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Warfare as the Illness of the State: Economic Dogma in Russia's War on Ukraine

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EXECUTIVE SUMMARY

The dominant approach to economic statecraft vis-a-vis a post-conflict Ukraine has prioritized the role of the market in distributing resources and de-emphasized state involvement. In line with the U.S.-led policies of 'shock therapy' in former Eastern Bloc countries, this approach to state reconstruction has created a series of states either hostile to U.S. interests or totally reliant on the U.S.-security umbrella. These policies, best summarized as the application of 'stabilization, liberalization, and privatization' to states either recovering from war or deep economic crises, have resulted in a marked decline in living conditions. As a former member of the Soviet bloc, Ukraine already endured a privatization round in the 1990s.[1]

Throughout its history as a free and democratic state, the country has been forced to undergo further structural adjustment campaigns that seek to curtail state involvement in the economy and reduce social spending. These structural adjustment policies are typically undertaken to access International Monetary Fund (IMF) loans and Western capital. This situation produced a deeply uneven society, even before the brutal Russian invasion in February 2022.

The war revealed a state that was hamstrung by neoliberal economic dogma. As manufacturing output slipped from 2000 to 2022, Ukraine was left to rely mainly on Western aid.[2] Despite the historical tendency of state involvement in the economy to expand during wartime, Ukraine has been slightly reluctant to undergo a nationalization campaign, typical for countries in its position. Rather than viewing the war as an opportunity to create a post-war society with a more generous social safety net and robust defense sector, as the United States did after World War II, some Ukrainian lawmakers have used the wartime state of exception to crack down on organized labor and introduce further privatization measures. The Western think tank and NGO sectors have largely supported these efforts.

This has created an unusual situation while Russia is faring horribly on the battlefield but surviving the Western sanction regime better than expected, primarily due to high oil and natural gas prices. Though the focus is understandably on Ukraine achieving military success and regaining stability, as well as ultimately finding an end to the conflict, Ukraine emerging from the war in an economic recession and the weakened by war could lead to a permanent regime of U.S. aid to the country or a similar sense of embitterment and wounded nationalism

that permeated 1990s Russia. This could potentially sow the seeds of future conflicts.

To build a strong, independent post-war Ukraine, the United States should lead the way in providing debt forgiveness measures, loans free of structural adjustment guarantees, and promoting industrial policies.

To the Victor go the Spoils: Plunder in the Post-Soviet Space

Shock Therapy and a Newly Independent Ukraine

With the triumph of Western capitalism over Soviet-style central planning in 1991, Western economists envisioned the post-Soviet space as a laboratory for new forms of capitalism. The proclaimed "End of History" and the subsequent crisis in the former Soviet bloc presented an opportunity to test new economic theories. John Williamson, a British economist, coined the term "Washington Consensus" and articulated the West's approach to the Soviet bloc best as he said, "These worst of times give rise to the best of opportunities for those who understand the need for fundamental economic reform." He later asked, "Whether it could conceivably make sense to deliberately provoke a crisis as to remove the political logjam to reform."[3]

At the time of dissolution, Ukraine lagged behind even poorer Soviet republics such as Moldova and Turkmenistan in terms of GDP per capita.[4] However, its large population, fertile land, and Soviet-era infrastructure gave the country the great potential to join the high-living standards of its Western European peers.

Political corruption and the development of a massive informal economy led GDP to annually contract between 9.7 and 22.6 percent between 1991 and 1996.[5] Despite his successes in pursuing peaceful independence from the Soviet Union and denuclearization, Ukraine's first President, Leonid Kravchuk, largely delegated economic matters to his prime minister, Leonid Kuchma.[6] During his reign, the major economic question concerned the breaking up of the ruble zone and the transition to a national currency. Ukraine wanted to exploit the ruble zone for cheaper access to Russian materials while also introducing its own coupon used at state-run shops called the karbovanets, causing serious instability. Using the ruble, karbovanets, and an informal barter-based black-market system led to a hyperinflation crisis.[7] As the country's economy floundered in its first years of independence, it was not until Kuchma usurped Kravchuk and ascended into the presidency in 1994 that Ukraine developed a coherent economic policy and thrust itself toward liberalization.

While Ukraine was initially slightly behind its peers in adopting radical reforms, Kuchma quickly brought the country into the IMF and the Washington Consensus. While guaranteeing a $371 million loan for the country, Kuchma acknowledged that "Strict and unpopular measures will have to be taken."[8] These policies included liberalization of prices, freeing trade, and trimming the budget deficit.

The infusion of Western capital through IMF loans stabilized the economy somewhat. However, the short-term stabilization required the Ukrainian population to swallow a bitter pill and lose access to many social welfare benefits. A 1998 IMF Memorandum of Understanding with Ukraine discussed the West's economic designs for the newly independent nation: "We will eliminate most budgetary privileges and review the benefits provided by the Chornobyl Fund, the Social Insurance Fund, and the Employment Fund, aiming at streamlining and rationalizing their activities. Finally, during the program period, in addition to arrears on wages, benefits, and social benefits, we intend to eliminate or restructure, in consultation with the staff of the Fund and the World Bank, all other budgetary arrears."[9] Reforms intended to break up a bloated Soviet-era kleptocracy ended up hurting Ukrainian workers as former communist bosses seamlessly transitioned to capitalist oligarchs.

The Rise of the Ukrainian Oligarchy

Ambitious, politically connected Ukrainians took advantage of the Western-backed privatization policies to accumulate massive amounts of capital.

Oligarchs tended to arise out of heavy resource-extraction-based industries. The wealthiest Ukrainian, Rinat Akhmetov, came out of Donetsk through a series of investments in metallurgy, energy, and close connections to organized crime.[10] Mr. Akhmetov owns the famed Azovstal Iron and Steel Works factory, which saw intense fighting and a heroic stand by Ukrainian fighters during the Battle of Mariupol.[11] The accumulation of oligarchic wealth during this period of Western-backed privatization became so extreme that by 2008 the 50 most influential oligarchs made up 85% of Ukraine's GDP.[12] Oligarchs used their extreme wealth and power to curry favors and push for further privatization. Victor Pinchuk, the second-wealthiest Ukrainian and Kuchma's son-in-law, controls a media empire and financially supports the pro-free market Peterson Institute for International Economics.[13]

As oligarchs grew richer, questions of class conflict and ethnic divisions bled into each other. In 1996, 500,000 coal miners, mainly in the Donbas, went on strike as Kuchma tried to press forward with a series of free-market reforms.[14] Outrage was understandable, as extreme unemployment, inflation, corruption, and crime destroyed the very fabric of Ukrainian society. The immediate opening of the fragile Ukrainian industry to foreign capital and competition proved disastrous. The decision affirmed the striking coal miners' concerns about economic reform; instead of seeking to protect and stabilize the Ukrainian industry, it was now subject to harsh global economic competition.

"The reforms," Ukrainian political economist Yuliya Yurchenko wrote, "created mutually reinforcing negative effects on the economy by opening up outdated industry for competition with foreign transnational corporations and by reducing financial state support for enterprises and citizenry, thus making the latter poorer and the former even less competitive with expected negative aggregate consumption and potential revenue drop."[15]

The economic and social collapse had real human consequences for the fledgling democracy.
From 1991 to 2008, Ukraine's death rate, or the number of deaths per 1,000 people, grew from 12.9 percent to 16.4 percent. Even under Soviet tyranny in 1970, the country's death rate stood at 8.83 percent.[16] Additionally, it would take until 2011 for Ukraine to reach the same life expectancy it had in 1989.[17] For young men living through the collapse of the Soviet era, the change proved particularly destructive; a lack of stable employment opportunities led to an epidemic of alcoholism and violence. In the decade between 1989 and 1999, Ukrainian men experienced a three-year decline in life expectancy at birth.[18] The Western-backed economic regime had clearly failed at integrating Ukraine into the West. The country was left to flounder as its Russian neighbor grew increasingly embittered by her shock therapy campaign.

The Pinochet Stick

In neighboring Russia, a similar process of painful Western-backed reforms created its own oligarch class to decide Russia's future. Riding the back of outcry and rage over the economic reforms, a young Vladimir Putin would take charge from an ailing President Boris Yeltsin. Yeltsin, along with his Russian financial adviser Anatoly Chuabis and U.S. advisors Larry Summers and Jeffrey Sachs, had presided over an economic crisis and one of the sharpest declines in life expectancy in modern history.[19] Yeltsin was allowed to rule by decree and exploited a state of exception to pass his extreme economic agenda.

From 1992 to 1994, 15,000 previously state-run economic firms were privatized.[20] In 1991, Yeltsin decided to immediately drop all Soviet-era price controls.[21] By 1994, consumer prices had risen by a factor of nearly 2000.[22] Russian male life expectancy cratered during this period of intense liberalization and political upheaval. In 1980, the average Russian man lived until 62; by 1999, they lived until 58.[23] One study projected that from 1990 to 1995 alone, the economic transition in Russia led to four million excess deaths.[24] Throughout this time, the United States continued to support economic reform and back Yeltsin. When Yeltsin led a bloody campaign in Chechnya, President Bill Clinton compared him favorably to Abraham Lincoln.[25]

During this period, some Western economic advisors and Russians recognized the error in trying to transform an economy that had operated through central planning for nearly 70 years into a laissez-faire pro-enterprise economy overnight. Former Soviet Premier Mikhail Gorbachev repeatedly told Soviet workers that he was not interested in pursuing the style of shock therapy that Poland had instituted.[26] Later in life, Gorbachev went on to push for a more social democratic economy in Russia as an alternative to both the oligarchic-dominated capitalism and the bureaucratic Soviet-style socialism.[27] Additionally, even some pro-shock therapy Western advisors, such as Jeffrey Sachs, thought the program went too far. Sachs called for the cancellation of Russian debts and for the implementation of a Marshall Plan-style, $30 billion reconstruction package for Russia.[28] The American government rejected both plans.

Even as Yeltsin succumbed to his physical ailments and unpopularity, Putin was seen as the heir to his shock therapy reforms. Proponents of the neoliberal model of economics, such as the famed U.S. economist Milton Friedman, argued that political and economic liberalism were inseparable: "Historical evidence speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom and that has not also used something comparable to a free market to organize the bulk of economic activity." [29]

Putin's backers in the Russian elite business classes clearly took a different view. In 2000, Russian banking oligarch Petr Aven urged the newly elected President Putin to apply the proverbial Pinochet stick to fast-track reforms (named for the American-backed neoliberal Chilean dictator Augusto Pinochet). "The only way ahead is for fast liberal reforms, building public support for that path but also using totalitarian force to achieve that. Russia has no other choice," Aven said.[30] The hallmarks of Putin's Russia that still define it today- oligarchy, political repression, irredentism, and nationalism- were incubated in these years, often under direct U.S. economic advisors' supervision or tacit approval.

Try, Try, Again

Despite the original round of shock therapy failing in both Russia and Ukraine, current U.S. plans for post-war Ukraine look to bring another round of extreme privatization to the country. "State-owned enterprise and privatization is an important part of domestic revenue reforms. [the United States Agency for International Development, or USAID] and other donors already have programs dealing with these issues. As the economy recovers, they should look for additional opportunities to encourage competition in key industries," U.S.-based consulting giant Deloitte said on the potential reconstruction of Ukraine.[31]

A report from the Centre for Economic Policy concerning the macroeconomic policy of wartime Ukraine is more explicit in its push to prune away the state and institute another round of 1990s liberalization reforms:

> The government has encouraged businesses to move to Western Ukraine, where security risks are lower, but this policy has had only modest effects (fewer than 1,000 firms have moved). This problem can be addressed by a radical liberalization of markets to accelerate the flow of the workforce and capital towards sectors/regions where the economy can operate robustly. For example, the government dramatically loosened labor market regulations (e.g., firms can fire workers relatively easily and unilaterally suspend elements of labor contracts; workers who would like to quit do not need to give advance notice to their employers). This approach should be applied to other areas. Land regulation, access to electricity, and other infrastructure should be streamlined to allow easier reallocation for firms. … Perhaps, the government can appoint a high-level official (e.g., ' deregulation chief') to coordinate and push for deregulation.[32]

This approach to the Ukrainian economy differs little from the 1990s approach. Fundamentally, both seek to take advantage of a crisis to implement a series of radical liberalization reforms. The Centre for Economic Policy report and other proponents of the extreme liberalization and shock therapy policies for Ukraine's war or post-war economy claim that the Ukrainian state cannot take a more active traditional war-economy role due to a lack of state capacity. This assertion would also seem to undermine the case for sending Ukraine the military aid it needs to repel the Russian invasion. Rather, the lack of state function will actively hurt the case for sending arms to Ukraine. A robust proactive state could go far in terms of easing weapons smuggling and corruption fears. Additionally, the claim would counter the message top political leaders in the West have painted of

Ukraine's civil society. As President of the European Commission Ursula von der Leyen said, "Ukraine has everything it takes for a successful reconstruction. It has determination; it has a vibrant civil society; many friends around the globe who want to support [it] . . .; and an impressively resilient economic base."[33]

A Real Crisis

As discussed earlier, the crisis of the 1990s and the uneven transition to capitalism led to an already weakened Ukrainian economy. Even before Russian troops crossed the border into Ukraine on February 24, 2022, the country was already dealing with the fallout from the COVID-19 pandemic. The invasion introduced an even bigger exogenous shock to the economy. The massive displacement of Ukrainians caused the poverty rate to rise from 2% to 25% from the start of the war to the end of 2022.[34] In 2022, the IMF projected that the country lost a third of its GDP to the war.[35] The high costs of the war have caused the government to run a deficit of around $5 billion monthly.[36]

At the top levels of Ukrainian economic planning, divergent approaches to handling the crisis have led to political shakeups. In October 2022, Ukraine's former central bank governor Kyrlo Shevchenko mysteriously resigned abruptly, citing health problems. Later he would be accused of embezzling more than 200 million hryvnias.[37] Shevchenko had been an ardent devotee of the IMF program. During his term, the government continued to place immense pressure on the central bank to continue to finance its war by creating more capital. Some analysts have suggested that Shevchenko's ousting was politically motivated and symbolic of larger clashes between President Volodymyr Zelensky and the NBU concerning wartime funding.[38]

Workforce concerns will also make any potential reconstruction projects much more difficult. The poster child for economically successful post-war reconstruction, West Germany, benefited from a massive influx of human capital due to refugees fleeing from Soviet-dominated East Germany. Ukraine will not have the same advantage. As mentioned previously, the high death rate Ukraine endured as part of its transition to a market economy has already left the country on fragile grounds in terms of healthy population growth.

The Russian occupation of Crimea and the Donbas further cuts off Ukraine from 16% of its population.[39] Since the start of the invasion, eight million Ukrainians have fled the country. While some research shows that as many as 5.6 million have returned, the compounding effects of wartime casualties and refugees on the population could have serious economic ramifications. Already the country was experiencing demographic decline; its population had slipped from almost 52 million in 1991 to 36 million on the eve of the 2022 Russian invasion.[40] The demographic crisis could have compounding effects on the Ukrainian pension system, tax base, and even labor relations.

In August 2022, the country was able to narrowly avoid economic catastrophe as it reached a two-year freeze on payments on $20 billion worth of bonds. Prime Minister Denys Shmyhal said the deal saved Ukraine $6 billion.[41] However, the Center for Strategic and International Studies notes that the deal made it substantially more difficult for Ukraine to access foreign capital, further compounding the country's macroeconomic problems.[42]

Wartime Economic Woes

Many Ukrainians have advocated for an alternative to the state's market-focused wartime financial policies. Vadym Denysenko, the undersecretary of the interior, went so far as to call for direct state management of the economy.[43] Even the researchers at the Centre for Economic Policy reiterated the need for Ukraine to institute a temporary regime of progressive taxation to help pay for the war. "Ukraine has a flat personal income tax with a rate set at 18%," the researchers noted. "The existing military levy (introduced in 2015) is also a flat 1.5% of income. If the government cannot make these taxes progressive, it can introduce a progressive war surcharge' (for example, the surcharge would apply only to income or capital above a certain threshold) that may be easier to accept politically and could be rolled back after the war."[44] Despite this, Ukrainian finance minister Serhiy Marchenko has reiterated his commitment to not changing the tax code in any way, including through easing or tightening it.[45]

Ukraine has largely financed the war through a series of loans from foreign powers and turning on the money presses. The extremely loose monetary policy, already taking place under a global inflationary crunch, has led prices to skyrocket. Currently, the Ukrainian inflation rate stands at about 25%.[46] The high prices have made food and energy unaffordable for many people, especially as Russian attacks have targeted the energy sector. Ukraine's 2023 budget calls for an increase in defense spending by a factor of six. Security expenditures will make up 75% of the budget, according to Marchenko.[47]

Disciplining the Labor Market

In addition to wartime privatization, some Ukrainian policymakers have taken steps to undermine the country's labor unions. Labor unions and class conflict in Ukraine have been a major part of Ukrainian history, including the conflict with Russia. Class-based struggle, particularly in the mining sector, was a way some Ukrainians displayed dismay with the 1990s era of liberalization.

Since the start of the war, Ukrainian unions have adapted to rapidly changing labor conditions and mobilized their bases and strong social connections to assist with the war effort. The Construction and Building Materials Industry Workers Union (PROFBUD) immediately recognized that the union would need a new purpose with most of its members out of work. PROFBUD helped preserve internal stability in the immediate months of the war as millions of internal refugees flowed across the country, turning its facilities into shelters. In the crucial early days of the war, from March 2022 to July 2022, the union provided 505,500 bed nights to refugees, along with food and medical care. [48]

Under martial law, the Ukrainian government outlawed strikes and anti-government protests. While unfortunate, this sort of law is standard for governments facing an all-out invasion. Labor unions have primarily abided by the practice and halted strike activity. The only real organized labor activity since the beginning of the war was a protest from miners at Novovolynsk Mine No. 9 that stopped the takeover of the mine by a government official previously accused of corruption.[49]

The Ukrainian government has not been content with the union's large-scale abandonment of the strike and organizing activity. Instead, they have used the war as a pretext to break union power. Under Ukrainian law 5371, signed by President Zelensky in August 2022, workers at firms of under 250 employees would now negotiate contracts directly with their employers. Practically, the law affects 70% of Ukrainian labor protections. [50]

Ukrainian social policy analyst Nataliia Lomonosova said these anti-labor measures predated the war as goals of the government and are designed to help attract foreign investment. Other wartime anti-labor measures include the legalization of zero-hour contracts.[51] The British Foreign Office has advised the Ukrainian government on these anti-labor laws.[52] These efforts harm Ukraine's social fabric and are so extreme that they could damage Ukraine's post-war integration into the European Union (EU). The weakening of labor protections could also disincentivize some Ukrainian workers living abroad from returning home. Union jobs help provide stability and decent wages. As 2.4 million Ukrainians have lost jobs, the government should be looking to rebuild with decent union jobs rather than using the war as a way to push through anti-union measures. [53]

The Trimming of the State

Additionally, the deindustrialization policies favored by the IMF for Ukraine in the 1990s have held up poorly as the country fights a pitched traditional land war. Between 2018 and 2021, Ukraine spent $650 million on 55 French Airbus helicopters for its police and security services.[54] Ukraine possesses a Soviet-era aerospace industrial grid that has fallen in disarray mainly due to the move away from heavy industry as part of the transition to a market economy. The French aircraft have proved far from reliable. In January 2023, a French-made Super Puma Airbus helicopter malfunctioned and crashed outside Kyiv, killing 14 people on board, including interior minister Denys Monastyrskyi.[55]

Historically, the United States has taken a confounding line in terms of letting Ukraine develop its own domestic aerospace and defense industry. Motor Sich, a large aerospace firm with Soviet-era industrial capabilities, was in dire straits after losing Russia as its leading exporter due to the annexation of Crimea. In 2016, the Chinese firm Skyzirion attempted to purchase a controlling stake in the company. While unable to buy a controlling stake, Skyzirion gained a 41% share in the Ukrainian aerospace giant.[56] Fearing that Chinese control of the Zaporizhzhia-based firm would allow the Chinese to produce their own fighter jets and present problems for the United States in its accelerating contest with China, the Trump Administration pushed hard to cancel the deal.[57]

Washington blacklisted the Chinese aerospace firm. The Trump Administration sent over informal advisor and Blackwater founder Erik Prince to pursue an acquisition of Motor Sich on more favorable terms for Washington.[58] To resolve the affair, the Zelensky government nationalized Motor Sich by purchasing back the shares from Chinese investors. The nationalization kept the Americans satisfied by keeping Chinese capital out of Europe.[59] However, it also allowed Ukraine to retain sovereignty over its economic policies and keep Blackwater out of its aerospace sector.

The government took additional wartime nationalization measures on the company. Interestingly, honorary president of Motor Sich Vyacheslav Boguslav was detained by Ukrainian security services during the Russian invasion and accused of collaboration.[60] The whole episode is an example of the Ukrainian state taking reasonable economic actions and pursuing a localized industrial policy that will be crucial in the post-war reconstruction of a stable Ukraine.

Despite the Motor Sich episode, the Ukrainian government has largely been reluctant to undergo the type of large-scale nationalization campaigns typical of a country in its position. Possibly out of fear of sounding Soviet or alarming Western backers, the government has skirted around even the language of nationalization. “This is not nationalization... this is a direct taking-over of assets during wartime. These are totally different legal forms,” Ukrainian defense minister Oleksii Reznikov said on the country’s first use of the wartime legal code to nationalize five strategically essential firms, including Motor Sich, in November 2022. [61]

While this intervention into the wartime economy is a move in the right direction, the rate of wartime privatization has actually outstripped nationalization. Under the period of immediate martial law following the invasion, privatization had been halted. However, the introduction of Law 7451 created an exception allowing privatization to continue.[62] The Ukrainian government approved a list of 420 companies to sort into liquidation, continued state ownership, or directed to the State Property Fund for privatization.[63] The government has justified the privatization campaign on the basis that it can serve as a revenue source for the ailing economy and help transfer property out of combat zones. However, the economic crisis caused by the invasion also means that the assets will not be sold at their highest potential value. The lack of business insurance operating in the country could further problematize the campaign. The unique funding of the war through a combination of heterodox loose money monetary policies and raising revenue through privatization has led economic historian Adam Tooze to describe the wartime Ukrainian economy as a form of “neo-Keynesian shock therapy.”[64]

Shock Therapy Undermines Security

In his remarkably prescient 1994 strategy for Ukrainian defense, grand strategy scholar Barry Posen noted the necessity for an active Ukrainian state in the economy: “If Ukraine wishes to fight a war of any duration, careful planning, organization, and even some investment will be necessary. Some military production capability should be moved to the western part of the country, particularly for the production of ammunition.”[65] While Ukrainian officials have preferred entrance into NATO as a post-war security guarantee, Washington officials are uneasy about the prospect of being dragged into direct conflict with Russia via Ukraine.

At the same time, changes in U.S. domestic politics and general war fatigue make funding Ukraine’s military-industrial complex for an unspecified period of time untenable. The dual reality that a post-war Ukraine will need a strong security state and that it would not be in the U.S. interest to bring it totally into its security umbrella reveals that continued liberalization is not an option.

Under the post-Maidan era of liberalization in Ukraine, around 40 percent of the Ukrainian state's purchases came from foreign countries.[66] Comparatively, the U.S. and E.U. import around 5 and 8 percent of their purchases from abroad. Industries critical to military function, such as aerospace, were hit particularly hard; from 2013 to 2019, exports of aerospace products slipped by 4.8 percent.[67]

State directed-military industrial policy in Ukraine would help the country rely less on Western imports. In a potential future conflict with Russia, localized industry, particularly in the western part of the country, would allow, as Posen predicted, Ukraine to fight a longer protracted defense while staying resupplied.

Additionally, the state-directed military policy can create unity within the armed services. While Western countries have been generous in terms of military aid to Ukraine, the need to provide training and transport supplies to the battlefield has hamstrung some military assistance from being effective. A Ukraine-led effort to direct military production allows Ukraine to dictate what it needs for its own defense rather than relying on an array of different technologies from the diverse NATO coalition.

Military Industrial Troubles

The protection of Ukraine's defense industry is crucial to its long-term stability. As the United States and EU nations warn about a shortage of shells and a breakdown of their military industry, partly due to the arming of Ukraine, the United States should help Ukraine cultivate a semi-autarkic mode of defense production. Ukraine was left with about 30 percent of the Soviet Union's legacy military production.[68] While it was understandable that the country would seek to transfer some of its military production to civilian use, the shock liberalization of the post-Soviet years had extreme effects on the defense industry. When the Soviet Union collapsed, the defense industry employed one million Ukrainians.[69]

By the time of the Russian invasion in 2014, that number had slipped to 250,000.[70] In 2010, Ukraine attempted to rectify some of the damage caused by shock therapy by creating Ukroboronprom, a conglomerate of 134 state-owned defense firms.[71] While this effort has borne some fruit, a lack of state capacity, a muddled procurement process, and corruption plagued Ukronosbom. A ranking of companies by Defense News saw Ukronosbom drop from 68th in 2016 to 97th in 2021.[72] In March 2023, the Zelenksy government took a seemingly positive step to transform Ukroboronprom into a stock company still fully owned by the government, but with a more corporate structure and ability to attract investment.[73]

As part of the Ukronosbom reform process and as an acknowledgment of its export-driven defense industry, Ukraine created the Ministry for Strategic Industries in July 2020.[74] Prime Minister Shmyhal said the new ministry would focus on industrial development in the military and technology sectors.[75] However, so far into the war, the new ministry has suffered from the same tepid inaction that has plagued other sectors of the Ukrainian war economy.

"But over a year into a full-scale war with Russia, the ministry remained almost completely non-functional. It has not yet developed any long-lasting, comprehensive strategy that could gradually enable the mass production of hardware and munitions in Ukraine," Ukrainian defense correspondent Illia Ponomarenko wrote on the Ministry for Strategic Industries.[76]

Fed up with the failure of the recently created ministry in its first major task, former head of Ukrainian Railways Oleksandr Kamyshin took over the Ministry of Strategic Industries.[77] While announcing his appointment, First Deputy Prime Minister Yulia Svyrydenko reiterated the need for the localization of defense production, "Ukraine cannot always rely solely on weapons of its allies. The domestic defense industry is a priority for the president and the government, both now and after the war is over."[78]

While he has a slightly unorthodox background, Kamyshin is a serious operator with solid experience delivering results for state-owned enterprises. He helped organize President Biden's successful "Rail Force One" trip to Ukraine and has earned plaudits for his ability to keep Ukrainian railroads operational during the war.[79] Kamyshin's appointment allows the United States to discuss how Ukraine will adopt a more self-sufficient defense posture after the war.

Despite the positive steps by the Ukrainian government to reform its defense industry while seemingly keeping it under direct state control, general anti-state economic orthodoxy still permeates the country. While Svyrydenko seemingly understands the need for autarky, she also places a priority on market fundamentalism, "The state should not manage businesses—a private owner will do it much more efficiently."[80]

The creative destruction of the market and the power of competition is evident in peacetime economies. However, a failure to directly manage the economy can seriously affect battlefield performance and operations. While it is understandable that Ukraine would ask for any available weaponry as it fights a war it regards as existential, a muddled sense of procurement from multiple sources has created a standardization problem for the Ukrainian military. The Defense Department has defined interoperability as key to Ukraine's ability to fight a long war. Standardization procedure will require the state to set certain guidelines in production.[81]

The immediate threat to the Ukrainian defense industry is, of course, Russian bombs. The defense industry has played a key role in the maintenance, rather than production, of new weapons. However, if handled correctly, the potential exists for a stable, robust post-war Ukrainian defense industry. The Russian flagship Moskva was destroyed by a missile designed and produced in Ukraine.[82]

Ultimately, Ukraine's defense industry will only be partially autarkic. Turkey's Bayraktar drone firm is looking to open a plant in Ukraine.[83] This creates the possibility of a two-tiered post-war Ukrainian defense industry that primarily imports 21st-century defense capabilities, such as drones, while producing its heavy military capabilities on its home front by relying on its own industrial complex.

Procurement Problems

After the 2014 Maidan revolution, the U.S. government pushed for a series of anti-corruption reforms aimed at increasing market competition and private enterprise in Ukraine. One of the significant reforms was changes to Ukrainian's state procurement process. ProZorro, a new form of open-source electronic state procurement, was created with help and encouragement from USAID after Maidan. [84]

ProZorro has had some success in saving the Ukrainian government money- by some estimates, the as much as $6 billion.[85] However, its efforts to prevent backroom deals and graft through bidders taking several months to compete for government contracts electronically can be problematic during a crisis.

Already during COVID-19, President Zelensky looked to override ProZorro as part of his promise to deliver lightning-fast results.[86] Similarly, during the Russian invasion, some Ukrainian officials clashed with ProZorro's bureaucratic nature and its tendency to sideline domestic Ukrainian industry. The mayor of Dnipro, Boris Filatov, has furiously clashed with the Zelensky government on its insistence that wartime military procurement go through ProZorro.[87] The procurement website has no way to ensure that local firms are receiving priority, and for Mr. Filatov, such bureaucracy only helps the Russian invaders. Additionally, while ProZorro's patented form of openness is useful in fighting corruption, such matters could undermine Ukrainian operational security.

In 2023, the Ukrainian government temporarily canceled the ProZorro system due to Russian shelling shutting off electricity in certain areas, making for an unfair auction process.[88] The suspension will be a telling period of whether ProZorro is helpful for a state fighting a war of survival. Additionally, USAID and other groups can use the suspension to evaluate whether the program makes sense for a post-war Ukraine. ProZorro is reflective of a post-Maidan era of Western economic policy toward Ukraine that prioritized liberal anti-corruption politics while in actuality hampering state capacity.

What Must be Done

The World Bank has assessed Ukrainian reconstruction costs to be $411 billion.[89] It has become popular in the West to suggest that Russia can pay the cost of Ukrainian reconstruction if the United States and E.U. seize frozen Russian bank assets. As a moral argument, it makes intuitive sense to make Russia pay for the war it inflicted upon a sovereign country. However, the seizing of the assets faces serious legal hurdles. Additionally, the immediate seizure of assets gives up another point of leverage the West could use to help pressure Russia into a negotiated settlement or ceasefire. The reality is that the West will and should pay for much of Ukraine's reconstruction.

Additionally, by paying for reconstruction, the United States can put pressure on the Ukrainian government to bolster its military-industrial complex and not have to rely as much on Washington in a potential future conflict. In 2021, Ukraine passed bill 3739, which was designed to localize state purchases and reindustrialize the country.[90] The original text of the bill was heavily criticized by Washington and Brussels, with some charging that the localization of production would lead to corruption.

The amended bill passed into law, exempted the E.U. and United States from the state purchasing requirements. The successful rebuilding of Europe after World War II saw the United States take similar protectionist measures to support the growth of West German industry. In a post-war environment, it would actually be in the interest of the Europeans and Americans that Ukraine develops localized military production and prioritize state purchases from Ukrainian firms as a way to spur economic growth and rely less on Western backers.

The country will need to attract foreign capital as part of its rebuilding process. However, it should not feel that it has to undertake radical measures such as the crushing of labor unions and privatization measures to bring in necessary investment. Business and investment can be attracted through the development of new forms of business insurance. U.S.-led debt forgiveness measures or a short-term Ukrainian 'debt jubilee' would go a long way to inspire confidence in Ukraine's financial situation, allow for businesses to operate with a more stable macroeconomic picture, and take the pressure off Kyiv.

Private capital should be naturally attracted by the end of hostilities in the region. The return of millions of motivated Ukrainian refugees, many of whom will need new employment, will spur investment. However, the Ukrainian government should also turn inward to raise capital. Even pro-market publications, such as the Centre for Economic Policy, have advocated for raising taxes, specifically on Ukrainian oligarchs.

The war has vastly reduced the wealth of many oligarchs, as much of their assets in heavy industry or agriculture have been destroyed. While reconstruction presents opportunities for a new wave of oligarchs, the government can get ahead of this issue by increasing taxes on existing Ukrainian oligarchs. The Pandora Papers leaks revealed that 38 Ukrainian politicians hid capital through offshore companies, the most of any country included in the papers.[91] Ukraine should work with partner countries to make sure offshore oligarch money is returned to Ukraine. Oligarchs found to be hiding money abroad could even be subject to a one-time patriotic reconstruction tax. Policies such as these are illustrative of the way Ukraine could turn its wartime nationalism into a broader sense of post-war economic nationalism and stability.

At a time when the war has shown a revival of Ukrainian nationalism and faith in the state to defend Ukrainian territory, it would be a foolish and short-sighted policy to force upon the country a series of ideological policies that have failed it so many times and undermine the power of the state. Already, liberalization policies are undermining the country's security as it cripples their wartime economic efforts. A 2019 survey of Ukrainians found that 73% favored a larger state role in the economy and regulated industry.[92] The current round of shock therapy being discussed for Ukraine by Brussels, Washington, and some Ukrainian lawmakers is out of touch with the views of the Ukrainians fighting and dying to defend their homeland. A prosperous and self-reliant post-war Ukraine cannot be sold off for scraps.

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