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INSIDE UKRAINE

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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. State Decisions

All decisions of Ukrainian government may be classified under two categories: decisions of war and decisions of peace.

Government tries to improve defense capacity of the country, but military potentials of Russia and Ukraine are difficult to compare.

Reforms are the only means to strengthen Ukraine's positions in internal and external politics. Successful Ukraine with democratic government and market economy is a direct existential threat to the Russian regime. Therefore, Ukraine's ability to counter Russian aggression will depend on success of these reforms.

1.1. Decisions of War

Response of Ukrainian government to the situation in Crimea is several weeks late. The Crimean Parliament should have been dismissed right after it was seized by armed groups. Instead, this decision was taken only on March 15th and even at that time it caused heated debate in the Ukrainian Parliament. Putting army on an alert, military draft and arrest of Russian separatists in the East were the first things to do, but the government and Parliament took these measures two weeks after Russians started to implement their scenario on annexation of the part of Ukraine's territory.

For many times Ukrainian soldiers in Crimea addressed national government with the request to give direct orders, but officials did not offer comprehensive plan of resistance to the Russian intervention.

Except for increasing military presence in Crimea, Russia also started massive informational war against Ukraine. Resistance of our country in information sphere was weak and chaotic. Some groups of activists fulfilled functions of the state in this sphere.

ATR TV channel is probably the only media that provides online coverage of the events in Crimea. On the other hand, there is no single resource which would accumulate information on development of the Russian scenario in Crimea and be the most complete and objective source of news on Crimean events both for citizens of Ukraine, and for rest of the world.

National Security and Defense Council of Ukraine is responsible for coordination of counterpropaganda campaign and development of the strategy on protection of territorial integrity. New leadership of this institution mostly consists of civil activists who have insufficient expertise to counteract such a serious enemy as Russia. That is why the Council should employ the most qualified Ukrainian specialists in the area. Low qualifications of managers are an unacceptable luxury in the times of war.

Creation of the National Guard, better financing of Ministry of Defense and Interior Ministry, deployment of troops to strategic regions and intensive army exercises were the right things to do in order to increase defense capacity of the country.

1.2. Decisions of Peace

Ukraine's government must demonstrate that it is able to achieve effective changes Ukrainian society strives for. First of all, it must demonstrate it to people in Crimea and Russians who are under influence of

Ukrainian government acts too late

Low qualifications of managers are an unacceptable luxury in the times of war

the Kremlin's propaganda. If the government progress is ensuring equality of citizens, independence of branches of power, democratic governance and market mechanisms in economics, it will be an effective weapon of war against the country, military potential of which exceeds Ukrainian one manifold, yet the regime of which is highly corrupt and undemocratic.

The Ukrainian leaders should not treat events in Ukraine as a temporary turbulence, but as a powerful challenge. Otherwise, we will face another revolution. The biggest danger for Ukraine's government today is to lose its strategic function. Government officials repeat their predecessors' mistakes because there is no other knowledge. Similar problems were experienced by all Arab countries which had gone through revolutions and changed one corrupted government to another.

In order to avoid it, Ukrainian government should switch from programs of reforms – sort of dreams about happiness – to transformation of these dreams into specific administrative structures, procedures, standards and skills. When the world understands that Ukraine implements a deep strategy in transformation of state institutions and economics, Western countries will have more levers to assist our country in its implementation.

For the West to start “recognizing” reforms, it is necessary not only to ensure public control over decision-making and appointments, but also to create a mechanism of democratic state control. Controlling institutions must not depend on the officials they are to control. State control should be democratic as totalitarian state control supports superiority of government, making it corrupt. In their turn civil activists should control whether the system is created and whether it works according to the standards.

In order to fight corruption, division of functions is needed when management, appointment of officials and control over managerial decisions are done by different people from different institutions.

Mission to fight corruption was assigned to Anti-Corruption Bureau, but the situation with its creation is catastrophic. Legal framework for the institution activities is not defined and no training is offered to the official who will manage work of the Bureau. If this work is not done, it will lead to a total failure of state anti-corruption policy.

New government continues the practice of office distribution based on party quotas while a complete reset of the system requires transformation of civil service which should not depend on political parties. Civil servants should be career bureaucrats, with strict hierarchy and intensive training courses which would prepare them to fulfill their functions.

Creation of civil service is directly linked to administrative reform which will help to democratize territorial management. Local authorities must have broad financial functions to implement socio-economic policy on their territory – rights to collect taxes, to take loans, to conduct economic activities, to have their own accounts etc.

National interests – territorial integrity, security, protection of citizens' rights and freedoms – are to be secured by representatives of the state administration in the respective regions.

Ukraine may face another revolution

Reforms require democratic state control

Civil service democratizes territorial management

2. Economic Situation

Ukrainian government has an extremely difficult task to solve the economic crisis in Ukraine. Since beginning of the year macroeconomic situation has been deteriorating. Structural reforms which would make corruption impossible and introduce transparent market mechanisms are the only remedy for Ukrainian economics.

2.1. Macroeconomic Trends and Course of Actions by Government

Major macroeconomic trends in Ukraine include acceleration of recession, inflation, deterioration of pay balance and monetary and credit market indicators, speculative demand for FX and a drastic drop in trust to the banking system. These factors destabilize both FX and banking markets.

They were triggered by unfavorable socio-political events in Ukraine and abroad. These factors influence expectations of economic agents negatively, they cause panic among population and provide negative impact on investment climate.

A serious challenge for the government is to define priority of economic tasks. The first option is to solve current problems in ad hoc mode with prompt implementation of singular reforms which may be negatively perceived by population, but are necessary for economic development and international financial aid. The second one is to launch a large-scale program of comprehensive economic reforms with consideration of the EU accession prospect.

However, government capacity to conduct deep reforms is questionable, first of all, due to a short period of its existence. Understanding the need to solve problems quickly, high expectations of society and international community as well as time constraints, government has elaborated the program “100 days, 100 steps”. It seems that the program is envisaged for the period current government will stay in power and it rather represents a memorandum of intentions.

The program elaborated by Ministry of Economics sets the tasks to carry out reforms in budget sphere, to simplify business procedures in Ukraine, to conduct deregulation, reduction and optimization of state administration structure.

In order to achieve the goals, government plans to take measures to soften fiscal pressure on entrepreneurs, to provide guarantees of automatic VAT repayment and reduce a number of taxes from 100 to 8. Number of controlling institutions and regular inspections will be reduced. Other priorities include electronic government, transparency of state procurement, anti-corruption and judicial reforms.

It is doubtful that these measures may be taken within three months, but the program sets up a foundation for further structural reforms. Taking into account social upheaval and citizens' readiness to put up with difficulties, government has an opportunity to make unpopular, but necessary reforms.

Government should either promptly implement singular reforms, or launch a large-scale reforming of economics

2.2. Macrofinancial Aid to Ukraine

Government being ready for reforms and an exclusive situation Ukraine is currently in due to confrontation with Russia open window of opportunity in terms of considerable financial aid from international organizations. Total volume of the assistance may amount to USD 40 bln.

For instance, after signing agreement with the IMF, Ukraine plans to receive USD 15 bln. within 30 months and the first tranche may be channeled in April. Market reforms are a major condition for the IMF loans.

Also, financial aid from the EU is expected in the amount of more than EUR 1.6 bln. Ukraine also expects to receive financial assistance from the EBRD in the amount of USD 5 bln. for the next 5 years.

This year World Bank is ready to provide Ukraine with USD 3 bln. of financing. These funds are added to the existing investment program which foresees financing of up to USD 3.7 bln. for a year. Out of these funds, USD 1 bln. may be used to finance budget deficit, USD 400 mln. – to finance real economics. USD 352 mln. are assigned for modernization of urban heating systems. Healthcare reform and modernization of social security will receive USD 300 mln. each.

Ukraine also expects to receive USD 1 bln. from the US government as direct financial aid to conduct reforms.

There are no doubts that the funds will be used, first of all, to solve urgent problems such as covering budget deficit and repayment of Ukraine's debt. However, it is extremely important to use financial aid to modernize economics which will lay foundation for accumulation of funds which may be used to repay the debts in future.

2.3. Banking Sector

For the last weeks in Ukraine there was speculative demand for foreign currency, caused by socio-political situation and Russian aggression. They led to significant deterioration of situation on banking and FX markets. Panic resulted in large-scale withdrawal of deposits in national and foreign currencies and negative financial results for banking system in January-February 2014. The losses made up UAH 2.6 bln. comparing to UAH 788 mln. of income received in January-February 2013.

Some banks were recognized insolvent. On March 3 "Brokbiznesbank" and "Real Bank" left the market and on March 14 National Bank declared insolvency of "Forum" and "Merkuriy". Now these banks have temporary administration assigned by Retail Deposit Guaranteeing Fund. Owners of these banks were affiliated with previous government, so the process may be perceived as a sort of lustration campaign against banking capital.

Under these circumstances the major task of National Bank is to ensure stability of banking system (through refinancing of commercial banks) and stop panic among individuals and legal entities. Measures against speculation were rather efficient, especially increase in transparency of refinancing ensured by the NBU resolution saying that the banks receive major volume of liquidity at weekly tenders on refinancing. It is expected that refinancing tenders will be held without announcing volumes and rates to reveal actual market needs.

Rather heated debate was caused by the government initiative to introduce tax on deposit interest rate and dividends, which exceed UAH 50

Reforms will open window for international financial aid

The funds should be used not only to cover deficit and repay debts, but also to modernize economics

Insolvent banks get temporary administration

thsd. Though such an approach is used in some countries with market economy, in the situation when trust to banking sector is quite low, this step may totally destroy it and cause massive withdrawal of retail deposits.

State economics directly depends on strength of banking system and its potential. The National Bank should not only create conditions for development of banking sector, but also recover trust of citizens to national currency and national banking system.

***National Bank
must recover trust
to national
currency and
banks***

3. Political Competition

Russian actions significantly change political landscape in Ukraine. Support of parties which build campaigns on pro-Russian slogans decreases while new players obtain favorable conditions to enter political arena in the wake of national unity caused by the external threat.

Consolidation of major political parties, their involvement in government and reforms are topical in the times of military intervention as success of these reforms is a major weapon against the Kremlin.

3.1. *“Kolo Doviry Maidanu” Becomes a New Political Player*

New political movements which appeared in the country during Maidan reject the role of passive observers and demonstrate their readiness to take responsibility for reforms. This week “Kolo narodnoi doviry” – an association of Maidan representatives – started transformation into a political movement as they are alert to absence of reforms and signals on corruption schemes being restored.

Civil activists stress the need to create coalition government of national trust.

They believe that corruption may be eliminated through division of political and administrative positions. Party representatives may be appointed only on political positions. Ministers and people assigned by parties for their political support are not entitled to obtain rank of civil servants and all of them should resign after the party loses the power.

Division of positions may be achieved through introduction of state secretaries – the highest rank officials in the system of civil service. They are not related to minister and are responsible for organization of the ministry operation. State secretaries and their deputies are not changed after change of political leadership and they implement decisions of the latter. They are career bureaucrats, not related to any parties and appointed by reformed Chief Administration of Civil Service according to procedures, standards, exams for obtaining ranks.

“Kolo narodnoi doviry” is ready to take responsibility for reforms in the country

Introduction of state secretaries as a way to fight corruption

3.2. *Policy of “Praviy Sektor” Requires Changes*

“Praviy Sektor” is a new player on political landscape of Ukraine; therefore, they should actively develop their political platform.

For the last week “Praviy Sektor” was mentioned in mass media due to armed assault of pro-Russian radicals at the Kharkiv office of “Patriot Ukrainy”, refusal to join National Guard and turn in arms, Dmytro Yarosh’ address on possibility to destroy elements of gas transportation system and in-absentia arrest of Yarosh in Moscow.

Character of these key messages shows that “Praviy Sektor” is associated exclusively with military and radical ideology. In order to strengthen its positions on all-Ukrainian level, this political movement must develop its vision of changes in the country and learn how to influence the government with peaceful actions.

In order to deliver its aims, mission and program to target audience effectively, “Praviy Sektor” requires a detailed plan of its positioning in informational field and access to national media. Statement on cooperation with Tonis TV channel may be perceived as the first step in this direction, but exclusive character of such cooperation is worrisome.

“Praviy Sektor” is associated exclusively with military ideology

Government tries to institutionalize activities of “Praviy Sektor” through creation of National Guard and appeals to voluntary turn in weapon. Dmytro Yarosh expressed strong criticism against both initiatives, having explained that due to Russian threat to territorial integrity, what is needed is to simplify the procedure of weapon registration by citizens.

*“Praviy Sektor”
needs to elaborate
its political
platform*

These statements show that “Praviy Sektor” will continue conducting policy different from the one imposed by former Maidan allies. This political movement should define what political platform they have and what team will deliver their position to internal and external players.

3.3. “Western Style” of Vitaliy Klitschko’s Campaign

Vitaliy Klitschko conducts Western-style election campaign. He visits different regions of Ukraine, supports Ukrainian soldiers and delivers adequate statements in media and parliament. The politician focuses his attention on the need for reforms and tougher measures to secure territorial integrity of Ukraine.

For instance, leader of UDAR was present at exercises of Ukrainian troops in Zhytomyr, visited border guards, and suggested that MPs should channel 25% of their salaries for military needs. These steps are correct, but they are not sufficiently covered in mass media.

At the ENP Convention Vitaliy Klitschko defined the EU accession, direct talks with the NATO and structural reforms as major goals of his political party. However, UDAR team should also offer a specific program of attaining these goals and make steps for its implementation. If they fail to offer their vision of the country development, appeals to reforms will be perceived as nothing but pre-election rhetoric.

*Klitschko should
develop his
political team*

In order to conduct reforms, Vitaliy Klitschko should also clearly understand what politicians in his team have qualifications to take responsibility for reforms. It will help to create a strong political team and not to be perceived as a party of one leader. Iryna Gerashchenko, Oksana Prodan, Sergiy Kunitsyn and Pavlo Ryzanenko already appear as official speakers of UDAR on certain issues. UDAR should continue its work in this direction in order to have a complete team in case they obtain power to implement reforms.

3.4. Reforms are Expected from “Batkivshchyna” and “Svoboda”

Government of “Batkivshchyna” and “Svoboda” makes efforts not to allow repetition of the Crimean scenario on continental part of Ukraine. Organizers of separatist rallies in the southern east are arrested, police departments are reinforced with policemen from other regions, heads of local police departments are substituted. Passivity of policemen in eastern regions is explained with close ties of these policemen to local elites, which see a new government as a threat to their business and influence. “Batkivshchyna” and “Svoboda” continues practice of party appointments in police and state institutions, which, no doubt, harms national interests.

*Party
appointments in
police and
prosecution office
harm national
interests*

In order to counteract separatism, “Batkivshchyna” announced its course for decentralization, but it does not explain how it will be implemented. Local communities do not need slogans, but specific steps to fulfill the European Charter of Local Self-Government. In his statements Arseniy Yatseniuk does not indicate exact commitments and deadlines for their implementation, which is negatively perceived by target audience.

*Slogans without
specific steps
breed mistrust*

Prime-Minister also underlined that Ukraine's accession to NATO was not in the agenda and signing of political part of the Association Agreement would not influence economics of industrial regions. Reassurance that everything will be good does not instill confidence and plays against "Batkivshchyna" rating. Interested parties know the steps which should be done to mitigate negative effect of signing economic part of the Association Agreement, but no one conducts consultations with them.

Government actions in Crimea were too late when control over the peninsula had been lost. Positions of Ukrainian government in confrontation with Russia largely depend on the ability to neutralize Russian threat in the southern east and to start making reforms. Society does not see specific steps of governments in this direction yet, while behavior of certain politicians aids to develop Russian scenario.

The fact that Svoboda MPs attacked Oleksandr Panteleimonov, Head of National TV Company of Ukraine, was widely used by Russian media in anti-Ukrainian propaganda. It also casts doubts on ability of these MPs to build democratic state with rule of law in Ukraine. Legal assessment of this fact will show to what extent new government is sincere in appeals for equality of citizens and independence of judicial system.

3.5. Passivity of Party of Regions in the East Cuts their Chances

Though different political parties made their contribution in Russian-Ukrainian confrontation, it is Party of Regions that is responsible for current events in the southern east. For years it was building its political program on issues of protection of Russian-speaking population in the East, federalization of Ukraine and struggle against fictitious neofascism. Ideological work was done and now Russia uses its results for intervention.

As for Crimea itself, we should bear in mind that majority in the Crimean parliament consists of Party of Regions representatives and their voting led to illegitimate referendum and annexation of Crimea by Russia. Since the very beginning Party of regions could have influenced its Crimean unit, but it decided to wait and see.

Passivity of Party of regions facilitates Russian scenario, though annexation of Crimea directly influences its status as all-Ukrainian party. It is already clear that people in Crimea will not participate in Ukrainian elections, which means Party of Regions losing 1.5 million people of its target audience. At the parliamentary elections in 2012 support of Party of Regions in Crimea was 52,2%, while their allies – communists – received 19,4%.

Regardless of an obvious loss of electoral base, Party of Regions does not help to stabilize situation in the southern east of Ukraine. Representatives of this political party control these regions as their fiefdoms, they have connections in police and other resources to counteract Russian separatism, but they deliberately distance themselves from this process. Their behavior may be interpreted as assistance to Russia in development of its scenario or as a desire to raise stakes in negotiations with national government. For instance, these negotiations may concern distribution of important administrative positions or guarantees that they will not be persecuted because of their ties with Viktor Yanukovich.

Party of Regions was always building its campaign on pro-Russian slogans. In order to be perceived as all-Ukrainian party, it needs to review its political platform. As an option, it may transform into a party of business

***Party of Regions
that is responsible
for current events
in the southern
east***

***Passivity of Party
of Regions
influences its
status as all-
Ukrainian party***

and continue its work with Russian-speaking electorate in the East and the South. Then it should switch from populist Soviet-era slogans to focus on creation of favorable conditions for industrial development and protection of interests of regional employers.

In their turn, representatives of “Svoboda” and “Batkivshchyna” should start a dialogue with democratically oriented representatives of Party of Regions and try to incorporate them in government, thus creating government of national unity. It will help to forge a single front against Russian aggressor.

*Democratically
oriented
representatives of
Party of Regions
should be
incorporated in
government*