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AN ECONOMIC DEVELOPMENT STRATEGY FOR THE DONBAS WITH SPILL-OVER POTENTIAL: INCENTIVES, INVESTMENTS, AND INSURANCE

EXECUTIVE SUMMARY

On 10 December 2020, the School of Transnational Governance (STG) of the European University Institute, Florence, convened the fourth edition of its High-Level Policy Dialogue (HLPD) on Donbas' Future.¹ The focus lay on the new Concept of Economic Development of the Donetsk and Luhansk Oblast² presented by Oleksii Reznikov, Deputy Prime Minister and Minister for Reintegration of the Temporary Occupied Territories of Ukraine. Representatives from the United Nations (UN), the European Investment Bank (EIB), the World Bank, the European Union (EU), and the Atlantic Council, as well as high-level Ukrainian policy makers and business representatives critically reflected upon the Concept, that will form the basis for a comprehensive development Strategy for the region to be submitted to Cabinet and Parliament by the Summer of 2021, and discussed ways to achieve the newly set economic objectives.

1 This Dialogue series was launched in 2018 and is organised by the STG in Florence, Italy, with the involvement of the Office of the OSCE Special Representative in Ukraine. For previous editions see [STG Policy Brief 05/2020](#), [STG Policy Brief 04/2020](#), [STG Policy Brief 06/2019](#).

2 The Concept was [approved by the Ukraine government](#) on 23 December 2020.

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THE DONBAS CONFLICT – AN UPDATE

One and a half years after the Ukrainian presidential and parliamentary elections of April and July 2019, the prospect of a fast convergence towards a settlement of the conflict in the Donbas region is fading away. Negotiations at the international level have come to a standstill, with only part of the agreements reached at the Normandy Four Summit of 9 December 2019 implemented during the year. On the ground, while the coronavirus pandemic has forced a reduction of hostilities, it has worsened the disconnection between government-controlled and non-government-controlled parts of the region, and the formal ceasefire established in July 2020 – while being relatively well observed to date – has yet to prove sustainable.

Encouraging factors are nevertheless on the horizon. On the external side, the imminent inauguration of a new US-administration under President-elect Biden may infuse international negotiations with a new dynamic. The EU will operate in greater confidence of a reliable transatlantic partner and Russia will see fewer chances to exploit lenience or restraint on the part of the US leadership. Internally, weak progress in the Minsk and Normandy formats is no longer seen as a restraint on Ukraine's capacity to develop its own reintegration tactics and policy. In this context, a new approach to the economic redevelopment of the Donbas can not only provide the key to increasing the attractiveness of the government-controlled areas and improve the socio-economic conditions for its population, but may also showcase what reintegration could bring to the people living in non-government-controlled areas. This way, it could become an important incentive towards the restoration of Ukraine's territorial integrity.

A STRATEGY OF ECONOMIC DEVELOPMENT OF THE DONETSK AND LUHANSK OBLAST

The Strategy is one of the two major projects currently pursued by the Ministry for Reintegration of the Temporarily Occupied Territories of Ukraine.³ It foresees the designation of priority development

territories, state incentives for economic development and new economic development models that are meant to boost the economy in the government-controlled areas of the Donbas. This can ultimately assist in the reintegration of the non-government-controlled areas.

Concrete measures are envisioned to attract internal and external investment and improve the institutional framework for development. Among them are:

- incentives in the spheres of taxation, financing, and customs,
- tools for the protection of investments and property rights, including a readily accessible international arbitration mechanism based on English common law,
- insurance mechanisms for military and political risks,
- a simplification of regulatory frameworks.

Further measures will aim at strengthening specific economic sectors, developing essential infrastructure, reviving the regional labour market and improving public communication internally as well as externally on the economic development of the Donbas. Economic connectivity with the non-government-controlled areas will be under discussion as the Strategy shapes up.

The Strategy is guided by a focus on improving the living conditions of the population in economic terms but also regarding infrastructure and social systems (health, education) as well as environmental conditions. It emphasises local communities as the basis of economic growth and targets, especially the development of small and medium-sized enterprises. While aiming at the creation of attractive investment regimes, the Strategy takes into account Ukraine's commitments to international agreements such as the Association Agreement with the EU or the accession agreement with the World Trade Organization.

The Strategy is thought of as an economic and legal experiment that could become a model for the economic development of the whole Ukraine.

³ The other project is a law 'On the Transition Period' that will define the main stages and procedures for gradually restoring, during the transition period, the constitutional order, the rights of citizens (including the internally displaced persons and refugees), and the legitimate interests of local legal entities that have been violated by the conflicts in Crimea and the Donbas.

THE PROPOSALS BY THE INTERNATIONAL COMMUNITY

As in previous editions of this STG policy dialogue on Donbas, concrete proposals emerged from discussion and are presented here as advice from the international community:

- 1. Damage assessment:** A detailed damage assessment is a prerequisite for any development effort. Carried out by credible actors, it can serve as a common platform for national and international development partners to design assistance programs. The World Bank study on the economic recovery of the Donbas, currently being finalised for presentation to the Ukrainian authorities, marks a significant step and broadens the basis for evidence-based policy formulation.
- 2. Need for a strong Recovery Institution:** A Recovery Institution (or Coordination Council) should have a comprehensive mandate to pull together government resources and international assistance. It would take charge of entire project cycles leading the way from the identification and planning to the realisation and implementation of projects. A supervisory board would bring together the interests of the major actors concerned from the Ukrainian central government, the Parliament, regional and local administrations, business, donor institutions, NGOs and civil society. A high-ranking member of the Ukrainian Cabinet of Ministers would head this institution. It would be staffed by local personnel with deep knowledge of the region and international experts able to devise rules and procedures acceptable to international donors and investors.
- 3. Insurance/reinsurance:** The state needs to create a system that guarantees companies and investors access to insurance tools. The state can additionally step in as reinsurer or seek to negotiate the creation of an ad hoc funding mechanism to that effect with private-sector and/or international partners.
- 4. Expert teams can increase visibility for investors:** Under the volatile conditions of an unresolved conflict in a region where economic actors, supply chains and the industrial landscape have changed radically in the past seven years, up-to-date knowledge of local conditions and existing economic structures, based on field experience, is of the essence for investment decisions. Credible expert teams able to provide such knowledge would increase the visibility and attractiveness of local investment opportunities for both domestic and international investors. The state could incentivise the constitution of such teams. While establishing credibility takes time, a nascent basic network of expert teams could already make a difference. Knowledge itself should be seen as an investment of direct interest to implement the Strategy.
- 5. Social infrastructure to attract human capital:** Labour and education migration have depleted the population and work force in Donbas. To attract talent and to facilitate the return and resettlement of the local population, improvements to the social infrastructure are necessary. This includes the provision of primary health care, the rebuilding of a school system, and providing opportunities in higher education. In addition, addressing environmental issues will positively affect the quality of life.
- 6. Rule of law remains top priority for investors:** To create a stable and safe environment for investment, the rule of law needs to be strengthened. An independent judiciary, better law enforcement and anti-corruption measures remain indispensable elements of a positive investment climate.
- 7. Policy coherence across the whole territory of Ukraine:** Special economic incentives in the Donbas region, as currently foreseen by the Strategy, should not lead to a distortion of the national economic landscape. Clarity and transparency regarding differences between local and national regulations is essential. The development model for the Donbas needs to be consistent with the macroeconomic framework of Ukraine as a whole and should feed into a national reform agenda. The national dimension of the regional economic strategy needs to be developed more clearly.

The Strategy is expected to be finalised by the summer of 2021 and to be subsequently introduced to the Verkhovna Rada of Ukraine together with a legislative package on the implementation of the Strategy. The next STG High-Level Policy Dialogue on Donbas' Future, tentatively envisaged for March, would provide further input useful for the modelling and forecast phase of the Strategy.

The School of Transnational Governance (STG) delivers teaching and high-level training in the methods, knowledge, skills and practice of governance beyond the State. Based within the European University Institute (EUI) in Florence, the School brings the worlds of academia and policy-making together in an effort to navigate a context, both inside and outside Europe, where policy-making increasingly transcends national borders.

The School offers Executive Training Seminars for experienced professionals and a Policy Leaders Fellowship for early- and mid-career innovators. The School also hosts expert Policy Dialogues and distinguished lectures from transnational leaders (to include the STG's Leaders Beyond the State series which recorded the experiences of former European Institution presidents, and the Giorgio La Pira Lecture series which focuses on building bridges between Africa and Europe). In September 2020, the School launched its Master-of-Arts in Transnational Governance (MTnG), which will educate and train a new breed of policy leader able to navigate the unprecedented issues our world will face during the next decade and beyond.

The STG Policy Papers Collection aims to further the EUI School of Transnational Governance's goal in creating a bridge between academia and policy and provide actionable knowledge for policy-making. The collection includes Policy Points (providing information at-a-glance), Policy Briefs (concise summaries of issues and recommended policy options), and Policy Analyses (in-depth analysis of particular issues). The contributions provide topical and policy-oriented perspectives on a diverse range of issues relevant to transnational governance. They are authored by STG staff and guest authors invited to contribute on particular topics.

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