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Guest post: Ukraine must fix itself

By Dalibor Rohac

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Are things finally turning around for Ukraine? In the space of a few hours on Thursday, a cease-fire with the Kremlin-sponsored separatists was agreed in Minsk, and the International Monetary Fund (IMF) pledged $17.5bn in financial assistance to the government as part of a package from various donors totalling $40bn.

The events on Kiev's Maidan last year opened a window of opportunity to stop the economic, social and human devastation of Ukraine by its own political elites. The popular will to stop corruption and fix the country's political and economic institutions was palpable. Two successive governments of Prime Minister Arseniy Yatsenyuk have included a number of promising reformists, raising hopes that this time might be different.

The prospect of Ukraine's transformation from a client state run by gangsters into a successful market democracy would set a precedent for the region – most importantly for Russia. That might be the best explanation for Vladimir Putin's ongoing military escapade in Donbass.

Attacked by Russia and entering a second year of a continuous economic downturn, the country needs – and deserves – some form of help from the west. But, ultimately, Ukraine's economic and institutional problems can only be solved in Kiev. Nor should western donors have any illusions about the effects of their financial assistance. Ukraine, after all, has a history of IMF programmes going back to the 1990s, with the various governments typically reneging on its reform commitments. We have yet to see evidence that this time really is different.

We should not discount the tragedy of the military conflict initiated by Putin. Yet, for the future of Ukraine, getting the economy on track, stopping corruption and government predation and building inclusive economic and political institutions are just as important as containing the Kremlin-sponsored aggression.

At a discussion event in Washington, a young Ukrainian journalist recently raised an important rhetorical question: "The war is taking place on just 3 per cent of Ukraine's territory. But what happens on the rest?" Although it has affected industrial production, the conflict hardly explains the magnitude of Kiev's economic and financial problems. This year's military and law enforcement expenditure – increased substantially relative to previous years – is still a mere 86bn hryvnias (around $3.2bn), or 5 per cent of the country's public budget.

There is a thin line between showing a united front in face of a foreign aggression and giving the government slack with policy reforms. Ukrainians should certainly not err on the side of the latter. If anything, the sense of urgency created by Russia's aggression ought to be harnessed, while there is still time, to support politically difficult reforms.

Those have yet to materialize. As Balasz Jarabik, a scholar at the Carnegie Endowment for International Peace, wrote recently, "the old ways of doing business—through endemic corruption and state capture by oligarchs and their proxies—are still the rule, not the exception."

Even with financial assistance from western donors, public finances are out of control. The budget deficit was in the neighbourhood of 12 per cent of GDP last year and although the government promises a sharp deficit reduction in 2015, this cannot be achieved without eliminating energy subsidies, which accounted for roughly half of the overall financing gap in 2014.

Last year, the government made some cuts to healthcare and education spending, and more are planned this year. But much bigger savings could be achieved, even without compromising the quality of public services – often questionable to begin with – by tackling the massive waste, excess employment, and outright fraud in the public sector, which accounts for some 53 per cent of the GDP, far above other post-communist economies.

Ivan Miklos, the former Slovak minister of finance who has been advising the Ukrainian government for the past year – and who was the main driving force behind the impressive economic reforms in Slovakia in the 2000s – notes dryly that he fired 30 per cent of the employees at Slovakia's finance ministry in 2003 with no noticeable impact on the ministry's work. He says the optimal number in the Ukrainian government would be somewhere between 30 and 40 per cent.

It should not surprise anybody if the new Minsk agreement is short-lived, for reasons beyond Kiev's control. What is more tragic, is that there are equally good reasons to think that the financial assistance provided to Ukraine will be squandered, for reasons perfectly within Kiev's control. And with that, the opportunity to turn Ukraine into a success story might be gone for many years to come.

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