

# FINANCIAL TIMES

## Could Putin's war be good for Ukraine?

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July 28, 2014

One can only hope that Vladimir Putin's war against Ukraine, which has claimed, among others, the lives of the passengers of flight MH17, will come to an early end. But is it possible that the conflict, for all the suffering and senseless destruction it has brought, could have a silver lining?

The past 20 years, during which many Ukrainians thought of their country as a bridge between the West and the East, without any obvious enemies, were years of complacency and failed economic policies, which ultimately resulted in the capture of the government by special interests.

Besides economic backwardness – Ukraine's GDP per capita is barely \$4,000 – these 20 years created a weak state, unable to deliver even the most basic public goods and services. Ukraine's military, for example, did nothing to counter the Russian invasion of Crimea and is still struggling to contain the Russia-sponsored militants in Donbas.

The sudden realisation that the country's eastern neighbour represents a potentially existential threat may serve as an impetus for the country's elites to get Ukraine's economy on track, and to repair – or, in some cases, to build from scratch – the institutions underpinning democratic capitalism.

Traumatic experiences can foster positive change. As Tyler Cowen recently wrote in the New York Times, “the very possibility of war focuses the attention of governments on getting some basic decisions right — whether investing in science or simply liberalising the economy. Such focus ends up improving a nation's longer-run prospects.”

The external threat from the Kremlin has already served as an incentive to invest in the capacity of governments to provide essential public goods, such as security and justice, in countries such as Georgia, a victim of Russia's earlier military excursion in 2008. Georgia has been the post-Soviet country that made the biggest progress during the 2000s in terms of strengthening the rule of law, eradicating corruption and improving its business environment.

While the threat from Russia is preoccupying the minds of Ukrainian policy makers, the country also suffers from more mundane problems, some of which were at the heart of the government's recent discussions with the IMF, which concluded its mission to Ukraine on the day of the tragedy of flight MH17. Economic difficulties, corruption and the weakness of Ukraine's

institutions have neither magically disappeared since the fighting in the east began, nor are they likely to go away once Ukraine finds itself at peace. If anything, many of these problems seem to be gradually getting worse.

The IMF estimates that Ukraine's economy will contract by 6.5 per cent in 2014, and not by 5 per cent as was predicted earlier in the year. The rise in expenditure driven by the war and a fall in revenue in the east are responsible for the rising fiscal deficit, which is likely to attain double digits this year – in spite of a fiscal consolidation that is scheduled to take place over the period 2014-2016. The government is limiting wage and pension increases and is seeking ways to reduce public sector employment and stop the wastefulness, corruption and theft that traditionally characterised public procurement in the country.

The good news is that numerous post-communist countries have faced and in many cases successfully tackled the same challenges. Being a latecomer gives Ukrainians an opportunity to avoid some of the pitfalls encountered earlier by the more precocious reformers in the region – such as the partial privatisation of pension accounts in Poland, Hungary or Slovakia, which happened without sufficient guarantees against potential government predation.

What is more, until last week, Ukrainians had the most reform-minded political leadership in decades, with ministers such as Pavlo Sheremeta, previously the president (and the founder) of the Kyiv Mohyla Business School, which offers one of the leading MBA programmes in the country. While it remains to be seen if the new government will share the enthusiasm for possibly unpopular reforms, the association agreement with the European Union and the prospect of membership may help solidify a commitment to economic and institutional reforms.

The challenges facing Ukraine are enormous but they are not insurmountable. Only 25 years ago, Ukraine enjoyed the same income levels as Poland and dealt with similar political legacies. Let us hope that one unintended consequence of Putin's military adventurism will be that Ukraine catches up with its Western neighbours again.

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