



## Policy Brief

based on the discussion that took place during the round table on:

“Institutional development of Ukraine in light of the EU integration”

on May 11<sup>th</sup>, 2022

as part of the “New Dawn” initiative

Yevhen Dubohryz<sup>1</sup>, Christopher Hartwell<sup>2</sup>, Volodymyr Vakhitov<sup>3</sup>, Olha Zadorozhna<sup>4</sup>

---

<sup>1</sup> CASE Ukraine

<sup>2</sup> ZHAW School of Management and Law and Kozminski University

<sup>3</sup> Kyiv School of Economics

<sup>4</sup> Kozminski University

## **Property rights as one of the most important institutions in an economy**

- Property rights are a crucial institution for growth. However, they rely heavily on an effective judiciary and other contracting institutions.
- According to North (1987) as well as North and Weingast (1989), property rights can be sustained and functional if there is a true balance and diffusion of power throughout a political system; simply put, power should be dispersed among many players with many veto points.
- Throughout its history, Ukraine saw extreme centralization of power and a lack of supporting institutions. The power remains in the hands of the Parliament and the President in Kyiv, and thus, the diffusion of power is still limited.
- The current situation with regards to property rights in Ukraine is on the right path but needs to be accelerated:
  - The agricultural land sale moratorium was finally lifted in 2020 and tentative steps have been taken toward a functioning land market.
  - The judicial system remains problematic as a supporting institution,
  - Corruption has not been eradicated mainly because the state is still too large.
- Policy solutions to develop the property rights further and sustain the well-functioning institutions include:
  - Continuing decentralization reforms and giving much more power to regions;
  - Remove restrictions on the agricultural land sales to liberalize the market even further;
  - Complete judicial system reforms perhaps along the lines of Estonia's reform in the 1990s but also create an Ethics Council to approve members of the High Council of Justice based on standards of integrity; and
  - Complete the creation of the Special Anti-Corruption Prosecution Office and finalize the appointment of its head prosecutor.

## **The decentralization reform**

- The main aim of the decentralization reform is to conduct the transfer of powers and finances from the state authorities to the local communities.
- Among other things, during 2014-2015, the local communities got the right to retain a share of the taxes paid by the residents and businesses. This gave those communities significant financial independence from the central Government as they could decide how to spend this income.
- Moreover, local community-level elections took place for the first time in 2020.
- The war with Russia showed that Ukrainians can organize very efficiently and work together very effectively on the local community level (i.e. territorial defense forces that were created in each community to protect the locals from the invaders; volunteering initiatives that supplied military equipment to Ukrainian Armed Forces and humanitarian aid to civilians, etc).
- Current challenges of the reform:
  - territorial-administrative division of Ukraine does not include local communities as statistical units, and hence, there are significant challenges to collect the statistical community-level data.
- Policy solutions to further develop the decentralization reform:
  - finalize the reform by introducing appropriate changes to the Constitution of Ukraine (i.e. about the administrative division of the country, the local referenda, etc);
  - intensify the cooperation with the EU with regards to the institutional and financial support for the reform.

## **Financial and banking sectors and their compliance with the EU standards**

- The Ukrainian banking system is stable and growing, however, is relatively small. Based on net assets, the Ukrainian banking system is 9 times smaller than the Polish one. Nevertheless, it is more profitable with net profit being equal to EUR 2.58 bn in Ukraine vs. EUR 1.91 bn in Poland in 2021.
- Moreover, the Ukrainian banking sector has one of the best in Europe cost-to-income ratios of 54.8% (compared to 58.9% in Poland and 64.3% in top EU banks).
- No bankruptcies have taken place after February 24<sup>th</sup>, 2022. There are only 6-7 (out of 69) banks at risk and these are the banks that mainly operate in the East of Ukraine. Together they constitute less than 8% of net banking systems' assets.
- Financial system liquidity is enough to meet all the payments and deposit outflows even under more severe external shock than Ukraine experiences now.
- Starting from mid-March, there is net cash inflow to the banks and they have a liquidity surplus.
- The foreign exchange rate has experienced moderate depreciation of 10-11%. Inflation has increased to 16.4% (y/y) in April 2022 (following 13/7% y/y in March).
- The banking and financial system in Ukraine has met all prerequisites to comply with Basel III and CRD IV.
- Policy solutions to comply with the EU standards:
  - support the compliance with Pillar I and Pillar II compliance for financial companies;
  - the banks should be allowed to have a grace period after Ukraine's accessions to the EU to absorb the war losses and attract fresh capital. During this period the banks may be allowed to continue working under the Basel principles.

### **References:**

North, D.C., 1987. Institutions, transaction costs and economic growth. *Economic inquiry*, 25(3), pp.419-428.

North, D.C. and Weingast, B.R., 1989. Constitutions and commitment: the evolution of institutions governing public choice in seventeenth-century England. *The journal of economic history*, 49(4), pp.803-832.