a requirement for supporting all kinds of regulatory draft laws with a prior impact assessment;

- Overhaul of all business-inspecting government bodies, including the State tax service (STS) and State customs service (SCS), and increase the personal responsibilities of all kinds of government officials for abusing power in the regulatory area;
- Simplify taxation and customs procedures: revisit the usage of cash registers for micro-businesses and consider dramatically simplified versions of corporate income tax (CIT), i.e. the so-called “Estonian CIT” (or capital exit tax) to remove widespread discretionary practices in CIT administration.

5.4.2 **Anti-Monopoly Policy**

Among the main obstacles to foreign investment in Ukraine are the monopolization of markets and unstable, complicated legislation. After the privatization of the early years of independence, many enterprises fell into the hands of powerful oligarchs. In addition, there is a significant presence of SOEs in more than half of the country’s economic sectors—15 out of 28. Some 60% of sectors have enterprises associated with politically exposed persons or oligarchs.²⁵ Total factor productivity (TFP) shows the sectors in which such businesses exist and demonstrate 4 to 10 percentage points less productivity growth;²⁶ in other words, monopolization stifles competition and undermines the efficiency of the economic system.

Ukraine’s anti-monopoly policy is facing three issues:

25 <https://case-ukraine.com.ua/publications/pozbutysya-oligarhatu-yakoyu-povynna-buty-antymonopolnopolityka/>

26 <https://case-ukraine.com.ua/publications/pozbutysya-oligarhatu-yakoyu-povynna-buty-antymonopolnopolityka/>

- **A stalled privatization process.** The country's economy is still overly monopolized and features an excessive share of state-owned enterprises and their concentration in certain sectors.
- **Poor institutional capacity at the Anti-Monopoly Committee (AMC).** The Antimonopoly Committee's effectiveness is directly related to its independence from political interference. Its powers need to be very clearly defined and defended, civil society needs to be engaged in anti-monopoly policy, and communication needs to be more effective. On July 13, 2021, the Verkhovna Rada passed the first reading of a bill²⁷ to strengthen the AMC's capacity and to harmonize anti-monopoly legislation with best European practices. The bill is currently ready for its second reading.
- **Stalled judiciary reform.** Currently, any anti-monopoly investigation can be blocked by involving administrative courts. In short, the anti-monopoly policy will fail without proper judiciary reform.

Post-War Recommendations

- Improve the AMC's institutional capacity via technical assistance and twinning with international staff.
- Harmonize anti-monopoly legislation with best European practices.
- Implement the EU's provisions on integrity, transparency, and preventing the distortion of competition in wholesale markets.
- Privatize the economy and reduce the share of state-owned enterprises.

²⁷ <https://itd.rada.gov.ua/billInfo/Bills/Card/26405>

- Ensure that regulatory changes encourage free competition to prevent monopolies from ever coming into existence.
- Implement and finish judiciary reform in tandem with developing a coherent—but not distortionary—anti-monopoly policy.

5.4.3 **Energy Markets**

Ukraine has carried out significant reforms in its energy sector and energy policy. Subsidized natural gas and heating tariffs for households were among the key stumbling blocks of reforms in the energy sector for many years. The tariffs for natural gas and heating for households, kept below market rates, created a huge quasi-fiscal deficit, stimulated the over-consumption of natural gas, disbalanced external accounts via substantial energy imports and generated significant corruption. The problem was almost resolved by 2020, and household heating tariffs almost reached the market level. In 2021 the problem of subsidized heating prices returned due to ballooning global inflation. From 2020 onwards, the natural gas market for households (also allowing them to choose their supplier) was established. However, it has encountered many difficulties due to the monopoly position of local gas distributors.

The reform of the electricity market was launched in 2019. The goal was to move to a competitive mechanism whereby consumers could choose their supplier. However, this arrangement also faced many complications due to a structural lack of competition. The tariffs for households remained subsidized and this translated into underinvestment in electricity grids.

From the start of the war, the problems of the energy sector were aggravated. Firstly, the energy sector is one of the key targets for Russia. Missile strikes caused huge damage to critical electricity and heating infrastructure. Secondly, the problem of subsidized utility tariffs returned on a new scale, since the cost of energy surged

while capacities of households to pay utility bills diminished. Thirdly, Ukraine faces higher consolidation of market power in the hands of the SOEs and, at the same time, corporate governance with SOEs in the energy sector has weakened and become less transparent. For instance, the government issued a Resolution in May 2022²⁸ that allowed the appointment of top management at state companies without going through open competitions.

Post-War Recommendations

- Put reforms back on track to continue the implementation of EU legislation in Ukraine and ensure integration with European energy markets. Non-market-based decisions that could be justified by martial law should be revised and adjusted in accordance with the EU legislation.
 - Seized assets of companies that belong to Russian and pro-Russian oligarchs should be passed to those investors prepared not only to develop them but also to ensure greater competition on the markets.
 - Corporate governance of state-owned energy companies should revert to OECD rules and regulations.

- Increase liquidity in the natural gas and electricity markets, which means: (1) increasing energy exports from Ukraine, whenever possible, (2) raising energy prices domestically to market levels, with appropriate protections for vulnerable consumers, and (3) further deregulating the sector.

- Expand energy trade with EU countries:
 - The European Network of Transmission System Operators for Electricity (ENTSO-E) has already allowed commercial electricity exports²⁹ starting

²⁸ <https://zakon.rada.gov.ua/laws/show/643-2022-%D0%BF#Text>

²⁹ <https://www.kmu.gov.ua/en/news/30-cherivnya-startuye-komercijnij-eksport-elektroenergiyi-z-ukrayini-do-yevropi-german-galushchenko>

June 30, 2022, but trade volumes between Ukraine and the EU need to be increased in both the gas and electricity sectors, whenever possible. This should result in growing cross-border capacity, harmonized regulation, and greater information and data exchange among transmission systems operators.

- European companies already use Ukraine’s gas storage facilities: as of January 1, 2022,³⁰ foreign companies stored 540 million cubic meters of gas in “customs warehouse” mode. This kind of business with the EU will also contribute to greater liquidity in Ukraine’s energy markets and growing trust between the country and its European partners.
- Undertake further deregulation and de-monopolization of the gas and electricity markets and increase the capacity of the energy regulator:
 - After the war, the National Energy and Utilities Regulatory Commission (NEURC) should reduce its nearly manual price controls across all electricity markets with the relevant protection of vulnerable consumers at the same time.
 - In the natural gas sector, the government should, in addition to liberalizing prices, implement a “gas release program” to increase competition. According to negotiations between Ukraine and the IMF,³¹ Ukgazvydobuvannia, the state-owned company, was supposed to sell 40-50% of its gas on the exchange starting in May 2022: this plan must be jump-started after the war.
 - NEURC should regain its status as an independent regulator through appropriate changes to the Constitution and the strengthening of its capacity. It should start monitoring energy markets in line with the

30 <https://mind.ua/news/20235830-kompaniyi-nerezidenti-viveli-majzhe-vsi-svoyi-zapasi-z-mitnogo-skladu-gazoshovishch-ukrayini>

31 https://bank.gov.ua/en/file/download?file=Lol_MEFP_Ukraine_2021-11-08_en.pdf

EU approach and based on the experience of the energy regulators in EU countries, and introduce new price comparison tools and other instruments to support competition.

- Protect vulnerable consumers and bring about their better integration with the market:
 - After the war, the government should revisit the issue of defining “energy poverty,” “vulnerable consumers” and related indicators, agree on the measures needed to protect vulnerable consumers, and encourage them to actively conserve energy and apply energy efficiency measures. The Energy Community has developed recommendations³² for Contracting Parties, including Ukraine, to implement these concepts in line with EU legislation.
 - Experience with raising gas rates to market levels in 2016³³ and the full liberalization of the gas market in 2021³⁴ revealed gas suppliers to be reluctant to work with certain types of consumer, including subsidized ones, because of complicated and time-consuming compensation procedures.
- Further digitalize interaction between consumers, market participants and the NEURC. So far, the government has announced the launch of an “e-consumer” tool, which should also work in the energy sector, but there is no information about how it will work or which government agency will manage

32 <https://0o8mr.mjt.lu/lnk/AVUAAft61HMAAAAAAAAAAABsPiAAAAAnkIAAAAAAB2gAOBjDOpLGFVxXjO9QHO9UEXnUJVsrQAcKfk/1/OCz9haWnH8Xs9T9olquz1g/aHR0cHM6Ly93d3cuZW5lcmdd5LWNvbW11bml0eS5vcmcvZGFtL2pjcio1NjYzNmMmZiZi1iYWY2LTQ5YzUtYWQyMy1kOTk3YjU1MmUxZTYvUEcyMDlyLTAyLUVDU19wb3ZlcnR5LTA4MjAyMi5wZGY>

33 https://www.ukrinform.ua/rubric-other_news/2016766-grojsman-edina-cina-na-gaz-rinkova.html

34 <https://ua-energy.org/uk/posts/odyn-rik-rynku-hazu-chomu-ne-zmenshylys-platizhky>

the tool. In order to foster competition among suppliers, which should improve services and increase consumer protection and empowerment on the markets, the sector needs to:

1. Develop more price comparison tools,
 2. offer pricing and billing options, and
 3. provide contracts or enable the online switching of suppliers for natural gas and power.
- Restore public access to energy sector statistics, the availability of which is regular in EU states:
 - Because of security concerns after the outbreak of war, the government stopped releasing most statistics and data on the energy sector. According to the Dixi Group, more than 50% of the data sets available before the Russian invasion have been closed to public access.
 - Ukraine should apply the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT), based on existing commitments. The necessary bill has been registered in the Verkhovna Rada but has not yet passed into law.
 - Improve network management in both the natural gas and power sectors:
 - More than 80% of Ukraine's gas networks³⁵ are state- or community-owned, and the owners lack the funds to maintain the networks, let alone upgrade them to meet EU requirements.
 - Start a transparent, open privatization process after the war to attract investors to develop the country's energy networks. This will also require regulatory changes to establish gas and power distribution rates that reflect the providers' needs.

35 <https://ua-energy.org/uk/posts/v-poshukakh-vlasnykiv-hazovykh-merezh>

- Significantly increase the number of energy efficiency programs and their options:
 - The existing Energy Efficiency Fund's procedures are too bureaucratic and slow to cover future needs, and they should be simplified: as of 2021,³⁶ it was providing support to 80,000 households, although there are more than 14 million households³⁷ in Ukraine.
 - Streamline the provision of grants and loans and require more frequent and transparent reporting and auditing instead of focusing on permit procedures. This will make it easier for many stakeholders to attract funds quickly while closing off access to financing for those who refuse to go through the reporting and auditing process.
- Create strategic oil reserves to increase energy security and resilience. Ukraine currently has a fuel supply market with EU countries that is well developed. However, it has not yet implemented European legislation requiring the establishment of oil reserves.

While the Government has been developing models for creating such reserves for a long time, the necessary legislation has never been passed. Ukraine must not just adopt such legislation, but also start forming national strategic oil reserves.

- Include the decarbonization goals that the EU has announced as part of its Green Deal. As Ukraine continues to move towards EU membership, post-war reconstruction represents a serious challenge, as the country will have to undertake reforms several times faster and invest significantly

36 <https://www.kmu.gov.ua/news/fond-energoefektivnosti-vidzvituvav-pro-rezultati-roboti-za-2021-j-ta-prezentuvav-strategichni-napryami-na-nastupni-roki>

37 <https://voxukraine.org/dani-opytuvannya-domogospodarstv-za-2021-rik/>

more money in these reforms than EU countries. The following three criteria should be part of all reconstruction programs in order to meet European energy reform goals:

1. reducing energy consumption,
2. improving environmental standards, and
3. moving to renewable energy sources.

Apply these three criteria not only in the energy sector, but also in agriculture, industry, transport, and others.

5.4.4 **Liberalizing Labor Relations**

Ukraine has faced serious problems in the area of labor relations because of its inherited Soviet Labor Code of 1971, which was based on communist ideas. The Labor Code was designed for a centrally planned economy in which the state was virtually the only employer. The Code is skewed towards the employees' protection, is restrictive and bureaucratically burdensome for employers, requires tight control and allows little flexibility. The legal framework for labor relations has not changed since Soviet times and evidently does not reflect the demands of real life. As a consequence, employers have responded with mass non-compliance through unofficial employment and "envelope" wages paid at the discretion of the employer. Still, the formal requirements have remained in place, creating room for labor inspections to apply the law at discretion and seek bribes

The problem of excessive labor regulation was seriously aggravated following the outbreak of war. Millions of refugees and IDPs faced the problem of non-compliance with the outdated legal framework of labor relations. As a consequence, the Verkhovna Rada introduced a simplified contract-based system of labor relations, but only for the period of martial law.

Post-War Recommendations

- Make labor contracts the primary document for labor relations for both martial law and for the post-war recovery.
- Undertake a review of the Labor Code and limit its scope—especially pertaining to minimum wage regulations—for private companies.
- Overhaul the labor inspectorate and agencies which undertake inspections and limit their powers.
- Develop a government-wide reform inspectorate, coordinating inspections across all agencies and ensuring that businesses are not constantly dealing with inspectors.
- Support the reforms by targeted communications to voters concerning the advantages of a free labor market.

5.5 Ownership Relations

5.5.1 Finalizing Land Reform

On July 1, 2021, the moratorium on the sale of agricultural land was finally lifted. Due to fierce resistance, the reform was far less comprehensive than it could have been and was passed with multiple limitations. Until 2024 only individuals are allowed to buy land plots, with a cap of 100 hectares for any individual. Legal entities will be allowed to buy land from 2024, subject to a cap of 10,000 hectares for any one entity. State-owned and community land will not be for sale at all at present, while foreigners will be able to buy land only after a national referendum, which should be arranged in the not-too-distant future.

Despite many fears connected with land reform, the first year of land market operations passed smoothly with only technical difficulties reported (such as the need to streamline certain procedures for the easier closing of deals). A full 88,000 sale agreements totaling UAH 7 billion in value were reported for the first 12 months during which land sales were allowed by the government.³⁸ The average price per hectare was reported at UAH 37,900 over the market's first year of operation, an increase of 30% on their starting points. All information on land plot circulation has been digitized and the information is available only to registered users. Most importantly, banks have already started treating land plots as a source of collateral for new loans.

Post-War Recommendations

- The government of Ukraine must enable an open land market for legal entities in line with the initial plans of the 2021 reform.
- Ukraine should open this market to non-residents to speed up the modernization and business of agriculture and its integration with international markets.
- State and municipal land should be the subject of sale and privatization according to a transparent procedure.

38 <https://agropolit.com/spetsproekty/980-rinok-zemli-v-ukrayini-osnovni-dosyagnennya-ta-provali-za-rik>

5.5.2 Privatization and Corporate Governance for SOEs

Reform of state-owned enterprises (SOEs) and privatization have proven to be among the most difficult reforms in Ukraine. The ill-designed privatization process, inextricable from politics, and the magnitude of the wealth involved made it difficult to break vested interests, thus complicating or stalling the reform.³⁹

Privatization was one of the three elements of the common recipe for transition from a command-and-control to a market economy.⁴⁰ The idea was to hand over formerly state-owned assets to individuals so that a class of private owners would be created. Instead, the mass voucher privatization in the 1990s was controversial and helped entrench a class of oligarchs (which emerged during the late Soviet era due to asset stripping and which profited from the delayed macroeconomic stabilization) rather than private entrepreneurs, leaving a perception (accurate or not) of unfairness.

Even after the Revolution of Dignity in 2014, privatization stumbled due to vested interests, and not a single large SOE was sold. However, the Revolution did create a push for the corporate governance reform of SOEs, which showed a promising start at *Naftogaz* in 2014 and spurred reform at the national level.⁴¹ In 2016, parliament adopted a new law on the corporate governance of SOEs.

The law introduced three fundamental changes for SOEs, even when such enterprises were not corporatized: (1.) it increased disclosure requirements, (2.) made the auditing of SOEs mandatory, and (3.) required that major SOEs should establish supervisory boards, with a majority of independent board members. Later, in 2018,

39 For a more detailed account, see Boytsun, Andriy (2019), *Privatisation and SOE Reform – Chapter 7* in: Miklos, I. & Kukhta, P., *Reforms in Ukraine after Revolution of Dignity: What was done, why not more and what to do next*, SAGSUR, Kyiv, 2019. Available online at: https://ces.org.ua/wp-content/uploads/2019/07/SAGSUR-book_WEB_ed.pdf.

40 The other two are market liberalization and macroeconomic stabilization.

41 <https://www.epravda.com.ua/columns/2015/10/15/563374/>

Ukraine also adopted a law on the corporate governance of state-owned banks, and the government established independent supervisory boards at *Oschadbank*, *Ukreximbank*, and *Privatbank* in 2019.

In 2017, the government initiated the so-called “trriage” that categorized SOEs to be privatized, liquidated, or remain state-owned,⁴² but the results of these exercises were never duly enforced or even published. In 2018, the government approved an overarching state-ownership policy⁴³ that described the rationale for the state to own enterprises.⁴⁴ However, the policy was adopted as an internal decision of the Cabinet of Ministers, giving it weak legal power and poor enforceability.

In 2018, Ukraine adopted⁴⁵ a fundamentally new privatization law that sought to ease the sale of both large and small assets (called large-scale and small-scale privatization, respectively).⁴⁶ The privatization of smaller assets and companies was launched almost immediately after the new law was enacted. However, not a single large SOE was privatized, with many auctions postponed or cancelled. As a result, despite the positive trend noted above, today the state remains the largest (and inefficient) owner of assets in the Ukrainian economy. In 2020 (the latest available data), the Ministry of Economy reported⁴⁷ that 3,343 companies were owned by the state at the central level of government. And this number does not include thousands of enterprises owned by regional and local governments, for which no statistics are available.

42 <https://me.gov.ua/News/Detail?id=18732169-7335-448a-a73d-650ae59a1bdd>

43 <https://www.kmu.gov.ua/news/minekonomrozwitku-rozrobilo-politiku-vlasnosti-u-derzhavnomu-sektori-ekonomiki>

44 <https://www.kmu.gov.ua/news/minekonomrozwitku-rozrobilo-politiku-vlasnosti-u-derzhavnomu-sektori-ekonomiki>

45 <https://www.oecd.org/corporate/SOE-Review-Ukraine.pdf>

46 <https://www.oecd.org/corporate/SOE-Review-Ukraine.pdf>

47 <https://www.me.gov.ua/Documents/List?lang=uk-UA&id=2e24db81-1b0d-4322-80ce-89e6d3c269e2&tag=MonitoringEfektivnostiUpravlinniaObiektamiDerzhavnoiVlasnosti>

After Russia launched its full-scale invasion of Ukraine in February 2022, most of the largest Ukrainian SOEs had their assets physically damaged by Russian shelling, or suffered business losses due to falling demand and increased costs. These included the largest SOEs—mostly in infrastructure (such as *Ukrzaliznytsia*, *Ukrposhta*, the *Ukrainian Sea Port Authority*, and *Boryspil International Airport*), the power sector (*Ukrenergo*, *Energoatom*, and *Ukrhydroenergo*), and oil and gas (*Naftogaz* and *GTSOU*—the *Gas Transmission System Operator of Ukraine*).

None of these SOEs had been slated among the first to be privatized, but now they were also given new tasks by the government, and their role in the Ukrainian economy has substantially increased during wartime. For example, *Naftogaz* was tasked with additional public service obligations to sell cheap gas to multiple consumer segments. *Naftogaz* estimated that in 2022 indirect subsidies to consumers would reach an astonishing UAH 842 billion, or as much as 19% of Ukraine’s nominal GDP.⁴⁸

Once Russia invaded Ukraine, privatization was effectively put on hold, although small-scale privatization was relaunched in September 2022.

Post-War Recommendations

- Ukraine should radically speed up its transition to a free market economy, with rule of law properly established, property rights well protected, and market mechanisms functioning efficiently. This includes adopting an economic model based on efficient capital markets⁴⁹ as the resource allocation mechanism. The role of the state has to be limited to ensuring the integrity of the markets; the state should not substitute SOEs for functions that the market can perform.

48 <https://www.naftogaz.com/short/67171076>

49 http://ayacapital.com/uploaded/overviews/denied/140314_Economic_reforms-AYA_Research.pdf

- Ukraine should approve an updated state-ownership policy at the level of parliament, clearly describing the rationale for the state to own enterprises.
- The triage of SOEs should be completed, based on the updated state-ownership policy. Any SOEs or parts of SOEs that do not fit the rationale for state ownership should be sold off or liquidated.
- The post-war recovery will provide great momentum for bold privatizations and initial public offerings (IPOs), possibly with dual listing on a reputable international exchange and a growing Ukrainian stock exchange. This is Ukraine's chance to sell large stakes in *Naftogaz*, *Ukrenergo*, *GTSOU*, *Energoatom*, *Ukrhydroenergo*, *Ukrzaliznytsia*, and *Ukrposhta*. The state should also sell off any and all of the banks it owns: *Privatbank*, *Oschadbank*, *Ukreximbank*, and *Ukrasbank*.⁵⁰
- Due to the risks of corruption and poor performance of the state as an owner, it is more important to sell these SOEs in a fast and transparent manner to strategic investors rather than to postpone this with the excuse of maximizing proceedings from privatization.⁵¹
- The SOEs and municipally owned enterprises (MOEs) that have a clear rationale for state ownership should be corporatized. They should receive independent supervisory boards and a full-fledged ecosystem around these boards—internal audit, compliance, and risk management—ultimately leading to visible performance improvements, such as higher quality of services and better financial results.

50 <https://ces.org.ua/wp-content/uploads/2017/12/What-to-do-with-the-state-banks.pdf>

51 <https://nv.ua/ukr/opinion/notatki-ekonomista-uroki-opz-181866.html>

- All of the above requires a strong institutional framework, and we believe that Ukraine's best option is to establish a centralized ownership entity, the National Wealth Fund, which would be ring-fenced against political meddling, would be accountable to parliament, and would manage state-owned enterprises and assets in such a way as to maximize their value until they can be removed from state ownership.

5.6 Social Reforms

5.6.1 Pension Reforms

Ukraine is facing serious pension system problems. A government-run pay-as-you-go pension system is the main pillar supporting retired Ukrainians. The solidarity system is heavily subsidized to balance the Pension Fund, subsidies amounting to 3.9% of GDP in 2021.⁵² The demographic crisis, discouraging taxation of wages, and low replacement rates of the pay-as-you-go pension system are behind the problem, as is the inefficiency of the system.

In 2004, the Verkhovna Rada passed legislation⁵³ that gave the green light to establish a second pillar or compulsory state pension savings accounts, and a third pillar or private pension savings in the national pension system. Unfortunately, the second pillar never developed since then, while private pension funds have developed very modestly and, in many cases, unevenly. Issues connected with the business environment and financial instability have also contributed to dampening the appetite for such financial vehicles.

52 <https://www.pfu.gov.ua/2152676-zvit-pro-vykonannya-byudzhetu-pensijnogo-fondu-ukrayiny-za-2021-rik-3/>

53 Law of Ukraine "On mandatory state pension insurance."

Since the start of the war the pension system problems have only worsened, with millions of Ukrainians leaving the country and thousands of working-age citizens killed or injured due to military operations. Current demographic figures are not available (and the pre-war statistics are unreliable), but the ratio of working people to pensioners (1.2/1 in 2021) seems set to worsen by the end of the war.

Post-War Recommendations

- Organize a formal census as the first step to preparing for pension reform after the war ends.
- Consider raising the retirement age, taking into account the different life expectancy of men and women.
- Develop a long-term plan to gradually transform the pay-as-you-go system into a sustainable pension system with basic pension benefits paid by the public purse, mandatory savings accounts, and voluntary savings accounts.
- Provide a public awareness campaign to explain the limitations of the pay-as-you-go pension system.

5.6.2 Social Assistance

Ukraine's social assistance system is extremely complicated, opaque, and burdensome, attempting to do far too much and thus resulting in lower levels of quality. The cost of the legislated social commitments even before the war exceeded the state budget by several times, and the parameters involved were very sensitive to political cycles. The efficiency of public social expenditures was low. Only 36% of social assistance payments went to the 30% of households with the lowest incomes, while 24% went to the 30% of households with the highest incomes.

The social assistance problem has deteriorated further since the outbreak of war. Ukraine currently has an estimated 6.9 million⁵⁴ IDPs in addition to 7.8 million Ukrainians who left the country altogether. According to estimates by the International Organization for Migration (IOM), some 60% of Ukraine's IDPs have no job,⁵⁵ while about 60% of those who have returned to their homes need social assistance. State budget spending to support IDPs has increased several times. In addition, a number of countries and IFIs are providing social assistance to certain vulnerable groups in Ukraine.

As the war continues, the pressure on public funds will mount. New groups that need social assistance will emerge. For instance, the war has increased the number of military personnel 3-4 times. The government needs to be prepared for a steep rise in social outlays after the war. This increase in budget spending will include social assistance, benefits to military personnel and veterans, and compensation to families that lost their breadwinners in combat.

Post-War Recommendations

- Work towards a more just and equal society:
 - Revise and analyze the goals and effectiveness of all social assistance programs. Improve such programs to provide a properly targeted, means-tested, and affordable safety net that can effectively support poor and vulnerable households. Eliminate poorly designed programs.
 - Strengthen targeting and ensure that social assistance recipients are properly verified. Set up a unified integrated register of recipients of

54 <https://displacement.iom.int/reports/zvit-pro-vnutrishne-peremischennya-v-ukraini-opituvannya-zagalnogo-naselennya-raund-7-23>

55 <https://displacement.iom.int/reports/zvit-pro-vnutrishne-peremischennya-v-ukraini-opituvannya-zagalnogo-naselennya-raund-7-23>

social assistance and social services. Improve consistency in the use of related data elements and information kept in other public registers and databases.

- Avoid old mistakes when designing social assistance for new targeted groups:
 - Avoid introducing new programs in preference to using effective existing programs to provide a decent level of social protection to all categories of the war-affected population and vulnerable groups.
 - Plan properly and shore up capacities of institutions to provide pensions and social assistance to veterans of war, military personnel and their families. Assess and estimate the probable medium-term fiscal burden caused by increased transfers to special groups of the population.

- Use a comprehensive approach to alleviate poverty:
 - Strengthen and expand active labor market policies and foster workforce participation.
 - Provide opportunities for reintegrating veterans into civilian life. Social protection for veterans should be comprehensive and include physical rehabilitation, mental health support, social and professional adaptation, and incentives to participate actively in the labor market.

- Revisit the approach to applying an artificial subsistence minimum⁵⁶ for determining the volume of social assistance and defining those eligible for social support.

⁵⁶ Actual subsistence minimum is calculated by the Ministry of Social Policy of Ukraine according to article 5 of the Law of Ukraine “On subsistence minimum”, based on the average prices and tariffs as reported by the central government bodies.

- Facilitate and expand digital services, carefully ensuring security and open access to such services while improving their quality in terms of making them more user-friendly and reliable.

5.6.3 Health care

In 2015, the Government of Ukraine began to reform the national health-care system to improve public health and provide financial support against excessive out-of-pocket costs. This goal was to be achieved through greater efficiency, a streamlined service delivery system, and open access to a better quality of care.

The reform entailed establishing a package of medical services guaranteed by the state, a single purchaser called the National Health Service, and transparent, efficient procurement of services; converting state-run health-care institutions into autonomous medical entities that run on the principle of “The money follows the patient;” reforming medical education; and developing a modern system of medical information management.

Pre-war reform was not completed, although it did reach a high level of implementation. Once the war started, the financing of hospitals seriously suffered, which damaged the system of incentives. A huge number of medical facilities were damaged or destroyed. Many medical workers moved to new places, which created imbalances in qualified health-care staff location and the demand for their services.

Post-War Recommendations

- Health-care reforms that have already started should be put back on track immediately upon the cessation of hostilities.

- Replace destroyed health-care infrastructure with a new system of compact high-intensity health-care facilities. Undamaged facilities should be reorganized to reflect the impact of migration and opportunities for conserving energy.
- Shore up medical services that meet the special needs of military and civilian casualties alike. Key services should be increased: injury and burn rehabilitation, mental health diagnosis and treatment, and intensive care units for trauma, orthopedics, burns, and so on.
- Encourage further expansion of the private sector into various medical services.
- Foster the expansion of private health insurance and rationalize publicly funded services.
- Establish a single portal for medical information and foster the provision of healthcare through distance-spanning technologies.
- Update government placements for medical professionals to reflect demand for new services. Facilitate the modernization of educational and training programs for doctors and other medical professionals and offer incentives to obtain additional specializations.
- Implement measures related to financing according to the intensity and effectiveness of health-care operations, rather than carte blanche supporting existing facilities.

5.6.4 Education

Ukraine has been working on implementing ambitious reforms in education for several years. For instance, a network of pre-school facilities of varied forms of ownership has been developed, educational programs are being made more consistent, and their quality raised for all ages of schoolchildren. In 2014, a new Law on Higher Education aimed to eliminate imbalances in the labor market, increase the cost-effectiveness of public funding, and raise the quality of educational services. A key educational reform was adopted in 2016 as a concept called “The New Ukrainian School.”⁵⁷ Major goals include updating curricula and ensuring equal access to educational services, encouraging continuous learning at all stages, introducing modern methods into the classroom, establishing a modern, comfortable learning environment for all, assuring quality at all stages of education, and bringing programs in line with the needs of the labor market. The “Modern Vocational Education” concept adopted for 2020-2027⁵⁸ calls for decentralized funding on the regional and municipal level, measures to increase education quality, and stronger links between education and the labor market.

Despite substantial progress in education reform, there was room for improvement in both the accessibility and quality of pre-school services before the war broke out. Russia’s aggression has led to a large number of damaged and destroyed educational facilities, while also putting pressure on the system of secondary schools in the western and central parts of the country due to IDPs and the migration of children, young people, and teachers.

57 <https://www.kmu.gov.ua/npas/249613934>

58 <https://zakon.rada.gov.ua/laws/show/419-2019-%D1%80#Text>

Post-War Recommendations

- Invest in human capital to support economic recovery. Post-war educational reforms should prioritize the streamlining of the entire educational network to reflect recent migration flows and long-term demographic trends. Corruption and the purchasing of grades also needs to be rooted out.
- Develop system-wide digital and alternative education. Facilitate the development and dissemination of novel teaching methods and technologies that reflect the hybrid approach required by the pandemic and now by the war.
- Continue with “The New Ukrainian School” reforms, improving the quality control, funding and management of post-secondary education. Continue the integration of higher education and research, strengthening professional development, working with projections of labor market trends and government placements in education. Restore state exams for grades 4, 9 and 11.
- Expand opportunities for continuing education among adults.



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