

PEER REVIEW: 'EBRD'S EXPERIENCE WITH POLICY DIALOGUE IN UKRAINE'

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The Evaluation Department's Special Study on EBRD policy dialogue has been prepared during the most critical moment of Ukraine's 20-year period of independence. When the evaluation began, Ukraine's political system and policy-making institutions were under pressure. Today its statehood is at risk. If Ukraine loses its statehood, *de jure* or merely *de facto*, the EBRD might find that it has no role to play there at all.

But if Ukraine's interim government and elected successors succeed with Western backing in sustaining the country's statehood and reconstituting political legitimacy, the Bank could well be called upon to expand its activity, assistance and presence. In this reviewer's assessment, policy dialogue should be the connecting thread in this enterprise. Ukraine's institutions will be in crisis well after the most immediate threats to the state's sustainability are overcome. The EvD is right to believe that crisis creates 'an opportunity for reform that did not exist' (p iii). As a case in point, during the time of the Bank's 'energy efficiency' project, reform of the energy sector was a matter of national security as well as efficiency. Today, it is a matter of national survival. The Bank should be prepared to re-engage in these conditions, and it should be proactive in doing so. It will find this Study an excellent point of departure.

Strategic Aim

Whilst drawing attention to the exponential growth of policy dialogue as an EBRD business tool, the Study nevertheless notes that it is a 'poorly documented area in the Bank'. More critically, it states that the strategic purpose of policy dialogue is not clear (p 27). The Study provides a definition of policy dialogue as 'interactions and actions...for the express purpose of bringing about changes ...for the overall benefit of [Ukraine]'. (p 1). Yet this description of what policy dialogue *is* stops short of defining a strategic aim. The Bank might wish to consider the following:

to encourage and assist Ukraine in the multi-faceted task of establishing a rules-based and law-governed system in policy-making and in the relationship between business and the state.

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The *premise* behind this aim is that an economy based on patron-client relationships and lacking firm property rights, judicial integrity and institutional neutrality will not only be corrupt *per se*, but fail to realise the state's stated objectives, external as well as internal. The *precondition* of the Bank's success is observable progress in changing *institutional cultures*.¹ But as EvD is at pains to note, progress in this area demands an understanding of the institutional context in Ukraine, as well as a lack of illusions about the interests and practices that obstruct change.

Context

This reviewer finds much to praise and little to fault in the EvD's understanding of the policy environment in Ukraine. But out of this detailed and nuanced evaluation, two conclusions require bold restatement. First, Ukraine's shortcomings are systemic. Second, before the crisis erupted, its economy was losing the ability to produce national wealth and reward for honest work. I would also give emphasis to several points that are recognised in the Study, though sometimes implicitly:

- *The culture of declaration is stronger than the culture of implementation.* This reflects a combination of: a) the Soviet habit of assuming that a change decreed is a change accomplished; b) underestimation of the difficulties of implementation; c) cases where those responsible for making policy have no authority for implementing it; d) cynicism on the part of leaders who use 'reform' and 'state programmes' as a disguise for inaction or regression.² Nevertheless, EvD is right to note that even when unimplemented, changes in legislation and 'policy' have the merit of legitimising internal criticism and provide a benchmark for external evaluation and pressure.
- *Formal institutions are often remote from practical policy-making.* In a rules-based system (as found in any advanced democracy), institutions and their norms are stronger than the individuals inside them. In a patrimonial society (one based on patron-client relationships), it is the opposite. Either they are 'captured' vehicles for personal or sectoral interests or, alternatively, they serve as *pokazuka* (show), disguising real channels of policy deliberation and implementation.³ In either case, it is difficult to sustain standards of professionalism or rightful conduct. Those who seek to do so readily become cynical or demoralised.
- *Rent-seeking is not only an opportunity for the greedy but a means of institutional survival.* In a well-functioning democracy, corruption is confined to corrupt people. In most of the former Soviet Union, it is a necessity for all. As I said in another context, 'if the *militsioner* (policeman) is paid a wage inconsistent with life, he will cheat rather than die'. The casualty of rent-seeking is not only trust, but competence. Even in institutions that have high prestige and are of cardinal importance, miserable salary structures limit recruitment to those who are well connected, self-financing, willing to bribe and ignore malpractice.
- *Infirm property rights and contract-enforcing mechanisms (aka 'rule of law') render all reform reversible.* Under Yanukovich, the unwritten law became: 'if you covet somebody else's assets, take them'. *Reyderstvo* (corporate raiding and asset grabbing) became a principle of economic management. Even the representatives of

large companies had to spend uneconomical amounts of time on non-business activity. Yet even before Yanukovich came to power, the tax system disenfranchised entrepreneurship and talent, and the regulatory system, like the legal system itself, was a charter of harassment for every power in the land. In these conditions, SMEs have the least security of all and find themselves forced to negotiate and renegotiate terms of entry and protection.⁴

If policy dialogue is to serve its purpose, these ills of the status quo must find their place in it. But they also describe the constraints within which such dialogue takes place. It is not within the Bank's means or, arguably, its remit to challenge all of these conditions directly. But it needs to understand them if it is to 'sell the problem along with the solution', as EvD recommends. By speaking plainly and by practical work, EBRD can also develop a culture of awareness in Ukraine that these systemic failings damage the core interests of the country.

Despite these failings, the Bank should not lose sight of Ukraine's core accomplishments and attributes, which are not directly acknowledged in the Study:

- Ukraine not only established its core state institutions from scratch after 1991, it did so with marked professionalism and on the basis of a clear understanding of the national interest. During the 1990s, Ukraine's progress in most areas was well ahead of the Western expectation;⁵
- Until recent events, there was no ethnic conflict in Ukraine (in stark contrast to its eastern neighbour). Ukraine has received commendation from international organisations (UN, OSCE, PACE) for its ethnic, religious and linguistic tolerance.

Before the current conflict, Ukraine was far from being a failed state. If it emerges from the conflict with an elected government and in one piece, it possibly will be more receptive to EBRD advice, and more keen on implementation, than at any time in the past. In these conditions, *pace* the Study, it is the decision *not* to act that will have consequences.

Recommendations

The Evaluation Department and the reviewer are of one mind on five points:

- The Bank's expectations must be guided by the realities of power in Ukraine at both national and institutional level;
- The Bank's approach must be guided by the discipline of political economy rather than theory. This reviewer is not alone in ascribing many of the failings of Western advice to Russia in the 1990s to the dominance of theoretical economists;
- The Bank requires augmentation (and better utilisation) of staff with region and country-specific expertise. Generic specialists (e.g. on privatisation, sectoral reform) need an on-site education before offering advice. Until they are bonded with the cultural environment, they will lack credibility and might unwittingly strengthen local prejudice about the irrelevance of Western practice;
- The Bank must not only 'sell the problem' but 'show what success looks like'. The latter tends to be better accomplished by veterans of successful transformation in

post-Communist countries than by Western experts who have faced superficially similar challenges (e.g. 1980s privatisations in the UK), though the combination can work well once the participants have bonded. The best tools of instruction are examples of best practice (or even good practice) in Ukraine. For this reason, there is merit in a project-based approach by EBRD, since it can produce examples that others can emulate. It is possible to square the circle between a project-based and a strategic approach by recognising that well-crafted reforms in one sphere can strengthen capacity to overcome inertia and obstruction in others

- The Bank must give priority to enhancing its institutional memory and collective wisdom. Combining country-level with discipline-specific expertise is a long-term process that cannot be transferred on the hoof. Serious thought needs to be given to how the Bank can teach itself, renew its expertise and repeat success.⁶ The results of policy dialogue (and its difficulties) need to be well publicised within the Bank.

The reviewer seconds all other recommendations in the Study but would also add the following.

- Engagement with SMEs should become a priority effort. As others have observed, this is because they offer the greatest potential for long-term innovation and growth. But an equally strong reason is that they are a natural constituency for change along European lines. In contrast to many political and institutional stakeholders (and the principals of most state-protected enterprises) they have a ‘class interest’ that coincides with the rules-based system that the EU represents, and an increasing proportion of them know it. The reviewer has found that they provide a sobering perspective on the discontinuity between official policy and realities on the ground (e.g. harassment, the callousness of bureaucracy, the indifference of higher authority, the impermanence of all rights and rules);
- Offline relationships are vital. Anecdotal information is often the most revealing and reliable. It will be helpful to cultivate relationships with Ukrainians who have been retired for good behaviour (some of them young/middle-aged *emigrés* from big enterprises and state service). They might not be able to influence policy, but have perspective about its continuities and discontinuities, will be frank as to ‘how things work’ and how to change them (e.g. Oleksandr Todichuk, former Head of *Ukrtransnafta*, ditto the Energy Club he founded). Naturally, many also will have hobby horses of their own.

Concluding Note

By widening its ambit and deepening its bank of knowledge, the EBRD will find ample reasons to expand its work and promising, if hidden, constituencies who would like to support it. There are reasons to hope that these constituencies will be more visible and accessible in post-conflict and post-Yanukovich conditions. See Appendix (KSF TF 713) for the report of a task force by one such constituency, the national security establishment, chaired by the reviewer, on fundamental national priorities (April 2013—a bygone era).

ENDNOTES

¹ Between 1994 and 2010, a salient example of success was the Ministry of Defence and Armed Forces, whose leadership had a strong interest in change but whose institutions had inherited a sovietised command and administrative culture. By 2008, according to the in-house NATO assessment, the concept of professionalism internalised by Ukraine's defence leadership and junior officers was approaching greater commonality with NATO officers than with Russian counterparts.

² Thus the gaping discrepancy between Ukraine's improved standing in the 2014 EODB Index and realities on the ground (p 3).

³ A noteworthy case—doubly noteworthy because it occurred under President Yushchenko—was the 'resolution' of the Russia-Ukraine gas crisis in 2006. The National Security and Defence Council and its expert staff (which even under the 'authoritarian' Kuchma were used as the key format for inter-departmental coordination) was completely bypassed, and a 'back of the envelope' resolution was negotiated between *Gazprom* and trusted cronies of the President. The same format emerged in the gas dispute of 2008-9.

⁴ From a different national perspective, but for similar reasons, Arkady Dvorkovich (then Adviser to President Medvedev, now Deputy Prime Minister) frankly stated in 2009 that 'there is no legal small business in the country'.

⁵ Paradoxically, this partially reflected, on the part of many architects of this transformation, their seniority in the Soviet system. Unlike Yushchenko's circle of 'dear friends' and Yanukovich's circle of cronies, these individuals understood institutions, organisation, policy-making, project management and implementation. They also established a talented 'successor generation', some of them now side-lined, but others in responsible positions.

⁶ From his previous work in government, the reviewer noted that success tended to be reinforced when neophytes in embassies were paired with experienced individuals and when the latter returned to HQ posts with similar responsibilities (e.g. from British Embassy Kyiv to Ukraine/East European sections of the FCO or MOD). Otherwise, there was a noticeable and sometimes discordant disconnect between 'locals' and HQ).