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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. The Government Policy

The post-Maidan Government has been working for more than three months, but no reforms have been implemented. After months of struggle against the regime of Viktor Yanukovich and against the background of the Russian aggression, there is a huge demand for changes in the Ukrainian society. The citizens are ready for unpopular reforms aimed at changing the system of governance. Reforms are carried out either immediately or never. The new President will have only a few weeks to give a boost to their implementation. Otherwise, a unique chance to get rid of the Soviet legacy in public administration and the ubiquitous corruption in Ukraine will be lost.

So far, no reform in Ukraine was accompanied by a public document on national policy, which would contain an assessment of all risks, identification of support groups and social groups that might suffer from these changes. These documents can be prepared only after consultations with stakeholders, which is never done in Ukraine. The new President has a chance to introduce a new process of public policy development in various fields.

1.1. Administrative reform as the basis for changes in the country

Although in his inaugural address Petro Poroshenko devoted much attention to the improvement of combat capability of the Ukrainian army, the creation of a democratic civil service is another important task for the new President. A professional bureaucratic apparatus should be created in the state. Moreover, it should not be linked to political parties, as well as be able to effectively transform political decisions into specific administrative procedures. It will be possible to implement reforms in all other fields only after changing the Soviet system of public administration and instituting a democratic governance.

A democratic public service provides for abolition of party quotas in the appointment of state officials. After the revolutionary events of February 2014 the use of party quotas did not reduce, yet it even increased. It is expected that in his appointments the new President will draw not upon the party affiliation or personal convenience, but on the knowledge and experience of these officials.

There should be a clear separation of political and administrative posts in the state. A “political bloc” should be created within the Ministries’ structure including the Minister, one or several of his political deputies and the executive support service. A “professional public service bloc” should be headed by the state secretary. The post’s protection from party interference is to be enshrined in law.

It will allow creating permanent uncorrupted state apparatus that will ensure consistency and continuity of the government activities regardless of which party is in power. Such a step will also protect civil servants and help to stop their vertical change with each elections.

In order to implement reforms, the President will require a network of local representatives who will be responsible for constitutional compliance and implementation of national policy in the regions. These officials cannot be elected by local councils as one of their functions is to control the activities of the local governments.

Despite the importance of the separation of functions between

Creation of democratic governance system will become a basis for transformations in the country

Each ministry should have political and bureaucratic blocs

government representatives and the executive committees of local councils, Vitalii Klitschko urges the President to unite the posts of the head of Kyiv City State Administration and the Kyiv mayor. Such a merger is unnatural and unconstructive, as it will lead to power usurpation and reduction of the local government effectiveness.

Merger of two major municipal positions in Kyiv is unnatural

1.2. The President promised to initiate a dialogue with the East

Radical reforms implementation requires the consolidation of the whole society. Achieving mutual understanding between the East and the West on the strategy of state development is also a key to the stabilization in Donbas. While initiating a national dialogue, one should not be afraid to rely on the international experience. Using the right methodology will make the dialogue results legitimate.

At the inauguration, Poroshenko promised to set up a dialogue process with peaceful citizens of the East. In order to get socially legitimate representatives of the region's interests, snap elections to local authorities will be held in Donetsk and Luhansk regions.

Snap elections in Donbas as a way to get legitimate interlocutors

The main challenge is the question how to hold democratic elections in areas controlled by gunmen. The ability of the separatists to disrupt the electoral process has been proved by the last presidential election.

It should be noted that the Ukrainian government attempted to initiate a national dialogue before the presidential elections. As a result, there have been three roundtables held in Kyiv, Kharkiv and Mykolaiv. The government had an extremely formal approach to the selection of dialogue participants, inviting mostly officials and politicians to the discussion. Only a roundtable held in Mykolaiv had quite an impressive representation of local community activists. However, there was no balance as to the number of participants from different regions and no clear formulation of the agenda. Thus, conducting these roundtables did not bring any results, and after the election, the government forgot about them.

The organization of a national dialogue has its methodology: identifying issues to be discussed, selecting participants from different regions supported by the local population, preparing the program document according to the discussion results. Only if this methodology is sustainably applied, the roundtables will be recognized by the society and become a useful tool to find common ground between different regions. These points of contact will form the basis for achieving national reconciliation.

The dialogue requires certain methodology

1.3. Internal migration – a new challenge for the Government

For the first time in the history, Ukraine has faced the problem of internal migration. Tens of thousands of people are leaving their homes trying to escape from the occupation authorities (in Crimea) or from military actions and militants terror (in Donbas).

This tendency creates both risks and opportunities for the government. It will be a real ordeal for the Ukrainian authorities. The success of the government in passing this test depends on the Ukrainian authorities' ability to meet the needs of migrants and integrate them into public life in a new place.

Since the problem is complex, the government needs a coherent public policy on internal migration. Experience of other post-Soviet countries shows that providing migrants with temporary housing with poor

Ukrainian government will take the refugee test

conditions leads to social tensions increase and aggravates the problem. In order to avoid mistakes of the neighbors, the government can either start creating the infrastructure for permanent residence and employment opportunities for refugees, or focus on the rapid settlement of the situation in the East and returning people to their homes.

According to the UN High Commissioner for Refugees Mr. Oldrich Andrysek, as of June 8, 10 000 residents of Donbas became refugees. One third of them has moved to Kyiv. The separatists argue that 40% of local residents in Sloviansk left the city (population - 117 thousand). The head of the NGO "Union of IDPs" Mr. Mykola Podolyaka declares about 70 thousand of migrants from Donbas and the possible increase of the number to 100 000 by the end of June.

It is an indisputable fact that the vast majority of them are internal refugees who are resettling not abroad, but in other regions of Ukraine. Although the Russian media are speculating on humanitarian disaster in Donbas and mass migration of refugees, few Ukrainians seek asylum in Russia. According to the Federal Migration Service of the Russian Federation, from May 30 to June 6, only 151 Ukrainian citizens appealed to the Service with a request for a temporary residence permit or citizenship. Pro-Ukrainian sentiments of the Donetsk in-migrants are another proof that the region does not support the idea of joining the Russian Federation and consider the separatists as an alien phenomenon.

People who have relatives in other regions of Ukraine, representatives of the middle class who have enough funds to support their families in a new place financially, were among the first to resettle from the area of hostilities. Public activists and NGOs help to solve the problem of housing and food for those citizens, whose financial situation is more difficult.

An economic migration also becomes more intensive. Many companies are relocating their activities into other regions, particularly into the Dnipropetrovsk oblast, as conducting business in Donbas is impossible and dangerous to life.

Increased internal migration has a chance to run out of control if the government does not develop a mechanism how to work with migrants. On June 10, 2014, the Cabinet of Ministers set up a special coordination center on the basis of the State Emergency Service aimed at supporting people who leave the ATO zone. It will include the representatives of the migration service and MIA units, Ministry of Health, Ministry of Social Policy, Ministry of Education, Ministry of Regional Development, and Ministry of Transport. It should be noted that civil society is responding to the needs of resettles faster and more flexibly than the Ukrainian government.

At the same time, the migration of Donbas residents and their political demands to get the official status of migrants and financial aid from the state could become an additional irritant for the people from other Ukraine's regions. In the long term, such a trend can become a factor of discord, not the unity of East and West.

The middle class representatives, who were forced to leave their homes in Donbas and who are mostly committed to the territorial integrity of Ukraine, can become a liaison element in establishing a dialogue with Donbas announced by the new President.

Most refugees from ATO zone move to other regions of Ukraine, but not to Russia

Economic migration from the East becomes more intensive

Refugees may become a liaison element in the dialogue with the East

2. Economic Situation

Ukraine still lacks systemic economic reforms. Singular measures are taken in different spheres, yet their cumulative effect is not thoroughly evaluated. For instance, moratorium to foreclose mortgage property under FX loans was introduced in the banking sector. Lay people may perceive it positively, but in general it will negatively influence banking system. State Fiscal Service is created through merger of tax agency, customs office and financial police. However, the government does not explain why a new body should be created and what consequences would be if the decision were not taken. In the energy sector negotiations between Russia and Ukraine about the gas prices are ongoing. Their outcome will influence the Ukrainian government stance toward reforms in the sector.

2.1. Moratorium on alienation of mortgage property

Last week the Law of Ukraine “On moratorium to collect Ukrainian citizens’ property pledged under FX loans” was signed. The Law forbids forced collection of real estate which is pledged by Ukrainian citizens (borrower or property guarantor) under consumer FX loans.

For the Law to be applied, the real estate should be the place where the borrower lives or the object under construction. Besides, borrower or guarantor cannot possess any other real estate. Maximum area for the real estate is the following: for an apartment – not more than 130 sq. m., for a residential house – not more than 250 sq. m.

An important detail is that the Law does not cover territory of Ukraine which is temporarily occupied. It neither applies to the individuals who are subjects of the Law on prevention of corruption.

According to the NBU data, overall exposure under FX mortgages makes up UAH 46 bln. Average loan volume is USD 45.5 thsd.

The Law is rather contradictory. On one hand, it is aimed against dishonest actions of some banks which work in collusion with collection companies. These banks try to foreclose apartments of customers who cannot repay the mortgage at the moment, but are eager to restructure the exposure and repay it in the future.

On the other hand, the Law is a populist measure, which will deliver a significant blow to mortgage financing of individuals.

The moratorium was introduced on collection of mortgage under FX loans

The Law is aimed against dishonest banks, but it will hit the whole sector

2.2. Budget income from Donbas is lower than expected

According to Arseniy Yarseniuk, in June 2014 state budget will receive less income from Donetsk and Lugansk regions than it was expected. The shortage may make up UAH 1 bln. It is related to problems with delivery of materials to enterprises, shutdown of transit and intimidation of workers by gunmen.

In May the budget shortage of proceedings from Lugansk and Donetsk regions made up UAH 422 mln. It is highly unlikely that the situation in the East will stabilize within one or two months. Due to the fact that the companies will not return to regular business activities in short term, state budget will continue receiving less money from these regions.

Under such circumstances the government will have to review the budget in autumn and to do another budget cut. Escalation of the conflict in Lugansk and Donetsk regions and terrorists getting control over new

Separatism reduces budget proceedings from the East

territories may block the work of large industrial companies. In its turn it will negatively influence GDP dynamics and deteriorate its drop.

2.3. The Government has created State Fiscal Service

In Ukraine State Fiscal Service was created, which will combine tax service, customs office and financial police. The government appointed Ihor Bilous, deputy minister of revenue and duties, as a head of a new agency.

A new service of financial investigations will combine the functions of tax police, control and auditing administration, police department for combating organized crime, and police department for combating economic crimes. Creation of the new body will be accompanied with staff reduction and increase of salary for employees. The latter will undergo a thorough selection. The major requirements will be university degree in economics or law studies and sufficient work experience in analytic centers.

Reorganization of Ministry of Revenue and Duties will have positive impact. In particular, it is expected that the system of planned indicators will be abolished. It was used by tax officers to fulfill the tax plan of the budget. It is extremely important that the changes in tax and customs services have systemic, not formal nature. It will help to improve the quality level of human resources, introduce new functions for employees of the reorganized body and to combat high level of corruption in tax and customs services.

State Fiscal Service will combine the functions of many state agencies

2.4. Energy sector

Ukraine and Russia still cannot strike a deal on terms for natural gas supply. Russia offered Ukraine 100-dollar discount for gas, while Kyiv demands changes in the contract. Moscow offers a mechanism of price discount through cancelation of export duty. Kyiv opposes the idea as the discount may be introduced and cancelled through a decision of Russian government.

“Naftogaz Ukrainy” does not intend to repay the exposure until proposed package deal is approved. Ukraine insists that the gas price should be USD 268 per 1000 cubic m, while Russia offers the price of USD 384.86 if the discount is included. The price is a key issue in negotiations; in case it is not settled, Ukraine will sue Russia in Stockholm arbitration court.

At the same time the government displays the intention to reform the gas sector. Creation of new companies, which are operators of gas pipelines and underground gas storage facilities, announced by the government, will enable attraction of European partners to the management of the facilities. Such a step will help to ensure financial stability of the sector and to attract investments to modernize and develop gas transportation system. In its turn, it will secure and broaden distribution market for Ukrainian gas transportation system and underground gas storage facilities. The project of “Naftogaz” reform does not foresee reassignment of property rights on pipelines and storage facilities.

As well, Ministry of energy and coal industry plans to synchronize energy systems of Ukraine and the EU by 4Q 2016. Privatization of state shares in energy companies should be accompanied with the reform of electricity market.

Prospects of “South Stream”, whose major aim is to bypass Ukraine, will largely depend on the results of the European Council session scheduled for June 26-27, 2014.

Russia and Ukraine will meet in Stockholm if the compromise on gas price is not reached

Construction of “South Stream” through the European territory does not meet the requirements of European energy legislation. Last week Plamen Oresharski, PM of Bulgaria, claimed that his country put the project on hold until the discrepancies would be eliminated. As a result, Serbia also had to postpone the launch of “South Stream” project.

Under current circumstances “South Stream” undermines energy security of Europe as it is not a new source to diversify the energy supplies, but a new route, which again totally depends on Russia.

***“South Stream”
undermines
energy security
of Europe***

3. Political Competition

Over the next few months the political competition in Ukraine will be determined by preparations for early parliamentary elections. Both Petro Poroshenko and Yulia Tymoshenko repeatedly stated about their necessity. The question is at what time the elections will be scheduled and what mechanism will be chosen to dissolve the parliament. The new President might not drag out this issue, as currently he has a high rating, which may be shared with his own political project. The “Batkivshchyna” party as well as new parties that have a chance to pass to the parliament will try to build the campaign based on criticism of the President and his steps. The longer the President will stay in office until the election, the more likely the opposition will have grounds for criticism.

3.1. Early parliamentary elections are subject to negotiation

According to the Constitution of 2004, there are three reasons for the dissolution of the Parliament by the President: 1) the plenary session doesn't start within 30 days, 2) the coalition isn't formed within one month, and 3) the members of the Cabinet are not appointed within 60 days.

Before the presidential elections the most plausible scenario was the withdrawal of UDAR deputies (40 members) and Poroshenko's group in “Batkivshchyna” (15-20 members) from the coalition that consists of 257 MPs. Now the implementation of such scenario has some risks. New parliamentary groups which continue to crystalize on the ruins the Party of Regions can take the vacant place in the coalition. The MPs who got to the parliament under FTPT-system are also against new elections. Since their re-election chances are small, they may be interested in joining the coalition.

Thus, UDAR refuses to be the only force behind the coalition destruction and insists that the decision be taken after consultations with “Batkivshchyna”. The subject of potential horse trading may be the formulation of a new election law. Currently Petro Poroshenko and Vitaliy Klitschko insist on a proportional system with open lists, while “Batkivshchyna” insists on a proportional system with closed lists.

The amendment to the electoral law requires parliamentary majority. So, other coalition parties, as well as the Party of Regions will try to defend their interests in the electoral reform, or at least to get some preferences from the new President.

3.2. “Batkivshchyna” could become a constructive opposition

The results of the presidential election showed that Yulia Tymoshenko needs to reorganize her political party. Certain organizational conclusions have been made, which resulted in the administration shifts, e.g. Ivan Kyrylenko has replaced Serhiy Pashynskiy as the first deputy of the party headquarters. Changes in regional branches of “Batkivshchyna” are also foreseen, especially in the regions where the support of Yulia Tymoshenko diminished very sharply.

Potential switch of “Batkivshchyna” into opposition to the current President may have numerous positive effects. The parties' political experience will make it a watchdog over the presidential activities and ensure their quality control. In addition, the recently adopted law on parliamentary opposition provides “Batkivshchyna” with considerable

Other political players may take the place of UDAR in the coalition

“Batkivshchyna” requires reorganization

powers, including the presidency in key parliamentary committees. Thus, the party can get effective tools to influence public policy in various fields.

However, “Svoboda” party will also try to seize the niche of a “constructive opposition”. Facing the failed result of Oleh Tiahnybok at the presidential election, “Svoboda” realized that it is better to act as an opposition party facing the forthcoming parliamentary elections. Resignation of Iryna Sekh, the Head of Lviv Regional State Administration, and potential resignation of other governmental officials representing the party illustrate this trend. Thus, the parties “Svoboda” and “Batkivshchyna” can start to fight about who is better opposition to the current President.

Yulia Tymoshenko also learned from the presidential results of Oleh Lyashko and Anatoliy Hrytsenko. The radical rhetoric of these politicians is on demand by Ukrainian voters and contrasts with the diplomatic approach of Petro Poroshenko. The leader of the “Batkivshchyna” may try to play on this contrast, proposing radical ideas such as Ukraine's future membership in NATO. This can return her a part of adherents who voted for Hrytsenko and Lyashko and also allow positioning herself as a more pro-Western politician, in comparison with Poroshenko.

“Svoboda” and “Batkivshchyna” may compete for the opposition status

3.3. Experienced politicians are exploiting the idea of “new faces”

Realizing that the society has a request for a new political force, some “experienced” politicians will try to enter the parliament by creation of own political projects that claim to be “new faces”. One of those politicians is Serhiy Liovochkin, former head of the presidential administration, who is creating a new political project “The Party of Development of Ukraine”. His assistants to launch the new party will be Serhiy Larin, deputy head of the presidential administration at the time of Viktor Yanukovich, and Yuriy Miroshnichenko, the representative of Yanukovich in the Parliament.

This political party can claim on a part of the Party of Regions electorate, which is now in a vacuum of uncertainty. The election results showed that Serhiy Tyhytko was able to gain over only a small part of the Party of Regions voters, while others simply did not come to the poll stations.

For the success of the new project Serhiy Liovochkin has a team of technologists, experience in ideological work and relationships with regional party activists. Financial support of the party may be ensured by his own money or through connections with influential businessmen. A big advantage for the party will be the ability to influence the information policy of one of the major TV channels in Ukraine – “Inter”.

On the other hand, Serhiy Liovochkin has a stable image of a “gray cardinal” from the times of Viktor Yanukovich. However, the fact that he always was a non-public politician and managed to avoid image loss during the “Revolution of Dignity”, will help him to create a political project, the main focus of which is new personalities coming to power.

In fact, this political party is not a new face in Ukrainian politics, but a rebranding attempt of one of the groups in the Party of Regions. It also displays Serhiy Liovochkin’s desire to start an open independent game on the Ukrainian political chessboard.

Serhiy Liovochkin creates his own political project

A new party is a rebranding attempt