

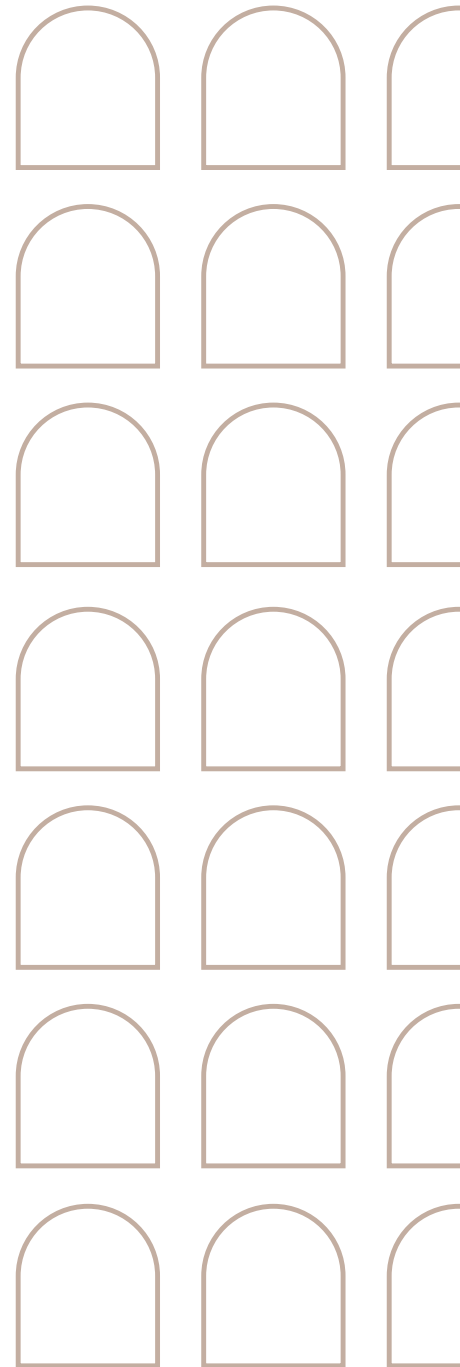
STG Policy Papers

POLICY BRIEF

BETWEEN POLITICAL IMPASSE AND ECONOMIC RECOVERY: FINALIZING THE ECONOMIC DEVELOPMENT STRATEGY FOR THE DONBAS

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EXECUTIVE SUMMARY

The School of Transnational Governance (STG) of the European University Institute, Florence, continued its High-Level Policy Dialogue (HLPD) series on Donbas' Future with its fifth installment on 9 July 2021.¹ After discussing the Concept of the Strategy of Economic Development of Donetsk and Luhansk regions at its fourth meeting, this Dialogue focused on the finalization of the Strategy and ways to maximize its impact and effectiveness.² The Strategy was presented by Oleksii Reznikov, Deputy Prime Minister and Minister for Reintegration of the Temporary Occupied Territories of Ukraine. Representatives from the United Nations, the European Investment Bank, the European Union and the OSCE, as well as high-level policy makers, think tankers and business representatives from Ukraine engaged in the debate. The Strategy targets the government-controlled territories in Eastern Ukraine. It seeks to change the region's economic model, improve living conditions and create new economic opportunities for the population and for investors. Its ambition is to create a role-model with spill-over effects that could prepare a future re-integration of the temporarily occupied territories into Ukraine. If implemented successfully, the Strategy may significantly alter the region's fate over the next decade.

¹ This Dialogue series was launched in 2018. It is organized by Luigi Narbone, Part-time Professor at the STG and Director of the Middle East Directions Programme at the EUI Robert Schuman Centre for Advanced Studies, in cooperation with the Office of the OSCE Special Representative in Ukraine. For previous editions see [STG Policy Brief 06/2019](#), [STG Policy Brief 04/2020](#), [STG Policy Brief 05/2020](#), [STG Policy Brief 01/2021](#).

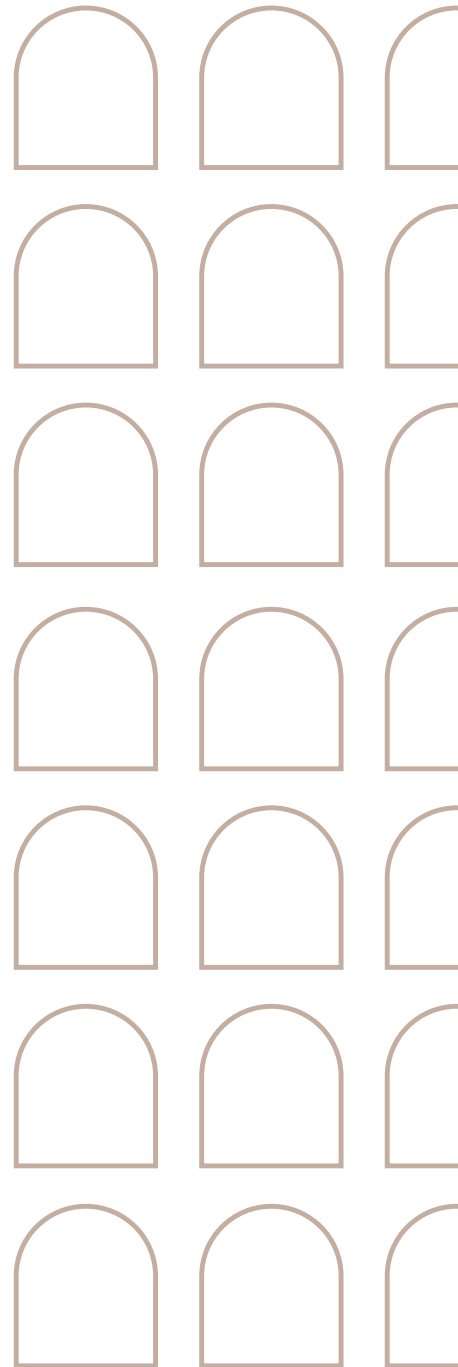
² The finalized Strategy was recently presented in public and will shortly be submitted to the [Cabinet of Ministers](#)

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THE DONBAS CONFLICT – POLITICAL IMPASSE AND OPPORTUNITIES:

2021 has seen a sudden and fast deterioration of the security situation along the so-called 'contact-line'. Violations of the ceasefire have increased, and military confrontations reached a new climax with the use of heavy weaponry. Under the pretext of military exercises, the Russian Federation deployed ca. 110,000 troops to the border of Eastern Ukraine and the occupied Crimea alarming the Ukrainian government and its Western partners. Even after withdrawal of most troops, the Russian army kept personnel and a considerable amount of equipment in the region.

Beside the military build-up, the Ukrainian government noted a raising level of hybrid threats, with aggressions observed in the economic and cyber spheres as well as through disinformation and destabilization campaigns. The conflict's worsening regional impact in turn manifests itself in growing ecological risks, such as water pollution spreading from the war affected areas to the Sea of Azov, as well as an intensifying military contestation for control in the Black Sea area.

Nevertheless, as the new US administration rolls out its foreign policy agenda, the opportunity for a new approach to the conflict may have arrived. After his Geneva summit with Russian president Vladimir Putin on 16 June, US president Joe Biden had stressed the [potential role of diplomacy](#), hinting at the possible involvement of the US in negotiations related to the Minsk Agreement. Ukraine and its European partners, on closely coordinated lines with the US, might strive to relaunch diplomatic efforts to prepare a long-term solution for the conflict.

THE STRATEGY OF ECONOMIC DEVELOPMENT OF THE DONETSK AND LUHANSK OBLAST

The Strategy, in the making since 2020, is an essential tool of what Minister Reznikov called the "Ministry of Soft Power", i.e. the Ministry for Reintegration of the Temporarily Occupied Territories of Ukraine. Aim of the Strategy is

"building a belt of success, turning Donetsk and Luhansk oblast into role models for swift economic development". These role models could boost the desire in the non-government-controlled areas to re-integrate with Ukraine but also provide a blueprint for economic progress that could be scaled up to the national level. Participants noted positively that many recommendations formulated at the previous STG High-Level Policy Dialogue were reflected in the finalized Strategy.

Minister Reznikov emphasized that the Strategy was fully integrated with other national strategy documents and part of a comprehensive national strategy for economic development. The Strategy does not build on massive state investment, but primarily seeks to generate investment from national and international investors and donors. The Minister furthermore stressed this reform needs to be a reform "done by us", which in no way should limit the engagement of international partners but ensure that ownership of the reform and identification with the projects rests with the local actors that carry these efforts.

To address the economic needs and still prevalent negative economic trends in the region, the Strategy foresees concrete measures in five strategic directions:

1. Improving financial instruments and regulatory frameworks (e.g. by designating priority development territories, introducing investment protection tools and an insurance system against military and political risks, reducing excessive regulation, attracting financial resources including from international partners, support for start-ups and micro and small businesses).
2. Strengthening the real sector of the economy, industrialization and innovation (e.g. by stimulating high-tech industries, accelerating sensible privatization, building production facilities to supply export markets in the US and EU, transformation of the agro-industrial complex and of the coal industry, and de-carbonization).
3. Building critical infrastructure (e.g. by modernizing railways and improving other

transport connections, esp. North-South connections, reconstructing water, energy and gas supply systems, and reducing ecological risks such as air and water pollution).

4. Re-constructing the regional labour market (e.g. by preventing outflow of human capital, creating new jobs, reducing informal employment and improving professional development and adult learning opportunities).
5. Preparing effective communication to boost the impact of the Strategy (e.g. by promoting confidence in the authorities in charge of the Strategy, supporting media projects, projecting a positive investment image of the Donetsk and Luhansk regions).

The governance structure for the implementation of the Strategy, as currently planned, includes inter alia:

- An Advisory Council including representatives of government agencies, international financial organisations, and world-class expert,
- An executive Agency for the management of the priority development territories in Donetsk and Luhansk regions, located with-

in the central government and setting the agenda,

- A Consortium Financing Fund, managed by an international financial institution such as the European Investment Bank (EIB), able to inspire trust among donors and investors,
- A State Venture Fund to invest in priority development territories or provide other forms of support for new business projects,
- An Investment Agency whose functions will include assistance in attracting investment primarily for small- and medium sized enterprises,
- A branch of the International Arbitration Court to introduce new investment protection tools,
- Local self-government bodies and local state administrations.

Main obstacles to the take-off of the region's economic recovery continue to be a lack of confidence in the judicial system, the military volatility and continued, widespread security risks.

PROPOSALS FOR THE POLITICAL PROCESS AND THE STRATEGY IMPLEMENTATION

Following the model of previous STG Dialogues on Donbas, discussions led to several concrete proposals for the next steps. The following is presented as advice from the international community:

- 1. Window of opportunity for the political process:** The new US administration's emphasis on diplomacy provides a political opening for the Ukrainian government, together with its European partners, to re-launch the political process. Together they should seek close coordination with the US administration, for which President Zelenskyy's planned visit to the White House in August will offer a key opportunity. While the Minsk Agreement remains an important reference point, a significant re-launch will have to go beyond Minsk.
- 2. Changed perception of Russian behaviour:** Russia's military build-up in Spring has underscored the persistent threat to Ukraine's sovereignty and the plausibility of a scenario of hybrid and incremental aggression leading to further territorial intrusions. Ukraine's Western partners need to maintain readiness for a unified and determined response to deter further Russian provocations.
- 3. International study on ecological damages and risks:** The tragic losses of human lives, human capital and economic resources during the conflict have been subject to studies and quantifications. The ecological damage and enduring ecological risks that spread beyond the borders of Ukraine, however, urgently need to be assessed. An internationally organized in-depth study should bring the dimension of the problem – that is likely to endanger lives and livelihoods in the region – to the attention of the international community. International partners and fora, including the UN, should exert pressure on Russia to cooperate in damage control and risk mitigation.
- 4. The Strategy – priorities:** The finalized Strategy of Economic Development of the Donetsk and Luhansk Oblast can be "game changer" for the Donbas region and Ukraine. In the immediate future, its priority should remain on improving people's lives both in government- and non-government-controlled areas by facilitating access to health care, education and welfare services. People-to-people contacts remain an important element on this agenda.
- 5. The Strategy – governance:** An efficient governance structure will be key for a successful implementation. While allowing the input of relevant stakeholders, a diversion of responsibilities and competencies on different levels of government and among different authorities could seriously weaken the Strategy's impact. Implementation, administration and monitoring should be concentrated in one government organ – as is currently foreseen in the planned Executive Agency. The Ministry for Reintegration has to take the leading role in this agency.
- 6. The Strategy – unintended effects:** The implementation of the Strategy should avoid creating new barriers – economic, administrative or otherwise – that would make re-integration of the non-government-controlled areas more difficult in the long run. Measures taken today in government-controlled areas should be scalable later to non-government-controlled areas.
- 7. Finance and investment security:** The envisioned model of a consortium trust fund, managed by an international financial institution (e.g. EIB), was generally supported. In addition to international donors and investors, there should, however, also be Ukrainian investment in the fund. The strategic direction of the fund should be defined by the Ukrainian government, but some flexibility for decision making by donors should be provided. Finally, [with one of the lowest recovery rates of emerging economies](#), the problem of resolving insolvency needs to be addressed urgently.

8. **Fight against corruption:** Corruption remains one of the single most important obstacles to good governance and successful reform implementation. The Strategy therefore has to go hand in hand with continued efforts to reduce and prevent corruption.
9. **Legal Ombudsman:** Corruption in the judicial system and a weak rule of law are major road-blocks for investments. A legal ombudsman, equipped with adequate budget, staff and authority, could be installed to provide oversight over the judicial system. The ombudsman could be empowered to make legally binding decision, or s/he could order the review of judgements deemed wrongful. International precedents show the effectiveness of such an institution, and Ukraine has already positive experience with the business ombudsman.

A LOOK AHEAD

The Strategy will shortly be submitted to the Cabinet of Ministers and will then be introduced in the Verkhovna Rada of Ukraine. A related legislative package is currently under preparation. [Initial steps of the implementation have already been made](#), Minister Reznikov expects the first projects to be launched in the first quarter 2022.

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.

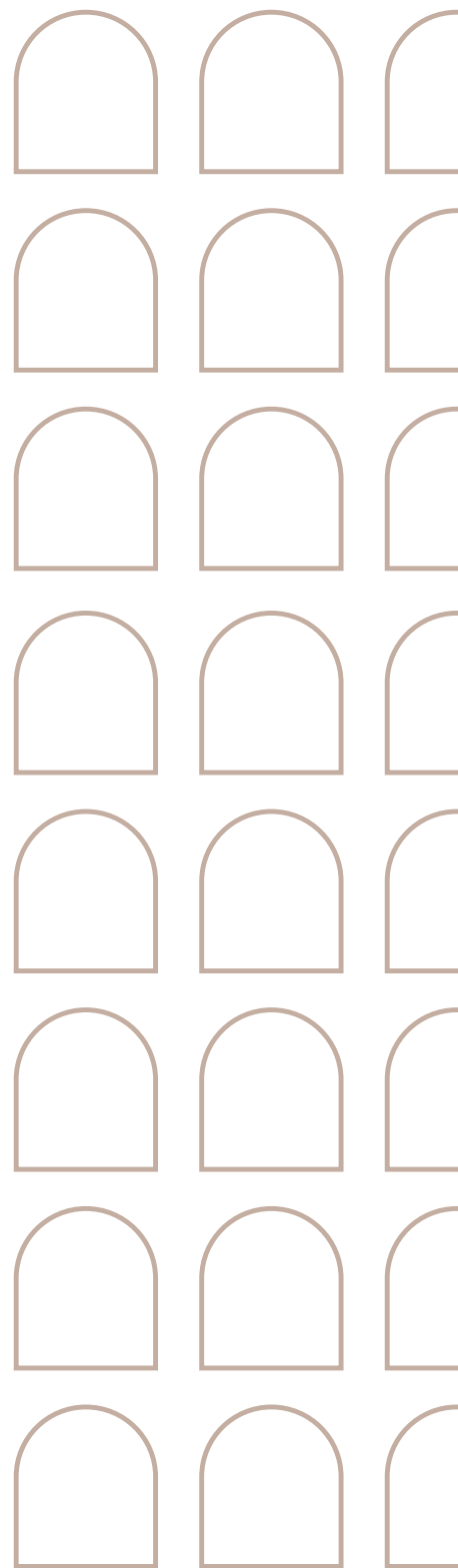
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