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Overview: In this issue of showCASE, our experts take a look at the themes discussed by Professor Anders Åslund during the 153rd mBank CASE Seminar *Will Ukraine Be Able to Establish Real Property Rights?* Professor Åslund also features in a short interview, in which he sheds more light on the most important take-aways from the Seminar. Our experts also analyze the post-election situation in the Czech Republic and discuss the role that Andrej Babiš may play in future economic path of the country.

Ukraine's Toughest Reform Yet

By: *Krzysztof Głowacki, Economist at CASE*

Unlike in its CEE neighbors, in Ukraine the reform path has been jagged and inconsistent, reflecting the country's political cycle of prolonged periods of stagnation interrupted by popular revolutions. Since the 2014 Euromaidan Revolution, the country seems to be on the right track, with a number of important economic reforms already under its belt. But more challenges lie ahead. Ukraine is still one of the most corrupt countries in the world, its rule of law is weak, and the civic and economic rights of the citizens, including property rights, remain feeble. These systemic challenges have been the subject of the 153rd mBank-CASE Seminar held on November 9th, during which Professor Anders Åslund presented his paper *Will Ukraine Be Able to Establish Real Property Rights?*

Professor Anders Åslund

Professor Anders Åslund, the longstanding Chairman of the CASE Advisory Council and a Senior Fellow at the Atlantic Council, enumerated the crucial reforms that have been implemented in Ukraine since 2014. Notably, mass energy subsidies have been removed, bringing an end to corruption via energy arbitrage. In 2013, the industry was paying \$400 per 1,000 cubic meters of natural gas, while households, owing to state intervention, were able to get it for as little as \$50. But the real benefactors were well-connected traders, who would buy the gas cheap and sell it expensive, warping a system that cost the country 8% of the GDP (2014). Public finance has been consolidated: expenditures were revised down from 53% of GDP in 2014 to 40% to GDP in 2016, with many expenses identified as cases of embezzlement and discarded. Moreover, the spending on pensions was brought down from 17% of GDP in 2013 to an estimated 11% of GDP in 2016. With the reintroduction of the flat 18% PIT rate, reduction of the payroll tax from 45% to 22%, and a streamlining of VAT refunds, the tax system has been significantly overhauled, raising hopes for increased tax compliance in an economy that is largely still in the shadows. Finally, in a campaign engineered by Central Bank's Governor Valeria Hontareva, the banking sector was cleansed of banks whose anonymous owners lived off Central Bank loans. As a result, half of the 180 Ukrainian banks, including Privatbank, were closed in the years 2014-2017.

While the economic reforms have been relatively uncomplicated (which is far from saying that they were easy) and almost immediately effective, the institutional reforms, due to the inbred inertia of existing arrangements, are far less straightforward and may take generations to take full effect. In fact, Georgia can be described as the only country in the post-Soviet sphere that has successfully handled corruption, thanks to President Saakashvili's efforts. In Ukraine, corruption remains the number one problem, as testified by the country's distant 131st rank in Transparency International's Corruption Perceptions Index 2016. Corruption among judges is common rather than exceptional: 16% of them preferred to resign from post rather than declare their assets in late 2016, knowing that they could not conceal their illegal sources. Prosecutors' habits are similar, and similarly destructive: prosecutors have been known for closing or delaying cases, and even for allowing suspects to leave the country – all in exchange for suitable compensation. Together with some other relics of the exploitive state, these practices are what Daron Acemoğlu dubs extractive institutions, which harm the incipient property rights of Ukrainian citizens.

The economic reforms implemented in Ukraine since 2014 have been absolutely necessary. However, they are on their own insufficient. Markets and transactions are anchored in an institutional setup and depend on it for effectiveness. For example, whether a company will or will not commit to investment depends on its risk assessment, of which legal certainty and risk of expropriation are the crucial components. Even transactions as simple as a deposit of savings or a sale of supplies rely on the state for enforcement via independent judiciary in a process that is fair and free from corruption. With the institutions that back them, contracts become a powerful tool of deal-making – flexible, certain, and convenient. Without them, they are inconsequential pieces of paper, much like banknotes of a careless central bank.

The reform in Ukraine, like in every post-Communist country, is about the state relinquishing feigned economic security and providing genuine institutional security instead. The first has been largely attained. The second is Ukraine's toughest reform yet.

Professor Anders Åslund is Chairman of the CASE Advisory Council and Senior Fellow at the Atlantic Council

Ukraine became an independent state in August 1991, yet the country’s social and economic development still lags behind Central and Eastern European countries. How can Ukraine catch up with its western neighbors? What are the most important reforms that the government should implement immediately?

The most important thing is to get real property rights now. If you travel around the former Soviet Union, you see a lot of modern enterprises that had been transformed into ruin because somebody had blocked their activities under the former owner, because he was not liked politically or because somebody wanted to take over the property. I have a good hope for this reform. Ukraine has a strong civil society, which is pushing for it, as are many parliamentarians and about half of the government. And the Western donors, who are interested in this reform, are also very important for Ukraine. Of course, we can wonder why Ukraine did not start this reform earlier. If you take for example Poland in 1989, there were millions of Poles who had worked abroad and knew life in the West from their own experience. In Ukraine, there were very few people who had known foreign languages or who had started something significant abroad.

Do you think that the crisis Ukraine is facing now can be seen as an opportunity to reform the country’s economy?

Reforms usually happen in a crisis. Ukraine has carried out very many reforms lately in the economic area but also in social areas, like health care, education and pension system, which are normally seen as second-generation reforms. But it is critical now also to reform law enforcement and the judicial system, and also the electoral system, which now we are seeing is being reformed.

It is a common concept in Poland that the Polish transformation can serve as a model for Ukraine. But are Polish and Ukrainian cases comparable?

In many ways this is true, in others not. Poland was quite corrupted in the 1980s, but it was not the same degree of corruption that we have seen in Ukraine. Also, the judicial system in Poland at the end of communism was more dogmatic than corrupted. These are the most important differences. But the economic structures of the two countries were quite similar: coal and steel industry, machine building, and a large agricultural sector.

According to the Democratic Foundation Initiative poll conducted in July, 77% of Ukrainians were *concerned* about price rises, 61% about unemployment, 12% percent were thinking about emigrating. Ukrainians think that *economic instability* is a *bigger* threat *than* military aggression (3%). Do you think that the government can convince people to stay and that is able to conduct reforms?

The fundamental issue is that the average salary in Ukraine today is about one quarter of that in Poland. For example, if you live in Lviv and if you move just a little bit you can earn four times more than in your country. Around 1.5 million of Ukrainians work in Poland, a few hundred thousand in the Czech Republic and Slovakia. There are 7 million people who are missing in the labor force statistics in Ukraine. Most of them probably work abroad. Can the government convince them to stay? If you have much lower salaries you will always have higher emigration. This is a general problem for Eastern Europe, especially when it is so easy to travel now. Can the Polish government convince Poles not to emigrate?

In your book *Ukraine. What went wrong and how to fix it* you advocate what you called a "Marshall Plan" for Ukraine. But is this plan possible after *Trump's "America First"* foreign policy, the Brexit, immigration crisis in Europe, and the rise of populists and nationalists a*cross* the *continent?*

The amount of money that is needed is really quite minor. 5% of Ukraine's GDP today is $5 billion. For international institutions and export credit agencies delivering this amount of money should not be a problem. Helping Ukraine should be a major issue also for the European Union, yet Frederica Mogherini [High Representative of the European Union for Foreign Affairs and Security Policy] has not been to Kiev for two years.

The Czech Republic After the Election

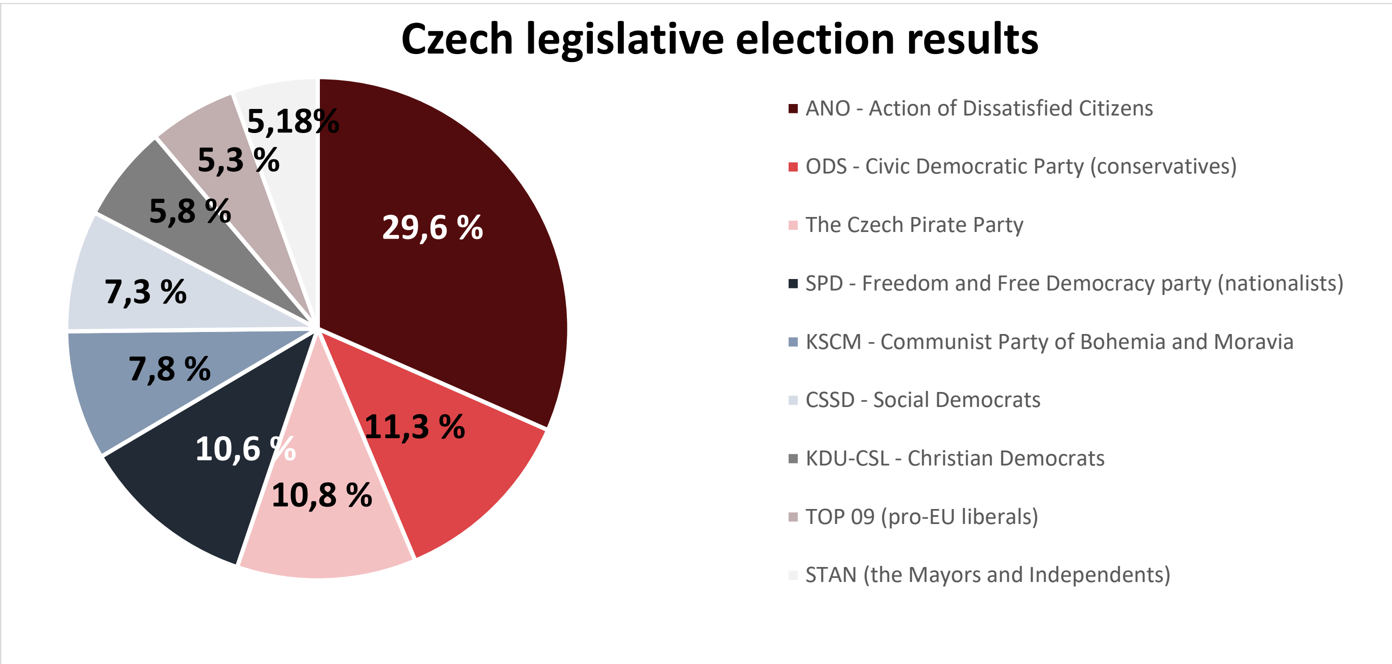
By: Monika Rębała, *Communications Officer at CASE*

The new Czech parliament is set to meet for its first session today, November 20, when the outgoing center-left government of Social Democrat Bohuslav Sobotka is expected to resign. President Miloš Zeman formally designated Andrej Babiš, 63-years-old billionaire, media mogul, and leader of the winning ANO party, to form the next government.

Source: Reuters

Although ANO (an acronym for "Action of Dissatisfied Citizens" in Czech but is more commonly known as the word for "yes") received almost 30% of the votes cast in recent elections and will have 78 lawmakers in the 200-seat lower house of the parliament, it is struggling to form a government. Both the mainstream center-right and center-left parties have already ruled out a coalition with Mr. Babiš, arguing they could not join a cabinet led by somebody who repeatedly depicted them as corrupt and incompetent (the irony is, of course, that Babiš is himself facing fraud charges in a case involving a EUR 2 million EU small business subsidy a decade ago).

The ANO leader says he will form a minority government, including experts who are not MPs as possible Ministers. More importantly, even if Babiš loses the confidence vote to secure the office of Prime Minister, the Constitution does not require the dissolution of the Chamber of Deputies (the lower house of Parliament). Indeed, Mr. Zeman, who is a Babiš supporter, has already said that he will not call for snap elections is the vote fails.



Source: Czech Statistical Office

As elsewhere in the world, political instability could impact the Czech Republic's booming economy. According to preliminary figures published by the Czech Statistical Office, GDP was up by 0.5% in Q3 2017 q/q and by 5.0% y/y. The unemployment rate is at record lows (2.8 %), while wages are increasing at the same time. But Mr. Babiš has been characterized as a "populist" and "Eurosceptic," rejecting the European Union's refugee quotas, criticizing the EU sanctions on Russia as ineffective, and standing against the Czechs joining the Eurozone in the near future. But this is not detached from the popular sentiments, as recent Eurobarometer poll shows 63% of Czechs do not trust the EU. Such a sentiment means that there are valid fears that Mr. Babiš may join Poland and Hungary on their anti-EU collision course with Brussels. For his part, Babiš said in a recent interview with Reuters that ANO was pro-European and ready to take on an active role in the EU.

Despite the current round of political wrangling, Mr. Babiš, who served as finance minister from 2014 until his dismissal in May 2017, has declared that the Czech economy will grow even faster when he is in charge of the government. During the election campaign he was successful in convincing voters that the country's economic success was due mostly to his skilled tenure at the Ministry, and, like Donald Trump, he repeatedly touts his management skills as the secret to his own success (Forbes estimates his fortune at USD 4 billion).

There may be some hope that the Czech success continues, as Babiš's program is generally enterprise-oriented and not particularly ideological. His party's slogan during the electoral campaign was simple: "Things will get better." A key promise also focused on reducing income taxes for lower earners while simultaneously boosting spending on highways and railroads. Babiš also has said his government would not levy a bigger burden on companies but would instead finance his plans with better tax collection and savings from improved state efficiency. Although the ANO leader is opposing mass immigration, he is also in favor of keeping doors open for workers from Europe. In a country of 10 million people there live more than 500,000 foreigners (5% of country's population), around half of them from Ukraine.

However, to keep the economy on the right track, he not only needs favorable tailwinds but also allies among other parties to push his reforms through the parliament. Yet Babiš' critics say that he is an opportunist and can easily reverse a stance if he sees political advantage in doing so. Most importantly, the electoral season in the Czech Republic is far from over, as January sees elections for President. If incumbent Miloš Zeman can retain his lead in the polls, Mr. Babiš will be strengthened and likely have the chance to enact some of his reforms. As the sometimes-turbulent politics in Central Europe show, however, two months can be a very long time indeed.

Countries at a glance

This week: The Central Statistical Office estimates that Poland's seasonally adjusted GDP in Q3 reached 5.0% y/y, the highest rate since 2011. Growth is primarily driven by private consumption boosted by increasing salaries, record-low unemployment, and transfers from the government under the "500+" program. Additionally, Poland has been benefiting from the improving economic situation in neighboring EU countries.

GDP (Q3 2017)

5.0% y/y (est.)

Up from 4.2% in Q2

Inflation (Oct 2017)

2.1% y/y

Down from 2.2% in Sep

Unemployment (Sep 2017)

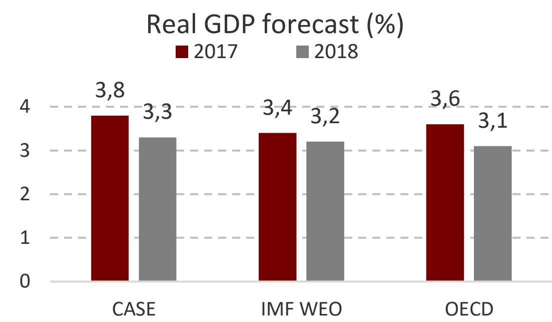
6.8%

Down from 7.0% in Aug

NBP Base rate

1.5%

From 2% Mar 2015



This week: According to Russia's Central Bank, economic growth in Q3 equalled 1.8% y/y, which represents a decrease compared to the previous quarter (2.5% y/y). Meanwhile, a positive trend can be observed in food exports: Russian wheat exports grew by 20% this season, and the country is expanding its exports to Africa and Asia. Diversification of exports is crucial for an economy which remains wholly dependent on oil and gas prices.

GDP (Q3 2017)

1.8% y/y (est.)

Down from 2.5% in Q2

Inflation (Oct 2017)

2.7% y/y

Down from 3.0% in Sep

Unemployment (Sep 2017)

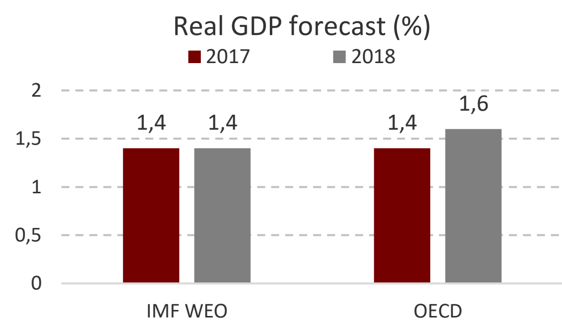
5.0%

Up from 4.9% in Aug 2017

CBR Base rate

8.25 %

From 8.5% in Oct 2017



This week: According to the Nation Brands Index (NBI) survey published on 16th of November, Germany has the best international image in the world. The country has replaced former leader the United States, which is now in the sixth position. The total score is aggregated from categories including governance, exports, tourism, people, investment and immigration, and culture and heritage.

GDP (Q3 2017)

2.8% y/y

Up from 2.0% in Q1

Inflation (Oct 2017)

1.5% y/y

From 1.8% in Sep

Unemployment (Sep 2017)

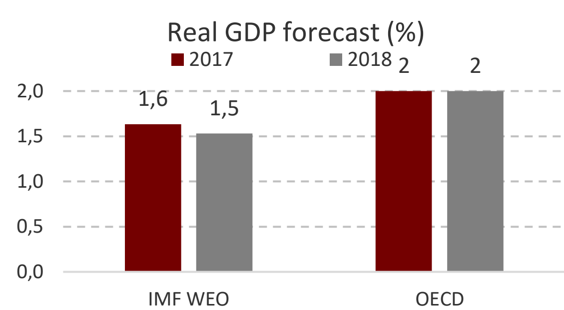
3.5%

Up from 3.7% in August

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



Countries at a glance

This week: The production of agricultural products in Ukraine from January to October decreased by 2.3% y/y. According to the State Statistics Service (Gosstat), crop production in the period fell by 2.9% y/y and livestock production by 0.5% y/y. Land reform remains a crucial issue holding back production but has yet to see any serious movement by the government.

GDP (Q2 2017)

2.3% y/y

From 2.5% in Q1

Inflation (Oct 2017)

14.6% y/y

Up from 16.2% in Aug

Unemployment (Q2 2017)

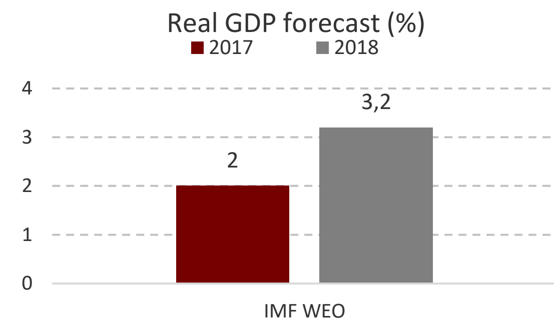
9.1%

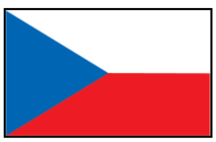
Down from 10.5% in Q1 2017

NBU Base rate

13.5%

From 12.5% in Sep 2017





This week: The Czech Statistical Office announced that the country's GDP in Q3 had grown by 0.5% q/q, and by 5.0% y/y. On the fiscal side, Finance Minister Ivan Pilný stated that the state budget was expected to end the year with a deficit of around CZK 10 billion (EUR 400 million). Taking into consideration applicable EU subsidies, the Czech Republic can expect a surplus of several billion crowns.

GDP (Q3 2017)

5.0% y/y

Up from 4.7% in Q2 2017

Inflation (Oct 2017)

2.9% y/y

Up from 2.7% in September

Unemployment (Q3 2017)

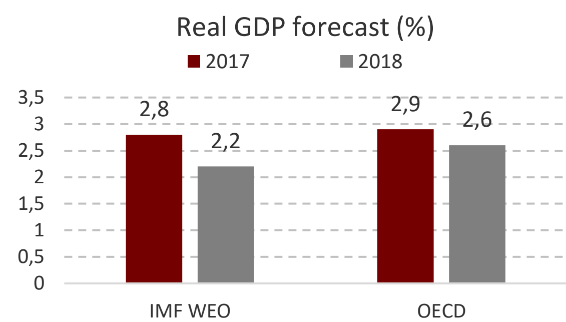
2.8% (est.)

Down from 3.0% in Q2

CNB Base rate

0.50%

From 0.25% (3rd November 2017)



This Week: According to the Hungarian Central Statistical Office, gross domestic product in Q3 was 3.6%. Hungary's Minister for National Economy Mihály Varga said that the construction industry had contributed strongly to the growth of the GDP. According to Budapest Business Journal, the expansion of buildings construction and civil engineering was particularly strong.

GDP (Q3 2017)

3.6% y/y (est.)

Down from 4.2% in Q1

Inflation (Oct 2017)

2.2% y/y

Up from 2.1% in July

Unemployment (Q2 2017)

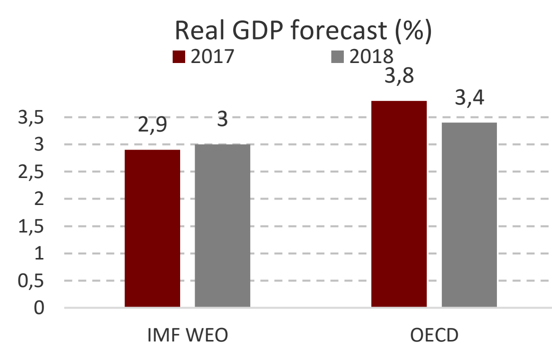
4.2%

Down from 4.3% in Q1

MNB Base rate

0.9%

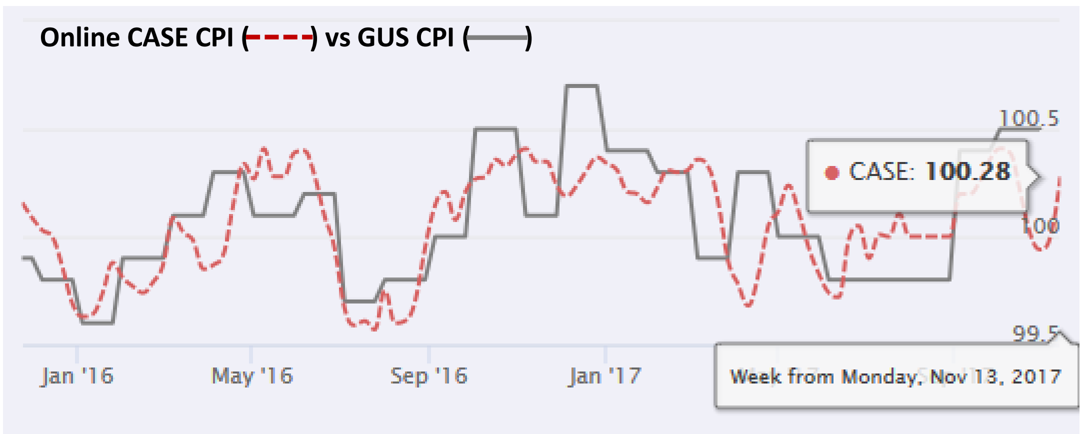
From 1.05% May 2016



The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI



Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2017	3.8	4.3	2.7	4.3	1.9
2018	3.3	3.3	3.1	3.7	2.1
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2017	5.1	201.6	201.8	-0.2	-4.7
2018	3.5	211.3	213.1	-1.8	-5.9

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