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## PROCESSES AND PROGRESS IN UKRAINE IN THE FIRST HALF OF 2015

It is our pleasure to present the first piece of the monthly digest "Prism.UA" which is devoted to analysing the ongoing social, political and economic processes in Ukraine. Even though Ukraine has been at the centre of world attention for quite some time, the reason behind the project is to present more qualitative and reliable expertise for stakeholders in the EU and Eastern Partnership.

Since the Revolution of Dignity in February 2014 Ukraine has become the target of severe multifaceted aggression from Russia. The Crimean peninsula, an integral part of Ukraine, has been annexed and two other regions in the East of Ukraine have been flooded with Russian weaponry and regular troops. Unfortunately, not everyone is aware of these cynical actions that threaten not only Ukraine but the whole of Europe as well.

It is worth blaming the so-called hybrid war that Russia is waging against Ukraine on the different tools of the propaganda machine. Kremlin's mouthpieces and media have proved active in distorting reality on the ground and the facts pertaining to the Russia-led conflict. The most telling manifestation you might remember is the downing of flight MH17 and the desperate attempts by Russia, even exotic ones, to avert direct accusations.

On the other side of the coin there is a difficult internal political and economic situation in Ukraine – a legacy of the previous state administration of the Yanukovich era and the current transformation processes launched by the Ukrainian authorities. Against this backdrop, the path of reforms is far from smooth or secured in the country. But at the same time Ukraine has some tangible

achievements when it comes to constitutional reform, decentralisation, anticorruption, defence and security. Implementation of the Association Agreement and the Association Agenda between the EU and Ukraine is also on the public radar. But Russia is using its huge information resources to paint Ukraine as a "failed state", and this is another reason why more objective, unbiased and on-the-ground assessments that provide a holistic picture of all the processes, are needed.

The core group of experts engaged in this project constitutes the expert network "Ukrainian prism", the initiative of like-minded people in Ukraine with strong expertise in political sciences, economics, diplomacy and international relations. In cooperation with the Eastern Europe Studies Centre, a Lithuania-based think tank, and with the support of the Ministry of Foreign Affairs of Lithuania, this digest will do its best to fill some gaps in distributing analytical products that might be useful to politicians and experts interested in Ukraine.

Taking into consideration the time of this first digest, the first piece draws on general assessment and trendsetting in Ukraine in the first half of 2015. Should you have any ideas on how to make the digest more attractive to the audience, please do not hesitate to contact us.

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A serious challenge to ongoing changes in Ukraine is the threat of revenge on the prospective local elections by forces of the pro-Russian group.

## SUCCESSSES AND RISKS OF THE POLITICAL CONFIGURATION IN UKRAINE

*Oleskiy Krysenko*

The snap elections called by the President of Ukraine (25 May 2014) and the Verkhovna Rada of Ukraine (26 October 2014) allowed the national political system to be legally reloaded<sup>1</sup> and the foundations for the formation of a rather consistent configuration of political power in Ukraine to be laid. The key characteristic of Ukraine’s current political system is its institutional design – premier-presidential (parliamentary-presidential) model of executive authority based on a parliamentary coalition, mainly consisting of 5 parliamentary fractions representing the constitutional majority.

The efficiency of the functioning of the “President – Cabinet of Ministers – governing coalition” triangle is in many respects dependent on domestic electoral dynamics. The specific nature of the political model lies in the fact that both the prime minister and the president, representing different political actors, often take up the competitive struggle for domination in adopting political decisions in the system of political government. Two or more clientelism type verticals are created: presidential vertical, premier vertical, and opposition vertical. Ukraine faced similar challenges when the cabinets of President Viktor *Yushchenko* and Yulia Tymoshenko and V. Yanukovich (2006–2010) co-existed, in the context of frequent electoral cycles (reference points of this rivalry were nationwide elections in 2006, 2007, 2010, which sharpened the electoral competition inside the pro-European “orange camp”, thereby, finally, enabling Yanukovich to get revenge).

Unlike the preceding co-existence, in the current situation both the president and the parliament have 3–4 years before the next electoral cycle,<sup>2</sup> i.e. frequent elections cease to play a destabilizing role in the system of power sharing in the executive authority. The weaker actor in this case is the prime minister (Arseniy Yatsenyuk) as he is the hostage of the parliamentary coalition’s sustainability. His political positions/prospects are the most inconsistent, as his yearly immunity expires in October 2015. It is very likely that November will

see not just a revision of the activity of the Cabinet of Ministers and the prime minister personally, but will also allow a re-configuring of the governing coalition in respect of some specific members of the coalition in the Parliament. This will happen, *inter alia*, depending on successes and failures of the prospective control over regional assemblies, regional media, and regional businesses.

The core of the parliamentary coalition consists of 5 democratic pro-European actors (“Petro Poroshenko Bloc” [PPB], “People’s Front” [PF], “Self-Reliance” [Ukrainian – “Samopomich”], “Radical Party of Oleh Lyashko” [RPOL], “Fatherland” [Ukrainian – “Batkivshchyna”]) united by a common coalition agreement representing a contradictory attempt to formalise the programme of government actions in implementing urgent reforms and the strategic development of the country. Alongside this, the coalition association remains rather sustainable as “the senior partners” of the coalition – PPB and PF – represent the president and the prime minister and are interested in supporting the existing coalition’s configuration, and none of the “junior partners” (all other participants) has “the golden share”. This factor pre-conditioned the coalition’s responsibility for the number of extremely unpopular government decisions, which defines some kind of short-term optimism in respect of the sustainability of the dynamics of the internal politics.

Alongside this, there are risks and threats that could destabilise the situation:

A serious challenge to ongoing changes in Ukraine is ***the threat of revenge on the prospective local elections*** by forces of the pro-Russian group (Party of Regions, Opposition Bloc, the Communist Party of Ukraine), which occupied a marginal niche in the formed political configuration on the wave of the last all-national elections. It should be noted that a decrease in the electoral rating of the political parties-participants of the coalition increases the chances of current outsiders for electoral and political rehabilitation.

A significant factor complicating the functioning of the Ukrainian state is ***the continuation of military actions*** with the pro-Russian troops in the East of Ukraine. Apart from heavy human losses inflicted on Ukraine, the continuation of war draws the Ukrainian economy, which is not yet sufficiently developed, towards military mobilisation which is contrary to the efforts aimed at destatisation and economic liberalisation. The significant contributing factor is the “reload” of the state

<sup>1</sup> As distinct from the national level, the restart on the level of regional political regimes emerged fragmentally and remains incomplete. The prospects of such reload as well as of institutionally and politically oriented modernisation of regional political regimes depend on the results of the elections in the local councils, which will preliminarily take place on 25 October 2015.

<sup>2</sup> Ordinary elections of the President of Ukraine and of the Parliament of Ukraine will take place in 2017.

**The probability of summer military escalation (July-September) in the East of Ukraine (if last year's events are anything to go by) remains high, and this could result in destabilising the state.**

budget by expenses on defense and safety (the level of these expenses is close to 5% of GDP), which is significantly reflected in the state performance of its social guarantees. In 2015, 80% of Ukrainians live below the poverty line, the official minimum subsistence level is UAH 1,176 (≈USD 50) or less than USD 2 a day, which pushes Ukraine towards the poverty line of African countries.

The issue of the prospects of *state reformation during the war* remains topical despite the existing sustainable understanding of the fact that Ukraine might not have another time for anti-crisis reform. The ruling elite has concerns that, at the first stage, deep institutional changes in the system of state government will decrease the level of control over the system. Moreover, the decrease of the level of control of the system in the case of external aggression by Russia may lead to fatal consequences.

**The speed of social, economic and political transformations** is important. In today's public opinion, this speed is evaluated as unacceptable, society wants fast and improved changes for the better, which is extremely complicated due to the institutional inadaptability to quality transformations. One of the most important dysfunctions of the state system is the **total corruption in the state sector (compounded by the low level of state service)**, which has a clear vertical dimension, confounded by the post-Soviet system of administrative centralisation. The solution to the current situation is the prospective reform involving decentralisation of the system of state management, however, this reform will be implemented against a background of external aggression, and reduced control of the state system by centre and opposition-minded local councils. Political monopolisation of local councils by opposition parties in the context of the decentralisation of the system of state management bears the threat of "*regional political feudalisation*": regime of Igor Kolomoysky in Dnepropetrovsk, regime of Gennady Kernes in Kharkov, regime of Gennady Trukhanov in Odessa, and etc.

One of the most significant challenges to the stability of the political process is *the quota principle of forming the acting Ukrainian Cabinet of Ministers*. On the one hand, this principle is the most practical one in terms of the necessity to divide the collective political responsibility and electoral costs between all the participants of the coalition to implement the line, but, on the other hand, the quota principle undermines the management expertise as technocratic competence is often substituted by various kinds of corporate and party loyalty inconsistent with the public interests. The key executive posts are occupied by "non-professionals", in which institutional and political sustainability in the vertical of state management is defined by backstage inter-party compromises, degree of sustainability of the coalition, political

climate and not by departmental successes, professional competence or public opinion. For example, fatal staffing mistakes were made in the party and quota placements for the position of General Prosecutor (Oleh Makhnitsky – Freedom Party, Vitaly Yarema – Fatherland Party), etc.

The most remarkable decision in the staffing policy (from the end of 2014 to the first half of 2015) was the proactive attraction of managers/non-residents (foreign citizens with experience in successful state or corporate management) to state authorities (Cabinet of Ministers, Prosecutor's Office, regional state administrations etc.). It is actually the personal participation of these persons which conditioned progress in reforming the relevant structures and directions. Among others, the most popular and authoritative are:

Eka Zguladze, deputy Minister of Internal Affairs of Ukraine – responsible for MIA reform and creation of the "new police";

Davit Sakvarelidze, deputy General Prosecutor of Ukraine – responsible for reform of the Prosecutor's Office and the justice system;

Mikheil Saakashvili, governor of the Odessa region – headed the unique experiment of reforming the system of state management in the Odessa region.<sup>3</sup>

#### Forecast for the second half of 2015:

1. The probability of summer military escalation (July-September) in the East of Ukraine (if last year's events are anything to go by) remains high, and this could result in destabilising the state. Since the forthcoming local elections are the only opportunity to reload regional political systems/regimes, the importance of these elections for all domestic actors cannot be overestimated.
2. Based on the foregoing, the following threats emerge:
  - undermining/rescheduling of local elections;
  - complication of relations between the central authority and local elites, challenges of voluntary armed forces;
  - rupture/reformatting of the governing coalition.<sup>4</sup>
3. Local "stories of success", their application to other regions/areas, and acceleration of reforms increase the rating of the parties of the governing coalition, which will stabilise the European line on the development of Ukraine.

<sup>3</sup> Odessa region is one of the strategic but most corrupt regions of Ukraine.

<sup>4</sup> Threat of the coalition rupture remains due to the utilitarian strategies of particular members of the coalition to participate in the local elections as actors quasi-opposing the governmental line. Indicators of such strategies are counter-reformation populist legislative initiatives adopted by the coalition, blocking of the most part of the governmental legislative initiatives as "unpopular" before the elections.

Unfortunately, reform efforts of the government are not enough to deflect this continuing decline.

The impact of the “Russian factor” on the national economy remains significant.

## THE ECONOMY OF UKRAINE IN THE FIRST HALF OF 2015

*Iurii Vdovenko*

The first half of 2015, over which Ukraine survived in a state of ongoing economic crisis, has come to an end.

The main contributing factor to the current state of the national economy remains continuous military actions on the Eastern borders. Destruction of transport infrastructure, loss of main funds, and external factors such as the drop in world prices for the main export positions and closure of the Russian market, remain the main factors contributing to the current state of the national economy. In addition, the first half of the year has seen many different defining events for the country, which has been teetering on the edge of economic disaster for a long time now.

Unfortunately, reform efforts of the government are not enough to deflect this continuing decline. By the end of the first half of the year, many international institutions have worsened the forecast of decline in the Ukrainian economy. For instance, according to different evaluations and the results of 2015, GDP will decline by 9%, the level of state debt will be up to 90% of GDP (amount of repayment of liabilities in 2015 is approx. USD 11 billion), and by the end of the year, inflation will exceed 45%. The topic of restructuring the foreign debt against the background of setting a pre-default rating for Ukraine by world agencies is becoming increasingly popular in the informational space. Already the state enterprise Ukrzaliznytsia has experienced a technical default, and so has the Metinvest company, which is part of Rinat Akhmetov's SKM.

For example, the World Bank notes that the situation is worsened by a decrease in internal demand because of budgetary consolidation, reduction in pensions and increases in taxes. At the same time, the country is also experiencing changes – in energy, banking, management of state companies and corruption management sectors.

The most notable changes occurred in the system of state finances and are related to the decentralising changes of budget and tax legislation, which came into effect from the beginning of the year. Further to their implementation according to the results of the first quarter, local budget income has increased by 35%. As regards the functioning of the state sector of the economy, after conducting an analysis of the activity of state companies and concluding that most of them were inefficient, the profile Ministry is preparing to launch large-scale privatisation. At the same time, the state has

actually regained control of the state company Ukrnafta, which has been falling under the influence of Igor Kolomojskij.

Preserving relative macro-financial stability can be seen as the main achievement of the government's economic policy during this period. However, this was reached mainly because of the support of the world community, first of all the IMF. For instance, Ukraine has already received the first transfer of USD 5 billion, of a total USD 10 billion for 2015, in financial aid from the IMF. In total, within the scope of the programme of support to the Ukrainian economy, IMF will allocate USD 17.5 billion. However, one of the painful effects of such financial aid are the growing prices of community services conditioned by bringing the tariffs in line with the prices on imported energy resources. The price of gas has increased 285% since March, the price of water has doubled since May and electric energy tariffs are expected to increase 2.5 times within the next two years.

In addition, even though the Conference held in support of Ukraine on April 28 witnessed the pro-Ukraine position of the international partners, it did not bring the expected results as regards the provision of economic aid in the amounts desired by the government. In total, by the end of the year, Ukraine needs more than USD 7 billion of credit, aid and investments (apart from the IMF programme). In May, during the summit of the Eastern partnership, the European Union and Ukraine signed an agreement granting a loan of EUR 1.8 billion for the redevelopment of Ukraine's economy.

The currency market has been relatively stable recently, although there was a significant devaluation of the national currency in February. Currently, the absence of significant fluctuations of the currency rate is in many respects related to the restrictive policy implemented by the National Bank of Ukraine. By 1 June, gold and exchange currency reserves had increased compared to the beginning of the year, and now stand at USD 9.9 billion. In addition the banking system remains under significant pressure due to the insolvency and liquidation of commercial banks, which leads to the necessity to make payments to the natural persons' Deposit Guarantee Fund.

Foreign Trade was the worst hit by the disasters in the national economy. One of its main problems is its focus on low-productivity export-oriented industries and dependence on imports. In the first quarter, as compared to the indicators of last

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year, export of goods and services from Ukraine decreased by 32.6%, import – by 35.6%, the positive balance was USD 597.5 million (share of goods exported to the EU is 34.1%, share of import from the EU is 42.6% of the total volume). There are no valid grounds for increasing foreign investments or growth in the spending capacity of Ukrainians.

At the same time, the impact of the “Russian factor” on the national economy remains significant. This is primarily related to the rapid slowdown in economic growth and disruption of traditionally tight economic relations. The role of the Russian Federation as Ukraine’s key trade partner continues to decline (the reduction in the volumes of foreign trade is about 60%) by continuing the restrictive trade policy with respect to Ukrainian exports. It also implements coordinated actions of a shake-out of Ukrainian exports from the national markets of CIS countries. Meanwhile, despite the steadfast position of Ukraine and the EU regarding the beginning of unimpaired operation of the free trade area from 1 January 2016, the Russian

Federation continues its attempts to influence this process with a view to dilatory tactics and reformatting the current contract into a trilateral one.

Therefore, it is almost certain that the second half of the year will be crucial for the Ukrainian economy with the following issues remaining extremely relevant:

- state debt restructuring, including both roll-over and writing down of the main amount and decrease of interest rates;
- state expenses decrease by virtue of decrease of the level of state consumption, particularly managerial expenses;
- real tax system reform, which shall ensure a decrease of the shadow economy sector, attraction of investments and job formation.

It is obvious that the current state of the Ukrainian economy cannot be overcome without application of cardinal measures based on a review of state policy and systematic operative implementation of sectoral reforms, which may be only by keeping and enhancing international support.

**To summarise the work of the OSCE’s SMM in the first half of 2015, we should note that the main task of assisting Ukraine in decreasing the level of tension and in holding a dialogue between all sides has not so far been achieved.**

## SUCCESSSES AND FAILURES OF THE OSCE’S SPECIAL

*Dmytro Levus*

To summarise the work of the OSCE’s SMM in the first half of 2015, we should note that the main task of assisting Ukraine in decreasing the level of tension and in holding a dialogue between all sides has not so far been achieved.

At the same time, in the current period, the Mission has achieved certain results and has undoubtedly improved the quality of its work. This can be seen first of all in the case of information collection and the increased number of daily reports that are drafted.

The objective work of the Mission on the line of fire demarcation was certainly responsible for the fact that the majority of the members of the OSCE Parliamentary Assembly, which took place in Helsinki in July, passed the resolution recognising the aggression of the Russian Federation in Ukraine.

This directly concerns the work of OSCE’s SMM to Ukraine as more than 30 Russian representatives are part of it. In this regard, it would be logical for the Russian Federation to adopt an independent decision to withdraw its representatives from the Mission, which would allow it to avoid accusations of it not being objective enough.

We would like to expressly indicate the issue

of the territorial location of the Mission’s work. According to the decision of the OSCE Permanent Council of 21 March 2014, the Mission’s mandate covers the whole territory of Ukraine. OSCE’s SMM has actually kept its distance from assisting in resolving the issue of Crimea’s annexation. Instead of trying to resolve the reasons for the Ukrainian conflict it has focused its attention on the effects provoked in the Donetsk and Luhansk regions by the annexation of Crimea. More specifically, the Mission does not monitor violations of human rights and freedoms in Crimea, which, in its turn, does not lead to talk about relieving stress in the Ukrainian community.

We should also note that a complete cease-fire on the line of demarcation and withdrawal of heavy arms have failed to materialise and these should be seen as failures of the OSCE’s SMM to Ukraine. Because of this, people, including peaceful citizens of Ukraine, are dying.

The issue of violation of the rights of prisoners of war as well as the issue of illegal export of Ukrainian servicemen to the territory of the Russian Federation are not covered enough. This in turn provokes criminals to commit similar actions with respect to peaceful citizens. The recently improved communication with the Ukrainian civil community and mass media is

**The recently improved communication with the Ukrainian civil community and mass media is certainly a positive development in the work of the OSCE's SMM to Ukraine.**

certainly a positive development in the work of the OSCE's SMM to Ukraine. In the initial stage of the Mission's work, its representatives rarely responded to invitations to participate in research and practice events, trying to formalise their contacts. The last half of the year demonstrates positive trends in this direction. Specifically, participation of the Mission's representative Karl Pleintinger at the round table "Security Mechanisms' Crisis in Europe: Ways Out", which took place on 17 February in the city of Kiev and the organisation of a dialogue between the patriots of Ukraine and the participants of the so-called Anti-Maidan in the city of Odessa on 24 April (on the eve of the tragic events of 2 May 2014).

These gestures by the Mission and the actual work of speaker Michael Bociurkiw have been positively evaluated by the civil community.

To summarise, we should note that several components are necessary for quality enhancement of the work of the Mission, whose mandate was extended to 31 March 2016:

1. Binding decision on the issue of the presence of Mission employees in occupied Crimea;
2. Enhancement of the SMM by a military component for successful implementation of the SMM's tasks in the Donetsk and Luhansk regions of Ukraine. It is only by direct extension of the Mission's mandate or enlisting the support of some other international organisation that SMM can reach its main goals of terminating the Ukrainian conflict provoked by Russian aggression.

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