



# ICPS

International  
Centre for  
Policy  
Studies

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

**19 June 2014**

**№16**

## INSIDE UKRAINE

<b>1. The Government Policy .....</b>	<b>3</b>
<b>1.1. The President’s ratings may fall due to the “policy of waiting”.....</b>	<b>3</b>
<b>1.2. Separation of political and administrative positions will give rise to public service reform .....</b>	<b>4</b>
<b>2. Economic Situation .....</b>	<b>5</b>
<b>2.1. NBU continues to clear out the banking sector .....</b>	<b>5</b>
<b>2.2. Ukraine expects the Third gas war with Russia .....</b>	<b>6</b>
<b>3. Political Competition .....</b>	<b>7</b>
<b>3.1. Political parties are getting prepared for pre-election campaign .....</b>	<b>7</b>
<b>3.2. Obscure political manoeuvres are still taking place in Kyiv City Council.....</b>	<b>8</b>



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.

@2014 International Centre for Policy Studies (ICPS)  
If citing please give reference on the ICPS

Team of authors:

Vira Nanivska, Iaroslav Kovalchuk, Vasyl Filipchuk, Olena Zakharova, Volodymyr Prytula, Vasyl Povoroznyk, Svitlana Mizina, Anatoliy Oktysiuk, Oleksiy Obolenskiy, Svitlana Sudak

This issue is made possible by financial support of International Renaissance Foundation. Views expressed in the issue do not necessarily reflect those of International Renaissance Foundation

## 1. The Government Policy

Since a complete career civil service system has not yet been established in Ukraine, administrative and political functions in public administration remain unseparated. For instance, Canada has separated administration and politics in public service system back in 1890.

Each election cycle in Ukraine restarts the entire system of public service, as political winners with the illusion of “plenary authority” grant administrative posts to those persons, who financially supported them. Such state officers will not support the state interests and will follow the party guidelines. Under such circumstances, there is a real risk that the rule of power will take precedence over the rule of law.

### 1.1. *The President’s ratings may fall due to the “policy of waiting”*

Petro Poroshenko is the guarantor of constitutional rights, the Supreme Commander of the army and the manager of the state foreign policy. Today’s most important tasks for the President are to reestablish relations with Russia and to put an end to the conflict.

The Russian-Ukrainian crisis is the most critical situation for the entire period of our state independence. Confrontation with pro-Russian terrorists in the East has transformed into a diplomatic, trade and gas war.

Starting from June 16, “Rosselkhoznadzor” banned Ukrainian potato imports referring to a detected quarantine infection. It should be noted that the Ukrainian exports of potato in Russia is 36,5%.

The issue of gas supplies from Russia to Ukraine remains unresolved. The government of the Russian Federation has taken an uncompromising stance demanding Ukraine to pay the debt for consumed gas and aiming to impose gas prepayment regime.

On June 17, the international gas pipeline “Urengoy-Uzhgorod” has been undermined. Surprisingly, Russian journalists were at the scene of explosion filming the event. According to prosecutors, this sabotage was organized by pro-Russian diversionists. Constant diversions on the part of the separatists require government’s decisions to be directed towards the strategic objects security.

There are also hitches in water, gas and energy supplies in the area of ATO. Lack of normal living conditions increases the number of refugees from the East of Ukraine. The influx of people into stable regions creates social tensions that could result in a conflict between in-migrants and the hosting communities. There are some incidents of confrontation between resettlers and local people in western regions of Ukraine. The point is that the hosts are required to speak in Russian language.

On June 15, the acting mayor of Drohobych (Lviv oblast) Mr. Roman Kurchyk reported that men of Luhansk and Donetsk regions should start fighting against terrorists and stop seeking an asylum. Thus, the Drohobych City Council made a decision of principle, according to which it provides an assistance only to women and children.

Political ratings of the President will depend upon his ability to solve urgent state problems. Mr. Poroshenko adhered to neutrality and avoided active actions during the election campaign. But now a rapid reverse process may happen. The policy of “waiting” under conditions of war will lead to a dramatic loss of trust to the President and may result in a new wave of parliamentary confrontation. There are many positive points in military government’s initiatives. But these decisions were made with a time delay.

The Supreme Commander of the armed forces of Ukraine announced the start of an operation on restoring the state border and the implementation of a plan on conflict de-escalation in Donbas. The problem of state borders opening have

*Relationship between Ukraine and Russia is the most complicated crisis for the entire period of independence*

*Russia began trade and gas war against Ukraine*

*The increase of the refugees influx from the East raises the level of social tensions*

*The President announced the demarcation of the state border*

*Nobody thinks about ratings under conditions of war*

been raised by the ICPS experts since the beginning of the Crimean events in March 2014. If this primary problem is resolved, opportunities for infiltration of foreign agents and terrorists into the territory of Ukraine will be significantly decreased.

The state has finally begun to conduct full information and awareness campaign among citizens. In addition, politicians' statements and comments have become more meaningful and accented.

The most important thing for Poroshenko is to be not afraid to lose ratings due to unpopular decisions or appointments. Now it is important to adopt a strategic initiative in making state decisions, promoting and coordinating reforms. It is impossible to establish the rule of law, protect the rights of citizens and to combat corruption without implementing reforms.

## ***1.2. Separation of political and administrative positions will give rise to civil service reform***

The Council of Europe obliges the Ukrainian authorities to take decisive action in order to ensure the apolitical system of governance and the effectiveness of public administration system.

Appointment of officials at all levels of state governance on the basis of party quotas is one of the factors that led to the loss of Ukraine's territories, the state apparatus weakness and sabotage of the security forces.

The current system of partisanship harms administrative activity, causes the turnover rate of personnel, does not protect civil servants legislatively, thus, prevents smooth operation of the whole state apparatus.

A strict separation of political and administrative positions, their responsibilities and procedures for the appointment is one of the priorities of the government in order to bring the civil service system in line with European standards of good governance. The position classification system, described in the current Law of Ukraine "On civil service", does not provide for the separation of political and administrative positions. The Law of Ukraine "On the Cabinet of Ministers of Ukraine" defines the position of a minister as a political post and does not provide for higher administrative positions with all the authority for public service in ministries.

The way out of this situation may be reestablishment of the institution of state secretaries. In public administration system, this institution functioned just for two years. In 2003, the posts of state secretaries and their administrative deputies were eliminated by Leonid Kuchma's decree. Instead, the posts of first deputies and deputy ministers were introduced to the system. Such appointments were considered as political ones.

Politically independent state secretaries were disadvantageous and inconvenient for the country that functioned and continues to function according to the principle of "political corruption". As a reward, representatives of the ruling political parties obtained administrative posts in addition to their political duties. The fact of the institution of independent state secretaries impeded shadow schemes implementation, and therefore it has been eliminated.

The current law of Ukraine "On public service" does not envisage appointments to senior public service positions (deputy ministers and heads of ministries' departments) on the basis of competition. Now, such appointments are based not on the competitiveness among career officials, but on the political and party motives.

Thus, administrative reform should be an instrument for changing existing institutions, standards and procedures. Development, implementation and control of government decisions depend on an effective, legislatively protected state apparatus of civil servants. Such a structure will work cohesively without focusing on party and business elites.

***Positions in bodies of state authority are obtained not by the career officials, but by the party functionaries***

***The current legislation of Ukraine does not provide for a separation of political and administrative positions***

***The state secretaries should be legislatively protected from parties' interference***

## 2. Economic Situation

Since the end of February, nine Ukrainian commercial banks have an interim administration, and some of them will be closed. However, the number of such banks can increase. There are potential risk group banks that are associated with money laundering, poor management, carrying out a risky policy, and banks with a portfolio including loans from unscrupulous borrowers.

An important task for the government is to compensate customers' deposits of insolvent banks.

### 2.1. NBU continues to clear out the banking sector

Provisional administration was introduced in banks that belonged to the so-called Yanukovich's "Family" and in small banks that have failed to get adequate support from their owners: "Brokbusinessbank", "Real Bank", "Forum", "Mercuriy", "Zakhidinkombank", "Avtokrazbank", "Pivdencombank", "Promeconombank", and "Interbank".

The last bank, where a provisional administration was introduced, is the bank "Forum". The volume of deposits in this bank to be subject to compensation is about 3 billion UAH. The regulator could not find new investors for the listed banks. The NBU decided that "Real Bank" and "Forum" will be closed. Due to the current problems of liquidity, there is a probability of an interim administration introduction in "Delta Bank" as well.

The situation will become more clear after the stress-test provided by the National Bank to identify risky banks. At this stage, about a dozen of banks are in the risk zone, including several big ones. Some of them have already limited the cash withdrawals from bank accounts and payment of deposits. If the owners of these banks will be unable to provide capitalization and recovery, a provisional administration will be introduced in these banks. Huge attention of the NBU is focused on the banks suspected of money laundering, in particular related to financial fraud of the so-called "family circle" of the former Ukrainian president, and those involved in speculations on the currency market, which led to a deep currency collapse.

Depositors Insurance Fund (DIF) guarantees private deposits in an amount up to 200.000 UAH. However, there is a risk that the existing resources of DIF (6.8 bln. UAH) won't be enough to compensate guaranteed deposits of individuals in the abovementioned banks (about 10 billion UAH). Besides, this fund has not yet made all payments to customers of the three banks, where the interim administration was introduced earlier – the banks "Erde", "Daniel" and "Tavryka". If the new banks are rated as insolvent and an interim administration is introduced, the burden on DIF will significantly increase as the total liabilities of individuals in these banks are estimated at tens of billions USD.

In case of the lack of funds, the DIF may receive funding as a loan from the Cabinet of Ministers or from the state on an irrevocable basis. Besides, there is also an option to receive grants and loans from international financial institutions. It is expected that DIF may receive about 10 billion UAH through loans and grants by the end of the year. Despite the growth of social tension due to the risk of non-reimbursement of guaranteed payments to banks' depositors, the withdrawal of unhealthy financial institutions from domestic banking sector is a positive development that will improve the banking sector.

### 2.2. Ukraine expects the Third gas war with Russia

The Government of Ukraine established the energy crisis headquarters that were entrusted with the task to balance energy resources, energy efficiency, energy

*There are provisional administration introduced in the "Yanukovich's family" banks*

*Depositors Insurance Fund does not have the resources to compensate deposits in risky banks*

consumption and expenditure of natural gas.

The recent Russian-Ukrainian negotiations on the gas issue had no positive result. The main controversy between the parties applied to the regulatory consolidation of \$ 100 discount for Ukraine. The Russian side is convinced to fix this discount as a decision of the Russian government, while Ukraine called to prescribe the rate in the gas contract. Fixing this discount in the contract won't allow the Russian gas monopolist to manipulate the price of energy resources in the future.

Russia demands Ukraine to primarily pay out the debt of 1.951 billion USD, and afterwards to pay for gas on a prepayment basis. The Russian government is trying to accuse Ukraine of an artificial crisis exaggeration. Ukraine agreed to the proposal prepared in cooperation with the European Commission, but Russia declined all compromise possibilities, thus rejecting a possibility of peaceful settlement. That is why Ukraine was cut from Russian gas supply, and filed a suit in the Stockholm arbitration court. "Naftogaz" requires fixing of a fair market price for gas supplied by "Gazprom" to Ukraine.

The lawsuit also includes the requirement to recover the overpayment from "Gazprom" (the estimated sum is around 6 billion USD) for gas that was supplied by the Russian monopolist to "Naftogaz" in 2010. "Gazprom" pledged to transit at least 110 billion cubic meters of gas p.a through the Ukrainian GTS.

It is important that Ukraine has moved the gas issue to the legal framework. In this situation, an accelerated prosecution and positive suit results can be expected. In this case, Russian military aggression plays into the hands of Ukraine.

It is planned to conduct negotiations with European companies on reverse gas supply at prices lower than the Russian ones. "Naftogaz" is trying to decide on the opening of the "big reverse" in Slovakia direction. Therefore, it should be noted that if the volume of reverse supply is increased, Ukraine will be able to prepare for the next heating season.

The European Commission firstly proposed European companies to consider the possibility of buying gas and pumping it into Ukrainian underground natural gas storages. This brings up the question of gas purchases by European companies at the eastern border of Ukraine, and the preservation of gas in Ukrainian underground storages.

The National Commission for State Energy Regulation (NERC) might establish reasonable rates for the transit of Russian gas through Ukraine. Thus, the country will not subsidize Russian "Gazprom"; Ukrainians will not provide from their pockets 5 billion USD per year. The cut of Russian gas supplies to Ukraine won't affect the average consumers, as the country has domestic gas output and available gas reserves in storages.

Czech Republic, Poland, Slovakia, Romania and Germany stated that the transit of gas is conducted as planned, with no malfunction. The Ukrainian side is able to provide gas supply to domestic consumers and reliable gas transit to European countries.

On June, 20, a special EU gas coordination group together with representatives from Ukraine will try to find a solution to the gas problem in Ukraine. The EU understands that this crisis has Russian political implication.

***The Russian-Ukrainian gas talks have failed***

***Ukraine demands the establishment of market prices for natural gas in the Stockholm arbitration***

***The suspension of Russian gas supplies to Ukraine will not affect domestic consumers***

### 3. Political Competition

Petro Poroshenko's first appointments to top official positions suggest that he decided to depart from the practice of political party quotas. Unlike previous Ukrainian presidents, the newly elected President doesn't have overt political commitments to any political parties, financial and industrial groups, or Ukrainian oligarchs. The billionaire was running for president as a political loner without taking into account situational alliance with Vitali Klitschko and his political power. It is important for Mr. Poroshenko not to apply political party quotas principle in making new public appointments in future when his political party "Solidarity" will gain a visible presence in political life of Ukraine, with its regional offices being established all over Ukraine.

While Yulia Tymoshenko, Oleh Lyashko, Anatoliy Hrytsenko and members of the Party of Regions are preparing for the parliamentary elections by reorganizing and strengthening their presence in Ukraine's regions, the Communist party of Ukraine is overtly backing up separatists in Luhansk region.

Vitali Klitschko insists on merging the positions of Kyiv mayor and Head of the Kyiv City State Administration. There is a growing conflict over the division of key commissions between the ruling majority and the opposition in Kyiv City Council. The lack of procedures and an opaque agenda of Kyiv City Council are conducive to abuse of power and manipulations by the ruling majority.

#### 3.1. Political parties are getting prepared for pre-election campaign

There is a temporary lull in political fighting. Petro Poroshenko has decided to see first how the Ukrainian political establishment and the public will react to his intentions to order a "one-week unilateral ceasefire", enter into "talks with terrorists" and create "corridors at the borders".

President's announcements were met with much opposition and criticism from various Ukrainian experts and politicians. For example, Oleh Lyashko heavily criticized Poroshenko's decision to hold talks with terrorists.

Other political players are vigorously preparing themselves for parliamentary elections. Everyone understands that the dissolution of the Parliament is a matter of time, which depends largely on the success of anti-terrorist operation in the East of Ukraine.

Yulia Tymoshenko is engaged in reorganizing her political party and preparing for the upcoming elections. She announced her plans to tour several regions of Ukraine in order to meet local representatives of her party in different Ukrainian regions, as well as local residents. The political party "Batkivshchyna" will support the idea of early parliamentary elections only if the Parliament adopts lustration laws package. Anatoliy Hrytsenko is trying hard to strengthen his Civil Position party. Hrytsenko's party is getting stronger by absorbing new party members and local councils' deputies. For instance, in the Ivano-Frankivsk City Council a relevant deputy faction was formed on June 12.

New people in Ukrainian politics remain outside the political process. They happened to be situational leaders and appeared due to extraordinary circumstances and the Euromaidan revolution. Dmytro Yarosh and Olga Bohomolets failed to turn their success into political capital during the Euromaidan revolution. Their low voting results at the presidential elections and refusal to try their luck in Kyiv local elections made their chances of a political survival extremely low. However, they can extend their political life if they build a coalition with the existing political parties. For example, Dmytro Yarosh and his "Right Sector" party might build a Ukrainian right-wing coalition with the "Svoboda" party. Olga Bohomolets with her socialist movements support could join the creation of a new socialist party.

The "Svoboda" party is very active in the Ukrainian Parliament, bringing up and promoting issues of social justice, lustration and counteraction to Russian

*The President should not employ the principle of political party quotas*

*Political players take wait-and-see position on President's actions*

*New people in Ukrainian politics turned out incapable to compete with political veterans*

aggression against Ukraine. Oleh Tyahnybok claims that there is an urgent need for early parliamentary elections.

The Party of Regions is planning to revise its current composition in June. Businessmen and former top political players from the Party of Regions are seeking political refuge in new political projects. It is noteworthy that the failure of the Party of Regions helped Serhiy Tihipko's party "Strong Ukraine" take a new lease of political life. It also helped to create the Party of Development of Ukraine headed by Serhiy Larin and Yuriy Miroshnychenko. The Congress of the Liberal Party of Ukraine is due to take place at the end of June. This party provided the Party of Regions with many of its members at the beginning of 2000s.

The Security Service of Ukraine has clear evidence of the involvement of the Communist Party of Ukraine into separatists' movement, as well as their anti-Ukrainian campaign. On June 17, the whole Communist Party's fraction in the Luhansk City Council began working in the parliament of the self-proclaimed Luhansk People's Republic. Besides, representatives of local offices of the Communist Party are involved in recruiting terrorists and supplying weapons to separatists.

While the Ukrainian President is tackling the issue of war and peace, his political opponents are preparing themselves for the "pre-election war". Petro Poroshenko has a brief window of opportunity to implement reforms and put an end to separatism.

### ***3.2. Obscure political manoeuvres are still taking place in Kyiv City Council***

High voting results of Vitali Klitschko's UDAR Party in Kyiv local elections provide for speedy decision-making in Kyiv City Council and allow to quickly solve problems faced by local community. Nevertheless, an absolute deputy majority doesn't rule out the possibility of taking non-transparent decisions, usurpation of power in deputies' commissions and bypassing established procedures and rules. Besides, a great deal of public trust to Vitali Klitschko now can significantly be decreased if Klitschko fails to ensure that all necessary reforms in the Ukrainian capital are carried out. The absence of necessary changes can lead to public disillusionment with Vitali Klitschko.

The newly elected mayor needs the help of various experts in performing his duties. The last meeting between Klitschko and heads of housing utilities and Kyiv city council departments revealed that Klitschko's team lacked systematic approach towards this particular issue. One can dismiss heads of departments and replace them with others, but if the model of state governance doesn't undergo serious changes, the old system remains unchanged.

The decisions made by Klitschko will show what tactics Klitschko's team has employed. The first test for his team would be managing permanent deputies' commissions and the appointment of Secretary for Kyiv City Council.

The "UDAR" Party with its current majority claims 10 commissions out of 15 in Kyiv City Council. "UDAR" offered the deputies' minority to head culture, education, environment and local government commissions. Opposition members demand to chair budget, land and common ownership commissions instead. These commissions were often linked to financial crimes during Leonid Chernovetsky and Oleksandr Popov administration.

Oleh Lyashko's Radical Party, Democratic Alliance and "New Life" political party have announced their political opposition to the ruling majority. The political position of "Samopomich" political party is still unclear. It needs to consolidate its position in Kyiv City Council and fulfill promises made by its leader Andriy Sadovyi. The "Batkivshchyna" and "Svoboda" parties have also small chances to support the majority's policy. After all, the mandate of the newly elected deputies of Kyiv City Council is valid for one year and a half. That is why

***The Party of Regions has split into three political groups***

***The Communist Party of Ukraine openly supports terrorists in Luhansk region***

***Vitaliy Klitschko and his team might burn themselves out if they fail to organize their work***

***The "UDAR" Party proposed that the deputies' minority should head humanitarian commissions***

most political parties will aim at the opposition policy and prevention of corrupt practices of the ruling majority in Kyiv City Council.

In Poland, for example, deputies' commissions are divided between political parties proportionally according to election results. In light of foreign experience, the results of Kyiv local election suggest that a maximum number of commissions that "UDAR" party can claim is 9, instead of wanted 10.

Moreover, in order to satisfy demands of the local elections winners, the number of commissions was expanded from 13 to 15.

In Polish parliamentary practice, local self-government commissions on revision as well as commissions on budget and finances throughout the country were headed or controlled solely by opposition members in order to prevent political imbalance and corruption.

In all democratic states, opposition has a possibility to control the ruling majority with the help of "shadow cabinets", public financial control system and active participation of civil society organizations. The biggest corruption crimes are usually committed by commissions that deal with public funds and taxes. Such system of checks and balances is used in the Polish model of decentralization.

Vitali Klitschko continues to demand the President to merge the positions of Kyiv mayor and Head of Kyiv City Council. According to Klitschko, there is an urgent need for new appointments to public positions, as well as dealing with refugees from Crimea and the East of Ukraine. It is quite possible that Klitschko's new appointments may be the continuation of partition policy. Vitali Klitschko should do everything possible to ensure that decentralization reform is implemented, even to demand the President to speed up the decentralization process. The "UDAR" Party should also bring up this issue in the Ukrainian Parliament. The Kyiv City State Administration has to become an executive body of Kyiv City Council. Public functions will be performed by a prefect with his own administrative apparatus. State authorities must not merge with self-governance bodies.

Thus, while enjoying strong public support, Vitali Klitschko is running a high risk of failing to justify extremely high expectations of Kyiv residents as to Klitschko's ability to ensure deep and speedy reforms in the Ukrainian capital.

***In Poland,  
opposition controls  
finance and budget  
commissions in  
order to keep the  
balance***

***Klitschko's team  
seems to  
underestimate the  
importance of  
decentralization  
reform***