

Ukraine's Post-War Reconstruction: Taking the Path Toward Strategic Victory

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KEY TAKEAWAYS

Post-war reconstruction offers a historic opportunity for Ukraine to radically break away from the Soviet legacy that has hindered its development.

Reconstruction must have as its principal aim private sector-driven economic integration into Western institutions—not passive receipt of massive donor aid.

Ukraine's Western integration could refresh Europe's moribund security posture by moving the European Union's center of political gravity eastward.

May I express my joy at returning to beautiful Budapest after many years.

There are three points I want to make for today's conference on the new geo-strategic environment for transatlantic cooperation, values concerning Ukraine's post-war reconstruction, and its future strategic implications:

- First, post-war reconstruction offers Ukraine a historic opportunity to radically break away from the Soviet legacy that has hindered its development since independence and to end its subservient economic reliance on Russia.
- Second, reconstruction must have as its principal aim private sector-driven economic integration into Western institutions, not passive receipt of massive donor aid transfers.

This paper, in its entirety, can be found at <http://report.heritage.org/hl1336>

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- Third, Ukraine's Western integration could refresh Europe's moribund security posture by moving the European Union's [EU's] center of political gravity eastward toward its more security-minded Members.

Not Whether, But How

When discussing Ukraine's post-war reconstruction, we must settle on a strategy that works. We have tried donor-centered reconstruction in many places and failed many times, wasting hundreds of billions of dollars in U.S. taxpayer money. Ukraine undoubtedly will need massive amounts of funding to rebuild its cities and industrial base. The question is not whether to help Ukraine meet those needs, but how.

We must keep in mind that no country has grown wealthy through foreign aid. Rich countries emerge through pro-growth, free market-based, export-driven, and investment friendly policies that economically liberate the entrepreneurial energies of their own people and that attract foreign capital. Therefore, Ukraine, and its willingness to make tough and permanent reforms, must bear the primary responsibility for the success of any Western-backed post-war reconstruction initiative.

Government-to-government aid negatively reinforces state-directed economic planning that is characteristic of the Soviet model of development (albeit today through the medium of state-sponsored oligarchs), and it discourages genuine reforms that reduce state controls over the economy—a necessary condition to boost economic growth. Contrast Ukraine with high-growth Baltic states, Poland, and other neighbors that suffered the same Soviet legacy. The latter are living proof that the issue is about policy choices—not legacy, geography, or culture.

Generating Economic Growth

For 30 years, traditional foreign aid approaches in Ukraine assigned the state the lead role in generating economic growth. From 1992 through 2021, Kyiv received more than \$30 billion in assistance from the European Union, \$8 billion from the United States, \$23 billion in soft loans from the International Monetary Fund, and billions more from other donors. The outcome? Ukraine fared poorly on most economic indices and remained economically beholden to Russia.

There are already calls for more of the same, including a push for a \$100 billion reconstruction fund to be financed by the U.S. government. There is no political appetite for that in the U.S., nor is there in Europe.

That approach has been tried many times. *It does not work.* If retried in Ukraine, it will fail and leave the country weak and vulnerable to another Russian attack.

My view is that Ukraine must take another approach to reconstruction. The massive funding Kyiv needs to rebuild is not to be found in other governments' coffers, but in private capital markets that eagerly seek attractive investment opportunities. In 2021, total global equity stood at \$124 trillion, dwarfing Ukraine's rebuilding needs. Countries that attract capital create wealth. Countries that erect barriers to it see high debt, political instability, and poverty.

Creating a Reconstruction Strategy

What does a private sector-driven reconstruction strategy for Ukraine look like?

First, Ukraine must eliminate all obstacles to its small- and medium-sized businesses. Tens of billions of dollars of capital are held by Ukrainians ready to start and restart new family enterprises. Many are already doing so and showing resilience amid great adversity. Small and medium-sized enterprises (SMEs) are the true engine of sustainable job creation and a stable tax base. SMEs will create domestic feeder enterprises for what will likely be a massive construction-led boom. In effect, the Ukrainian government must get out of the way of the entrepreneurial spirit of its own people.

Second, Eastern European companies have operated in Ukraine for years and are likely to be the first wave of foreign investment in Ukraine. Russian aggression has forced Ukraine to seek alternative export routes through Poland, Romania, and Bulgaria, exposing the need for upgrading regional infrastructure that would, in turn, further integrate their economic futures while marginalizing those with Russia. EU accession should accelerate that process.

We should keep in mind that Ukraine's more than 40 million people represent a large and educated market. Millions of Ukrainians are working in Europe and are already economically acculturated into Europe's way of doing business. But will corruption—which always grows in periods of post-war economic expansion for the simple reason that there is more money to steal—and bureaucratic red tape stand in the way of progress? Reducing the state's economic role reduces the opportunities for corruption. The answers ultimately will determine Ukraine's post war success or failure.

Third, Ukraine's large infrastructure and industrial-size project needs can be financed by global capital through privatization schemes,

design-build-operate agreements, corporate financing, and co-investment through joint ventures. Ukraine is a critical energy hub with stores of natural gas, coal, hydro, and nuclear power that could end Europe's energy reliance on Russia. Ukraine is a major global supplier of food that can stabilize food prices for developing countries.

The Big “If”

With the right policies—and this is the big “if”—Kyiv could attract tens of billions in global capital. But to do so, it must be willing to cede government control of major sectors of the economy and forego the political patronage opportunities that come with it. It requires Kyiv to shut down or sell off its 3,300 money-losing, corruption-filled state-owned enterprises (SOEs), many of which have been destroyed during the war and should not be revived. Moscow has used Ukrainian SOEs as instruments of economic control.

Why Should This Matter to the U.S.?

It matters quite a bit.

From the American security perspective, Ukraine's integration into Europe could move the continent's political center of gravity eastward toward more security-minded Eastern Europe that has shown the political will to take more responsibility for Europe's collective defense and expend resources to back it. Meanwhile, Western Europe still lags, more than one year into the war.

With the Communist China threat demanding more U.S. resources to defend our strategic interests in the Indo-Pacific, it is critical that Europe provide for its own defense. Ukraine's western integration would tilt the political balance toward Eastern Europe and act as a healthy counterweight to Germany, France, and Italy, each of which favor short-term commercial benefits of engagement with Russia (and China) rather than addressing strategic risk through higher defense spending.

Ukraine also affords the U.S. an experienced defense production partner that could maintain the Kyiv-Washington partnership into the post-war period, as would strategic U.S. energy and agribusiness investments. With Ukraine's agricultural and fertilizer production capacity better capitalized, one could see Ukraine displace Russia as global leader on food diplomacy and draw Africa and other fragile food importers away from nefarious Russian influence. That said, should China, which has backed Russia's

aggression against Ukraine, swoop in and win post-war reconstruction contracts, that would be a deal breaker for continued American support and again leave Kyiv subject to the political whims of Western Europe.

Max Primorac is Director of the Douglas and Sarah Allison Center for Foreign Policy Studies at The Heritage Foundation. This lecture is taken from remarks made on May 27, 2023, in Budapest, Hungary, at “The New Geo-Strategic Environment for Transatlantic Cooperation and Values” event sponsored by The Heritage Foundation, International Republican Institute, International Center for Development and Democratic Transition, Danube Institute, and the Hungarian Atlantic Council.