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# **INSIDE UKRAINE**

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Benaissance

The International Center for Policy Studies (ICPS) restores issuing analytic paper «Inside Ukraine», the last issue of which was prepared in September 2010.

The aim of the publication is to provide objective information on current political events in Ukraine and thorough analysis of major tendencies in domestic politics. Such analysis will assist in setting priorities in the process of implementing reforms in Ukraine and in evaluating quality of state decisions from the viewpoint of their impact and sustainability. Special attention is paid to evaluation of political competition in Ukraine and ability of key political players to address challenges.

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# **1. The Government Policy**

The collapse of the coalition and Arseniy Yatseniuk's statement on the government's resignation, which should be considered in the Parliament within 10 days, provide an opportunity to analyze the Cabinet of Ministers' activities for the last five months. Although the government has got the country in a deep political and economic crisis, and in the face of external Russian aggression, it managed to avoid default with the help of international donors.

However, in terms of the reform progress little has been achieved. The coalition government, consisted of party quotas, proved to be unable to provide efficient public management and systemic reforms. Government work on fight against corruption also remains unsatisfactory.

## 1.1. Wins and semi-wins of the government

The main achievement of the Arseniy Yatseniuk's government was consistent fulfillment of the IMF cooperation program requirements. It allowed ensuring of the external loans needed to stabilize the financial situation in the country. Thus, it managed to fulfill four "economic" items of the 23 tasks outlined in the government's program in February 2014. In particular, the government resumed its cooperation with the IMF, imposed austerity measures, contributed to the adoption of the law on public procurement and made unpopular decisions regarding prices and tariffs.

Another task successfully fulfilled by the government was fair and transparent presidential elections held on May 25, 2014. Although the separatists managed to disrupt voting process practically in entire Donbas region, elections in other regions of Ukraine did not cause negative comments of observers and the international community. It is important that the authorities arranged the elections in procedural terms and the necessary legislative amendments were made. These changes enabled the electoral process organization, despite the annexation of Crimea and acts of terrorism in Donbas.

Significant part of the promises were not fully implemented. The program covered signing of the Association Agreement with the EU and the immediate implementation of its provisions. The signing process had two stages: signing of the political part in March and economic part in June 2014. At the same time, ratification of the agreement is artificially prolonged. Currently, the document is under the approval process in relevant ministries. Therefore, it indicates preservation of the command-administrative bureaucracy procedures and the principle of collective responsibility among civil servants.

The central executive body, which would have broad authorities to coordinate the entire process of European integration, has not been established. Currently, the government decided to set up an office at the Secretariat of the Cabinet of Ministers, but the authorities of this institution are not sufficient to carry out the necessary functions.

Insufficient progress has been made regarding criminal responsibility of the organizers and perpetrators of crimes related to mass protests in November 2013 - February 2014. The investigation came to nothing more than investigation of the events of 18-20 February, which resulted in detention of two "Berkut" officers suspected of committing crimes. Other 63 Government is consistent in fulfilling the IMF program

The Association Agreement is signed, yet ratification is delayed "Berkut" officers left Ukraine destroying almost all evidence of their involvement in these crimes. No steps were taken as to arrest and prosecution of senior political leadership of the state, which gave the orders to suppress the protests. In addition, other crimes, such as supression of the students' demonstration on November 30, protesters' beating on Bankova Street on December 1, or mass arson of activists' cars have not been properly investigated.

Three objectives of the government's program covered humanitarian policy, including language and education. However, the only achievement of the ruling coalition in this area was the adoption of the Law on Higher Education and the Law on Public Broadcasting. The government has also learned how to build its information policy at the international level and in the coverage of the ATO more effectively. Official communication regarding reform course requires a radical change. Progress in some sectoral reforms, which is negligible, is further leveled by the lack of government capacity to inform the public about the specific steps, performers and the results of its innovations.

## 1.2. Lack of reforms is a major government defeat

Keeping the situation with public finances under control is a minimum program, which the Arseniy Yatseniuk's government managed to cope with. In the conditions of political and economic crisis, it is hard for the Cabinet of Ministers to carry out reforms. However, on the other hand, the willingness of society to unpopular decisions and financial support of foreign donors create a window of opportunity to implement the reforms. During five months, the government failed to lay the foundation for reforms, although in its program, some of them have been identified as a priority.

First of all, it concerns the changes in law enforcement and the judiciary systems. Such changes remain unfulfilled promises in the government program.

Chairman of the Ukrainian Helsinki Human Rights Union, Yevhen Zakharov, believes that the first step in the reform of justice is the adoption of the law on the Public Prosecutor's Office in its second reading. The first reading was held in November 2013, and the text of the draft law was commended by both Ukrainian and international experts. Over the past five months, Ukraine had two Prosecutors General. However, changes in the system of prosecution did not get out of the deadlock. Appointments are made on party quotas or through family ties; there is no fight against corruption and no legal assessment of the actions of hundreds of prosecutors involved in political persecution. The new Prosecutor General, Vitaliy Yarema, also prefers to keep quiet about the draft law No. 3541, summarizing his vision of changes in the prosecutor's office system with popular concept of decentralization - the transfer of powers to prosecutors at local level. In turn, the draft law No. 3541 proposes to deprive the prosecutors of the right to conduct business inspections, establishes a competitive selection when applying for a position and reduces the number of prosecutors (from 15 000 to 5 000). Civic activists insist that the prosecutor's office should not conduct investigation, but just represent the state in court.

Judicial reform is blocked not only by the public prosecutor's office, but also by influence groups interested in personal control over the judicial system, such as Serhiy Kivalov. The only positive change was the adoption People guilty in the Maidan crimes have not been punished

Official communication on reforms requires radical changes

The first step in justice reform is to adopt the law on prosecution

Judicial reform is blocked by different lobby groups of the Law "On restoring trust in the judiciary system in Ukraine" in April 2014. However, MPs called into question the constitutionality of this law appealing to the Constitutional Court. In addition, 80 percent of court heads, dismissed according to the provisions of this law, have been restored to their posts through collective decision. Judges, who have lost positions in the Constitutional Court and the High Council of Justice, are returning to their offices under the decision of the Supreme Administrative Court of Ukraine. According to Christos Giakoumopoulos, Director General of the Department of Human Rights at the Council of Europe, the judicial reform in Ukraine has slowed down.

Reform of law enforcement system has a similar fate. There is no concept of the new government policy on reforming the law enforcement bodies. Amendments to the law on police have not been made. Lustration of the law enforcement officers is a slow process and mainly concerns Donetsk police, which collaborated with separatists. Instead of reform, authorities decided to conduct a pilot project in Lviv region regarding the improvement of law enforcement system. The project provides for the creation of municipal police and re-attestation of personnel officers. This project aims to show how to implement reform at the national level. However, without changes in the current law on the police, this experiment only distracts public attention from the need to carry out a full-scale reform.

The government has promised to reform the political system and electoral law and to create mechanisms on preventing the usurpation of state power. The collapse of the coalition means that at the end of August, the President will be able to dissolve the Parliament, but no amendments has been made to the electoral law yet. Verkhovna Rada may lack political will to introduce proportional representation system with open lists. Thus, elections are likely to be held under mixed system that enhances the merger of business and politics and creates conditions for vote buy-out.

Promises to carry out economic reforms remain unfulfilled. Due to the economic problems, tax burden on the population continues to grow, while the return of capital, registered in Cyprus and other offshore areas, remains just beautiful words on paper. Because of the coalition government and the fact that coalition members are directly linked to the leading business groups in Ukraine, it is impossible to implement initiatives against the interests of oligarchs. In addition, the government did not start taking steps toward deregulation, although expanding the freedom of entrepreneurial activity was determined as one of its priorities.

## 1.3. Flourishing corruption in times of war

Russian external aggression and annexation of Crimea has made two program tasks - maintaining the territorial integrity and good neighborly relations with Russia - objectively impossible.

However, over the last five months, the Ukrainian army combat capability has been greatly improved thanks to getting combat experience in the confrontation with separatists and numerous volunteer groups and civic activists' support.

Civil society took over a number of state functions, including the issue of the military supplies. The main reason is flourishing corruption in times of war and a slow response of the Ministry of Defense and other departments to the situation, which is dynamically changing.

Increase in security forces financing coupled with simplified

There is no concept of police reform

It is impossible to realize initiative which go against oligarchs' interests

Society fulfils state functions supplying the army needs procedures of army procurement provides a fertile ground for embezzlement. At the same time, it is difficult to ensure control over financial activities of the government's departments during hostilities, especially when there are no independent regulatory authorities in the state. The coalition promised to create a national anti-corruption bureau, but failed to do it. There were draft laws on new institution drawn up, but the majority of MPs did not support them.

Corruption in the Ministry of Defense has increased after several rounds of partial mobilization. One can found growing number of reports about disappearance of ammunition and food prescribed to entire units, as well as information about fixed rates to avoid conscription. Unclear mechanism of mobilization creates opportunities for military commissars' malfeasance, who offer to avoid the ATO zone for a bribe.

Flourishing corruption under war conditions, when Ukrainian servicemen die every day, intensifies social tension. Soldiers' mothers are blocking highways and picketing public authorities. Moreover, civic activists criticize the government officials and military officers for poor soldiers' provision. Lack of measures on combating corruption undermines the effectiveness of ATO and strengthens anti-government sentiment in the public.

Corruption in Ministry of Defense increases social tension

# 2. Economic Situation

In 147 days Ukrainian government managed to improve its cooperation with international financial institutions, especially IMF, and stabilize the financial situation in the country. This is undoubtedly a great success. However, profound economic reforms and the fight against corruption have not been implemented, which calls into question the effectiveness of the government work.

Government policy in energy sector was aimed at minimization of external threats to the market and implementation of internal energy market reforms. The basis for energy sector reform was provided in compliance with the Treaty on establishing the Energy Community. However, due to the absence of transparent discussion of government initiatives, it was not possible to take a political decision on reforms.

#### 2.1. Outcomes of the government program implementation: economy

The main items of Yatseniuk government program regarding economic situation were the following: renewal of cooperation with the IMF; immediate stabilization of the financial situation, especially through tough austerity measures; demonopolization of economy; improvement of investment climate; revision of prices and tariffs with the introduction of relevant compensatory mechanisms etc.

Ukrainian government, apart from the program, elaborated a special programme entitled "100 days, 100 steps". It was proposed to work out a regulatory framework for further reforms in the country within 100 days. The program provided for improvement of public finances and business climate, development of financial sector, restoration of public trust in the state. However, after the program had been promulgated, no further steps were taken to implement it.

The biggest achievement of Ukrainian government was the restoration of cooperation with the IMF. However, it made the government take unpopular measures. At the end of March, Ukrainian Parliament adopted a package of anti-crisis laws that allowed for the IMF financial aid. The adoption of anti-crisis package of laws envisaged austerity measures and stabilization of financial situation. The main law in this area was the Law of Ukraine "On prevention of financial catastrophe and creation of conditions for economic growth of Ukraine", which increased taxes and froze minimal social security guarantees. Anti-crisis package of laws contained a political decision on increasing prices and tariffs that affected solvency of Ukrainians.

The adoption of the Law of Ukraine "On public procurement" (which was necessary to adopt in the context of cooperation with the IMF) laid foundation for the fight against corruption in state bodies. The Law also provides for increasing control over public procurement, especially as to making procurement results public. What is more important is to ensure effective control over the implementation of laws at every stage of public procurement – from calls for tenders to signing relevant agreements.

Concrete steps as to economic reforms were presentation of Tax reform concept and Banking reform concept (it covers period until 2020).

The main areas and key elements of the tax reform concept cover cut in tax number down to eight, differentiated VAT rate, reduction in the single social contribution from 36.77% to 18%, harmonization of accounting and Government elaborated "100 days, 100 steps" program, but it did not even start to fulfil it

Law on public procurement made the procedure more transparent taxation, fiscal decentralization etc.

The concept of banking reform is aimed at strengthening the banking system stability and restoring the trust of both citizens and businesses. As a result of reform, the National Bank will become a megaregulator of the financial system, which will carry out the prudential supervision of key financial markets. The project concept largely considers the Basel III standards, which will become mandatory for all the EU countries in 2019.

One can observe the biggest problems in monetary and fiscal policy. With the growth of demand for foreign currency, the NBU introduced a floating exchange rate. In this situation, the National Bank did not carry out any interventions, as a free FX rate has been introduced. This led to the devaluation of the hryvnia by over 50 %. Before implementing a floating FX rate, the NBU should have developed effective measures to minimize the devaluation of the national currency - a transparent mechanism of bank refinancing and tougher supervision of banks engaged in FX speculation.

Fiscal policy of the government was not efficient enough. Recent government's initiatives on amendments to the state budget in 2014 (budget cut) and the tax code faced harsh criticism. It was proposed to carry out budget cut for the second time this year. It is supposed to significantly reduce (by 70%) the budget of regulatory authorities and simultaneously prohibit inspections. It is also proposed to cut costs for the public sector (except justice and defense sectors) by 90% of two-months expenditures volume. However, the appropriateness of expenditure reduction in the public sector is controversial due to possible aggravation of social situation.

Due to the problems with budget fulfillment and the need to find additional reserves to finance military needs, long-awaited deregulation did not take place. On the contrary, tax burden has increased, which will lead to growing share of shadow economy and increase smuggling and counterfeiting volumes.

The government failed to keep its promise on improving the investment climate of Ukraine. The reason is a lack of actions to improve the legislation on the protection of investors. Another reason is the constant changes in the tax legislation, without any explanations, often at the expense of potential investors. The monopolization of the economy remains the unsolved problem, which impedes competition and creates artificial preferences for some entrepreneurs.

Arseniy Yatseniuk's government was expected to rapidly settle major economic problems. However, it has not happened. Although areas of reforms were chosen correctly, the lack of effective mechanisms for their implementation undermines positive intentions. In addition, criticism is reinforced due to insufficient information activities regarding the course of major reforms and their public policies.

## 2.2. Outcomes of government program implementation: energy sector

The government program in the energy sector was aimed at ensuring energy security and energy conservation; energy sector reform in accordance with the provisions of the Energy Community Treaty, including the Third energy package; gradual replacement of imported gas with domestic gas extraction; diversification of energy sources and supply routes; implementation of long-term state program for energy efficiency and a significant reduction of the economy needs in energy import.

It is difficult to definitely estimate government activities in the

NBU has not elaborated measures to mitigate currency devaluation

Tax burden will increase share of shadow economy

Government policy in energy sector may hardly be called efficient energy sector as effective. The planned intentions to implement energy sector reform according to the international obligations has failed. Due to the Ukraine-Russia relations deterioration, a priority for the government was to solve the energy supply problem before 2014-2015 heating season.

External threats to the energy market functioning has been kept to a reasonable minimum. The government position on the issue of gas dispute between Russia and Ukraine at the level of the Stockholm arbitration was unwavering. This position is fully consistent with the national interest. However, Ukraine is ready to resume negotiations with Russia on gas supplies on mutually beneficial terms. In order to ensure the energy supply diversification, the government established cooperation on gas reverse from Europe. Though optimistic amounts of possible gas reverse, claimed by the government, are widely criticized and gas reserves in the underground gas storage are not enough to provide the heating season, the government did some progress in mitigating the risks of energy dependence from Russia during the heating season.

The government efficiency in settling domestic energy market problems is more controversial. First of all, the efforts to reform the energy sector in accordance with the Energy Community Treaty provisions, including the Third Energy Package, did not lead to some tangible results. It also did not solve the existing problems of "Naftogaz Ukrainy" (as the Company's deficit is increasing, the level of state budget support will not reduce, the investment attractiveness and market liberalization remain low). There was lack of politically agreed decision about the improvement of the bill "On amending some laws of Ukraine on reforming the gas transportation system of Ukraine". Therefore, both the government and the parliament should bear joint and several liability for the lost time and careless approach to reforming of the strategically important sector of Ukraine. Ineffectiveness of joint actions undermines the international community trust in Ukrainian reforms and the prospects of Ukrainian energy become even more elusive.

Secondly, trying to ensure a stable energy consumption during the heating period, the government initiates an energy saving policy and domestic gas production stimulation. In practice, the policy of ensuring population gas needs may create unacceptable conditions for the gas companies. The government proposed to increase the rate of payment for subsoil use in gas production to 70%, as well as to direct all domestic natural gas production to cover the population needs. Moreover, the government will set a price for such gas, that is not always profitable for the gas producer. In this case, the government's statement about "stimulation" of domestic production seems to be inconsistent.

Although the directions of Ukraine's energy sector reforming have been identified correctly, the means for providing transformation re criticized. Due to the absence of transparent dialogue, there is no constructive solution concerning planned activities implementation. The wide discussion should involve the government, business, consumers, experts, NGOs, the media, all market players and operators, investors. The effective reforms should be carried out after consultations with stakeholders, while taking into consideration the interests of all energy market participants. Such mechanism will help to formulate a politically agreed decision about the reform. Government has managed to somewhat decrease risks of energy dependence from Russia

Policy of meeting population demands will create unbearable conditions for gas extraction companies The coalition breakup on July 24, 2014 started a 30-day countdown till Petro Poroshenko gets entitled to dissolve the Parliament and call early parliamentary elections. As the law establishes a two-month period for electoral campaign, the elections will most probably take place at the end of October 2014.

The outcomes of the parliamentary elections will be determined not only by political conduct of key political players, but also by the type of electoral system. The preservation of the existing mixed electoral system will enable businessmen and experienced politicians, whose parties have a slim chance to win, to make it to the Parliament in FPTP constituencies. Though "Batkivshchyna" and UDAR declare that they support proportional system with open lists, in the light of the coalition collapse the introduction of amendments to the electoral law seems unlikely.

Public activists have a good chance to make it to the Parliament provided different civic initiatives are consolidated into one political party. There also might be a tendency for experienced political parties to engage individual civic leaders to improve the public image of their party lists.

## 3.1. The coalition breakup as a result of agreements

Last week UDAR, "Svoboda", "Economic development" group, a number of non-faction deputies and representatives of "Batkivshchyna" associated with Petro Poroshenko quit the coalition. Since Ihor Kolomoiskiy is said to have influence on the parliamentary group of Vitaliy Khomutynnik and "Svoboda", the breakup of the coalition was impossible without certain agreements between the Dnipropetrovsk governor and the President. Both politicians enjoy great public support and favour early parliamentary elections, which will allow them to introduce their own political parties into the Parliament. Serhiy Lyovochkin, who will try to put his money and efforts into several political projects at once, is also in favour of early parliamentary elections.

As for Yulia Tymoshenko, delay in parliamentary elections would be much to her advantage. However, after July 24, 2014 "Batkivshchyna" had no other choice but to back the idea of early parliamentary elections while insisting on the introduction of proportional representation system with open lists. This step may be seen as the creation of a platform for criticizing their political opponents for their inconsistency. Before presidential elections Yulia Tymoshenko insisted on closed lists while Petro Poroshenko stood for open lists. The current configuration in the Parliament hinders the adoption of a new electoral law. That is why parliamentary elections are likely to be held under the proportional system.

Public reaction to the coalition collapse was controversial. Nonetheless, most Ukrainians believe that early parliamentary elections are necessary because they will allow to change the current composition of the Parliament. The incumbent Parliament does not represent the current electoral preferences of people. It lost social legitimacy the minute it voted for the so-called "dictatorship laws of January 16, 2014", which aggravated confrontation between Euromaidan protesters and riot police. Furthermore, the majority of MPs in the Parliament was a convenient tool at the hands of Yanukovych. The majority legitimized the usurpation of state power by the politician and economic crimes committed by the previous government. Coalition collapse became possible due to agreement between Petro Poroshenko and Ihor Kolomoiskiy

Elections are likely to be held under mixed system Another argument in favour of early parliamentary elections is that they will reduce social tension in the country. Lack of reforms, corruption in state bodies and great human losses suffered by Ukrainian army during ATO only add to the general dissatisfaction with the coalition government. The economic crisis, problems with energy supplies and their rising costs, which will hit Ukrainians with the arrival of winter, will only aggravate the political situation in Ukraine in November-December 2014.

The most effective mechanism for solving the political crisis is democratic elections. Thus, at the end of October 2014 Ukrainians will get a chance to cast a vote for those political parties which they trust most. After the elections, the newly created coalition government will have honey moon period to fulfil their electoral promises.

## 3.2. First ratings reveal current front-runners of elections

The results of opinion poll conducted at the beginning of July showed that 5 political parties are likely to make it to the Parliament under proportional electoral system. 23.3% of those respondents that would participate in the elections said they would support Petro Poroshenko's "Solidarity", 13% would cast their vote for the Radical party of Oleh Lyashko, 11.1% would give their vote for "Batkivshchyna", 7.3% - for Klitschko's UDAR, and 4.9% - for "Civil position" of Anatoliy Hrytsenko.

There are parties that are left behind the electoral threshold, namely the Communist party of Ukraine (3.7%), «Svoboda» (4.1%), «Strong Ukraine» of Serhiy Tihipko (3.3%) and the Party of Regions (if led by Mykhailo Dobkin ) – 3.2%. The chances of the mentioned political parties to win seats in the Parliament will depend on how they manage to build their electoral campaign. For example, "Svoboda" may try to consolidate some other right-wing parties, or draw away the Radical party's electorate by showing active support for ATO participants. Serhiy Tihipko's calls for dialogue with the East of Ukraine may increase his ratings in that region after the successful end of anti-terrorist operation. Besides, the direct support of Ihor Kolomoiskiy may also strengthen his position.

Since the aforementioned political parties have their own representatives in the Parliament, it is in their interests to introduce amendments to the electoral law in order to reduce the electoral threshold from 5% to 3%.

The changes in the list of election front-runners will also depend on the conduct of Ihor Kolomoiskiy. The Ukrainian billionaire from Dnipropetrovsk, apart supporting right-wing political projects and "Strong Ukraine" of Serhiy Tyhypko, may lead his own political project. His popularity in Dnipropetrovsk region alone, with the population totalling 3.3 million, is a serious bid for passing the electoral threshold.

## 3.3. The influence of public activists on electoral process

Civil society in Ukraine currently experiences activity boom. Public activists monitor the actions by state authorities in terms of corruption. They also demand high-ranking officials be responsible and accountable to civil society for their actions. Expert community elaborates the roadmap for reforms and lobbies necessary draft laws to be approved by the Parliament despite encountering much opposition from MPs. Multiple civic initiatives have been introduced aimed at providing Ukrainian army with ammunition. Elections will decrease social tension

Five parties may get to the Parliament under proportional representation system

Boom of civic activity in Ukraine Such civic initiatives become more popular in the society while activists also establish direct contact with Ukrainian military. Active Maidan members enlist in the volunteer battalions to fight separatists in Ukraine's East.

In order to be able to influence the political process, public activists should create their own political parties and take part in the elections. For the time being, various civic initiatives are poorly coordinated. It undermines their chances to win seats in the Parliament. Only by pooling mutual efforts, consolidating separate groups into one political party and introducing methods of electoral campaign that would show the difference between new faces in politics and the "old" ones, they will be able to compete for seats in the Parliament.

Different parties, including the biggest ones, will try to draw different civic leaders into their lists. By doing so, they will improve the public image of their party and get reasons to claim that they stand for the renewal of Ukrainian politics. In particular, such line may be taken by "Batkivshchyna", UDAR, the Radical party of Oleh Lyashko. However, one or two public activists on the party list will not change the party policy and principles of functioning. On the other hand, civic leaders will get a social lift and possibility to become MPs. At the same time, the situation when different civic leaders are dispersed between different political projects will undermine effectiveness of civil society in its struggle for changes in the country. Lack of coordination between different civic initiatives undermines their chances to influence political process in Ukraine