



ICPS

International  
Centre for  
Policy  
Studies

# *INSIDE UKRAINE*

*#9, June 2010*

# Table of Contents

NEWS OF THE MONTH	3
TOPIC OF THE MONTH: UKRAINE'S CHOICES	6
THREE INTEGRATION MODELS	7
HISTORICAL CAPITAL	8
STATUS QUO: PASSIVE INTEGRATION	8
OPTION 1: HOW TO DISMEMBER A STATE	10
OPTION 2: HOW TO TAKE THE LEAD IN INTEGRATION	11
LESSONS IN SAFE INTEGRATION	12

## Editorial Board

### **Gaspar BERGMAN**

Head of Secretariat, Soderkoping Process,  
Kyiv

### **Vira NANIVSKA**

Director of the ICPS

### **Nicu POPESCU**

Research Fellow, European Council  
on Foreign Relations

### **Olga SHUMYLO**

ICPS supervisory board

## Editor

### **Vira NANIVSKA**

Director of the ICPS

## Authors

### **Maxim BORODA**

Head of Social Economy Program,  
ICPS

### **Ihor ZHOVKVA**

Director of Foreign Policy Programs,  
ICPS

### **Olga LVOVA**

Analyst, ICPS

## Consultant

### **Vladimir GRANOVSKY**

e-mail: [office@icps.kiev.ua](mailto:office@icps.kiev.ua)  
[www.icps.com.ua/eng](http://www.icps.com.ua/eng)

# News of the Month

## First 100 Days: Two opposing views

*The opposition sees only bad news, the Administration no mistakes*

The first 100 days of Viktor Yanukovich and his team passed in June 2010. Already, their first steps have raised two separate debates that are virtually unrelated to each other. The opposition sees nothing good happening at all, while the new team is quite happy not to see its own mistakes. In fact, both points of view have some real basis.

Voters have positively responded to a number of actions taken by the new Administration:

- The revival of properly steering in the government system;
- Improvements in relations with Russia which have made it possible to sign an agreement demarcating the Ukrainian-Russian border;
- A quick adoption of the State Budget for this year;
- The drafting of an Economic Reform Program and the launch of broad public debate on this issue.

At the same time, serious criticism and disquiet were caused by:

- Illegal steps taken to establish the administrative chain of command and a monopoly over the court system;
- The signing of the Kharkiv Accords with Russia;
- Efforts to muzzle the press;
- Growing administrative pressure on business;
- Widespread use of administrative leverage ("administrative resources") in the political arena;
- The new Government's approach to social and educational policy.

*The reform program contains a clear list of steps*

## Program to the max

At the conclusion of his first 100 days in office, President Yanukovich provided a truly memorable occasion for Ukraine: the presentation of the Government's Economic Reform Program for 2010–2014. This is the first Government program that actually has something meaningful to talk about, containing a clear list of actions rather than a string of slogans and promises.

Still, the Program also has its serious faults, which could cancel out its indubitable success. The greatest of this is the separation of economic reforms from administrative reform of the very government bodies in charge of economic policy. The reforms intended to modernize the public administration system will be ready only this fall, whereas the program of economic reforms for 2010-2014 is already a go.

In order to fulfill the objectives of the Program, there are plans to change legislation, but this is only presented as a series of bills planned for adoption, rather than an actual plan of legislative initiatives pointing to what exactly needs to be canceled, approved or changed. The planned changes in law also have no proper institutional and fiscal underpinnings, that is, of the three necessary components for developing state policy (legislation, institutions, funding), the Program only has one (legislation).

*The Program fails to establish priorities*

One of the big problems in the Economic Reform Program for 2010-2014 is the lack of priorities. Fully 17 substantial reforms in nearly every sphere of the economy are proposed for the next five years—a completely unrealistic goal. In short, the Program is impossible to actually carry out.

## Tax Code: A wake-up call for business

*The State Tax Administration could become a political weapon*

The draft Tax Code that passed first reading in the Verkhovna Rada in June faced serious resistance from the opposition, business and civil society. It was sharply criticized for increasing the tax burden on business, especially SMEs, and for granting the State Tax Administration unprecedentedly broad powers to repress taxpayers. The risk that the STA could be used not just for its "designated purposes" but as a political tool to put pressure on any opposition roused particular concern.

*Tax breaks are a farce?*

The tax holidays for SMEs promised by President Yanukovich have been kept in the new Tax Code but in a very marginal form. They will only apply to entrepreneurs who "provide basic consumer services" and legal entities with turnover of less than UAH 100,000 per annum, which does not even cover a street kiosk in the countryside, far from any major highways. This raised a storm of accusations that the Government was making a farce of its campaign promises.

The fact that business reacted actively and collectively on one side and that the government was prepared to hold a dialog, on the other, has ensured that public

debate on tax reform is meaningful. The result was that the President declared the Tax Code not ready for signing in its current version and called for it to be substantially rewritten.

### Nota Bene

- |         |   |
|---------|---|
| 8 June  | The Stockholm Court of Arbitration rules that NAK Naftogaz Ukrainy must pay RosUkrEnergo the equivalent of UA \$5.5 billion. The Yanukovich Administration offers no comments on the court decision while the opposition is sharply critical of what it considers a corrupt decision in violation of Ukrainian national interests.  |
| 18 June | 6 deputies from Nasha Ukraina–Narodna Samooborona (NU-NS) join the “Stability and Reform” coalition as the ruling coalition continues to expand its ranks. Media analysts predicted that in a few months the coalition could well have a Constitutional majority. This would allow the Party of the Regions to carry out its intentions to extend the powers of the Presidency and local governments, as well as to institute a second state language.  |
| 22 June | A Constitutional Court ruling was published declaring that it would be unconstitutional to postpone local elections to 2011. This means that local elections will take place on October 31, 2010, as Party of the Regions insisted. With the new Administration enjoying fairly high support among voters, it is interested in running these elections as soon as possible. These elections will enable the Yanukovich Administration to complete its governing chain of command and to begin to undertake politically unpopular reforms, such as increasing the retirement age and utility rates.  |
| 24 June | Ukraine signed an agreement on a Free Trade Area with the European Free Trade Association, which includes Iceland, Liechtenstein, Norway and Switzerland. According to Ukrainian Government officials, this agreement is an important step towards establishing a Free Trade Area with the European Union and could provide a kind of training ground. However, the agreement will actually not have much impact on Ukraine’s economy, because of a series of significant exceptions, such as that it does not provide for the removal of duty on automobiles, farming equipment and chemical products. In any case, trade with EFTA countries is relatively small. |

# Topic of the Month

## Ukraine's Choices

The last issue of Inside Ukraine was dedicated to Russia's agenda on Ukraine. Should it be carried out without any change in Ukraine's current position, the country will disappear as a player in the geopolitical arena and lose control of its own economy. Over the past five years, Ukraine rejected any joint projects with Russia, counting entirely on Euroatlantic integration. Meanwhile, no reforms took place internally, corruption mushroomed, and a rancorous conflict between the President and his Premier dominated the headlines. Russia, in the meantime, gave its support to a broadening anti-NATO and anti-European campaign for the hearts and minds of Ukrainian voters. In the West, Russian diplomacy chalked up major successes in establishing its terms for cooperating in areas of vital importance to the US and key EU countries. The main one was to choose between supporting the thorn in Russia's side that was Ukraine and an opportunity to undertake critical joint enterprises with Russia. After the February 2010 Presidential election, the West no longer felt the unpleasant and hopeless need to support a dysfunctional Ukraine.

The country's new political leadership has undertaken that which is no longer possible to ignore in a globalizing world. Integration, especially economic integration, has become the basis for relations among countries, a world trend. According to the WTO, more than 190 regional integrational agreements had been registered by the beginning of the 21st century, of which more than 130 were actually in force. Moreover, more than half had been drawn up after 1990.<sup>1</sup>

Ukraine has little choice but to integrate regionally, and that means, first and foremost, integrating with the regional leader, Russia. For now, the country's leadership has chosen integration rather than total opposition, but this is not the only choice facing the country. The next conscious step that Ukraine must make is to choose between passive and active integration.

Indeed, Ukraine has all the elements necessary to take up an active, constructive, pragmatic integrational position.

<sup>1</sup> Maurice Schiff and L. Allan Winters, "Regional Integration and Development," World Bank (2003), Moscow edition in Russian, Ves Mir, 2005, p.17.

*Integration between  
Ukraine and Russia  
is picking up pace*

## Three integration models

### *Belarus: Head in the sand*

The path Ukraine has gone down in recent months, taking many big and small steps, has already been beaten by its neighbor, Belarus. For that reason, moving down this path seems very easy and swift, as it doesn't require much effort on Ukraine's part—simply to change nothing: NOT reform the system of public administration, NOT establish rule of law, NOT take any politically unpopular steps, maintain the soviet-style top-down chain-of-command, neutralize the opposition in the usual ways, and play the patriotic card from time to time, demonstratively standing up to Big Brother.

This kind of approach has assured stability and order in Belarus for many years. But foreign policy and appointments are supposed to be approved by Moscow.

### *Georgia: Feet first*

Georgia is an example of what Ukraine might have become, had the country's previous President demonstrated greater decisiveness and consistency in his policies. Georgia's leadership has chalked up clear successes in improving the business climate and overcoming corruption, although the country has also lost a large chunk of territory as a result of armed conflict with Russia. The question, whether the one was the price of the other, is certainly debatable.

### *Kazakhstan: Standing strong*

The average Ukrainian knows a lot less about stable, successful Kazakhstan than about half-swallowed Belarus or tattered Georgia. Nor is it a question of the perceived gap that separates Ukraine from Central Asia, but the fact this country has become a regional leader without much fanfare, without exposing itself to resistance from Russia but maintaining good neighborly relations with it.

Kazakhstan has been an active participant in all of Russia's integrational initiatives. It not only does not reject the embrace of its Big Neighbor, but actually meets it halfway, preserving its benefits in unchanged soviet rhetoric about the inviolable friendship of nearly half the population considers itself Russian and most citizens do not know the Kazakh language, from step-by-step reforming its own economy and energy sector, its public administration, and its armed forces.

One brilliant example of this kind of "oriental wisdom" is a decision by Nursultan Nazarbayev to require all civil servants in Kazakhstan to demonstrate a command of the Kazakh language. On the face of it, this violates the rights of ethnic Russians, who constitute nearly 40% of the population, far more than dubbing Russian films in Ukrainian here does. Yet Moscow has been silent—because the whole world sees Astana as a close friend and reliable partner of Russia.

## Historical capital

The loss of sovereignty is possibly the biggest nightmare of Ukrainians. Even the national anthem talks about the unfinished battle for independence: "Ukraine's glory and freedom have not yet died..." This kind of focus on its own statehood is hardly unfounded, given that the Ukrainian people have spent the majority of their history without it. Still, this not only does not place Ukraine's existence as an independent nation in doubt, but is actually its greatest confirmation. A brief excursion in history makes this amply clear.

In one of his first decrees after the Battle of Poltava, Peter I of Russia banned the Ukrainian language. This same issue was touched upon further in more than 20 additional ukases by Russian tsars. Why pay so much attention to the "dialect" of a non-existent people?

An equally convincing affirmation of the viability of Ukraine as a state is its ability to reinvent itself. Every time such an opportunity has arisen, the Ukrainian nation has established an unambiguously-named state on its own territory: the Ukrainian National Republic, the Ukrainian State under Hetman Skoropadsky, the Western Ukrainian National Republic, the Ukrainian Soviet Socialist Republic, Carpathian Ukraine, and, finally, today, Ukraine.

From the ruins of each subsequent empire, the Ukrainian nation has always come out richer. It is worth noting just the way Ukraine was transformed from a fragmented provincial farm belt in the Russian Empire into a formal, independent, territorially whole and industrially developed republic of the Soviet Union with its own seat at the UN. Then, how Ukraine met the fall of the Soviet Union as one of the largest European countries, with its own nuclear arsenal, space technology and Crimea tossed in as a gift.

## Status quo: Passive integration

Russia has been actively and consistently carrying out its own agenda, presented in the last issue of *Inside Ukraine*, which consists of returning Ukraine to its orbit. The most fundamental points are:

- The enshrinement of Ukraine's non-block status and rejection of membership in the North Atlantic Treaty Organization;
- Gazprom's control over Ukraine's gas sector, especially the gas transport system (GST);
- the revival of sector-based industrial conglomerates according to soviet principles by merging specific branches of Ukraine's and Russia's economies;
- Russian being granted the status of the second official language in Ukraine;

*The Ukrainian nation  
has always emerged  
from the ashes of  
the empire stronger*

*Moscow sees Kyiv as  
being part of its sphere  
of influence*

- the establishment of a single Orthodox Church in Ukraine under the Moscow Patriarchate.

To have these conditions met, of course, Russia is prepared to pay. The most resonant example of this is the conclusion of the Kharkiv Agreement: the Russian fleet in exchange for gas. A less publicized example was an agreement on the atomic energy sector, where Ukraine gets outdated and overpriced technology together with loans to build reactors. The high level of corruption in the Ukrainian government has only made it easier to reach such agreements and have them carried out.

Meanwhile, Russia steadfastly maintains its own principles, however flexible it may show itself as to methods for exercising them. Whenever one or another of Moscow's plans suddenly run into a wall on the Ukrainian side, the wording of these agreements is very quickly and easily changed—as long as the essence remains the same. "You don't want to merge Gazprom and Naftogaz Ukrainy? Let's not, then, and call it 'organizing a joint venture.'"

*Russia wants  
to swallow Ukraine's  
economy*

The basis for Moscow's integration plan is the principle of economic efficiency, which means that Ukraine's economy will be subsumed into the Russian one. The decision-making center will be in Moscow. Formally, Ukraine remains sovereign: it is completely "independent" when it comes to domestic matters, but is expected to freely share its resources with its northern neighbor.

For this scenario to come to pass, two conditions must be met: no actual reforms that might bring in European standards and a switch to "managed" democracy. The first condition suits Ukraine's leadership just fine at this time and they are steadily working on meeting the second one.

Confirmation of the fact that Ukraine is currently moving towards this scenario—or is allowing itself to be led down that path—can be found in any number of events even just in June 2010:

- The passing of the Law "On the basis for internal and external policy in Ukraine," in which Ukraine's non-block status is enshrined and the removal of provisions in the Law "On the basis for the national security of Ukraine" regarding the prospects of membership in NATO;
- The adoption in principle of the Bill "On the procedure for organizing and running peaceful events," which does not meet international standards and has been severely criticized by civil society organizations;
- A resolution of the Crimean Rada on granting the Russian language official regional status.

The policies of the current government are aimed at maintaining order and stability. This is impossible to properly achieve without extensive reform of the

public administration system, the government machine, primarily in terms of bringing it in line with democratic governance and a market economy.

The Government will be unable to maintain stability for any length of time using repressive methods as this will only worsen the economic situation and cut into State Budget revenues. Crushing the Ukrainian language and gradually reducing the country's sovereignty will inevitably lead to political resistance and social unrest.

### Option 1: How to dismember a state

Fortunately, Ukraine so far does not have any hot spots or frozen conflicts within its borders that might constitute a direct threat to its territorial integrity. Still, the risk that this country might split up has been brought up in more than one study by world renowned analysts, including Samuel Huntington, the author of the concept of the clash of civilizations.

This controversial American political scientist based his arguments on the fact that Ukrainians belong to two different civilizations: the Orthodox in the East and the European in the Uniate (Greek Catholic) West. He illustrated the break line between these two territorial parts of Ukraine with the results of the 1994 Presidential election, when support for Leonid Kravchuk in western oblasts and Leonid Kuchma in eastern oblasts was 90%. The results of all the elections in the subsequent 15 years have only reinforced this conclusion.

*Centrifugal forces  
threaten to disintegrate  
Ukraine*

Enough centrifugal trends, both in the West and in the East, have emerged in the years of the country's independence for Huntington to declare that the Ukraine was quite likely to break apart. In another scenario described in details by the editor-in-chief of Limes, an Italian journal of geopolitics,<sup>2</sup> Donbas and Crimea go to Russia; several western oblasts separate and, in one form or another, join the European Union; rump Ukraine remains as an ostensibly independent state that is under Russian influence. The inevitable result of such a scenario would be the disappearance of Ukraine as a geopolitical player on the world map.

The high-speed efforts of the new Administration to ensure rapprochement with Russia coupled with its restriction of democratic freedoms could well rouse equally strong resistance in regions that are generally anti-Russian. Political games with principles that are touchy for both sides, such as language or history, could push the pendulum of mutual antagonism to such a degree that the least pretext will be decisive and launch an irreversible disintegration. There are all-too many threatening signals of such an eventually:

- The resolution of the Severodonetsk assembly that called on setting up a Northeastern Ukrainian Autonomous Republic during the Orange Revolution;

<sup>2</sup> See <http://temi.repubblica.it/limes-heartland/the-tsar%E2%80%99s-sabres/920>

- The coming to office of political forces whose acknowledged goal is reunification with Russia in local and oblast councils and the Crimean Rada in the 2006 local elections;
- A Decree issued by former President Yushchenko awarding Stepan Bandera the posthumous title of Hero of Ukraine.

## Option 2: How to take the lead in integration

Ukraine is not afraid of getting closer to Russia and integrating with it. Mutual integration is actually the basis for international relations in the modern, globalized world.

*Ukraine is proposing its own principles for integration with Russia*

Blind submission or knee-jerk resistance is not the best modality for communicating with a country that is Ukraine's strategic partner. What is more appropriate is an active, constructive and pragmatic approach. In other words, Ukraine fully supports the process of integration with Russia and proposes its views of how this integration should actually take place.

Firstly, all integrational processes in any given sphere take place on the basis of a unifying political principle and not horse-trading over commercial assets. The EU's approach to this is a good example, as today it constitutes the best worked-out model for supporting the interests of every participant in the integrational process. This not only gives the European vector—declared by the President to be key—some real meaning but brings both Ukraine and Russia closer to EU requirements by providing the conditions for them to participate in broader integrational projects. At the same time, the countries can join joint Ukrainian-Russian projects as a guarantee that mutual commitments are carried through. If the gas transport system is going to be modernized, then that will only be with the inclusion of European partners.

Secondly, Kyiv becomes the center of all integrational processes and the base for carrying out joint projects. After all, this is where all the newly build integrational institutions are located. The territorial principle for placing Kyiv at the center of integration is critical. Why should Moscow agree? Because it has no reason not to agree if this is Kyiv's unwavering position, based on historical realities and European principles of integration.

Thirdly, the principle of mirrored commitments is applied. Ukraine has a fundamental position regarding the Ukrainian language as the only state language while agreeing, as Moscow requests, to ensure the necessary conditions and support for the Russian language and culture to evolve. For its part, the Russian Federation fosters an active policy regarding media, educational and cultural development in areas where there is a concentration of ethnic Ukrainians—Moscow, Siberia, the Far East, Krasnodar Krai, Surgut, Tiumen, and Vladivostok—by funding Ukrainian-language schools and media through the State Budget.

*A regional leader is a desirable partner for the EU and NATO*

For the European Union, this kind of development would not only not lead to a rejection of Ukraine's Eurointegration ambitions but, on the contrary, to a persistent, steady transition to European standards. A country that is a regional leader and is actively working with one of the global centers of power is a much more desirable and interesting partner for both the EU and NATO, than a country that cannot cope with relations with its closest neighbor.

This scenario can be ensured in Ukraine because all the necessary conditions are in place:

- A consolidated, strong and effective government;
- The ambitious goals set by the President and his party;
- Openly declared readiness among the country's leaders to undertake reforms;
- Intellectual capacity to develop a new post-conflict ideology of statehood;
- A high level of trust in the current government among voters;
- Support from Western partners, who are not interested in seeing Ukraine go down the drain as an independent player.

## Guidelines on safe integration

Playing out this last scenario is the only option Ukraine has to reach the goal set by its President: to become one of the Top 20 developed countries in the world over the next decade. For this, Ukraine needs to apply world practice and follow the ten commandments of successful integration:

### **1. Integration with wealthier and stronger countries is useful.**

Joining forces with wealthier countries is more economically convenient than joining poorer ones. The benefits include greater investment and trade, access to cutting-edge technologies, and stronger domestic competition.

### **2. Economically convenient integrated associations are worth political consideration.**

If an economic association costs more than it benefits, they can cause political losses as well. Economic integration more easily spills over into political integration than the reverse.

*Integration requires reforms*

### **3. Integration is a spur to reform.**

Integration requires reforms. Otherwise, the effect could be counterproductive. Greece's refusal to undertake macroeconomic reform after joining the EU considerably intensified the country's current problems. At first glance, this was not especially obvious, because accession itself ensured the country additional resources, including financial ones, that made it possible to postpone reforms. The consequences of this "do nothing" attitude for Greece became evident only in 2009-2010.

*More trade means less conflict*

### **4. Integration strengthens national security.**

Growing trade tends to increase economic interdependence among partner countries. Stable trade relations reduce the likelihood of military confrontations, as they increase the level of access to strategic resources among the partners and reduce the threat of trade embargoes. According to World Bank statistics, a 6% rise in trade flows reduces the level of conflict between countries by around 1%.<sup>3</sup>

### **5. Integration increases investment inflows.**

Integrated associations in general are able to attract more foreign investment into a region that is developing than any of the individual fragmented national markets could.

### **6. Integration encourages competition.**

Integration should serve as an instrument to stimulate competition, including expanded competition on the domestic market.

### **7. Integration optimizes tax system.**

Those countries for which sales taxes constitute a major part of public revenues are at greatest risk during integration. During the course of integration, these countries are forced to reform their own tax systems, including internal excise, turnover taxes, value-added tax (VAT) and so on.

### **8. Multiple integration is useful.**

Prior to joining the European Union, Slovakia belonged to 9 integrated associations; Czechia and Slovenia to 8; Estonia to 6; Hungary, Latvia, Poland and Romania, to 5.<sup>4</sup>

<sup>3</sup> Op. cit., Schiff and Winters, p. 245.

<sup>4</sup> Ibid., p. 106.

### 9. Deliberate integration with predicted consequences.

A customs union can be more convenient than a free trade zone, but only when internal boundaries are effectively dropped—which is usually the case—and a low, general external duty is set.

Having a free trade area could be more convenient than not, but only when it does not involve a large number of asymmetrical exceptions. Any integrational agreement must also contain clear mechanisms for settling disputes, otherwise it is not worth signing.

### 10. WTO does not protect from integrational mis-steps.

Since it defends the principles of global liberalization based on the most facilitating regime, the WTO forbids only certain destructive forms of regional integration. Integrated associations should be judged through the prism of national interests, not their compliance with WTO requirements.

*National interests  
are the foundation  
of integration*