THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

PeaceRep
Peace and Conflict Resolution Evidence Platform

RESEARCH REPORT

1st December 2022

Market economics in an all-out-war?

Assessing economic and political risks to the Ukrainian war effort

Luke Cooper

PeaceRep's Ukraine programme

The Peace and Conflict Resolution Evidence Platform (PeaceRep) is a research consortium led by the University of Edinburgh Law School. Our research is rethinking peace and transition processes in the light of changing conflict dynamics in the 21st century. PeaceRep's Ukraine programme is a multi-partner initiative that provide evidence, insight, academic research and policy analysis from Ukraine and the wider region to support Ukrainian sovereignty, territorial integrity and democracy in the face of the Russian invasion.

PeaceRep is funded by the UK Foreign, Commonwealth & Development Office (FCDO). The information and views set out in this publication are those of the authors. Nothing herein constitutes the views of FCDO. Any use of this work should acknowledge the authors and PeaceRep.

PeaceRep's Ukraine programme is led by the London School of Economics and Political Science (LSE) partnering with the Kyiv School of Economics (KSE) in Ukraine, the Leibniz Institute for East and Southeast European Studies (IOS) in Germany, the Institute of Human Sciences (IWM) in Austria and Jagiellonian University in Poland. Through our collaboration with KSE we work closely with researchers, educationalists and civic activists in Ukraine to ensure that policy solutions are grounded in robust evidence and are calibrated to support democratic outcomes.

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Introduction

This research report offers a summary analysis of the acute economic challenges facing the Ukrainian war effort and critically reviews the current policy agenda of the Government of Ukraine. Drawing on existing research undertaken for PeaceRep and the LSE Conflict and Civicness Research Group (CCRG) we argue that Ukraine's success in the war to date is reflective of popular support for the war-effort and the fact its democratic political institutions enjoy a high level of legitimacy from the population. The imperialist character of the Russian state's actions, and the extremely authoritarian nature of Putin's regime, have created a 'liberation war' dynamic on the Ukrainian side.

Ukraine currently has an abundance of 'civic spirit', which sees citizens willing to mobilise and sacrifice to protect the country's democratic public authority from its military overthrow by Russia. This popular buy-in to the war effort goes a long way to explaining Ukraine's success in prosecuting its war of self-defence against Russia.

Despite serious social and economic problems this has hitherto allowed Ukraine to avoid the societal collapse and state fragmentation seen in cases of intractable conflict. However, this now risks being undermined by macroeconomic conditions and poorly conceived policies. As a result, we see a significant downstream risk of societal fragmentation, which would seriously imperil Ukraine's ability to win the war. To mitigate this, we propose that the government adopts a policy of social partnership and aims to achieve full employment so that all resources can be directed to support the war-effort.

Author

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The Russian war on civilian infrastructure and the impending winter crisis

In the last few months, the territorial dimension of the war has moved in Ukraine's favour. The Russian army has suffered a series of reversals, most dramatically in Kharkiv Oblast. A steady Ukrainian offensive in the south has also been making progress. Russia has undertaken a so-called 'evacuation' of citizens from Kherson, a move that the Ukrainian side allege has involved forced deportations by an occupying authority, which breaches multiple international statutes including Articles 45, 49 and 147 of the 1949 Geneva Convention IV.[1] This was followed by an announcement of the withdrawal of Russian troops. By 11th and 12th November social media was awash with jubilant scenes from Kherson, as citizens that had bravely protested in their thousands against the Russian occupation during the first phase of the war, now celebrated the liberation of the city by Ukraine.

Vladimir Putin has responded to his reversals with a mass mobilisation of soldiers. A number of reports have since emerged of conscripts being sent straight to the front after just a few days of training.[2] While the draft is unlikely to change the balance of forces in Russia's favour in the short-term, Russia's purchase of 2,400 of the Shahed-136 drones from Iran (as well as other drones and missiles including the Fateh-110, Zolfaghar, and Qods Mohajer-6) has proven to be highly effective, despite the success of Ukrainian air defence systems in shooting down these weapons. On the one hand, the fact Russia is dependent on Iranian imports illustrates its weak industrial capacity and the effects of Western sanctions on its domestic armaments sector. On the other hand, it underlines how Russia retains external sources of geopolitical and economic support that it can leverage to make progress in the war.

A key target of these weapons has been Ukraine's energy infrastructure and networks. After more than a week of this new round of attacks, President Zelensky announced on the 18th October 2022 that a third of the power system had been taken offline due to the Russian campaign. The campaign has continued across the month of October. Even prior to the onset of Ukraine's harsh winter, Kyiv is experiencing significant power shortages and blackouts, and migrants from overseas have been asked not to return to Ukraine in order to limit energy demands.

Attacks on core energy infrastructure strike at where Ukraine is weakest, i.e., on the 'home front,' due to the severe economic collapse the country is currently experiencing.

Attacks on core energy infrastructure strike at where Ukraine is weakest, i.e., on the 'home front', due to the severe economic collapse it is currently experiencing. In this sense, they have a pernicious but effective political logical and military rationale. They seek to undermine Ukraine's democratic civicness, i.e., the legitimate nature of its public authority, by generating severe hardship and eroding the country's ability to support basic needs. Indeed, these actions could be read as drawing on Russia's experience of operating in sites of intractable violent conflict (such as Syria, Libya and Mali) by seeking to actively cultivate these conditions, reproducing a form of 'state failure' that would make it very hard for Ukraine's democratic institutions to survive.

By 1st November 2022, these attacks on critical infrastructure were producing not only energy blackouts but also water shortages in Kyiv and other major Ukrainian cities. The country now faces a major winter crisis with the transition to freezing temperatures, which are expected from early to mid-November onwards. On the 6th November 2022, mayor of Kyiv, Vitaliy Klitschko, raised the prospect of a civilian evacuation of the city in the event that electricity blackouts became so serious that it was no longer possible for water and sewage systems to function.

The Ukrainian economic crisis: a threat to the country's war-effort

In this context, a key question for Ukraine, as well as its allies and donors, is what policy mix is best able to sustain Ukrainian resilience, maintain the social infrastructures that cohere society around the war-effort, and make the most effective use of the resources (labour, capital and aid) that the country has at its disposal. As PeaceRep's Ukraine team have previously argued,[3] this points to the state stepping in to offset the collapse in private sector demand and using planning to direct labour and capital as required to support the war.

[1] For a summary of legal breaches forced displacement entails see 'Practice Relating to Rule 129. The Act of Displacement. Section A. Forced Displacement', International Humanitarian Law Database, ICRC https://ihl-databases.icrc.org/customary-ihl/eng/docs/v2_rul_rule129_sectiona (Accessed 7th November 2022).

[2] See Macfarquhar, N., 2022, 'Coffins are Already Coming: the Toll of Russia's Chaotic Draft, New York Times (16 October 2022) https://www.nytimes.com/2022/10/16/world/europe/russia-draft-ukraine.html

[3] Cooper, J., and Kaldor, M. (2022). 'In Europe's gift: How to avoid a Ukraine 'forever war'. European Council on Foreign Relations (26 September 2022) https://ecfr.eu/article/in-europes-gift-how-to-avoid-a-ukraine-forever-war/; Brik, T., Shapoval, N., Cooper, L., and Kaldor, M. (2022). 'Meeting the immediate needs of the Ukrainian economy, the role of international actors and the importance of understanding the conflict as a conventional war.' London: LSE IDEAS https://peacerep.org/wp-content/uploads/2022/05/LSE-Policy-Briefing-Economic-Support-for-Ukraine-2_.pdf

Such a framework should be combined with the utilisation of corporatist policies that draw trade unions into negotiations that facilitate their buy-in for the sacrifices entailed by the war, while also ensuring that the Ukrainian state maintains, as far as possible, the social safety net and the ability to provide public goods.

Ukraine has not developed such a 'war-economy' to date and continues to experience a profound economic collapse. The key elements of this crisis run as follows:

- Severe economic recession. Ukraine is expected to experience around a one third fall in GDP across 2022.[4] This is less severe than earlier estimates[5] and reflects how there are signs that the economy is growing again, illustrating the relationship between the military campaign and economic conditions. The National Bank of Ukraine has reduced its estimated contraction for 2022 from 35% to 31.5% but this progress is highly dependent on the security environment – and does not take account of the recent Russian attacks on Ukrainian critical infrastructure.[6]

- Fiscal crisis. Ukraine is running a deficit of around $5 billion per month (equivalent to 30% of pre-war monthly GDP). Heterodox monetary policy (i.e., the central bank printing money) is making up for this shortfall. Around a third of government revenue has been raised by tax, loans and grants, another third has come through emergency assistance from international organisations like the IMF, and the remaining deficit has been covered by the National Bank of Ukraine.[7] The IMF has estimated that Ukraine's monthly external funding needs in 2023 will be around $3 to $4 billion per month.[8]

- Damage assessments to buildings and infrastructure. Estimates from the KSE for the period 24 February 2022 to 1st September 2022 put the cumulative total damage to residential and non-residential real estate, including infrastructure, at $127 billion.[9] This was prior to the new round of Russian bombardment of Ukraine's critical infrastructure across October. Even as early into the war as June 1st 2022, the World Bank had already estimated the total damage of the war as $349 billion,[10] equivalent to 150% of Ukraine's 2021 GDP. In short, long prior to the latest wave of attacks, the Russian campaign had inflicted massive damage.

- Very high levels of unemployment – especially among the internally displaced. As of 20th October 2022, the National Bank of Ukraine estimates an overall unemployment rate of 28.3%.[11] The International Organization for Migration's (IOM) Internal Displacement survey found that as of 23 August 2022, 27% of the internally displaced population (IDP) is unemployed and looking for work and a further 11% is unemployed and not currently looking for work.[12] One estimate puts the decline in available vacancies since the start of the war at 80%.[13] These figures are well above Ukraine's official unemployment rate in 2021, which was a high but by no means catastrophic 9.8%.[14]

- Inflation and wage levels. Ukraine faces a serious cost of living crisis. Around half of firms have reported cutting nominal wages (in some cases by 50%) and operating reduced hours since the start of the war.[15] Added to this, these incomes are now being eroded by rising inflation. Although the scale of the collapse of economic demand has offset some of the inflationary effects of heterodox monetary policy, Ukraine is still facing a historic squeeze on incomes and impoverishment. Consumer inflation is running at 24.6% and core inflation

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[4] The World Bank, Government of Ukraine and European Commission, 2022, Ukraine Rapid Damage and Needs Assessment, p.44. Washington: The World Bank.
[5] In April, the World Bank anticipated a 45% contraction in GDP.
[6] National Bank of Ukraine, 2022, 'Inflation Report Summary – October 2022', p.4 https://bank.gov.ua/admin_uploads/article/IR_2022-Q3_en.pdf?v=4
[7] Torbjörn Becker, Barry Eichengreen, Yuriy Gorodnichenko, Sergei Guriev, Simon Johnson, Tymofiy Mylovanov, Maurice Obstfeld, Kenneth Rogoff and Beatrice Weder di Mauro, 2022, 'Macroeconomic policies for wartime Ukraine; Rapid Policy Response' #2, London: Centre for Economic and Policy Research, p.5.
[8] Kristalina Georgieva, 2022, 'Remarks of the Managing Director at the International Expert Conference on the Recovery, Reconstruction and Modernization of Ukraine' [As prepared for delivery], 25th October 2022 https://www.imf.org/en/News/Articles/2022/10/25/sp-md-remarks-at-the-international-expert-conference-on-recovery-of-ukraine
[9] KSE Institute, 2022, 'Assessment of damages in Ukraine due to Russia's military aggression' as of September 1, 2022', Kyiv: Kyiv School of Economics.
[10] 'Ukraine Rapid Damage and Needs Assessment', p. 11.
[11] National Bank of Ukraine, 2022 'Inflation Report Summary', p.6.
[12] IOM, 2022, 'Ukraine International Displacement Report – General Population Survey Round 8 23 August 2022', p.6 https://displacement.iom.int/sites/g/files/tmzbdl1461/files/reports/IOM_Gen%20Pop%20Report_R8_ENG_updated%20logo.pdf
[13] 'Macroeconomic policies', pp. 2 – 3.
[14] 'Inflation Report Summary', p.6.
[15] 'Macroeconomic policies', p.2.

at 20% (year-on-year) as of September 2022.[16] While there have been calls for targeted financial support, rather than a universal programme of assistance or World War 2-style price controls,[17] this is questionable given the scale of Ukraine's humanitarian crisis. The IOM found that more than 1 in 2 Ukrainians reported needing emergency financial support to pay for basic necessities like food, healthcare and utility bills – with little difference among non-IDPs (52%), IDPs (51%) and returnees (55%).[18]

- The relationship between uneven sectoral and geographical impacts. There are steep differences in the impacts of the war by sector and geography – and these two dimensions are closely interrelated due to the concentration of some types of economic activity in specific localities and the extent of their vulnerability to Russian attacks. For example, in August 2022, the IT sector was said to be relatively stable and recorded similar levels of vacancies as prior to the war[19] (though it seems likely this will be put under strain by the current wave of energy blackouts). In contrast, Russian-occupied Mariupol was a centre for Ukrainian steel prior to the war, but now the Azovstal steel works has been completely destroyed, while the Ilyich mill is significantly damaged.[20] Crude steel production is down 40% overall - of which half is potentially recoverable with Ukrainian territorial advances.[21] In some heavy industries like mining (iron ore and coal) and drilling (oil and gas) data suggests that a very large majority of assets were still available as of the third week of September 2022.[22] However, testimony from the mineworkers' union suggests that these estimates may be underestimating the scale of destruction.[23]

Ukraine's remarkable 'civic spirit'

Given this overall negative picture it is important to caveat the analysis with a recognition of the extraordinary resilience of the Ukrainian population and

Before and after photos at Chotyrbot Lyceum of the Lenkovets Village Council of the Shepetiv District of the Khmelnytskyi Region. Photos: Osvita.UA

the many examples of economic adaption and ingenuity.

Businesses are tailoring their offers to the challenges of the war. The Kyiv Kooperativ advertises its co-working space as offering back up power supply lines and internet providers, as well as 'sleeping capsules' for breaks, under the call, 'Let's get through the hard times together!'[24] There are similar responses in workspaces across the city.[25] Restaurants are also responding defiantly. 'Our doors are open for guests under any conditions', as the Kanapa Restaurant put it.[26]

KSE (the central academic partner on PeaceRep's Ukraine programme) offers an example of educational resilience. It continues to run a full suite of research and teaching activities and has installed generators and an on-campus air raid shelter with internet access. Its charitable arm, the KSE Foundation, has also responded to the war with a range of initiatives supporting Ukraine's public services and armed forces. For example, it provided funds and support for a school in the Khmelnytskyi Region to turn their basement (which was not suitable for children due to damp) into a modern air

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16 'Inflation Report Summary', p.2.

17 'Macroeconomic policies', p. 27. See also The Economist, 'The Long March Back', London: The Economist, Vol. 445, Issue 9318 (Oct 22, 2022).

18 IOM, 2022, 'Ukraine International Displacement Report – General Population Survey Round 9 26 September 2022', p.7 https://displacement.iom.int/sites/g/files/tmzbdl1461/files/reports/IOM_Gen%20Pop%20Report_R9_IDP_FINAL%20%281%29%20%282%29.pdf

19 'Macroeconomic policies', p. 2.

20 Oleksiy Blinov and Simeon Djankov, 2022, 'Assessment of damages to Ukraine's productive capacity', London: Centre for Economic Performance, 21 Sept 2022 https://cepr.org/voxeu/columns/assessment-damages-ukraines-productive-capacity

21 Ibid.

22 Ibid.

23 As of the 31st August 2022, the miners' union, the NGPU, says that all seven mines in the Luhansk region have stopped work. In Donesk region, two mines in Vugledar have been destroyed and the others were, at this point, operational. See Ford, C., 2022. 'Unions Strive to Keep Ukraine's Mines Running, Protect Civilians and Appeal for Solidarity' London: Resistance Books, p.106.

24 https://www.facebook.com/kooperativkyiv/

25 Others example are the Coworking Platforma Leonardo.

26 https://www.facebook.com/restoransalonKanapa

raid shelter (see the 'before and after' photos above).[27]

Mirroring the resilience of educational institutions like KSE, and their effective building of global education and research partnerships, trade unions have also been active 'first responders' to the crisis. The Federation of Trade Unions of Ukraine (FPU) has won support from the US relief fund, Corus International, to expand trade union sanatoriums housing IDPs, illustrating the productive dynamic between global civil society and domestic actors, which should be further developed. As these examples suggest, an effective political and economic policy should harness this powerful 'civic spirit', deepening support and ties with external actors, from states, to NGOs and intergovernmental bodies and agencies, in order to strengthen Ukrainian resilience. At the domestic level, this posits the need for a social dialogue approach that draws labour movement and civil society actors behind the sacrifices required for the war.

An assessment of Ukrainian government economic policy

Unfortunately, rather than establish a state-managed war-economy, Ukraine's government is pursuing what Adam Tooze has described as an experiment in 'neo-Keynesian shock therapy'.[28] This hybridises several different economic approaches into a potentially unstable unity, combining a heterodox monetary policy and modest increases in taxation, with a programme of deregulation and (neo)liberalisation through labour market reform and privatisation, and, finally, tentative elements of state-direction of the labour force and strategic assets.

So, while the latter aspects are associated with 'conventional' state-directed wartime economies, these have been introduced alongside neoliberal policy prescriptions.

Although the leading group of globally influential economists supporting this policy framework recognise that 'wartime governments [like Britain and the United States during World War 2] usually take over the allocation of resources', they argue that Ukraine does not have the state capacity to enable this shift, that it would encourage corruption and the black market, and that Ukraine should, therefore, instead seek to incentivise private sector investment through 'radical deregulation'.[29] Ukrainian government policy to date has followed this experimental model of market-based allocation of resources and deregulation in a war.

The following critically outlines the main elements:

Abandoning social partnership and dialogue

Under the auspices of martial law, employment rights have been steeply curtailed. Law 2136 suspended large parts of the country's labour code for the period of martial law, including protection from dismissal during sick leave (Article 5), expanding the maximum working week to up to 60 hours (Article 6), and allowing employers to unilaterally suspend collective agreements (Article 11).[30] Law 5371 removed 70% of Ukraine's workforce (those working in small and medium sized enterprises) from the protection of national labour law, including taking away their rights to engage in collective bargaining. This 'simplified regime' means that workers in enterprises of less than 250 people will lose all protection from arbitrary dismissal, enforced overtime and the right to undertake trade union organising. Law 5161 legalised the use of UK-style 'zero hours' contracts.

The new labour laws are likely to breach the minimum standards of the Charter of Fundamental Rights of the European Union.

As many of these reforms had been planned prior to the war, and sparked mass protests from the labour movement,[31] the government have been accused by the trade unions of using the conflict as a pretext for attacking basic employment rights.

The new laws put Ukraine in breach of international labour conventions and European law. These reforms go against recommendations from a joint International Labour Organisation (ILO) and European Union (EU) report in June 2021,[32] violate ILO Conventions 132,[33]

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[27] Bereznitska, Y., 2022 'How to equip a school bomb shelter: the experience of a school director', Osvita.ua, 13 October 2022 http://osvita.ua/school/method/87559/

[28] Tooze, A., 2022, 'Chartbook #163: Warfare without the state - New Keynesian shock therapy for Ukraine's home front', 22 October 2022 https://adamtooze.substack.com/p/chartbook-163-warfare-without-the See also, Tooze, A., 'Chartbook #149: Success on the battlefield whilst the pressure mounts on Ukraine's home front', 10 September 2022 https://adamtooze.substack.com/p/chartbook-149-success-on-the-battlefield

[29] 'Macroeconomic policies', pp. 24 – 25.

[30] Vitaliy Dudin, 2022, 'The war on workers? What is wrong with labor regulations under martial law' Commons.com.ua, 29th April 2022 https://commons.com.ua/en/sho-ne-tak-iz-regulyuvannyam-praci-pid-chas-voyennogo-stanu/

[31] Industrial-union.org, 2020, 'Ukrainian unions oppose anti-worker labour law reform', 16th January 2020 https://www.industriall-union.org/ukrainian-unions-oppose-anti-worker-labour-law-reform.

[32] EU-ILO Project, 2021, 'Towards safe, healthy and declared work in Ukraine', 29th June 2021 https://www.ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---sro-budapest/documents/presentation/wcms_808753.pdf

[33] Holidays with Pay Convention (Revised), 1970 (No. 132).

135,[34] 158[35] and even its founding charter of 1919 that limited working hours in industrial enterprises to 8 hours a day and 48 hours a week. As a result, Ukraine's pathway to membership of the EU has been put into question by this poorly conceived turn to deregulated labour markets.

The new laws are likely to breach the minimum standards of the Charter of Fundamental Rights of the European Union (specifically, Article 28: the right to form trade unions, to engage in collective bargaining, negotiate collective agreements and to take strike action). By removing collective bargaining rights for workers in SMEs, Law 5371 is also likely to be incompatible with the recently passed EU Directive on the 'Framework for Adequate Minimum Wages', which creates a legal obligation on states to promote collective bargaining, and provides a formal position for trade unions in the setting of national minimum wages.[36] In short, as European states move towards much stronger social protections for the workforce, Ukraine appears to be going in a very different direction.

Some supporters of this agenda have pointed to the fact that in SMEs the widespread use of self-employed contracts means that many workers had already, in effect, lost their employment rights. So, the changes should be seen as technical modifications which formalise existing arrangements – and, in any case, it is not possible for the government to substantively protect labour rights during wartime.

However, this raises a question of whether the normalisation of 'fake' self-employment is, in itself, a desirable framework (and this also has tax implications – see below). MPs in the ruling party have also described the proposals in normative terms, rather than as a short-term technical shift. 'A worker should be able to regulate his relationship with an employer himself. Without the state', argued MP Danylo Hetmantsev, head of the Ukrainian parliament's finance committee,[37] ignoring the inequality in power between workers and employers which underpins all protective employment legislation.

Above all, the 'war politics' of pursuing these changes without negotiations with the labour movement is unlikely to engender societal cohesion. **The allies during World War 2 correctly recognised that partnership agreements with trade unions representing workers in industries essential for the war effort were critical to ensuring their support for the sacrifices of wartime.**

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Appearing to affirm the Ukrainian government's overall rejection of social partnership and dialogue are its parallel moves to seize trade union-owned property under Law 6420. Although there are legitimate concerns regarding corruption in relation to these assets, the new legislation would likely lead to these properties becoming subject to the government's new streamlined privatisation process (see below). This would effectively amount to redistributing buildings currently held by workers' organisations to the wealthy. The ILO has proposed a consultation and negotiation process as an alternative to unilateral seizures. This would be consistent with a social partnership and dialogue approach to the overall conduct of the war.[38]

Privatisation and deregulation

Under Law 7451 the Ukrainian government has made a renewed turn to the privatisation of state assets. They have initially earmarked 420 entities for sale during the course of the war, and reduced the conditions that may be placed on new buyers.[39] However, the very volatile economic environment makes the current conjuncture a poor time to maximise the value of any sales of government assets to the private sector – and reducing the conditions that may be placed on purchases to protect the public interest seems problematic.

One group promoting deregulation argues that it will facilitate the transfer of economic activity to regions less impacted by the war's security challenges through creating more incentives for private sector investment. They welcome the government's 'dramatically loosened labour market regulations', propose adopting this approach in other areas and advocate for the creation of a 'deregulation chief' as a senior government official

[34] Workers' Representatives Convention, 1971 (No. 135).

[35] Termination of Employment Convention, 1982 (No. 158).

[36] States now have two years to transpose the EU Directive into national law. See Council of the EU, 2022, 'Council adopts EU law on adequate minimum wages', 4th October 2022 https://www.consilium.europa.eu/en/press/press-releases/2022/10/04/council-adopts-eu-law-on-adequate-minimum-wages/

[37] Quoted in Rowley, T., and Guz, S., 2022, 'Ukraine uses Russian invasion to pass laws wrecking workers' rights', 20th July 2022, Open Democracy https://www.opendemocracy.net/en/odr/ukraine-draft-law-5371-workers-rights-war-russia/

[38] Guz, Z., 2022, 'Ukrainian government threatens confiscation of trade union property', 8 November 2022. https://www.opendemocracy.net/en/odr/ukraine-trade-unions-property-soviet-confiscation/

[39] https://www.kmu.gov.ua/en/news/uriad-rozpochne-masshtabnu-pryvatyzatsiiu-z-veresnia https://ti-ukraine.org/en/news/how-to-purchase-public-or-municipal-property-during-war/

responsible for this drive.[40]

Others have called on Ukraine to go much 'further and faster' on this line. A group of influential Ukrainian economists and think tanks have published, Ukraine after the victory; Imagining Ukraine in 2023.[41] Casting itself as a 'civil society' coalition, this network proposed a very radical neoliberal agenda. They go as far as advocating sweeping marketisation of healthcare, 'total privatisation' of state assets and a programme of austerity in the public sector.[42] They even take up the 'one instead of two' principle,[43] a long-time favoured policy of parts of the US Republican Party, which is based on the idea that for every new regulation introduced two have to be removed.[44] While Ukraine's official National Recovery Plan did not go to this extremity, it did commit the government to 'deregulation', a pro-business 'crowdsourcing' initiative generating ideas for 'burden shifting' and a 'Red Tape reduction programme'.[45]

Overall, these proposals seem strikingly detached from the fundamental context that is facing Ukraine: namely, the need for the government to direct all available resources – labour and capital – to protect Ukraine's sovereignty, territorial integrity and democracy.

This 'air of unreality' is particularly notable in relation to the Ukrainian labour reform policy which appears to be aimed at reducing the costs of labour, something which makes little sense on its own terms given that labour is already very cheap, due to the reduction in nominal wages and extremely high levels of unemployment. The overall volatile nature of the economic context makes it highly unlikely that investment in the labour force will increase simply by virtue of workers' having fewer rights.

Ukrainian fiscal policy lacks substantive burden sharing

In light of the serious fiscal situation, and the need for massive military spending, Ukraine clearly faces major challenges in relation to tax, spending and debt. The government are currently pursuing very large cuts to non-military expenditures, e.g., the 2023 budget for education is cut by 17.2%, Youth and Sports by 55.4% and Ministry of Culture by 47%.[46] Troublingly, given Ukraine's history of corruption, funding for both the anti-corruption agencies has also been reduced.[47]

For the most part (and reflecting the ideological assumptions described in the foregoing), the Ukrainian government has chosen to pursue cuts over tax rises.

Ukraine has a flat-tax system with an income tax rate of 18%. For the self-employed, this falls to just 5%. A number of companies and institutions, including in the education sector, employ staff on self-employed contracts. In essence, these workers are asked to sacrifice their labour rights and job security in exchange for an ultra-law taxation rate by any international standard. The government has recognised the need to raise taxes but in a modest and non-progressive form. The military tax of 1.5% (introduced in 2014) was supplemented by a further war tax of 1.5% in the 2022 martial law period, bringing it to 3%. Like the other taxes these rates are flat i.e., there is no variation by income.

While Ukraine is rightly prioritising massive increases in military expenditure, current taxation policies seem poorly suited to maximising domestic sources of fiscal revenue. By far the largest component of anticipated government income in 2023 comes through Value Added Tax (VAT), which is expected to bring in 596.3 billion hryvnias ($16.2 billion). Personal income tax, in contrast, is predicted to raise just 21% of this amount (129 billion hryvnias / $3.5 billion).[48] As noted in the foregoing (p.6) a third of government revenue has been raised by tax, loans and grants, another third has come through emergency funding and the remaining deficit has been covered by the National Bank of Ukraine.[49]

Given Ukraine's very low rates of taxation, there is a clear case for the introduction of a progressively weighted system modelled on those in western European countries to generate greater funds for the war effort and protect the social safety net. Other taxes, for example on wealth and property or increases in corporation tax (currently at 18% i.e., low by international standards) should also be considered to fund the war.

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40 'Macroeconomic policies', pp. 24 – 25.

41 Hlibovytskyi, Y., et al. 2022, Ukraine after the victory; Imagining Ukraine in 2023, 27 June 2022.

42 Ibid, p. 42.

43 Ibid, p.44.

44 A more moderate version of this policy ('one in, one out') was adopted just over a decade ago by the British Conservative Party but later abandoned on the grounds of its unworkability.

45 National Recovery Council, 2022, 'Ukraine's National Recovery Plan', July 2022.

46 https://www.slovoidilo.ua/2022/10/04/infografika/ekonomika/proyekt-derzhbyudzhetu-2023-yak-zminyatsya-vydatky-potochnym-rokom

47 https://www.slovoidilo.ua/2022/09/15/stattja/ekonomika/byudzhet-povnomasshtabnoyi-vijny-yaki-osnovni-pokaznyky-zakladeno-2023-rik-derzhava-vytrachatyme-hroshi

48 https://www.slovoidilo.ua/2022/09/15/stattja/ekonomika/byudzhet-povnomasshtabnoyi-vijny-yaki-osnovni-pokaznyky-zakladeno-2023-rik-derzhava-vytrachatyme-hroshi

49 Torbjörn Becker, Barry Eichengreen, Yuriy Gorodnichenko, Sergei Guriev, Simon Johnson, Tymofiy Mylovanov, Maurice Obstfeld, Kenneth Rogoff and Beatrice Weder di Mauro, 2022, 'Macroeconomic policies for wartime Ukraine; Rapid Policy Response' #2, London: Centre for Economic and Policy Research, p.5.

Ukraine's use of flat rate taxes, and very low levels of revenue from personal income tax, is similar to other emerging markets economies in the region. International financial institutions have, however, increasingly challenged emerging market non-progressivity in this area over recent years and put forward alternatives.

The International Monetary Fund (IMF) has advocated for the greater use of the personal taxation fiscal revenue stream in emerging economies, identifying a key role for efficiently collected and well spent progressive taxation in economic development. An IMF report from earlier this year found a positive correlation in low to middle income states between the share of personal income taxation within the tax structure and the total level of tax collection, especially in middle income, emerging market economies like Ukraine.[50]

The Ukrainian government has taken some limited steps to 'de-oligarchization' and asserting greater state control over the market economy to fight the war.

The World Bank have also argued this is a key part of state capacity building in lower income and emerging markets economies. In their 2022 report, Innovations in Tax Compliance; Building Trust, Navigating Politics and Tailoring Reform they warned against the use of 'flat rates… [that] impose a disproportionate burden on the least well-off'[51] and stressed the role of 'fostering quasi-voluntary tax compliance through trust-building', which sought to underpin effective revenue collection with 'social contracts' based on the delivery of public goods.[52]

Research for PeaceRep (and previously the LSE Conflict Research Programme) has also highlighted the importance of empowering populations to demand greater financial transparency from the state, creating the basis for a social contract that sees an engaged citizenry become supportive of paying their taxes.[53]

In Ukraine, which has long had well publicised problems with state corruption, the impact of the war on voluntary compliance with public authority may provide a chance to create the strong social contract that can underpin the payment of taxes which improve state capacity.

Indeed, the tremendous popular support for the Ukrainian war-effort (the 'civic spirit') should be leveraged to maximise income from those that have the capacity to pay higher taxation rates, while also providing a safety net for the most vulnerable. The aim of such a policy framework would be to connect the protection of Ukrainian democracy today with the building of a prosperous and socially just economy in the reconstruction period.

Unfortunately, the Ukrainian government is considering a very different approach. The Office of the President has publicly mooted huge tax cuts under the banner of a so-called '10/10/10' principle. This would see VAT (currently 20%), personal income tax (currently 18%) and corporation tax (currently 18%) all reduced to 10%.[54] The Recovery Plan itself stops short of this dramatic neoliberal measure but commits the government to reviewing the 'potential for decreasing the share of tax revenue in GDP'.[55]

Turning Ukraine into a tax haven in all but name would pose geopolitical problems for the government, especially its relationship with the United States and EU.

The Biden administration led negotiations for a pathbreaking agreement involving 130 states in 2021 that committed to a minimum corporate tax rate of 15% - far higher than the suggested new Ukrainian rate of 10%. Given the importance of these relationships to Ukraine, even if the country could be expected to reap an economic dividend from these proposals (which it almost certainly would not do) it would face a backlash from its major strategic allies. This is not in the least because Ukraine was one of the signatories of the OECD minimum corporation tax agreement just last year.[56]

In short, much of the Ukrainian policy debate appears to be moving in the opposite direction to contemporary global trends. As Joseph Stiglitz has argued, from the Bretton Wood institutions to major players like the Biden administration, as well as a host of EU countries, there is now a wide recognition that states have a democratic obligation to regulate markets in order to protect the interests of their citizens and the environment. This requires a shift away from the 'form of globalisation

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50 Benedek,D., Benítez, J., C., and Vellutini, C., Progress of the Personal Income Tax in Emerging and Developing Countries, IMF Working Paper (WP/22/20), Washington DC: International Monetary Fund.

51 Custers, A., (eds), 2022, Innovations in Tax Compliance; Building Trust, Navigating Politics and Tailoring Reform, Washington, DC: World Bank Group, p.31.

52 Ibid, p.5.

53 For example, see Benson, M. 2022. 'Taxation and Civicness in South Sudan', PeaceRep https://peacerep.org/publication/taxation-and-civicness-in-south-sudan-revenue-reforms/

54 European Business Association, 2022 'Tax reform 10-10-10 : business opinion', 3rd October 2022. https://eba.com.ua/en/podatkova-reforma-10-10-10-dumka-biznesu/

55 'National Recovery Plan', p. 18.

56 OECD.org, 2021. 'Members of the OECD/G20 Inclusive Framework on BEPS joining the Statement on a Two–Pillar Solution to Address the Tax.
Challenges Arising from the Digitalisation of the Economy as of 31 August 2021' https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf

[which was] prescribed by neoliberalism [and] left individuals and entire societies unable to control an important part of their own destiny'.[57] In a war situation, this question of control is posed even more sharply. Societies facing a 'war of necessity' to protect their sovereignty have little choice but to harness all available resources and direct them centrally to the goal of national self-preservation. Relying on the mythology of 'rational' and 'self-correcting' markets, in the face of the extraordinary exogenous shock of a military invasion would be a disaster.

Limited state intervention and active labour market policy

The Ukrainian government has taken some limited steps to 'de-oligarchization' and asserting greater state control over the market economy to fight the war. It has seized Russian and Belarusian assets worth $1.21 billion since the start of the war and may use this to fund re-construction.[58] The government also announced on the 7 November 2022 that it was taking strategic control of five strategic companies (Ukrnafta and Ukrntatnafta, both in the oil sector, Motor Sich, an aerospace firm, truck company AvtoKrAZ, and Zaporizhtransformator, a transformer company). President Zelensky did 'not rule out'[59] further confiscations of oligarch property as needed by the war. Presently, however, these moves appear to be restrictive responses to specific crises in industry and energy infrastructure, rather than a more concerted pursuit of state allocation of economic resources per se.

The government have also sought to address the unemployment crisis through active labour market intervention. Some of these measures involve market-based policies, such as offering subsidies to businesses to provide jobs to IDPs and vulnerable groups.[60] But the government is also pursuing a large-scale public works programme; what it calls the 'Recovery Army' which sees civilian authorities working closely with the military. Promisingly, this policy involves an element of state direction of the labour force. Wages are, however, low (6,700 hryvnias per month – in line with the national minimum wage) and this will potentially impact take-up of the voluntary scheme. It will also inevitably be vulnerable to fiscal shocks,[61] and its longer-term durability poses a need for increasing tax revenue.

While tentative, these steps towards asserting greater state management of the economy do recognise the realities of the war. They mark a clear shift from the Recovery Plan published in July,[62] which had made no mention of providing state jobs for public works en masse.

Sites of intractable violence: lessons and warnings for Ukraine

Experiences of intractable conflict in the other sites studied on the PeaceRep programme (for example, Somalia, Sudan, South Sudan and Syria) provide a series of warnings regarding the importance of Ukraine maintaining its political cohesion and avoiding a drift into state fragmentation. If the war maintains its 'conventional' character, then it should – like all of the other such wars across history – come to an end.[63] In this sense, a key risk is that the conflict ceases to be a conventional war and takes on the characteristics of intractable conflicts ('forever wars').

Intractable conflicts tend to be the outcome of some form of rapid economic liberalisation in the context of authoritarianism, sectarianism and/or weak state capacity.

These are typified by state fragmentation, a criminalised war economy, and the construction of sectarian politics; and sees a range of state and non-state actors increasingly acquire a continuing economic and/or political interest in the reproduction of violence. Troublingly, given the critical analysis of Ukraine's economy in the foregoing, these intractable conflicts tend to be the outcome of some form of rapid economic (neo)liberalisation in the context of authoritarianism, sectarianism and/or weak state capacity. They have occurred when incomes and production fall dramatically, due to the dynamics of conflict in tandem with neoliberal economic policies. Individuals and groups facing this socioeconomic and political collapse come to participate in violence as a means of survival.

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57 Stiglitz, J., 2019, 'The End of Neoliberalism and the Rebirth of History, Project Syndicate, 4th November 2019 https://www.project-syndicate.org/commentary/end-of-neoliberalism-unfettered-markets-fail-by-joseph-e-stiglitz-2019-11

58 https://www.reuters.com/world/europe/russian-assets-seized-ukraine-may-be-used-reconstruction-minister-2022-10-28/

59 https://twitter.com/KyivIndependent/status/1589796777309659137?s=20&t=Yh4OzA_Zr366aUHIjMKObQ

60 https://www.me.gov.ua/News/Detail?lang=en-GB&id=64b16325-5e71-4a07-b178-b85bb872fefc&title=ParliamentHasSupportedTheGovernmentInitiativesToIntensifyTheLabourMarketAndStimulateEmployment

61 https://www.me.gov.ua/News/Detail?lang=uk-UA&id=1455dd6f-3083-4891-af96-00ed9c7c497a&title=Bezrobitni

62 'National Recovery Plan'.

63 Snyder, T., 2022. 'Timothy Snyder: "Russia will only recognize Ukraine when it is forced to do so"' in Cooper, L., and Kaldor, M., (eds) (2022). Is a Peace Deal Possible With Putin? On the problems of peacemaking in the Russian war on Ukraine (Policy Brief). London: Conflict and Civicness Research Group, LSE IDEAS, The London School of Economics.

Ukraine has direct experience of these ‘forever wars’ or ‘hybrid conflicts’ due to the efforts that Russia has taken after 2014 to create armed proxies based on sectarian ethic identities in Ukraine through links of patronage and clientelism. **While Russian intervention has backfired by generating a more cohesive Ukrainian democratic identity and polity, the combination of largescale unemployment combined with the arming of the civilian population posits downstream risks. These material conditions are often associated with state fragmentation and a political economy of violence.**

Without an effective economy that prioritises full employment and the central direction of labour towards the war effort, Ukraine is left relying upon its ‘civic spirit’ to maintain societal cohesion. Although the mobilisation of volunteer networks, charitable foundations and civil society to ‘plug the gaps’ in the safety net has been remarkable, it will be very hard to maintain this level of resilience without a restructured, state-coordinated economy.

In lieu of a u-turn from its current policies, Ukraine is embarking on a political experiment. As the policy prescriptions used by states in a total war environment are ‘tried and tested’, and could facilitate tackling longer-term problems like weak state capacity and corruption, Ukraine would be wise to change course.

The problems of running a war-economy without central planning

Ukraine’s current economic policy framework represents an unstable mix of different elements. It abandons social partnership policies (which was previously formally institutionalised by labour law) in favour of conflict with unions representing workers in industries critical to the war effort. The government have attempted to use neoliberal market economics during a ‘total war’ scenario. This seeks, broadly, to expand opportunities for capital, while reducing the bargaining power of labour and financing the war itself by squeezing the ‘social wage’, i.e., public goods and amenities. Income tax remains exceptionally low, especially in the context of the widespread use of ‘fake’ forms of self-employment in middle class professions, and lacks progressivity. In sum, this puts the overall burden of financing the war on the shoulders of those least able to pay. Doing this raises obvious downstream political risks for Ukraine. However, some relatively recent policy shifts, particularly the public works programme, do add an element of state management into an otherwise ‘neoliberal war’ toolkit.

Ukraine should not be experimenting in a ‘free market war economy’ but should model its response on an orthodox policy for an all-out-war scenario. In this area, best practice may be derived from the experience of the allies in the Second World War that rejected the use of market mechanisms of resource allocation. In a total war situation, due to the extreme physical and security risk to property, the barriers to kickstarting private investment will always be very high. A report by the German Marshall Fund adds this vital note of realism:

> Even if there is a ceasefire or a settlement, Ukraine’s reconstruction will begin in a volatile environment, possibly including the risk of renewed Russian aggression. In the absence of a policy intervention, this situation will deter private-sector actors, especially foreign ones, from directly participating and investing in reconstruction, possibly for a prolonged period. Insurance premiums, if at all commercially available, will be prohibitively high for private-sector economic activity to commence.[64]

The Ukrainian government and its intellectual outriders are right, however, to argue that its policies today should prepare the ground for reconstruction in the post-war period. But this should follow the current trend line in global political economic thinking, not discredited free market remedies. In the face of persistent ‘exogenous shocks’, which posit the need for state intervention (from COVID-19 to climate change and, indeed, the Russian war against Ukraine) neoliberalism’s popularity has declined markedly in global policy debate over the last decade. A genuinely modernizing economic strategy should start from ensuring the capacity of the state to protect its citizens and the environment. Investment in capital projects for a green transition, public services like healthcare and education, and the social safety net, will be critical to ensuring Ukraine’s long-term development.

In the short-term, Ukraine should move rapidly to a system of central state allocation of resources, and seize the chance presented by the impact the war has on voluntary compliance to raise taxes, tackle corruption and sharply improve the state’s institutional capacity.

Above all, it is vital to recognise that ‘normal’ economic prescriptions (regardless of ideological preference) cannot be successfully applied in an all-out-war. The central difference between a war-economy and conventional ones lies in the relationship between consumption and investment. Whereas in peacetime states will generally seek to encourage consumption in order to facilitate growth, in a ‘total war’ the state actively seeks to constrict it. Consumption is restricted by tax

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[64] Ganster, R., Kirkegaard, J., Kleine-Brockhoff, T., and Stokes, B., 2022, Designing Ukraine’s Recovery in the Spirit of the Marshall Plan, Washington, DC: German Marshall Fund of the United States, p. 30.

increases and active state intervention into the supply of goods (e.g., rationing), while investment is prioritised.

This recognises that shortages of goods are inherent to a context in which vast amounts of economic capacity are committed to fighting a war. This, in turn, brings a fundamental risk of inflation and war-profiteering due to a basic situation of war-related resource scarcity. Rather than heterodox monetary financing (which is likely to accentuate inflationary pressures), the allies during World War 2 pursued aggressive increases in taxation to pay for the war. This was combined with sweeping state intervention, both in the form of price controls and the direction of industry, in order to drive the war effort.

These policies are radically different from those that are currently being pursued in Ukraine. This is especially the case in relation to the role that the allies assigned to sharply increasing taxes on incomes and profits to finance the war and inhibit inflationary pressure. These policies were largely successful in taming inflation and resulted in a historic transformation of state capacity:

> The number of Americans required to pay federal taxes rose from 4 million in 1939 to 43 million in 1945. With such a large pool of taxpayers, the American government took in $45 billion in 1945, an enormous increase over the $8.7 billion collected in 1941.[65]

While taxation did not cover the overall costs of the war (the remainder was paid for with war bonds in the United States), mechanisms for inflation control (incl. price controls and state intervention into goods supply) were so successful that wage growth outstripped inflation during the war in the United States. The majority of Americans therefore experienced improved living standards. [66] While this, of course, reflected the specific security context for the United States, the example of the allies, incl. the UK, offers a toolkit for Ukraine's war effort.

Conclusion: economic turmoil is Ukraine's critical downstream risk

The Russian invasion has created a 'war of necessity' for the Ukrainian side. The conflict represents a classical political contest between two sides fighting for clearly defined objectives, democracy, territorial integrity and national self-determination, on one side, and authoritarianism, expansionary ethnic nationalism and imperialism, on the other. It therefore resembles a classical Clausewitzian 'total war', in which the Ukrainian side is seeking to mobilise society around its political objectives. For this to be effective and for the war to ultimately come to an end through a political agreement favourable to Ukraine, it is essential that the Ukrainians avoid a scenario in which its democratic public authority breaks down under acute socioeconomic pressure.

Battlefield success is crucial for any negotiation with Russia to be conducted on terms favourable to the Ukrainian side.[67] This thus poses the need for an effective planned economy that (a) directs Ukraine's large unemployed population into work, and (b) asserts state control over investment decisions and the allocation of resources in order to support the national war-effort. Conventional wars are often decided at the level of productive capacity and economic resilience.[68] While Ukraine will require continued external support to maintain its momentum in the war, it must also maximise the domestic resources at its disposal.

Unfortunately, in light of Ukraine's apparent reluctance to model its war-economy on the instruments used by the Allies in World War 2, any assessment of Ukraine's longer-term prospects in the war - despite the remarkable military victory in Kherson city - has to be fairly negative.

Ukraine is left reliant on the country's extraordinary civic spirit, the popular support for the sacrifices entailed by the war, and the hope that its political-economy and domestic institutions will prove to be less brittle than that of the Russian side. Due to the government's decision to pursue liberalisation in a war, the major danger that Ukraine faces is growing disintegration in the face of the war's punishing economic effects.

However, it is important to note that this does not make a 'forever war' - in which the state loses its monopoly on the use of force, and violence becomes a means of survival for armed groups - inevitable. If such a trajectory were to be emerging it would become visible to the Ukrainian side prior to running out of control and there would be a window of opportunity to change course, either through some form of enforced armistice with a similarly exhausted and broken Russia, or a sharp U-turn in Ukrainian policy towards state allocation of resources.

Worryingly, if Ukraine were to become a site of intractable violence (i.e., in one lexicon, a 'failed state'), this would very clearly satisfy Putin's war objectives. It would make it impossible for the country to join either NATO or the European Union and would likely mark the end of its post-2014 democratic transformation. In short, the economic turmoil following a self-imposed process of (neo)liberal 'structural adjustment' represents the central downstream risk facing Ukrainian democracy.

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65 Christopher J. Tassava, 2008, "The American Economy during World War II", Economic History Association, edited by Robert Whaples. February 10, 2008. URL http://eh.net/encyclopedia/the-american-economy-during-world-war-ii/

66 Ibid.

67 'Timothy Snyder: "Russia will only recognize Ukraine when it is forced to do so"'.

68 On this see O'Brien, P., P., 2015, How the War was Won, Cambridge: Cambridge University Press.

PeaceRep is a research consortium based at Edinburgh Law School. Our research is re-thinking peace and transition processes in the light of changing conflict dynamics, changing demands of inclusion, and changes in patterns of global intervention in conflict and peace/mediation/transition management processes.

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PeaceRep is funded by the Foreign, Commonwealth and Development Office (FCDO), UK.

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Design: LSE Design Unit (lse.ac.uk/designunit)
Photography: Nigel Stead, LSE School Photographer.