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POLICY BRIEF

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Economic resilience, social dialogue and democracy in wartime

Critical reflections on the challenges
facing Ukraine's economy

*An interview with LRT, the Lithuanian public
broadcaster*

Luke Cooper



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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.

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Background

Justinas Šuliokas, a journalist with LRT, the Lithuanian public broadcaster, interviewed Dr Luke Cooper, the Director of PeaceRep's Ukraine programme, on the 16th December 2022. The article was initially published in Lithuanian on the 2nd January 2023.¹ This English language version is reprinted by LSE and PeaceRep with the permission of LRT. Some minor drafting edits have been made in the preparation of the English language version.

Author

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¹ Justinas Šuliokas, LRT.lt, 'Laisvąją rinką karo nelaimėsi – britų tyrėjas kritiškai vertina Kyjivo ekonominę politiką' 2nd January 2023 <https://www.lrt.lt/naujienos/pasaulyje/6/1850384/laisvaja-rinka-karo-nelaimesi-britu-tyrejas-kritiskai-vertina-kyjivo-ekonomine-politika> (Accessed 3 January 2023).

Introduction

States at war tend to centralise their economies. This allows investment, labour and economic resources to be directed to the demands of the war. Ukraine is currently doing the opposite, pursuing liberalisation and economic deregulation, while attempting to fight a war of self-defence. This may undermine its war-effort and even risk the unity and stability of the state.

Political scientist Dr Luke Cooper, a researcher at LSE IDEAS, the LSE's foreign policy think tank, has [recently criticised](#) the economic policies currently being pursued by the Ukrainian government.² He argues that they rely too heavily on free-market ideology and disregard the lessons of previous conventional wars in history; namely, that central planning, close cooperation with unions, and the social protection of workers, are necessary to keep society mobilised and to avoid economic and social collapse.

The Ukrainian authorities have undertaken labour market reforms. They have suspended much of the labour code and the rights of workers enshrined therein. Ukrainians working in companies with fewer than 250 employees – around 70% of the country's workforce – can now easily be dismissed, forced to work overtime, and have lost their collective bargaining rights. At the same time, the government has embarked on an extensive privatisation programme, committing to offer some 420 state-owned enterprises to private investors. Dr Cooper argues that now is not a good time to sell state assets off and that Ukraine may be repeating “the mistakes made after the collapse of the Soviet Union”.

Justinas Šuliokas,
2nd January 2023

Key points

- States fighting conventional wars tend to centralise their economies in order to direct resources, investment and labour to where they are needed to win the war. Ukraine is doing the opposite.
- The Ukrainian government has suspended much of the country's labour code designed to protect workers' rights, even though it should at this moment be seeking closer social dialogue with the trade unions and the working class that will have to bear a heavy burden in order to win the war and rebuild the country afterwards.
- The planned privatisation programme undertaken by the Ukrainian Government could repeat some of the mistakes made after the collapse of the Soviet Union in the 1990s.
- The sharp economic downturn, increased unemployment, regional imbalances and a lack of opportunities *per se* increase the risk that society and the state will fragment. In other war zones, similar conditions combined with the wide availability of weapons have sometimes led to civil conflicts, violent outbreaks and state collapse.
- A strong state role in the economy will be essential not only for Ukraine to win the war, but also to rebuild the country after it. Private investors and liberalised markets will not do it.
- Ukraine joining the European Union is unlikely in the short or even medium term, and, in any case, the rapid entry of a country at war into a large and highly integrated free trade area could have negative unintended consequences. However, the EU could support Ukraine's reconstruction with grants - not loans - and preferential trade terms: allowing it to export Ukrainian goods to the EU, but shielding its industry from competition from stronger and more developed Western firms.
- Ukraine's economy has fallen into a deep recession this year as a result of the war, with the World Bank forecasting a contraction in GDP of a third this year. Unemployment in the country topped 28% in October. Even the incomes of employed workers have fallen considerably due to wage cuts combined with high inflation.

² Luke Cooper, PeaceRep-LSE, 'Market economics in an all-out-war? Assessing economic and political risks to the Ukrainian war effort', 1st December 2022, <https://peacerep.org/publication/market-economics-ukraine/> (Accessed 3 January 2023).

How would you describe Ukraine's economic policy during the war?

First of all, states fighting conventional wars, as Ukraine is doing now, are usually forced to take a large part of the economy into their own hands in order to direct capital, labour and business to the demands of the war-effort. So, the economy becomes quite centralised.

This is necessary because a market economy cannot function normally during wartime. For example, insurance does not work in the same way as it does in peacetime; private insurers simply cannot take on the risk when a country is bombed. And that is why states fighting conventional wars have always resorted to massive interventions in the economy to counterbalance collapsing private demand and possible recession. This usually creates war-related demand – for weapons, for food for soldiers, for economic activity - and so on. Perhaps surprisingly, economies often grow during wars.

In Ukraine, unfortunately, we do not see a conventional war economy. We see a mixture of different elements. GDP has collapsed by more than a third this year, Ukraine is in a very severe recession and unemployment has increased. Of course, a large number of workers have left the country or have become internally displaced within the country and their unemployment is a particular problem.

It is true that Ukraine's economic policy has some elements of centralisation. The state has taken over some of the businesses needed for the war, and not only from oligarchs linked to Russia. This is a good sign.

There is also a programme to organise the unemployed to construct and support humanitarian and military infrastructure. The army is also taking part in this new programme, which only started in October. The question remains whether Ukraine will have the resources to implement it on a large enough scale to really address the unemployment crisis.

So, there are elements of centralisation, but I am afraid that overall the picture is one of deregulation of the economy and reliance on free market mechanisms. A free market economy in a time of total war, I believe, poses very serious risks to the Ukrainian war effort.

It is worrying that Ukraine has abolished a large part of the worker protection measures and labour laws at the very time when a strong social partnership is needed with the people working in the industries needed for war.

So, from my perspective, there is a clear problem: the elements of centralisation and state direction are insufficient to rise of the challenge of the situation. We

Now is not a good time to sell state assets off... Ukraine may be repeating the mistakes made after the collapse of the Soviet Union.

want Ukraine to win, and to do that it needs an effective war economy that builds and develops the resilience of the entire population at this difficult time. Unfortunately, this is not the case at the moment.

How is this suspension of some workers' rights justified?

The justification is, in my opinion, rather weak. Before the escalation of the war, the Ukrainian Government made it clear that it wanted to reform the labour code in order to abolish or limit certain workers' rights. The government argued that this would lead to the creation of a more dynamic market economy. So, it had already drawn up a number of labour market reforms before the war, but at that time the trade unions staged major protests and successfully blocked them.

Now these reforms have been introduced as a wartime measure, not as permanent changes?

True. Most were introduced as temporary measures. It remains to be seen whether the previous labour laws will be reinstated when the war is over.

But in any case, workers need even stronger social protection during wartime than before. And most of all, during wartime, dialogue with the trade unions representing workers is needed, because sacrifices will be demanded of them.

The war is a terrible situation, a humanitarian crisis, and Ukraine is also facing an infrastructure crisis. The burden and hardship on the population is, of course, very difficult. And in this situation, it is important to talk to the working classes and the trade unions, to negotiate what that burden will be, so that they feel listened to and have a stake in how the war-effort is being conducted.

This is the element of these labour market reforms that worries me the most. The trade unions have not been consulted. The government has even boasted that it does not believe in collective structures of worker representation, which is bad in itself. The idea that workers should only negotiate individually with their employers, which was bandied about when these measures were introduced, is very problematic. It ignores the inequality of power between managers and employers, recognition of which underpins all social and employment legislation designed to protect workers.

What is driving Kyiv to pursue such a radical liberalisation policy? Is part of the elite simply using the war to push through the reforms

they have always wanted, or does the government genuinely believe that such measures will help win the war?

I am an outsider, speaking from London, but I have spent a lot of time interacting with Ukrainians over the last year. From what people have said, I have the impression that the Ukrainian Government is ideologically firmly committed to the vision of a small state, which we could perhaps call neoliberal, and that it genuinely believes that this is the best way to safeguard democracy.

This stems from the perspective that any economic centralisation is associated with the Soviet Union and decentralised markets are, in contrast, associated with democracy. I can understand that. However, I would say that this approach lacks nuance, especially now that many societies around the world are beginning to rethink the logic of the free market.

Just look at the Biden administration in the US. There is no longer a "Washington Consensus" on free markets. The prevailing view now is that the state must intervene and create a strong social safety net for all, because we are living in a period of crisis and we want to build a sustainable, green future.

Of course, there is a lot of debate about how to achieve this in concrete terms, but there is a new consensus, which cuts across both left and right, that free markets left unattended will not do it.

It seems to me that Ukraine, or part of the intellectual elite pushing these reforms, is somewhat behind the tide of political and economic thinking on this issue. Although ordinary Ukrainians, in contrast, are perhaps closer to this evolving norm than the intellectual elite.

Liberalisation advocates argue that the Ukrainian state is simply too corrupt and too weak to be able to adopt an active policy of economic diversion. Do you find these arguments valid?

I have no doubt that they identify a real problem. I do not doubt the analysis that shows that there is a problem of corruption in state-owned enterprises and in the Ukrainian state in general.

However, such an analysis, which says that it will be a

big challenge for this country to create a state-regulated war economy, does not negate the fact that all the countries that have successfully fought conventional wars have had state-regulated war economies.

However, instead of saying that, "although it will be very difficult to achieve what is needed, it is nevertheless necessary to try", they say: "we will do things in a completely different way, even though we know that this is unlikely to work". I must say I find that quite problematic.

In your report,³ you also write that, if Ukraine continues with its current economic policies, it is threatened with the fragmentation of society and the state and, in an extreme case, it could even turn into a failed state. Can you explain?

Here some context is needed. In the LSE programme that I am part of, I work with the Ukraine team. My colleagues are also looking at Somalia, Sudan, South

Sudan, Syria. They are all very different from Ukraine. They are all caught up in situations of intractable violence that could be described as civil wars, but where there are many different sides fighting.

Ukraine is very different. It is fighting a "normal", i.e., conventional, war. What is happening in Ukraine is terrible, but if it remains a conventional war, we know from history that all conventional wars end in some kind of agreement. Unconventional wars, unfortunately, often end in the collapse of the state and the emergence of a multiplicity of actors with a political and economic interest in maintaining the cycle of violence. This is essentially what has happened in Syria, in South Sudan and in many other places.

Usually, this situation arises when there is a combination of factors - very rapid economic liberalisation, recession, widespread availability of weapons, sectarian politics and authoritarianism. Not all of these factors are present in Ukraine, and I hope that they will not become present.

However, if the government continues with its economic

The prevailing [global] view... is that the state must intervene and create a strong social safety net for all, because we are living in a period of crisis and we want to build a sustainable, green future.

³ ibid

liberalization agenda it will likely lead to rising unemployment, further emigration of workers, major regional economic imbalances. We have a domestic population which is tilted towards men (because women and children are allowed to leave), has consciously been armed by the state and where unemployment is high.

For conflict analysts, these are usually taken as warning signs: the widespread availability of weapons, combined with the lack of economic opportunities and jobs, the weakening and potentially even collapse of the state, should sound alarm bells. This scenario would be very bad for Ukraine, creating the preconditions for a potential outbreak of unrestrained violence.

Of course, there are also countervailing trends in relation to this. The incredible support of Ukrainians for their country, the resistance of the population, etc. These are serious and vital countervailing factors. So, I am not saying that it will happen. I am just saying that it is worth bearing in mind the specific risks and making sure that everybody has a decent job, a roof over their head, as far as possible, to work in areas that contribute to the country's war effort. That is the best way to prevent the risk of fragmentation and weakening of the state.

And what kind of economic policy will Ukraine need to rebuild the country after the war?

It will need enormous economic support, much more than it receives now. One thing we have not talked about yet is internal taxation. Ukraine should collect much more taxes from its population, both for the current war effort and for future reconstruction.

It currently has a non-proportional tax system, with income tax for the self-employed dropping to just 5%. There is also an additional war tax, but this is also not proportional, i.e., it is a flat tax which is not dependent on income. So, progressive taxation will also be very important in the reconstruction of Ukraine. The higher earners will have to pay more, and the incomes of the lowest earners will have to be protected as much as possible.

And there is also a huge job ahead of us to rebuild the destroyed infrastructure. Thinking about how to rebuild better should look to the EU's example of the New Green Deal, new sustainable energy and infrastructure, and so on.

I think one of the more difficult questions is how to get the balance of regional development right. At the moment, the government is encouraging companies to retreat from the more war-affected eastern regions, and this is perfectly logical. However, during the reconstruction period, there is a risk that western Ukraine will do well and eastern Ukraine will do worse, that regional inequality will grow. So, what is needed is an effective policy of redistribution between regions, measures to combat regional, as well as social

inequalities.

What kind of balance between state intervention and the free market would be needed?

The state has a huge role to play in the reconstruction. Even if there is a peace agreement, or perhaps just a ceasefire, the situation for private investment will be very precarious. Private investors are risk-averse because their main motivation is to secure a return, which is understandable.

But this means that there is a clear link between the war economy and the needs of a future post-war reconstruction, because both phases require a strong state that defends the public interest, mobilises resources, provides employment, pursues effective regional policies and achieves sustainable development. The state will therefore have to play a central role.

And yes, this will mean higher taxes and reforms in state-owned enterprises, although probably not 7privatisation. Of course, Ukraine has a large number of state-owned enterprises and there is no doubt space for some 7privatisation, but the question is whether it will be possible to get an adequate price for these assets now or during the reconstruction period. I suspect not, because the situation is too unstable, and there is a risk of giving away valuable state assets for a low price.

This would also undermine the Government's anti-corruption objectives and repeat some of the mistakes made after the collapse of the Soviet Union.

Moreover, in terms of reconstruction, Ukraine has high hopes for EU membership. Is this a realistic ambition?

I think it is realistic, but not in the short term. It will probably take several decades.

It seems to me that EU Member States can be divided into two groups, which do not really agree on this issue. One group is the countries that support enlargement to Eastern Europe, but only if the EU's decision-making mechanism is reformed to reduce the role of the veto and increase qualified majority voting. This group consists mainly of the larger EU members.

The other group is made up of countries that support further enlargement to Eastern Europe, but are not so keen to change the EU's decision-making mechanisms. These are mostly smaller states, which I believe may include the Baltic States.

So, the European Union has to reach some kind of compromise. I think an agreement is possible, but it may take time. So, I doubt that Ukraine will join the EU any

time soon.

In addition, its membership would require geopolitical stability. Would a peace treaty with Russia be necessary for Ukraine to meet the membership criteria, or would a ceasefire suffice? Will we have to wait for a change of government in Moscow before signing a peace agreement? This is a really difficult question.

So, I think that Ukraine should now seek as much influence as possible in shaping European integration policy and as much support as possible from EU countries for the development of its economy. It needs grants, not loans, and it needs as much support as possible for reconstruction.

EU membership might not be an entirely positive thing – on the one hand, Ukraine would receive financial and institutional support, but, on the other hand, its industry would be open to competition from stronger Western European companies, and it would probably experience a significant outflow of manpower. What could be the balance between the advantages and the possible negative consequences of membership?

Yes, I completely agree with the assumptions underlying the question.

Recently, the ECFR think-tank produced a report entitled 'Survive and Thrive', which calls for Ukraine to be admitted to the single market without waiting for anything.⁴ There are many useful things in this report – such as the idea for partnerships between Western and Ukrainian arms manufacturers – but the basic proposal for Ukraine to join the EU single market immediately is deeply flawed.⁵

First of all, the entry of a country at war into what is the world's second-largest and certainly the most closely integrated free trade area is unprecedented, both in Europe and globally. And there is no way that Ukraine could compete on an equal footing in the common market with the much richer EU countries at peace. Such a relationship would inevitably lead to radical liberalisation and market-driven reconstruction – exactly as I warned earlier.

So, it is a well-intentioned but flawed proposal. It would not be in Ukraine's own interests to join the single European market immediately, in a war situation. Instead, Ukraine needs preferential treatment. The EU could say to Ukraine: "We have a fairly open free trade agreement at the moment, but we will allow you to impose tariffs on EU goods in areas where you feel it necessary to protect your internal market. Normally we would impose retaliatory duties in such cases, but this time we will not do so because we understand your particular circumstances."

I think the European Union could consider something like this - individual, tailor-made, smart economic conditions for Ukraine.

⁴ Piotr Buras, Marie Dumoulin, Gustav Gressel and Jeremy Shapiro, ECFR, 'Survive and thrive: A European plan to support Ukraine in the long war against Russia', 9 September 2022, <https://ecfr.eu/publication/survive-and-thrive-a-european-plan-to-support-ukraine-in-the-long-war-against-russia/>, (Accessed 3 January).

⁵ Luke Cooper and Mary Kaldor, ECFR, 'In Europe's gift: How to avoid a Ukraine "forever war"', 26 September 2022, <https://ecfr.eu/article/in-europes-gift-how-to-avoid-a-ukraine-forever-war/> (Accessed 16 January 2023).

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PeaceRep's wider consortium members include: Conciliation Resources, Conflict and Civiness Research Group at LSE, Coventry University's Centre for Trust, Peace and Social Relations, Dialectiq, Edinburgh Centre for Constitutional Law, International IDEA, LSE Middle East Centre, Queens University Belfast, University of St Andrews, University of Stirling, and the University of Glasgow.

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