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ECONOMIC
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Edited by Yuriy Gorodnichenko and Vladyslav Rashkovan

Supporting Ukraine: More critical than ever

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CEPR

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Vladyslav Rashkovan

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Contents

| | |
|--|-----------|
| Introduction | 1 |
| Yuriy Gorodnichenko and Vladyslav Rashkovan | |
| 1 Why helping Ukraine helps all humanity | 3 |
| Andriy Pyschnyy | |
| 2 Democracy needs Ukraine to win | 7 |
| Daron Acemoglu and Simon Johnson | |
| 3 Helping Ukraine is not only crucial for peace in Europe but also for world peace | 13 |
| G rard Roland | |
| 4 The fiscal case for Europe to ‘go Dutch’ on defence | 17 |
| Hanno Lustig | |
| 5 The peace dividend can be saved in Ukraine | 23 |
| Yuriy Gorodnichenko | |
| 6 Observing freedom’s vanishing act | 27 |
| Noam Yuchtman | |
| 7 Why it is imperative to help Ukraine | 31 |
| Sergei Guriev | |
| 8 How Ukraine can finish the unfinished transition agenda | 35 |
| Torbj rn Becker | |
| 9 Russia’s imperial war and the need for assistance to Ukraine during and after the war | 41 |
| Jan Svejnar | |
| 10 Why the world needs Ukraine as much as Ukraine needs the world | 45 |
| Harold James | |
| 11 Ukraine has finally started to exist on Germany’s map | 49 |
| Klaus Adam | |
| 12 Ukraine is the latest Guernica. Let’s make it the last | 53 |
| Maurice Obstfeld | |
| 13 Why does Ukraine matter so much to me? | 57 |
| Charles Wyplosz | |
| 14 Why the West must not waiver in its support for Ukraine: Three critical issues | 61 |
| Adonis Yatchew | |
| 15 Why Ukraine must be given full support | 65 |
| Anders  slund | |

| | |
|---|------------|
| 16 Supporting Ukraine with sanctions has been much less costly than many predicted - we should do more of it | 69 |
| Benjamin Moll | |
| 17 Why it is imperative to help Ukraine | 75 |
| Rüdiger Bachmann | |
| 18 Postwar reconstruction assistance and local governments in Ukraine | 81 |
| Roger Myerson | |
| 19 Why central banks around the world should be interested in Ukraine's victory | 85 |
| Sergiy Nikolaychuk | |
| 20 The all-out aggression requires an all-out response | 89 |
| Oleksiy Blinov and Simeon Djankov | |
| 21 The Russian invasion and the risks to global financial stability | 95 |
| Stephen G. Cecchetti and Kermit L. Schoenholtz | |
| 22 Why the West needs Ukraine and its IT business | 101 |
| Monika Schnitzer | |
| 23 Latin America's duty to stand with Ukraine | 105 |
| Vanessa Rubio-Márquez and Francisco Varela Sandoval | |
| 24 From local regions in the EU to those in Ukraine (and back again): How FDI and global value chains tie our local economies together | 111 |
| Riccardo Crescenzi and Oliver Harman | |
| 25 Trade, war, and reconstruction | 117 |
| Philippe Martin, Thierry Mayer and Mathias Thoenig | |
| 26 Why the West should help Ukraine win: The economic arguments | 121 |
| Basil Kalymon | |
| 27 Ukraine deserves what others of us in Eastern Europe got - the EU | 125 |
| Wojciech Kopczuk | |
| 28 Foreign support to Ukraine: Evidence from a database of military, financial, and humanitarian aid | 129 |
| Christoph Trebesch | |
| 29 Ethics and enlightened self-interest pointing towards standing with Ukraine | 147 |
| Refet S. Gürkaynak | |
| 30 The West benefited tremendously from expanding to Eastern Europe - supporting Ukraine is likewise in its best interest | 151 |
| Michał Wyrebkowski | |
| 31 Italy should do more for Ukraine | 155 |
| Tito Boeri and Roberto Perotti | |
| 32 Why Ukraine's triumph is important for Latin America | 159 |
| Federico Sturzenegger | |

Introduction

Yuriy Gorodnichenko and Vladyslav Rashkovan

University of California, Berkeley and CEPR; IMF

1

Russia invaded Ukraine on February 24, 2022. The war brought destruction, death and suffering at a level not seen in Europe since the Second World War. Against very long odds, Ukraine continues to fight for its freedom and independence. Many countries support Ukraine by providing defence equipment, humanitarian relief, and economic aid. The war is far from over and international support will continue to play a critical role. As we approach the one-year mark of the Russian invasion, it is important to reflect on why Ukraine's fate is important for all of us.

To this end, a group of prominent scholars, experts and policymakers have written essays presenting their arguments for why Ukraine deserves extraordinary support from the global community. The essays, which are collected in this eBook, are a mixture of research, personal accounts, case studies, and historical comparisons. The diversity of arguments shows that the war has enormous implications for a broad spectrum of issues ranging from world peace to proliferation of nuclear weapons to international trade to food security to inflation to democracy to human values. Clearly, liberty, freedom and welfare for each of us are at stake. Even if one does not care about Ukraine per se, one should support Ukraine out of sheer self-interest, for if Ukraine does not defeat the Russian aggression the world is likely to enter a genuinely dark era. Indeed, the success of Ukraine both now and after the war is over is essential for preserving hard-fought gains in human rights, prosperity, and security across the world.

We are grateful to everybody who contributed to this eBook.¹ We hope that their perspectives will give ammunition for many current and future debates about if, when and how the global community should help Ukraine to withstand this Russian war of aggression. By helping Ukraine, we are choosing a better future for ourselves and generations to come.

ABOUT THE EDITORS

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¹ The editors also thank CEPR staff, particularly Sophie Roughton and Anil Shamdasani, for their extremely hard work in getting this eBook published to very tight deadlines.

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CHAPTER 1

Why helping Ukraine helps all humanity

Andriy Pyshnyy

Governor, National Bank of Ukraine

GLOBAL WAR AND ITS MANIFESTATIONS

During the recent Munich Security Conference, the UK Prime Minister Rishi Sunak and US Vice President Kamala Harris agreed that Putin's war on Ukraine is a global war, "both in terms of its impact on food and energy security and in terms of its implications for internationally accepted norms like sovereignty."

This statement sends an important message to many Western politicians and 'opinion leaders' who are still pushing a narrative that misrepresents the Ukrainian people's heroic fight for freedom and humanity's future as a kind of Russian-Ukrainian domestic squabble that has nothing to do with the free world.

Why do such views continue to exist even as the extremely cruel war grinds on? Russia has made this a hybrid war by weaponising misinformation and propaganda and using it to support conventional arms. Furthermore, Russia's propaganda machine, which has multi-billion-dollar budgets and boasts a huge arsenal of weapons of 'psychological mass destruction', is still achieving many of its goals. The 'carpet bombing' of socio-political opinion – through social media, influencers, NGOs, think tanks, and political parties – has been going on for more than 15 years, starting at least as early as the memorable Munich Conference in February 2007, when Putin delivered a speech that some observers think was a lead-up to a new cold war.

It became a hot war back in 2014, when Russia first annexed Crimea and then captured a large swath of the Donbas. At that time, however, Russia's hybrid war efforts rendered the international community reluctant to recognise the global nature of the conflict and the obvious threats to the world order's status quo. On the contrary, for many years we had seen persistent attempts to categorise the hostilities as a local – or even a civil – war. It was only a year ago, when Russia launched its full-scale invasion of Ukraine, that the double standards became apparent.

THE VIRUS OF EASY SOLUTIONS

The narratives circulated by Russian propaganda have fallen on fertile soil, given that in recent decades globalisation has often been a subject of heated discussions despite its obvious benefits. Its impact on economic inequality, both perceived and real, provokes

strong feelings. This and other side effects of globalisation have been used by authoritarian and populist leaders to promote their agenda. The tensions that keep accumulating at the geopolitical level find release in, for example, the trade wars between the US and China, Brexit, and the increase in the number of military conflicts in the world.

Unlike COVID-19, populism and authoritarianism have been infecting societies and elites slowly and imperceptibly, having gone unnoticed for far too long. This is why familiar and convenient solutions were used to deal with ever more complex inconsistencies and challenges of modern times. The convenience of these simple solutions allowed the true nature of Putin's regime to go unrecognised for so long. We should now focus on finding a vaccine for the virus of easy solutions just as was done for the recent pandemic.

The challenges faced by the world are now truly extreme. Having divided the world into 'before' and 'after' 24 February 2022, the unprovoked full-scale invasion by the Russian Federation of Ukraine became a trigger that aggravated the problems of the global economy.

Recession, the energy crisis, the forced slowdown of the 'green agenda', the increasing hunger in the Southern countries, social unrest in democratic countries and active populism – each of these recent challenges has been magnified by the war that Putin is waging against Ukraine and against the rest of the Western world.

The war may seem to have pushed the world further towards fragmentation and strategic autonomy. Yes, fragmentation exists. However, the common purpose in fighting evil has become ever more visible. Moreover, companies and governments are showing an increased ability to make difficult decisions. The EU's decision to reduce their reliance on Russian gas was one of them. The search for alternative energy sources was mostly an urgent, painful, and costly process, yet it helped Europe return to the path towards energy independence, laying the foundation for a sustainable model of energy security. Eventually, Europe has gained a critical victory, bringing a strategic advantage in the fight against a common enemy rather than just a protection from energy blackmail.

THE VOICE OF COMMON SENSE

When we communicate with the international community, our interlocutors are greatly impressed by the wailing of sirens and that discussions with Ukrainian bankers and others are being conducted even from bomb shelters. However, over time people even get used to these things, especially when these sirens wail thousands of kilometres away. Ukrainians must not be expected to get used to living under these conditions. If it does, authoritarianism will have triumphed over democracy, predatory instincts over human values, populism over common sense, and darkness over light. It will also mean the defeat of the civilised part of humanity across the planet, to which, as the experience of the recent pandemic has shown, the definition of 'somewhere far away' can no longer be applied.

If Ukraine is defeated, everyone will be defeated. Globally. Although the hostilities are taking place in Ukraine, the war is being fought at the global level. And it will have repercussions for everyone. Perhaps these repercussions will not be felt immediately, but in the foreseeable future it may lead to the collapse and the loss of democratic values, of everything that is enshrined in the charter of a united Europe and in the constitutions of free democratic states.

Ukraine's victory will be a victory for the entire world. It will help overcome hunger, preserve democratic values, maintain the capabilities of international institutions and, ultimately, protect the lives of millions of people. As our fellow Ukrainian, Oleksandra Marviichuk, the head of the Ukrainian human rights organisation Center for Civil Liberties, aptly phrased it in her Nobel Peace Prize acceptance speech: "You don't need to be Ukrainian to support Ukraine. You just need to be human."

The central result of our joint victory should be the restoration of the world order and mechanisms of cooperation that are based on fundamental universal values. Opinion leaders – theoretical scientists, practical entrepreneurs, pragmatic politicians and actual defenders, who have not lost the ability to think critically and to find and implement complex solutions – should champion and promote real, rather than fake, criteria and standards.

This is why it is important to have this timely eBook to bring together contributions from experts across the world to give people an understanding of what this war is really about. That is why a 'truce' with the Kremlin would actually be a global defeat that would have, eventually, extremely dramatic global consequences. The authors use real (rather than false) hypotheses, arguments, estimates and predictions. For people who are truly concerned about Ukraine and the future of the world, who support efforts to that effect and who are taking steps to achieve a Ukrainian victory, the expert insights in this book will be a source of evidence and ideas, as well as a means to promote them.

ABOUT THE AUTHOR

Andriy Pyshnyy is Governor of the National Bank of Ukraine. He has been working in the financial sector for more than 16 years. In 2000 he became the Head of Legal Support Department at Oschadbank OJSC. From 2003 to 2007, he held positions as a Management Board Member, First Deputy Chairman of the Management Board, and Acting Chairman of the Management Board of Oschadbank OJSC. From April 2007, Mr Pyshnyy continued to develop the Ukrainian financial sector as the First Deputy Chairman of the Management Board at Ukreximbank OJSC, and later as a Member of the Supervisory Board of Ukreximbank OJSC and Oschadbank OJSC. From March 2014 to November 2020, he served as the Chairman of the Management Board of Oschadbank JSC. In 2012, Andriy Pyshnyy was elected a member of the Ukrainian parliament and the First Deputy Head of Parliamentary Committee on Rules of Procedure, Parliamentary Ethics, and Administration of Verkhovna Rada's Work. Between 2009 and 2012, he held

the position of the Director of Social Strategy Fund LLC. He graduated from Chernivtsi National University with a degree in law, and from the Ukrainian Academy of Banking of the National Bank of Ukraine with a degree in banking. In 2008, Andriy Pyshnyy earned his PhD in Law from the Legislation Institute of the Verkhovna Rada of Ukraine (Kyiv).

CHAPTER 2

Democracy needs Ukraine to win

Daron Acemoglu and Simon Johnson

MIT and CEPR

More than 30 years ago, the Berlin Wall fell, the Soviet Union disintegrated, and triumphalism prevailed throughout Western capitals (Bandow 2021). Rising from the disaster of the Great Depression and the ashes of WWII, established democracies had prevailed – in North America, Western Europe, and elsewhere – and now new democracies were lining up to join the fold. The communist alternative had hit a brick wall and belonged with absolute monarchies and medieval theocracies in the dustbin of history. Democracy had prospered, the world was at peace, and everything else was unimportant detail (Fukuyama 1989).

Ukraine chose to give up nuclear weapons in 1994¹ and rely instead on vague security guarantees provided by the unlikely troika of the US, the UK, and Russia – a weird arrangement that only made sense if the world was now safe for fledgling democracies. In retrospect, this view was completely wrong (Menand 2018).

The 2014 Russian invasion of Ukraine and massive escalation of aggression from February 2022 force us to re-evaluate when democracy can survive and whether this century will be ruined by conflict. What happens next in Ukraine matters enormously, because this will send a powerful signal – encouraging or discouraging – to anyone attempting to become democratic, especially if they live within striking distance of well-armed autocracies such as China, Russia, Iran, and Saudi Arabia. Such signals will be read carefully throughout Asia, but also in Latin America, Africa, and even Europe itself.

The defining geopolitical competition for this century is between people who support democracy, with all its imperfections and blemishes, and autocrats, who always want to rig elections and control civil society.

During the 1990s, many policymakers foolishly fell for the notion² that as countries become richer and more educated, they will inexorably become more democratic. The evidence, however, firmly rejects this so-called ‘modernisation theory’ (Acemoglu and Robinson 2022). There is no general tendency for countries that grow faster (or become

1 https://en.wikipedia.org/wiki/Budapest_Memorandum

2 www.pbs.org/wgbh/commandingheights/shared/mini-text/int_robert_rubin.html#3

richer) to become more democratic. Authoritarian rulers have on many occasions strengthened their hold over countries with an educated population and a rising middle class – Persian Gulf oil states, Putin’s Russia, and Xi’s China are just the latest examples.

There is a corollary to modernisation theory, which may appear more sophisticated and benign, but in essence is equally flawed. This corollary maintains that the technological innovativeness of democracies ensures that they will triumph against autocracies. This version of techno-optimism may have reached its apogee in the 2010s when there was a general euphoria about online communication and social media, with some even claiming this constituted a transformative technology that would bring down dictators, for example during the Arab Spring of 2011-2012.³

As we argue in a forthcoming book (Acemoglu and Johnson 2023a), technologies are highly malleable, and can be used in many ways. Social media and the internet illustrate this point by proving to be tools in the hands of autocracies intent on surveillance, censorship, and heavy-handed oppression.

In fact, there is nothing new about this technological innovation being a force for both good and evil. Improved communication technologies have often been used effectively for propaganda by anti-democratic regimes and leaders. The Nazis were masters of radio propaganda, and in the US, the most adept users of this medium included not only democratically elected leaders such as President Franklin Roosevelt, but also the fascist-sympathiser, rabble-rouser Father Coughlin.

Seen through this lens, it is obvious how counterproductive American and Western European policies towards autocrats have been. From at least the 1990s, the US foreign policy establishment claimed that all we had to do was trade freely with China and democratization would occur naturally. China was admitted into the WTO in 2001 on favourable terms.⁴ Of course, cheap Chinese labour was great news for multinational corporations, especially as they enthusiastically offshored activities to China and built more complex supply chains, transferring much of their technology to Chinese companies in the process. But there was nothing to worry about, in the eyes of our business leaders and politicians, because this was all ‘win-win’: everybody would benefit from Chinese exports, and China itself would soon join the ranks of peace-loving democratic countries.

The US was also a leading voice in the international system which allowed, or perhaps even encouraged, OPEC to manipulate oil prices,⁵ even though such activities would be viewed as a criminal conspiracy in most Western legal systems.

3 www.npr.org/2012/02/09/146636605/wael-ghonim-creating-a-revolution-2-0-in-egypt

4 <https://slate.com/business/2016/09/when-china-joined-the-wto-it-kick-started-the-chinese-economy-and-roused-a-giant.html>

5 www.reuters.com/world/us/why-nopec-us-bill-crush-opec-cartel-matters-2022-05-05/

The European approach to Russia has been even more problematic. For more than 20 years, German political leaders maintained that the Nord Stream gas pipeline would help bind Russia to a peaceful Europe.⁶

Of course, some well-connected people in democracies also benefited mightily from this complacency. London and other European capitals opened their arms to foreign oligarchs wishing to buy prime real estate⁷ or sports clubs. The European banking system has been complicit in allowing rich Russians to launder their vast fortunes into their real estate, financial assets, and very large yachts (Acemoglu 2022).

When questioned on these practices, policymakers would fall back on a version of modernisation theory: this was a passing phase, and with the children of elites from Russia, Saudi Arabia and China studying at famous British boarding schools and American colleges, their parents would surely soon become staunch defenders of democracy, free markets, and human rights. Nothing of the sort has happened.

Alas, over the past three decades rising prosperity in leading nondemocracies has strengthened the political dominance of a small elite, rather than building any type of democratic movement. In the 1980s, before China became completely integrated into the world trading system, there was a strong dissident student movement in cities and genuine bottom-up organization among peasants in the countryside (Pan 2008). All of that was crushed in the 1990s by a wave of repression funded by buoyant government revenues from foreign trade and western investments, after the Tiananmen Square massacre.

Capitalism alone will not bring democracy to more places, either. Under current arrangements, capitalists are willing to sell autocrats anything they want. Western countries sold components used in advanced weapons to Russia after 2014,⁸ despite a supposed EU ban on such shipments. US companies sell advanced chips to the Chinese military industrial complex,⁹ despite prohibitions – and even though China is currently a major source of re-supply to the Russian military,¹⁰ including for jet-fighters that are used indiscriminately to kill Ukrainian civilians.¹¹

It's time to wake up. Providing autocrats with advanced technology does not make them more peace-loving, better behaved, or mellow in any way. Autocrats stay in power by fragmenting society and by fomenting nationalist messages – to counteract the demonstration effects created by Western success. Drawing on either a religious or secular basis, autocratic rulers tell their people: we are special, we are threatened, it is

6 www.politico.eu/article/vladimir-putin-german-chancellors-nord-stream-russia-energy-angela-merkel/

7 www.standard.co.uk/homesandproperty/property-news/revealed-true-scale-russian-owned-property-in-london-b995498.html

8 www.reuters.com/business/aerospace-defense/exclusive-russian-weapons-ukraine-powered-by-hundreds-western-parts-rusi-2022-08-08/

9 www.wsj.com/articles/chinas-top-nuclear-weapons-lab-used-american-computer-chips-decades-after-ban-11674990320

10 www.nbcnews.com/news/us-news/us-officials-believe-china-may-providing-russia-non-lethal-military-as-rcna71336

11 www.wsj.com/articles/china-aids-russias-war-in-ukraine-trade-data-shows-11675466360

us against the world, and if we allow the West to ‘prevail’, they will destroy us, our way of life, our culture, and so on. All of this is nonsense, but as we discuss in Acemoglu and Johnson (2023a), it can be sold to people through cleverly designed information filters, millions of internet bots, and well-funded official media. Autocratic oppression is like a bicycle – the people on top fear that if they don’t keep peddling lies, they are likely to fall off.

Seen this way, what happens next in Ukraine is of paramount importance. After some decades of hesitation and underperformance, in 2019 Ukraine chose – through the ballot box – to reduce the power of the existing pro-Russian ruling elite and move its institutions in the direction of Western Europe. Vladimir Putin either found this shift threatening or simply decided there was an opportunity to grab more territory. Putin uses propaganda to effectively control Russian society and to mobilise more than enough popular support. The West has helped Ukraine, but slowly – fearing the consequences of escalation, including the potential use of nuclear weapons.

Think what happens if Putin prevails. This will send a signal that autocratic nations can invade more democratic neighbours with impunity. The incentive for autocrats to acquire nuclear weapons will also increase, because this obviously allows them to get away with more.

Recent experience in Afghanistan reminds us that democracy is rarely successful when imposed from the outside (Brick Murtazashvili 2022). And when a country chooses democracy for itself, the process can be contentious, with steps forward and back – as we have seen in many parts of Eastern Europe. For democracy to flourish, or even to survive, it needs to have a ‘safe haven’. This means that expansionist autocrats need to keep their hands off – and their tanks out of – countries such as Ukraine that are attempting to control corruption, eliminate the power of oligarchy, and genuinely become democratic.

We are now entering the most dangerous phase of the 21st century. Based on prosperity due to its success as an exporter to industrial democracies, China has picked up its game as an inventor of technology, particularly for surveillance. The race to develop artificial intelligence is on, with two big players: the US and China. Now the autocrats have a potential source of oppressive technology being developed within their own ranks – although we should also not rule out that misguided Western companies may invent tools that can be used to undermine our own political systems (Acemoglu and Johnson 2023b).

Over this century, the number of people living in today’s prosperous democracies will peak, likely around 1.5 billion. But the world’s population will continue to grow from 8 billion today, towards 10 billion (United Nations 2022) or perhaps even 12 billion.¹² India will soon become (or perhaps already is) the world’s most populous country, but

¹² www.wired.com/2014/09/human-population-2100/

there is nothing secure about its vaunted democracy now, as Prime Minister Narendra Modi is reportedly using advanced surveillance technologies against opponents¹³ (these allegations have been denied).¹⁴

Much of the population growth in the coming decades will be in Africa, where the conflict between democracy and autocracy is very much alive.

What technology will be invented or adopted in China, India, Latin America, and Africa, who will benefit, and how will attempts to create more democracies affect global security? Will there be a further emergence of aggressive autocrats, using AI from China, drones from Iran, and mercenaries from Russia? Much of this will be determined on the battlefields of Ukraine.

If Russia is allowed to continue occupying Ukraine and to declare success, this would send a powerful and harmful signal – autocrats can invade democratic countries and get away with murder.

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¹³ www.nytimes.com/2022/01/28/magazine/nso-group-israel-spyware.html

¹⁴ www.bbc.com/news/world-asia-india-60194265

United Nations (2022), *World Population Statistics 2022*.

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12

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CHAPTER 3

Helping Ukraine is not only crucial for peace in Europe but also for world peace

G rard Roland

University of California, Berkeley and CEPR

Western support for Ukraine against the unprovoked aggression by Russia since 24 February 2022 is often presented as a form of solidarity with, or even charity towards, the innocent victims of this brutal and cruel act of Russian imperialism. From that perspective, Ukraine's continuous requests for financial and military help against the Russian aggressor are met in many countries with comments that help for Ukraine has limits and that politicians should care first about their own people (New York Times 2022). These views are totally misguided and myopic. Helping Ukraine win against Russia is as existential for Europe – and indeed, the world – as it is for Ukrainians fighting for their survival and freedom. Seen this way, Ukraine needs more help and faster delivery than is currently the case. In this column, I explain why.

European leaders increasingly understand that a Russian victory in Ukraine would only be a first step in Russia's expansionist goal to invade other countries and ultimately to destroy the EU. Leaders in Baltic countries, Moldova, Poland, Finland and other countries who have suffered at some point in their history from Russian invasion and occupation understand very well the nature of the Russian imperialist threat. They understand that Ukrainians are also fighting and dying to defend their own country's freedom and independence. The British people, who had to fight alone against the Nazis in the beginning of WWII, also understand the plight of the Ukrainian people. Right now, the borders of Ukraine are the centre of gravity of the new cold war between Russia and its allies and democratic Europe. Helping Ukraine chase Russia from all its occupied territories is thus of existential interest to all European countries.

But helping Ukraine win against the Russian invader is not only in the interest of the European Union, it is also in the interest of world peace. A first reason is that a Russian victory would ruin for years the attempts of recent decades to try to build a rules-based international order that would guarantee peace and prosperity. A Russian victory would mean a return to the raw and violent 19th-century international politics based on military force and threats, bullying, invasion and colonisation of smaller countries. For Putin, this is how the international order should be structured and therefore Russia's imperial ambitions should be respected. A return to such an international order would

be catastrophic for world peace. It would mean the return of colonial wars and wars between big powers. In the age of nuclear weapons, it could represent an existential danger to life on our planet.

A second reason, which is more important in the short run, is that a Russian victory in Ukraine would strongly embolden Chinese President Xi Jinping in his plans to militarily invade Taiwan. For decades, Chinese communist leaders have insisted on recovering Taiwan, where the Kuomintang retreated to in the late 1940s after their defeat in the civil war. The concept of unification with Taiwan has been, since Deng Xiaoping, one of 'one country, two systems'. This was the concept applied to Hong Kong after it was returned by the British to China in 1997, and it was also meant for Taiwan in case it agreed on reunification. It is, however, well known that Xi Jinping has been hostile to the 'one country, two systems' principle since he took power. The takeover of Hong Kong's institutions by the Communist Party of China under the 2019 PRC's National Security Law has in effect ended 'one country, two systems' in Hong Kong, and it has become obvious it would be of no protection to Taiwan's democracy in case it accepted reunification with the mainland. China will certainly try to recover Taiwan through peaceful means if it can, but Xi Jinping has mentioned more and more the possibility of a military takeover and the People's Liberation Army (PLA) has been actively preparing for this possibility.

There are many symmetries between Russia's claim on Ukraine and China's claim on Taiwan. Ukraine's independence has been denied explicitly by the Russian government, and Chinese leaders have repeatedly stated that a declaration of independence by Taiwan would be met by a military invasion. Note that in both cases, it is not just about Putin or Xi. The goal of taking over Ukraine and Taiwan has strong support inside Russia and China, respectively.

A Taiwan war scenario may look a lot like that of Ukraine, where Taiwan would be supported indirectly by the US, Japan and South Korea by sending weapons and military advice. This would be the only way to keep the conflict localised, but this scenario seems less likely as there may be direct naval battles between the US and the Chinese military. The conflict could easily develop into a world war centred in Asia, with countries like Japan, Australia and India actively supporting Taiwan and the US (e.g. Roland 2023a). Note that there does not exist a military alliance like NATO in Asia.

All in all, Russia's decision to invade Ukraine has increased the likelihood of China militarily invading Taiwan, which would have enormous repercussions for all of Asia and for the world as a whole (e.g. Ruta 2022). A Russian victory in Ukraine would undoubtedly embolden China in invading Taiwan, but a Russian defeat would certainly have the opposite effect. While Russia is militarily superior to Ukraine (at least in terms of quantities of troops and weapons), China's superiority relative to Taiwan is of magnitudes larger. But a US intervention to help Taiwan would change that calculus. Moreover, Taiwan is an island and therefore more difficult to invade.

A Russian defeat in Ukraine, as well as having possibly very negative consequences for the Putin regime within Russia, would almost certainly convince many Chinese leaders that invading Taiwan would be too risky. Helping Ukraine to win against Russia is thus not only in the interest of peace in Europe, but also in the interest of world peace.

Before WWI, the world was one of competing empires with clashing expansionist interests. Since WWI, we have seen the emergence of nation states and democracies with different geopolitical interests and incentives from empires (e.g. Roland 2023b). The autocratic regimes of Russia and China are the last two remaining empires. It is no coincidence that they are trying to form an alliance. Helping Ukraine crush Russia's expansionist goals would certainly help contain China's hegemonic ambitions. Given its economic weight as the largest economy in the world, China represents a bigger threat to world peace than Russia. The Biden administration understands this, and it understands the implications of Russia's invasion of Ukraine for world peace and for the likelihood of China invading Taiwan as well as the implications it may have for world peace. It would be better if the governments and people in all existing democracies grasped this fully and increased help to Ukraine as a consequence.

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CHAPTER 4

The fiscal case for Europe to 'go Dutch' on defence

Hanno Lustig

Stanford University

If you start from the economic fundamentals, Russia's decision to invade Ukraine seems hard to fathom. A country whose GDP is roughly equal in dollars to that of Belgium, the Netherlands, and Luxembourg combined, and less than 5% of the combined GDP of the US and the EU, decides to invade Ukraine and indirectly take on the EU and the US. But it is perhaps less surprising once you dig into the details. What matters for deterrence is defence spending. In 2021, the US spent 3.3% of its GDP on defence, but Germany spent only 1.1% of its GDP on military expenditures. That's one-third of the US spending/GDP ratio. This puts Germany roughly in the middle of the EU pack. Countries like the Netherlands and France spend more, but others like Belgium, Austria, and Portugal spend even less. All of these countries are NATO members. All have pledged to spend at least 2% of their GDP. Only the UK, Lithuania, Estonia, Latvia, Norway, and Greece kept their 2% promise in 2021.¹

Since the fall of the Berlin wall, the US has spent an average of 2.6% more of its GDP each year than Germany on defence. If Germany had spent as much as the US on defence over this period, then, all else equal, it would have been running large deficits in excess of 3% of GDP instead of small deficits of around 1% of GDP.² Germany has benefited tremendously from a large US defence subsidy, as have other NATO countries.

Six decades of spending cuts reduced German defence spending from 4 % of GDP in 1960 to 1% of GDP in 2021 (see Figure 1). These cuts have taken a toll. When the invasion started in March of 2022, the commander of German Army forces, Alfons Mais, stated unequivocally that his troops were not battle-ready: "And the Bundeswehr, the army that I am allowed to lead, is more or less broke. The options we can offer policymakers to support the alliance are extremely limited."³ German soldiers even lacked basic equipment, such as helmets and backpacks. At the start of the Ukraine war, Europe's largest army, the Bundeswehr, was effectively declared to be of no practical use by its own commanding officer. Putin may have made some mistakes in invading Ukraine, but

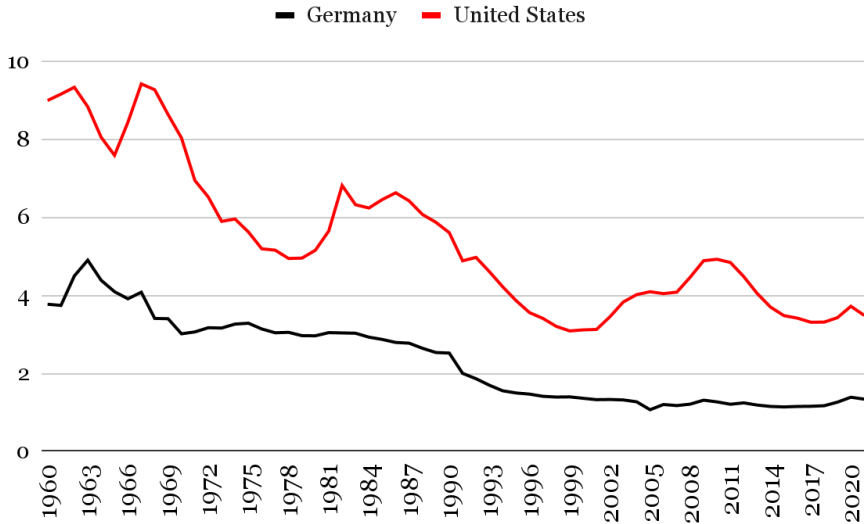
1 OECD Data, "General Government Spending, Defence", 2021.

2 World Bank World Development Indicators, "Net lending and borrowing as % of GDP".

3 "Germany is ready to lead militarily," *New York Times*, 23 March 2022.

underestimating Europe's defence posture was not one of them. Since then, the German Chancellor has announced significant increases in defence spending, but the German government has been slow to execute.

FIGURE 1 DEFENCE SPENDING AS A PERCENTAGE OF GDP



Source: World Bank World Development Indicators, "Military Spending as % of GDP".

According to the Ukraine Support Tracker⁴ at the Kiel Institute for the World Economy, even now, the EU's overall support for Ukraine is barely keeping up with the US at about \$55 billion in 2022, less than 0.3% of its GDP, even though Ukraine is in the EU's backyard. And when it comes to direct military support, the EU countries' efforts again fall short compared to those of the US. Looking at bilateral aid as a percentage of GDP between January and August in 2022, the UK and the US outspent all other European countries except for those bordering on Russia (Estonia, Latvia, Poland, Norway, and Lithuania). In spite of the rhetoric coming out of Paris, France itself spent less than 0.05% of GDP on direct aid to Ukraine, as did Italy and Belgium (Antezza et al. 2023: 24).

Incentives matter. After WWII, many NATO countries decided to free-ride on US defence spending, betting that the protection afforded by the NATO umbrella renders their own national defence efforts moot. This is a textbook example of 'moral hazard'. Joining NATO was like getting fire insurance. Once you have acquired fire insurance for your property, you might be less inclined to clear the brush around your house to prepare for fire season.

4 www.ifw-kiel.de/topics/war-against-ukraine/ukraine-support-tracker/

Some European countries failed to maintain and renew their fleet of military aircraft and helicopters, and their tanks. European countries have even pursued policies that have actively endangered their national security and that of others. The German, Italian, and Austrian energy policies that fostered dependence on Russian gas are one example of this. Another example comes from the shipping industry. Incredibly, for much of 2022, European shipping companies were transporting Russian oil to Asia, helping to fund Putin's war.

Going forward, the US-backed insurance policy may prove not to be as valuable, because the insurer's financials are less sound than they used to be. To understand why, the EU's defence ministers should start by studying the US federal government's fiscal situation. The US federal government is not on a fiscally sustainable path.

The US Treasury can borrow at lower rates than other governments because Treasuries play a unique role in the international financial system. Even after accounting for the extra seigniorage revenue the Treasury earns from its role of safe asset provider to global investors, it is hard to rationalise the current valuation of Treasuries (Jiang et al. 2019). Bond market investors desperately need safe assets, and this need may lead the bond market to ignore the country's own fiscal fundamentals for long periods of time. But eventually, bond market investors will return to the US' fiscal fundamentals. That is what happened to the Dutch Republic at the start of the 18th century and the UK at the start of the 20th century. Both countries were the safe asset suppliers of choice in their respective eras (Chen et al. 2022).

The fiscal fundamentals of the US are not sound. The US federal debt exceeds its GDP. Once you add state and local debt as well as unfunded pension liabilities, the US general government debt-to-GDP ratio exceeds that of most European countries.⁵ The Congressional Budget Office (CBO) just released its latest budget projections for the federal budget a few days ago. Starting from the laws currently on the books, the CBO currently projects average federal deficits of 8% of GDP after interest expense, and a debt/GDP ratio of 195% by 2053.⁶ These are projections of future spending and tax revenue based on current law. They are not the best forecasts conditional on all available information, but they still serve as a helpful benchmark. Over the past two decades, ten-year projections have been overly optimistic relative to what actually happened to the debt/output ratio and deficits.

These projections imply that Congress will likely have to consider unprecedented spending cuts in the near future. And it seems unlikely that US taxpayers will continue to subsidise Europe's defence when they face cuts to Social Security and Medicare. Politicians on both sides of the political aisle in the US are increasingly reluctant to spend US taxpayer dollars on foreign 'military adventures'.

5 OECD Data, "General Government Debt", 2021.

6 Congressional Budget Office, "Long-Term Budget Projections", February 2023. Jiang et al. (2022) provide an analysis of the US fiscal capacity based on CBO projections.

There are other reasons for Europeans to look askance at the US protective umbrella. The US faces more significant national security threats elsewhere. Its foreign policy continues to pivot to the Pacific, and away from the Atlantic. The US political system has become increasingly polarised and dominated by populists on the left and the right, making each presidential election a high-stakes gamble that could portend the end of the US protection Europe has benefited from.

The invasion of Ukraine serves as a reminder to Europeans that there is nothing inevitable about the survival of liberal democracies. The most effective way to preserve the security and freedoms of future generations of Europeans is to permanently degrade the military threat posed by the Russian Federation. Ukraine's defence forces have shown themselves to be willing and able to accomplish this task. Ukrainian soldiers are actively containing Russia, buying the rest of Europe time to get its own defences back in shape after years of underinvestment. It is hard to understand why the EU does not provide significantly more direct military support to Ukraine.

There is a clear self-interested fiscal rationale for Europe to invest more in its own defence, starting by stepping up its aid to Ukraine. It also happens to be the right thing to do. When it comes to national defence, Europe has been behaving like that friend who always runs to the restroom when the check arrives. It's time for Europe to start picking up its own tab, beginning with Ukraine. It's time for Europe and the US to 'go Dutch' on defence.

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economy. These risk characteristics help to understand the behavior of exchange rates. In addition, Lustig has explored the impact of government guarantees on the pricing of tail risk borne by large financial institutions. More recently, Lustig has also worked on understanding the determinants of a firm's volatility (volatility of sales, cash flows, stock returns etc).

CHAPTER 5

The peace dividend can be saved in Ukraine

Yuriy Gorodnichenko

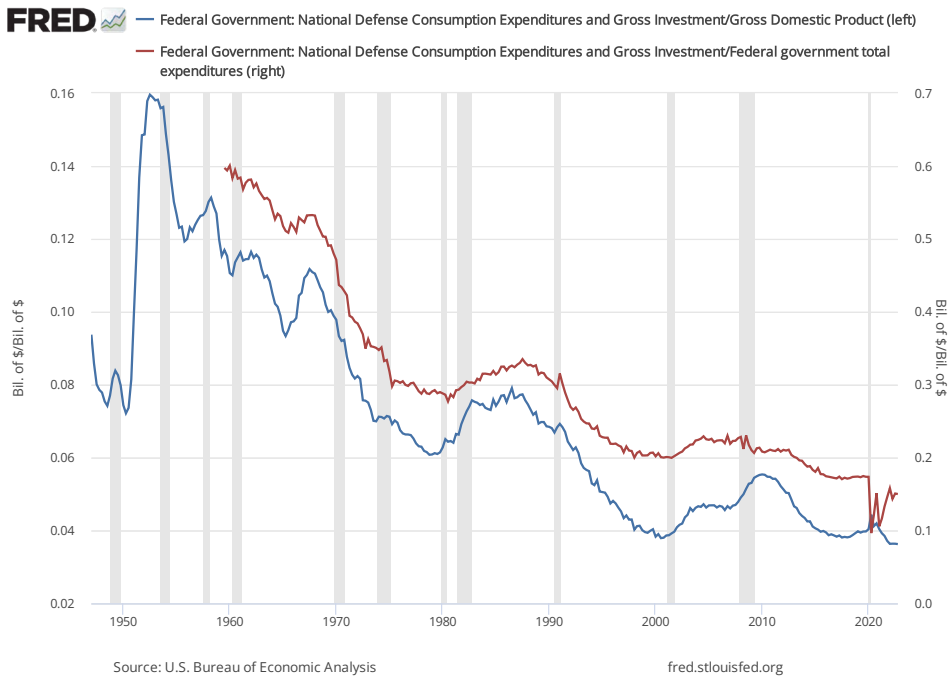
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The Russian invasion of Ukraine on 24 February 2022 brought back the spectre of a nuclear war, WWII, and other potential horrors. Announcing the attack, Vladimir Putin threatened to launch nuclear missiles at anybody standing in the way. The shattered European – and global – security and Russia’s nuclear blackmail have enormous implications for the world: international treaties seem to have little security value, nobody confronts nuclear powers, smaller countries are particularly vulnerable, and economic dependence on actual or potential aggressors is a critical weakness. The rational response for everybody is to arm as quickly as possible. Because only nuclear weapons can offer a credible deterrence, the proliferation of nuclear weapons seems inevitable. We are facing the prospect of an arms race like never before.

Indeed, we see many pieces in motion already. Pacifist countries like Germany and Japan announced their plans to revamp their military forces. Neutral countries like Sweden and Finland are applying for NATO membership to get protection. The defence industry is booming: the defence stock index jumped by more than 10% from 23 February to 28 February 2022. Many countries and companies are re-evaluating their ties with China and are trying to move their production elsewhere before it is too late. Potential victims feel particularly eerie. For example, Taiwan announced it would be extending its military draft to beef up its defences.¹ All of these carry huge economic costs.

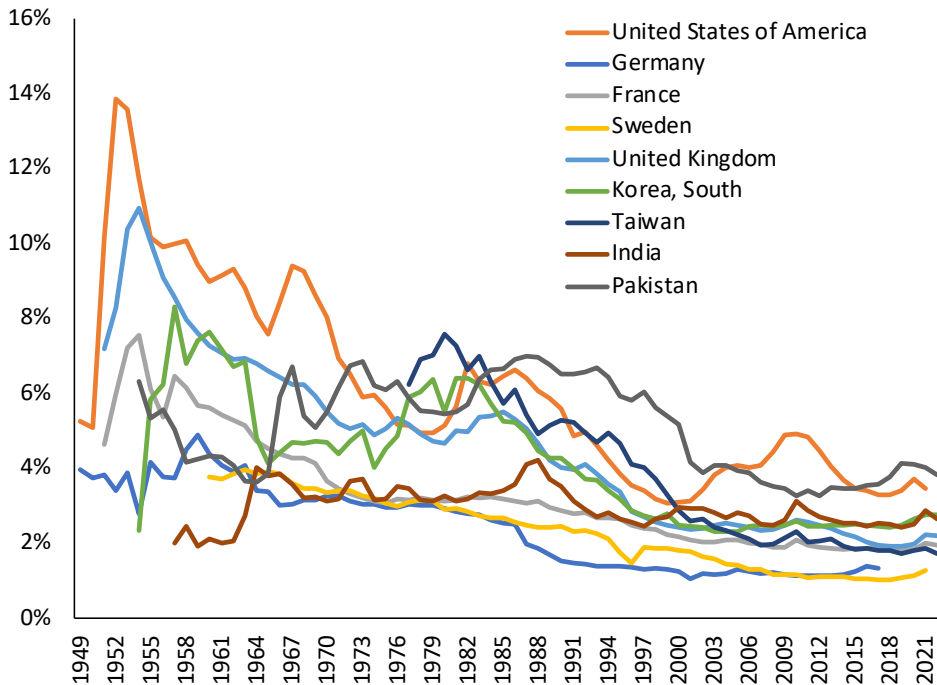
At the height of the Cold War, the US committed 10% of its GDP to military spending (Figure 1). With the current GDP, this amounts to over \$2.6 trillion. Every year. In the US alone. It may be hard to comprehend now, but military spending accounted for over a third of federal government spending. This means that instead of building schools, hospitals, etc., the government was building submarines, missiles, etc. Was this due to the lobbying of the military-industrial complex? Maybe, but only partly so because there was no other plausible alternative given the Soviet menace.

1 www.cnn.com/2022/12/27/asia/taiwan-military-conscription-intl-hnk/index.html

FIGURE 1 US DEFENCE SPENDING AS A SHARE OF GDP

The US carried a disproportionately large burden of defence spending during the Cold War, but other democracies spent fortunes on defense too. According to the estimates of the Stockholm International Peace Research Institute,² the UK spent 5% of its GDP on defence in 1980. Neutral Sweden was not too far behind with 3%, which was close to France and West Germany. The current generation of Europeans may be shocked to learn that total dollar defence spending in Western Europe was roughly half of US defence spending. Other parts of the world had to be in the arms race too. For example, South Korea and Taiwan spent 7.3% and 6.2%, respectively. Proxy wars in Africa led to more military spending there as well.

The collapse of the Soviet Empire not only reduced war risks but released enormous resources for peaceful uses. Military spending declined everywhere (Figure 2), even in places with unresolved territorial disputes (e.g. India and Pakistan). These newly available funds were called the ‘peace dividend’.

FIGURE 2 DEFENCE SPENDING AS A PERCENT OF GDP

Source: Stockholm International Peace Research Institute.

The Russian invasion of Ukraine puts the dividend at risk. For example, after the Russian annexation of Crimea in 2014, the Obama administration announced the modernisation of US nuclear weapons. The Congressional Budget Office estimates the cost at \$400 billion over the next 30 years,³ which comes on the top of \$800 billion necessary to maintain nuclear forces. With the growing security threats emanating from Russia and elsewhere, one can expect that more dollars will be committed to this and similar programmes. Another round of Cold War appears to be a rather plausible scenario. It seems now that only a miracle can save the world from sliding into an out-of-control arms race.

THIS MIRACLE HAS A NAME: UKRAINE.

The Ukrainian David has not only depleted the armed forces of the Russian Goliath but also returned some Ukrainian territories occupied by the Russian invaders. The heroism and determination of the Ukrainian people are most inspiring but, of course, Ukraine is not alone. The military and economic aid from Western democracies is helping Ukraine to maintain the war effort. The sums are significant, but they should be put in perspective.

3 www.cbo.gov/publication/53211

For example, Ukraine needs roughly \$45 billion in 2023 to keep its economy running. Undoubtedly, this is a large amount, but it is only 0.1% of the GDP of Ukraine's allies, 4% of NATO's annual budget, and 9% of the spending announced so far by European countries on helping consumers with energy costs (Shapoval et al. 2022). And as observed by Jens Stoltenberg, the NATO Secretary General, while the West pays in dollars, Ukraine pays in blood.⁴ In other words, the cost of containing Russia is orders of magnitude smaller than what the West would have to shoulder with another Cold (or not-so-cold) War. Furthermore, if (or hopefully when) Ukraine defeats the Russian aggression and initiates changes in Russia that will make future aggression or nuclear threats impossible, future aggressors will think multiple times before invading other countries.

On the other hand, if Russia subdues Ukraine, the law of the jungle will describe international relationships: weak/small countries will be conquered by large/strong countries. The fall of Ukraine will almost certainly invite more aggression. Thinking that the Nazi invasion of Czechoslovakia was a “quarrel in a far away country, between people of whom we know nothing”⁵ was a capital mistake that resulted in WWII. Similar thinking about the Russian invasion would be a tragic repeat of history.

This is why rivers of economic and military aid should flow to Ukraine. Only Ukraine's victory can prevent an unprecedented arms race. No country in Europe or Africa (Fofack 2022) or elsewhere can afford another Cold War. Helping Ukraine is the best investment in global security that can save the peace dividend.

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4 <https://rubryka.com/en/2022/11/21/zahid-maye-ne-dozvolty-putinu-vygraty-vijnu-proty-ukrayiny-gensek-nato/>

5 www.bbc.co.uk/archive/chamberlain-addresses-the-nation-on-his-negotiations-for-peace/zjrjgwx

CHAPTER 6

Observing freedom's vanishing act

27

Noam Yuchtman

London School of Economics

Between 2014 and 2019, much of my academic research was focused on understanding individuals' participation in protests that were part of Hong Kong's democratic movement (Cantoni et al. 2019, Bursztyn et al. 2021, Cantoni et al. 2022). My co-authors and I spent many stimulating days in Hong Kong discussing the protests with each other and with leaders of the movement – ranging from idealistic high school students to thoughtful university professors.

We did this work within the political institutions of Hong Kong at the time: under the Basic Law, freedom of expression and assembly as well as adherence to the rule of law were constitutionally enshrined and visible throughout society. I recall attending a 1 July march in Hong Kong, held every year as a protest against Chinese Communist Party (CCP) rule, in which Hong Kong police officers protected a group of individuals with signs promoting Hong Kong's independence. Further on in the march, effigies of the Chief Executive of Hong Kong (the head of government) served as punching bags. This political speech was fully protected and legal, and as such, our work studying democratic protests was institutionally supported by university collaborators in Hong Kong.

Yet, in the blink of an eye, Hong Kong's political equilibrium was fundamentally altered. On 30 June 2020 (just before the yearly march), the CCP imposed a National Security Law on Hong Kong that coercively suppressed protests. The protest leaders with whom we met – whether students, politicians, or university professors – were arrested. This signalled the CCP's abandonment of its commitment to a 'one country, two systems' arrangement – which had guaranteed civil liberties in Hong Kong that were absent in mainland China – in favour of a system of total political control.

My co-authors and I wrote about the importance of active protests for preserving 'one country, two systems' while it was still in force (Cantoni et al. 2017). In the absence of democratic checks and balances, we argued, popular mobilisation was crucial to prevent authoritarian overreach. Indeed, such mobilisation was previously effective in forcing policy reversals on national security legislation, curricular reform, and a proposed extradition bill. Once the threat of mobilisation was neutralised by the National Security Law, civil liberties crumbled: Hong Kong citizens lost the freedom of the press, freedom of speech, and freedom of association they had previously enjoyed (e.g. Freedom House 2022).

My co-authors and I experienced the change personally as well: our institutional collaborators turned adversarial toward us and largely abandoned their collaboration in our research. Pro-CCP newspapers in Hong Kong and even the Chief Executive of Hong Kong, Carrie Lam, suggested that our research was aimed at inciting violence or interfering in Hong Kong politics.¹ The experience was as unpleasant as it was absurd.

What are the lessons I take from my experience in Hong Kong for thinking about the democratic world's response to Russia's invasion of Ukraine? Having experienced close at hand a vibrant, free society transformed so quickly into an oppressive, unfree one was a shock. Had I not experienced it so directly, I might not have believed such a rapid loss of civil liberties was possible. Hong Kong thus serves as a warning: freedoms that we enjoy and take for granted can be made to disappear very quickly – and there exist powerful political actors who actively want to make them disappear. The world's democratic powers acquiesced to China's renegeing on its international commitments to preserve 'one country, two systems', and the Hong Kong we knew was lost. If the democratic powers do not contribute to the stand against Vladimir Putin's aggression, then Ukraine as we know it will be lost as well.

Yet, it doesn't end there. Each case of authoritarian aggression and democratic acquiescence appears to encourage the former. Does anyone doubt that Xi Jinping became more confident that he could extend authoritarian CCP rule to Taiwan as a result of the ease with which he extended it over Hong Kong? The lesson applies easily to Ukraine and to Eastern Europe more broadly – all the more so having observed how, incrementally, Putin moved from Crimea to the Donetsk and Luhansk regions of Ukraine. The countries of Eastern Europe today enjoy civil liberties and the rule of law; Hong Kong very recently enjoyed these as well, until they were brutally taken. The shadow of an authoritarian threat can materialise all too quickly into actual authoritarian repression, and then freedom vanishes. By helping preserve democracy in Ukraine, we help preserve democracy everywhere.

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CHAPTER 7

Why it is imperative to help Ukraine

Sergei Guriev

Sciences Po and CEPR

Contrary to conventional wisdom, Putin is not a ‘one of a kind’ villain. Yes, he has nuclear weapons and controls a country with the largest landmass in the world. But, as argued in Frye (2021), Putin is, in many ways, similar to other autocratic leaders. This is why these leaders are watching Putin’s war in Ukraine and his growing repression at home with utmost attention – comparing his challenges and solutions to their own. If they take note that Putin’s 2022 war prolonged his autocratic rule, we will have more wars and more repression around the world.

In a recent book (Guriev and Treisman 2022), Daniel Treisman and I show that most of today’s non-democratic regimes are what we call ‘spin dictatorships’ – similar to what Putin practiced for his first 20 years in office, before 2022. Unlike the traditional 20th century model of dictatorship based on open repression, modern autocrats prefer to pretend to be democratic leaders and undermine political checks and balances in a covert way. Instead of fear, they rely on manipulation of information; instead of terrorizing their citizens, they try to deceive them.

Putin has been one of the most sophisticated spin dictators. He has used co-optation of elites, sophisticated propaganda, hidden censorship of traditional and online media – while maintaining a democratic façade. Even when he launched his wars of aggression, he managed to create complex veil of deniability so that some Western leaders and businesses continued to do business with him.

However, as with other spin dictators, Putin eventually faced a major problem: in order to remain popular, he had to deliver income growth – and in a modern middle-income country, growth comes from educated and creative citizens. But this class is sufficiently sophisticated to see through spin dictators’ informational tricks. Hence the conundrum. On the one hand, the spin dictators need more of such ‘knowledge workers’ to increase economic performance, hence convincing the average citizen that they are competent leaders worthy of support. On the other hand, the greater the number of knowledge workers there are in the country, the harder it is to silence them. Inability to resolve this problem often results in democratic transitions. However, there have also been cases when, in order to cling to power, dictators went back in time – replacing the modern spin-based dictatorship model with the 20th century approach based on open repression. For example, Venezuela under Hugo Chávez was a classical spin dictatorship, while his successor Nicolás Maduro became a true fear dictator – at a huge cost to Venezuelan

society and economy. Under Maduro, Venezuela's GDP declined by 75% and five million people (15% of the population) have left the country (Hausmann and Morales-Arilla 2021).

The Venezuelan example should have served as a warning to other regimes. Indeed, spin dictatorships have become the dominant model in the post-Cold War world exactly because they are better suited to the modern world of a globalised economy, cross-border capital and talent flows, global media and human rights NGOs. Pretending to be an imperfect democrat – rather than an open despot – allows regimes to attract foreign direct investment and benefit from trade flows. The old-style dictatorships cannot perform as well; this is why they have been almost extinct today.

So why do some spin dictators choose – as Putin did in 2022 – to go back to open violence? They know that violence begets violence, that the old-style tyranny is not only bad for the country but dangerous for the tyrants themselves (Guriev and Treisman 2022). Still, as they are cornered by growing resistance from better-educated and better-informed classes, they take this risk – because they overestimate the odds that they can get away with that.

Dictatorships are prone to making mistakes (Treisman 2020). As they silence opposition, introduce censorship and suppress dissent voices, they lack critical feedback and tend to overplay their hands. Some dictators understand this and allow partial media freedom, but others, especially in resource-rich countries, still prefer to limit liberties (Egorov et al. 2009) – even partial media freedom creates political risks, while resource rents can help pay at least the economic costs of wrong decisions. Not surprisingly, in 2022, Putin overestimated the strength of his own army and underestimated the courage of Ukrainian resistance and the unity and resolve of the West. He probably thought his 2022 aggression would be a replay of his 2014 invasion in Ukraine – a typical spin dictator war. He hoped to take Kyiv in a few days, change the government at gunpoint – like he did in Crimea in 2014 – and to present this as a *fait accompli* to the world before the West could agree on significant sanctions and military support. Then he would continue to function as a spin dictatorship, a more efficient and less isolated regime.

Putin's 2022 invasion in Ukraine was his greatest mistake. But does he understand that he has already lost? It may seem obvious: Russia's share in global GDP is about 1.5%; the pro-Ukraine coalition produces about half of global GDP. However, Putin is not giving up because he is counting on fatigue of Western public opinion. He believes that, eventually, Western societies will be distracted by other problems, which will result in declining military and financial support for Ukraine so that Putin will be able to keep at least some of the occupied Ukrainian territory and, as in 2014, this war will be presented to his base in Russia as a victory. Yes, this will be very costly for the Russian economy and society. But in terms of one thing Putin cares for – his hold on power – his 2022 bet might still pay off.

Putin must be proven wrong. If he wins, many other spin dictators around the world will make similar bets on moving back to violence. With all their dishonesty and opportunism, spin dictators torture and kill substantially fewer people than the old-style despots. Helping Ukraine win this war will convince other dictators how costly open violence is. This will save many lives in the future.

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Sergei Guriev joined Sciences Po as a tenured professor of economics in 2013 after serving as the Rector of the New Economic School in Moscow in 2004-13. In 2016-19, he was on leave from Sciences Po serving as the Chief Economist and the Member of the Executive Committee of the European Bank for Reconstruction and Development (EBRD). In 2022, Sergei Guriev was appointed Sciences Po's Provost. Professor Guriev's research interests include political economics, development economics, labor mobility, and contract theory. Professor Guriev is also a member of the Executive Committee of the International Economic Association and a Global Member of the Trilateral Commission. He is also a Research Fellow at the Centre for Economic Policy Research, London. He is a Senior Member of the Institut Universitaire de France and an Ordinary Member of Academia Europaea.

CHAPTER 8

How Ukraine can finish the unfinished transition agenda

Torbjörn Becker

Stockholm School of Economics

Russia's full-scale invasion of Ukraine on 24 February 2022 came as a surprise to many Western observers and policymakers. This was perhaps based on the belief that more than three decades of transition since the fall of the Berlin Wall and the dissolution of the Soviet Union would have ended this type of aggression in Europe. To people in Georgia (who saw Russia invade their country in 2008), to people in Ukraine (who witnessed the annexation of Crimea in 2014 and war in Eastern parts of their country), to people in Moldova (who live with the Russia-supported territory of Transnistria within their country), and to most others that live in countries that were once incorporated in the Soviet Union, this was less of a surprise. The transition that started in 1989 is far from finished in many of the countries that came out from under the oppression of the Soviet Union's communist regime.

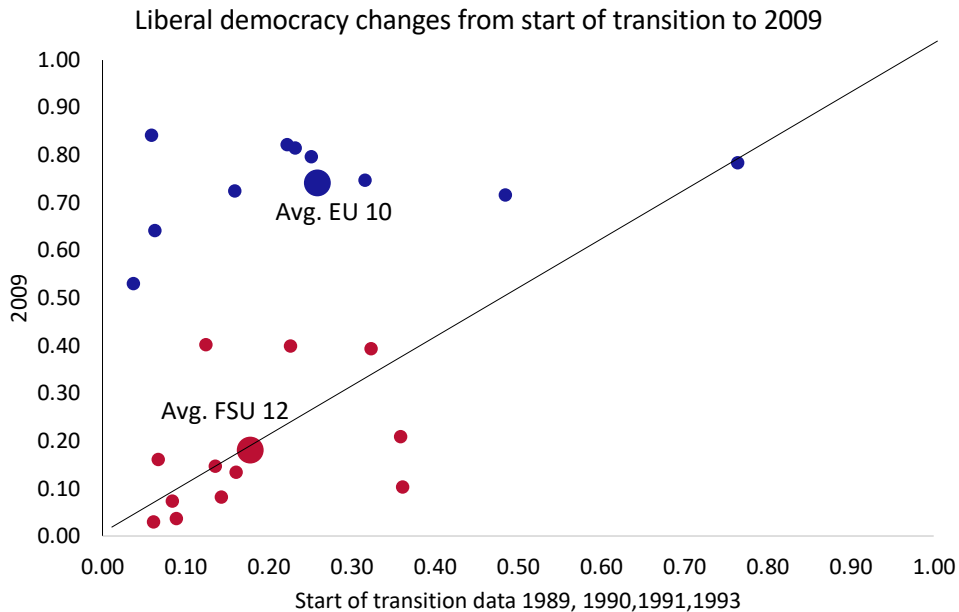
For scholars that focus on this region, it has long been clear that the transition process from autocratic, communist, planned economic systems to open, democratic, rule-of-law-based, market economies still has some way to go. Progress has been very uneven among the countries that came out of the Soviet Union and the communist bloc in Europe. However, this progress is highly correlated with how countries have chosen to move their institutions and focus towards the EU rather than Russia. In this contribution, I will outline this in some detail and argue that a successful Ukraine entering the EU can trigger a new wave of transition not only in Ukraine but across the region, to the benefit of all of Europe's citizens and beyond.

THE TRANSITION TOWARDS LIBERAL DEMOCRACY

The start of transition after the fall of the Berlin Wall in 1989, the independence movements in the Baltics, and then the dissolution of the Soviet Union in 1991 set off a first wave of transition to liberal democracy in the region. Although this transition was very different across countries, there is a very strong correlation between the transition and becoming a member of the EU (Figure 1, from Becker 2019). Two decades after the fall of the Berlin Wall, the average transition country that had become a member of the EU ('EU10' in Figure 1) had improved its liberal democracy score, as measured by the V-Dem project, from around 0.25 to above 0.7. During the same period, the twelve countries that

came out of the Soviet Union and did not become EU members ('FSU12') had stayed at a liberal democracy score of around 0.2. There is of course significant variation within the groups, but regardless of the starting point, all of the countries in the EU10 group ranked well above all of the countries in the FSU12 group. In some countries, the starting point is part of the explanation, but this explanation is not valid for the majority of countries.

FIGURE 1 THE TRANSITION TO LIBERAL DEMOCRACY: THE FIRST 20 YEARS



Source: Becker (2019) based on data from V-Dem project.

Figure 1 does not provide a causal link between EU membership and the development of liberal democratic systems. However, it is clear that countries' choice to move towards the EU and away from Russia's sphere of influence is highly correlated with significant reforms of these societies. It is also clear that when Ukraine wanted to follow this path towards the EU, Russia found it so threatening that it first invaded parts of the country and then launched a full-scale war.

HUMAN DIMENSIONS OF TRANSITION AND THE FIGHT FOR DIGNITY

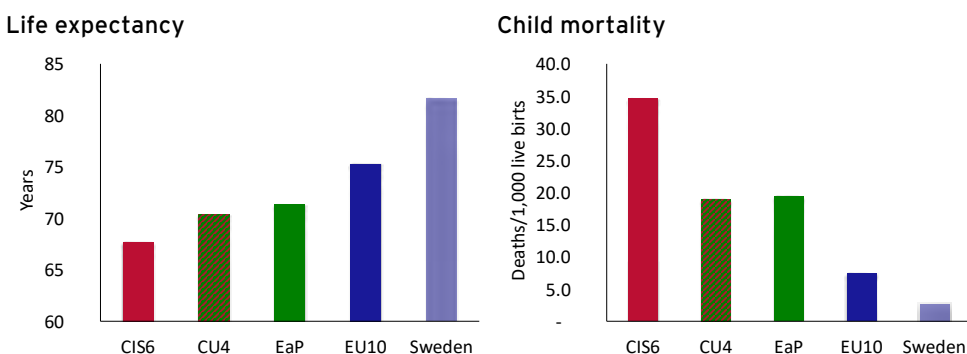
As economists, it is easy to focus on economic variables in the transition process. In Becker and Olofsgård (2018), we look, for example, at how growth has evolved over time in the same groups of transition countries that are shown in Figure 1 above. There we noted that the FSU12 group of countries were further behind the EU10 at the end of the first 25 years of transition because the initial decline in incomes were so severe in the FSU 12 group that the commodity price boom later was not enough to compensate

for this initial economic disaster. We also document how investments in EU10 countries are significantly higher than in FSU12 countries, but that also this can be dwarfed by external factors such as changing oil prices when we look at growth over a decade or two.

However, we know that over the longer term, relying on favourable external factors is a poor substitute for creating an environment that can deliver sustainable growth for generations to come. This is why institutions and building human capital are so critical in any fundamental transition process, and this region's development is a testament to this. When we broaden our scope to include other variables that are critical for the wellbeing and happiness of people, the gap between countries that moved closer to the EU compared with those that did not becomes even starker. In Becker (2014), written at the time of the Russian invasion of Crimea, I showed several indicators of what it was people in Ukraine were fighting for in the Revolution of Dignity. Back then, I wrote: *"...the real issue is if people in Eastern partnership countries want to live in modern, democratic, and transparent countries or in less open societies where most of the benefits accrue to ruling elites. These different social models are correlated with significant differences in a long list of indicators that are related to the well-being and happiness of people..."*.

Some of these indicators are shown in Figures 2-4.

FIGURE 2 HEALTH INDICATORS



Note: the EU10 is defined as above while CIS6 consists of Russia, Kazakhstan, the Kyrgyz republic, Uzbekistan, Tajikistan and Turkmenistan; CU4 includes Russia, Kazakhstan, Belarus and Armenia, members of the customs union set up by Russia as an alternative to free trade in the EU; and EaP are the Eastern Partnership countries at the time with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.¹

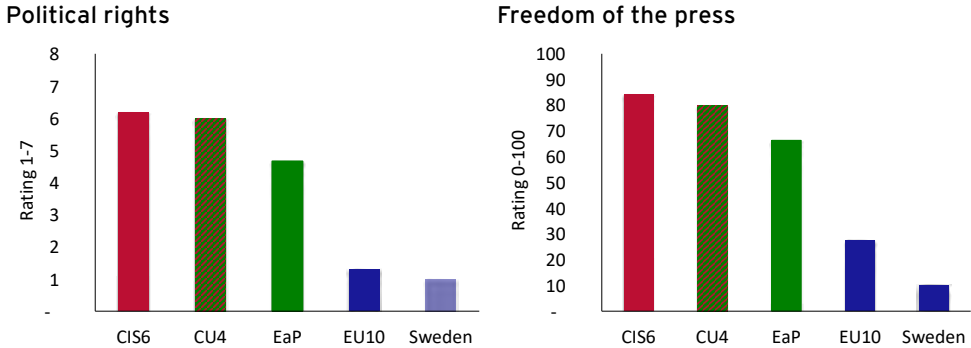
Source: From Becker (2014) based on UNDP and IHME data.

Leading long, healthy lives and seeing your children survive are important factors for the wellbeing and happiness of most (Figure 2). Being able to vote in free and fair elections, being represented in political processes, and having access to media that can report on all issues that are relevant to you also contribute to a sense of meaning and dignity (Figure 3). Access to a legal system that is unbiased in providing justice and public

¹ Sweden is included since it is the EU country that is home to the Stockholm Institute of Transition Economics, which I head.

officials that are there to serve citizens rather than themselves and their superiors are also important factors contributing to both dignity, human rights, and prosperity in a country (Figure 4).

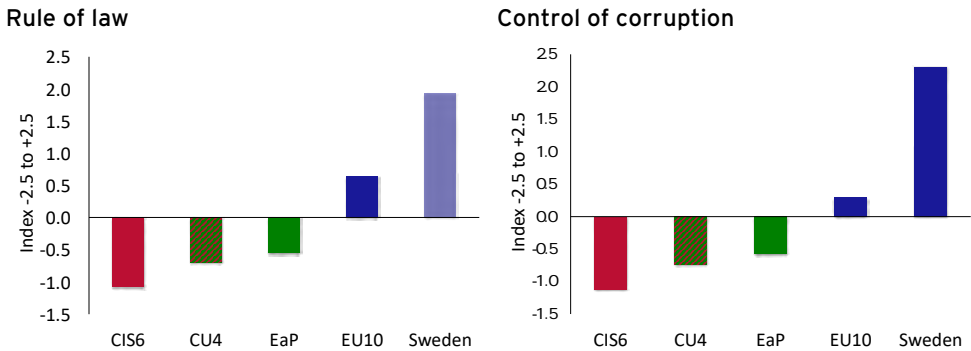
FIGURE 3 FREEDOM INDICATORS



Note: A lower rating is better.

Source: From Becker (2014) based on Freedom House data

FIGURE 4 RULE OF LAW AND CORRUPTION INDICATORS



Source: From Becker (2014) based on World Governance Indicators data.

It should not have come as a surprise that people in Ukraine would rather move in the direction of the EU than the customs union with Russia back in 2013. What seems to have surprised Russian leaders as well as many outside observers was that people in Ukraine were ready to sacrifice their lives in the Revolution of Dignity to achieve these freedoms. It is the duty of the EU and its partners to make sure this fight for dignity was not in vain.

FINISHING THE TRANSITION PROCESS WITH UKRAINE'S VICTORY

The fall of the Berlin Wall in 1989 and the dissolution of the Soviet Union in 1991 set off a first significant wave of transition from autocratic, communist systems towards liberal, democratic, market systems across the region. However, many countries that came out of the Soviet Union remain stuck in transition and have not managed to move close enough to various EU standards to allow them to join the Union.

The victory of Ukraine will not only pave the way for the citizens of Ukraine to join the EU but will also set an example for many other transition countries that got stuck on the way to membership. This could include not only Moldova, which is already a candidate country, but also Georgia, other countries in the Caucasus and Balkans, and perhaps also Belarus once it is freed of its Russian shackles and its own dictator. The road away from Russian domination and into the Union is not only the road to economic freedom, but also the road to longer and happier lives for the citizens of the countries that join in the wake of Ukraine's victory over its long-time oppressor. It is also a transition that will make all of Europe safer, more prosperous, and happier as our region is finally freed from the last remnants of Soviet repression.

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CHAPTER 9

Russia's imperial war and the need for assistance to Ukraine during and after the war

Jan Svejnar

Columbia University and CEPR

Vladimir Putin's invasion of Ukraine on 24 February 2022 and the prior annexation of Crimea on 10 February 2014 constitute a fundamental breach of international law. They also constitute direct contravention of the 5 December 1994 Budapest Memorandum, signed inter alia by Russia, the US and UK, giving Ukraine security assurances and prohibiting the signatory countries from threatening or using military force against Ukraine. In return, Ukraine agreed to move nuclear weapons from its territory to Russia. Russia's invasion pretty much ensures that in the future no country in possession of nuclear arms will voluntarily give them up against security assurances.

From a historical perspective, Putin's invasion represents a continuation of Russia's long-term drive to create and maintain an empire and a substantial sphere of political and economic dominance in Europe and Asia. Putin expressed this view continually during his rise to power and in his 2005 Annual State of the Nation Address he specifically termed the collapse of the Soviet empire the "greatest geopolitical catastrophe of the century". Putin's invasion and war in Ukraine has to be seen and interpreted in light of this historical perspective. (In a larger perspective, given the governance developments in Russia and China, the Ukraine war represents a fundamental philosophical conflict between the West and East (Russia and China) over the superiority of the democratic versus autocratic system of national and global political governance.)

There have been a number of relatively recent invasions by the Soviet Union, and subsequently Russia, that testify to Putin's and his predecessors' imperial posture. One just needs to recall the 1956 invasion of Hungary, the 1968 Soviet-led invasion of Czechoslovakia by the Warsaw Pact countries, and the Russo-Georgian War of 2008. The 2022 Russian invasion of Ukraine and the ensuing war that continues to date is the greatest, and most recent, manifestation of Putin's desire to enlarge Russia and extend its zone of influence. The developments to date also make it clear that Putin is willing to pursue this goal by whatever means may be necessary.

THE SITUATION ONE YEAR INTO THE WAR

The Ukraine war is different from Soviet Union's and Russia's other invasions since WWII in that Ukraine's territory is large and the Ukrainian leadership and people have demonstrated an unprecedented willingness to fight the invading army. The losses in human lives and physical destruction have been enormous, but the country resolutely perseveres in its struggle.

Given Putin's threat and ambitions, and the resolute Ukrainian response, the reaction of the West has been strong, albeit slow and not fully coordinated. Western sanctions imposed since the invasion of Ukraine have been more all-encompassing than those imposed after the invasion of Crimea in 2014 and they have been escalating over time. The supply of war material has been substantial and gradually shifting from the provision of lighter weapons and accessories to heavier artillery, tanks and fighter jets. The effect of sanctions has been limited, however, as Russia's economy declined only slightly in 2022. The inability of Europe to immediately cut off Russia's supplies of oil and gas and Russia's ability to sell oil and gas to other countries, especially China and India, helped to stave off a major decline of Russia's economy. So did the surprising fact that most Western firms remained in Russia and continued to pay the Russian government sales and excise taxes despite the sanctions. The Western economic response has hence been fragmented and overall inadequate in achieving its goal of greatly weakening Russia's economy.

It must be noted that in all this the excellent public relations and lobbying campaign of President Volodymyr Zelenskyy and other Ukrainian officials has played a major part in generating Western support.

THE ROLE OF CENTRAL AND EASTERN EUROPEAN COUNTRIES

While on the large scale it was the US that reacted most quickly and provided the most substantial military support after the start of the war, regionally it was the countries of Central and Eastern Europe (CEE) that reacted most quickly, provided the largest per capita assistance, and stimulated the Europe-wide response. As Russia's invasion took place, the leaders of the Czech Republic, Poland and Slovenia almost immediately travelled to Kyiv to meet with Ukraine's leaders and express their support to Ukraine. The CEE countries were also the first to provide military and civilian assistance, and they welcomed and effectively absorbed a major inflow of refugees, primarily mothers and children as many men joined the Ukrainian army. By the end of 2022, the number of Ukrainians refugees per 1,000 inhabitants had reached 46.4 in the Czech Republic, 41.4 in Poland, and 19.9 in Slovakia. The corresponding numbers were also relatively large for Germany (12.7), Austria (10.4) and Switzerland (9.1) but, except for Ireland (14.5), they were much smaller elsewhere (Protivinsky and Munich 2023).

Military and non-military support for Ukraine from the NATO countries has been growing over time, as has been the sophistication of the weapons provided. This, in addition to a surprisingly ill-prepared Russian army, has enabled the Ukrainian army to carry out a successful offensive and so far also to resist a counteroffensive by Russia. The challenge for the West going forward is to deliver the necessary military support permitting Ukraine to succeed militarily. The political will enabling this hinges in turn on maintaining popular support in the West for Ukraine and the acceptance of refugees. Studies indicate that the strong popular support is moderating over time. For instance, an in-depth analysis of the situation in the Czech Republic, where the support still remains very high, identifies as principal causes of the declining support the withering away of the initial shock of the war and a gradual fatigue with accepting additional refugees (Protivinsky and Munich 2023). This is to be expected, but it can be offset by other measures that could be taken by the West. The CEE countries have been calling on NATO to provide security guarantees to postwar Ukraine and for the European Union to initiate the process for EU membership. These and other steps would clearly boost the morale of the Ukrainian troops and provide for a postwar transition.

RECONSTRUCTION DURING AND AFTER THE WAR

As this discussion indicates, major military support for Ukraine is needed if the country is to protect itself from the aerial and surface attacks, and eventually repel Russia's aggression. The destruction of civilian targets, including hospitals and schools, is dramatic and Western assistance in the ongoing reconstruction of these sites is valuable, but needs to be stepped up.

The big question is naturally the postwar reconstruction of Ukraine. Estimates of costs exist, blueprints of strategies have been drafted (Gorodnichenko et al. 2022,) and preparations are to some extent underway. The estimated costs are high and growing, but lessons from the post-WWII reconstruction of Europe and Japan are instructive. At the local level, the reconstruction of extensively destroyed cities, such as Hamburg or Hiroshima, turned out to be much faster than expected because of the presence of human capital (Ehrenberg et al. 2021). The important lesson is that reconstruction can be relatively rapid in the presence of destroyed physical capital if human (and financial) capital is present.

What strategy is needed for the economic reconstruction and advancement of Ukraine as a whole? In 1990, after the fall of the Berlin Wall, I had a discussion with Thomas Schelling about the success of the post-WWII Marshall plan for Europe in the preparation of which he participated. His main point was that while the US financial aid was important, by far the more important economic aspect turned out to be the US insistence that the European countries set aside war-time animosities and start trading with each other. If Schelling is right, and I think he is, then it is imperative that Europe

establish free access for Ukraine's products to its markets.¹ On the domestic front, it is obviously crucial for Ukraine to establish an effectively functioning governance system with an emphasis on stamping out corruption.

CONCLUDING REMARKS

Ukraine is in a dire situation, given Putin's ruthless pursuit of imperial expansion. However, Ukraine's heroism and capable leadership, Russia's surprisingly inadequate military capabilities, and Western support provide hope for Ukraine's effective defence and postwar reconstruction. A dangerous development would be if China, which has so far only increased its trade in non-military products with Russia, were to start supplying Russia with arms. The Western world is increasingly recognising that the battle over Ukraine is very important per se, but that it also represents a larger struggle over the global rules and governance of the world.

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¹ The same obviously applies to other countries, but Europe is by far the largest potential market for Ukraine.

CHAPTER 10

Why the world needs Ukraine as much as Ukraine needs the world

Harold James

Princeton University

The world has a stake in Ukraine's defence of its sovereignty. The case for this proposition is compelling, but the argument may appear abstract, too abstract, and in consequence large numbers of people in many countries are unpersuaded. On 24 February 2022, the Russian Federation launched an all-out assault on the rules-based international order (which political scientists sometimes simply term RUBIO). The obvious victims of the act of aggression were the people of Ukraine; but the intended victims were the citizens of every state that depends on conventions, rules, and laws to manage the multi-fold connections with the rest of the world. In short, this was an attack on the whole world and its values.

The Russian attack was the outgrowth of a thinking in terms of a zero-sum game, in which every interaction involves a loser and a winner. That vision's attraction had grown over the last 20 years, especially since the 2008 financial crisis focused attention on American weakness. Russia put itself at the spearhead of a current of thought that criticised the pretensions of US power. It offered a challenge, or a balancing, that some people in many countries all over the world – including in the US – found appealing.

Something of this zero-sum mood was always around in the chaos of the post-Soviet transition. The nationalist and communist leader Vladimir Zhirinovsky in the 1990s formulated his response to the hardship of the economic transition pithily, "Why should we impose suffering and hardship on ourselves? We should impose suffering and hardship on others." That was exactly the course on which President Putin embarked from the very beginning of his political career when he consolidated his power with the ruthless prosecution of the Chechen war.

There are powerful arguments that are frequently raised against a policy of resistance to aggression and the violation of rules and norms of international conduct. They often amount to 'whataboutism': what about other breaches of norms? Putin likes to invoke NATO's bombing 1999 of Belgrade, or the US-led coalition's attack on Iraq in 2003. Others look at other parts of the world, noting that genocidal aggression is often left unpunished when the victims are not white Europeans.

One of the most prevalent arguments that follow the ‘what about’ logic is that earlier moments in which the international community could have asserted its collective belief in the rules-based international order were missed. Many people will think of 2014-15 and the brutal interventions of Putin to defend the Assad regime in Syria, which were also accompanied by massive human rights violations, but President Obama forgot about the ‘red lines’ he had set for Syria. Or should there not have been a more sustained response of Europe and the US to the beginning of the Ukraine war in 2014? Or to Russia’s 2008 war with Georgia, which many now see as a turning point in Russia’s relations with the international community, but when no one in Europe (except the Polish government) wanted to support Georgia.

There are of course good practical reasons why the rest of the world failed to respond adequately on these occasions: the absence of an effective sanctions regime, worries about collateral damage. In retrospect, it might have been better to prepare earlier – and to leave fewer western vulnerabilities.

Today, the situation is different in the sense that the world has already seen plenty of – too many – examples of how lives, communities, and solidarities have been destroyed. The act of Russian aggression in 2022 was staggering in its scope and ambition: the announced aim of the ‘special military operation’ was to end the existence of a country with a population of 44 million, on the grounds that Ukraine was a territory which had no right to exist or to self-determine its fate and its politics. As Vladimir Putin put it in the programmatic essay of 2021, “Russians, Ukrainians, and Belarusians are all descendants of Ancient Rus, which was the largest state in Europe,” and their identity was decided by the “spiritual choice made by St. Vladimir, who was both Prince of Novgorod and Grand Prince of Kiev.” A curious historical argument is thus used as a justification for conquest, imperialistic war, and the demonisation of the other side as Nazis.

The Russian side began its war with the claim that the Ukrainian government needed to be removed, and that idea was reasserted even more vigorously as Russia reformulated its strategy in the face of stalemate. There is at the same time a broader vision premised on the idea that Ukraine does not matter and that it is only a tiny pawn in a geopolitical game. In this reasoning, the war is not about any Russian ‘historical unity’, but rather about the complete destruction of the West and its security and economic institutions – NATO, the EU, and also the structure and institutions of Western democracy.

There may be a Russian calculation that rich industrial countries cannot bear the hardships brought by higher fuel and food prices and by reductions in effective incomes. The current equivalent is the calculation that worldwide hunger will trigger political unrest in countries dependent on food imports and other food vulnerable countries in the Middle East. The unrest, then, would provoke new conflicts, and a new wave of refugees. The disrupted lives of miserable and starving people would be used as a human weapon

against the West to heighten disruption and conflict. That playbook was already used in Syria in 2015 to heighten strains and tensions in Europe. Food is as vital a weapon as energy.

Who will win from an ending of the war on Ukraine's terms? Ukrainians, of course. But the conflict in Ukraine has also given other Europeans a powerful demonstration that Europe is about much more than just the charms, possibly dangerous, of increased economic connectivity. It is about the possibility of self-realisation, self-development – in short, freedom.

In order to make this case about the universality of Ukraine's struggle, the world should also think about the way in which all post-conflict situations need to be addressed through reconstruction plans, and above all improved access to international markets and resources.

A profound rethinking about Europe and its meaning is underway. One of the most dramatic transitions has occurred in Germany. Soon after 24 February 2022, Chancellor Olaf Scholz proclaimed a new age, a *Zeitenwende*, in which Germany would be obliged to take a more resolute position in defence of both German and European security. Since then, the German path has been bumpy. There were hesitations and fears about sending more than the military helmets that the Germans rather feebly initially offered to Ukraine. There was an insistence that Europe and the US should move together. The tank deal was a massive change, with Germans overcoming a historically grounded fear of using force in international relations (with the Panzer, the tank, occupying a powerful symbolical role as the Nazi instrument of conquest), and a historical sense of guilt towards Russia (even though, as many Ukrainian historians have pointed out, a large part of the victims of Nazi aggression were Ukrainians).

There may be a similar galvanising effect on US politics, long demoralised by the cyber manipulations of Russian trolls aiming to escalate divisions, fanning radical White and Black nationalisms so as to destroy hopes of solidarity and civic community.

Paradoxically, the greatest winner of a Ukrainian victory would be Russia. There exists an old historical pattern that everyone in Russia (as well as in the West) knows well: in Russia's past, defeat in war produced major upheavals and revolutions. The defeat in the Crimean war in the 19th century led to Alexander II's wide-ranging reform legislation, including the end of serfdom. Defeat in the Japanese war of 1905 was followed by revolution and then parliamentarisation, the calling of the Duma. WWI destroyed first the tsarist monarchy, then the provisional government of Alexander Kerensky. The Afghan war was one of the precipitants of the disintegration of the Soviet Union, with mothers of dead soldiers playing a prominent role in protests against that war.

Germany might give a guide to how to think about defeat. The most important speech in the Federal Republic's history was that given by President Richard von Weizsäcker, by coincidence the son of the most senior official in the German Foreign Office of the 1930s.

On the 40th anniversary of the end of the European war, on 8 May 1985, von Weizsäcker explained that “For us Germans, May 8 is not a day of celebration. Some Germans felt bitterness about their shattered illusions, whilst others were grateful for the gift of a new start.”

Like Germany in the decades after WWI and the collapse of Imperial Germany, Russia after the collapse of the Soviet Union took a wrong turn. Instead of thinking about how a political order could be built on the basis of a vibrant civil society, it privileged a narrow political and business elite that would exercise internal control through political repression, bribery, and theft of state assets. Instead of building links with other societies, it sought to revenge a perceived wrong (the breakup of the Soviet Union) and to dominate others. Instead of reflecting on human potential, it dug out old historical myths. Instead of modernising and diversifying its economy, it relied on energy extraction and export, which it saw as a tool of leverage and control over its trade partners.

One day, a Russian president may make a speech that parallels von Weizsäcker’s 1985 declaration. When that Russia faces up to its mistakes and crimes, the world will know that the lesson that Ukraine is currently teaching Europeans, and others, has reached everyone. It is the lesson of freedom.

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CHAPTER 11

Ukraine has finally started to exist on Germany's map

Klaus Adam

University of Mannheim and CEPR

Something remarkable has happened in Germany. Just one year ago, Ukraine was a country that hardly any German politician would take seriously or attribute political agency to. Ukraine was part of a corrupt no-man's land situated somewhere between Russia and the EU. It didn't really exist. Within a year, the situation has dramatically reversed. Ukraine has managed to firmly establish itself on Germany's map of Eastern Europe. The question is, why did it take so long and what can Germany learn from it?

The view that Eastern Europe – with the exception of Russia – does not really exist has a long tradition in Germany, especially among the current generation of politicians, whose history education in schools was heavily tilted towards Western Europe. In fact, many people in Germany leave school – some after seven years of history lessons – without having ever heard of the Grand Duchy of Lithuania or the Polish-Lithuanian Commonwealth, not to speak of Ukraine.

In many schools, Eastern European states would be introduced for the first time just to let them come to an end: the various rounds of divisions of the Polish-Lithuanian Commonwealth at the end of the 18th century, for instance, are studied in great detail. At the same time, there is virtually no time to study the four-century-long existence of the Polish and Lithuanian states before their demise. This is important because the Polish divisions present Russia and important Central European powers (Prussia and the Habsburg Empire) as the sole actors. This fosters the view that the place between them is simply something to be bargained over. The place in the middle doesn't really exist – in fact, it simply ends.

The next occasion where German history lessons would make contact with Eastern Europe is WWI. The war in the East, however, is not taught in great detail; the focus is mainly on what happened on the Western fronts. The only relevant outcome for the East that is taught, besides the territorial losses for Germany of course, is the Bolshevik revolution in Russia, which is studied in quite some detail. Again, this portrays Russia as the only place in the East with political agency.

And things don't look better when it comes to teaching WWII. History lessons force Germans to acknowledge that Nazi Germany was the main culprit for starting the war. Students also study the atrocities Germany committed in Eastern Europe, including the

concentration camps. Yet, these atrocities have no real location on the map and there is no serious discussion about the nationality of the people involved. In fact, very few in Germany would know that most of Germany's war in the East was fought on the territories of Ukraine and Belarus.

Instead, the common view is that Germany fought in and against Russia during WWII. And on this war, there is – quite surprisingly – a common understanding with postwar Russia. Both nations have conveniently agreed that Russians were the victims and the victors of WWII, while Germany was the aggressor, but one that has learned its lesson from history. Again, this is an understanding that leaves out all places in the middle and an aberration of history: relative to population size, deaths were highest in Belarus and Ukraine, and it was Russia that – together with Germany as an ally – set in motion WWII.

When Russia invaded Ukraine in 2014 and occupied Crimea and other Ukrainian territories, the vast majority of Germans did not grasp the significance of these events. They have no knowledge about Crimean history, which is not taught in German schools, where even Byzantium and the Mongol Khanates do not receive much attention. As a result, Germans bought the Russian narrative that Crimea is effectively Russian territory, as it was 'given to Ukraine' by Soviet Leader Nikita Khrushchev. The fact that Russia itself has no real historic claim to Crimea, and therefore could not simply 'give it' to anyone else, was not widely understood. Again, places in the middle simply never mattered much in German history lessons.

What this tells us is that Germany needs to rethink the way it teaches history in schools. The history curriculum needs to properly incorporate the history of Eastern Europe, by which I mean the agency of the territories west of Russia. It is no longer acceptable to exclude them from consideration. It matters a great deal for the ability to understand current politics.

How could this long-held view suddenly change over the last year? It was because of an unimaginable surprise: a place that did not really exist (i.e. Ukraine) suddenly managed to stop – on the battlefield – the country that the East was supposed to be all about (i.e. Russia). This, coupled with lingering doubts about one's own ability to achieve the same, made it clear that the dominant way of thinking had missed something of first-order importance. As with many misconceptions, it started with a distorted view of history.

The way history is taught in Germany reflects the history of the Russian colonial empire. But just like the world moved on from empires in Africa, Asia and the Americas, we need to recognise the agency of Ukraine and other former Russian colonies. Specifically, we need to understand that Russia's aggression is very much a colonial war. For this reason, Ukraine deserves every euro of aid on its path to genuine independence and recognition. There can be no freedom in Europe until we are done with the empires in every sense – from history textbooks to aggressive wars.

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CHAPTER 12

Ukraine is the latest Guernica. Let's make it the last

Maurice Obstfeld

University of California, Berkeley and CEPR

In late April 2022, Russia's unprovoked invasion of Ukraine was just over two months old. Despite widespread predictions that Russia would quickly decapitate Ukraine's government and seize control of the country, fierce Ukrainian resistance had beaten back Russian forces in the north and scored key victories in other theatres.

But the elements of Russia's longer-term strategy were already becoming clear: to terrorise civilians and wreck civilian infrastructure in order to undermine resistance capacity, morale, and ultimately Ukrainians' sense of national identity. The United Nations Office of the High Commissioner for Human Rights (OHCHR) estimated more than 6,000 civilian casualties by the end of April 2022,¹ many children among them. The OHCHR declared the true number to be "considerably higher" and observed:

Most of the civilian casualties recorded were caused by the use of explosive weapons with a wide impact area, including shelling from heavy artillery and multiple launch rocket systems, and missile and air strikes.

More than five million civilians had already fled the country. Drone, artillery, and missile strikes had flattened cities like Mariupol² and Popasna.³ Where the Russians retreated, they left behind a trail of murder, rape, and torture. Evidence on the notorious case of Bucha started to emerge in April, momentarily shocking the world, but of course denied by Russia.

Coincidentally, April 2022 also saw the 85th anniversary of an event many regard as signalling a new and savage era of warfare, where the deliberate targeting of civilians would no longer be off limits. On 26 April 1937, at the height of the Spanish Civil War, German and Italian air forces under the command of Spanish nationalists attacked the Basque town of Guernica. Starting around 4:30pm on a Monday, the customary regional market day, waves of bomber attacks lasting about two and a half hours destroyed many of the town's buildings and killed hundreds of civilians, with the exact numbers still in dispute.

1 <https://www.ohchr.org/en/news/2022/04/ukraine-civilian-casualty-update-29-april-2022>

2 <https://edition.cnn.com/2022/03/15/europe/ukraine-mariupol-destruction-footage-intl/index.html>

3 <https://edition.cnn.com/2022/05/04/europe/ukraine-drone-footage-popasna-intl/index.html>

Guernica was neither the first nor the last civilian bombing by German and Italian forces during the Spanish Civil War. The bombing of Jaén in Andalusia earlier that April killed more than 150; the aerial attack on Lleida in Catalonia in November 1937 killed hundreds more, including 48 children in a targeted school. Nazi Germany and Fascist Italy had multiple objectives in supporting nationalist Spanish leader Francisco Franco, but for the Germans, one goal was to test new equipment and refine the aerial tactics of the recently created German air force, the Luftwaffe. At the Nuremberg trials after WWII, air commander Hermann Göring offered this chilling testimony: “I urged [Adolf Hitler] to give support [to Franco] under all circumstances: firstly, to prevent the further spread of Communism; secondly, to test my young Luftwaffe in this or that technical aspect.”⁴

Outside of Spain, Italy had earlier resorted to aerial bombardments using mustard gas in its invasion of Ethiopia. In the late 1930s, expansionist regimes’ practice of civilian targeting was not restricted to airborne assault or to European fascists. The Nanjing massacre that Japanese forces perpetrated in 1937-38 is thought to have resulted in about 200,000 murders and 20,000 rapes. Nonetheless, because of its global notoriety – symbolised by Picasso’s famous painting completed in June 1937 – Guernica stands out in memory as the opening act in a new era of savagery in human warfare.

All of these indiscriminate attacks on civilians met with widespread international condemnation, but generated no effective international response. The League of Nations was seen as toothless and became irrelevant in a setting of growing global tensions. Notwithstanding what fascist regimes had revealed about their basic natures, Great Britain and France signed the Munich Agreement with Germany and Italy in September 1938. That capitulation set the stage for a second world war in which large-scale air attacks on civilian targets would become a regular feature and take hundreds of thousands of lives in London, Coventry, Dresden, Tokyo, Hiroshima, and Nagasaki – not to mention the systematic exterminations of the Holocaust.

After WWII, the international community aimed to establish a global security order that would prevent similar horrors. But the past decade has seen considerable backsliding. Notably, the Russian intervention in Syria during 2015-16 subjected civilians and civilian infrastructure to months of aerial bombardment, providing crucial support to the Assad regime in its own efforts, which included use of chemical weapons. As in the 1930s, the international community expressed verbal outrage but failed to act decisively and largely maintained business as usual with Russia. Arguably, that failure helped embolden Vladimir Putin to invade Ukraine a year ago. In Ukraine, we are witnessing Guernica again daily on a national scale.

We cannot slip back to the 1930s. Thankfully, the forceful response so far by the US, Europe, and important allies in Asia has made that outcome less likely. However, as the Russia-Ukraine war moves into its second year, some cracks in Western resolve are

4 Quoted in Thomas (1961: 228).

appearing, notably in the isolationist wing of the US Republican Party, even (perhaps fleetingly) among a fringe of progressive Democrats, and among some in Europe. Particularly in the US, sceptics of support for Ukraine argue that the conflict is far away, of little strategic significance to America, and is not worth the risk of a wider war or the substantial expenditure of US economic resources when there are pressing needs at home.

Heeding these voices would only validate Russia's strategy and reward the intentional military targeting of non-combatants. In a world of increasing authoritarianism and pressure on democratic institutions, the precedent would undermine further the postwar global security architecture, to everyone's detriment.

The siren song of 'negotiations' may seem appealing as an alternative to continuing conflict, especially if one ignores the low credibility of any promises that Putin's Russia might make. Nevertheless, allowing Russia to retain territory conquered through state terrorism would send a message that it is not in the interest of the global community to send: that the postwar attempt to banish the barbarities of the past has failed, and in the 21st century, crime does pay. Events in Ukraine, though seemingly distant to some of us, have consequences for us all. For that reason, Ukraine's success is the world's success.

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ABOUT THE AUTHOR

Maurice Obstfeld is the Class of 1958 Professor of Economics and former Chair of the Department of Economics at the University of California, Berkeley. He arrived at Berkeley in 1991 as a Professor, following permanent appointments at Columbia (1979-1986) and the University of Pennsylvania (1986-1989), and a visiting appointment at Harvard (1989-90). He received his PhD in Economics from MIT in 1979 after attending the University of Pennsylvania (BA, 1973) and King's College, Cambridge University (MA, 1975). From September 2015 to December 2018, he was the Economic Counsellor and Director of Research at the IMF. From July 2014 to August 2015, he served as a member of President Barack Obama's Council of Economic Advisers. Dr. Obstfeld was previously an Honorary Adviser to the Bank of Japan's Institute of Monetary and Economic Studies. He is a Fellow of the Econometric Society and the American Academy of Arts and Sciences. Since February 2019, he has been a nonresident senior fellow of the Peterson Institute for International Economics. He has consulted and taught at the IMF and numerous central banks around the world. He is also the co-author of two leading textbooks on international economics, *International Economics* (12th edition, 2021, with Paul

Krugman and Marc Melitz) and *Foundations of International Macroeconomics* (1996, with Kenneth Rogoff), as well as more than 100 research articles and books on exchange rates, international financial crises, global capital markets, and monetary policy.

CHAPTER 13

Why does Ukraine matter so much to me?

Charles Wyplosz

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I grew up during the Cold War and, as a teenager, I spent many a night grappling with the thought that a third World War was a real possibility. This is one reason why, right after the collapse of the Soviet Union, I rushed to Moscow to try and help the new Russia to cope with its economic transition from central planning to markets. I was driven by the desire to do whatever I could to make sure that the new Russia would be a friendly nation. I shared the then-widely held view that an economically integrated and well-to-do Russia would be a peaceful neighbour. Once in Moscow, with funding from the European Commission, I worked with a number of ministers and their economic collaborators. I found them eager to learn ‘Western economics’, which they initially understood poorly, and determined to do the ‘right thing’. It was exciting. Then, it turned bad. I could see corruption taking hold at all levels. I witnessed the emergence of the oligarchs, I noticed that many ministers were increasingly wearing expensive clothes and less interested in seeking advice. Being a foreigner started to close doors. Economic mistakes proliferated, despite warnings. Having concluded that a public debt crisis was becoming unavoidable, I quit and stopped travelling to Moscow a few months before it happened. It left me with a deep feeling of failure. It was not my own failure, of course, but the fear that a historical opportunity was being squandered.

Still, I was hopeful. People were free to express their views and so were the media. Open political debates were raging in a country that had never experienced democracy before. Elections were contested and reasonably free and fair. A market-driven economic infrastructure had fully replaced the Soviet system. The New Economic School, financed by George Soros’ Open Society Foundation, was training bright students as effectively as top departments in the West. Much more had to be done but, even though corruption was taking its toll, Russia seemed poised to grow. The big issue, I thought, was whether it would move from its reliance on extractive industries to a diversified economy. It did not. The oligarchs, whose wealth was mostly based on primary commodities, cemented their control. Then came Putin. Although he continued to rely primarily on liberal – in the European sense – reformers to conduct fiscal and monetary policies, he turned back from liberalism in all other domains. Gradually, all freedoms have been eroded. There

are no independent media anymore. Justice has been perverted. My Russian friends now tell me that they have rediscovered the old Soviet times habit of only sharing views with very close friends.

Then came 24 February 2022. The failure is complete. My old nightmares are back.

I had travelled a few times to Kyiv in the late 1990s. It was depressing. Most of the people – officials, politicians, academics – that I met there looked exactly like the old apparatchiks that I had seen in Moscow. They did not seem to have learned much since the end of the Soviet Union. Their economic discourse was still dominated by Soviet-era considerations. Corruption had taken hold there as well. Ukraine looked like a lost cause. After my last visit, the Orange Revolution greatly surprised me. It suggested that a new generation was pushing aside the people that I had met. Although the Orange Revolution failed, a decade later, the Maidan Revolution eventually dismissed the old-timers, but corruption survived. Russia responded by invading Crimea and parts of the Donbas. This left me confused. I could see that Putin was sending an unobvious message to the new generation of Ukrainian leaders. Even though it revealed a degree of cynicism that went far beyond the already considerable level that he had displayed, I did not realise how much he shared with his Soviet predecessors a lack of concern for human lives, including those of his fellow countrymen.

On 24 February 2022, I thought that the special military operation would restore the old order in a matter of days and reintegrate Ukraine into the Russian empire. That is when a miracle occurred. The Russian army proved to be inept and cruel, which should not have come as a surprise. The surprise, to me, was that Ukrainian army had changed after Maidan (and Crimea) and that its citizens were no longer willing to let Russia be the tough big brother.

Is this miracle reviving old hopes? My own hope is that a profoundly chastised Russia will give up on its dreams of imperial power and its enthusiasm for strong leaders. It is tempting to draw a similarity with Germany's imperial military period, which extends far in the past, long before the Nazis (at times when there were other countries competing for supremacy). As in today's Russia, a paranoid fear of neighbours and a cult of strong men coexisted with sophisticated elites. Today, Germany is arguably one of the world's most pacifist countries, to the point of irritating its partners in support of Ukraine. In many ways, this is the result of a complete military defeat combined with the postwar effort to change the old historical narrative.

Here again, things become personal. During all my childhood, I have heard my Polish Jew parents express deep gratitude for the Red Army that freed them from the Nazis, which is another reason while I rushed to Moscow to try and help out. Now I praise Germany's pacifism and wish that Ukraine, which has a long tradition of antisemitism, destroys the Red Army. Historians like to remind us that old traditions are perpetuated through

generations, which makes me wonder whether that is really what I wish. Without doubt, these days Germany is not a threatening dictatorship, Russia is not liberating anyone anywhere, and Ukraine is undergoing a deep transformation.

Ukraine currently is the only hope of solving the ‘Russian problem’ as it fights for its survival as a nation. Unless Russia is defeated, the Russian problem will remain a major threat. But what does defeat for Russia mean? Something bad enough that it will abandon its sick vision of its role in the world and its readiness to aggress those who disagree, at home and abroad. Hopefully, whatever the Ukrainians decide is a Russian defeat will suffice, and I do not want to think what will happen if it does not suffice. Meanwhile, Ukraine fights for us. Our support must be total, not just because we want to be helpful to brave people subject to cruel violence, but also because we are the eventual target.

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Charles Wyplosz is Emeritus Professor of International Economics at the Graduate Institute in Geneva where he has been Director of the International Centre for Money and Banking Studies (ICMB). He also was Policy Director at the Center for Economic Policy Research (CEPR). He is a member of the Bellagio Group and of Euro 50. Previously, he has served as Associate Dean for Research and Development at INSEAD and Director of the PhD programme in Economics at the Ecole des Hautes Etudes en Science Sociales in Paris.

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He has served on the Advisory Scientific Committee of the European Systemic Risk Board, on the Panel of Experts of the European Parliament’s Economic and Monetary Affairs Committee, on the ‘Conseil d’Analyse Economique’, which reports to the Prime Minister of France, and on the French Finance Minister’s ‘Commission des Comptes de la Nation’. He has been a consultant to several international organisations and has advised the Presidents of France and of the European Commission as well as the governments of the Russian Federation and of Cyprus.

Wyplosz holds degrees in Engineering and Statistics from Paris and a PhD in Economics from Harvard University. He has been awarded the *Legion d’Honneur* by the President of France.

CHAPTER 14

Why the West must not waiver in its support for Ukraine: Three critical issues

Adonis Yatchew

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We are arguably at a critical juncture in history. Humankind is faced with mounting challenges on multiple fronts, among them the decline of democracies and assaults on human rights and freedoms, nuclear sabre-rattling and proliferation, and global warming. In this commentary, I argue that continued resolute support for Ukraine in the face of naked aggression can contribute materially and significantly to addressing each of these challenges.

Support for Ukraine is not limited to direct military, political, and humanitarian initiatives. The current framework includes, and must continue to include, policies which indirectly support Ukraine's quest for freedom¹ by limiting Russia's ability to constrain it. Perhaps the most prominent of these is European curtailment of dependence on Russian hydrocarbons, a remarkable feat largely accomplished in less than a year. Such policies have come at major immediate economic costs but will contribute to economic and security benefits in the longer term.

Democracy and human rights have been in retreat for more than 15 years (Freedom House 2022), but Putin's invasion has re-energised free societies into a cohesive response, at least for the time being. On 24 February 2022, Russia launched an invasion with the specific goal of decapitating the duly elected Ukrainian government by attempting to capture Kyiv and installing a government favourable to the Kremlin. The objective was not novel – continued meddling in Ukrainian politics has been a standard tool since Ukraine declared independence in 1991. Russia's subversion of efforts by Ukraine to 'turn West' led to the Orange Revolution in 2003 and the Revolution of Dignity, also known as Maidan, in 2014. The Russian invasion into eastern Ukraine and Crimea in 2014 was not sufficient to galvanise the West into a meaningful response. Indeed, Nord Stream 2 approvals came *after* the 2014 invasions, continuing a pattern of appeasement. Following Lenin's dictum, Russia probed the West with bayonets, found mush, and pushed on.

¹ The desire of Ukrainians to free themselves from Moscow goes back at least to Voltaire. In his *History of Charles XII*, published in 1731, he states "L'Ukraine a toujours aspiré à être libre".

But once awakened to danger, democracies are a formidable foe. NATO leadership organised a vigorous response, ramping up military, logistical, and intelligence support. The EU formulated a multi-pronged strategy to weather Russian weaponisation of natural gas supplies and, remarkably, Europe will survive the winter of 2022-2023. Not all of Europe had blithely walked into natural gas dependence on Russia. In 2014, Lithuania installed an LNG storage and regasification facility sufficient to service national needs in the event of disruption of Russian supplies. Lithuania named the facility *The Independence*.

Over the course of the first year of the invasion, the West has drawn a line that it will not turn away when a fledgeling and viable democracy is invaded. But it now must hold that line, lest autocrats learn that they need only wait until Western resolve dissipates.²

History will judge whether collective and sustained support for Ukraine marks a geopolitical reversal, with democratic forces advancing rather than retreating. Supporting Ukraine comprises an opportunity not to be missed.

Putin and his inner circle have engaged in nuclear sabre-rattling which must not be rewarded lest it provide a template for other nuclear powers or aspirants. To put matters in perspective, the Russian economy is smaller than that of Canada – the latter’s GDP was about 10% larger in 2020 and 2021 despite having only about one quarter the population. Prior to the invasion, Russia was one of the three largest producers of oil (the others being the US and Saudi Arabia). Russia’s geopolitical leverage arises primarily from two sources: its vast reserves of hydrocarbons (natural gas and oil) and its arsenal of nuclear weapons.

Ukraine’s experience provides a hard lesson for those who seek to limit the proliferation of nuclear weapons. Following the dissolution of the Soviet Union, Ukraine was in possession of the third largest stockpile of nuclear weapons in the world. In 1994, the Budapest Memorandum was signed by Ukraine, Russia, the UK, and US. In return for guarantees of its sovereignty and territorial boundaries, Ukraine agreed to give up its nuclear weapons. The ostensible argument advanced by diplomats was that this would lead to greater stability. The clear message to countries possessing or seeking to possess nuclear weapons (for example, North Korea and Iran) is that these weapons magnify one’s geopolitical clout (look at Russia) and their abandonment would be foolhardy (look at Ukraine).

Having failed to dissuade Russian meddling and invasions of Ukraine, a country which has repeatedly been thwarted in its efforts to ‘turn West’, there is now the opportunity to fashion an approach which deters rather than encourages nuclear blackmail. It is *because* nuclear war is unthinkable that we must think carefully about it. Succumbing to nuclear threats will increase the incentives for their acquisition because it confirms their value

2 The imposition of economic sanctions has also steadily increased, but history suggests that sanctions are a relatively weak tool for altering the behaviour of autocrats.

as a threat. Thus far, the Western strategy has been measured and consistent, though public information on the messaging to Russia of how the West would respond to the use of tactical nuclear (or chemical or biological) weapons is limited, perhaps as it should be. Indeed, such messaging likely should have a degree of ambiguity.

But the one element that *should be unambiguous* is that nuclear threats will not alter support for Ukraine. Faltering on this path signals to others that blackmail works; steadfastness signals that it does not.

At first blush, any bearing of the invasion on dealing with global warming would seem to be peripheral. On the one hand, European use of coal, as a replacement for natural gas, will increase. Coal has approximately twice the carbon footprint of natural gas, thus this would appear to be a step backwards. On the other hand, within weeks of the commencement of the invasion, the EU committed to accelerating decarbonisation programmes. But the real global challenge is not so much the decarbonisation of wealthy economies, but of developing countries.³

Commitment by Europeans not to restore natural gas imports from Russia creates a powerful incentive to accelerate innovation in decarbonisation. The point is not simply the implementation of existing low-carbon technologies or even continued declines in their unit costs. What is necessary are game-changing innovations which will be affordable in developing economies and lead to tipping points there. Europe's instinctive response to wean itself off Russian hydrocarbons has been costly, but it was the right decision, and must be sustained. It will further stimulate innovation in the decarbonisation space.

Autocratic forces have been gaining momentum for more than a decade, while democracy has been in retreat in many parts of the world. Continued support for Ukraine – military, economic and humanitarian – comprises an historic opportunity to halt, and even reverse, democratic decline. Faltering in this commitment will embolden autocrats and dictators to pursue their nefarious objectives by any means, including the committing of war crimes.

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3 It is estimated that if the latter are to achieve Western standards of living, a tripling of global GDP would be necessary, with a concomitant tripling of energy consumption.

ABOUT THE AUTHOR

Adonis Yatchew's research focuses on energy, regulation and econometrics. Since completing his PhD at Harvard University, he has taught at the University of Toronto. He has also held visiting appointments at Trinity College, Cambridge and the University of Chicago, among others. He has written a graduate level text on semiparametric regression techniques published by Cambridge University Press. He has served in various editorial capacities at *The Energy Journal* since 1995 and is currently the Editor-in-Chief. He has advised regulators, public and private sector companies on energy, regulatory and other matters for over 35 years and has provided testimony in numerous regulatory and litigation procedures. He currently teaches PhD level courses in econometrics, and MA and undergraduate level courses on energy in the University of Toronto Department of Economics and the School of Environment. The energy courses are interdisciplinary, spanning economics, the environment and sustainability, politics, geopolitics and security. He has also taught short courses covering these areas at international conferences.

CHAPTER 15

Why Ukraine must be given full support

65

Anders Åslund

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According to Freedom House, global democracy has steadily declined since 2005, ending three decades of increasing democracy. Corruption is closely related to democracy: the more democracy, the less corruption. Since its Revolution of Dignity in 2014, Ukraine has been one of the few countries that have offered hope in both regards. It has advanced on the Transparency International Corruption Perception Index in rank from 146 in 2014 to 116 in 2021, and Freedom House considers it almost fully democratic.

Ukraine offers the greatest hope in the world for democracy and rule of law. It forms a potent threat against the authoritarian kleptocracy of Russian President Vladimir Putin. Facing this danger, Putin has started two wars of aggression against Ukraine. His greatest fear is that democracy and rule of law will proliferate into Russia. He has also realised that wars make him more popular at home and make it possible for him to impose more severe repression. Finally, he thrives on neo-imperialism.

If Russia wins this war, the whole international order established after WWII will have been demolished, and Russia will not stop with Ukraine. Presumably, Putin will opt for Moldova as the next target. Therefore, wars of aggression must never be allowed to succeed. Russia has committed tens of thousands of war crimes. They can only be punished if Ukraine wins. This is also a war between democracy and dictatorship, between good and evil. If Ukraine wins, Putin's dictatorship is likely to collapse into a more liberal order, and his kleptocracy will probably collapse.

For all these reasons, Russia must be defeated. First, Ukraine needs to recover all territories that it has lost since 24 February 2022. Second, it must also regain the Ukrainian lands Russia seized in 2014, that is, Crimea and half of Donbass. Third, since Russia started its assault on Ukraine from the naval base Sevastopol it had leased from Ukraine, Ukraine must take it back. Fourth, all the Ukrainians citizens that have been deported to Russia must be allowed to return. Fifth, Russia must pay war reparations for all the damage it has caused to Ukrainian lives and property. President Volodymyr Zelensky has included all this in his ten-point plan for peace in Ukraine.

At present, Ukraine has an army of one million soldiers under arms. The vast majority are volunteers who want to defend their country. But Ukraine is utterly dependent on the supply of Western arms. Only gradually has the West started to understand that its

interest lies in Ukrainian victory. For too long, many confused minds, including Henry Kissinger, called on Ukraine to negotiate with Russia and offer to give up territories that Russia had seized with force, killing, torturing, and raping the inhabitants.

Instead, the West needs to fully commit to Ukraine's victory as defined by President Zelensky and Russia's defeat. The West should no longer drip-feed Ukraine with arms but provide all the arms that Ukraine asks for as fast as possible. Ukraine has received HIMARS (high-mobility artillery rocket systems) from the US, which changed the war, and more long-distance precise missiles. Most recently, the main stumbling block was major battle tanks, which will now be delivered, but so late that they have hindered a Ukrainian winter offensive. The next big item is modern fighter planes, such as the F-16, Swedish Gripen, or French Rafale. Yet, Western arms donors still insist that Ukraine must not attack Russia with their arms, while Russia persistently terror bombs Ukrainian civilians from Russian and Belarusian territory. This makes no sense. The West must commit to Ukraine's victory and offer all the means that are needed. After all, Western governments have not contributed a single soldier.

Arms are vital, but not enough. Ukraine runs a risk of winning on the battlefield but losing out economically. Ukraine's GDP declined by slightly over 30% in 2022. The World Bank assesses that Ukraine's reconstruction and recovery may cost as much as \$650 billion. Russia is acutely aware of Ukraine's economic weakness and does whatever it can to cause Ukraine higher costs. It has pursued severe economic sanctions for years. Just before its assault in 2022, Russia blocked all Ukraine's Sea of Azov and Black Sea ports. Russia has systematically bombed Ukraine's infrastructure, housing and hospitals.

The West must keep Ukraine afloat financially. Last year, the Ukrainian government asked for \$60 billion in budget financing, but it received only \$32 billion. It was forced to cut its budget as much as possible, but even so it had to turn to monetary financing, which boosted inflation to 27%. This year, the budget situation looks more promising. The government calls for \$38 billion in budget financing, and the EU has committed \$19 billion and the US \$10 billion for the first nine months. Hopefully, the IMF will finally come in with a substantial programme with financing.

After the war has been concluded, or at least slows down, comes reconstruction. The Ukrainian government assesses that three years of reconstruction will cost \$300 billion. Such a large amount of money requires good governance and the inclusion of all potential donors. The G7 leaders want to lead the coordination of financial support for Ukraine and they have made the operative decisions to proceed speedily. In late January 2023, the G7 representatives agreed on the governance of the coordination platform. They appointed a steering committee consisting of a triumvirate with a US, Ukrainian, and EU representative. They also agreed to set up a Secretariat at the EU in Brussels with an additional office in Kyiv. The G7 intends to invite all potential donors.

Three hundred billion dollars is an enormous amount of money. Obviously, Russia should be forced to pay reparations for all the damage it has caused, but it will not do so voluntarily. Fortunately, Russia does not need to agree because immediately after Russia invaded Ukraine, the G7 decided to freeze the international currency reserves of the Central Bank of Russia held in Western countries. These funds are very large. According to the public statistics of the Central Bank of Russia, on 1 January 2022 they amounted to \$316 billion. Germany held \$96 billion, France \$61 billion, Japan \$57 billion, the US \$39 billion, the UK \$31 billion, Canada \$17 billion, and Austria \$15 billion.

The Russian central bank reserves have many advantages. They are the indisputable property of the Russian Federation, which is directly responsible for the war crimes in Ukraine. They can be located. They are perfectly liquid, and require a minimum of administrative and legal work. The countries that hold and have frozen these funds should confiscate them through national legislation on the basis of Putin's unprovoked war of aggression against Ukraine and his gross violations of international law. Unfortunately, Western central banks have so far refused to cooperate, or even acknowledge the size of the Russian reserves they hold. This must change. It is up to the relevant Western parliaments to legislate the confiscation of these funds.

Ukraine should not only carry out a reconstruction, but also modernisation and restructuring, EU accession and reform. In June 2022, the EU granted Ukraine membership perspective and made it a candidate for EU membership. The next step for the EU is to formulate a negotiation mandate and start membership negotiations. On 3 February 2023, European Commission President Ursula von der Leyen led a delegation of 15 EU commissioners to Kyiv for an EU-Ukraine summit, which issued a strong Joint Statement.

The EU repeated its commitment to Ukraine: "The EU recalled the decision by the European Council to recognise Ukraine's European perspective and grant to Ukraine the status of a candidate country. The EU reiterated its commitment to support Ukraine's further European integration." Yet, the EU insisted: "The EU will decide on further steps once all conditions specified in the Commission's opinion are fully met." Fortunately, "Ukraine underlined its determination to meet the necessary requirements in order to start accession negotiations as soon as possible." The EU proceeded to praise Ukraine for its considerable reform efforts.

The Joint Statement rightly focused on the most important judicial reforms: "We reaffirmed that comprehensive and consistent implementation of judicial reforms, in line with the recommendations of the Venice Commission, including the reform of the Constitutional Court and the selection procedure of politically independent and qualified constitutional judges, remains vital for strengthening Ukraine's resilience and for progress on the enlargement process."

The collective West and Ukraine are on the right track together. The West needs to deliver plenty of high-tech arms and funding, while Ukraine needs to be as successful as it has to date on the battlefield, and it is great that it now seems serious about key judicial reforms.

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CHAPTER 16

Supporting Ukraine with sanctions has been much less costly than many predicted – we should do more of it

Benjamin Moll

London School of Economics

Immediately following the Russian invasion of Ukraine, an influential view in German policy circles held that, while it was important to support Ukraine, an embargo on Russian energy exports should be off the table because the economic costs would be enormous. Chancellor Olaf Scholz warned of “the loss of millions of jobs” in the event that Russian energy were cut off and vice-chancellor Robert Habeck warned of “mass unemployment and poverty”. These warnings were in line with those by industry leaders. For example, the CEO of BASF, Martin Brudermüller, predicted that a cut-off from Russian gas “could bring the German economy into its worst crisis since the end of World War II and destroy our prosperity”, adding “Do we knowingly want to destroy our entire economy?”¹

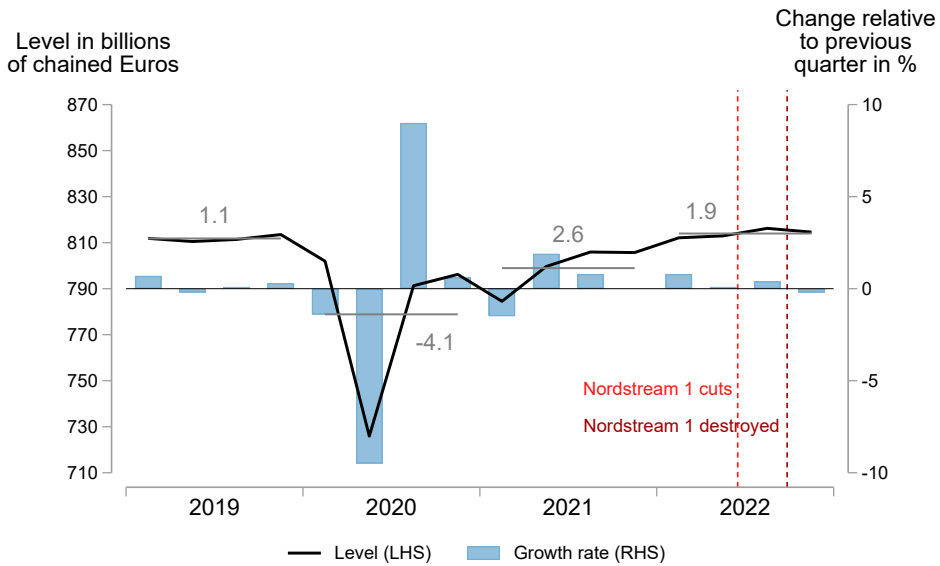
At least in part due to these apocalyptic predictions, Western countries opted for a cautious approach to sanctioning Russian hydrocarbon exports and such sanctions did not begin in earnest until the EU crude oil embargo took effect in December 2022, i.e. almost ten months after the start of the war. Sanctions on gas exports were noticeably absent from any sanctions packages. But already in the spring and summer of 2022, Putin started weaponising Russia’s gas supplies, first substantially cutting deliveries in June in particular through the Nord Stream 1 pipeline and then completely halting them in September, effectively resulting in the same outcome as a gas embargo.

HOW WESTERN ECONOMIES ADAPTED TO PUTIN’S ENERGY WAR

As we now know, in the wake of the Russian gas cut-off, European economies did not see the type of collapse predicted by German politicians and industry representatives. As an example, Figure 1 plots the evolution of German GDP since 2019.

1 See www.spiegel.de/politik/olaf-scholz-und-der-ukraine-krieg-interview-es-darf-keinen-atomkrieg-geben-a-ae2acbf-8125-4bf5-a273-fbcd0bd8791c, www.theguardian.com/world/2022/mar/14/russian-gas-oil-boycott-mass-poverty-warns-germany, and www.faz.net/aktuell/wirtschaft/unternehmen/basf-chef-warnt-vor-gas-embargo-schaeden-fuer-deutsche-volkswirtschaft-17925528.html.

FIGURE 1 REAL GDP IN GERMANY



Note: Seasonally and calendar adjusted.

A large drop in economic activity is visible in 2020 during the Covid pandemic. However, there is no (even remotely) comparable drop following the cuts in gas deliveries marked by the two red vertical lines: Germany's GDP grew in all quarters of 2022 except Q4, when it declined by 0.2%. Of course, from the time-series it is impossible to infer the counterfactual of economic activity would have looked like without the gas cut-off. But what is clear is that the truly apocalyptic scenarios have not come true.

Why did Putin's energy weapon fail to fire? There is a multitude of factors but the most important among these was energy demand reduction and substitution by European households and firms. For example, as of January 2023, EU-wide natural gas consumption was a striking 25% below its 2019–2021 average, with similarly large reductions in many individual member countries (McWilliams and Zachmann 2023). Alternative supplies available on the world market also played an important role. The large observed demand reductions are in line with predictions of both basic economic theory as well as more complex multi-sector models (Bachmann et al. 2022). Thus, both our experience and our models suggest that sanctioning Russia has been much less costly than many predicted.

“EACH EURO OF RUSSIAN ENERGY EXPORTS CONTRIBUTES EXACTLY ONE EURO TO THE WAR”

The main rationale for sanctioning Russian energy exports has always been simple, namely, that these exports represent an important source of fiscal revenues for the Russian state, money that is then used to wage war in Ukraine. As Oleg Itskhoki has put it, “each marginal euro received [by Russia] from energy exports to Europe contributes exactly one euro to the war, as simple as that”.² Opponents of the energy embargo idea have often argued that this effect is absent because the Russian government can print its own money and therefore does not need to rely on export revenues. My favourite rebuttal of this argument is due to Hanno Lustig: “Suppose we did a helicopter drop of dollars in Red Square in Moscow. If no one bothers to pick them up, then export curbs are irrelevant. Not a likely outcome.”³ Or, as Bachmann puts it in his contribution to this volume: “This is an example of how modern monetary theory-like thinking can literally cost lives.”

The delayed and cautious implementation of energy sanctions by Western countries therefore contributed to Russia earning record export revenues in 2022. This in turn likely contributed to Russia’s ability to wage war in Ukraine. For example, Babina et al. (2023) argue that, even though the EU oil embargo only came in effect in December 2022, it has already materially affected Russian export revenues and, furthermore, that an earlier introduction of the EU oil embargo and/or G7 price cap in the immediate aftermath of the invasion could have reduced Russia’s oil export earnings by up to \$50 billion, or about one third.

Related, there is evidence that other forms of sanctions, in particular sanctions on Russian *imports* did play an important role in weakening the Russian economy and state. For example, Figure 2 plots the evolution of real GDP in Russia as reported in the official Russian national accounting statistics (Rosstat 2022), the same series that was also used by Bachmann (2023).⁴

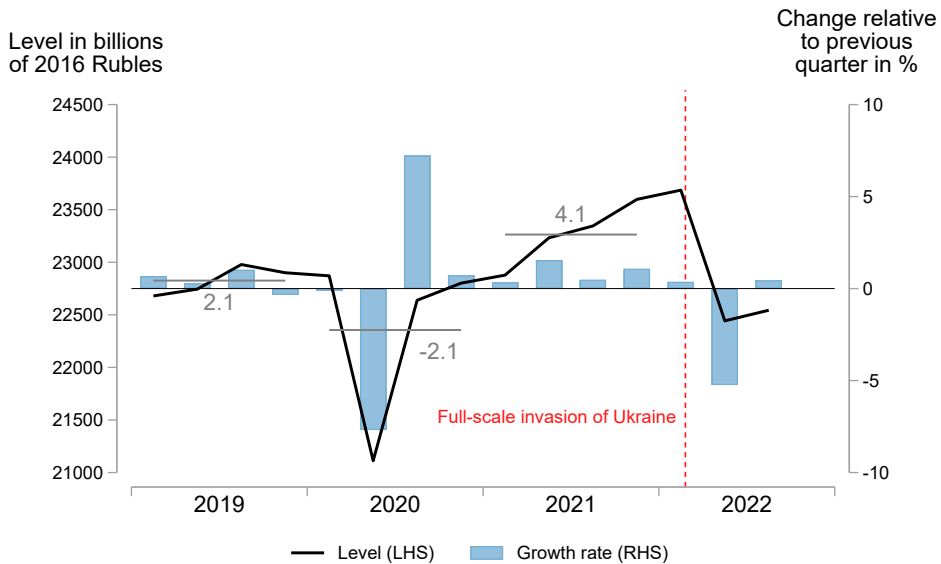
The figure shows a very sizable drop in Russian GDP of around 5% that begins right after the full-scale invasion of Ukraine and the imposition of sanctions. As noted by Bachmann (2023), aggregate consumer spending fell even more, by up to 7.5%. Note in particular how the size of the drop in 2022 compares to the barely noticeable dip for Germany in Figure 1. Also see the contribution by Schmith and Sakhno in this volume, who use an alternative tracker of Russian economic activity which points to a recession that is deepening further than the official statistics suggest.

2 See the tweet by Oleg Itskhoki on 8 April 2022 (<https://twitter.com/itskhoki/status/1512508687641763844?s=20>).

3 See tweet by Hanno Lustig on 4 June 2022 (<https://twitter.com/HannoLustig/status/1533000546659012608?s=20>).

4 See Bachmann (2023) for a discussion of caveats to using the official data and alternative data sources. As noted by Bachmann GDP is real, seasonally adjusted GDP in 2016 rubles from Rosstat (2022), Sheet 9, row 5.

FIGURE 2 REAL GDP IN RUSSIA



Note: Seasonally adjusted.

OPTIONS FOR TIGHTENING ENERGY SANCTIONS ON RUSSIA

On the one hand, sanctions and Putin's ensuing energy warfare have been much less costly for Western economies than many predicted. On the other hand, it remains true that Russian hydrocarbon exports fund the war in Ukraine. This suggests that the West should look for ways to further tighten the sanctions regime on Russian energy exports.

Here I briefly discuss possible strategies for achieving this, mostly drawing on work from two sources: Babina et al. (2023) as well as a number of papers written by the Yermak-McFaul International Working Group on Russian Sanctions.⁵ Given the existing sanctions infrastructure, in particular the EU oil embargo and G7 oil price cap, some natural ways of tightening sanctions are:

- improving the enforcement of the G7 oil price cap, for example via audits of attestations regarding compliance with the price cap (Babina et al. 2023);
- lowering the oil price cap;
- implementing a cap on oil products (and not just crude oil) (International Working Group on Russian Sanctions 2023).

Other options (like taxes and tariffs) were laid out by International Working Group on Russian Sanctions (2023) but may be less feasible politically. In weighing these options, we need to remind ourselves that the costs of tightening sanctions will likely be moderate but that each euro less paid to Russia is one less euro for the war in Ukraine.

5 <https://fsi.stanford.edu/working-group-sanctions>

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Benjamin Moll is a Professor of Economics at the London School of Economics. He is a macroeconomist studying how the enormous heterogeneity observed at the micro level, and in particular the large disparities in income and wealth, impact the macro economy and macroeconomic policy. Moll’s work analyzes the macroeconomic and distributional consequences of monetary and fiscal policy as well as disruptions like the Covid-19 pandemic. Most recently, his work has focused on the European energy crisis. In particular he coauthored a number of analyses predicting that the consequences of an import stop of Russian energy for the economies of Germany, France, and the EU as a whole would be substantial but manageable. Moll holds a Ph.D. from the University of Chicago, he is a Fellow of the Econometric Society and the recipient of the Bernácer Prize for best European economist under 40 working in macroeconomics and finance.

CHAPTER 17

Why it is imperative to help Ukraine

75

Rüdiger Bachmann

University of Notre Dame and CEPR

It is imperative for Russia to lose its war of aggression in Ukraine. Since Ukraine cannot win this war without succour, it is imperative for the other European states to help Ukraine.

Why is it imperative for Russia to lose this war? First, this is a question of international order. Without a supranational entity in Europe that can provide centralised policing and military power, the European post-war order had to be built, again, on a system of explicit and implicit contracts between not-always-free but ever-freer countries. This system was built – more than any of its predecessors – on the principles of territorial integrity and the self-determination of peoples. It is these principles that ensured lasting peace in Europe and also allowed Europe to make its internal borders less onerous to cross, to the extent that they have become almost irrelevant, which, in turn, has given Europe decades of economic prosperity and growth.

Should Russia win its war of aggression in Ukraine, Europe's foundation and all the prosperity that was built on it will be in jeopardy.¹ Borders would be important but also violable again. Ukraine's western-border countries would be in immediate military jeopardy. Even NATO could be, for Russia would only need to wait for another 'Trump' in the White House. Russia would continue to influence and manipulate the democratic process and societal dynamics in every other European country. In short, Europe, including Western Europe, would become quasi-vassals to a Russian Empire.

Second, this is a question of economics. In a Europe thus outlined – who would want to invest and innovate there? What would the risk premia be in such an economy? What would Europe's contribution to the – necessary – global climate-protection transformation be when it lives again on 'cheap' Russian fossil energy? After all, why would Russia not want to sell this energy to its periphery? Europe's brain drain would likely accelerate. Peace dividends would evaporate for a long time.

Third, this is a question of history. I find most plausible the interpretation that this war is the war of an empire attempting to ensure that a perceived periphery state does not venture too far from the centre and its influence. Russia simply cannot afford a prosperous

¹ And, yes, Western countries have themselves, at times, violated the international order, but it is illogical to conclude from this fact that now it can be Russia's turn to do so.

and democratic Ukraine even if Ukraine was not a member of NATO or the EU. The correlate of this is that Putin's regime models itself not on the Soviet Union, with its internal conservatism and checks and balances, but on the tsarist era of great expansion.

What is more, this empire exhibits now open fascism: militarism, manipulative propaganda, clericalism, a surveillance state, the ideology of a 'New Russia' rising again from humiliation, genocide, and – increasingly – a death cult, when Putin tells mothers of fallen Russian soldiers, "Your son lived, and his goal has been achieved. And that means he did not leave life in vain" (Reuters 2022). If this sounds familiar, then that's because it is. The world has heard and seen this in the 1930s from Nazi Germany. Just as the order in Europe had to deal with a German Question in the 19th and 20th centuries, Europe, inevitably, now has to deal with a Russian Question in the 21st century.

Given these stakes, it should almost be unnecessary to discuss the costs of fighting this war, including imposing the harshest of sanctions against Russia and its ability to fight and win this war. Yet, we have heard and read a lot of schlock economics in this debate.

"Germany, and with it Europe, would collapse into mass unemployment and mass poverty if it stopped the import of Russian fossil fuels in the spring of 2022!"

Bachmann et al. (2022), using a multi-sector, multi-country trade model with calibrated input-output and trade structures and substitution elasticities, argued that there would be a recession, but a manageable one, for Germany, not deeper than that during the COVID-19 pandemic. After Russia did stop its exports of fossil fuels in the summer of 2022, little happened to either the German or the European economies: there was, for a price, sufficient alternative supply in the world markets, firms and households could save on energy consumption, and increased imports of energy-intensive products did the rest. Consequently, overall GDP and industrial production numbers were stable, only production in very energy-intensive sectors declined without cascading into the rest of the economy. Doomsday predictions were based on a wrong view of flexible and open market economies, an anti-market ideology, and a lust for subsidies.²

"The ruble appreciates again!"

So what? As Itskhoki and Mukhin (2022a, 2022b) have convincingly argued, exchange rate dynamics are influenced by many factors, such as the type of sanctions whether they are levelled against imports or exports, financial frictions, and fiscal policy, and are not a sufficient statistic for welfare.

"Russia can just print its own money to pay for everything!"

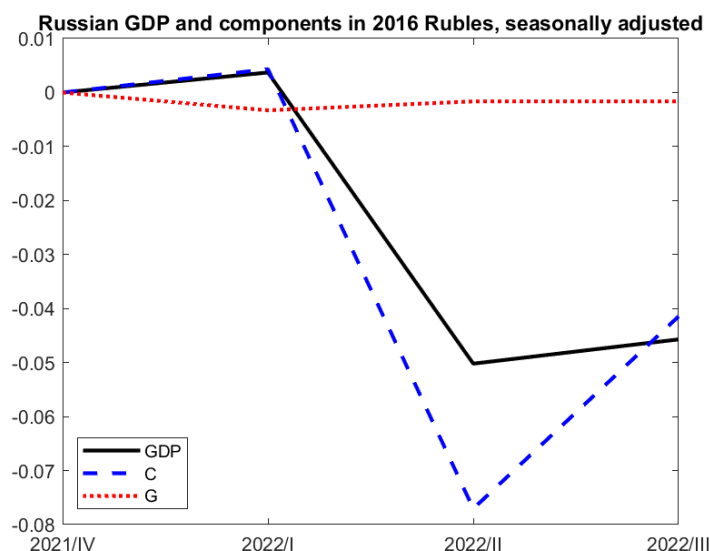
This is an example of how modern monetary theory-like thinking can literally cost lives.

² This is consistent with the summary of findings in Morgan et al. (2023) that countries that impose sanctions usually face little economic damage.

“Russia hardly slipped into a recession!”

The official Russian national accounting statistics do not support this claim. Although these data may not be fully trusted, they show a decline of real, seasonally adjusted GDP in 2022 from the fourth quarter in 2021 by approximately 5%, and a decline of real, seasonally adjusted private consumption expenditures by approximately 7.5%, while the government expenditures appear to have become an ever larger share of Russia’s GDP (see Figure 1).³ These numbers suggest a rather strong decline of real economic activity, which already is remarkable in a time of war that is not waged on its own territory. This decline in real economic activity is accompanied by an even larger decline in Russian average welfare, as marked by the collapse in private consumption as well as the likely massive decline in consumption varieties available to Russians, which corresponds to a decline in welfare that would not necessarily be picked up in the national accounting statistics (see also Morgan et. al 2023).⁴

FIGURE 1 RUSSIAN GDP AND COMPONENTS IN 2016 RUBLES, SEASONALLY ADJUSTED



Notes: Real, seasonally adjusted GDP and components in 2016 rubles from Rosstat (2022), Sheet 9. GDP: row 5, C (private consumption) row 8, G (government purchases), row 9.

3 While the official national accounting statistics from Rosstat are not yet available for the fourth quarter of 2022, the Central Bank of Russia, on 10 February 2023, published an estimate of negative 4.6% for the year-over-year fourth-quarter growth rate of real GDP, confirming the overall picture in Figure 1. For completeness, I note that the decline in yearly consumption between 2021 and 2022 estimated by the Central Bank of Russia is, with 1.8%, not quite as strong as the one they estimate for the decline in yearly GDP (2.5%). However, this calculation, because of time aggregation, hides somewhat the impact of the war and the ensuing sanctions.

4 In a tweet from 2 February 2023, Janis Kluge (@jakluge) documents a persistent and similarly strong collapse in Russian retail sales.

With so much bad economics, it is almost not worth mentioning that a focus on growth rates rather than levels is also terribly misguided: even if the Western countries had suffered higher GDP or private-consumption losses than Russia because of their sanctions, they would have hit at a much higher level. With concave welfare functions, Russia would still be hurt more.⁵

I want to conclude this column with a personal remark as a German citizen: I submit that Germany has to help Ukraine also from a moral standpoint. I grew up believing that “Never again!” is the core of German civil society and its government after the historically singular atrocities that Germans committed during the Holocaust and during WWII, often on Ukrainian soil. Instinctively, this “Never again!” had always meant “Never again Auschwitz!” or rather, not to relativise the historical singularity that is Auschwitz, “Never again genocidal wars of fascist aggression!”

It is true that a different strand of German public discourse interpreted and still is interpreting the “Never again!” differently, as “Never again war!”, as a form of pacifism that at most allows self-defence. On 13 May 1999, the then German foreign minister and vice-chancellor Joschka Fischer, during a special convention of the Green Party debating the German contribution to NATO’s Kosovo campaign, clarified the “Never again!” position emphatically against its pacifist interpretation. Thus, to me, in light of the historic pain that Germany has inflicted on Ukraine and its people, it is its moral duty to help Ukraine militarily and economically to the utmost.

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⁵ Neuenkirch et al. (2023) argue that, after a few initial weeks of negative financial market reactions to announcements of stronger support for Ukraine by the Western allies, these reactions have now changed to positive, suggesting that global financial markets value a Ukrainian victory against Russia as a net positive economically.

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Rüdiger Bachmann received undergraduate degrees in Economics and Philosophy from Mainz University, and a PhD from Yale University in 2007. His academic career includes an assistant professorship at the University of Michigan, full professorships at the RWTH Aachen University and Frankfurt University, as well as visiting professorships at the University of Pennsylvania, Harvard University and Boston University. Bachmann also serves as an Associate Editor for the *Economic Journal* and as a member of the executive committee of the German Economic Association. He is a CEPR Research Affiliate, a CESifo research network fellow, and an external Research Professor at the Munich-based Ifo institute. Bachmann’s research area is macroeconomics, where he specializes in the macroeconomics of heterogeneous agents. He is also interested in the implications of uncertainty and expectation formation on macroeconomic outcomes. His research has been published in the *American Economic Review*, the *Journal of Monetary Economics*, the *American Economic Journal: Macroeconomics*, the *American Economic Journal: Economic Policy*, the *Review of Economic Dynamics*, *Quantitative Economics*, *Economics Letters*, and *Economic Theory*. At Notre Dame he teaches undergraduate and graduate classes in macroeconomics.

CHAPTER 18

Postwar reconstruction assistance and local governments in Ukraine

Roger Myerson

University of Chicago

The Russian invasion has caused vast destruction in Ukraine, and postwar reconstruction will be expensive. The victory of freedom in Ukraine should offer an example for a better world, but this victory will be incomplete as long as the damages wrought by Russian forces remain unrepaired.

Hopes for a more peaceful world depend on maintaining the basic principle that international military aggression cannot succeed. Putin's fundamental goal in this war has been to prevent Ukraine from becoming a positive example of successful democratic development that might inspire people in Russia to turn against his own corrupt autocratic rule. He could still achieve this goal, even after the defeat of his military forces, if the devastation of his war left a permanent legacy of suffering in Ukraine. Thus, generous offers of reconstruction assistance from the US and Europe will be appropriate, benefitting the broad global interests of donors as well as the recipients.

It can certainly be argued that Russians have a moral obligation to pay reparations for the destruction that their forces have caused, but trying to compel Russia to pay a massive reparations debt could be very dangerous. Efforts to extract reparations from Germany after WWI ultimately poisoned postwar German politics, setting the stage for the rise of a militant regime that launched a second world war which was even more costly than the first. This precedent would argue against trying to compel Russia to pay more after the war than the value of its foreign assets that have already been seized.

However, the cost of Ukraine's reconstruction will be a fraction of what the US and its European allies expect to spend for defence and security over a period of several years. Reconstruction assistance can be considered a good investment by the standards that we use to evaluate defence budgets, because success in rebuilding in Ukraine will be a strong positive precedent for encouraging a more peaceful international order. But the assistance funds must be spent effectively.

A basic lesson from the Marshall Plan for postwar reconstruction of Europe in 1948 was that foreign reconstruction assistance can be much more effective when it helps to promote reforms that will be fundamental for successful future development (Price 1955).¹ Reforms that have been widely considered vital for Ukraine's future development include strengthening ties with the EU and increasing the capacity of local governments to serve their communities.

The first of these considerations has motivated a recent recommendation that all foreign reconstruction assistance should be coordinated and supervised by an agency of the EU (Gorodnichenko et al. 2022).² That is, even reconstruction assistance from the US should be channelled through an EU agency, because government officials in Ukraine can benefit from the experience of working with the EU's fiscal regulations and standards, given that closer integration with the EU could be vital for Ukraine's future prosperity.

Reconstruction work must be under the direction of officials of Ukraine's sovereign democratic government. But donors should recognise that, in 2022, the people of Ukraine have been fighting to defend a system of government that includes responsible locally elected officials as well as nationally elected officials of the central government.

The current system of local governments is the result of decentralisation reforms that were implemented between 2015 and 2020.³ One effect of these reforms has been to ensure that every part of Ukraine has elected local leaders who have real power to organise their communities and maintain local defence (Keudel and Huss 2023). Indeed, since the Russian invasion began in February 2022, there have been regular reports of mayors leading their communities in resisting the Russian invaders.⁴ But in 2014, the old Soviet-style centralisation of power in Ukraine meant that, in some vulnerable regions, it was hard to find any trusted local leaders who would organise their communities to defend the state's local authority against even a small band of Kremlin-supported insurgents. So, the extraordinary increase in Ukraine's ability to resist Russian invasion between 2014 and 2022 owes much to the empowerment of democratic local governments. As Brik and Murtazashvili (2022) have observed, citizens have rallied not just in support of President Zelenskyy in Kyiv, but also to defend their locally elected mayors and community councils.

To support and advance the development of these local governments in Ukraine, we may suggest that a significant share of foreign reconstruction assistance should be set aside for use by local governments. That is, while the largest portion (perhaps two-thirds) of foreign assistance should be directed by officials of Ukraine's national government, a significant portion (perhaps one-third) should be budgeted for allocation by local reconstruction boards that consist of locally elected officials. In each district of Ukraine,

1 See also De Long and Eichengreen (1991).

2 See also Becker et al. (2022).

3 For evidence of improvements in local public spending resulting from the decentralization reforms, see Harus and Nivyevskiy (2020).

4 See, for example, <https://apnews.com/article/e4e8d5a847aff39c78871c7ab1cb9c10>.

an official of the European assistance agency could work with the local mayors and other locally elected officials to help them develop and implement a plan for allocating their district's share of the locally directed portion of foreign assistance. In this way, the process of rebuilding the infrastructure of Ukraine can also help to promote the development of local governments' capacity to serve their communities, which is vital for Ukraine's successful democratic development.

Stationing foreign assistance coordinators in local offices throughout Ukraine can also help to improve monitoring of how assistance funds are used. For example, if a nationally administered project failed to deliver its promised local benefits, foreign assistance coordinators could hear about the problem from the mayor of an adversely affected community. Conversely, the use of assistance funds by local governments should be monitored by appropriate agencies of the national government. Thus, an active engagement with Ukrainian officials at both the local and national levels can help a foreign assistance agency to identify problems with the use of its funds by officials at either level.

There are other important reasons for recommending some decentralisation of authority over foreign assistance to Ukraine. Costs of postwar reconstruction may be three to five times larger than Ukraine's 2021 GDP, and so foreign assistance will be needed on a scale that vastly exceeds prewar government spending in Ukraine. We can hope that a well-designed system of fiscal oversight by independent agencies from Ukraine and from donor countries can minimise corrupt diversion of these funds; but even with the best fiscal controls, there will be great potential profits to be earned by the contractors who get responsibility for managing reconstruction projects. If these profits are concentrated among a small group of businesspeople who have connections to the top national leadership, then the result could be to create a new class of oligarchs to dominate Ukraine for many years to come. Decentralising some authority over foreign reconstruction assistance can help to spread the profits of reconstruction among a broader class of businesspeople throughout Ukraine. That is, if government officials cannot be prevented from steering lucrative contracts to their friends and cronies, spreading profits of reconstruction among the thousands of businesspeople who have connections to their local mayor's office may be better than concentrating all these profits in the pockets of the few businesspeople who have connections in the President's office.⁵

Ukraine's success in resisting a massive Russian invasion in 2022 has been based on its people's confidence in the ability of an independent Ukraine to provide a better future for them, and reforms to establish responsible local governments have been one key factor contributing to this confidence. After the war, the international community should generously support the development of an independent democratic Ukraine that can

5 This point has been raised by Garton Ash (2023).

build peaceful and mutually beneficial relations with all its neighbours. Above all, the postwar reconstruction of Ukraine should aim to fulfill its people's hopes for a better future, for which they have given so much.

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CHAPTER 19

Why central banks around the world should be interested in Ukraine's victory

Sergiy Nikolaychuk

National Bank of Ukraine

The invasion of Ukraine by Russia has brought about a significant transformation in the country's standing within the global economic and political arena. Although the invasion is unjustifiable and brutal, the world must address it with diligent rigor to secure a fair and just victory for Ukraine. Such an outcome would have far-reaching benefits not just for the people of Ukraine, but also for the central banks of the world.

The war has had a significant impact on the global political and economic landscape. Surging inflation, subdued economic performance and potential consequences of deglobalisation have led to increased political influence over central bank operations, which may have significant long-term implications.

The global economy remains weakened by the impact of the war, which has caused substantial trade disruptions and price shocks in food and fuel markets, leading to heightened inflation and a subsequent tightening of global financing conditions.

The effects of the invasion have been felt most dramatically in commodity markets, with Russia and Ukraine being among the top ten global exporters of certain grains and oilseeds. Disruptions to food supplies from the Black Sea region resulted in a significant increase in prices and heightened concerns about food security in Africa, Asia, and the Middle East. The UN World Food Programme, which relies on Ukraine for around 40% of its wheat purchases, has had to halve food rations in some countries due to the rapid growth in operating expenses.

Meanwhile, energy markets, which Russia has long dominated, have also experienced significant turbulence. Despite technical limitations that restrain the distribution of natural gas, the European infrastructure managed to withstand a reduction of more than 70% in Russian gas supplies in 2022. Thanks to aggressive liquefied natural gas (LNG) imports, EU countries were able to fill more than 80% of their storage facilities ahead of schedule, but energy prices still increased significantly.

However, medium-term risks for central banks stemming from the Russian-Ukrainian war pose an even greater concern. In recent decades, central banks have enjoyed the advantages of globalisation, which has resulted in a low-inflation environment and

enabled them to maintain lower and stable inflation despite having an excessively accommodative monetary policy. Deglobalisation fuelled by war could constrain their capacity to stabilise inflation in the future, absent tough measures, if inflation is predominantly determined at the global level.

Despite the advantages it offers, globalisation has generated considerable controversy in recent years. This is largely due to its impact on economic inequality, which has resulted in genuine and perceived grievances, leading to dissatisfaction with the prevailing economic order. Populist and authoritarian elements have capitalised on this discontent to bolster their positions. Geopolitical tensions have gradually escalated, culminating in trade wars between the US and China, Brexit, and a rise in global military conflicts. Nevertheless, it was Russia's full-scale invasion of Ukraine that brought the issue of global economic fragmentation to the forefront of the international agenda.

The heightened exposure of current production networks, compounded by Russia's invasion of Ukraine, presents a genuine obstacle for the global economy. As a consequence, inflation rates reached multi-year highs and surpassed central bank targets in major parts of the world, both in emerging markets and in advanced economies. Of particular note is the surge in food and energy costs, which has disproportionately impacted inflation in countries where these commodities account for 40–50% of the consumer basket.

The persistence of inflationary pressure, which was initially anticipated to be temporary (and with high probability could be proved to be so without effects of the war), has presented significant risks of de-anchoring inflation expectations. As a result of re-evaluating the underlying strength of inflation, a majority of central banks have reverted to tightening their monetary policy stance dramatically in 2022 and 2023.

However, central banks face a challenging task, as they must balance the competing objectives of reducing inflation and stimulating economic growth while the world is now on the brink of recession. Central banks are not empowered to provide a structural solution to this issue. Instead, the stabilisation of a fragmented world economy and volatile prices hinges on the success of Ukraine in its war.

As economies endeavour to adjust to the post-pandemic dislocation and help mitigate the impact of the conflict in Ukraine, central banks face the question of whether price stability should remain the foremost goal in light of the need to bolster employment, maintain growth, prevent social instability, and support government policies. This is particularly relevant when considering the necessary rollback of accommodative monetary policy measures, which have fostered a reliance on loose financial conditions among economic actors.

Additionally, the backlash against globalisation has posed a challenge to the prevailing support for central bank independence. Recent empirical findings for emerging economies indicate that there could exist an adverse correlation between the increase in nationalistic ideology and the acceptance of central bank independence.

In what ways can Ukraine's victory alleviate the struggle of central banks worldwide?

Ukraine plays a vital role in food supply to regions such as Africa, Asia, and the Middle East. A triumph for Ukraine would ensure a stable supply of grains and oilseeds, improving the quality of life for the 5% of the world's population residing in these areas. This, in turn, would contribute to sustainable development, minimising social unrest and migration crises.

Additionally, Ukraine's victory and joint reconstruction efforts will preserve the existing world order, which faces threats from Russian weaponry and rising populism and autocracy. The awareness of an inevitable response from the free world, both militarily and economically, will prevent autocracies from instigating new conflicts, reducing the risks of an arms race. Instead, the focus will shift to investments in civilian infrastructure, as shown in the 'guns versus butter' model.

One such investment is in the green transition, for which the International Energy Agency estimates capital expenditure will need to double by 2030 and remain at that level until 2050. A robust response to global challenges leads to a more predictable and stable world, helping central banks preserve their independence and pursue their mandate of maintaining financial and price stability.

To achieve this better world, it is necessary to support Ukraine with arms, financing, and international backing. By supporting Ukraine, the world supports itself.

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CHAPTER 20

The all-out aggression requires an all-out response

Oleksiy Blinov and Simeon Djankov

Sense Bank; London School of Economics

In the face of the Ukraine's resolute response to Russia's invasion, President Putin has escalated the economic warfare against its citizens by incessantly attacking the country's energy infrastructure and cutting off vital trade channels. These acts have severely hampered the prospects for economic recovery in 2023.

A large part of Ukraine's civilian population, an estimated 6 million people, is awaiting the spring to return to their homeland, as the frequent power outages have forced them to keep temporary shelter in other European countries (Constantinescu 2022, Blinov and Djankov 2022a). These immigrants look forward to reuniting with their families and continuing with their jobs or finding new economic opportunity. In both cases, massive foreign help is needed to jumpstart the economy. The needs are enormous: rebuild infrastructure, provide financing for entrepreneurial activities as many old enterprises are razed to the ground, open new export opportunities, invest in training of workers and new technologies.

In this chapter, we gauge the economic losses from just two of the multiple ways in which the war has threatened the livelihoods of ordinary Ukraine citizens. We show that the near-daily aerial attacks on the country's power grid and the frequent stalling in allowing ships to leave Ukrainian ports have hindered the economy to the tune of at least 15% of production, all else equal.

This analysis is in the spirit of previous work on estimating the cost of the war in Ukraine (e.g. Constantinescu 2022, Kappner et al. 2022, Artuc et al. 2022, the papers in the CEPR eBook edited by Rohner et al. 2022). As the aerial attacks on the power infrastructure continue at the time of this writing, as does the naval blockade, estimating their effect on economic prospects in Ukraine is an evolving task.

THE EFFECT OF ATTACKS ON THE POWER GRID

To gauge the effect of power blackouts on the economy, we use daily data from ATMs operated by one of Ukraine's biggest commercial banks. The bank has a wide network of around 500 ATMs covering all Ukrainian regions except for the temporarily occupied territories. When electricity is cut off from the ATM or from its data connection, this

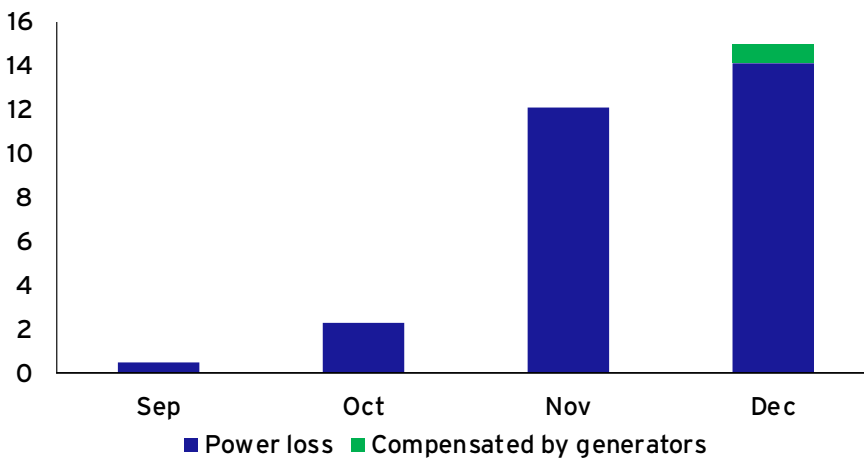
event is immediately recorded. Another recording takes place when power is restored, providing a good timing record of the lengths of blackouts in the respective geographical area. The analysis is extended to the month of December 2022 from our previous analysis in Blinov and Djankov (2022b).

We concentrate on the most business-intensive time period between 8am and 8pm. We then use power outage data for every ATM, calculated as a percentage of productive time without power. This measure at the ATM level is then averaged to a regional indicator and in turn we derive the national indicator from these regional measures, using as weights the pre-war shares of regions in Ukraine's GDP.

Using this methodology, we calculate the monthly power loss (Figure 1). The national energy system had been resistant to attacks in September and October, localizing power outages to certain badly hit communities. However, Ukraine lost over 12% of its productive time in November, including a loss of over 23% of productive time during the last seven days of the month (after an air attack that caused a nation-wide blackout).

For the month of December, we have gauged the effect of alternative local power supply (electricity generators) installed in ATM-hosting property, as this way to provide stable electricity supply had become a widespread trend among banks and other businesses. We are hence able to assess both the absence of electricity and the amount of it compensated by emergency local power supply. Overall, Ukrainian businesses lost 15% of productive time because of power outages in December (more than in November, but less than in the final 'black week' of the previous month). Businesses managed to mitigate only 1 percentage point of this loss with installed emergency power supply, at significant cost of buying and installing these backup generators.

FIGURE 1 LENGTH OF POWER OUTAGES IN OCTOBER-DECEMBER 2022 (% OF PRODUCTIVE TIME)



Source: Authors' calculations based on commercial bank ATM data.

STALLED GRAIN EXPORTS

Prior to the war, 89% of Ukraine's grain exports were transported via Black Sea ports. The Ukrainian ports of Odesa, Chernomorsk, Pivdennyi and Mykolayiv were handling up to 6 million tonnes of grain per month in 2021 and were preparing to set new records in 2022 thanks to investment in expanded port infrastructure and bountiful crops.

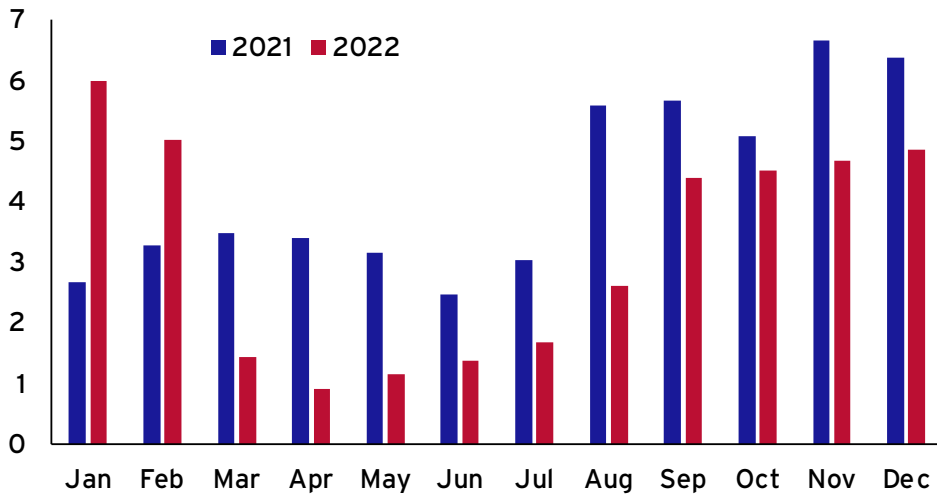
Even before the start of the Russian invasion, the sea routes had been partially blocked by Russian military naval training. When the war started, full naval blockade was instituted upon Ukrainian ports and two of them – Berdyansk and Mariupol – were occupied by Russian troops. Ukrainian exporters have had to improvise with grain handling there, an intermediary step to the Romanian port of Constanța. Overall, Izmail and Reni handled around 45% of total grain exports in May. As a result, the financial losses to agricultural exporters are estimated at \$200 million a day in March through May 2022 (Blinov and Djankov 2022c).

Railways and trucks have started being used to haul grain into EU countries, increasing transit costs dramatically and still not being to fill the gap of blockaded ports. In May 2022, for example, only 40,000 tonnes of grains (4% of the total) were exported by trucks. The remaining exports (around half of the total quantity) were transported by train through Poland, Slovakia and Hungary. With all this effort, Ukraine managed to export only around 1 million tonnes per month in April and May.

Partial reopening of Ukraine's seaports (Odesa, Chernomorsk, Pivdennyi) in August after a brokered agreement with Russia has allowed to expand monthly grain exports to over 4 million tonnes. However, frequent stalling by Russia in allowing ships through the blockade, elevated insurance and freight prices, and recent threats to halt the grain corridor altogether have meant that November and December exports have again fallen down relative to the 2021 export volumes (Figure 2). This trend is worrying, and grain exports suffered a further setback in January 2023 when Russia instituted ship security checks.

Grain has not even been the most constrained item in Ukraine's exports, which totaled \$81.5 billion, or over 40% of GDP, prior to the war. Exports of non-food items via ports are still blocked. As a result of these export blockage and the physical destruction of steel-mills in Mariupol, Ukraine's steel output dropped 85% as compared to 2021. In 2022, Ukraine lost 30% of its exports, with much of that loss unlikely to be recovered in the foreseeable future.

FIGURE 2 MONTHLY GRAIN EXPORTS FROM UKRAINE IN 2021-2022, MLN TONNES



Source: State Customs Service of Ukraine.

ALL HELP, ALL NOW

In this chapter, we illustrate with just two examples the huge economic damage that Russia’s invasion has dealt to ordinary Ukrainian citizens. This is on top of the daily cost of war and tremendous loss of life and livelihood.

And all-out aggression requires an all-out response. Such response is necessary in financial terms as well. For Ukrainians both at home and in temporary refugee status, it is important to see prospects of normal economic life. The sums of foreign aid to ensure such normality are staggering and will no doubt be made over the years to come. Better start now, without hesitation.

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CHAPTER 21

The Russian invasion and the risks to global financial stability

Stephen G. Cecchetti and Kermit L. Schoenholtz

Brandeis International Business School and CEPR; NYU Stern School of Business

There are numerous compelling reasons to oppose the unprovoked armed invasion of a democracy by a dictatorship. Russia's violation of Ukraine's sovereignty is akin to the German and Japanese invasions of their neighbours in the 1930s that ultimately led to WWII. Like those 1930s aggressors, Russia is engaging in widespread indiscriminate bombings and massacres. As a result, any Russian success puts democracies everywhere at risk. The invasion of Ukraine has also seriously disrupted the global economy, contributing to the largest inflation surge in 40 years and threatening widespread recession.

In this column, we focus on the risks posed by the Russian invasion to the complex web of arrangements that comprise our global financial system. Financial stability is a public good that rests on confidence in the global security framework. At the most basic level, households and businesses have an incentive to run out of any jurisdiction that is perceived as vulnerable to an attack of any kind.

As we all know, finance supports real economic activity. It gives us the ability to shift resources over time, to channel savings where the benefits are greatest, and to allocate risk to those best able to bear it. Doing this efficiently requires an elaborate infrastructure built on institutions and markets, as well as widely accepted rules that establish trust. A well-functioning financial system is necessary to support global trade and investment. Yet, the financial system is vulnerable precisely because it has so many positive spillovers: no jurisdiction can secure all the benefits, so no one has an incentive to make all the costly investments that are necessary to protect it.

By violating the most fundamental international norms, military aggression like Russia's can trigger an immediate loss of trust in financial instruments, markets, and institutions. When people lose trust in finance, we know what happens. They run. If the problem is with a single bank, it is possible to contain the damage. But when the threat extends to a country or a region of the world, large swaths of the financial system can fall victim to a loss of trust.

This creates an obvious connection between the conflict in the Ukraine and global financial stability. Starting with its nearby neighbours, a Russian victory poses an immediate security threat to countries in eastern and central Europe. This, in turn, creates a risk of runs that would damage that region's financial system.

But would the impact of a Russian victory on finance stop there? The danger is that investors' concerns will soon spread to include the countries of Western Europe. A Russian victory could also intensify worries about a potential invasion of Taiwan by China, fuelling security concerns elsewhere in Asia and the Pacific. While we are cautious about relying on domino theories, history teaches us that a loss of confidence can occur very quickly and can spread far beyond the locus of any military conflict.

Consider, for example, the experience of the US at the onset of the WWI. The isolationist nation was famously distant from the conflict 'over there'. Nevertheless, to quote from William Silber's brilliant 2007 book, "[t]he Great War threatened the United States with financial disaster" (Silber 2007). To counter that threat, the New York Stock Exchange (NYSE) closed for more than four months from 31 July 1914 to 12 December 1914. (Keep in mind that the US did not enter the war until April 1917, nearly three years later.)

Why did then-Secretary of the Treasury William Gibbs McAdoo work to shut down the NYSE? With Europe needing to fund the war, the United States faced a potential 'sudden stop' of finance from abroad in the form of a fire sale of US securities by Europeans (Cecchetti and Schoenholtz 2018a). As Silber explains, unrestrained outflows of the gold proceeds from these sales could even endanger the US ability to repay foreign debts. By temporarily stemming the 'run' on Wall Street, the US bought time for an expansion of agricultural exports that helped balance European capital flight when the NYSE reopened. (The US merchandise trade surplus surged from just over 1% of GNP in 1914 to more than 5% of GNP in 1917.)¹

Could a comparable scenario play out today? If governments come to expect a Russian victory, would they rush to rearm? Might authorities in countries that feel threatened sell liquid assets held in distant foreign lands and use the proceeds to buy weapons? If so, the impact could be widespread and immediate.

To see it, we need look no further than the US Treasury market – the worlds' most liquid securities market that sets the risk-free benchmark for dollar instruments and in which foreign official entities are among the largest participants. Indeed, we recently witnessed a disruptive foreign dash for cash at the onset of the pandemic panic in March 2020. Recognising that a dysfunctional Treasury market would spread financial chaos globally, the Federal Reserve intervened massively to steady the market.²

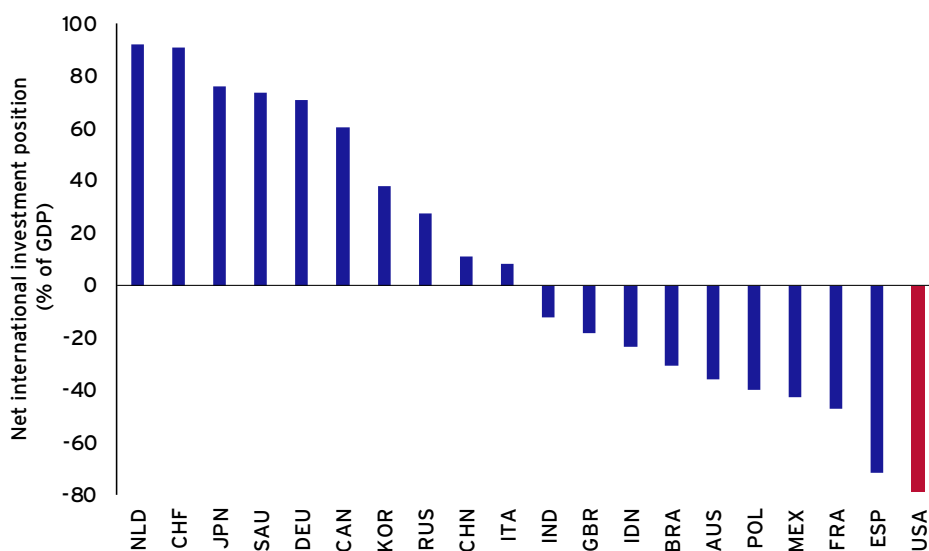
1 For information on the merchandise trade surplus see US Department of Commerce (1975) and for data on GNP, see Balke and Gordon (1986).

2 There are a number of excellent studies of this episode (e.g. Barone et al. 2022, Vissing-Jorgenson 2021, US Treasury et al. 2021).

One way to assess the spillover risks that might come from a rush to rearm is to look at cross-border holdings of assets. The net international investment position (NIIP) of a country is a way to summarise its external balance sheet: the NIIP is the excess of assets held abroad by domestic residents over their liabilities to foreigners. For the world's 20 largest economies, Figure 1 ranks the NIIP (as a percent of GDP) from the largest surplus to the largest deficit. Those with big NIIP deficits (on the right) are probably at greater risk, as are those with highly liquid assets that are widely held.

Unsurprisingly, the US (red bar) tops both these vulnerability rankings. Its NIIP shortfall is nearly \$17 trillion. Of that, more than \$7 trillion is in US Treasury securities. And, of that total, more than \$4 trillion is held by official entities.³ To be sure, the Federal Reserve has well-developed facilities to provide dollars rapidly to foreign central banks both through long-established swap lines and through the newer foreign and international monetary authorities (FIMA) repo facility. Many central banks have similar arrangements.⁴ Nevertheless, it is impossible to know whether these facilities, together with policymakers' discretionary actions, would prove sufficient to stabilize global financial markets in the event of sudden, vast cross-border capital flows.

FIGURE 1 NET INTERNATIONAL INVESTMENT POSITION, 2021 (PERCENT OF GDP)



Source: Milesi-Ferretti (2022).

³ See the Treasury International Capital (TIC) data here.

⁴ These include various networks, such as the Chiang Mai Initiative arrangement among eight Asian countries; the reciprocal arrangements of the European Central Bank, Federal Reserve, Bank of Japan, Bank of England, Bank of Canada and Swiss National Bank; and the Eurosystem repo facility for central banks (EUREP).

To conclude, there are numerous channels through which a successful Russian invasion of Ukraine puts global financial stability at risk. We have discussed just two: the loss of trust in a range of countries that could trigger widespread runs; and sudden pressures to rearm that could fuel fire sales even in the safest, most liquid financial markets. Unfortunately, these are not the only possibilities. There are plenty of other nightmare scenarios. For example, we can envision an escalated fear of cyberattacks (Cecchetti and Schoenholtz 2018b) that weakens confidence in the central clearing parties (Cecchetti and Schoenholtz 2017) that are vital to global payments.

The bottom line is clear: it is imperative to help Ukraine expel the invaders. Any Russian success not only threatens democracy everywhere, but also undermines global financial stability as well. By fuelling the fragmentation of the world into security zones and increasing the focus on national defence, the attack on Ukraine threatens the international economic integration over the past 50 years that the global financial system made possible, and that still benefits billions of people.

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CHAPTER 22

Why the West needs Ukraine and its IT business

Monika Schnitzer

University of Munich and CEPR

In the first weeks and months after the start of Russia's war of aggression against Ukraine, there was great concern that the war would jeopardise agricultural exports from Ukraine and thus the nutrition of millions of people, with dire consequences also for Ukraine's export revenues. The failure to deliver Ukrainian wiring harnesses also made headlines in Western Europe, with these supply chain problems causing some automakers to run into difficulties assembling their cars. Less prominent were the headlines about the Ukrainian IT industry and its vital importance for Western companies.

The background to this is the massive shortage of IT specialists in Europe. In Germany alone, in 2022, 137,000 IT positions could not be filled, according to a survey by the Digital Association Bitkom. Many companies have therefore increasingly relied on working with Ukrainian IT providers, either directly with Ukrainian IT companies or indirectly via Ukrainian IT service providers. Companies such as Cisco, Google, Lyft, Microsoft, and Snap, as well as many small and medium-sized enterprises and startups, use Ukrainian IT experts directly or indirectly via IT outsourcing partners to develop and maintain their software and digital offerings.

This is possible thanks to the Ukrainian education system, which produces many highly qualified people. The mathematical education at the universities is excellent and many students are interested in jobs in the IT industry due to a lack of other interesting job prospects. Before the outbreak of the war, the number of IT specialists in Ukraine had been growing steadily, reaching 285,000 IT specialists.

Ukraine was in 11th place in the IT competitiveness ranking among European middle-income countries in 2021 (IT Ukraine Association 2021). The increasing importance of the IT sector for the Ukrainian economy is clear. The IT sector has taken over first place in the export of services and generated more than 4% of Ukraine's GDP in 2021. In three years, the industry has more than doubled its exports, generating \$6.9 billion in export revenue in 2021. If the trend were maintained, the forecast for export revenue in 2022 is \$8.5 billion. More than 5,000 IT companies (including startups) are active in the labour market. Over the past three years, the industry has increased its number of specialists by more than 50% (Lviv IT Cluster 2021).

There are more than 2,000 tech companies and startups registered in Ukraine.¹ Investments in the IT startup sector increased tenfold over five years, from \$39 million in 2014 to \$509 million in 2019. Between 2020 and 2021 alone, investment in Ukrainian startups increased by 45%. In the first quarter of 2022, 11 venture deals worth \$11.5 million were made (Kreston Ukraine 2021). Forty per cent of Ukrainian startups are geared toward the export market, while for 60% of startups, the key market is Ukraine.²

Even after the outbreak of the war, work in the IT sector was initially not significantly affected and cooperation with Western clients could continue. IT companies were well prepared and quickly relocated employees within the country, out of the contested areas to western parts of the country. Nevertheless, IT companies are also suffering from contracts being terminated by clients, and they face increased cyber-security risks.

Another major challenge for the IT industry is that, as a consequence of the war, 43% of IT specialists want to or are considering moving abroad (Lvivi IT Cluster 2021). As of summer 2022, 20% of IT specialists have already moved abroad since the beginning of the full-scale war, while around 3% of workers have been mobilised to the military or the territorial defence force.

More than half (55.7%) of IT startups continue their operations exclusively from Ukraine. Since the beginning of the war, they have lost about 12.7% of their employees. Ninety-one per cent of startups confirm that they need financial support to continue operations and/or expand their business (Komarnytska et al. 2022). Ukraine has dropped 16 positions in the Global Startup Ecosystem ranking.³

The IT sector could be relatively less affected by the events of war, since one can work remotely as long as a quiet room, a laptop, and a working Internet connection and power are available. However, it is precisely these conditions that have been increasingly compromised in recent months. The attacks of the Russian armed forces on the power supply and the resulting power outages make work more and more difficult, as colleagues from Ukraine tell me in video calls when power is working. Thus, the rehabilitation of the energy infrastructure is of paramount importance, both for the population and for the economy.

Even though the war has so far been fought primarily with conventional weapons, the importance of IT experts to the war effort should not be underestimated. The fact that the energy supply infrastructure is being attacked and destroyed with missiles is at the same time proof that Russian IT specialists have not succeeded in achieving the same thing through cyberattacks. The lessons learned here will continue to play an important role in the future.

1 <https://uatechecosystem.com/>

2 <https://ukraine.ua/invest-trade/startup-ecosystem-ukraine>

3 <https://startupgenome.com/report/gser2022>

Let me conclude on a personal note. For me, supporting the Ukrainian war effort and its economy is a humanitarian duty. But it is also in our own security interests and, as I have tried to illustrate with the example of the Ukraine IT sector, in the interests of our economy. Moreover, it is the young people employed in this sector who can and want to ensure that Ukraine's economy and society are modernised. I saw firsthand the young generation's willingness to engage at a conference in Kyiv in 2015. This was a few months after Euromaidan, after the Russian annexation of Crimea and the start of its open military engagement in Donbas. The topic of the conference was how to modernise Ukraine and fight corruption. Ukrainian participants seemed very determined to fight for it. That experience made a deep impression on me. We must not leave them alone.

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CHAPTER 23

Latin America's duty to stand with Ukraine

105

Vanessa Rubio-Márquez and Francisco Varela Sandoval

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Russia's invasion constitutes an attack on Ukraine's sovereign territory that has led to the loss of thousands of human lives, destruction, and to widely documented violations of human rights. A year into the escalation of this unlawful attack, and considering the vacillating positions adopted by some governments in Latin America and the Caribbean (LAC) such as Mexico and Brazil, it is vital that all countries in the region condemn Russia's actions strongly. First and foremost for the major damages Russia is causing to Ukraine and the Ukrainian people; but also because Russia's invasion is a major violation of the rule of law that jeopardises the future of an international rules-based system and that contradicts the unobjectionable principles that LAC, as a region, should stand for.

The war has also resulted in a massive shock to the world's economy through the disruption of global supply chains and prices, which has negatively affected Latin America. Russia is a major player in global energy markets, accounting for 14% of the world's total oil supply, and as a result the invasion has led to shortages, price volatility, and changes in trade flows. The attack has also distorted agricultural markets worldwide. The production of wheat in Russia and Ukraine represents 10% and 3% of global production, respectively, and the capacity of Ukraine – the third largest exporter of maize – to harvest and export crops has been greatly affected. These processes have exerted more pressure on inflation, which had already reached 14.6% in LAC during 2022.

THE SHOCKS AND THE RESPONSES

Latin America and the Caribbean represents 8.42% of the world's population, with 665 million inhabitants,¹ 6% of the world's GDP, and 50% of the planet's biodiversity.² In 2021, the region's exports represented 27.6% of its GDP,³ with petroleum oils, copper, soja beans, and cars constituting the top products. Brazil and Mexico rank 12th and 15th, respectively, in the list of the world's largest economies. Mexico is particularly integrated with global supply chains through its vast network of trade agreements that give the

1 <https://data.worldbank.org/indicator/SP.POP.TOTL?locations=ZJ>

2 <https://initiative20x20.org/news/5-projects-protecting-biodiversity-latin-america-forests#:~:text=Latin%20America%20and%20the%20Caribbean,and%20mangroves%2C%20are%20found%20there.>

3 <https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS?locations=ZJ>

country access to 50 countries, most notably in North America. A region of contrasts and heterogeneity, LAC has steadily traded with the world, with commodities being its driving force. In this regard, the effects in the LAC economies caused by the invasion of Russia can be analysed around three issues: fluctuations in commodity prices (mainly food and energy), exacerbated inflation, and increased pressures on monetary policy caused by this inflation.

Oil prices soared due to the sanctions imposed on Russia. Important regional oil producers such as Mexico, Brazil and Argentina, which have complex energy matrixes, are net importers of other inputs and final products whose price fluctuations affect their trade balances and price structure. Measures in response to price surges of fuels – such as price subsidies and tax cuts on fuel in Brazil and temporary elimination of tax on fuel in Mexico and Peru – created significant fiscal pressures. In the case of Mexico, for example, the growth of revenues for Pemex, the state's oil company, were not enough to compensate for the cost of subsidies to fuel in 2022,⁴ so the increase in oil prices had a net negative overall effect on public finances.

In terms of inflation, most countries in LAC were already facing out-of-target results, and average regional inflation soared to 11.6% in 2021 (according to the IMF). The outbreak of the conflict led to increased prices of important products such as wheat and maize, resulting in worldwide food inflation. As a consequence, Chile, for example, established customs duties while Colombia eliminated tariffs on food and other commodities. According to the IMF, inflation in the region is forecasted to have reached 14.6% in 2022, which is 3 percentage points higher than the already high figure from the previous year.⁵

Food inflation has been especially worrisome for many of the continent's most disadvantaged, in a region where, according to the Economic Commission for Latin America and the Caribbean (ECLAC) one third of the population, or around 200 million people, live in poverty. A recent report by the UN's Food and Agriculture Organization concluded that by the end of 2022, 22.5% of the population in LAC (131.3 million people) could not afford a healthy diet (FAO 2023).

One consequence of the sustained inflation across the region has been heightened pressure for the tightening of monetary policy, thus exacerbating a trend of increasing interest rates in the aftermath of the Covid-19 pandemic. The trade-off between recovery and price stabilisation has become more salient and the fiscal space for governments has been notably reduced. In the context of reduced global growth, the conflict cost accounted for 1% of the global GDP in 2022 (according to the OECD).

4 <https://imco.org.mx/los-excedentes-petroleros-no-compensaron-el-coste-de-los-estimulos-a-los-combustibles-en-2022/>

5 www.larepublica.co/globoeconomia/inflacion-de-america-latina-y-el-caribe-seria-de-14-6-este-ano-y-la-de-colombia-de-11-3467000

It is thus clear that during 2022 Latin America and the Caribbean suffered direct negative economic effects of Russia's invasion of the Ukraine and there was a wide variety of policy responses aimed at mitigating these effects, with enormous costs in terms of growth, budgets, and welfare.

A NEIGHBOURHOOD DIVIDED

The war in Ukraine has led to at least two very different political reactions. In the case of Mexico and Brazil, both presidents declined to condemn the invasion back in 2022. Moreover, they framed their positions at the time in such ambiguous terms that some have interpreted them as pro-Russia. Bolsonaro visited the Kremlin the week before the invasion, while López Obrador has insistently criticised the military support offered to Ukraine by NATO – particularly by the US. It is worth noting, that Mexico's foreign policy principle of 'non-intervention' has not implied neutrality in conflicts in the past. It is clear that government ideology in two of the leading countries in Latin America has been prioritised ahead of the defence of international law and human rights.

But this has not been the majority position in Latin America, where 19 countries voted in favour of the United Nations General Assembly Resolution of 7 April 2022, by which the Assembly voted to suspend Russia from the UN Human Rights Council (Table 1).

TABLE 1

| In favour | Abstention | Against |
|----------------------------------|-----------------------|----------------|
| Antigua and Barbuda | Barbados | Bolivia |
| Argentina | Belize | Cuba |
| Bahamas | Brazil | Nicaragua |
| Chile | El Salvador | |
| Colombia | Guyana | |
| Costa Rica | Mexico | |
| Dominica | Saint Kitts and Nevis | |
| Dominican Republic | Suriname | |
| Ecuador | Trinidad and Tobago | |
| Grenada | | |
| Guatemala | | |
| Haiti | | |
| Honduras | | |
| Jamaica | | |
| Panamá | | |
| Paraguay | | |
| Peru | | |
| Saint Lucia | | |
| Saint Vincent and the Grenadines | | |

While the relationship with the US and Europe, in some cases, and domestic politics of each country account for much of the variation in this positioning, this division contrasts sharply with other regions such as Europe, where support for Ukraine has been mostly unanimous. It is also relevant to emphasise that Mexico was part of the UN Security Council until 2022 and Brazil and Ecuador are current members until 2023 and 2024, respectively. Regarding its political position on the war in Ukraine, Latin America is a divided neighbourhood. This is the result of the polarisation, populism, and pragmatism that are pervading this increasingly fragmented part of the world.

UKRAINE MATTERS FOR LATIN AMERICA

Apart from the evident negative economic consequences of the war, what is at stake in this conflict is the future of democracy and the rule of law in an uncertain and volatile world. The invasion of Ukraine by Russia should matter to LATAM as a matter of principle: the flagrant violation of international law must be condemned by every country that stands for peace and democracy and which aspires to a more prosperous world.

In this regard, countries like Brazil and Mexico, which exert a significant degree of influence in the region and which have multiple belongings in the international sphere (for example, in the G20) should bear in mind a series of factors to develop a more creative, yet strong position. To begin with, this invasion constitutes a flagrant attack on the international law regime by Russia, and this fact cannot be overlooked. Additionally, both Mexico and Brazil are facing significant challenges in terms of economic growth, inflation, and, in the case of Brazil, an urgent need for fiscal consolidation – let alone Argentina, the third largest economy in the region, which is in the middle of a \$44 billion stand-by agreement with the IMF. The way in which economic growth behaves will define political margins for the three countries, one of which – Brazil – has a recently elected government while the other two – Argentina and Mexico – will have presidential elections in 2023 and 2024, respectively. In addition, the fight against poverty has also been affected by the war on Ukraine, particularly due to its effects on the cost of living, notably the shock to food prices. Finally, the evolution of the conflict in Ukraine will also continue to affect monetary policy and interest rates, which will in turn affect the stance of public finances.

Latin America and the Caribbean has experienced political fragmentation in the past, but the region has also been able to stand united in favour of international principles such as peace and sovereignty. If Ukraine is not a good reason to stand for the best causes of humanity, then what is?

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CHAPTER 24

From local regions in the EU to those in Ukraine (and back again): How FDI and global value chains tie our local economies together

Riccardo Crescenzi and Oliver Harman¹

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Oil. The Russian invasion of Ukraine triggered considerable debate on the reliance of European countries on this primary good – particularly the consequences for citizens and firms on their consumption and production. While important, there is another type of oil that is relevant when considering how Ukraine (and its future) is inextricably linked with the daily functioning of local economies in the rest of Europe. By looking at this other type of oil – seed oil – we can appreciate the often overlooked, but highly impactful, ties that link Ukraine with a large and diverse set of local economies in the EU (and beyond). This link is through the geography of foreign direct investment (FDI) and global value chains (GVCs).

TIES THAT BIND: HOW GVCS LINK UKRAINE WITH EU LOCAL ECONOMIES

A lesser-known fact to Russia's dominance in petrochemicals is Ukraine's dominance in seed oil. According to the Office of Economic Complexity (OEC),² it is the country's largest export, representing \$5,320 million of exports in 2020 and transported for purchase in large quantities to Europe (\$1,680 million), India (\$1,440 million) and China (\$971 million).

Ukraine is the global leader in seed oil – specifically, sunflower seed or safflower oil – and is responsible for 46% of global seed oil production. Russia is second largest, contributing another half of this again (23%). Considering seed oil as an intermediate product that feeds into the production of other intermediate or final products in multiple other countries through GVCs, three concerns for the European and global community become

1 This contribution draws from thinking and evidence in Crescenzi and Harman (2023). The authors would like to thank Vladyslav Rashkovan and Yuriy Gorodnichenko for the invite to contribute to Vox and the CEPR volume. Thanks also to Vlad Mykhnenko for comments on the draft. All errors and omissions are our own.

2 <https://oec.world/en/profile/country/ukr>

apparent: first, how the direct and indirect price changes from the war will affect firms; second, how this shock will oscillate across value chains; and finally, how different local regions rely on seed oil in different ways and thus the impacts will be felt spatially.³

First, the direct consequences: seed oil prices jumped in 2022 and affected firms. But taking a GVC approach, it is clear this was not just firms that produce the crop or sell seed oil in its crude form that suffered. After seed oil is exported, it is often transformed into other products for further export into third countries, adding value in the process. Seed oil can be used in cosmetic products as a moisturiser or in the creation of food such as kettle chips or fries. Depending on their specialisms, different importing regions will use it in different ways.

For example, there are direct effects on suppliers in Europe such as major French fries producers in the Netherlands, where the region of Zeeland holds four such processing facilities.⁴ The direct effects also apply to global cosmetics clusters⁵ in Avignon in France and Cremona in Italy where seed oil is part of their moisturiser product mix. These regions are ‘downstream’ from Ukraine in the global value chain – they import the primary good, use it as an input, and export the transformed product again. Their access to necessary inputs, their cost of production, and ultimately their competitiveness are directly tied to the war, with wider economic and employment implications for the local economies in which they operate.

Further afield, there are also downstream consequences for producers of such goods relying on US suppliers, except here they are indirectly affected by price increases. Although these producers buy most of their seed oil from the US, the global interconnected nature of the market drove up prices everywhere. Last year, kettle chip suppliers in Pennsylvania were shutting down manufacturing lines⁶ due to price shocks permeating through GVCs from production difficulties in Poltavaska oblast in Ukraine.

Some regions also benefit, either as direct competitors (for example, sunflower oil producers in Turkey, the Netherlands and Hungary; see Dun & Bradstreet 2022) or as indirect competitors, as manufacturers switch inputs from sunflower oil to other oil types. For example, rapeseed oil producers in Kent in the UK might benefit as suppliers switch production inputs due to the GVC shock.

This transformation and all the regions connected to this product highlight the importance of taking a GVC-aware approach when considering both the territorial consequences and impacts of the war – in particular, how the local, national and global decisionmakers may act in Ukraine’s interests for its reconstruction and recovery. Local

3 This example is even more apparent given the bulk of production is located in the temporarily occupied regions of Odeska, Mykolaivska, Khersonska, Zaporizka, and Donetska.

4 www.potatopro.com/product-types/frozen-french-fries/netherlands

5 <https://globalcosmeticscluster.eu>

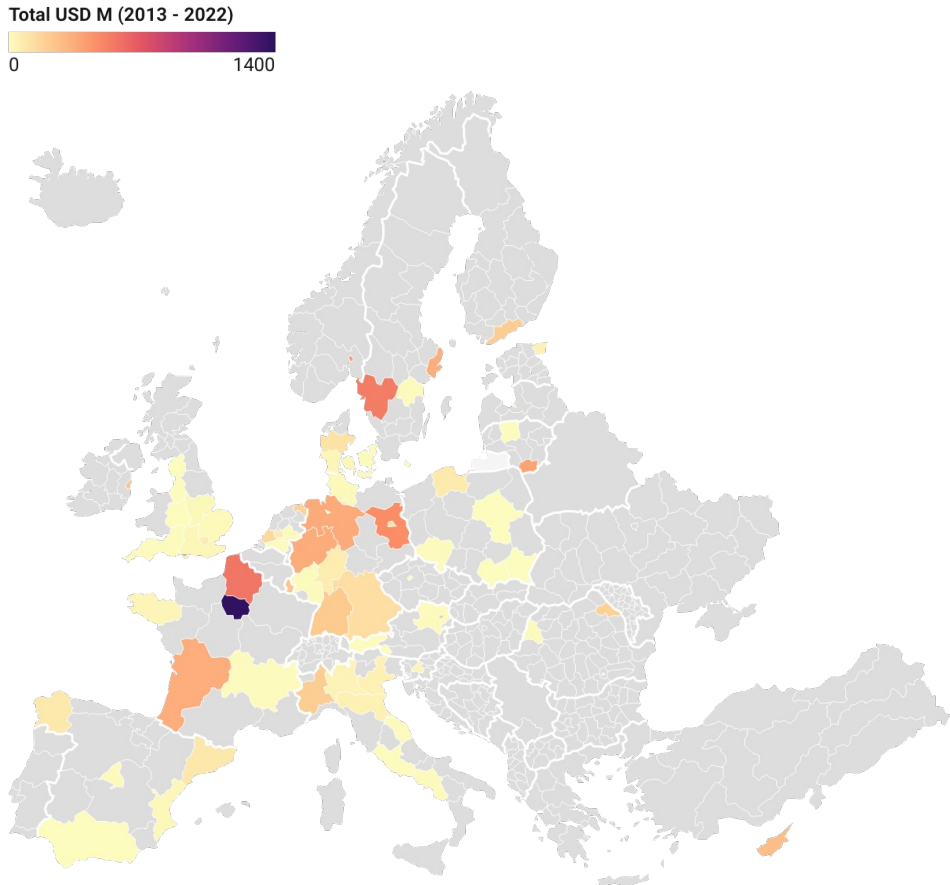
6 <https://time.com/6155095/sunflower-oil-russia-ukraine/>

economies in Europe have increasingly close ties with Ukraine through GVCs; timely reconstruction of these linkages is of paramount economic value for both Europe and Ukraine.

A LOOK INTO THE FUTURE: RESHAPING GVCs TO THE BENEFIT OF LOCAL ECONOMIES

Rather than just accepting these consequences, our recent work outlines the role of public policy and the importance of FDI in harnessing GVCs (Crescenzi and Harman 2023). Looking specifically at FDI from the EU, the UK and Norway towards Ukraine (Figure 1), we consider changes in these investments and their implications for regional connectivity.

FIGURE 1 FDI FROM REGIONS IN THE EUROPEAN UNION, THE UK AND NORWAY TOWARDS UKRAINE (CUMULATIVE VALUE OF GREENFIELD FDI FLOWS, 2013-2021)



Notes: To align spatial scales, capital expenditure of Limassol, Cyprus (\$11.41 million) added to Nicosia, Cyprus (\$255.9 million) and capital expenditure of Grevenmacher, Luxembourg (\$11.23 million) and Esch-sur-Alzette, Luxembourg (\$1.62 million) added to Luxembourg, Luxembourg (\$220.83 million)

Source: Authors' elaboration on BvD Cross-Border FDI data.

The largest manufacturing investment in Ukraine in the past ten years was Engie's (a French multinational utility company) pre-feasibility activities for a solar power plant in Chernobyl in 2017 (\$1,142 million). The second largest was Eskaro's new coatings and paint manufacturing in Odessa (\$536 million in 2013, with successive expansions). In the latter case, FDI explicitly ties the source region of investment (Gothenburg in the Västergötland region of Sweden) with Odessa oblast. What occurs in Odessa, the disruption and the difficulty, will subsequently have some consequences in Gothenburg – again as shocks transfer along the GVC.

Beyond seed oil (which accounts for the third largest FDI project in Ukraine by Cyprus-based Agroliga), neon is another relevant example of a product that plays a key role in multiple GVCs. Neon is a critical input to the extremely GVC-sensitive semi-conductor industry, and Ukraine produces 90% of semiconductor-grade neon used in the US.⁷ These semi-conductor (or micro-chip) GVCs were already under strain from Covid-19 pandemic following disruption in producing regions such as Fujian, China. Further GVC restraints will likely reduce supply once more. But again, these impacts are felt regionally. Two companies accounting for approximately half of global high-purity neon supply are Cryoin in Odesa, Odeska oblast and Ingas in Mariupol, Donetska oblast, while⁸ the US's largest semiconductor manufacturers are found in Texas and California. It is these regions which are most at risk if GVCs reshape.

Finally, it is worth considering Ukraine as a service hub. GVCs are not solely goods based, and while seed oil is the largest exported good, it is transport that is Ukraine's largest exported service. This is also associated with FDI data. After Retail trade, the most frequent (service) investment in Ukraine is in Warehousing and support activities for transportation. Ukraine's relative advantage in this stems from it sitting at a cross-roads between main trans-European corridors – both uniting Eastern and Western Europe as well as providing connectivity for the Baltic States to the Black Sea.

When breaking these investment flows down by business function, after Production (\$3,130 million) and Electricity (\$2,155 million), it is Logistics, Distribution and Transportation (\$1,070 million) that received the highest FDI flows from Europe between 2013 and 2021. These are (still) relatively low value-added activities, but they play an important role in sustaining higher value-added creation in firms and regions in the sending economies along the GVC.

Turning to FDI originating in Ukraine's regions towards the rest of Europe, FDI in postal and courier services emphasises Ukraine's relative comparative advantage in this area. It is not just Kharvic and Chernobyl in Ukraine that benefit from inward FDI from the EU in GVC-sensitive industries; Galicia in Spain, Malopolskie in Poland, and Lisbon in

7 www.reuters.com/breakingviews/ukraine-war-flashes-neon-warning-lights-chips-2022-02-24/

8 www.tomshardware.com/news/ukraine-neon-gas-production

Portugal benefit as destinations of FDI from Ukraine in GVCs. These are just three of the twelve regions that have received over \$10 million greenfield FDI inflows from Ukraine since 2013.

GVCs, FDI AND EU REGIONAL INTEGRATION

FDI inflows and outflows – as well as the wider global, European and local value chains that they orchestrate – capture inter-regional connectivity. It is this connectivity that forms the initial backbone of future trade and investment flows in view of Ukraine’s accession to the EU. Ukraine’s centre of economic gravity – its international trade ties – has been moving West towards the EU and away from Russia since 2003 (Neffke et al. 2022). Yet, it is doing so at a slow rate, arguably because of generally low levels of FDI from the EU. For example, in 2019 employment in foreign firms was only 2% of total in Ukraine, contrasting with 7% and 9% in Poland and Romania, respectively. It has been argued that this still insufficient integration with the EU is a major contributing factor to Ukraine’s dismal economic performance compared to its peers since 1990 (Hausmann 2022).

If EU countries are serious about Ukraine’s candidate status or accelerated membership to the EU, then facilitating FDI and connected trade must be a key programme of work. To achieve this, de-oligarchisation, fighting corruption, liberalising foreign firms’ access to the domestic market, ensuring property rights, as well as reducing investment uncertainty and information asymmetries are critical. Some argue security guarantees should be part of this package to facilitate firms’ participation in value chains (Hausmann 2022). We would also propose important roles for horizontal and vertical public policy. This would mean deploying skills and infrastructure in a GVC-sensitive manner as well as connecting with GVCs through dedicated regional investment promotion agencies (Crescenzi et al. 2021). These agencies should work in a coordinated manner in Ukraine as a candidate country and in current EU member states. Pro-active vertical engagement with GVCs and FDI will facilitate the connection between the most appropriate inward or outward FDI and the most appropriate region to receive or provide it. This aids in managing investment in a context of significant information asymmetries and institutional failures.

These policies – where implemented in a well-coordinated manner – will play a key role in shaping future patterns of economic integration to the benefit of local economies, fostering cohesion and inclusive growth in all regions. For it is through FDI and GVCs that the connected nature of Europe’s regions to counterparts in Ukraine (and back again) is illuminated. Thus, the local economic importance of helping Ukraine now and in its recovery becomes clear. By helping and supporting Ukraine, local economies across Europe support themselves and their own future prosperity.

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CHAPTER 25

Trade, war, and reconstruction

117

Philippe Martin, Thierry Mayer and Mathias Thoenig

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The Russian invasion of Ukraine has brought the link between war and international trade back into the spotlight. For some, it calls into question the pacifying effect of globalisation. For others, the trade sanctions against Russia, by increasing the cost of war for Russia, could encourage Putin to change his strategy and push him to negotiate. For the first time, these sanctions take the form not only of an embargo that affect the quantities exported, but also a maximum price on the Russian oil exported. In any case, this war is disrupting world trade, with repercussions on value chains and on the world prices of energy, raw materials, and agricultural products, both in rich countries and in the most fragile poor countries. Today, it is the immense commercial entanglement of economies that is spreading the human cost of war far beyond Ukraine's borders.

The link between trade and military conflict is complex and ambiguous. One fact has been well established since the end of WWII, however, and it holds true in the case of the Ukraine conflict: war persistently damages trade links between countries, but does not eliminate them. In an empirical study we conducted in 2008 (Martin et al. 2008) and which was subsequently corroborated by others, we estimated that on average since WWII, military conflict rapidly reduces trade between belligerents by an order of magnitude of around 35%. The 'return to normal' in terms of trade once the conflict is over takes between 15 and 20 years. In the case of the 2014 conflict between Ukraine and Russia, bilateral trade was reduced but not eliminated. Even in the midst of conflict, trade continues. Moreover, a conflict can reduce trade not only between the warring parties but also between them and the rest of the world. Since the war began, Russian imports have fallen (partly due to sanctions) from Western countries (which had already been the case in 2014) but also from Asian countries.

Wars thus have, beyond the human cost, an economic cost. Montesquieu's belief in "le doux commerce" which has the "natural effect of bringing about peace" may be partly based on this economic calculation. If leaders take these costs of destroying trade into account, even partially and in conjunction with a host of other non-economic factors, then they will be more likely to prevent a conflict from escalating into a military confrontation; and all the more so if their country is open to international trade. This peacemaking effect of trade between two countries has been empirically verified after WWII. European integration is an emblematic case. In fact, it can be noted that trade flows between Ukraine and Russia decreased between 2014 and 2022. Ukraine spent

about 17% of its expenditure on Russian goods in 2010, compared to less than 7% in 2018. During the same period, the share of Russian consumption from Ukraine was almost divided by three.

But to deduce from this that globalisation is always a factor of peace or that the decrease in trade flows is a factor of conflict would be wrong. By increasing trade flows further afield, multiplying partners, and reducing local economic dependence on nearby countries with which conflicts are most frequent, globalisation has been able to reduce the economic cost of a regional conflict. In fact, the number of such conflicts has increased with the growth of multilateral trade. At the same time that bilateral trade relations between Ukraine and Russia were weakening, both countries were increasing their trade with the rest of the world: between 2010 and 2018, Ukraine increased the share of its spending on goods from the rest of the world by about 11 percentage points (a significant portion of which came from the EU). Russia reduced its dependence on European imports, but increased imports from outside the EU and outside Ukraine by almost three percentage points.

In the area of energy, the EU's (and particularly Germany's) commercial dependence on Russia illustrates another dimension of the complexity of the links between trade and conflict. This dependence was partly orchestrated by Russia and has certainly delayed sanctions against Moscow. The embargo on oil countries was not implemented until the end of 2022 and it was the Russians who took the initiative to reduce gas exports. Thus, it is likely that by increasing the cost to Europe of possible sanctions, Europe's dependence on Russian energy has facilitated Putin's decision to attack Ukraine. In this case, it is trade which, through the dependence it generates, becomes a weapon of war.

It will be retorted that these mechanisms assume the rationality of political actors weighing the costs and benefits of a conflict and that a dictator such as Putin does not give the same weight to the human and economic cost of going to war as a leader of a democratic state. This is certainly true, but even dictatorships are sensitive to the economic impact of their decisions. If this were not the case, then the whole logic of Western sanctions against Russia would falter. We still believe that, even if imperfect, the trade sanctions against Russia should be strengthened with the objective to increase the cost for Russia of the war against Ukraine.

Trade (and more broadly, economic interests) is only one factor among others in the dynamics of escalation or containment of armed conflicts. But it is one of the levers on which we can act directly.

From this point of view, the war in Ukraine invites us to go beyond the purely mercantile vision of globalisation that has prevailed since the 1990s. From now on, the face of trade policy has changed: geopolitical risk must be fully taken into account in the architecture of future trade agreements. In the case of Ukraine, reconstruction will require strong growth and therefore strong trade flows. However, even after the end of war and as long as Russia remains aggressive, Ukraine will have to massively redirect its trade to the West

and the EU. But, if at some point in the future the regime in Moscow changes, Ukraine should be able to restore its trade ties with Russia to set the geopolitical conditions for a smoother relationship in the long term. However, the size and urgency of the task of reconstruction requires quickening the integration process with the EU to benefit as quickly as possible from the growth benefits of trade. In other words, the institutional challenge for Ukraine and EU is to strengthen trade sanctions against Russia, build an architecture of trade agreements with the prime objective of reconstruction of Ukraine in sight and a variable geometry according to political developments in Russia.

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CHAPTER 26

Why the West should help Ukraine win: The economic arguments

121

Basil Kalymon

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Ukraine has been brutally invaded by a Russia under the control of Vladimir Putin. There are many compelling reasons why the West should help Ukraine withstand this unprovoked attack, including moral, legal, political, military, historical, cultural, and economic ones. Morally, it is the proper course of action. Politically, it is important that a peaceful democracy prevails over an imperialistic dictatorship (Roland 2023). Legally, Ukraine is defending its internationally recognised borders. Militarily, a nuclear power should not be permitted free rein if proliferation is to be avoided (Gorodnichenko 2023). Historically, the Ukrainian people trace their roots back to the 10th century of the Kyivan Rus. Culturally, Ukraine has a rich culture in literature, religion, and traditions to offer within global diversity. However, this column will focus on the economic reasons for supporting Ukraine.

At 603,000 square kilometres, Ukraine would territorially be the largest country of the EU and with around 40 million people, also one of the most populous. Ukraine has vast agricultural lands and is rich in mineral and energy resources. At the same time, its human capital is substantial, with a highly educated workforce. It possesses an extensive infrastructure of oil and gas pipelines and storage facilities together with a major complex of electricity generation plants. All of these economic resources lie at the borders of present-day EU members, including Romania, Hungary, Slovakia and Poland, with direct connections to the rest. An independent and democratic Ukraine is truly a prize worth defending.

One of the key economic contributions of Ukraine is as a global breadbasket, supplying grains, oils, meats, and other food products to the world. The disruption of supplies created by the Russian invasion has contributed significantly to inflation in food prices globally. Even more critically, shortages of Ukrainian exports are causing starvation in the more impoverished parts of the world (Artuc et al. 2022). An independent and thriving Ukraine would be a major contributor to the eradication of world hunger and moderation of global food prices.

In recent years, Ukraine has become one of the major suppliers of IT outsourcing to the world (Schnitzer 2023). With an open and unhindered IT sector, Ukraine has been able to establish itself as a significant force in a sector which is defining the future. Given

Ukraine's extensive educational system, it has been able to graduate a highly trained cadre of specialists whose impact would continue to grow. Already, an open economy has enabled the creation of many innovative startups whose integration with the global industry is becoming visible with companies such as Grammarly. Ukrainian IT specialists are contributing to the protection of the democratic world in critical areas of cyber security and even military planning.

As the world has drifted toward more unpredictable and autocratic rule, global trade is shifting in the direction of nearshoring of production. In addition, the EU is suffering from an intense labour shortage resulting both from the impact of the Covid epidemic and the low birth rates in developed economies. An independent and secure Ukraine would offer major opportunities for establishing manufacturing plants within easy reach of European countries, eliminating some of the more complex Asian supply chains. In this respect, Ukraine's potential membership of the EU would greatly enhance such cooperation.

In the energy area, the dependence of Europe on Russian oil and especially natural gas has been recognised as a major strategic liability. It is inconceivable that the current EU policies of withdrawal from the import of Russian oil and gas would be reversed in the foreseeable future. Even as much of the world is committing itself to decarbonisation, it is also recognised that fossil fuels will continue to be required for an extensive transitional period. Ukraine can make a significant contribution in this transition as it has major undeveloped gas resources both in the Eastern part of the country and in the offshore of Crimea. In addition, Ukraine has extensive gas transmission and storage facilities in place which, even at present, are highly integrated with EU country networks and are being used to deal with Russian gas withdrawal. These resources would be complementary and diversify the liquefied natural gas (LNG) imports which are being used to displace Russian gas.

In the electricity market, prior to the Russian invasion Ukraine had been a significant exporter to the EU grid to which it is connected. Much of the power was generated by nuclear stations, free of carbon emissions. With the massive rocket attacks by Russia against Ukraine's electricity infrastructure, this export capacity has been severely damaged. With the establishment of peace and a democratic Ukraine, such exports can be restored, offering electricity price moderation. Of course, given the age and destruction of many facilities, the system will require major re-investment to reinstate its capacity.

Given Ukraine's large territory and existing mineral resources, it is also quite likely that there is a potential for rare earth minerals which are so essential to modern technology. Much of the world's current production is in China, a remote and autocratic regime whose reliability is increasingly in question. Diversification of supplies in this area is as critical as the past excessive reliance on Russia in energy has already shown. Development of any such resources in Ukraine would contribute to global economic diversification and security.

With the vast destruction inflicted by Russian bombardment of Ukrainian cities and infrastructure, the reconstruction of Ukraine will require massive funding but also offer major opportunities for Western companies. Russia will need to be forced to pay reparation through the extensive assets being held in the West (Cocozza et al. 2023). These clearly should include the \$300 billion of frozen reserves of the Russian central bank, but also the billions of illicit oligarch funds frozen by sanctions. In addition, a post-war 'Marshall Fund' will also be needed. With these funds, Ukraine can be rebuilt with the inclusion of Western firms and technology. A highly modernised country can emerge which would offer many trading and investment opportunities.

In conclusion, it should be recognised that, with help from the West, Ukraine shall emerge from the war as a vastly transformed country. Under the strong leadership of President Zelensky, the country has become highly unified, with strong support for both EU and NATO membership. With the banning of the pro-Russian party led by the disgraced Victor Medvedchuk, the political system has been purged of the most outrageous Russian infiltration. The oligarch clans that controlled much of economic and political life in Ukraine have been vastly weakened by new laws limiting their control over media and political parties. The reform of the judicial system has started with the removal from the Supreme Court of a judge holding illegal Russian citizenship and other judicial dismissals. The Zelensky government has reacted swiftly to recently identified corruption schemes with extensive firings and prosecutions of individuals involved. While much remains to be done in reform, the commitment and initiative of the government is clear. With continued support, Ukraine will emerge as a strong democracy and future EU member that will strengthen the position of the entire West.

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CHAPTER 27

Ukraine deserves what others of us in Eastern Europe got - the EU

Wojciech Kopczuk

Columbia University and CEPR

It has been one year since the full-scale invasion of Ukraine by Russia on 24 February 2022. Of course, the conflict did not start then – Ukraine was invaded in 2014, with parts of it occupied and fought over ever since. There is a simple case for why Ukraine should be supported: when one country invades another, goes after its democratically elected government, kills its civilians, and causes untold economic damage, it is natural to stand with the victim. The world is complex, though, armed conflicts happen all the time (though the scale of this one is unusual) and people far away do not necessarily follow them or understand the stakes, and can be indifferent. That's normal, and the humanitarian arguments, while important, rarely drive politics and economic support.

I am not from a place that is far away, though. I am Polish, although I live in New York nowadays. My grandparents lived their lives a few miles from what's now the Polish-Belarussian border, speaking the language that's somewhere between Polish, Ukrainian and Belarussian. There is a lot of history, ethnic complexities, and mixed populations all over Eastern Europe. Ukrainians fought bitterly with Poles at the end of WWII, Poles oppressed the Ukrainian minority before 1939, and forcibly resettled the Ukrainian population from what is currently South-Eastern Poland in 1947. Communists in the Soviet Union and Poland recalled Ukrainian nationalism over the decades for their own purposes. We can go to prior centuries to find many other examples of ills flowing in both directions.

Yet, after 2014, and especially since 2022, it is hard to find anti-Ukrainian sentiment in Poland. To the contrary, Poles welcomed Ukrainian refugees, provided humanitarian aid, and are united in supporting military aid despite fractious politics and little agreement on everything else. What happened? Some people that do not understand the region think that the answer is 'Russophobia'. What this misses is that you could equally or even more strongly have 'Ukraine-phobia'. The complexities of Polish, Ukrainian and Russian history make it as much if not more possible because, on the ground, Poles and Ukrainians lived intermingled with each other. That is not what happened, and I think it is important to see why, because it reveals what this conflict is really about and what is at stake.

When communism in Eastern Europe collapsed starting with the Polish Round Table in 1989 and ending with the dissolution of the Soviet Union in 1991, countries embarked on various forms of economic transition. It has not been a smooth process everywhere, but 30 years later there are members of the EU that have been converging with Western Europe and then there are countries that have been left behind. Why was Ukraine left behind? It is not just about being the former Soviet Republic – Lithuania, Latvia, and Estonia were part of it too. It is not about being a nominal democracy – Ukraine has been one too. What Ukraine did not have was a path to joining the EU. I am not sentimental about the EU – it is a complex, bureaucratic, and often inefficient project. For countries in transition, though, it had one undeniable benefit: it imposed restrictions on domestic politics, because once on the path to the EU, you had to get your house in order to meet the accession criteria. Polish, Czech, Slovak, Romanian, or Hungarian politicians are not any better than Ukrainian ones (we've always known that, but the rest of the world can more easily appreciate it after we became members and the stick no longer works as well), but their room for excesses was curtailed by the promise of joining the EU.

Ukraine has not been offered that. It remained in nowhere land between Russia and the EU, with reforms that could not get off the ground, political setbacks, and corruption. Part of it was political meddling from its neighbour, part of it were domestic interests that, absent outside force, could not be controlled. Russia or developing while staying outside of the EU are not competitive alternatives – there is no example of success along these lines in Europe or anywhere close. The resource-rich and authoritarian Russia is not a model that led to its own growth and it's not a model that Ukraine (or, for that matter, other former Soviet republics) could follow and still keep up with the rest of the world. After 20 years into it, Ukrainian society finally rejected this path during the Revolution of Dignity that, at its core, was about the EU association agreement that Russia tried to sabotage. The Russian response was invasion of Crimea and Donbas.

The conflict is fundamentally not about nationalism, NATO, language, or anything like that. At its core, it is about the economic comparison of my home Poland and other countries in Central and Eastern Europe that have been converging with Western Europe, and Ukraine that has been not. Starting from similar levels in 1989, Polish GDP per capita was over three times higher than that of Ukrainian in 2021, even more now in the midst of the devastating conflict. Over one million Ukrainians worked in Poland already before the 2022 invasion. People travel, watch tv, and know what the policies of the last 30 years deprived them of. The only reason why it has been this way was the lack of a path to the EU, and the only reason there was no such path is Russia's interests in preventing that. We owe the over 40 million Ukrainians the opportunity to develop their country and start catching up with the rest of Europe, an opportunity that they have been deprived of for too long.

Beyond the benefits to Ukrainians, another emerging economy in Europe would be good for everyone else. Poland is a strong supporter of Ukraine because of geopolitics, but also because of economic interests. Ukraine is a big market, with a lot of people, an educated

population, and many economic opportunities. Basic economics teaches that countries benefit from economic exchange. An EU that does not have a stagnant and poor economy on its border is a safer and richer EU. So is an EU that does not have an unstable political neighbour.

The benefits of a safe and stable Ukraine would extend beyond Europe. This conflict highlighted the role of the country in the world's agricultural production – this is just another example of trade benefiting both sides. Another stable growing liberal democracy would be one more example for countries in central Asia and elsewhere of a path that they can follow. Dreaming somewhat, it would also be an example for Russia and Belarus of what they could become.

In order to get there though, Russia needs to change or it needs to lose. We cannot change it, so there is only one option left. Having some mythic peace agreement that leaves a frozen unresolved conflict with Russia occupying part of Ukrainian territory would be poisonous for Ukrainian EU aspirations. These aspirations are precisely what this conflict is about.

Helping Ukraine is fundamentally the right thing to do not morally, there are over 40 million people whose future depends on it, but also because it is the way for Europe to be richer and safer and of reminding the rest of the world that liberal democracies can flourish. I and all Poles have seen how our country has changed for our own benefit and how it has benefited others through economic exchange. At its most basic, this is what we want for Ukrainians and for ourselves as well.

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CHAPTER 28

Foreign support to Ukraine: Evidence from a database of military, financial, and humanitarian aid

129

Christoph Trebesch

University of Kiel, Kiel Institute for the World Economy and CEPR

Russia's attack on Ukraine has caused staggering human suffering and destruction. Since the full-scale invasion started, many Western leaders have pledged to 'stand with Ukraine' and announced major military and humanitarian support. In this column, I ask the following questions: What do the numbers say? How large is the support for Ukraine? Who are the most supportive governments? And what type of support do countries offer – military, humanitarian, and/or financial aid? The answer to these questions is often imprecise.

In the initial months of the war, the debate mainly focused on sanctions and other measures to hurt Russia (e.g. Bachmann et al. 2022); less attention was devoted to measures in support of Ukraine. Recent months, however, have a series of important contributions on aid to Ukraine and the required reconstruction efforts (Becker et al. 2022, Rashkovan and Eichengreen 2022, Shapoval et al. 2022). Nevertheless, systematic data remain scarce.

A SYSTEMATIC DATABASE ON FOREIGN SUPPORT TO UKRAINE

The Ukraine Support Tracker¹ by the Kiel Institute of the World Economy lists and quantifies the support of 40 donor governments plus that of the EU institutions (Trebesch et al. 2023).² In the most recent update, we trace aid commitments between 24 January 2022 (the day several NATO countries put their troops on alert) and 15 January 2023. Our main contribution is to quantify the scale of aid to Ukraine in millions of euros or as percent of donor GDP, which allows for systematic comparisons across countries. We trace both financial and in-kind transfers and create a comprehensive 'consensus' database that brings together information from official government sources, existing lists of Ukraine aid, and media reports, now covering more than 1,000 individual

1 www.ifw-kiel.de/ukrainetracker

2 Specifically, we trace commitments by 41 donors, including all G7 and EU member countries (31), plus Australia, New Zealand, Norway, South Korea, Switzerland, Turkey, India, China and Taiwan (9). In addition, we trace commitments by the EU institutions (i.e. the European Commission and EU Council), but also via the European Peace Facility (EPF) and the European Investment Bank (EIB).

donations. To quantify in-kind aid such as weapon shipments or ‘tonnes of foodstuff’, we assign a monetary value to each item using market prices and data on previous instances of international aid deliveries. The resulting database with sources is fully and freely available.

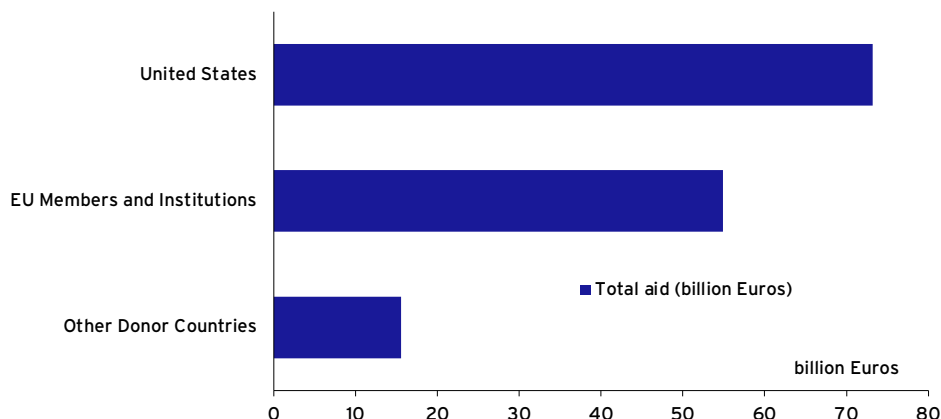
We mainly focus on bilateral (government-to-government) commitments transferred to Ukraine. This means that not all types of support are covered. In particular, in our baseline figures we do not add the costs of helping refugees who have fled Ukraine (but we do show results in additional figures). We also do not count private donations, mainly because reliable information across countries is not available. For international financial institutions like the IMF or the World Bank, we do track their support but report these results separately.

A main challenge for the quantification of aid flows is data transparency. We do our best to list and quantify all support measures that have become publicly known. But not all donations do become public. For better comparability across countries, we therefore create a ‘data transparency’ index that measures how detailed each government’s information on their Ukraine support is. We find considerable variation across countries, with some governments – such as France, Spain, and Poland – being rather opaque on their support (see Appendix Figure A1). The average scope of information sharing, however, is high, with often very detailed lists on donations and data availability, and transparency has clearly improved over the course of the war.

THE US AND EASTERN EUROPEAN COUNTRIES STAND OUT

Figure 1 shows the first key insight – a breakdown of aid to Ukraine by donor group. In total, we trace over €144 billion in government-to-government commitments from 24 January 2022 until 15 January 2023. The US is by far the largest bilateral supporter of Ukraine, having committed €73.18 billion, more than 50% of the total commitments in our database. EU country governments committed a total of €20.1 billion bilaterally, plus €29.92 billion through the European Commission and Council, €3.1 billion via the European Peace Facility, and €2 billion through the EIB. This brings total EU commitments to €55.12 billion. It is remarkable that the US alone has committed considerably more than all EU countries combined, in whose immediate neighbourhood the war is raging.

FIGURE 1 AID COMMITMENTS TO UKRAINE ACROSS DONOR GROUPS (IN € BILLION)



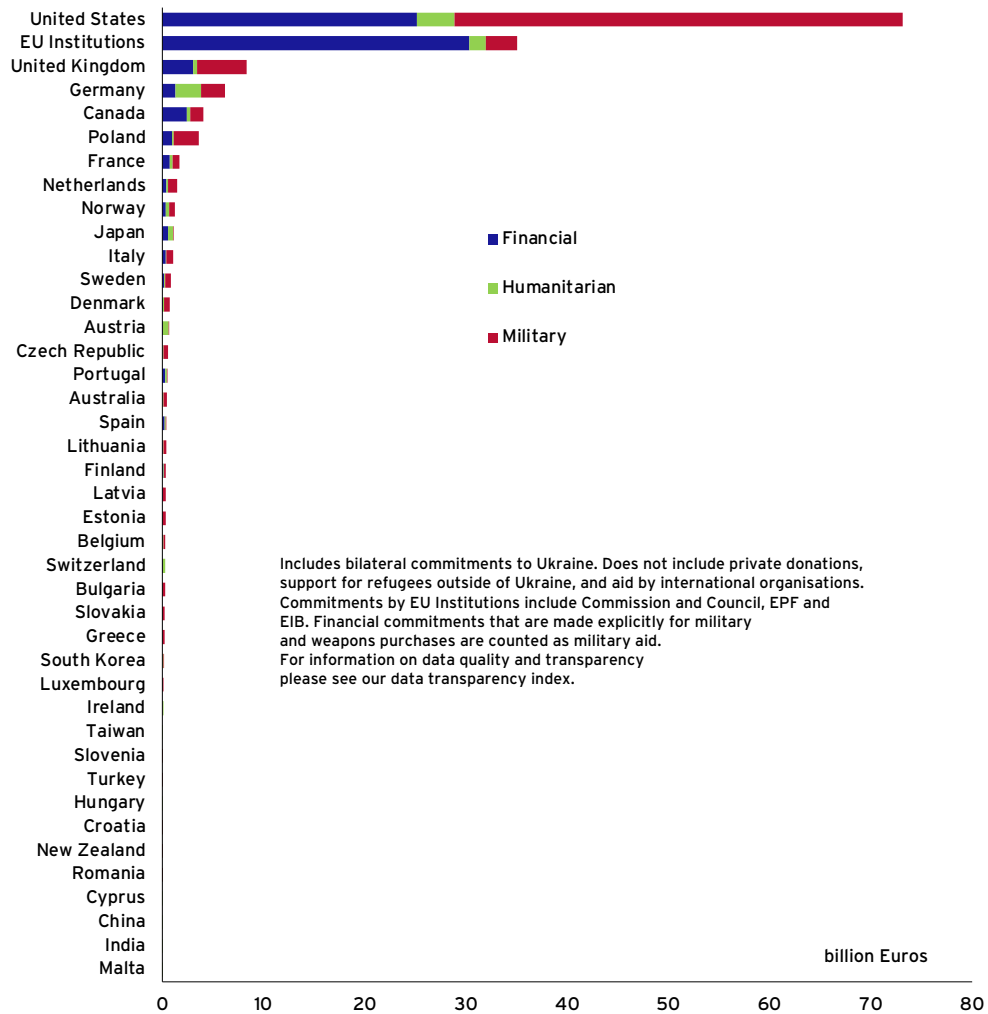
Note: This figure shows total bilateral aid commitments to Ukraine across different donor groups between 24 January 2022 and 15 January 2023. Other donor countries include the Anglo-Saxon countries (except the US), as well as China, Japan, South Korea, Taiwan, Turkey, Norway and Switzerland and India.

Figure 2 shows that there is striking variation in the bilateral support across countries. The US clearly stands out, followed by the EU institutions, and then the UK, and Germany. When we assign the EU commitments to the EU member countries, the overall patterns look similar, although some countries – such as Italy and Spain – move up the ranking considerably (see Appendix Figure A2).

When measured as a percentage of donor GDP, the support of Eastern European countries stands out (Figure 3). The Baltic countries, Poland, the Czech Republic, and Bulgaria rank high, but the US is also among the top five donors when measured as a percentage of country GDP. The large US commitments, both in absolute and relative terms, are striking.

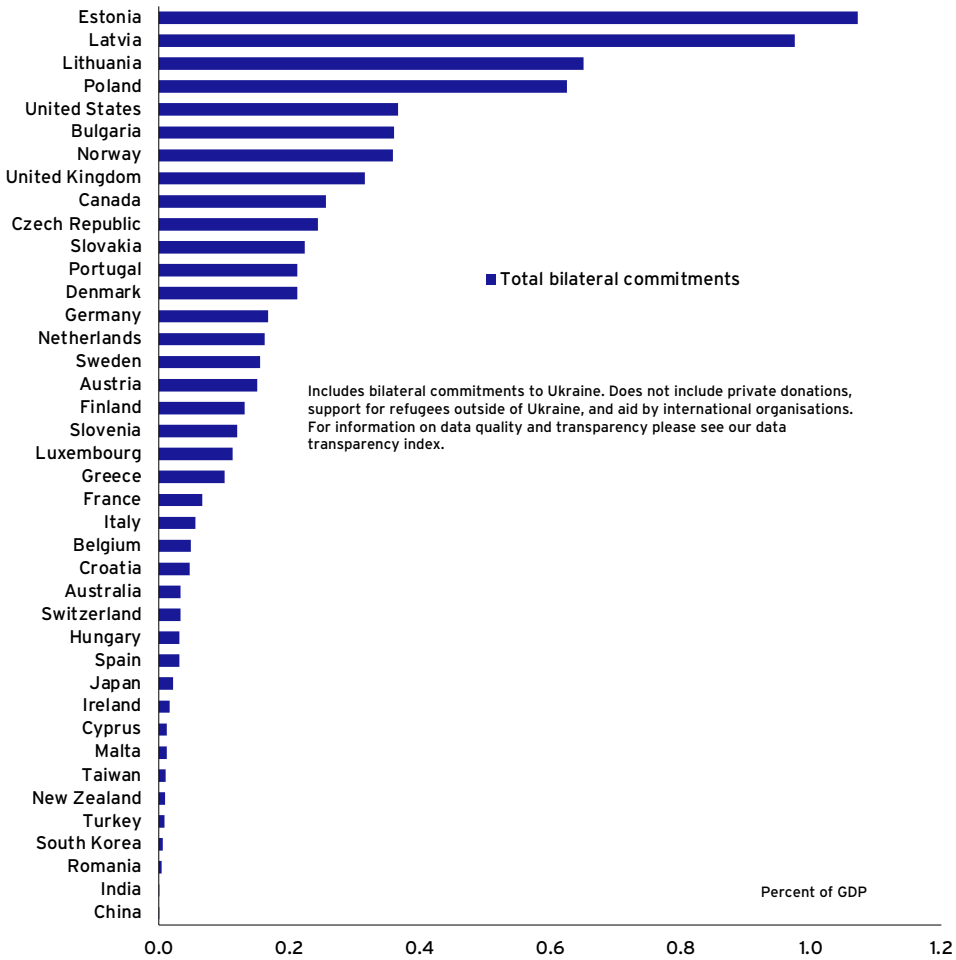
It is also striking that some of the richest Western European countries appear in the bottom third. Spain and Italy, for example, made bilateral commitments of just 0.06% and 0.03% of their GDP, respectively, according to our data. Other large countries such as Poland, the US, and the UK have committed up to ten times as much aid as a share of GDP. As shown in Figure A1, Spain and Italy are non-transparent, but even if the true scope of their support was twice as high than what has become publicly known – an unlikely scenario – then they would still rank in the bottom half. The same is true when reassigning EU-level aid to each EU country and then recalculating aid as a percentage of GDP (Figure A3).

FIGURE 2 TOTAL BILATERAL COMMITMENTS BY TYPE OF ASSISTANCE (€ BILLION)



Note: This figure shows total bilateral aid commitments to Ukraine across donors in € billion (covering 24 January 2022 to 15 January 2023). Each bar shows the type of assistance, i.e., financial (blue), humanitarian (green), and military (red) aid. Cost estimates for hosting refugees are added in Figure 7 below.

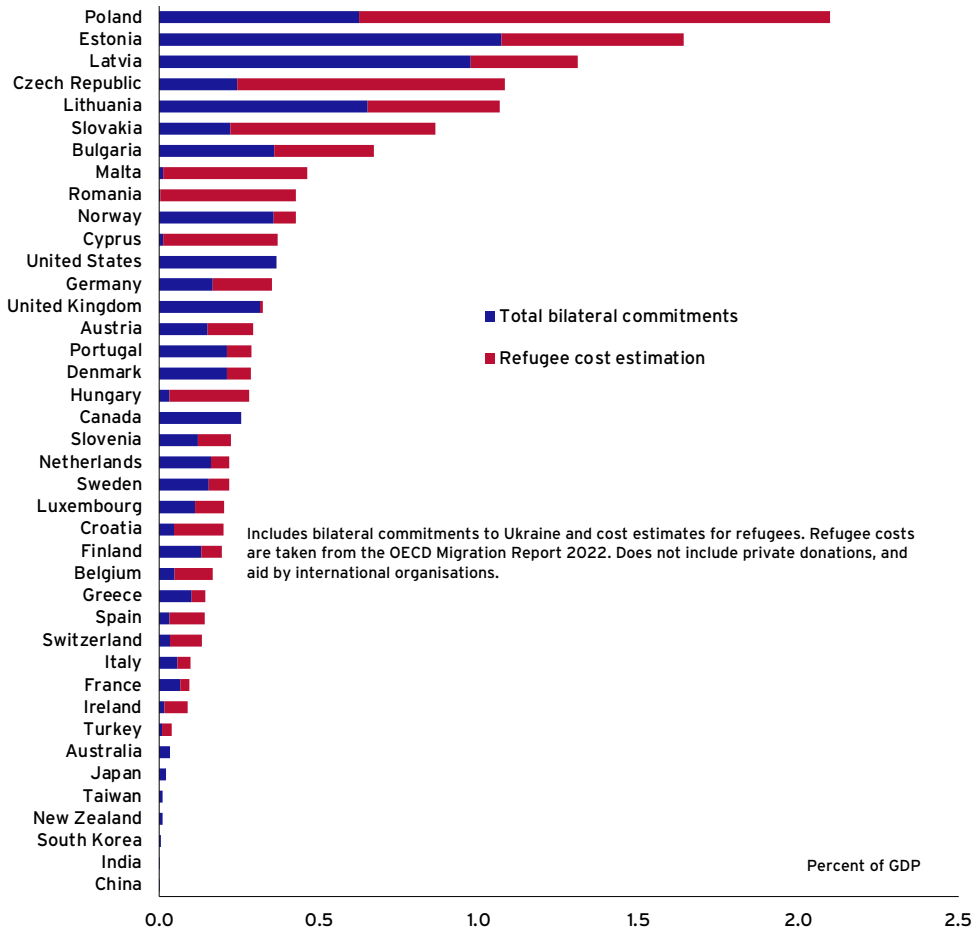
FIGURE 3 BILATERAL COMMITMENTS AS A PERCENTAGE OF DONOR COUNTRY GDP



Note: GDP data for 2022 is from the World Bank.

Once we add estimates on the cost of hosting Ukrainian refugees over the year 2022, the distance between Eastern and Western European countries grows further (Figure 4, using estimates on refugee costs by the OECD 2022). Now eight out of the top ten supporters of Ukraine are Eastern European countries, while countries like France, Italy and Spain rank even further down.

FIGURE 4 ADDING THE COST OF HOSTING REFUGEES (TOTAL SUPPORT AS A PERCENTAGE OF DONOR GDP)



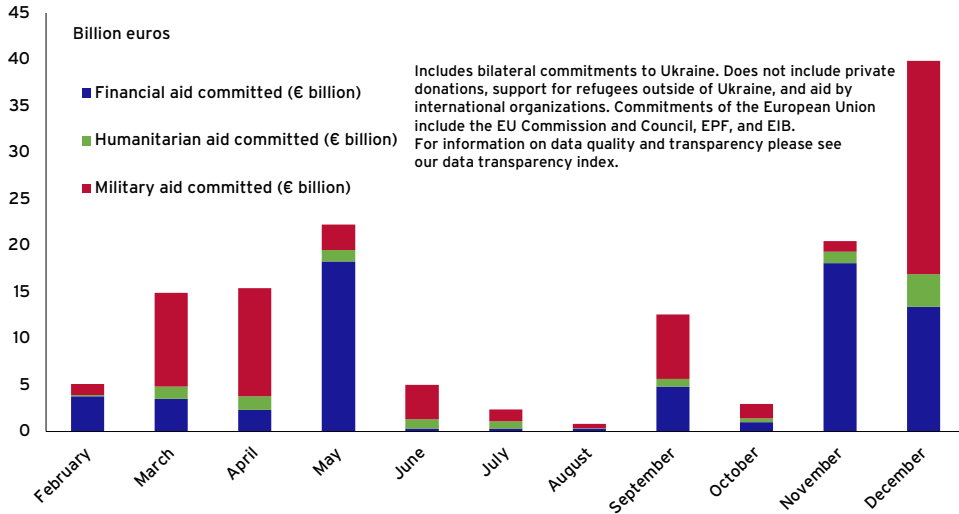
Note: This figure complements our main Figure 2 by adding estimates on the cost of hosting refugees from OECD (2022). GDP data (current US\$) are taken from the World Bank.

NEW COMMITMENTS ARE CYCLICAL AND OFTEN ARRIVE WITH A DELAY

Figure 5 tracks aid over time and shows that commitments have been highly cyclical in 2022. After a strong increase in pledges after February, newly announced aid fell to almost zero over the summer, only to increase strongly again in the end of the year.

135

FIGURE 5 TOTAL BILATERAL ASSISTANCE, JANUARY TO DECEMBER 2022 (€ BILLION)

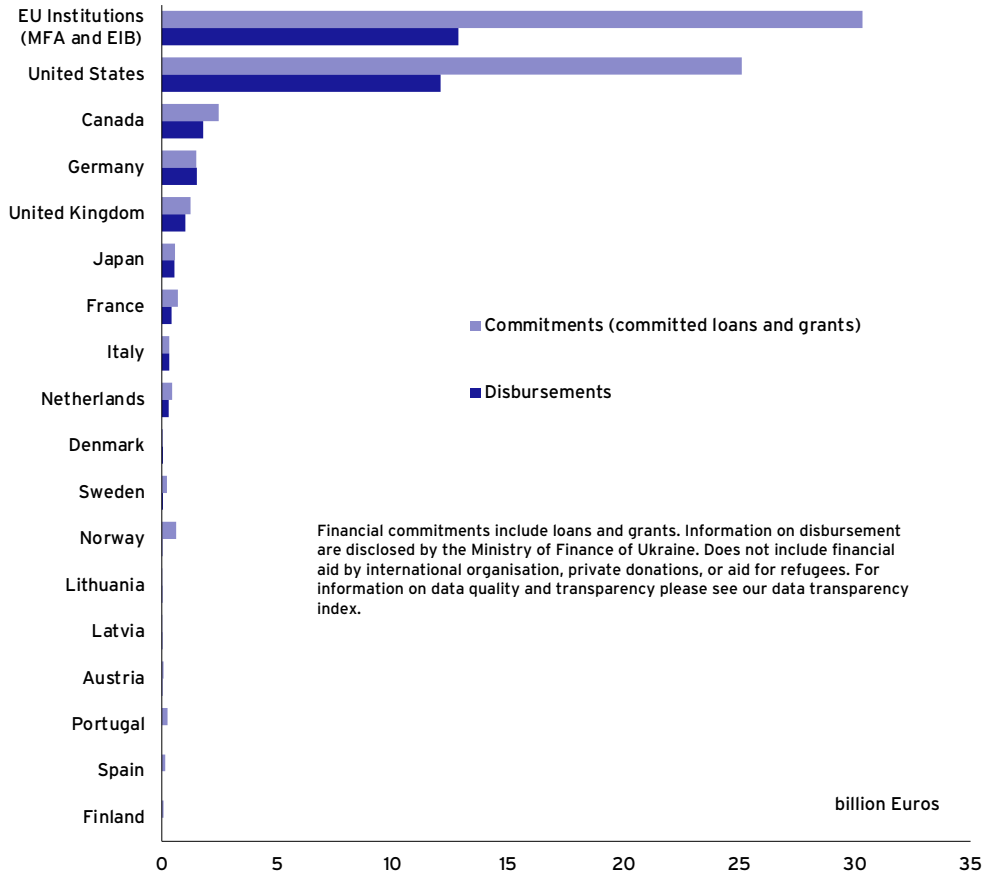


Note: This figure shows total bilateral aid commitments to Ukraine for all entries for which the commitment month is known.

Finally, we find that promised commitments are often disbursed with a delay. This can best be shown for financial aid, as we can combine our own data on commitments with detailed disbursement data provided by the Ukrainian Ministry of Finance. Figure 6 shows a very large gap between commitments and disbursements, in particular for the two largest donors – the EU and the US – which have each disbursed less than 50% of their total financial pledges.

The cyclical and delays in foreign support shows the urgent need for better coordination of Western aid to Ukraine. Thus far, aid flows have been hard to predict and aid announcements often erratic and uncoordinated. A central agency and/or platform would be a major improvement to allow Ukraine to plan ahead and make sure its most urgent financial, military, and humanitarian needs are addressed (see also Rashkovan and Eichenreen 2022).

FIGURE 6 FOREIGN BUDGETARY SUPPORT: COMMITMENTS VERSUS DISBURSEMENTS, 24 JANUARY 2022 TO 15 JANUARY 2023 (BILLION EUROS)



Note: This figure shows a ranking of financial donors, measured by the volume of external grants and loans given for budgetary support to the government of Ukraine (in billion euros). Light blue bars indicate commitments (from our dataset), while the darker blue bars show disbursements (using data from the Ministry of Finance of Ukraine).

SUPPORT TO UKRAINE IS SMALL COMPARED TO PREVIOUS WARS

In the rest of this chapter, I place the foreign support to Ukraine in a historical perspective. I combine data from our Ukraine Support Tracker project with historical data on military expenditures and military aid in previous wars. In this bigger picture, the international aid to Ukraine so far is surprisingly small.

COMPARING TO PREVIOUS WARS: SAMPLE AND DATA

Identifying comparable wars is not straightforward and is complicated by data limitations. I therefore take a pragmatic approach and focus on a small but well-known sample of wars that (i) involved a major foreign power (in particular, the United States), and (ii) which are well researched and offer reliable data for comparison purposes. The final comparison sample is as follows:

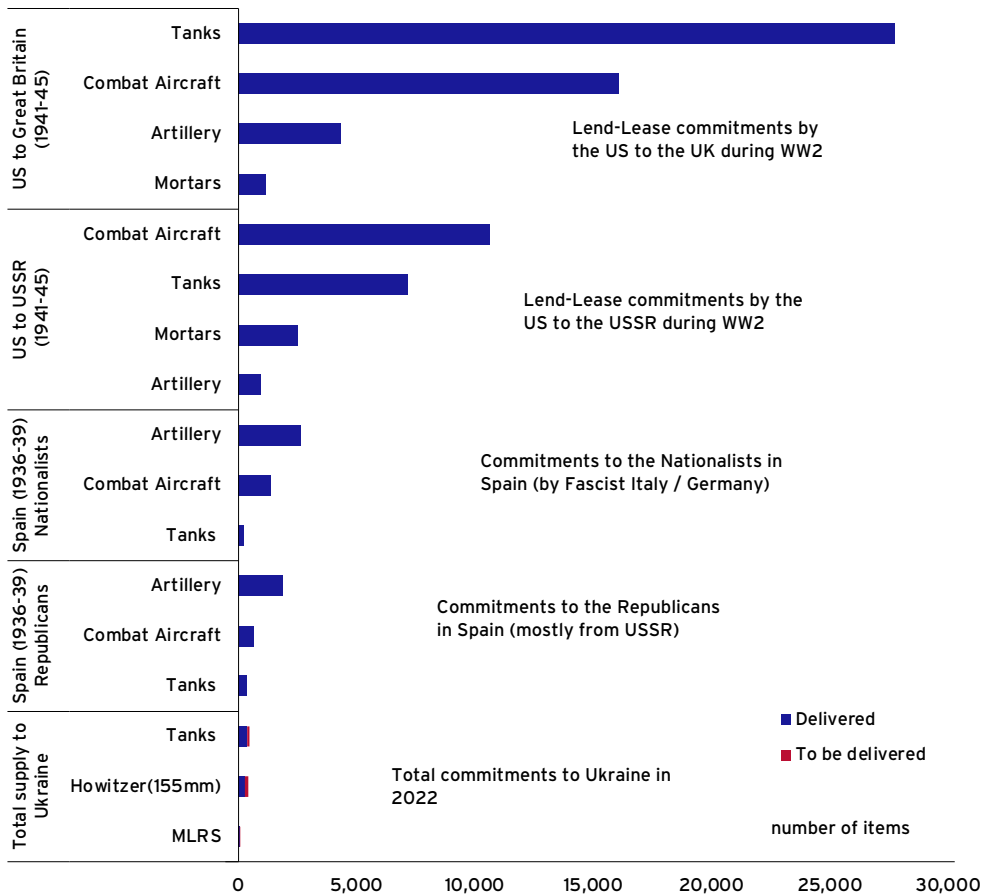
- We start with World War II, for which detailed data on the US Lend-Lease support to the Allies exist, in particular to Great Britain, the USSR and France.
- We also gathered data on foreign military support in the Spanish Civil War (1936-39), a typical case of a proxy war. Support for Franco's Nationalists came from Fascist Germany and Italy, while the Republicans were supported by the USSR.
- We further collect US expenditures in major US wars of the 20th century, as estimated by the US Congressional Research Service (Daggett 2010). These data allow us to cover the Korean War (1950-53), the Vietnam War (focusing on 1965-1975), the war in Afghanistan (focusing on 2001-2010), and the war in Iraq (2003-10).
- In addition, the Gulf War (1990/91) is an interesting case of international support within a Western Alliance. The war was largely waged by US forces, but non-participants such as Germany, Japan, and South Korea provided large financial and military assistance to the US and other combatants to liberate Kuwait. Our data on this war come from multiple official sources.

We aim to make the data across these different wars as comparable as possible. For monetary values, we start by converting into US dollars, if not already given by the source, and then adjust for inflation using the GDP deflator by the US Bureau of Economic Analysis (BEA). We also compute expenses as a percent of GDP at the time. For the United States, we rely on GDP data from the US Bureau of Economic Analysis until 1980 and the IMF-WEO afterwards. In the case of the Gulf War, we use nominal GDP from the World Bank WDI database. To adjust for war duration, we calculate yearly average expenses (except for the case of the Gulf War, which lasted just seven months). For Ukraine we use the period currently covered by the Ukraine Support Tracker database (between 24 January 2022 and 15 January 2023).

THE UNITED STATES SENT A 100 TIMES MORE HEAVY WEAPONS IN WORLD WAR II

To set the stage, we start by looking at the plain number of weapons committed by foreign powers in wars. High-quality data on weapon donations are available for World War II and for the Spanish Civil War. Figure 7 shows a comparison on the total number of weapons provided during these two wars compared to what was promised to Ukraine in the past year.

FIGURE 7 WEAPON SUPPORT IN MAJOR CONFLICTS: WORLD WAR II, THE SPANISH CIVIL WAR AND UKRAINE 2022 (IN-KIND MILITARY AID FROM FOREIGN POWERS, NUMBER OF ITEMS)

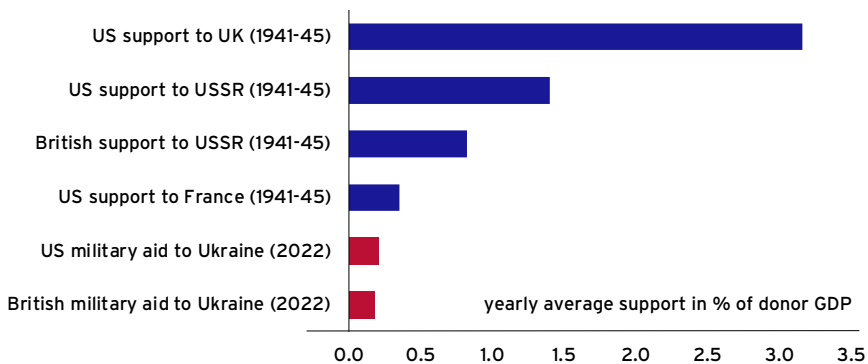


Note: This figure compares the number of weapons sent by foreign powers during WW2 and during the Spanish Civil War (green bars) to the number of weapons committed to Ukraine thus far (blue bars). For sources see Trebesch et al. (2023)

The difference in the scale of weapons committed is drastic. During 1941-45, the United States sent more than 25,000 tanks and more than 15,000 airplanes to Great Britain alone, and the USSR and France also received thousands of heavy weapons through the US Lend-Lease programme. Compared to that, the total number of heavy weapons to Ukraine are just a fraction – fewer than 500 tanks and howitzers, and fewer than 100 multiple rocket launchers. Also, the tally of weapons sent by foreign powers during the Spanish Civil War clearly outnumber that sent to Ukraine.

Both the price and the technological sophistication of weapons have increased markedly over the past century. We therefore also compare the Allied support during World War as a percent of donor GDP (by the United States or the United Kingdom). As shown in Figure 8, the support to Great Britain through the Lend-Lease scheme corresponds to 11.6% in total, or 2.6% of US GDP when averaged by year. Next comes the USSR, which received Lend-Lease support on a scale 4.7% of US GDP in total, or 1.2% when averaging per year. These numbers on annual support are up to ten times higher than the military support from the United States or the United Kingdom to Ukraine in 2022 (0.21% and 0.18% of GDP, respectively).

**FIGURE 8 FOREIGN SUPPORT DURING WORLD WAR II VERSUS UKRAINE 2022
(ANNUAL AVERAGE SUPPORT IN PERCENT OF DONOR GDP)**



Note: This figure compares the scale of foreign military support by the US and the UK during World War II (green bars, Lend-Lease program) to their military support to Ukraine 2022 (blue bars). We report total aid divided by the number of years during which aid was provided (WW2: 1941 to 1945). For sources see Trebesch et al. (2023)

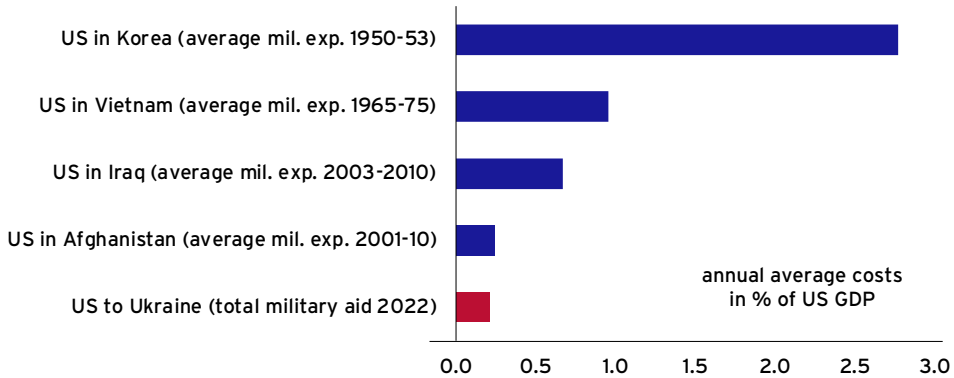
THE UNITED STATES SPENT FAR MORE IN KOREA, VIETNAM OR IRAQ

In a next step, we look at more recent wars, in particular wars involving the United States, for which approximate cost estimates are available. We again average costs on a yearly basis and use US GDP at the time for the comparison.

Figure 9 shows the result. By far the costliest war, in terms of yearly US military expenses to GDP, was Korea (1950-53), followed by the wars in Vietnam and Iraq. In each of these wars, US military expenditures far outweighed the size of US military aid committed to

Ukraine in 2022. Specifically, the estimates suggest that the US expenses for the Korean war were more than ten times higher than the amount committed to Ukraine in 2022 (0.21%). Similarly, the yearly expense numbers are almost five times higher for Vietnam, and three times higher for the Iraq war. The average yearly costs in Afghanistan are comparable to US commitments to Ukraine.

FIGURE 9 US MILITARY EXPENDITURES IN MAJOR WARS VERSUS UKRAINE 2022 (ESTIMATED YEARLY AVERAGES IN PERCENT OF DONOR GDP)



Note: This figure compares average annual US military expenditures in US wars to total US military aid to Ukraine in 2022 (both computed in % of US GDP at the time). Estimates on US military spending are from the US Congressional Research Service (Daggett 2010). US military aid to Ukraine is from our database. For details see Trebesch et al. (2023).

GERMANY SPENT THREE TIMES MORE TO LIBERATE KUWAIT THAN FOR UKRAINE IN 2022

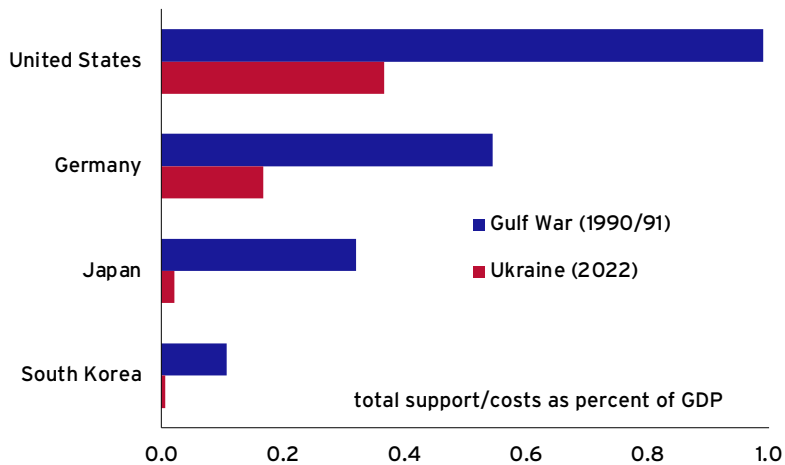
The last comparison focuses on the Gulf War (1990/91), which has some similarities to the Ukraine war. In both wars, a much larger neighbouring state started an unprovoked invasion, and in both wars Western countries formed an Alliance to repel the aggressor state. Specifically, the coalition against Iraq consisted of 35 countries, including a small number of states actively engaged in the war (such as the United States, the United Kingdom and France) and many non-participating states that granted financial and military support. As a result of this large-scale foreign aid, the United States was able to cover most of its own war expenses. Specifically, in a report the US Congress, the Department of Defense estimated that of the \$61 billion total incremental cost of the Gulf War (in 1991 dollars), US taxpayers only paid \$7 billion (US Department of Defense 1992).

For total aid numbers we can draw on country-specific sources, shown in Trebesch et al. (2023). For Japan, total commitments to Kuwait and the US-led alliance are worth a total of ¥1.5 trillion, corresponding to \$11.5 billion at the time. For Germany, we rely on official estimates showing that total financial and military aid amounted to 16.9 billion Deutsche marks (DM), or \$10.5 billion in 1990 US\$. Around DM 3 billion of this was

military assistance, partly coming from stocks of the German Democratic Republic. For South Korea, official numbers on aggregate support are hard to come by. We therefore use Korean transfers to the US budget as counted by the US Department of Defense. The resulting sum of \$355 million is a lower bound of actual support.

Figure 10 uses these data to compare the war support of these three countries in 1990/91 to their support to Ukraine in 2022, both as a share of country GDP at the time. For completeness, we also show total US expenses in the war, although a large part of this cost was covered by transfers from allied states. We compare total aid in 1990/91 to total aid to Ukraine from our database.

FIGURE 10 GULF WAR 1990/91 VERSUS UKRAINE 2022, EXPENDITURES AS A PERCENT OF DONOR GDP



Note: This figure compares the value of support by Germany, Japan, and South Korea during the Gulf War 1990/91 as well as total US war costs, with the size of bilateral aid to Ukraine, scaled by country GDP. Details and sources in Trebesch et al. (2023)

The differences are large. Thus far, Germany has committed bilateral aid worth 0.17% of its GDP to Ukraine, but it committed three times as much to liberate Kuwait in 1990/91 (0.55% of GDP in 1991). The gap is even larger for Japan and South Korea, which have given only limited bilateral aid to Ukraine, especially when compared to the sizable commitments in the context of the Gulf War (0.02% and 0.01%, respectively).

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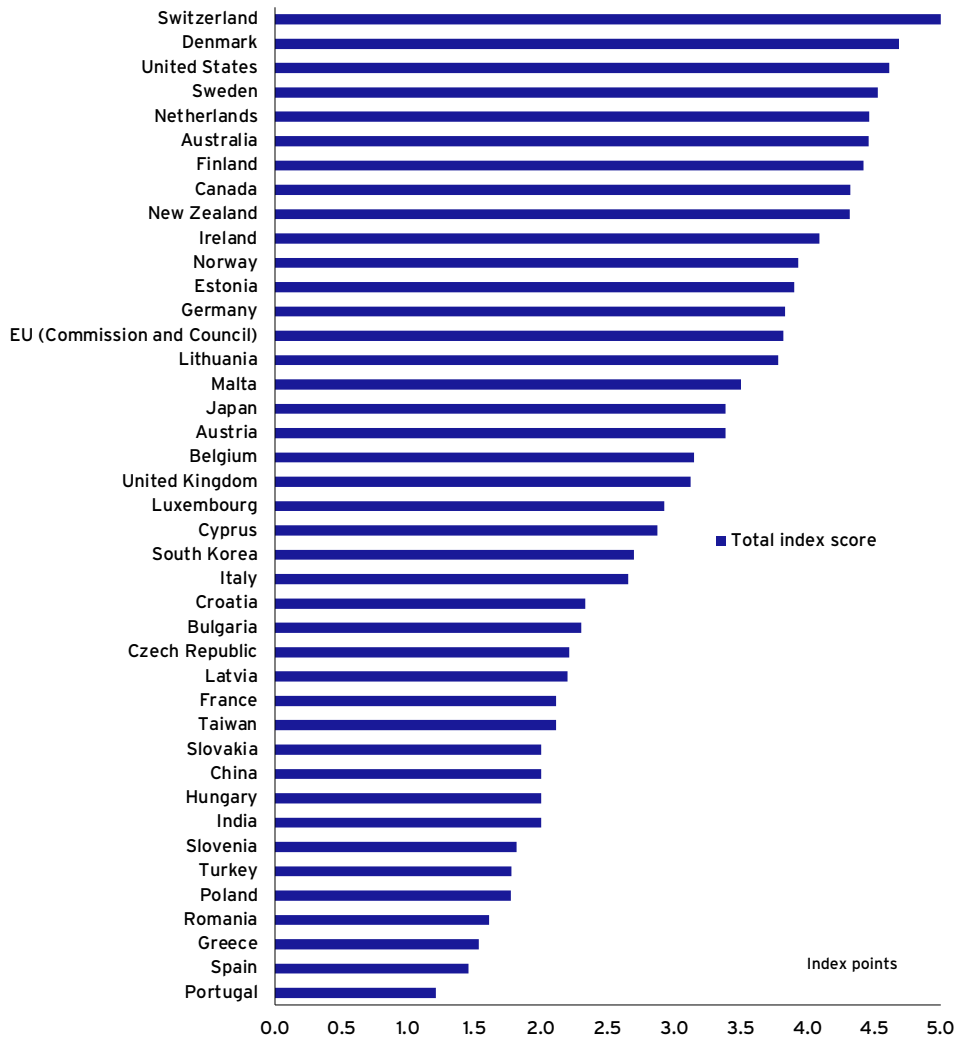
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APPENDIX

FIGURE A1 DATA TRANSPARENCY INDEX



Note: This figure shows the data quality and transparency ranking for all donors. Higher index values indicate higher levels of data transparency (5 = best, 0 = least transparent). The index is based on 5 sub-indices on data quality and transparency by country, the first two being qualitative (0-1) and the remaining three being quantitative (share of items with detailed information):

1 Designated website (yes=1/no=0): Is there an official website on government aid to Ukraine?

2 Total value of commitments given (yes=1/no=0): Is the total sum of Ukraine support provided by the government?

3 Government information on individual items (share in percent): Share of committed individual items in our database for which we have an official source (shares from 0 to 1 computed for each country).

4 Monetary value of individual items given (share in percent): Share of committed individual items in our database for which we have a monetary value (shares from 0 to 1 computed for each country).

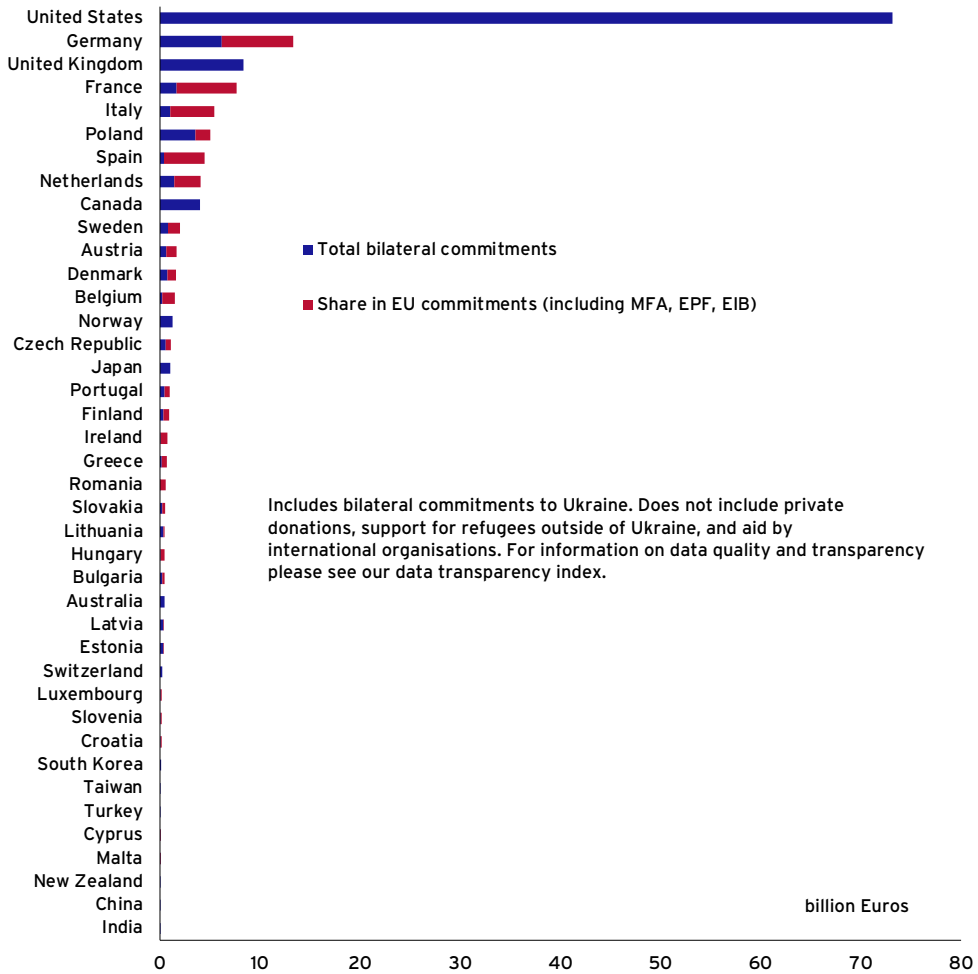
5 Exact number of weapons / military items disclosed (share in percent): Share of weapons and other in-kind military items committed for which we have the exact number of items (shares from 0 to 1 computed for each country).

The final index score per country is the sum of these 5 sub-indices. A score of 5 is the highest possible and suggests full data transparency, while 0 is the lowest possible score.

**FIGURE A2 REASSIGNING EU-LEVEL AID TO INDIVIDUAL EU COUNTRIES (BILLION EUROS)
TOTAL BILATERAL COMMITMENTS JANUARY 24, 2022 TO JANUARY 15, 2023**

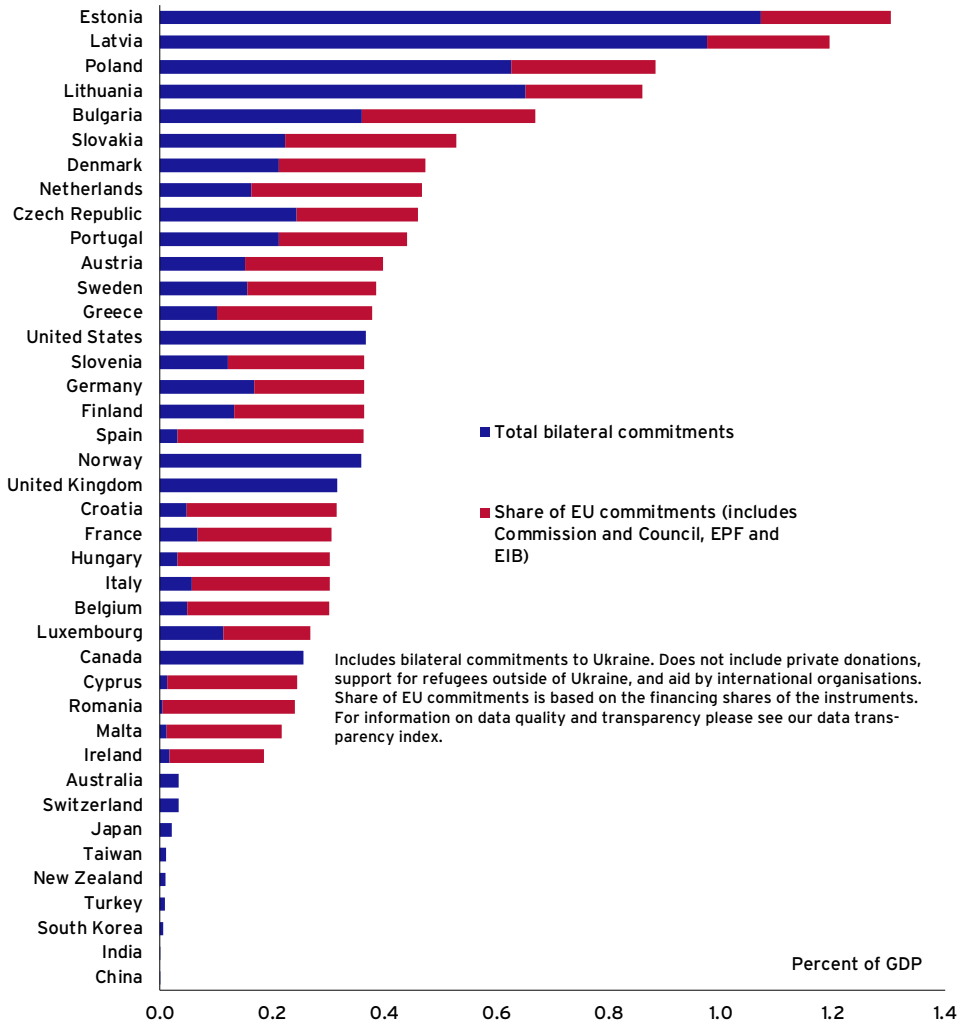
144

SUPPORTING UKRAINE: MORE CRITICAL THAN EVER



Note: This figure (on bilateral aid in billion Euros) builds on the main Figure 2 but assigns EU-level commitments to each EU country using their respective donation shares. We no longer show the donor bar for "EU Institutions" as in Figure 4 and instead allot EU commitments across EU countries as follows: EU commitments (in particular European Peace Facility, Macro-Financial Assistance) is assigned based on each member country's relative contribution to the EU budget. EIB commitments are assigned using each country's weight in the EIB's capital subscription shares.

FIGURE A3 REASSIGNING EU-LEVEL AID TO INDIVIDUAL EU COUNTRIES (AS A PERCENTAGE OF GDP)
TOTAL BILATERAL COMMITMENTS JANUARY 24, 2022 TO JANUARY 15, 2023



Note: This figure shows aid commitments to Ukraine as a percentage of GDP. It builds on Figure 3, but reassigns EU aid shares to the individual EU countries.

CHAPTER 29

Ethics and enlightened self-interest pointing towards standing with Ukraine

147

Refet S. Gürkaynak

Bilkent University and CEPR

Ethics tell us that killing is wrong, bullying is wrong, land grabs are wrong, invading a neighbouring country because it seems politically expedient is wrong. It is ethical to oppose Putin's invasion of Ukraine. This basic reason that appeals to human decency is not economic analysis, and sometimes economic analysis and ethics do not point in the same direction. In this case they do. It is not only ethically right to stand with Ukraine, but enlightened self-interest also requires it.

When we look at this war as economists and not only as concerned citizens, the costs of the invasion to parties outside Russia and Ukraine are clear. A noticeable part of the inflation run-up in 2022 was due to the spike in oil and gas prices in the aftermath of the beginning of the war (Caldara et al. 2022). Although energy prices as well as grain prices are back to their pre-war levels now, the counterfactual of what global inflation would have been in the absence of such a strong impulse to coordinate pricing behaviour is hard to know. Also hard to know is what would have happened during a winter that was not as mild as the one we lived through. Lastly and importantly, even if the global inflationary effect of the war indeed turns out to be transitory, we lived through that inflation and already had to suffer through it. Would we want a repeat of that if Putin succeeds in Ukraine and other autocratic rulers also set their sights on their neighbours?

The shock being transitory is immaterial for one more important reason. Inflation dynamics are fickle and it sometimes only takes a transitory shock to coordinate expectations for higher inflation. Despite two decades of low and stable inflation, expectations remain sensitive to realised inflation, especially in consumer goods such as gas. The deviation from rational expectations strongly affects households and hurts less-sophisticated households even more (d'Acunto et al. 2019). Controlling those effects requires diligent central banking, which is an inexact science, and comes with the cost of higher interest rates. It is preferable to stop the initial impulse. That is possible when the world stands together against invasions of the kind we are witnessing.

Another clear effect of the insecurity created by this aggression is the change in resource allocation. More spending on guns means less spending on butter. Residing in the country with the second largest army in NATO – Turkey – one has to ask: why? Why must so much manpower be dedicated to national defence? The standard Turkish answer

is “we do not have Switzerland’s neighbours”. Switzerland’s neighbours were not always so well behaved, and it took the decisive Nazi defeat in the Second World War for Western Europe to begin benefiting from a peace dividend, especially after the fall of the Iron Curtain. Not having to maintain large standing armies and spend on armament frees labour and creates fiscal space for better macroeconomic outcomes.

This is all the more true today, as the Russian invasion of Ukraine has changed our understanding of possible risks. A world where countries are not united against aggression is one where everyone will have to be suspicious of their neighbours. That leads to the pre-eminence of the military-industrial complex, as feared by Eisenhower (1961). We are much better off in a world of collective security, where individual countries do not feel that they have to fend for themselves. That begins with supporting Ukraine today.

A third and related global cost of the Russian war has to do with a related point. We do not want to live in security states. But in a world where insecurity due to erratic behaviour by authoritarian regimes is possible and expected, the desire for security leads to security concerns trumping everything else. It becomes all the more difficult to question who benefits from military contracts, for example. Again, the world would be a better place for everyone if Putin is unable to ‘win’ in Ukraine and is not a role model for other aspiring expansionist autocrats.

It is easy to see the many reasons to oppose this invasion and stand with Ukraine. The war is a threat to world energy supplies. It is a threat to world grain supplies. Letting it be will embolden any tin-pot dictator to set an eye on its smaller neighbours. These are all true. They are also all ways of saying “you too are or may be affected by this” to people outside Ukraine. There is nothing to be embarrassed about worrying about self-interest. But would we not be against the invasion of Ukraine if it had no economic and security repercussions for the rest of the world?

I hope the answer is that we would still be as opposed to the invasion. But we do not actually have to make the call. This is a case where self-interest overlaps with what is ethically proper. It is for the material good of all countries to stand in solidarity with Ukraine and make sure that Putin does not win. That stance is also the right one.

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CHAPTER 30

The West benefited tremendously from expanding to Eastern Europe - supporting Ukraine is likewise in its best interest

Michal Wyrebkowski

Yale School of Management

Anyone who has followed world events during the nine years since Russia first invaded Ukraine must have come up against at least one critique of the expansion of Western institutions to Eastern Europe following the end of the Cold War. In all likelihood, they would have found far more than one. Newspaper opinion sections have been awash in content blaming the expansion of the European Union for every misfortune from Brexit to Russian revisionism (Dejevsky 2019). Prominent and respected academics from George Kennan¹ to John Mearsheimer (Mearsheimer 2014) have at different times directly attacked the expansion of NATO to the East, both pre- and post-factum. Behind all those arguments is a logic that puts in question the very wisdom of integrating the formerly communist countries of Eastern Europe in the framework of the Western world.

Reading through them, you will find one persistent pattern. They always put the issue of EU/NATO expansion in the context of losses and negative outcomes for the West, as if there were no benefits to consider. These come in great variety, from the most common trope – the purported ‘provocation of Russia’ – to less popular ones. These include the alleged harm of East European labour immigration or the somehow inborn ‘incompatibility of values’ between the new members and the ‘old Europe’. If one puts the issue this way, a reasonable reader in Western Europe or the United States could think that “sure, the expansion of Western institutions helped the poor East Europeans, but for us it wasn’t worth it”.

This dangerously self-absorbed logic can also be applied to Ukraine, especially at a time when few people doubt the righteousness of the Ukrainian cause anymore. One year into the war, the critics of continued Western military and economic support for Ukraine are trying to present their case from the perspective of cool-headed and objective interests, presenting their opponents as radical or emotion-driven – practically rehashing the logic used to criticise previous engagement in Eastern Europe. We feel like this is a good time

1 www.ft.com/content/fbfc34eb-d722-43af-b160-63d5cd9604f5

to remind the citizens of the Euro-Atlantic world that previous expansion into Eastern Europe was not exclusively an idealistic (and certainly not a charitable) enterprise. Western Europe and the United States have benefited tremendously in economic and political terms from the inclusion of Eastern Europe in the common institutional framework of NATO and the EU. Ukraine today has all the cards to become a similar success in the future, given Western investment in its military victory and economic transformation.

The expansion of the European Union to the East was a boon of the century for the economies of the Western Europe. It goes without saying that the millions of workers moving West helped stave off a demographic disaster and filled the gap in the essential workforce. That Polish or Czech migrants assimilate easily within one generation and are never a source of persistent disturbance is also rarely mentioned. The economic ties that have grown between Germany and Poland over the past 30 years helped create a symbiotic relationship, which opened an era of unprecedented economic growth across the former Cold War divide.

As the trade links with Russia waned, German entrepreneurs started counting on the Eastern European economic miracle.² Growing prosperity in Eastern Europe added a dynamic and proximate market for export. For smaller Western European states, like the Netherlands and Denmark, having access to about 100 million new customers from Tallinn to Sofia is a godsend, given the small size of their domestic market and highly competitive industries. We should not forget about the ability to relocate their labour-intensive production to countries which subscribe to, by and large, the same legal and regulatory framework of the European Union within the Single Market, driving down the cost of production for the Western multinationals.

Successful, mutually beneficial economic cooperation depends on the achievement of security. The successive expansions of NATO since 1990 (East Germany) and 1999 (Poland, Czech Republic, Hungary) have extended the zone of stability and security over a 100 million people. All of the above-mentioned benefits would not have materialised had the Central European states fallen under the influence of the Kremlin or squabbled between themselves without the unifying framework of NATO like the Balkans. For the mutual benefit of ours and Ukraine, we should extend that offer of partnership to Kyiv.

There is a business case for doing so. Ukraine is going to be an unprecedented opportunity for Western businesses, not unlike Germany in the wake of the Marshall Plan. The call for the new Marshall Plan for Ukraine (Conley 2022) should be put on the table as an intrinsic part of the reconstruction and revitalisation effort of Ukraine's economy. Calls for that were articulated as late as six years ago by Lithuania's former Prime Minister, now Member of the European Parliament, Andrius Kubilius.³

² www.businessinsider.com/news-germany-is-counting-on-a-polish-economic-miracle?IR=T

³ <https://archive.kyivpost.com/article/opinion/op-ed/andrius-kubilius-western-europe-needed-marshall-plan-1947-2017-marshall-plan-needed-ukraine.html>

In the era of re-shoring or friend-shoring operations, and increased awareness of geopolitical issues, investing the capital that would have been used for oil and gas drilling in Russia into Ukrainian green hydrogen⁴ or uranium mining⁵ seems much more enticing in the context of the green transition. The technological rent that Ukraine will benefit from, as it would leave Soviet technology behind, would usher in a new era of economic growth, which the Western multinationals could ride. At a time when experts warn of economic reliance on potential adversaries (Pletka and Scissors 2020) and private companies take the lead in punishing criminal state-actors, catalysed by Professor Jeffrey Sonnenfeld,⁶ it pays double to invest – politically as much as economically – in promising and staunchly friendly markets.

For a moment let us consider the counterfactual, that is a Ukraine that ends up under Russia's immediate control or is thrown into a state of perpetual crisis and dysfunction. Would the West really benefit more from not making that investment in Ukraine's future and ending up with a source of constant geopolitical tension, humanitarian crisis and economic stagnation? Do we really want Russia to achieve its geopolitical goal of destroying Ukraine as a viable state and go on to try to corrupt and dismantle the European Union and NATO? Should one of the largest states in Europe really be abandoned to become a criminal oligarchy on the Russian model (Applebaum 2020) which, as the history of the past decade shows, can clearly reach with its tentacles into European and American politics?

Finally, as any savvy business owner or economist would, we ought to consider the opportunity cost. The price tag of not supporting Ukraine is not only a constant source of trouble for the future right on the Western world's border. It is also a chance for tremendous mutual economic benefits, perhaps greater than those brought by the successful integration of Eastern Europe some two decades ago. In our world plagued by geopolitical tension and economic uncertainty, can we really afford not to take this chance?

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CHAPTER 31

Italy should do more for Ukraine

155

Tito Boeri and Roberto Perotti

Bocconi University and CEPR

A year after the Russian invasion, there is a certain weariness in Western public opinion on aid to Ukraine. The share of US voters who believe their country is providing too much aid to Ukraine has quadrupled since the war began, according to the Pew Research Center. A sizable chunk of the Republican Party is riding this weariness. Steve Bannon incites audiences to cry “do you want to die for Ukraine?”.

In Europe, although closer to the front, the situation is not much different. According to the Project Europe Research of Századvég, only in nine out of 27 countries in the European Union are a majority of citizens in favour of supporting Ukraine’s war effort. Italy is among the most opposed countries. Part of the problem is that there has been a lot of misinformation about the actual costs of economic and military support to Ukraine to date. According to recurring arguments also in generally reliable newspapers, Europe has so far spent more than the United States and the sanctions on Russia have caused a 2.5% drop in EU GDP. These are misleading claims.

The Kiel Institute’s Ukrainian Support Tracker collects data on 40 governments and the European Union as an institution, broken down by type of aid: military, humanitarian and financial (soft loans). For these items, the EU countries have pledged (bilaterally or indirectly through the European Union and the European Investment Bank) €54 billion, of which €35 billion is loans. This is far less than the €73 billion committed by the United States. Only by adding the €26 billion in costs for refugees (estimated very roughly and borne largely by Germany and Poland) do the EU countries come to equal the commitments made by the United States. The entire European Union has allocated a tenth of the amount paid to Ukraine for measures aimed at families and businesses affected by high energy prices.

These are the commitments; the actual disbursements are another matter. Only €15 billion out of €35 billion in loan commitments (the figure is not available for humanitarian and military aid) has so far actually been given by EU countries. But at the moment the most pressing problem for Ukraine is probably not financial aid, but military aid – *‘primum vivere’*.

The problem is that since its foundation, the European Union has not been able to provide funds to buy lethal weapons, only individual member countries can do so. Recently, however, the EU ‘foreign minister’ managed to convince member countries

to use €3.1 billion of the €5.7 billion allocated to the European Peace Fund (perhaps not exactly the right name at this point) to finance the purchase of lethal weapons for Ukraine. With these funds, for example, 327 tanks will be paid for. EU countries have therefore so far allocated a total of €15 billion for military aid. We now want to allow the European Union to disburse funds directly for lethal weapons, without having to go through the small European Peace Fund (recall that some EU members, such as Austria, are constitutionally neutral). In any case, the big question is how to convert this money into weapons and ammunition on the ground, given that European (and even American) war industries are not prepared to produce at the pace dictated by war, and stocks are almost depleted.

Aid to Ukraine has so far been limited also in relation to previous conflicts. For example, Germany (the main European donor) has given Ukraine 30% of what it spent on the 1990-91 Gulf War, compared with 37% for the United States, which was also more directly involved in that war.

Italy is in penultimate position in the European Union in terms of bilateral allocations in relation to GDP, including costs for refugees (0.10%, ahead only of Ireland, one third of Germany's allocation and one twentieth that of Poland). In all, Italy's bilateral commitments total about €2 billion, less than one 60th of the building bonuses, half of which is costs for refugees and €660 million of which is intended for military aid. It is little wonder that Zelenski had a private conversation with Scholz but not with Meloni; from Ukraine's point of view, Italy is not a significant source of aid (and neither was the previous Italian government).

The decree passed at the beginning of March by the government provides only €300 per month for each adult refugee and €150 for each minor, and this is limited to the first three months of arrival in Italy and to those who are not hosted in centres for refugees. The service required for the reception of families in these centres does not include any activities aimed at facilitating the inclusion of children in schools or mobility towards the workplace. Unfortunately, the Italian government, unlike other EU governments, does not provide data on the integration of refugees into the labour market. The refugees' stories are alarming: women picking cherries at €6 euros an hour, confinement in areas far from any job, expiring permits that don't allow you to work or rent a flat on a regular basis. At a time when the need to attract more immigrants to Italy is finally being recognised in order to meet the needs of families and businesses, it is also important to understand that in welcoming more immigrants, their integration must be organised.

Italy should do more for the Ukraine. It is an investment in Europe's security and in the reconstruction of Ukraine, as refugees will be natural connections to their country of origin in the postwar period.

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CHAPTER 32

Why Ukraine's triumph is important for Latin America

159

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At first sight, you may think that the unprovoked aggression by Russia against Ukraine is somewhat remote to Latin America. But taking a few seconds to think about the connections reveals that it is of critical importance, not only because of the economic consequences, good or bad (they are different for different countries), but also because of the potential impact on ideas and political support for non-democratic regimes in the region. Surprisingly, Latin America also has something to offer to help Ukraine turn the tide in its favour. Let's analyse each of these issues in turn.

ECONOMIC IMPLICATIONS

The economic implications of the Ukraine war for Latin America have multiple dimensions, but the most important channels operate through commodity prices, the disruption of trade flows, the monetary policy responses of developed countries, and the eventual impact on the multilateral trade system that has served the world so well during the last 50 years.

The impact of these effects differs by country. Food importers (in Central America) have suffered from the increase in food prices, while food exporters (Argentina and Brazil) have benefited. The disruption of trade flows, particularly in energy products, has benefited countries with an ability to export energy (Colombia, Guyana, Trinidad and Tobago). It could have benefited others, like Argentina, the country with the second largest reserves of tight gas in the world and the largest in per capita terms, or Venezuela, known for its large oil and gas reserves. Both these countries have more than enough to fully replace Russian gas for at least a few decades. However, this potential has not been fulfilled. In the case of Venezuela, its domestic disarray leaves it with no capacity to increase production and therefore means it is unable to respond to the changes in patterns of world demand for energy. Argentina has thwarted this potential gain itself by engaging in aggressive restructurings with the Paris Club and private bondholders in recent years, which have made foreign direct investment all but impossible. This may revert in the future, and Argentina remains the country with the highest potential to benefit from the retrenchment of Russia from energy markets. At the same time, it remains the country that can contribute most to the independence of Europe from Russian gas. If it

manages to achieve this goal, it could represent a significant contribution to weakening the economic grip of Russia on Europe. This is the reason we argue that the region also has the potential to contribute to Ukraine's cause.

The turmoil produced by the invasion, and the short-lived commodity spike, while not responsible for inflation in developed economies or able to influence the inflation rate in the medium term (inflation in these regions is determined by monetary policy, not by a relative price shock in one commodity, regardless of how important that commodity is), did add substantial volatility to inflation in the short run, perhaps accelerating a policy response that may otherwise have taken longer to occur. Fortunately, and contrary to the consensus view of an imminent and impending collapse in emerging market debt resulting from higher rates (Acosta-Ormaechea et al. 2022, Pazarbasioglu and Reinhart 2022), the current increase in interest rates has had a muted effect on emerging market debt, probably due to two reasons. The first is that rates have increased but continue to be very low, if not negative, in real terms. The second is that a large share of emerging market debt is denominated in dollars and euros but issued at fixed rates. Inflation in the United States and Europe reduces the real value of this indebtedness. This stock effect is large and compensates for the flow effect of higher rates (Nair and Sturzenegger 2022).

Finally, it is still too early to gauge the impact of the war on multilateralism, but unfortunately, it seems realistic to argue that unless Russia is unconditionally defeated, multilateralism will not return to where it was prior to the conflict. Whether the world will be split into blocs or Russia will remain isolated, containing the damage mostly to the aggressor country, is still too soon to say. But one way or another, the reach of multilateralism will be limited, and so too will be its benefits.

POLITICAL EFFECTS

Beyond these economic effects, I also want to point to the potential impact of the war on the ideological debates in Latin America, and Russia's clout in the region. To start, we should acknowledge that Latin America is probably the most anti-capitalist region in the world.

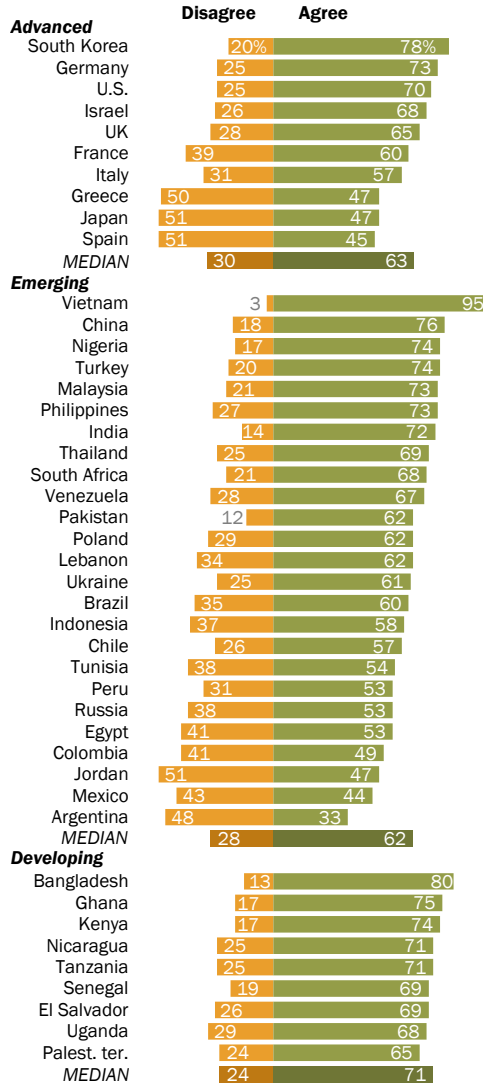
When asked by the Pew Research Center whether they agreed with the statement that "most people are better off in a free market system, even though some people are rich and some people poor", the biggest disagreement with this statement among respondents occurs in Argentina, closely followed by Mexico (Figure 1).¹ Within the group of emerging economies, Latin American countries seem to be in the middle half that is more hostile to capitalism (within this sample), with the exception of Venezuela (probably due to its own suffering under Maduro's socialist policies).

1 Source: Pew Research Center Spring 2014 Global Attitudes survey.

FIGURE 1

Support for Free Market System

Most people are better off in a free market economy, even though some people are rich and some are poor.



Source: Spring 2014 Global Attitudes survey. Q13a.

PEW RESEARCH CENTER

Latin American is the cradle of structuralism, and consistent with this view, it is a region where economic activity remains heavily regulated. In Liendo and Sturzenegger (2020), my co-author and I suggest four reasons for this. While they are not unique to Latin America, they reinforce each other. The first relates to the view on market economies mentioned above, which is the fuel on which the other reasons feed. In Latin America

it is believed that if markets are not regulated, mischief will occur (firms will abuse customers, there will be exploitation of monopoly or oligopoly rents, and so on). There is, however, a vicious circle in this view. The more regulated an industry, the less competitive it becomes. The less competitive it becomes, the more it deviates from competitive behaviour, justifying yet more intervention. These dynamics strengthen and provide fertile ground for other reasons for intervention: the pressure of private sector interest groups (who tinker with regulations in their favour), the role of bureaucrats (who lobby for persistence of regulation that justifies its existence), and finally, because regulation always provides room for corruption.

What does this have to do with Russia's unprovoked attack? Russia has built over the years significant political support in the region. The Argentinean president visited Moscow one week before the invasion and offered "Argentina as the beachhead for Russia's landing in the region". Mexico and Brazil, the region's two behemoths, abstained from voting on the United Nations General Assembly Resolution suspending Russia from the UN Human Rights Council. Bolivia, Cuba and Nicaragua voted against. Venezuela, which has lost its right to vote due to payment arrears with the UN, urged a vote against. Brazil also shares the BRICS forum with Russia.

Russia has increased its influence in the region by providing support to mostly non-democratic regimes in the region (Cuba, Venezuela, Nicaragua), and has tried to prop up its business ties (with a trail of corruption) in poor and cash-starved economies. Argentina, for example, in an incomprehensible decision, rejected an offer by Pfizer to provide 13 million Covid-19 vaccines in November 2020 in favour of a deal to buy Russian's Sputnik vaccine. This delayed the vaccination process, at the cost of thousands of additional deaths (Urbiztondo 2021). Any version of Russian success in its unprovoked aggression will only help boost these negative effects in the region. In a region so prone to anticapitalism, such a result would significantly boost the influence of Russia in the region.

In sum, Russia must be defeated, not only for the sake of justice and because it was an unprovoked aggression that cannot be allowed to succeed, but also because of potential far-reaching negative effects around the world, including in Latin America on the other side of the globe.

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This eBook, which was collated in matter of days to mark the anniversary of the Russian invasion of Ukraine, is a collection of essays written by prominent scholars, experts, and policymakers, arguing for extraordinary global support for Ukraine. The essays offer diverse perspectives on the implications of the war in Ukraine, highlighting its significance for world peace, nuclear proliferation, international trade, food security, democracy, human values, and more. While Ukraine continues to fight for its freedom and independence against Russian aggression, the authors argue that supporting Ukraine is crucial for preserving hard-fought gains in human rights, prosperity, and security across the world. The eBook provides valuable ammunition for current and future debates on how the global community can help Ukraine withstand this war of aggression, and ultimately, choose a better future for ourselves and future generations.

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