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Studies

4 Borys Hrinchenko st., office 3, Kyiv, 01001, Ukraine | Phone (380 44) 279 88 23 | office@icps.kiev.ua | www.icps.com.ua

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INSIDE UKRAINE

| | |
|---|-----------|
| 1. The Government policy | 3 |
| 1.1. Destabilizing factor in the East | 3 |
| 1.2. The Government should not forget about the Crimea..... | 4 |
| 1.3. The practice of party quotas continues | 4 |
| 2. Economic situation | 6 |
| 2.1. Ukrainian banks leave Crimea..... | 6 |
| 2.2. From Crimea to the East | 7 |
| 2.3. Foreign trade: the EU concessions and trade war with Russia | 7 |
| 2.4. Trends of energy market | 8 |
| 3. Political competition | 10 |
| 3.1. Poroshenko remains favorite of the elections | 10 |
| 3.2. Defeating the separatism may give advantage to Tymoshenko | 10 |
| 3.3. The Party of Regions relies only on Donbas | 11 |
| 3.4. Alternatives to major political players | 12 |



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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Team of authors:

Vira Nanivska, Iaroslav Kovalchuk, Vasyl Filipchuk, Olena Zakharova, Volodymyr Prytula, Vasyl Povoroznyk , Svitlana Mizina

1. The Government policy

The Government cannot define its position on a number of important issues in foreign and domestic policy. Ignoring the situation in Donbas makes this region a convenient bridgehead for implementation of separatist scenarios. The failure to establish direct negotiations with Russia leads to a silent legitimization of the Crimea annexation. A lack of progress in combating corruption and delays in administrative reform call into question the Government's desire to make qualitative democratic changes in state administration system.

1.1. Destabilizing factor in the East

Occupation of administrative buildings by armed groups in Luhansk and Donetsk regions remains a destabilizing factor for the whole country. Sloviansk has been controlled by separatists for two weeks. The Ministry of Internal Affairs recognizes that the Ukrainian security forces do not control the situation in the city.

The Government's inability to take control of the situation in the region raises questions about its ability to resolve internal issues and to resist the external aggressor. Anti-terrorist operation has not brought the expected results yet.

The central authorities do not offer an effective action plan for crisis settlement in Donbas. If it continues ignoring the situation in the region, "freezing" of the crisis will play into the hands of the Kremlin and will be used to escalate the conflict and destabilize other regions of Ukraine. The Government's inaction attaches a Russia's millstone about its own neck, and blurs its subjectness in the domestic policy.

In the city controlled by separatists, the situation with the rights and freedoms of citizens is critical. Journalists are detained, pro-Russian activists carry out pogroms of local Roma people, and a self-proclaimed mayor of Sloviansk called to report on people who speak Ukrainian. These facts, as well as placing the city under curfew, transform the region into "twilight zone" in the literal and figurative sense.

Both Russia and the separatists ignore the Geneva agreement signed on April 17. At the same time, the Ukrainian government is taking its first steps to implement the part of obligations. In particular, the amnesty draft law was brought in. It provides the amnesty for separatists who voluntarily lay down their arms. In addition, a discussion on decentralization was launched.

In order to calm down the Donbas region, Oleksandr Turchynov even promised that candidacies for heads of regional administrations in Luhansk and Donetsk could be nominated by local residents. This decision is quite risky, because there is no mechanism for the election of governors. Moreover, it is contrary to the Government statements about the decentralization of power and the elimination of local state administrations as an institution.

There is also a possibility that the leaders of marginalized groups will come to power. For instance, before the crisis in Crimea Serhiy Aksenov controlled only three members of the peninsula's parliament, and his party had a support of around four percent. However, this fact did not prevent him from becoming a self-proclaimed Prime Minister of Crimea and playing a

Ukrainian security forces do not control the situation in Sloviansk

Transformation of the region into "twilight zone"

Statements on election of governors in Luhansk and Donetsk are quite risky

key role in Russia's annexation of the peninsula. The so-called "popular" governors, elected at rallies through the vote of only a few hundred protesters, as it was in Luhansk and Kharkiv, will be used by Russia for similar purposes.

1.2. The Government should not forget about the Crimea

Separatism in Donbas shifted attention of the Government and international community from the Crimea annexation to the events in the East. Crimea was not even mentioned during the Geneva meeting of representatives of Ukraine, Russia, EU and USA. Ignoring the problem leads to legitimization of the Crimea annexation. At the same time, Russia gets time to fully assimilate the occupied territories.

Meanwhile, there remain the pro-Ukrainian forces on the peninsula. Arrival of Mustafa Dzhemilev demonstrated that Crimean Tatars are one of the most consistent supporters of unity with Ukraine. However, they face a real threat from the pro-Russian forces. Beating several women for placing the Ukrainian flag on the building of Mejlis, firing Tatars for refusing to obtain Russian citizenship are but a few examples of how the Russian government is struggling with the dissidents.

Increased support of the Crimean Tatars by the Government will allow the pro-Ukrainian citizens in Crimea to feel more confident in protection of their political rights and freedoms undermined by Russia. Providing the Crimean Tatars with the status of indigenous people was the first positive step in that direction.

The Government cannot allow the Crimean issue to be removed from the informational agenda. Ukraine should use all possible political and diplomatic means in order to discuss the Crimea annexation at international level and to put international pressure upon Russia. At the same time, Kyiv should conduct direct negotiations with Moscow and reach a compromise, should it be demilitarization of the peninsula or the establishment of a common administration.

Pro-Ukrainian population in Crimea will feel support of the continental Ukraine if the cooperation in humanitarian, social and cultural spheres is established. In turn, the Law on economic activity on the peninsula, which is being developed by the Ministry of Economy, must take into account the interests of Ukrainian enterprises in Crimea and develop mechanisms how the latter may minimize losses when transferring capacities from the peninsula.

1.3. The practice of party quotas continues

In Ukraine, the parties struggle for the nomination of their representatives to the position of local administration heads, as these positions can significantly facilitate the conduct of election campaigns. The use of administrative resources existed throughout the period of independence and is a relic of the Soviet era. The current government does not take any steps to eradicate it.

Until recently, the heads of district state administrations in Kyiv have not been appointed and their functions have been fulfilled by deputy heads, who are usually non-partisan bureaucrats. The situation in Kyiv decreased possibilities for the use of administrative resources during the elections, so it was profitable for most political players.

The situation in the East distracts attention from the Crimea annexation

Crimean Tatars are the most pro-Ukrainian forces in Crimea

Pro-Ukrainian population in Crimea should feel the support of Kyiv

Precarious administrative balance was violated by the decree of the acting President Oleksandr Turchynov, who appointed heads of district administrations on the party quotas basis of “Batkivshchyna” and “Svoboda”. Such administrative enhancement is advantageous especially for “Batkivshchyna”, which always considered Kyiv as its electoral fiefdom.

At the same time it shows disrespect of current Government to the local residents who, in their absolute majority, supported the Maidan and fought for introduction of democratic and transparent state governance. It was supposed to bring Ukraine closer to the European standards while eliminating the burden of Soviet heritage.

Lack of heads of district state administrations in Kyiv was advantageous for most of election process participants

2. Economic situation

Annexation of Crimea by Russia did not influence the Ukrainian banking sector considerably, though it raised the issue how Ukrainian banks would function on the peninsula. However, spread of instability to the East, the region with numerous large companies and corporate borrowers, will have a more serious effect. Crisis in relations with Russia leads to decrease in stock turnover between the two countries and brings to the forefront the issue of Ukrainian energy independence.

2.1. Ukrainian banks leave Crimea

Due to uncertain situation on the peninsula, Ukrainian banks continue leaving Crimea. As the share of Crimea in Ukrainian banking sector is small, it will not exert significant influence on the banking system in general. The situation will deteriorate in case the crisis spreads to the eastern regions of Ukraine.

On April 21, Central Bank of Russia suspended business activities of a number of Ukrainian banks in Crimea and Sevastopol: Privatbank, VAB, “Kyivska Rus” and Imexbank. Respective decisions were taken due to the banks not fulfilling their obligations towards depositors.

Meanwhile, Ukrainian banks will be able to continue their activities in Crimea till January 1, 2015 without re-registration in case they fulfill their obligations towards the clients. Russian banks, which already have the license of Bank of Russia, will not need additional license to operate in Crimea. As well, Russian Central Bank elaborated the procedure how to buy out the rights of Crimean depositors towards financing organization. “Fund of depositors’ protection” will deal with the buy-out.

Reiffeizen Bank Aval, Imexbank, “Pivdenniy”, “Kyivska Rus”, “Platinum”, “Finances and Credit”, “Terra-bank”, Ukrsibbank, Unicredit, Ukrainian “Alfa-Bank”, VAB, PUMB, and OTP Bank officially stopped operation of their units in Crimea.

According to the data of the National Bank, there were 1000 bank branches, 11 divisions and two Crimean banks on the peninsula. Assets of Ukrainian banks in Crimea made up UAH 22 bln. or 1.7% of the banking system in Ukraine.

At the same time, Russian banks do not try to occupy the niche. The main reason is that they are afraid of sanctions. It concerns, first of all, the Russian banks which have representative offices in Ukraine.

Banking crisis in Crimea resulted in the tendency that many four-star and five-star hotels reject banking cards. Hotels do not accept card payments as Ukrainian banks they have been cooperating with leave the market while there is no cooperation established with Russian banks yet.

Disastrous tourist season may hit the banks which finance individuals and legal entities. Drop in revenues may lead to deterioration in servicing the loans towards the banks.

Closure of bank branches resulted in lay-offs of more than 3000 qualified banking employees.

Not all the banks are able to leave Crimea promptly and with little effort. Those banks which did not own the branches and did not finance Crimean business and population will do it fast. For the others, closure of branches on the peninsula may be delayed. Thus, many banks need to

Situation with Crimean banks has minor influence on the Ukrainian banking system

Russian banks do not try to fill the void in Crimea

improve the mechanism of their work with delinquent borrowers.

In general, Ukrainian banks in Crimea have three scenarios of further actions: complete closure, sale of branches or assets to other banks and receipt of license from Russian Central Bank till January 1, 2015 and continuation of operation on the peninsula according to the Russian legislation.

***Three scenarios
for Ukrainian
banks in Crimea***

Due to small business volume on the peninsula, losses of banks in Crimea will not deliver a serious blow to the market. Depositors of the banks which leave Crimea will be able to withdraw the funds in other regions or transfer their deposits to other banks.

2.2. From Crimea to the East

Banking crisis may spread to the East. Some banks experienced first problems in the cities where separatists block administrative buildings.

On April 15, it was announced that branches are closed and there are no money in Privatbank ATMs in Slovyansk. Senior citizens serviced in the bank could not receive their retirement benefits. Privatbank stated that due to crisis situation in the East, there may be delays with ATM encashment and in some places branches may be closed. Bank branches and ATMs in Slovyansk and Kramatorsk will not operate till the situation is stabilized in the region.

***Losses in
Donbas are a
more serious
threat for the
banks***

Bank losses in Donbas constitute a bigger threat than in case of Crimea. Except for considerable presence of large banks, the region has many large corporate borrowers, solvency of which may be questioned. Loss of these borrowers or deterioration of their standing will influence reliability of the whole banking sector.

2.3. Foreign trade: the EU concessions and trade war with Russia

On April 22, the EU published the decision to cancel custom duties Ukraine pays towards the EU. These benefits will come in force two weeks after their publication.

As PM Arseniy Yatsenyuk stated, the Government will not distribute the quotas for delivery of goods to the EU.

Ukrainian agricultural sector will benefit the most from unilateral decrease of duties. According to the estimates, due to this reduction, Ukrainian exporters will save up to EUR 500 mln., out of which EUR 400 mln. will be allotted to the agricultural sector. Taking into account that temporary unilateral reduction of duties expires on November 1, Ukraine will have enough time to sell most of the harvest of 2014.

The major problem of Ukrainian export to the EU is not the duties, but the fact that Ukrainian produce (for instance, milk or pork) does not meet the European standards. At the same time some Ukrainian producers (for instance, of poultry) are allowed to export their products to the EU. It is likely that the EU will grant them with duty-free tariff quotas.

***Trade war with
Russia gets more
intensive***

At the same time, trade war with Russia is ongoing. Ukrainian potatoes are another victim of this war.

In late March Russian Agricultural Inspection stated that they were worried about the results of laboratory tests on Ukrainian milk and meat. They warned Ukraine that there may be restrictions on import of these products to the Russian Federation.

On their part, Ukrainians buy lesser volumes of Russian goods.

Import from Russia in January-February 2014 dropped almost by quarter (22.6%). It is also felt on the consumer market. Import of Russian fish decreased by 40%. Import of cocoa and its products fell by 12%.

Among non-grocery goods textile industry faces the largest losses. Ukrainians also purchase fewer toys from Russia – the decrease makes up 40%.

Decrease of Russian import does not concern all the groups of goods. For instance, there is a certain increase in import of shoes (+22%) and cotton (+16%).

Delivery of goods from Ukraine to Russia fell almost by 30%. Among the consumer goods, the largest decrease is observed for sugar and its products – almost 80%. Besides, export of cocoa fell by 40% while export of meat dropped by 60%.

Russia actively uses administrative mechanisms to protect the market from Ukrainian products. Further development of trade war will negatively affect a number of Ukrainian producers and volume of industrial production.

Russia limits access of Ukrainian products to its market

2.4.Trends of energy market

The issues of reverse gas supplies from the EU to Ukraine and minimization of dependence on Russian gas supplies are of paramount importance.

During the two-day visit to Kyiv Joe Biden, the US Vice-President, assured that the technical assistance would be provided for energy sector in Ukraine. It will mainly envisage sharing innovative technologies which will increase energy efficiency and extraction of gas and “unconventional” gas resources from Ukrainian gas fields.

The US aid in energy sector

American expert team came to Kyiv in order to help Ukraine to arrange reverse supplies of natural gas from the EU. In the following days American experts will visit Poland, Hungary and Slovakia to develop detailed measures on this issue.

The issues of reverse supplies and use of Ukrainian underground gas storage facilities would be solved faster if Ukraine reformed gas industry according to its obligations towards the Energy Community, especially in terms of signing the Third Energy Package.

Ukraine joining the Third energy package is extremely important

The Government should pay attention to stabilization of domestic gas extraction and invest funds into the development of gas industry – from exploration to extraction. It is equally important to involve investors in the process. State companies have joint agreements, which may be used not only to stabilize gas extraction, but also to increase it. Attraction of investments in exploration, including re-exploration of existing fields, re-interpretation of geophysical data using modern software will allow Ukraine to re-evaluate extraction reservoir and find new deposits in deep horizons of 6-7 thousand meters. In the foreseeable future it will increase gas extraction in Ukraine up to 25 billion cubic meters.

Only transparent and clear legislation as well as implementation of laws according to the obligations Ukraine received as a member of the Energy Community will attract investors and reform the gas market.

It should be noted that Russia continues to defend its interests as regards delivery of energy resources to Europe. The Russian PM Dmitry Medvedev made a statement that Russia will not sell gas to Europe on the border between Ukraine and the Russian Federation since long-term contracts were signed with the EU countries.

In order to meet the IMF requirements for financing, the Government dared to increase gas prices. It adopted the final schedule for the increase of tariffs for population till 2017, which will depend on the volumes of consumption. The Government offers setting differentiated retail prices for natural gas used by population, depending on the yearly volume and types of consumption. The schedule is the following: since May 1, 2015 the prices will increase by 40%, since May 1, 2016 – by 20% and since May 1, 2017 – by 20%.

In the energy sector the state needs to create a legal system which would be effective and under which the investors would understand the requirements, prospects and guarantees for their business. Only comprehensive reforms may solve such important issues as diversification of energy resources, mitigation of dependence from one supplier and implementation of programs on energy efficiency.

***Need for reforms
in energy sector***

3. Political competition

Ability to hold democratic presidential election on May, 25, remains a key factor to stabilize the country. Political heavyweights Petro Poroshenko and Yulia Tymoshenko carry out technological campaigns, acting in the niche “peacemaker” and “warrior” respectively. New faces of the Maidan that people pinned their hopes on regarding transformation of the country, have no influence on political processes and encounter strong resistance from oldies of the Ukrainian political scene.

3.1. Poroshenko remains favorite of the elections

Petro Poroshenko’s support remains high. He actively exploits the image of a “man of peace”. That is why he almost never speaks about a confrontation with Russia or about an armed suppression of separatists. Instead, he focuses on the fight against corruption, implementation of reforms and development of the economy. The successful development of his own business increases credibility of his stance in the economic sphere.

During the election campaign Poroshenko focuses on political advertising on TV and meetings with foreign politicians. In the past TV commercials used to be the main method in Ukrainian politics to raise ratings and were used by the majority of candidates, however now only Petro Poroshenko and Oleg Tyagnybok are actively using this resource. Reduction of political advertising on TV may indicate the changes among Ukrainians in their perception of politicians after the Maidan.

Negotiations of Petro Poroshenko on the highest international level strengthen his current status of the favorite in the presidential race. His meeting with US Vice President Joe Biden in Kyiv was especially important; one of the key issues discussed at the meeting was the lack of efforts of the current government on fight of corruption. The U.S. representative stressed that Ukraine will receive USD 27 billion of coordinated aid from the IMF only if the Government starts implementation of the anti-corruption actions. Interestingly, the fight against corruption is one of the key theses of the Poroshenko’s election program and the main topic of his political advertising.

While Petro Poroshenko was advised not to confront directly with Yulia Tymoshenko, he agreed to participate in the TV-debates at the First National TV channel. However, this does not mean that his opponent will be the Batkivshchyna leader. The draw is to decide. At the same time the politician conducts no meetings in the East, while his main competitor Yulia Tymoshenko shows that she is not afraid to negotiate with separatists in the Donbas region.

3.2. Defeating the separatism may give advantage to Tymoshenko

Having realized that conventional methods of campaign are inefficient because of lack of time and a huge breakaway from the main rival, Yulia Tymoshenko has focused her efforts on the fight against separatism in the East. The politician who can stabilize the situation in Lugansk and Donetsk regions will receive significant advantage in the presidential election.

It explains Yulia Tymoshenko’s appeal to create a National Resistance Movement with the local branches of “Batkivshchyna” playing

Poroshenko actively exploits the image of a “man of peace”

International encounters strengthen Poroshenko’s status as a leader of the race

Image of “the warrior” played by Tymoshenko

the role of volunteers' headquarters. It also explains her trip to Donetsk aiming to negotiate with the separatists. Although this did not bring tangible results, such activity makes a good TV picture: a female politician, not worrying about her own safety, negotiates with armed separatists. However, such behavior can positively impact the ratings only if the voters see specific results, not just TV stories.

In order to combat separatism, "Batkivshchyna" even started negotiations with the Party of Regions on the signing of a Memorandum of National Unity. The negotiations have not yielded results as the Party of Regions demands Russian to become the second state language.

It should be noted that the cooperation of the Party of Regions and "Batkivshchyna" has real threat to the latter. The Party of Regions does not control the situation in the Donbas region, so signing a treaty with them does not lead to disarmament of separatists. Changes in the Constitution about the status of the Russian language can not only destroy the existing government coalition, as it will cause the resistance of "Svoboda", but it will also negatively affect the perception of Yulia Tymoshenko in the Western parts of Ukraine that is her core region.

Besides, the Batkivshchyna leader is also criticized for the wish to create a broad coalition with the Party of Regions before the 2010 presidential election. The creation of a similar association in the current situation will allow the Government to depend less on the parliamentary groups and to facilitate voting on necessary bills. However, the price for facilitation of the work of Verkhovna Rada may cause further fall of the relatively low Batkivshchyna ratings.

3.3. The Party of Regions relies only on Donbas

Previously the Party of Regions supported the separatists in their idea of federalization, now the political party changed its position. They favor a unitary state with broad authority in the regions.

The idea of decentralization is proclaimed by almost all major political actors, including the Government, and therefore the debate on the regions' rights can be the basis for a political dialogue.

The Party of Regions calls for a referendum on the status of the Russian language to be held on May, 25. Initially, they insisted on a referendum to be held only in the East. Then they agreed to hold it nationwide, provided that Russian becomes the second state language if at least a third of the electorate votes in favor. Such requirements are unacceptable for Batkivshchyna and Svoboda.

Meanwhile, the Party of Regions loses control in the South-East. The results of a survey carried out by the Kyiv International Institute of Sociology (KIIS), ordered by the newspaper "Dzerkalo Tyzhnya", indicates that the political views of the South, for example, Kherson and Mykolaiv regions, are more similar to the views of the Center, not the East. The pro-Russian rhetoric used by the Party of Regions, will not work in these areas. The only regions where it is still in demand are Luhansk and Donetsk regions. However, the indulgence to separatism in Donbass by some Party of Regions members has led to the fact that the mentioned political party began to lose influence in its core region.

The rating of the Party of Regions candidates is also symptomatic in their core regions. In particular, Mykhailo Dobkin, whose candidacy was officially supported by the party, gains only 16.7% of votes in Kharkiv

***Negotiations
with the Party of
Regions have not
brought results***

***The Party of
Regions refuses
from
federalization***

***Difference in
political views
between the
South and the
East***

region, while the pro-Western Poroshenko is supported by 23.6% of voters. The situation is also similar in Dnipropetrovsk region, where Serhiy Tyhyhko comes from: around 10.2% voters are ready to support him, while Poroshenko may count on 27.5%.

In the East, there is a huge stratum of society who feels betrayed by the Party of Regions. However, they do not trust politicians who are supported by the West. The resulting vacuum leads to the fact that many voters in the Donbas region will ignore the elections. It is more important than ever that the new politicians who are opinion leaders in the Russian-speaking East and present the interests of the region, but not just the oligarchs, come to power. However, this process will take time and requires the development of civil society institutions in the East.

***Political vacuum
in the East
requires new
leaders***

3.4. Alternatives to major political players

The division into “peacekeepers” and “warriors” took place not only between the heavyweights Tymoshenko and Poroshenko, but also among the new faces of the Maidan, although on a smaller scale.

Olha Bohomolets represents moderate views of society and their desire for dialogue, while Dmytro Yarosh actively exploits his military image. Both approaches gain support in the society, but novices in politics have few resources and experience to bring their point of view to potential voters.

***Dmytro Yarosh
and Olga
Bohomolets – a
warrior and a
peacemaker***

Dmytro Yarosh does not conduct a conventional campaign, as he believes that in the light of a military threat from Russia there is no place for political games. Aiming to be closer to the epicenter of events in Donbas, Yarosh moved his headquarters to Dnipropetrovsk region, and is engaged in mobilization and training of his activists. He coordinates all his actions with the National Security and Defense Council, the Ministry of Internal Affairs and the Security Service of Ukraine.

While Dmytro Yarosh is omnipresent in the information field as both Russia and the separatists are actively using the “Right Sector” as a scary to the public, Olha Bohomolets has almost no access to the information resources. She makes the “right” moves (e.g., appeals for lustration of political parties, publishes the cost of her campaign etc.), but the voters do not have an opportunity to find it out.

Yuriy Lutsenko is also actively involved in the political process. He does not participate in the presidential election, but he tries to influence the campaign by setting “red flags” for candidates. He demands that all major political players should tell their attitude to reforms. The question of federalism and the status of Russian language should not be a “smokescreen” that covers the demands for immediate reforms in the administrative and judicial spheres, in law enforcement and local government. Assigned as an advisor to the acting President, Lutsenko makes a push at resolving the situation in the Donbas region. On his view, the Union of Donbass cities may be more legitimate than any “Donetsk republics”. Lutsenko also offered himself to mediate between Kyiv and Donetsk. One of his suggestions is to clear all administrative buildings taken by protesters in both regions at the same time – on May 25.

***Yuriy Lutsenko
sets “red flags”
for presidential
candidates
demanding
reforms***

Constructive attitude will allow Yuriy Lutsenko to develop his political project “Third Ukrainian Republic” to the level of a party and actively participate in the next parliamentary campaign.

***Positive attitude
facilitates
development of
political projects***