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Analysis of Ukrainian government activities



A report of the Ukrainian government to the Verkhovna Rada of Ukraine coincided with the second anniversary of the shootings in Instytut-ska Street, the end of the Maidan protests, and the rise to power of a new government led by Arseniy Yatsenyuk. Such a coincidence allows us to draw conclusions on the results of the Ukrainian government's work for the past two years in general, not only as a formal report of the Cabinet of Ministers of Ukraine.

Ukrainian authorities after the Maidan, on the one hand, faced unprecedented challenges and, on the other hand, received a high level of trust and support of the public, a mandate for the implementation of radical, deep, and systemic reforms. Ukrainians expressed their willingness to sacrifice their lives and well-being for a better future of the country through the volunteer movement and the heroism of volunteers and soldiers at the frontline in the east of the country. Ukrainian citizens expected political leaders to break the corrupt-oligarchic model of governance and abandon traditional Ukrainian politics

of Byzantine influence, lying, and playing with the rules instead of playing by the rules.

However, two years after the Maidan, it is fair to say that the government of Yatsenyuk has failed to accomplish this task. Corruption, inefficiency, the preservation of oligarchic rule, and the radical deterioration of both the economy and social standards have resulted in the growing alienation of citizens from the state and disappointment in the political class and its ability to change the country. A total lack of trust in the authorities is the main outcome of the two years of activities of A. Yatsenyuk and the current political crisis.

The credibility crisis was triggered by the fact that the organizers and planners of murders during the mass protests in Kyiv and the regions of Ukraine in autumn and winter of 2013-2014 have not yet been found. No corrupt officials from the inner circle of former President Yanukovich have been prosecuted. None of the reforms have been fully implemented. Moreover, the number of members of the Party of Regions

in the positions of power only increases. Officials of the Azarov government continue to feel comfortable occupying state posts not only in the regions but even at the central level. Lustration has become a formal tool for simply depriving state authorities of unwanted persons. New faces have become only facades for trying to cover up this shame. Citizens perceive it as a betrayal of their expectations by politicians.

The unsettled status of Donbass and Crimea, constant corruption scandals, the lack of synergy between the President of Ukraine and the Prime Minister of Ukraine, and, most importantly, the slow pace of reforms and subsequent catastrophic decline in living standards have all undermined public confidence in institutions of governance.

Arseniy Yatsenyuk had the chance to go down in the history of Ukraine as a technocrat and reformer who implemented unpopular reforms, tackled corruption, and uncovered shadowy schemes in the economy at the expense of his political ratings. However, Yatsenyuk lost both this opportunity and his ratings to become a “Ukrainian Balcerowicz”.

The government’s primary achievement is that it has managed to prevent a total social and economic collapse in the country solely through international support. However, Russian aggression has not become an incentive for the government to implement large-scale reforms. Instead of accelerating internal changes, the government has used Russian aggression as a justification for its own inaction and corrupt practices and rejected any criticism as “Putin’s propaganda”. Instead of trying elaborate and effective ways for a peaceful settlement of the conflict with the Russian Federation, the government has only provided flag-waving sentiments that sought to conceal and preserve the corrupt-oligarchic model of state governance. The government of Arseniy Yatsenyuk has not taken sufficient measures to restore macroeconomic stability and stop

economic decline, has lost the trust of the public, and has become a major constraining factor in the implementation of deep democratic changes in the country.

Economic achievements of the Yatsenyuk government

The average Ukrainian will remember the three primary economic patterns of Arseniy Yatsenyuk’s governance of increasing prices, devaluing the national currency, and increasing tariffs for housing and communal services. As a result of the government’s work in 2015, GDP declined by 10.4%, inflation exceeded 43%, real incomes of the population declined by 25%, the volume of industrial output decreased by 13.4%, and the volume of agricultural output decreased by 4.8%. In its annual ranking of economic freedom levels, the Economic Freedom Score 2015 ranked Ukraine 162 out of 178 countries, while Ukraine was ranked 154 in 2014. In the Doing Business 2016 rankings, Ukraine was ranked 83 out of 189 countries.

Fiscal pressure and corrupt state institutions are among the main causes for foreign capital outflow and the deterioration of the production process, and the lack of control of the main regulator led to the devaluation of incomes and intensification of inflation.

One of the key trends in the government’s activities in 2015 is the lack of a coherent strategy for the country’s economic development. Much of the announced reforms are solely declarative. The main elaborations of the government are the developed strategies which are usually designed for several years. Thus, it is not appropriate to mention any specific achievements based on the results of 2015.

At the same time, the government considers the tax reform as its main achievement in the economic sphere. However, such a statement

raises many comments. The tax burden on businesses, the deterioration of the investment climate, the balance of payments deficit, and business distrust in the authorities have become the major economic challenges of 2015. Over the year, there were discussions between the state authorities, businesses, and experts regarding the future tax reform, but all the interested parties failed to reach a consensus.

The main initiatives on the tax reform proposed by the government covered an institutional reform of the State Fiscal Service that was one of the benchmarks of the IMF program and changes in the administration of some taxes. In particular, the most major achievements include a significant reduction in the individual income tax, the introduction of a single base rate of 18%, and a rate of unified social contribution of 22% for employers, as well as the abolition of the single social contribution charged from employees' salaries. At the same time, it should be noted that any innovations regarding individual income tax are doomed to failure due to the poor development of the financial market, the primarily non-state pension insurance, and the lack of pension system reform. Thus, the issue of the search for compensators will be relevant in 2016, and other tax changes cannot be characterized as those that significantly reduce the tax burden on businesses.

In August 2015, the Ministry of Finance released a plan on reformatting the structure of the fiscal service in accordance with functional areas. According to statements by the Chairman of the State Fiscal Service (SFS), the institutional reform of SFS included two stages: the approval of the new structure of the central SFS apparatus formed in accordance with the IMF recommendations and the complete renewal of the staff of the central apparatus.

In addition, attention was focused on the restructuring of the local SFS bodies – the number of state tax inspections dropped from 311 to 161,

according to the report of the Cabinet of Ministers. Despite these statements and Ukraine's IMF commitments, the institutional reform of SFS failed to gain legitimacy in the eyes of the public because the principles of the body's activities, as perceived by taxpayers, have not changed. The further functioning of the tax police is also unclear, and despite the decision of July 2015 to transfer Zakarpattia, Lviv, Volyn, and Chernivtsi customs to international company management, the changes have not been implemented. Businesses are disposed toward fundamental changes in SFS work and fiscal policy aimed at simplifying the administration of taxes and fees, the effective use of electronic services, a reduction in corruption, and an improvement in inspector professionalism. Thus far, the authorities have not demonstrated readiness for such changes.

Truly successful results of the government's activities, namely of the Ministry of Economic Development and Trade (MEDT), include the reform of the public procurement system, which is considered a key element in the fight against corruption and an inefficient spending of public funds. Key developments in this area are as follows: bringing the Ukrainian legislation on public procurement up to European standards and launching the pilot project ProZorro in early 2015 – an electronic system of public procurement. However, the ideologists and developers of the system were not government officials but rather civil society activists. According to MEDT estimates, UAH 500 mln or 12-18% of transaction cost were economized last year. However, the system requires further refinement as the use of the system in practice uncovered a number of technical shortcomings.

Another area where positive changes can be observed is in deregulation reform. This reform was one of the most expected and demanded reforms in society. Its key task was the dismantling of the post-Soviet regulatory system and the establishment of a new regulatory system

that meets the needs of a market economy and the requirements of European legislation. As part of this reform in 2015, the total number of control bodies was reduced; the legal framework and infrastructure for the adoption of new technical regulations was prepared; the national body for accreditation received the last level of recognition by the EU; the compulsory certification of 16 groups of products was abolished; the certification of new cars was revoked; the time period of issuing phytosanitary and quarantine certificates was shortened and the list of objects of quarantine regulation for domestic traffic was cut; the conditions for opening a business were simplified, and so on.

However, despite some positive accomplishments in the field of technical regulation, food safety, the simplification of starting a business, sanitary and phytosanitary protection, and issues on property registration, the rate of deregulation, in particular as regards the implementation of the Action Plan on the deregulation of economic activity, which is the main document for the implementation of the reform, fuels considerable concerns. By the end of 2015, according to information provided by the central executive bodies of Ukraine and other state bodies, 72 out of 136 measures of the plan scheduled for implementation in 2015 were completed, which amounts to 53%. One of the main issues in implementing this reform in 2015 was its occasional and sporadic nature. Many problems in the field of deregulation were resolved in “firefighting” mode. A number of changes are simply declarative. Approved regulations do not work, and some documents are replaced by others (eg. a license is changed to a permission). The quantitative reduction was mechanical in nature. Many discussions took place around simplifying business registration procedures that would facilitate the improvement of Ukraine’s position in international rankings of Doing Business. However, in

practice, it appears that this problem is not urgent, and this is why the limited enhancement in registration procedure has had such a negligible impact.

Accomplishments in the international sphere achieved by the government include the promotion of Ukrainian exports, trade liberalization, the removal of barriers, etc. The main achievement of the government is the development of multiple strategies and procedures as well as a series of international meetings. At the same time, according to the State Statistics Committee, exports of goods and services shrunk by 30.8% and imports by 32.3%. Despite all the reported measures for enhancing trade and removing barriers, exports to the EU compared with the year 2014 decreased by 30.4%. Joining the free trade area with the EU is also referred to in the report as an accomplishment. This statement is not quite correct, because it is actually an achievement of the year 2014.

In the Strategy for Sustainable Development “Ukraine 2020” and the Action Program of the Cabinet of Ministers of Ukraine, a prominent place was given to local government reform and decentralization. According to the author’s view, the most important measure of the reform is to increase the incomes of local budgets’ general funds (excluding transfer payments) by 42.1% (29.6 bln. UAH.) compared with the year 2014. However, these funds are significantly devalued by inflation. Therefore, the decentralization process is incomplete, as amendments to the Constitution in the part of decentralization of the government have not yet been voted for in the second reading.

With regard to public administration reform, the adoption of the new Law of Ukraine “On State Service”, which comes into force on May 1, 2016, has certainly had positive effects. Creating a system of virtuous apolitical public service will enable a speed-up in reforms in other sectors. However, funding and the advance of salaries

for state officials still remains the main question. Without adequate financial support, public services remain an appendage of the party, whereby officials will continue to serve the interests of parties rather than taxpayers.

The most significant accomplishment of the government in the gas sector should be considered the development of a legal framework and the definition of key criteria for its development. In particular, legislation on reforming the natural gas market must be critically assessed. Instead, the burden for the state budget is expenditures for support for the unreformed Naftogaz, which, despite commitments to the EU and the IMF, is the de-facto monopoly in the national gas market. This brings the declared principles of the liberalization of the industry to the ordinary optimization of accounting and the distribution of strategic resources of the state. The increase of the rent payments rate significantly affected the performance of private companies and caused the departure of foreign investors from Ukraine.

The still indefinite model of separation of the gas transportation system (GTS) from Naftogaz creates risks for a further slowdown in the implementation of the principles of the EU Third Energy Package in the gas sector. Further on, such a situation might prevent progress in the modernization of the Ukrainian GTS, despite an agreement with the EBRD and EIB on reconstruction, overhaul, and technical upgrading of gas pipeline Urengoy - Pomary – Uzhgorod, ratified by the Verkhovna Rada of Ukraine in summer 2015.

The concrete steps of the government to reform the coal industry remain ineffective. The real privatization and optimization of coalmines work in the interests of the state, and compliance with social standards of worker protection has not happened. The complete liquidation of 4 mines has not demonstrated sufficient economic benefits to improve the work of other mines.

Saving public money by waiving the allocation of subsidies does not allow for the guarantee of optimal production of coal under the condition of the absence of access to the products of the mines in the occupied territories of Donbas. Ukraine remains dependent on imported supplies of coal, which leads to the unstable working of heating facilities.

The upgrading of the energy sector infrastructure in the economic crisis and the reduction of electric power consumption question the appropriateness of the commissioning of electric power facilities. In particular, for the effective operation of additional capacities, the issue of setting up electricity exports needs to be addressed. In the context of the extension of the service life of the power unit number 2 of South-Ukrainian NPP (almost 8 billion KWh of electricity per year), the data on possible environmental effects and safety risks is not presented in the report.

The government managed to achieve some success in diversifying energy supplies. First and foremost, the establishment of the reverse of gas supplies from some EU countries can be considered demonstrative. Thus, the increase of coal imports from South Africa caused a number of complaints regarding logistics and procurement prices.

The reduction of gas consumption during 12 months of 2015 by 21% (from 42.6 in 2014 to 33.8 billion cubic meters) cannot be considered an achievement because it is interconnected with a decrease of volumes, in particular, of industrial production (almost 13%).

The increase of nuclear generation in total electricity production in Ukraine in 2015 from 49% to 56% can lead to a lack of profitability of heating power plants and increase the level of danger at NPP, whose lifetime ends.

The increase of tariffs for gas and electricity did not lead to the stabilization of the energy market. It does not allow for the attraction

of the investments necessary for the reform of infrastructure, negatively affected by payment discipline.

The adoption of the Law of Ukraine “On Amendments to Certain Legislative Acts of Ukraine on transparency in the extractive industries” allowed to regulate legally the issue of accountability of the industry, but for the effectiveness of this tool it is necessary to solve the complex issues regarding the de-shadowing (legalization) of the national economy. The first report of the Transparency Initiative in the extractive industries, published on December 4, 2015, showed that only 32.5% of companies responded to a request to provide information on mining activities, while 67.5% ignored it.

The implementation of energy saving measures through the reimbursement of the part of the loan involved in the purchase of energy efficient equipment and / or materials had a positive effect in terms of providing households access to concessional financing and dissemination of this practice at the regional level. However, the government report provides no data on reducing energy intensity of GDP in 2015, which does not allow for assessing the complex effect of actions in this area.

Trying to show itself at its best, the government in its report manipulates statistical data and indicators of Ukraine in international rankings. In particular, there are mostly positive (or relatively positive) indicators where Ukraine managed to improve its position in 2015. However, the figures and positions that deteriorated are not shown in the report. This distorts the overall economic picture and may lead to the formation of incorrect views on the trends and processes taking place in the Ukrainian economy. One also cannot forget the fact that almost all successful achievements include the development of draft legislation, and those activities and processes have just started and have not yet given significant results.

The government report indicates that most decisions that are reported to have been made in 2015 were in fact completed in 2014. For instance, major initiatives in 2014 that are taken for achievements in 2015 include:

- reduced number of taxes from 22 to 11, essentially representing tax consolidation;
- electronic system for VAT administration in fund deposition on special accounts was subject to fierce criticism by businesses and experts, resulting in many floating assets washed out from enterprises;
- additional import duty was a heavy burden on national enterprises that depend on imported components;
- excise tax on retail sales of beer, alcoholic beverages, tobacco products, and fuel at 5%. The Tax Code of Ukraine also provides excise tax on production and import of such products. Therefore, excise taxes under retail trade will mean double taxation, which contradicts the fundamental principles of taxation and EU Directives that Ukraine is obliged to implement in accordance with the Association Agreement.

Conclusions

Generally, the government report hardly corresponds to the current economic situation and key development in Ukraine. Despite the government's intentions to carry out systemic and large-scale reforms, progress on economic reforms in 2015 is less than modest.

The government report is an imbalanced and lop-sided document that sets forth achievements in many spheres – from security and defense, finances and economy to culture and social services. However, it lacks critical analysis of the reasons for extremely slow reforms and sufficiently declined living standards. Moreover, the report does not contain the government's

vision on how the reforms can be activated and reinforced.

The reasons for the low efficiency of Yatsenyuk's government policy in 2015 arises from the following factors:

1. Fierce political competition between major shareholders for huge financial resources. Unfortunately, the government failed to abolish annuity monopolies that had been established since Ukraine proclaimed independence in 1991 and put an obstacle to market competition and the legitimate distribution of social benefits.
2. Lack of a single technocratic team that is aimed at concrete results. Yatsenyuk's government was formed according to political and business quotas where personal loyalty to the President or political leader prevails over professional and moral standards.
3. Fragile government communication strategy resulted in a situation whereby the public neither understands the course reforms nor sees a final goal of government policy.
4. Constant delay of civil service reform undermines practically all other reforms. The Soviet-style bureaucratic apparatus gradually transforms political decisions into administrative procedures while a level of coordination between ministries and other central executive bodies constantly requires manual control.
5. Slow progress on implementing the Coalition Agreement provisions on Cabinet of Ministers responsibilities is a result of fragile and diverse parliamentary coalition (the coalition managed to fulfill only 25% of the Coalition Agreement provisions for the year).

Prospects for Further Developments

Following Yatsenyuk's government report, the Verkhovna Rada has to take a decision on the

future of the PM and his team as well as the parliamentary coalition.

In case the parliament does not approve the current report, MPs may put forth a vote of no-confidence in Yatsenyuk's government after collecting the required 150 votes. In accordance with Article 115 of the Constitution of Ukraine, the adoption of a resolution of no-confidence in the Cabinet of Ministers of Ukraine by the Verkhovna Rada of Ukraine results in the resignation of the government.

There are two options for continuing reforms and escaping political crisis in Ukraine. The first one provides a power cleanse and a new technocratic government that consists of a professional and apolitical team. The second one means early parliamentary elections that may subsequently result in early presidential elections as well.

The current political crisis may be tackled by means of forming a new technocratic government that will reset Ukraine's political system and bring visible reforms. A reformatted government based on national unity and technocracy will launch a national dialogue and become an efficient instrument in fighting corruption. All MPs and politicians are infected with corruption. Therefore, the new PM must be a reformist leader who is neither party to a conflict of interests nor affiliated with oligarchs. In addition, further communication between the government and citizens must be facilitated. The public must be involved in elaborating and implementing state policy in order to bridge the gap between the government and its citizens. The new government's priorities in 2016 must include immediate, decisive, and sweeping reforms, a serious fight against corruption, and an increase in living standards.

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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