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# Inside Ukraine

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# The Government Policy

The pressure on Kyiv regarding the unilateral fulfillment of the Minsk agreements in terms of the elections in Donbas may become a factor of political destabilization in Ukraine, lower the President's rating, and aggravate the coalition's infighting and the dissatisfaction of Ukrainians with the West. Morel's plan will play into the Kremlin's hands as the elections will legalize pro-Russian forces in Donbas and lead to a frozen conflict with the potential to use the region's special status as a means to destabilize the whole country. The majoritarian elections, the formation of electoral commissions of local residents, and the delegation of control over the electoral process to the OSCE are related to a high risk of distorted election results.

The initiatives similar to Morel's plan may be introduced only after Ukraine regains control over its borders, foreign military units are withdrawn

from its territory, and equal opportunities are provided both for the mass media and political parties to organize their campaigns. The rush of the West regarding local elections in Donbas will bring tactical but not strategic results. Kyiv will be made responsible for the territories full of Russian weapons, Russian militants, and Russian puppets in power. This will not solve the conflict, but rather it will serve to freeze it.

The agenda of the "Normandy Four" meetings should include the elaboration of a long-term solution for the conflict, which would be free from the traps Russia incorporated into the first and second Minsk agreements and which would address the issue of Crimea. The actions of Crimean Tatars to block the supply of goods to the peninsula are a good reason to reintroduce the issue of the illegal annexation of Crimea to international discourse.

## The threats of Morel's plan



The West continues to push Kyiv toward the asymmetric fulfillment of the Minsk agreements, now in terms of the local elections in Donbas. The so-called Morel's plan, which appeared after the Minsk meeting held on September 12, 2015, is a major subject of discussion by the "Normandy Four" on October 2, 2015. Its aim is to develop a mechanism for local elections in Donbas, which would be acceptable for Russia, legalize the participation of DPR/LPR representatives in Ukrainian politics, and turn the conflict

in the East from an international problem into an internal Ukrainian problem.

The major threat in the realization of the plan is a potential for further destabilization in Kyiv (the violent confrontation near Parliament on August 31, 2015, triggered by the vote for constitutional amendments proves this may be the case). Other challenges include the aggravation of the ruling coalition's split along the line BPP-People's Front vs Batkivshchyna-Samopomich, the fall of the President's rating

due to his excessive submission to Western pressure in Minsk-2 matters, and the growing discontent of Ukrainians over EU actions. More and more people in Ukraine believe that the migration crisis and the war in Syria have gradually replaced the Russian aggression against Ukraine on the European agenda. Further, the interests of European businesses and actions of pro-Russian agents in the West more often raise the topic of lifting sanctions against the Kremlin.

In addition to the special status of Donbas, which has been proposed to be formalized in the constitution, Morel's plan foresees a special order for elections in the separatist region. Since September 2014, Ukrainian politicians have repeated many times that the elections in Donbas may take place only according to Ukrainian legislation. At present, Moscow, Berlin, and Paris have drawn Kyiv's attention to the fact that the text specifies that it may be any law approved by the Verkhovna Rada, not necessarily a previously existing law.

Such speculations show one of the major issues in Minsk-2: vague wording allows for different interpretations of the text by each party. However, Ukraine is usually the loser in this war of interpretations. Similarly, Ukraine perceived the Minsk memorandum as a clear sequence of steps, whereas its Western partners have insisted that there was no link between constitutional amendments and the fulfillment of the first steps in Minsk-2, such as the withdrawal of heavy weapons or the exchange of POWs.

If one follows this logic, Ukraine may now demand the fulfillment of Item 10 of the Minsk agreements (the withdrawal of all foreign military units from Ukrainian territory under OSCE supervision) even before the final vote for constitutional amendments and the holding of local elections in Donbas.

Major elements of Morel's plan include the holding of elections in Donbas under the FPTP system, the formation of territorial election commissions of local residents under the management of the Ukrainian Central Election Commission (CEC) members, the key role of the OSCE in ensuring transparency and fairness in the vote, and the access of national media to highlighting the elections through respective decisions of committees on joint accreditation. As an option, there has been a proposal to introduce

a five-year residential qualification for candidates (except for heads of local councils) and allow for the participation of parties that had local branches in the region before 2014.

Though Morel's plan was elaborated in the course of negotiations between Victoria Nuland and Grigory Karasin, many of its components were discussed by pro-Kremlin experts Vladimir Malinkovych and Mikhail Pogrebynsky in as early as June 2015. In particular, their plan foresaw majoritarian elections, the formation of electoral commissions from locals under the consent of the Ukrainian CEC, the key role of the OSCE in control over the elections, and the withdrawal of gunmen not from the territory of Ukraine, but rather only from the residential area on the election day.

Under the current conditions in Ukraine, majoritarian elections bear the largest risks for corruption due to the possibility of administrative resource abuse (in Donbas this resource is controlled by pro-Russian gunmen) and massive vote bribing (with the current humanitarian crisis in Donbas, voters will be ready to vote even for basic grocery packages). In addition, the election's results will be influenced by security considerations (the presence of gunmen, the active work of LPR/DPR security services, and citizens' fear for their own lives will prevent pro-Ukrainian citizens in Donbas from participating in the elections as candidates and even from sincere voting).

The initiative to allow parties who had local branches in Donbas before 2014 will give an advantage to the Communist Party and Party of the Regions in case of its rebranding. In the meantime, it will eliminate the party projects launched by the Kremlin only after the aggression started. Nevertheless, the majority of local activists representing the Communist Party and Party of the Regions were a backbone for spreading the separatist scenario in Donbas last year.

The appointment of CEC members as heads of territorial election commissions will only formally define the presence of Ukrainian authorities at the elections. They will not have a considerable influence on the election's course, as at the level of DEC and PECs the commissions will consist of representatives of current occupation forces or former party activists eager to cooperate with Russia.

The OSCE will be used to legalize the election results, as the observers will not be able to influence the organization of elections, providing only episodic observations of the process. Even if there is a huge OSCE mission, observers will not be able to stay at all the polls at all times (usually observers cover several dozen poll stations, out of which they may physically visit up to ten).

Equal opportunities for candidates to organize their political campaigns are also highly unlikely. Russian and separatist TV channels dominate in Donbas, whereas most advertising spaces have been used for propaganda purposes by the heads of the self-proclaimed republics for more than a year.

It makes sense to introduce a residential qualification not only for the candidates, but also for the voters in Donbas.

At the same time, the important question is how to arrange the participation of 950,000 IDPs (this figure includes 160,000 children). According to the State Emergency Service, as of September 17, 2015, IDPs were concentrated in the following regions: Luhansk (221,000), Kharkiv (190,000), Donetsk (113,000),

Dnipropetrovsk (84,000), Zaporizhya (66,000), Kyiv region (44,000), and the city of Kyiv (39,000).

They represent the Donbas communities and often share pro-Ukrainian positions, but they were forced to leave their places of permanent residence due to security considerations. If Moscow, Berlin, and Paris insist on the political reintegration of Donbas into Ukraine, it is necessary to ensure the right of IDPs to influence the future of their native communities. At the same time, they should vote in the place of their current residence, as any trip to the territory controlled by separatists is associated with serious security threats. Such remote voting at the local elections is possible under a proportional representation system and after a meticulous revision of voters' lists. It may also necessitate the introduction of an electronic voting systems or a change of ballot design (for instance, a voter may independently indicate the town s/he represents). One way or another, ensuring equal voting opportunities for all the residents of Donbas will require a considerable amount of time.

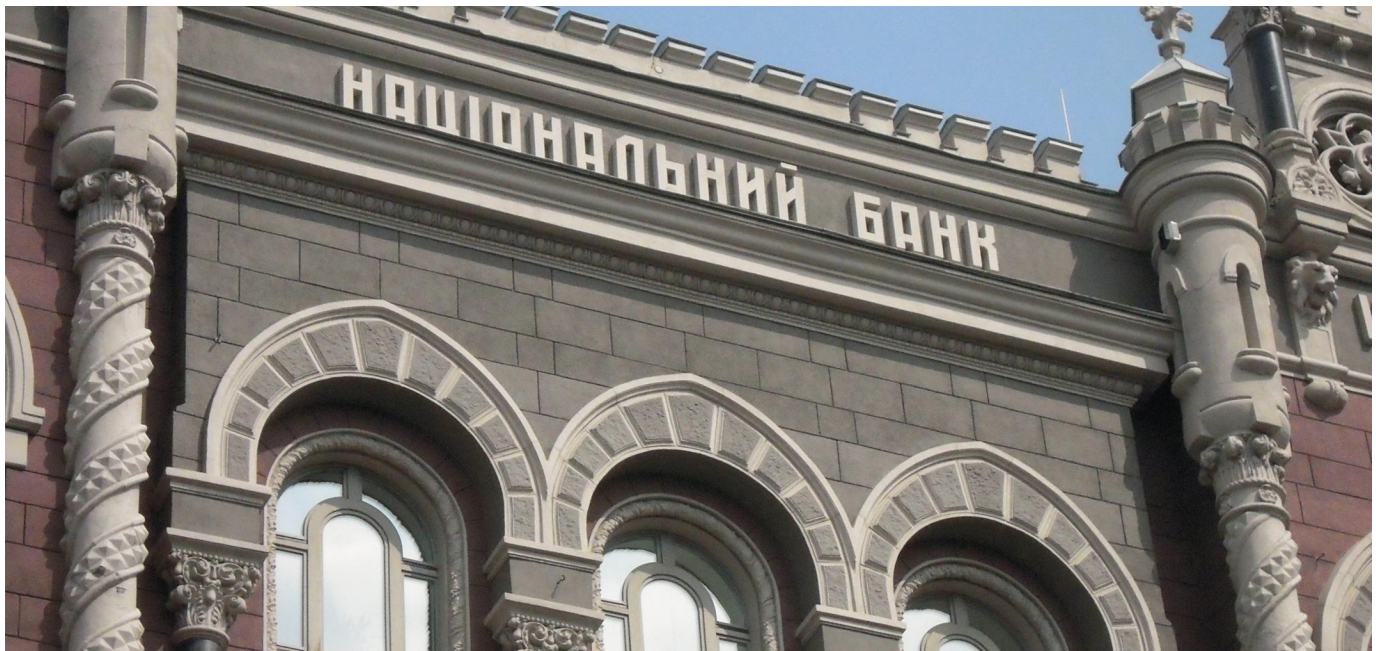
# Economic situation

At the beginning of September 2015, the National Bank of Ukraine (NBU) softened foreign exchange restrictions, which had been introduced earlier in order to stabilize the situation in the FX market. Such concessions on the part of the NBU were made possible due to the results of NBU monetary and exchange rate policy as well as expectations of moderate economic growth in 2016.

With the new heating season approaching, energy issues are again high on the agenda.

The balancing of the national gas market and the best use of underground gas storage facilities can be achieved through the effective use of a seasonal variation in prices, flexible approaches to gas production and imports, the construction of an LNG terminal, and open trade at the gas hub. Such issues require the elaboration of a balancing network code, which should take into account the interests of all market players.

## The NBU softens FX restrictions



The most significant NBU measure was the lowering of interest rates from 27% to 22 %. Before that, in early September 2015, interest rates were reduced by 3% - from 30% to 27%. It is noteworthy that in order to cushion the impact of panic in the FX market on March 4, 2015, the NBU increased interest rates to 30% from an initial 19.5%. Last year, the NBU increased interest rates as many as three times: from April 15, interest rates rose from 6.5% to 9.5%, from July 17 to 12.5%, and from November 13 to 14.0%.

The reason for the lowering of interest rates was a rather tough NBU monetary policy during the last six months, which helped stabilize the FX market and, as a result, drove down inflation. Considering yearly

figures, the consumer price index has been falling for three months in a row. Further, in July 2015, deflation was reported if one takes monthly figures into account. According to NBU officials, the planned increase in prices and tariffs as well as the government-introduced early rise in wages and social benefits will not have any significant impact on inflation rates.

The softening of FX restrictions will allow for gradual economic recovery, the signs of which were seen in the third quarter and which will continue in the fourth quarter of 2015.

In early September, the NBU relaxed a number of administrative restrictions, aimed at restoring confidence in the national banking system and driving

the inflow of FX deposits. In particular, the NBU increased the amount of FX cash and investment metals that could be withdrawn from clients' bank accounts per day from UAH 15,000 to UAH 20,000.

In case of purchases of FX currency by clients, the NBU has allowed banks not to include the account balances of foreign currency belonging to the 3rd Group of the Classification of Foreign Currencies and Investment Metals. This would make it possible for clients with account balances in nonconvertible currencies to purchase foreign exchange. The authorized banks are allowed to cease control over clients' export transactions if evidence is given that claims thereunder have been offset against similar counterclaims in foreign currencies that are not subject to the mandatory sale. The amount of such liabilities shall not exceed USD 0.5 million per contract.

The obligations to sell FX proceeds (surrender requirements) have also been revised. From now on, the surrender requirements shall not apply to funds, which were returned on the initiative of a foreign

bank within a 2-day period. The NBU also abolished the obligatory requirement to submit a certificate of no outstanding tax liabilities issued by the State Fiscal Authority of Ukraine as part of submitted documents. This translates to a great sense of relief for importers.

At the same time, the NBU continues its efforts to prevent nonproductive capital outflows abroad. In particular, the regulator imposed a ban on FX purchases for settlements for imported goods that underwent customs clearance procedures before January 1, 2014. This applies to cases when the replacement of a debtor and/or creditor takes place as regards obligations under foreign trade agreements. From now on, such resident companies have to fulfill such obligations by using their own FX funds. This requirement shall not apply to vital goods.

The aforementioned FX administrative limitations will be effective until December 4, 2015, inclusive. It is expected that the NBU will proceed with the gradual liberalization of FX regulation.

## Gas reserves: different views on the same problem



The delivery of gas to both Ukrainian and foreign consumers during the heating season will depend on Ukraine's capacity to fill up underground gas storage facilities. This year, the heating season in Ukraine starts on October 1, 2015, which coincided with the introduction of the Law of Ukraine "On the gas market", setting out new rules for the liberalization of the energy market and enabling consumers to freely choose energy suppliers. However, certain problems arise in

connection with national gas production growth under excessive fiscal pressure, the financing of necessary import purchases, and the elaboration of new rules for domestic companies regarding the formation of gas reserves. Once again, Ukraine has found itself in the situation where key energy issues are resolved just before it is too late.

Taking into account that as of late September gas reserves in gas storage facilities totaled almost 15.5

bcm and that the gas volumes should be no less than 19 bcm to cover the winter period, the difference should be compensated either through additional gas imports or increased domestic gas production.

On the one hand, there is not much to worry about. In September 2015, with the support of the EU, Ukraine finalized an agreement with Russia on Russian gas delivery starting on October 1, 2015, and running until the end of March 2015. Ukraine initialed a relevant protocol that obliged Ukraine to fill up gas storage facilities with an additional 2 bcm of gas in October 2015. The EU also promised to help collect USD 500 mln from international financial institutions by the end of the year to enable Ukraine to purchase gas from Russia.

On the other hand, in view of the current situation in Donbas, these agreements should not be considered final. The need for gas supplies may significantly increase in case domestic gas production falls and the financial situation of gas companies deteriorates.

The issue of high rental rates has not been resolved despite relevant demands from businesses, IMF proposals, and the current condition of some state-owned companies, especially “Ukrgezvydobuvannia” PJSC, the rental rate for which is 70%. In addition, the government is planning to increase the “burden” and establish a new procedure for the formation of gas reserves. As of today, these reserves are created by gas suppliers in the amount totaling 10% of quarterly gas volumes delivered to consumers. There is an ongoing debate in the government over the possibility to bring these gas volumes to monthly rates.

According to private companies, the increase in gas reserves may account for the freezing of 400 mcm of gas in underground gas storage facilities worth almost UAH 2 bln as well as it will create uncompetitive conditions for gas traders. At the same time, the issue will remain unsolved due to the fact that these gas volumes are insignificant on the national scale.

In the EU, which imports more than 60% of gas, obligations regarding energy supply security are at the top of the agenda. In particular, in Germany, the

market players agree that such obligations should be individual, though they do not object to considering other models: the creation of national gas reserves, the transfer of some gas storage facilities to transmission system operators, and obligations to create gas reserves for traders.

For example, the first model provides for the creation of gas reserves to cover gas volumes for a 45-day period of consumption (almost 10 bcm) through members’ contributions made by gas importers and gas producers within the gas accumulation agency.

According to the second model, individual facilities for gas reserves during the winter time (approximately 2 bcm) are transferred to transmission system operators alongside the introduction of a relevant compensation mechanism through tariffs. Gas reserves are used by transmission system operators to balance the domestic market.

The third model envisages that market operators or traders create gas reserves for the winter time (approximately 7 bcm, including 4 bcm for the protected category of consumers) according to their share in gas sales in the market. A transmission system operator decides on the use of gas reserves together with a relevant state body.

Therefore, it can be concluded that in Ukraine the issue of the balancing of the national gas market and the best use of underground storage facilities is of top importance, in particular through the effective use of a seasonal variation in prices, flexible approaches to gas production and gas imports, the construction of a LNG terminal, and open trade at the gas hub.

The absence of specific rules for the balancing of the gas market in the Law of Ukraine “On gas market” makes the elaboration of a gas network code a top priority in the future. However, the code should take into account the interests of all market players. That said, the absence of a comprehensive approach to solving problems in this specific sphere, which would consider international practices, will not allow for the liberalization of the gas market and will not offer national companies incentives to improve their performances.

# Political competition

Recently, Serhiy Lyovochkin announced that due to changes in strategic priorities and objectives, the “Opposition bloc” will be renamed the Party of Peace and Development. This shows that the main shareholders were unable to resolve the conflict of interest and agree on a common political future for the opposition under a single project.

However, the campaign has entered an active phase, and it is characterized by a large number of technical projects and election law violations on the part of the authorities. There is an active use of administrative resources by pro-government candidates and prescription violations on 30% gender quotas in the electoral lists of the political parties.

## Transformation of «Opposition bloc»



Since the establishment of the “Opposition bloc”, Serhiy Lyovochkin and Borys Kolesnikov sought to lead the party, but neither managed to enlist the support of the majority. Due to the conflictive nature of the confrontation, major shareholders of the party unsuccessfully proposed Vadim Novinskyi and Rinat Akhmetov as heads of the brand as the compromise candidates.

Serhiy Lyovochkin’s statement may indicate that corporate conflict is being resolved by the re-branding of the “Opposition bloc” to the Party of Peace and Development. The entire new project will be owned by Serhiy Lyovochkin, and economic pragmatism, peace, and the reconstruction of Ukraine will be the main slogans of this political project.

In turn, Borys Kolesnikov has legal rights and the seal of the Party of the Regions. It is not improbable that Borys Kolesnikov and Alexander Vilkul can

create a new project on the basis of the former ruling party. It should be noted that within the opposition government, Borys Kolesnikov pays special attention to the industrial reconstruction of Ukraine and the role of large enterprises. It is possible that the project will focus on these ideas.

The “Opposition bloc” will go as a single brand at the local elections, but quotas were determined on a regional basis. He or she who has the best network and influence in the region forms headquarters and voting lists. For example, Serhiy Lyovochkin forms lists in Kyiv, Odesa, Vinnytsia, and Bukovyna, and Borys Kolesnikov does so in Dnipropetrovsk, Zaporizhzhya, and Kherson. After the local elections, at least two political parties may be established based on the “Opposition bloc”, which will compete for the opposition electorate of the South and East of Ukraine.

# Features of the campaign for local elections

The current election campaign is characterized by rather dirty methods of political competition. Parties do not compete in ideas or programs aimed at improving life in their own communities, but rather they compete in political technologies, administrative resources, finances, and media. The election rhetoric is aimed at national themes and does not allow for the resolution of local problems.

With the support of the Administration of the President, many technology projects were created for the local elections, which are aimed at the dispersion of votes or achieving good results in particular regions. For example, in contrast to the party “Samopomich”, the “People’s Control” party was established. The party of mayors and former representatives of the Party of Regions, “Nash Kray”, was established as a potential satellite of “BPP-Solidarity” that cannot compose a majority in local councils alone. The “New Faces” party and “The Party of the local self-government” are entirely technological parties in the Kyiv region.

Organizations that monitor elections in regions state that the ruling parties actively use administrative resources, conclude “voluntary agreements on the financial basis” with the electorate, purchase and dole out provisions and medicines, pay utility bills for pensioners, and more.

Also, there has been a crude violation of provisions of the law on local elections with regard to 30 % gender quotas. Preliminary analysis of the voting lists of the leading parties shows that only the “Samopomich” party, “Power of people”, and to a lesser degree “Vidrodzhenya” have followed this policy.

On September 23, 2015, the Central Election Commission approved Resolution №362, according to which it was decided that parties in local elections that do not comply with 30% gender quotas would not be refused for registration. The “Samopomich” party has filed a lawsuit demanding to revoke this decision.

Local elections will become a serious challenge for Ukrainian democracy, and they will show whether the public is ready to renew the local elites.

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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