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Inside Ukraine

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The Government Policy

Over the past six months, the government has failed to develop a comprehensive strategy on Donbas. From the very beginning, the Minsk agreements were ignored by Russia and militants, and therefore cannot be considered as an actual plan of conflict settlement in the East. It was unfeasible regardless of the fact some of the President's initiatives, including special order for Donbas financing, were quite radical and worsened the President's rating.

The reason for the conflict in the East is not Russia-Ukraine relations, but Russia's desire to reconsider the architecture of global security formed after the Cold War. That is why this conflict cannot be resolved in a bilateral format only and requires a package of solutions at three levels: geopolitical, Ukrainian-Russian and Ukraine's internal one.

Normalization of relations with Russia requires comprehensive solution and should concern not only Donbas, but also Crimea. However, the latter is rarely mentioned in the statements of Ukrainian officials. At the same time, the Ukrainian government should elaborate an economic mechanism of coexistence with temporarily occupied territories. Refusal to pay pensions to Donbas residents means Kyiv's de-facto recognition of the loss of the territory and Ukrainian citizens who live there.

At the same time, the Ukrainian political elite is engrossed by coalition-making process. The final coalition agreement may be released only on December 1, 2014, although the loss of time under the Ukrainian economic crisis and external Russia's aggression is unacceptable.

The government's dilemma on Donbas support



The Ukrainian government is in a stalemate situation as regards economic maintenance of the Donbas districts controlled by militants.

On the one hand, providing the local residents with free electricity and gas, pensions and social benefits will become a burden for the Ukrainian budget, when the state is experiencing a severe economic crisis. Moreover, it is unlikely that pensions and social benefits will reach their target recipient as the armed militants will take cash immediately after it is delivered.

On the other hand, a refusal to finance the separatist region will be interpreted as Kyiv's backing out of its citizens in that territory. It will make the local residents with passive position, who did not previously support any party, get into the orbit of Russian influence. In addition, such a step will be successfully used by Russian propaganda both for its domestic consumer and for export to Ukraine.

Kyiv's refusal to finance Donbas means recognition of the loss of this territory

As an option, Ukrainian government may promote migration of pro-Ukrainian citizens of Donbas to the territory controlled by the government. It may focus on meeting the needs of IDPs in accordance with recently approved law “On internally displaced persons”. The law has not been signed by the President yet, though the deadline, according to the Constitution, is over. Nowadays 455 thousands IDPs are officially registered in Ukraine, though the UN officials claim that the actual number of IDP is around 1 million. The government should be ready that when winter comes and deficit of food and cash aggravates in Donbas the number may significantly increase.

Such challenges also represent new opportunities for the Ukrainian government. Firstly, meeting the needs of IDPs, Kyiv may claim that it supports Donbas

Support of IDPs provides new opportunities for Ukrainian government

as a whole. Secondly, these people may become a major resource for returning the region under Kyiv's control, since they show another, democratic and peaceful, “Ukrainian” face of Donbas.

Possibilities to use such resource were vividly illustrated by manifestations of Donbas IDPs which were held in various Ukrainian cities on November 2, 2014 to condemn “fake elections”. IDPs stress out that they represent true Donbas while Donbas local people constitute only 20% of military formations organized by Russia in the region. Olena Styashkina, a famous intellectual from Donetsk, underlines that in spring 2014, 65-67% Donbas population wanted to live in Ukraine. At the same time only one third saw itself as a part of the Soviet Union/Russia/DNR. Yet this minority was aggressive and received weapons and instructors from Russia, while the rest was done by Russian propaganda and beginning of hostilities on this territory.

Failure of the President's “peace plan”

Separatist elections of November 2, 2014 clearly showed that “peace initiatives” of Petro Poroshenko had failed and that the Ukrainian government did not have a back-up plan. On the other hand, the presidential administration does not provide any response to gunmen's actions, which may be interpreted as existence of secret agreements which had not been showed in official text of “Minsk protocol”.

The government, namely Arseniy Yatseniuk and Petro Poroshenko, did not use September-October to elaborate a comprehensive strategy as regards Donbas in case gunmen ignored the President's peace plan. Both politicians were occupied by electoral campaign, while separatists used the time to form institutions in their quasi-state entities and build up military presence of Russia. Government bodies were established; schools, universities and hospitals restored their work; food provision and economic activities improved in the region. At the same time some

The government has not elaborated a comprehensive strategy as regards Donbas

independent leaders of separatists, such as Ihor Bezler, were expelled from the region, while with others Russia held a talk on need to coordinate their efforts in struggle against the Ukrainian government.

Accumulation of weapons and aggressive stance of Russia after “separatist elections” prove that separatists may try to get Debaltseve (an important transport hub), Shchastya (a major power plant in Luhansk region), Mariupol (the largest Azov seaport) and Donetsk airport (a strategic object within city of Donetsk) to ensure economic and transport infrastructure of DNR and LNR. It will also transform them in unrecognized, yet functioning republics, such as Abkhazia or Transnistria. At the same time, the Kremlin will say that it was purely an initiative of Donbas separatists. In Russian perception of the world “fake elections” are enough to recognize puppet republics, if they play in the Russian interests.

In nearest future militants may try to expand their territory

Delay in coalition-making is an unacceptable waste of time for Ukraine

In peace time a month to form a coalition is a usual thing. However, when Ukraine fights an external aggressor and economic crisis, loss of even several weeks is an unacceptable luxury. Especially taking into account the fact that there are no ideological differences between the parties which form coalition, and their electoral promises are 80% the same. In the times when reforms and fight against corruption are a matter of survival for Ukraine, delay in coalition-making proves that major political players are not ready to cede their ambitions and the process is influenced by external players, namely oligarchs.

Reforms and fight against corruption are a matter of survival for Ukraine

According to the Constitution, coalition-making may take up to one month since the first session of a new Verkhovna Rada. Volodymyr Hroisman, vice-prime-minister and participant of coalition negotiations representing “Bloc of Petro Poroshenko”, recently stated that the first session might take place on December 1, 2014 and that coalition agreement may be presented on the same day. Delay with vote count in majoritarian districts played to the advantage of negotiators, as final results of elections were published only on November 12, 2014.

Right after the elections “Bloc of Petro Poroshenko”, “People’s Front” and “Samopomich” declared that coalition negotiations should be focused not on distribution of offices, but on definition of a common program for reforms, with specific deadlines and steps. At the same time, the politicians’ statements lack specificity. Representatives of all major democratic parties talk about eurointegration as a single foreign policy vector, the Association Agreement as a road map for reforms, decentralization as a way to provide regions with more authorities, the need to improve energy independence of Ukraine etc.

The politicians’ statements lack specificity

The politicians speculating on eurointegration topic may result in failure to implement reforms

and the fact that eurointegration rhetoric will be discredited in the Ukrainian society. Some public agencies already abuse the topic explaining their controversial steps by the need to meet the European standards.

Speculation on eurointegration topic has discredited the whole process

For instance, Valeria Hontarievna, head of the NBU, recently claimed that possibility to early terminate deposit agreements negatively influences balance of the banking system and does not meet the European standards. Similarly, in the EU it is not common to make payments over EUR 1000 in cash. Meanwhile, the NBU head does not say that restrictions of this kind should have been done before financial crisis, but not when trust of citizens to the banking sector is totally lost and hryvnya has fallen by 100% within a year.

Similar approaches are applied in Ministry of healthcare. The latter adopted a protocol, according to which a significant share of people having tuberculosis will be treated in general hospitals or through outpatient treatment programs, but not in special TB clinics. A patient not being isolated increases risks for the disease to be spread. The government officials refer to the European practice, but they forgot to mention that TB incidence rate is much higher in Ukraine than in the EU. In 2013 it was 67.9 cases per 100 000 population. Ukraine passed the epidemic threshold of 50 cases per 100 000 long time ago — in 1995. If to compare, TB notification rate in the EU was 13.5 cases per 100 000 population in 2012.

Examples of this kind show that while elaborating reforms the state agencies should consider peculiar features of current situation in Ukraine. Eurointegration cannot be an object of manipulations and reforms should be based on detailed public policies in specific areas, but not be a set of empty declarations made by some political forces.

While elaborating reforms, officials are to consider Ukrainian specifics

Economic Situation

Ukrainian government is going to introduce a position of business ombudsman who is to deal with complaints of business representatives as regards corruption in state bodies, corporate raids and other issues related to the improvement of investment climate.

Prime Minister expressed his willingness to deny financing of Donbas territories, which are not controlled by Ukrainian government. In terms of state budget this will be a positive thing, as self-sufficiency of Donetsk region is 39.8% and Luhansk region — 44.1%. However, economic situation in Ukraine may

worsen considerably, as Luhansk and Donetsk regions' contribution to state budget amounts to 16% of GDP.

Ukrainian energy sector needs comprehensive reforms. It concerns not only gas production, but also coal supply for thermal power stations and fuel supply for nuclear power stations. Ukraine's dependence on Russia in all of these three directions undermines Ukrainian national security. It is possible to meet Ukrainian gas needs by exploiting Ukrainian own resources. However, energy sector in Ukraine needs a simplified procedure for licensing as well as general liberalization of energy market.

Business ombudsmen will protect businesses in Ukraine



Ukrainian government in cooperation with EBRD signed an anti-corruption initiative, which creates the position of the business ombudsmen for anti-corruption issues. The Cabinet of Ministers is set to make a decision on introduction of business ombudsman position over the next two weeks.

It is expected that the business ombudsman will deal with complaints lodged by both Ukrainian and foreign businessmen working in Ukraine. In particular, this will concern accusations of corruption, corporate raids etc. The main goal of this

initiative is to stimulate investments to Ukraine.

As of today, government commission is working on the elaboration of regulatory and legal framework, in particular in regard to certain draft laws and regulations, which will create a legal basis for business ombudsman activities. EBRD, Ukrainian government and representatives of business associations in Ukraine announced a call for the position of the business ombudsmen for anti-corruption issues. There is high likelihood that this position will be taken up by a foreigner.

It is not the first attempt to create an institution of business ombudsman. Such positions exist in the US, Russia, Georgia. Public debate on the matter has been going on in Ukraine since autumn 2012. At that time State Entrepreneurship Committee of Ukraine tried to assume official powers of business ombudsman and certain control of a number of controlling bodies. Another attempt was made in 2013 when EBRD held negotiations with government officials as to creation of business ombudsman office in Ukraine to improve investment climate in Ukraine. However, negotiations ended up with nothing.

There were attempts to introduce position of business ombudsman in Ukraine in the past

Expert community's response to the creation of business ombudsman office was rather positive. Given permanent public expectation of judicial reforms, and unsuccessful attempts to secure the rights of investors, business ombudsman may become a civilized instrument for solving conflicts and disagreements between government and business. As well, it may be an effective mediator between the state and businesses, which will counteract abuse of power by judges. However, one should not expect that business ombudsman may become a guarantor

of fair justice and some kind of panacea as regards the protection of property rights. Apparently, the said official can deal only with a limited scope of problems, which arise in the process of interaction between business and government. At the same time, it may become another measure to eventually improve investment climate in Ukraine.

Business ombudsman should become a civilized instrument for solving conflicts and disagreements between governments and business

In the international context business ombudsman may deal with protection of businessmen's rights outside Ukraine. Governmental and non-governmental agencies in developed countries efficiently protect the rights of their own companies abroad. As regards Ukrainian public and non-governmental institutions, they lack personnel trained to effectively protect interests of Ukrainian businesses.

Today, the functions of business ombudsman are performed by some self-governed organizations, business associations and certain state bodies. While introducing this position, it is important to distinguish various functions in order to avoid duplication and potential conflicts.

Arseniy Yatseniuk does not want to finance Donbas

One of the most controversial issues of the past week was Yatseniuk's statement that Donbas territories not controlled by Ukrainian government would not receive state funding. Also, Prime Minister announced that these territories need additional subsidies worth UAH 19.6 bln. for Donetsk region and UAH 14.6 bln. for Luhansk region. In general, state subsidies are set at the level of UAH 37 bln. for the entire Donetsk region and UAH 19.8 bln for Luhansk region.

Territories of Donetsk and Luhansk regions which are not controlled by Ukrainian government need UAH 34 bln. in subsidies

Another matter of discussion is how those regions contribute to state budget. For example, Ihor Bilous,

head of State Fiscal Service, stated that in January-October 2014 state budget did not receive around UAH 6.7 bln. in taxes from Donetsk and Luhansk regions. However, according to statistics of Donetsk local administration, Donetsk region fulfilled its budget obligations by 91% for 9 months in 2014.

The revenues in Donetsk region in 2013 amounted to UAH 16.3 bln. Instead, budget expenditures totalled UAH 41 bln. Thus, self-sufficiency of Donetsk region is 39.8%. In Luhansk region, budget revenues in 2013 amounted to UAH 9.4 bln. vs UAH 21.35 bln. in expenditures, which means that expenditures exceeded revenues by 44.1%, with the difference being compensated by the state.

Financial independence of Donetsk region amounts to 39.8%

Acknowledging high financial dependence of Donbas on interbudget transfers and other public expenditures for the region, it should be noted that reduction of public expenditures may compensate for decrease of budget revenues. It may also cover pension fund deficit. However, the problem is that, according to the World Bank, Donetsk and Luhans regions produce 16% of GDP, 25% is their share in industrial production, 7% — in agriculture. This leads to the conclusion that the regions have a considerable impact on economic situation in Ukraine and their loss may cause a sharp decrease in industrial output and GDP.

It is unlikely that the said region will manage to use its economic potential over the next years. According to Deputy Minister of economic development and trade of Ukraine, economic downturn in Donetsk and Luhansk regions reached 80%. In Luhansk region 19 out of 23 major companies do not function, while in Donetsk region around 50% of companies have been closed. The loss of jobs reached 50% for major companies and 80-90% for small and medium enterprises. More than 90% of hotels, restaurants and sell outlets suspended their activities in Donetsk region.

The actual loss of control of some territories in ATO zone makes it impossible to perform a num-

ber of state functions, including pension payout and other social obligations, interbudget transfers and restoration of Donbas infrastructure.

Apparently, general economic tendencies are not going to change by the end of the year. For this reason, the problem should be dealt with in two aspects:

The loss of control of the territories makes it impossible to perform state socio-economic functions

1) For state budget the actual loss of control of the said region will signify the reduction of expenditures at the cost of high budget dependence of Donetsk and Luhansk regions;

2) In general, Ukrainian economic situation will be significantly influenced by the loss of control of the said region. In the first place, it would happen so due to high dependence of Ukrainian industrial production on coal industry (Donbas coal accounts for 80% of all coal extracted in Ukraine), fall in metallurgic industry (34.4% and 9.3% — shares of Donetsk and Luhansk regions in general structure of Ukrainian metallurgy), machine construction (shares of Luhansk and Donetsk regions in 2013 amounted to 15.8% and 6.9% respectively), chemical industry (share of Donetsk region — 16%, Luhansk region — 13%).

Energy sector needs liberalization

Today Ukraine is very dependent on Russian gas, fuel for nuclear power stations and coal. In order to solve the issue of energy deficiency in Ukraine, Ukraine and Russia signed temporary gas agreements in October 2014. However, Russia views these agreements as an interim political agreement, which is not legally binding.

Ukrainian government enjoyed a certain success in diversification of nuclear fuel suppliers by concluding an agreement with one American company. However, if Russia suspends supplies of gas, coal and nuclear fuel to Ukraine and does it simultaneously, such situation will result in energy collapse.

Ukrainian government made progress in diversification of energy suppliers

Ukraine has to purchase nuclear fuel from Russia due to its outdated nuclear reactors. Ukrainian thermal power stations are also dependent on Rus-

sian coal. In order to deal with Russian threat to Ukraine's energy security, domestic energy infrastructure needs to be modernized.

Within the "Recovery of Ukraine" action plan, Arseniy Yatseniuk introduced his energy strategy, which aims at attracting the EU and US investments in modernization and use of hydroelectric stations, diversification of nuclear fuel supplies, signing of agreements on construction and development of nuclear energy blocks.

60% of gas which used to be purchased from Russia is now supplied by European companies. Beside Russia, nuclear fuel will be now purchased from American "Westinghouse" company. Ukraine should stick to a hard austerity program as regards energy resources by replacing gas with other types of fuel. It has been decided to build new nuclear blocks to increase electricity production.

Ukraine needs to explore its gas fields more, to modernize its infrastructure and to create favour-

able conditions for domestic gas production. Almost all the drilling rigs need to be modernized. Licenses for the exploration of new gas fields are hard to receive. Licensing process is to be simplified

Ukrainian energy sector needs liberalization

— currently licenses are issued for 5 years and need to be prolonged after they expire.

The issue of gas supply may be solved by Ukraine's domestic resources. However, energy sector needs a simplified procedure of licensing and general liberalization of energy market.

Political competition

The number of coalition participants has increased from three to five but it has not significantly affected the balance of power between “Bloc of Petro Poroshenko” and “People’s Front”. The deliberations of coalition formation might turn into a discussion of cohabitation principles for two major parties.

Majoritarian deputy groups, formed from “Sovereign European Ukraine” and “Economic development”, will become full-fledged subjects in the new

Verkhovna Rada. Ihor Yermeyev was the first to play in this field. He has already announced that he will have a stronger team in the new parliament. Both groups will actually support the majority during voting but formally they will not be able to become its members. This is due to the fact that they mostly comprise former deputies of Party of the Regions or those who voted for Victor Yanukovich’s “dictatorship laws”.

Principles of the coalition agreement are laid down



In addition to “Bloc of Petro Poroshenko”, “People’s Front” and “Samopomich”, Oleh Lyashko’s Radical Party and “Batkivshchyna” joined the coalition negotiations.

Expanding the coalition to five members is Petro Poroshenko’s attempt to dilute the impact of Arseniy Yatsenyuk, who has received higher results under a proportional representation system and actively cooperates with “Samopomich”.

However, this step did not lead to a change in the balance of power since the President may confidently rely only on the support of the Radical Party, behind which Serhiy Lyovochkin is. This

Five parties take part in the coalition negotiations

politician is also credited with the influence on a considerable group of deputies within “Bloc of Petro Poroshenko”.

“Batkivshchyna” will tend to cooperate with “People’s Front” instead of the President’s party, given personal opposition between Yulia Tymoshenko and Petro Poroshenko. What is more, “People’s Front” consists of former allies of Yulia Tymoshenko and, therefore, contacts at the interpersonal level between the two teams are more plausible.

At the same time, the formal participation of the Radical Party and “Batkivshchyna” in the coalition is mostly counterproductive. The role of constructive opposition would suit these parties more when they

vote on reforms with majority, but are able to criticize the government. It would diminish “Opposition bloc” impact on work of the parliament. In case this party is the only opposition, it will automatically provide certain pre-eminent posts and create a convenient springboard for its political comeback.

The role of constructive opposition “suits” the Radical Party and “Batkivshchyna”

Participants of coalition talks have agreed on the format of the coalition agreement. It will consist of three components: general principles, regulations of the coalition activities and their areas (reform programs).

As it was the case in the preliminary coalition agreement presented by pro-presidential party, working bodies of the coalition will include Coalition Assembly and Council, but the principles of their formation will differ. In particular, the President’s team originally offered to set up the Council under “one representative per 15 faction deputies” principle, which would give advantages to “Bloc of Petro Poroshenko”.

Instead, it was agreed that three representatives from each faction will make up the Council and each faction will have only one vote. The decision requires at least $\frac{3}{4}$ of the votes. The application of this princi-

ple is quite weird because it implies that any decision should be voted for by at least four of the five existing parties. It enormously complicates the coalition decision-making and equates the largest (“Bloc of Petro Poroshenko”, 132 MPs) and the smallest (“Batkivshchyna”, 19 MPs) factions in rights. Only if the Radical Party or “Batkivshchyna” come out of the negotiations, it will simplify “the math”.

Factions, not independent deputies, will be able to join the coalition. This decision will increase the size of factions since majoritarians will not be willing to stay out of political processes. The negotiators also agreed that “Opposition bloc” and MPs who voted for the “laws of January 16” cannot be the coalition members.

Factions, not deputies, are the members of coalition

According to the approved provisions of coalition agreement, the Prime Minister will be able to form the cabinet independently, after consultations with the coalition. Ministers will also appoint their deputies independently, whereas these posts used to be subject to trading according to party quotas before. This independence lays special responsibility on the Prime Minister and Ministers for efficient functioning of ministries and for reform implementation.

Ihor Yermeyev promises to create a parliamentary group

The previous parliament had a distinct division of the parties and deputies along “power-opposition” line. Unlike the previous convocation, the newly elected Verkhovna Rada does not have a clear division since, in the result of the liberalization of political field and public demand for

A new parliament will not have a distinct division between power and opposition

new faces, civic activists, influential businessmen, volunteer battalion commanders and journalists gained parliamentary seats. In contrast to parliamentary factions, they will form parliamentary groups and interfactional bodies, whose policy may contradict the official policy of the parties. These political entities will be formed by party or business affiliation. For instance, “Volia” and “Svoboda”

can create a parliamentary group. Journalists and public figures promise to start interfactional entity to support reforms.

Ihor Yermeyev, co-owner of the “Continium”, was one of the first businessmen who announced his intention to create a large parliamentary group. After the fall of Yanukovich’s regime, he headed the parliamentary group “Sovereign European Ukraine” consisting of 36 deputies. Currently the politician can count on the support of about 30 MPs, most of whom voted for the “dictatorship laws of January 16”. Since the way to pro-presidential coalition is closed for former regionals, their participation in Yermeyev’s parliamentary group is one of the few options for parliamentary influence and lobbying business interests. In fact, this parliamentary group will support the pro-government coalition and its

legislative initiatives, although it will not be able to join the majority officially.

At the request of civil society and international organizations, upcoming parliamentary elections may be held under the proportional electoral system with open lists. So, the next step of further institutionalization of Ihor Yermeyev's parliamen-

tary group may become the formation of a new party. Obviously, it might happen on the basis of "People's Party" of Volodymyr Lytvyn, who has been a long-time political partner of Ihor Yermeyev.

Yermeyev's group will support a majority without joining it

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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