

# **Kenya Held Back By Lack Of Accountability, Corruption**

**WASHINGTON** – According to a BBC story, only 26% of money spent and collected by the Kenyan government has been fully approved in an audit for 2013-2014. Kenya's auditor-general, whose report covered an annual budget of about \$16 billion said there were "disturbing problems" in government's accounting.

## **Spending with no justification**

The recently released report indicated that there are "still persistent and disturbing problems in collection and accounting for revenue". According to the auditor-general, about 16% of all government accounts data is "misleading", a polite way to say that several government agencies release to the public a great deal of false information aimed at hiding graft, embezzlement and worse.

## **False payrolls**

The BBC indicates that "Among the numerous items being questioned [by the report] are empty office spaces paid by the police and 32 faulty armored vehicles for the military. The health department's accounts were particularly worrying as they failed to account for 22 billion Kenyan shillings (\$216 million) worth of spending, the report said. The auditor-general also noted that \$2 billion had been transferred to an offshore account, against regulations"... "When the authorities started biometrically registering all civil servants in 2014 they found more than 12,000 false names in the government's payroll."

## **Only 1.2% of total spending properly documented**

***A WSJ story on the same topic notes that, according to same auditor-general's report, only 1.2% of all Kenyan government***

*spending is properly accounted for. About half is murky, while a quarter lacks any documentation.*

There you go. 25% of the entire state spending cannot be justified.

Notwithstanding all this, Kenya is held up by the IMF and other multilateral institutions as one of Africa's important success stories. An example to be followed by others. Many point out its IT companies and its successful M-Pesa mobile phone based payment system, used by millions.

### **Too much corruption**

And yet Kenya is ranked among the world's most corrupt countries. It came 145 out of 174 nations on the Transparency International's Global Corruption Perception Index.

President Uhuru Kenyatta tried to get rid of or punish corrupt officials. In March 2015 four cabinet ministers and other high-ranking officials have been suspended.

Obviously this is not enough.

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## **Obama's Nairobi Speech In Praise of Enterprise Not Well Reported – A Pity**

**WASHINGTON** – US President Barack Obama traveled to Nairobi, Kenya to address a US-sponsored international forum on entrepreneurship. He said a lot about the value of enterprise

in modern societies.

### **The key point**

And yet this is what most international media quoted from his speech: *“Entrepreneurship offers a positive alternative to the ideologies of violence and division that can all too often fill the void when young people don’t see a future for themselves.”*

### **That’s it?**

Let me understand this. According to world media, of all the things that Obama said, the most quotable sentence is that Africans (and others) should foster entrepreneurship because it provides a good antidote to *“ideologies of violence and division”*? That’s it? This is the value of enterprise? An antidote to political extremism?

This is how you narrow down what the leader of America, the most successful capitalistic economy in history –an economy, mind you, founded on free enterprise– has got to say about the value of entrepreneurship?

### **There is a lot more in Obama’s speech**

Obama said a lot more in his speech, a lot more. He talked about the power of innovative ideas, creativity, risk taking, meeting challenges. He talked about ways in which America plans to support private sector entrepreneurship around the world. He talked about the role of women.

But none of this has been reported at any length. This is a missed opportunity. A speech extolling the value of enterprise in emerging countries, precisely because it has been delivered by an American President, illuminates why the capitalistic industrial democracy model that we would like other countries to embrace, is better.

### **The enabling environment**

Sure enough, enterprise is not everything. You need a real “*enabling environment*”. You need good laws that defend private property and investors rights. You need an independent judiciary, simple regulations, and a true commitment to fight corruption.

And there is more. You need infrastructure (power generation and distribution, railways, good highways, ports, and what not). Of course you need all this. And Obama talked about this in his Nairobi speech.

### **Enterprise is key**

And yet, the truth is that, if a society is unable to produce a robust group of future oriented entrepreneurs willing to take risks, you can have all these “building blocks” without making any real economic progress.

Look, it is very difficult to “breed” entrepreneurs. But one way to encourage more people to take a chance by starting a business is to make it clear to them that risk taking can have great rewards. You can make money. You introduce a new product or service. You can offer employment to others. You contribute to the overall progress of your society. And this is what Obama said in his Nairobi speech.

### **Incentives**

And this is why it is a great pity that most media chose to focus only on what Obama said about enterprises as antidotes to political violence. The US President said a lot more.

He said that enterprise is the engine of growth and innovation. He said that it is the best way to have faster economic growth. He said that America encourages women entrepreneurs in emerging countries. He talked about broad-based initiatives that will link US investors and technology leaders with young entrepreneurs world-wide. All this may not be revolutionary. But it is important.

Too bad that Obama's message extolling free enterprise was not properly reported, and therefore it was lost.

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## No Good Cities In Developing Countries

**WASHINGTON** – Many emerging countries have made progress in their own economic development. Growth is up, poverty is down. And this is good. However, when it comes to the growth of large cities in the developing world, it is generally a disaster.

### **Congestion**

Rapid urbanization resulted in chaos. Increased income means that more people can afford cars. But the streets cannot accommodate them. Hence the phenomenon of monumental daily traffic jams. From Cairo to Nairobi or Maputo, to Dhaka or Jakarta, it is all the same: hellish traffic conditions make it almost impossible to move around.

Add to this inadequate basic services (electricity, clean water, sewer systems) and you see how life in rapidly growing cities in the developing world can be pretty grim.

### **No good cities**

In the words of Hank Paulson, formerly head of Goldman Sachs and US Secretary of the Treasury under George W. Bush: *“Nowhere in the developing world do you see a successful urbanization model”*. Got that? Nowhere.

And if you think that mighty China is doing a lot better, think again. Traffic is awful and air pollution levels truly dangerous. As reported in a Financial Times piece, some Swedish diplomats apparently refused to be posted in Beijing because they find living conditions there to be unbearable, according to former Swedish Prime Minister Carl Bildt.

### **How do you fix this?**

Having said that, how do you fix this mess? How do you transform an underserved megalopolis of 10 or 15 million people? How do you create modern mass transit systems, decent schools, public parks, and good services like drinking water in countries that do not have any cash to spare?

Have bad development models created urban monsters?

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## **NYT Report From Cuba Silent About Moribund Economy**

**WASHINGTON** – In a longish report from Cuba, The New York Times tells us about various opinions expressed by different people on the island about the news of the new dialogue with the United States, with the possibility in the near future to re-establish diplomatic relations.

### **Cuba is a communist country**

However, reading this article a not particularly well-informed reader would not get a few basic facts about Cuba. Number one, after 55 years Cuba is still a communist dictatorship that continues to outlaw free speech, while denying basic human rights. Number two, the Cuban economy, on account of 55 years

of mismanagement by the dictatorship, is a basket case. But you get none of this from the NYT report.

### **Moribund economy**

This is rather amazing. Cuba is a communist dinosaur. But the NYT does not seem to know this. During the Cold War the Castro brothers managed to preserve their absurd regime in part thanks to Soviet subsidies. With the Soviet Union gone, more recently Cuba got help from like-minded Venezuela in the form of below market price oil supplies. But this help does not make much of a difference. Indeed, several analysts describe Cuba's economy as "moribund", "frozen", "stuck", "hopeless", and so on. But you get none of this from The New York Times.

### **Achievements?**

On the contrary, the article points out a few significant social achievements of the regime: namely universal public education and health care for every Cuban. Now, one could wonder why such a super healthy and super educated population performs so poorly. But this issue is not explored.

The thrust of the article is about an old US-Cuba political feud that may be finally settled thanks to Obama's more realistic approach.

### **We had no relations because of the communist dictatorship**

And why is there such a dispute? Perhaps it has something to do with a communist dictatorship in Cuba that throws political opponents in jail, while it prevented economic growth by outlawing private enterprise?

In order to avoid any misunderstanding, I stated before and I repeat now that I am completely in favor of this new "Cuba policy" just announced by President Obama. With the Soviet Union gone, Cuba is no longer a threat to America. The old "no relations with Cuba" approach makes no sense.

Still, as we enter this new phase inspired by pragmatism, let us not forget whom we are dealing with. Honest reporting that tells readers what kind of country Cuba is would be a good start.

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## **America Embraces Cuba?**

**WASHINGTON** – President Obama's unexpected announcement about re-establishing formal diplomatic relations with Cuba, while easing some of the travel and economic restrictions that prevent US companies from doing business with the island, is welcome news. For 55 years the American policy towards Cuba has been based on the effort to isolate this communist country.

### **Gigantic failure**

*By any measure, this has been is a gigantic failure. 55 years of trade and economic embargo and no diplomatic relations with Cuba did not produce the intended results of suffocating and then killing the communist dictatorship. The Cuban Communist Party still rules the 11 million people who live on the island. The (now considerably aged) Castro brothers are still in charge. The rest of the world never followed the American example and deals with Cuba.*

### **Recognize reality**

It is time to recognize reality and stop allowing the sizable but not omnipotent community of Cuban refugees (who live mostly in southern Florida) to dictate American policy towards the Caribbean nation. The (supposedly) morally righteous



principle whereby America should not have diplomatic relations with a country whose government engages in repression and human rights violations makes no sense.

Think of it. If we applied this principle of "*we only deal with good, democratic governments*" to all our foreign relations, then we should have no embassies in China, Vietnam, Saudi Arabia, Egypt, Venezuela, Russia, Zimbabwe, and many other countries.

### **This is no endorsement**

Having diplomatic relations is simply an internationally recognized modality for conducting state to state business. Having or opening an embassy in any country is not a "political endorsement".

Diplomatic relations are not and should not be construed as the equivalent of an American official approval of the system of government in place, in Cuba or anywhere else, for that matter. These days Washington openly condemns Russia's heavy-handed meddling in Ukraine. The US Government has enacted and enforced economic sanctions against Russia. And yet we still have a US Embassy in Moscow.

That said, let's see how all this will play out. Of course, some segments of the Cuban-American community loudly complained, claiming that this move just announced by President Obama is a betrayal, while it amounts to a "reward" for the Castro brothers. They argue that America should have demanded and obtained political reforms in Cuba before accepting "normal" relations with this dictatorship.

On the face of it, this is a silly argument. As already indicated, if this "political litmus test" principle applied globally, we should close down many embassies.

### **Change through trade?**

What is not clear is whether this diplomatic and trade opening to Cuba may indeed help trigger real changes within a reasonable period of time. On the face of it, the impact of America's gigantic economic power should be able to transform a relatively small country.

That said, do keep in mind that a full US economic and trade engagement would require additional and much more complex policy shifts. President Obama does not have the power to formally end the Cuba embargo. This would require new legislation that may or may not come soon, given the new Republican majority in the US Congress. In the meantime, Obama can only ease some of the restrictions, including travel, remittances and sale of certain goods, including construction material and telecom equipment.

### **Peaceful invasion**

Be that as it may, if we could picture a peaceful "invasion" of tens of thousands of America tourists streaming into Cuba, year after year, plus assorted business people looking for deals, it stands to reason that this phenomenon would influence the country. Most Cubans have never traveled. Only 5% of the population has (restricted) access to the internet. Cuba is relatively isolated. Two generations grew up under the Castro regime. Millions of Cubans have no idea about the rest of the world. Coming into close contact with people who live in a free society overtime will cause some new thinking.

And then there are the opportunities and channels of communication that may be created by new business relations with American companies. Again, for the moment, much of this is speculation.

Assuming the end of the embargo, will American companies seize this opportunity? Or will they conclude that Cuba is way too poor and backward, and therefore not a viable market? As some experts argue, in the Cuban economy the only thing that works

is the black market.

### **Does Cuba gain anything?**

That said, what is Cuba's interest in getting closer to America, given the political risks that closer "people to people" connections may end up creating?

Well, realistically, Cuba does not have that many options. It used to depend on the old Soviet Union. But that patron is gone. Post-Soviet Russia is not doing well these days. Venezuela, Cuba's main political ally in the region and provider of oil at discounted prices, is a basket case, because of the economic ruin created by Hugo Chavez and his successor Nicolas Maduro.

America can help Cuba economically. Of course, Raul Castro knows that close relations with a gigantic free market economy may change the political climate in Cuba. But Raul Castro is old. He is not going to see the long-term effects of this policy shift.

### **Keep things as they are?**

And the idea that the new generation of Cuban Communist Party leaders is determined to keep the island under the same old repressive regime, as dreadfully inefficient as it is, come what may, is almost absurd.

North Korea, with China's indirect support, may be able to keep the old game going for a while longer. But the Cuban regime does not have the same staying power. In the long run, the American embrace may prove deadly for the regime. But it is likely to benefit the Cuban people.

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# At The Root Of the Hong Kong Protests: Economic Prosperity Is Founded On Political Freedom

**WASHINGTON** – Will the Hong Kong protesters demanding true democratic elections for the special status territory win in the end? Who knows. Probably they will not. And yet this surprisingly large grass-roots “rebellion” should be noted, because it is an open challenge to Beijing’s will to control Hong Kong’s politics.

## **Guided democracy**

The Chinese government wants to establish a “guided democracy” in Hong Kong. The people will be able to vote. But the candidates for the top executive position will be vetted and approved by an ad hoc committee. Quite simply, this means that only candidates that have proven pro-Beijing credentials need apply.

Hong Kong citizens could have accepted this farce, recognizing that a semi-democracy is better than no democracy at all. But they did not. Unexpectedly, they staged protests. And the protests grew bigger and bigger.

## **Embarrassment**

This is a huge embarrassment for the current pro-Beijing Hong Kong leadership. But it is also a problem for Beijing, since it is the Chinese Communist Party itself that mandated the new elections procedures for Hong Kong.

At this point, giving in to the street demonstrators in Hong Kong may be impossible. This would amount to a loss of face and prestige. However, crushing the protesters in a violent manner would not look good. It would invite unpleasant comparisons with the brutal 1989 Tien An Men repression of pro-democracy protesters.

Be that as it may, one thing is clear. China, while respecting Hong Kong's special status, intends to tighten political control. *"Hong Kong people: You get to vote; but only for candidates we have pre-approved."* The people in Hong Kong saw this and resist.

### **Prosperity and political freedom go hand in hand**

Even though we do not know how all this will end up, (probably badly), this phenomenon of large pro-democracy demonstrations in Hong Kong underscore a point that most Western China observers try to avoid.

Indeed, despite the undeniable economic progress made by China in the last 30 years, this is still an illiberal autocracy, unwilling to transform itself.

The citizens of Hong Kong know this. And therefore, without challenging the basic reality that China is ultimately in control of the former British colony, they fight to protect what makes them different: political freedom.

While most mainland Chinese may feel differently, (they have never known democracy), in Hong Kong people believe that economic prosperity and political freedom are inseparable.

I think Thomas Jefferson would agree.

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# Why Are So Many Rich Chinese Leaving China?

**WASHINGTON** – If China were really the wave of the future, as many optimistic commentators argue, soon to replace America as the world number one economy, how come that so many rich Chinese leave or plan to leave the country?

## **The rich are leaving**

A recent Barclays survey quoted by the WSJ indicates that 47% of all Chinese with significant assets (\$ 1.5 million) plan to move abroad. Yes, the wealthy, that is those who gained the most from China's 30 year uninterrupted economic boom, go away, or want to go away. They buy properties in London, Paris or in the US. They send their children to study in America, Australia, Canada or Europe. In 2012, 70,000 Chinese students who went abroad did not come back to China.

## **Cash in suitcases**

On a related note, most cases of illegal importation of large amounts of cash (in old-fashioned suitcases) into the US involve Chinese nationals who try every possible avenue to take their money out of China.

## **Investor Visa**

Furthermore, the Chinese constitute by far the largest group of those applying for fast track US residency via an "Investor Visa", a controversial program that allows foreign national to become US residents by investing large sums of money in jobs creating enterprises in America. Wealthy Chinese see this as an easy way to "buy" their right to reside legally in America.

## **“Naked Officials”**

Last but not least, powerful Communist Party officials also position themselves for an exit. The now common expression “*naked official*” indicates a local or provincial party boss who has already sent his family abroad. Unlike the wealthy businessmen, in most cases these functionaries gained the money that allows them to pay for houses in America and expensive college tuition fees for their children through illicit practices, i.e. old fashioned corruption.

But the point is that they follow the same trend. They want to get away, or at least they are actively paving the way for a future exit.

### **Why leave a booming economy?**

Once again, if China were indeed the new economic model, soon to surpass old and sclerotic America, why is it that those who benefited the most from this unprecedented economic expansion want to get out and resettle in declining America?

History usually shows that immigration goes in the opposite direction. People from all over the world want to go to the country where there is a booming economy, (today’s China). Enterprising businessmen and adventurous young people want to get a piece of the action.

Sure enough, there have been and there are plenty of foreign investors in China. But Apple or General Electric going to China do not balance hundreds of thousands of rich Chinese individuals and their families who leave the country.

Although some of them may look at investment opportunities in their newly adopted countries, most of them are guided by the desire to leave China and settle in Western nations.

### **Trouble in Shangri-La?**

Once again, why leave the place where huge fortunes have been

made and where the economy still grows at 7% a year?

Could it be that these millionaires know (probably better than most) that, under the surface, this modern Shangri-La is not so shiny?

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## No Sustainable Economic Development Without Genuine Democratic Capitalism

**WASHINGTON** – Economic development specialist William Easterly pointed out recently that, reviewing all the speeches delivered by the past President of the World Bank, he could not find any reference to “democracy”.

### **Democracy?**

The reason for this incredible omission is that the World Bank deliberately avoids any reference to politics or political systems. We are told that this venerable multilateral lending institution, whose mission is to end poverty by promoting development, does not favor any particular political system. Politics is a matter for individual countries. The World Bank will provide assistance to any country, irrespective of its political regime. The implicit assumption here is that sustainable development can and will take place irrespective of the political institutions of any given country.

### **Catching up with the West**

But now, consider this. The International Monetary Fund (IMF) recently reassessed its prognostications about the time it will take for emerging countries to catch up with the



developed West.

Previous IMF forecasts, based on some years of good data, indicated that in 44 years the rich-poor gap would be gone.

But that proved to be a fantasy justified by unsustainable growth in many commodity exporting countries. This growth was caused mostly by China's incredible demand for enormous quantities of raw materials and other products needed for its rapid industrialization.

### **300 years to bridge the rich-poor divide**

Well, China's boom is over. As a consequence, the commodities driven export boom experienced by many emerging markets is also over. Hence the need to reassess growth rates.

*Well, based on current trends, according to the IMF, it will take emerging markets (minus China) 300 hundred years to catch up.*

Got that? The IMF revised its estimates about the time needed to have real standard of living "convergence" between developing countries and the prosperous West. They had predicted 44 years. Now they say 300 years.

### **Obstacles to growth**

And what is the main obstacle on the way to higher economic growth? Of course, everybody has a theory.

And I have mine. Please go back to the initial point about the World Bank and its support for development, irrespective of political regime.

I would suggest that this very point –avoiding the obvious correlation between democracy and growth– is precisely the problem.

While it is indeed possible to have impressive economic growth

without democracy –and China is the most obvious example– as a rule the two go together, if your goal is sustainable economic development. (From this perspective, the jury is still out about China’s model. 30 years of growth is a lot. But the West has been growing for 300 years).

## **The ecosystem**

The most prosperous Western countries engineered growth in ecosystems in which there was and there is a combination of deeply rooted political and economic freedoms, with clear and transparent rules administered by an independent judiciary.

This ecosystem protects individual freedoms. It favors free enterprise, the pursuit of learning that makes innovation possible and a reasonably rational, market driven allocation of resources.

And let me stress that by pro-growth “ecosystem” here I am referring here to the existence of a widely shared and deeply understood “*democratic ethos*” underpinning laws and rules that protect individual freedoms, including economic freedoms.

## **You need more than periodic elections**

***This ethos goes way beyond the adoption by certain societies of a few rules generally associated with democracy. In other words, in order to have real democratic capitalism, you need to have much, much more than elections every few years.***

And here is the problem affecting many if not most developing countries. They have yet to understand and fully embrace the principles of democratic capitalism and the impact they have in liberating and channelling society’s vital energies.

Sure, there is a lot of talk about “democracy”, “political freedoms” and “private sector-led development” in many developing countries. But in most instances it is adopted jargon, not the expression of genuine belief.

## **Poverty**

Of course, poverty is a stubborn, self-sustaining obstacle. Poverty breeds more poverty, in an endless cycle of misery.

But poverty can be overcome when a country sincerely adopts real good governance, when it rejects abuse by the powerful, corruption and/or tribalism and exploitation.

## **Democracy makes development possible**

A country that genuinely embraced the rule of law, that genuinely promotes education and the creation of an ecosystem that favors enterprise will attract investors. And this can help end the cycle of poverty.

I am not suggesting that democratic capitalism is the proven method to fast track development.

I am arguing, however, that without genuine democratic capitalism it is almost impossible to have sustainable economic development.

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# **South Africa's Economic Crisis Will Breed More Social Tensions**

**WASHINGTON** – According to most analysts, Sub-Saharan Africa is finally poised for a real economic take-off. Prevailing growth rates between 5 and 7% indicate a new vitality, and at the

same time the promise of a far better future for perennially under developed countries.

### **Challenges remain**

Yes, there are still major challenges in the Region: lack of electricity, poor infrastructure, deficient public health and inadequate public education, to name the most significant obstacles. But the Continent is finally moving ahead.

### **What about South Africa?**

Yes, it is moving ahead, except for South Africa, the country that in principle should be ideally poised to lead Africa's competition for higher rates of economic development.

After the bloodless political revolution of 1994, African National Congress (ANC) ruled South Africa had major advantages. The White South Africans during apartheid had developed several reasonably competitive modern sectors.

Therefore, post apartheid South Africa had decent infrastructure and manufacturing, not to mention banking, financial services and insurance. On account of all this, the new South Africa had by far the largest and overall most prosperous economy in the Continent.

### **Major advantages not used well**

That said, South Africa did not manage to leverage these valuable assets in a good way. The country, despite the relatively smooth political transition from White minority rule to a Black majority government, remains deeply divided. Whites still have most of the wealth.

### **Not enough progress**

Much has been done to help poor Blacks move up and eventually join the middle class. There have been significant investments in affordable housing and in basic services (water,

electricity) aimed at improving the lot of the really poor.

But it was and it is not enough. The Black-White economic divide remains enormous. And this wealth gap is fueling resentment. Radical Black leaders, like Julius Malema, the founder of the Economic Freedom Fighters, interpret and channel this discontent.

Trade unions have become much more combative. This widespread resentment this year culminated in an unprecedented wave of strikes affecting the most critical mining sector.

Mines were closed for months. No output means no platinum exports, and therefore no growth.

### **The impact of the strikes**

As the Pretoria News reports, (*SA Mining Output Falls To 19-Month Low*, September 11, 2014) , as a result of all these strikes, South Africa's economy is contracting.

*"South Africa's mining output fell more than expected in July, hitting levels last seen in late 2012 and compounding doubts about whether the central bank would hike interest rates next week, as the economy suffers.*

*Mining output in Africa's most advanced economy dropped 7.7 percent year-on-year in July, from a revised 5.4 percent decline in June, Statistics South Africa said, **with output largely hit by platinum group metals, which fell more than 45 percent.** [Bold added]*

*The data increases concerns about the health of the economy, which is still struggling to recover from the effect of a five-month strike in the platinum industry this year.*

*The number comes just days after the release of a wider-than-expected current account deficit for the second quarter.*

*Earlier this year the Association of Mineworkers and*

*Construction Union (Amcu) downed tools for higher wages at the world's top three platinum producers – Impala platinum , Anglo American Platinum, and Lonmin – **in the longest strike in South African history.*** [Bold added]

*The mining sector entered recession in the second quarter of 2014 and helped to drag the whole economy into contraction in the first three months of the year.*

***GDP managed a 0.6 percent expansion in the second quarter, effectively putting growth at zero in the first half of the year.*** [Bold added]

### **South Africa is in a bind**

There you have it. Zero growth. Not a very good prospect. It is understandable that under privileged South African miners demand higher wages and better working conditions. They can see the standard of living of the mostly White middle class and upper middle class.

Still, their protracted industrial actions have impaired mining, the country's most important economic sector. Because of these huge economic losses, now everything is more complicated.

### **No way to fund new social investments**

Do keep in mind that all government's economic and social investment strategies are predicated on a much higher rate of growth. (At least 5%).

Unless this stagnant economy starts growing again, millions of poor South Africans are destined to stay poor. (The official unemployment rate is 25%. The real numbers are much higher. Many rural people have no real work. But they are not counted). Inevitably, in this already tense climate, persistent inequality will breed more resentment.

Unless the government and civil society, working together, can

create a credible path that will allow the poor to find their way into the mainstream, I see only more trouble ahead.

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## **The War Against The East Has Ruined An Already Weak Ukrainian Economy**

**WASHINGTON** – A few weeks ago I wrote that Ukraine should cut its losses by letting its Eastern provinces go. Let them become independent. Let them join Russia. But let them go.

### **Let the East go**

I wrote this advisedly. I recognized then as now that this would have been an unprecedented, truly drastic action, with major repercussions, domestic and global. Giving in to Russia's political and military pressures, disguised as a spontaneous local rebellion, would have had consequences, none of them positive. It would have meant that the Russian bully wins.

### **Ukraine is fighting all alone**

***All true. However, this choice would have allowed the Kiev government to cut its losses and truly focus on the urgent need to fix a horrible economy.***

But Ukraine decided instead to fight the rebels, whatever the level of Russian direct or indirect support, even though Ukraine is in an extremely difficult situation, because it has to engage Moscow and its proxies all by itself.

Ukraine is not a member of NATO, therefore no direct support

from the West. And, as it turned out, little or zero appetite in Washington and in Brussels for any military support whatsoever, (the US offered meals ready to eat and socks to the Ukrainian army), in order to minimize the chances of an open confrontation with Moscow. Therefore, a few nice words to the Kiev government, some gestures, but that's about it. The sanctions against Moscow, even if a bit more serious now, still fail to hit the Russian economy really hard.

### **Ukraine is broke**

In the meantime, let's keep in mind that the Kiev government now fully engaged in this war is essentially broke, while it desperately needs natural gas supplies from Russia, its enemy.

But newly elected president Petro Poroshenko, following God knows what kind of game plan, decided to step up the military effort against the Moscow backed rebels. And it looks as if the situation on the ground has improved. The Ukrainian army is squeezing the rebels.

### **A deteriorating economy**

But these military successes, while relevant, come at a huge cost. As I said, Ukraine is essentially insolvent. It relies for its survival on loans and lines of credit from the IMF, the EU and the US.

An already poor performing economy is in a recession: -4.7% in the second quarter. The official forecast is for a GDP decline of 6 to 7% for 2014. At least 3 percentage points of this steep decline can be ascribed to the cost of the war. Manufacturing output is down 5%. construction is minus 9%. Unemployment is up to 9.3%.

### **The war is costing too much**

From the above it is easy to see how this war in the East, whatever the military successes on the ground, is simply



hastening Ukraine's economic demise. And, even assuming the ability to finally crush the rebellion in the East, (this would also assume that Putin would stop aiding the secessionists), then what?

How would Kiev deal with millions of unhappy and still restless ethnic Russians? Where is the money to rebuild destroyed cities and shattered economies in the East?

I have no idea if anybody even attempted to add all this up. But I suspect, even assuming a quick and favorable end of the hostilities, that we are talking about spending tens of billions of dollars before Ukraine can become a quasi-normal country again.

### **Tens of billions needed to fix Ukraine**

Indeed, if you put together money needed to revitalize the semi-comatose (and sadly very corrupt) overall economy, money needed to rebuild the virtually destroyed East, money to pay old energy bills with Russia and additional funds for future gas supplies, and whatever will be needed to resupply the armed forces, we are talking about billions and billions of dollars, money that Ukraine does not have.

Beyond all this, forget about any campaign to attract new foreign investors. No one will seriously consider a country at war as a good place to set up shop.

To sum it all up, whatever the future of this military campaign, from an economic standpoint Kiev's all out effort to crush the rebellion has been a major disaster. And the longer the fighting, the worse the economic impact.

### **Give up the East, focus on the economy**

*As I said above, to unilaterally give up the Eastern provinces would have been a terrible loss for Ukraine; but a loss that would have allowed the central government to end*

*this political crisis and redirect all its energies on the economy. Fighting this war, even if in the end there is military success, has made an already bad economic situation a lot worse.*

Expect Ukraine to be a basket case supported by Europe and by the IMF for years to come.