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# INSIDE UKRAINE

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# PUBLIC POLICIES



## THE LAW ON “REINTEGRATION OF DONBAS”: POLITICAL DECLARATION OR RESTORATION OF SOVEREIGNTY?

*In the context of the hybrid war, during the last three years, there remains a need to define a state policy on reintegration and a tool for ensuring the management of regions directly located in the area of hostilities. However, the Law that had been adopted became more a political declaration, rather than a real mechanism for ensuring the state sovereignty of Ukraine in the CDDLO<sup>1</sup>. The document solves certain operational tasks (improvement of the governance system and legalization of the use of the Armed Forces of Ukraine on the territory of Ukraine without a declaration of martial law), but does not contain effective mechanisms for achieving reintegration and restoring sovereignty.*

### The complex history of the draft law

The conflict in eastern Ukraine is a major problem for Ukraine and the contact point for different pressure groups. It remains a significant factor in the destabilization of the domestic political situation in the country. A longstanding political and legal uncertainty about what is happening in the Donbas region; lack of clear terminology and a single line of understanding of the situation negatively affect the public discussion on conflict resolution and the practical activity of executive authorities.

*The Law “On reintegration” is a wrapper for a bitterly perceived special status of CDDLO*

According to sociological surveys, the situation in eastern Ukraine is an urgent issue for citizens, which generates significant social pressure on the authorities. Attention of the society stimulates the desire of politicians to derive a benefit from the issue. That is why there objectively existed a need to adopt a document that would

<sup>1</sup> CDDLO – Certain Districts of the Donetsk and Luhansk Oblasts





normalize both terminology, the decision-making system and a lot of other existing gaps. At the same time, aware of the incendiary nature of this issue, the authorities showed some reluctance to put this Law to a vote. And only the necessity to fulfill obligations to international partners regarding the continuation of the law on the special status of the CDDLO forced to put forward a draft law on "reintegration" as a wrapper for a bitterly perceived law on the special status of CDDLO.

The draft law was introduced by the President as urgent on October 4, 2017, but then the people's deputies voted for the draft law only in the first reading. Its consideration was accompanied by fights between deputies and using of a smoke pellet in the Parliament. After that, the second reading was delayed as much as possible and only due to a number of circumstances was included into the agenda of the VRU. It is possible that the main stimulus for the continuation of the consideration of this draft law was the need to divert attention of the society from recent scandals – the story of Poroshenko's vacation in the Maldives, the scandal with

Rinat Akhmetov's money, and the laundering of Yanukovych's money by the campaign connected with Poroshenko. At the moment, it can be stated that the Law successfully coped with such a task. Despite the fact that the Law of Ukraine "On the Peculiarities of the State Policy in Ensuring the State Sovereignty of Ukraine over the Temporarily Occupied territories in the Donetsk and Luhansk Oblasts" has played a PR role becoming the subject of bold parliamentary statements both before and after its discussion, it is important and its adoption can be considered as a step forward.

The main stimulus for the continuation of the consideration of the Law was the need to divert attention of the society from recent scandals connected with the President

The consideration of the Law in the second reading lasted for three days and provided for the processing of 673 amendments. The position of the President was not understandable till the end; as far as his representatives had stated that after the amendments made the draft law was inconsistent with its initial logic. In view of this, Poroshenko insisted on the adoption of the draft law in the form as close as possible to the version proposed by him.

During the discussion of the draft law in the parliament, fierce debate regarding usage of words about the occupation of the Crimea and setting precise dates for the beginning of "occupation of the CDDLO and the Autonomous Republic of Crimea" in the title and the text of the draft law took place. The need for stating the exact dates was explained by deputies as an important factor for incurrence of liability of Russia, and for future court cases concerning the compensation to victims of aggression. There is no exact date of the "occupation of CDDLO" in the Law. There is only a reference rule to the Law of Ukraine "On Securing the Rights and Freedoms of Citizens and the Legal Regime on the Temporarily Occupied Territory of Ukraine".

Including words about occupation of Crimea, stating exact dates of the start of occupation and regulation of trade with CDDLO were the important question of deputy's debates



It should be noted that according to the rules of international law, the situation in the Donbas region falls not under the definition of "occupation", but under the "effective-control of the aggressor state". The difference lies in the fact that the occupying state establishes its authorities and directly manages the occupied territories. Currently, the Russian Federation has not created any authorities and does not directly manage the CDDLO. Effective control in its turn implies that hostilities on the territory of one state are conducted by non-state armed groups dependent on the support of another state. A state that supports non-state armed forces does not establish its authorities on the territory of another country.

According to the rules of international law, the situation in the Donbas region falls not under the definition of «occupation», but under the «effective-control»

In view of this, the annexation of Crimea is an occupation, and the situation with CDDLO is an effective control of Russia as an aggressor state. The use of the term "occupation" in relation to the conflict in the Donbas region to a certain degree is populism of the Ukrainian politicians. It is also important that the fact of occupation does not require judicial recognition, as far as the occupying state directly and openly controls the occupied territory (as in Crimea). But the effective control of one state over part of the territory of another state is determined by international courts. Ignoring the international legal terminology makes the future cases against the RF considerably complicated. Moreover, the PACE Resolution 2133 "Legal remedies for human rights violations on the Ukrainian territories outside the control of the Ukrainian authorities" as of October 12, 2016 recognized the existence of effective control of the RF over illegal armed groups operating in eastern Ukraine.

The use of the term «occupation» in relation to the conflict in the Donbas region is to a certain degree a populism.

In addition, regulation of trade with CDDLO was an important question of deputy's debates. The Law did not restrict trade with non-controlled territories, but the term "movement of goods"



was used, the possibility and limits of which will be determined by the Cabinet of Ministers of Ukraine.

The parliament has also refused to include in the draft law the amendment No. 652 on the denunciation of the Treaty on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation. This is a positive moment, because this document is the legal basis for Russia to respect the territorial integrity of our state, and in case of its denunciation, Ukraine would have lost such an opportunity.

After more than three months of "refinement" in the committee and three days of fierce debates in the Verkhovna Rada, the deputies have finally managed to pass the so-called Law "On the Reintegration of the Donbas region". 280 deputies voted for it.

It should be noted that the final text of this Law has not yet been made public. In the VRU certain amendments were made viva voce, therefore some provisions may differ from those that

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ПРОТИ	36	
УТРИМАЛИСЬ	2	
НЕ ГОЛОСУВАЛИ	33	
ВСЬОГО	351	
РІШЕННЯ ПРИЙНЯТО		





had been present in the draft law published on the website of the VRU.

The final text of this law has not yet been made public.

The day following the adoption of the Law (January 19), people's deputies from the "Opposition Bloc" blocked the signing of the Law by registering a draft resolution abrogating the decision of the VRU, by which the Law was adopted. According to the parliamentary rules, the chairman of the VRU does not have a right to sign the draft law before consideration of the draft resolution on its cancellation. Thus, the future of the Law is still uncertain.

The OB blocked the signing of the Law "Reintegration of the Donbas region".

The international community, except for Russia, has responded to the adoption of this Law in a rather restrained manner. The EU believes that the Law "On the Reintegration of the Donbas region" is aimed at resolving the internal civil and military order in Ukraine, and noted the unchanged support of the Minsk and Normandy processes. The federal government of Germany stated that it would find out how much the Law "On the Reintegration of the Donbas region" corresponds to the Minsk agreements. Russian President Vladimir Putin, in his turn, discussed with the members of the Russian Security Council the Law "On the Reintegration of the Donbas region" approved by the Verkhovna Rada of Ukraine. At the meeting, it was stated that this law could in the most negative

way affect the prospects of a Ukrainian internal settlement. Russia also stressed that Minsk agreements and the "Normandy format" have no alternatives.

The international community has responded to the adoption of this law in a rather restrained manner, underlining that Minsk agreements have no alternatives.

### Basic provisions of the Law

- Russia is an aggressor.** The Law actually changes the status of the Russian Federation from a neighboring country to an aggressor country. The document states that the Russian Federation is the initiator of the armed aggression against Ukraine and an invader of a part of the Ukrainian territory. In the text of the Law there are two references to Russia as aggressor (in the preamble and the final clauses), and "occupying power" is used once (in the Article 7). Representatives of the CDDLO will now be called "representatives of occupational administrations of the RF". From now on, Ukrainian prisoners taken captive by "DPR/LPR" and Russia will be called not hostages but prisoners of war.
- Occupied territories and protection of the civilian population rights.** The boundaries of "occupation" will be determined by the President of Ukraine upon the submission of the Ministry of Defense and on the basis of proposals of the General Staff of the AFU. Ukraine will not be responsible for the actions of "occupants" on the temporarily "occupied" territories. At the same time, the Ukrainian authorities will collect information on all violations that are taking place there, in order to bring Russia to justice. However, the Law does not specify either the period or the conditions for such violations, nor the territory where they occurred, which may complicate proving culpability of Russia in international courts. Ownership of property is retained for individuals and legal entities. Ukraine recognizes only documents confirming the fact of the birth or death of a person in CDDLO.

- **Completion of the ATO and the legal status of the military operation.** Ukraine no longer carries out the ATO, but takes measures to ensure national security and defense, deterrence and stand up against Russian armed aggression in accordance with Ukrainian legislation and the Article 51 of the UN Charter.
- **Integrated staff of the AFU.** The Joint operational staff of the AFU is the main authority to which the AFU, the National Police and other security agencies will be subordinated. The commander of the united forces will be appointed by the President of Ukraine. The commander of the united forces shall have a right to restrict the entry and exit of persons to and from CDDLO, but the procedure for the entry and exit of persons, as well as the transportation of goods from to the occupied territories, shall be determined by the Cabinet of Ministers of Ukraine.
- **Extension of the rights of military and law enforcement officers.** During repelling of Russian armed aggression in the security zones adjacent to the combat area, servicemen, law enforcement forces and individuals involved in the implementation of national security and defense measures receive quite broad rights, in particular: 1) to apply, in case of emergency, weapons and special means to persons who have committed or are committing an offense; 2) to enter (gain access to) residential and other premises, land plots owned by citizens, the territory and premises of enterprises, institutions and organizations, to check vehicles, etc. The list of powers of the security forces in the Law is unprecedented, since they come into force in very unprecise conditions for a very wide range of persons.

### “Pitfalls” of the Law “On Reintegration”

There are many pitfalls in the Law, in particular: threats of unwarranted violation of human rights; excessive expansion of powers of the President and security forces; transferring full responsibility for the situation in the CDDLO to the RF.



The document post factum legitimizes the actions of Ukrainian military forces in the Donbas region and does not particularly affect the change in the situation in the country. The theoretically approved Law, can strengthen the position of Ukraine in international courts and make the participation of Russia in a peace-keeping mission impossible. However, in the text of the Law, there is neither a period nor the conditions for causing harm to Ukraine by Russia, nor a clear definition of the territory where it occurred.

The document post factum legitimizes the actions of Ukrainian military forces in the Donbas region and does not particularly affect the change in the situation in the country.

The situation regarding human rights in the Donbas region, which are downplayed in this Law, is alarming. In fact, the protection of civilians has been forgotten or deliberately not mentioned in the Law. The State does not undertake to protect the population of non-controlled territories to the full extent as provided for by the European conventions and the Covenant on Political and Civil Rights. There is no humanitarian infrastructure in these areas, in particular to provide food supplies and medical assistance to wounded persons. The Law passed also gives law enforcement forces unlawfully broad powers creating a real threat of abuse. The Law deals with security zones adjacent to the area of combat where the security forces will have extraordinary powers, almost as if under the conditions of the martial law introduction, but at the same time, it is not specified what these zones are and what their limits are.





The Law in fact downplays the human rights in the Donbas region.

Also, one cannot but notice that the Law provides the President with significant powers. In particular, the head of state has the right to make decisions on the use of the Armed Forces in the CDDLO without the consent of the parliament, or to give law enforcement structures the right to hold measures having signs of the martial law introduction.

The law unreasonably extends the Constitutional authority of the President.

In addition, there is a danger that the transfer of full responsibility for the situation in CDDLO to Russia may further push off Ukrainian citizens in the non-controlled areas, since they are offered to address to the aggressor country, and not their own government, which now should not take care of them. The situation is aggravated also by the fact that the Law does not in fact foresee any legal consequences for Russia, and therefore the compensation for losses on the non-controlled territories becomes a serious problem. Without acknowledgment by the international courts of the fact of effective control of the RF in the CDDLO it is useless to expect any kind of reimbursement on its part. The Law also did not take into account the rights of internally displaced persons, both those in the vicinity of the conflict zone and those who left it.

The Law may further push off Ukrainian citizens in the non-controlled areas.

## State target program on recovery and peacebuilding in the eastern regions of Ukraine

Unlike the Law of Ukraine "On the Peculiarities of the State Policy in Ensuring the State Sovereignty of Ukraine over the Temporarily Occupied territories in the Donetsk and Luhansk Oblasts", the Government made a more significant step towards the real reintegration of the Donbas region on December 13, 2017, by approving the "State target program on recovery and peacebuilding in the eastern regions of Ukraine". This Program is the most progressive governmental document aimed at restoring the sovereignty of Ukraine today.

The "State target program on recovery and peacebuilding in the eastern regions of Ukraine» is the most progressive governmental document aimed at restoring the sovereignty of Ukraine today.

As stated in the decision of the Cabinet of Ministers, the "State target program on recovery and peacebuilding in the eastern regions of Ukraine" provides for: restoration of critical infrastructure and social services in the spheres of education, health care, social protection, energy, heat and gas supply, transport, water supply and drainage, ecology and environmental protection, physical culture and sports, creating conditions for increasing the level of employment of the population, providing business support and expanding access to the financial services, development of industry, construction, agriculture, etc.

This is a significant step towards in resolving the conflict in the Donbas region, as far as the Program seeks to restore confidence between the state and its citizens and foresees synergy of efforts of state authorities, local self-government, civil society institutions and international partners towards peace and sustainable development of the respective territories. Of course, such a program should and could have appeared earlier, having waited for approval for almost a year after the development. In any case, the fact that the government has made a decision on its approval is really necessary for the Ukrainian society, for whom the question of peace is a number one today. It is extremely important to strengthen commitment of Ukraine



to the peacebuilding principles developed by the UN, which are the basis for the implementation of the Program objectives. However, the question of financing of this Program remains open, since the state budget for 2018 does not still include it.

Program seeks to restore confidence between the state and its citizens and foresees synergy of efforts at all the levels of state authorities and society.

Thus, despite the declared goal, the Law does not offer clear mechanisms for the restoration of state sovereignty over temporarily occupied territories and will not bring fundamental changes. Recognition of the RF as aggressor is of more declarative than legally formal character. The document is more likely to solve operational tasks (improving the management system and legitimizing the use of the AFU on the territory of Ukraine without the permission of the VRU), but does not contain effective mechanisms for achieving the goals of reintegration and de-occupation, in particular the liberation of CDDLO and the protection of the rights, freedoms and legitimate interests of persons affected by the armed conflict. Many provisions of the Law constitute a political manipulation aimed at receiving electoral dividends rather than a real attempt to solve the problem, and the debate itself in the VRU more resembled the competition for the most radical statement made by the deputies.

In addition, the adoption of a Law with a loud name is not a panacea and can not by itself lead to the end of the conflict and the reintegration of the occupied territories. This requires a clear plan, a road map describing the steps, both of political and diplomatic as well as social and humanitarian character. The first signs of such a roadmap already exist in the form of a "State target program on recovery and peacebuilding in the eastern regions of Ukraine", but unfortunately, the Program and the Law do not comply with each other. Further active discussion on the strategy of restoring the sovereignty of Ukraine over the CDDLO and Crimea as well as the real reintegration of these territories remains necessary.



ДЕРЖАВНЕ БЮРО  
РОЗСЛІДУВАНЬ

*Fiat justitia, ne pereat mundus*

## STATE BUREAU OF INVESTIGATIONS: WILL IT BE POSSIBLE TO CREATE AN INDEPENDENT AND TRANSPARENT AUTHORITY?

*The process of law enforcement reformation in Ukraine reflects systematic political problems in the country as well as corruption influences and conflicts of various pressure groups. The SBI could potentially become an instrument for restoring the rule of law and fighting corruption but this purpose requires genuine independence and corresponding tools for its activity. However, the analysis of the processes surrounding the creation of the Bureau, in particular the procedure for appointing its chief executives, indicates the threat of transformation of the SBI into an ineffective law enforcement authority that will take over the worst traditions of the Prosecutor General's Office to become a tool of political and business competition in the hands of state authorities. Such a scenario will deepen disillusionment of the society with the reforms and will have a negative impact on the democratic as well as social and economic development of the country. Therefore, the civil society, the expert environment and foreign partners should monitor the process of establishing this body more actively and do everything possible to use the best international practices in the process of its formation.*

### What is SBI?

According to the Constitution and the obligations of Ukraine to the Council of Europe, the



State Bureau of Investigations (SBI), the authority to take over the function of investigation belonging to the Prosecutor General's office, had to be created 20 years ago. The unwillingness to deprive the GPO of the investigation function and the need for a complicated search for a compromise between different pressure groups was hampered the creation of the Bureau. The situation as it is can reach the collapse, since the functions and powers provided by the legislation have already been transferred to the SBI, accordingly, they are not conducted other law enforcement authorities, while the Bureau itself does not yet function. Consequently, a legal and security vacuum is being created.

The State Bureau of Investigations had to be created 20 years ago.

The very process of formation of the SBI and appointment of its chief executives has already become problematic. In accordance with the Law of Ukraine "On the State Bureau of Investigations" dated November 12, 2015, the Director of the SBI shall be appointed by the President upon the proposal of the Prime Minister, which shall be made by the latter on the basis of a decision of the competition commission. However, the Constitution defines an exhaustive list of powers of the president (Article 106) and does not empower him with a right to appoint the Director of the SBI. That is, by appointing the Director of the SBI, the President acts outside of his constitutional powers, which in general brings into question the legitimacy of the Bureau establishment procedure, and, accordingly, its activities. Accordingly, any person investigated by the SBI will be able to interpose an appeal on the actions of the Bureau on the

basis of its creation process being unconstitutional.

Appointing the Director of the Bureau by the President is unconstitutional.

Roman Truba, the Director of the SBI, appointed by the President believes that by the end of 2018 a core composition of the Bureau will be formed, which will include 20 directorates and departments, as well as 7 territorial directorates. The number of the Bureau staff reaches 1,500 persons.

The SBI will have the right to conduct a full range of measures from crime prevention to investigative activities. The main functions of the SBI include preventing, detecting, eliminating or disclosing terrorist crimes, war crimes or crimes committed by law enforcement officers, high rank officials, and people holding position of the highest importance (presidents, senior government officials, members of the Central Election Commission, people's deputies, chief executives of the Prosecutor General's Office, the National Bank, judges, law enforcement officers, employees of NACBU, prosecutor's office, SACPO, etc.); particularly grave violent crimes.

Crimes conducted by high rank officials is the main field of investigations of the SBI.

### The place of SBI in the law enforcement system

The launch of the SBI will be very complicated, not only because of the need to form a staff through competitive procedures, but also because the PGO must transfer to investigative jurisdiction of the Bureau 7,000 cases that the newly created body will have to start investigating right after it starts functioning. The PGO will no longer deal with crimes within the competence of the SBI. The establishment of the Bureau is a kind of completion of the long process of reforming the prosecutor's office, which should abandon the investigation. The withdrawal of the investigation function from the prosecutor's office is a top priority in achieving qualitative changes in the PGO. The prosecu-

tor's office will have to focus on procedural guidance and public prosecution.

The establishment of the Bureau is a kind of completion of the long process of reforming the prosecutor's office, which should abandon the investigation.

In addition, the SBI takes over all functions of the Military Prosecutor's Office and investigative functions of the MIA, the SSU and the NACBU, which are within the competence of the Bureau. The SBI should become the basis for qualitative reform of the SSU, the operation of which today goes far beyond the scope of counter-intelligence activity. SSU is currently fighting against corruption, entrench upon the basis of national security, acts of terrorism, crimes against peace, for the safety of mankind and international rule of law. In addition, the SSU officers, like the PGO, often take part in settlement of business conflicts and act rather as means of influence but not the establishment of a due course of law.

The SBI takes over all functions of the Military Prosecutor's Office and investigative functions of the MIA, the SSU and the NACBU, which are within the competence of the Bureau.

SBI holds a separate place in the system of anti-corruption bodies. The Bureau has become the fourth agency empowered for combating corruption and investigating crimes in which officials and high-ranking officials are suspected. The NACBU investigates corruption cases involving the highest state officials. The SACPO oversees the observance of laws in the process of the operational search activity of the pre-trial investigation of the NACBU. The NACP has a preventive function – to check the declarations of civil servants and their lifestyles, disclosing any information concerning corruption or abuse of office.

The SBI has become the fourth agency empowered for combating corruption and investigating crimes in which officials and high-ranking officials are suspected



### Independent body with dependent leadership?

Petro Poroshenko since the very beginning was intended to delay creation of the SBI for the maximum possible term in order to strengthen his influence on this institution. The President has obtained the right to appoint the head of the SBI and, ultimately, to appoint loyal chief executives. The election of the Director of the SBI, the First Deputy Director and the Deputy Director lasted for one year and a half. The competition commission was created on the basis of three persons from the president, the government and the parliament. As a matter of fact, the commission includes representatives of political forces – 5 from the BPP<sup>2</sup> and 4 from the NF<sup>3</sup>. The procedure has not been without scandals, because two of the nine members of the competition commission, in spite of Part 3 of Art. 11 of the Law "On the State Bureau of Investigations" did not have a degree in law.

The President has obtained the right to appoint the head of the SBI and, ultimately, to appoint loyal chief executives.

The election procedure of the SBI chief executives has allowed the experts to declare existence of a planned scheme for the external management of this body by means of appointing a weak leader – a representative of a political force (according to the media – NF), the First Deputy Director and the Deputy Director – of another one (BPP). According to the media, only a public scandal prevented the President from appointing "his" person as

2 "Blok Petra Poroshenka" (tr. Petro Poroshenko's Bloc)

3 "Narodnyi Front" (tr. People's Front)



a head of the Bureau. Experts and mass media associate the elected by the Commission and appointed by the President R. Truba with the secretary of the National Security and Defense Council O. Turchynov.

*A scheme for the external management of the SBI by appointing a weak leader (from the NF), and strong Deputies (from the BPP).*

According to the Law, the Director of the Bureau is dependent on his Deputies and may exercise personnel, organizational and financial powers only with their consent. Olha Varchenko (the First Deputy Director) and Oleksandra Buriaka (the Deputy Director) were elected as the Deputies. They had previously worked in the PGO system and were connected with the BPP according to the mass media. Varchenko led the procedural guidance in the Department of Investigation of the most important cases in the economy of the PGO. Buriak worked at the prosecutor's office for the past 17 years, having managed to be the Deputy Prosecutor of Sumy, Lviv and Kyiv during this time.

Consequently, interested pressure groups have actually received manual guidance over a new powerful law enforcement authority. The SBI can become a good tool for combating the "too independent" NACBU, as far as the Bureau must investigate crimes committed by the executives of the NACBU and SACPO, as well as the vast majority of heads of other law enforcement agencies, tax officials, customs officers, etc.

*The SBI can become a good tool for combating the "too independent" NACBU.*

This result was achieved due to low level of attention from the media, the public, activists and the international community. Under no circumstances, the process of appointing the SBI chief executives can be compared with much more transparent, society controlled and understandable for foreign partners, process of appointing the executives of the NACBU

*The creation of the SBI received a low level of attention from the media, the public, activists and the international community.*

## Launch of the SBI

At the end of last year, the Director Roman Truba presented the Strategy for 2017–2022, and the CMU approved the structure of the central body of the Bureau. At the same time, certain deputies and representatives of the expert environment prepared important amendments to several regulations concerning various aspects of the SBI operation, in particular: the transfer of the function of selection of chief executives of the SBI divisions from the external competition commission to an internal one, one third of which will consist of representatives of the Council of Public Control; abolition of the direct norm of quota formation of the SBI investigating divisions by investigators of the PGO and the National Police; clarification of the list of subjects of crimes under investigation the SBI will deal with; giving the head of the DBR the right to independently determine which proceedings to request for the continuation of pre-trial investigation at the Bureau; granting the right for automatic wiretapping for the SBI, full opportunities for carrying out operational and search activities, as well as the change of placement of the three territorial departments of the SBI. These changes do not solve the issue of unconstitutionality and submission to control of the appointment of the SBI chief executives, but can positively affect the further process of formation and functioning of this body.

*Certain deputies and representatives of the expert environment prepared important amendments to several regulations concerning various aspects of the SBI operation.*

Expert observation of the procedures for appointments (currently the managers of the middle level of the Bureau and its territorial directorates) prove that they are still hostage to political bidding, which causes doubts in the independence of the SBI. The two recent government resolutions on the method of establishing the Public Control Council (PCC) and on the approval of the Model Procedure for conducting an open competition for appointment – weaken more the independence and trust in the SBI.

### The procedures for staff appointments at the Bureau are hostage to political bidding.

These documents contradict the latest approaches to the formation of public authorities, and do not correspond to previous agreements between the society and the Director of the SBI. In accordance with these regulations, it is proposed to hold the usual constitutive meeting on the principles laid down in Governmental Decree No.996, instead of a full verified online voting for candidates for PCC under the SBI. There are no guarantees the PCC representatives will be included into the competition commissions for the selection of employees of the Bureau. The barriers set for the delegation of candidates from public organizations are too high. In fact, the "best practices" of public cover-up have been used to legitimize decisions in the interests of the certain pressure groups. Such practices have already been used extensively in the process of establishing the NACP and the Commission on Senior Civil Service. The subsequent activity of both institutions has simply confirmed that the engagement of civil society actors serves as a convenient cover-up for making the necessary decisions and demonstrating the allegedly successful reforms and openness to the Western partners.

### The authorities seek to eliminate the Public Control Council from recruitment to the SBI.

Thus, today it is possible to summarize that the DBR has been created under close political control that is why its activity does not contrib-

ute to public trust and support of Western partners. The unconstitutionality of the provisions of the Law of Ukraine "On the State Bureau of Investigations" in terms of the appointment of the Director, violation of the legislation during the formation of the competition commission, political agreements between the BPP and the NF regarding the appointment of the leadership of the Bureau, the actual removal of the PCC from the selection of employees make it clear that the formation of the law enforcement authority controlled by pressure groups is taking place. In case of preserving existing trends there is a threat that the SBI may become a "mini PGO", which does not have public and international trust and does not contribute to the establishment of the rule of law in society.

In order to restore trust in the SBI, it is necessary, first of all, to implement a system of steps for its control by the international donors, experts and the society regarding the selection and training of the employees of Bureau; to bring the Law "On the SBI" in line with the Constitution and restart the process of its formation, with a strict observance of the prescribed procedure and other legislative norms. A separate issue of importance in the process of amending the law on the SBI is the formation of conditions for its higher level of independence from political influence. In our opinion, such changes are still possible in the context of a significant increase in the attention to the SBI by the international and expert community, as well as the media.

# ECONOMIC ANALYSIS



## Hryvnia 2018: Past and Future Factors of Influence

During recent months Ukrainian hryvnia continues to lose its positions and demonstrates a rather rapid fall: since the beginning of the year, the national currency has already lost almost 3% of its value against the dollar and 5% against the euro. Such rates of depreciation can lead to the fact that the budgeted average annual rate of 29.3 hryvnias per dollar in the near future will be exceeded, especially on the background of future payments on external debt and a number of other factors. This creates additional threats to the development of Ukraine's economy and requires analysis of the reasons and prospects for such situation.

### Main prerequisites for the hryvnia's depreciation

Among the main factors that led to the depreciation of the national currency, it is necessary to emphasize the following:

The hryvnia has depreciated by almost 3% compared to the US dollar during just one month of the year 2018

### Economic factors

- Increasing the activity of exporters, that allocated the currency for purchasing the resources, and importers, that provoked the demand for foreign currency. Accordingly, during the 11 months of 2017, along with an increase in exports of Ukrainian goods by 20%, imports has increased by 27%. In turn, Ukraine's negative trade balance almost doubled in comparison with the previous year and amounted up to \$5.2 billion, thus hitting the hryvnia.
- Devaluation pressure on the hryvnia caused by the demand for foreign currency by the enterprises of fuel and energy complex and other industries due to the resource import dependency.
- Inflation processes that indirectly influenced the value of hryvnia in comparison with



other currencies. The National Bank (NBU) among the main causes of inflation, which reached 13.7% in 2017, noted an increase of the minimum wage level, which triggered an increase in production costs and in consumer demand, in prices for food and non-food products, in fuel prices and other factors as well as the peculiarities of the international market conditions.

- Slow rates of economic growth and insufficient growth of domestic production, which affected the provision of hryvnia by goods and services. In particular, GDP growth in 2017 according to the macroeconomic forecast of the Cabinet of Ministers has reached only 1.8%.
- The problems of the banking sector and the need for large volumes of refinance, which has resulted in additional emission. In particular, money supply increased by 6.9% in December and by 9.5% during the year 2017.
- The weakening of the hryvnia's exchange rate at the end of 2017 was due to the government's activation regarding the fulfillment of the expenditure part of the budget and the increase of procurement, which contributed to a quick inflow of hryvnia into the market. Accordingly, the balance of funds on the State Treasury's account has decreased from 54.104 billion UAH in the beginning of December to 5.1 billion UAH at the beginning of 2018.

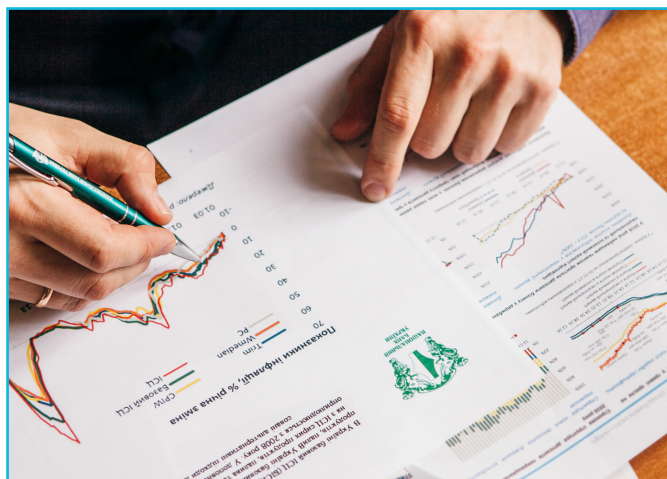
The prerequisites for the depreciation of the hryvnia were economic and non-economic factors

#### Non-economic factors

- Ineffective coordination of actions of the government, the NBU and the Ministry of Finance regarding to the course of the national currency and the inflation prevention. In particular, the chairman of the NBU Council Bohdan Danylyshyn emphasized that the measure of changing the discount rate of the National Bank of Ukraine was not enough to slow down the inflation in the country – this would require further strength-

ening of coordination of the state policy and various government bodies.

- Cancellation of state regulation of prices for products, which created additional inflationary pressure on the hryvnia.
- Indirect government interest. The weakened hryvnia allowed to increase revenues to the budgets through taxes and fees in order to fulfill the income plan. In particular, in the previous year there was over-fulfillment of plans and the surplus funds were kept on treasury accounts.
- Indirect interest of exporters who have received additional price advantages of their goods in foreign markets, while having the ability to influence government decisions through their representatives in order to depreciate the hryvnia. Accordingly, there is a certain underestimation of the national currency. This is reflected in anti-dumping investigations for certain categories of products, including heavy industry. In addition, this fact is confirmed by the rate of purchasing power parity of the World Bank, according to which hryvnia is a much stronger currency.
- The exchange rate in the Ukrainian budget for the year 2018 of 29.3 hryvnias per dollar (at the end of the current year – 30.1 USD per dollar) gave the signal to the main players of the market to focus on these indicators in order to minimize currency risks.
- Delayed IMF tranche due to non-compliance with the terms of the memorandum, which delayed replenishment of gold and





foreign currency reserves to strengthen the hryvnia, while partially reducing the confidence of foreign partners in the country.

### Future factors affecting the exchange rate

The following expectations will affect the hryvnia's exchange rate in 2018:

- Repayment of debts. Domestic debt repayment may lead to emission, and the repayment of external debt will result in the withdrawal of a significant amount of foreign currency from the market and in the reduction of gold and foreign exchange reserves. In this regard, foreign exchange reserves may be spent on repayment of external debt instead of supporting the national currency. In particular, the budget of 2018 provisions the need to pay 193,364 billion hryvnia for domestic debt and 112,562 billion hryvnia in foreign currency for external debt. Moreover, as of January 1st, international gold and foreign exchange reserves of Ukraine amounted up to \$18,808 billion, while net foreign exchange reserves (without borrowed funds) amounted up to \$6.7 billion, being increased by \$2.47 billion in 2017.
- Perspectives of the IMF tranche. Deputy Head of the National Bank of Ukraine Dmitry Sologub emphasized that the lack of a decision on the IMF tranche by the end of the second quarter of 2018 will indicate that with high-probability the current credit program will not be restored. In turn, this reduces the prospects of increasing the gold and foreign exchange reserves, especially

during the period of servicing and repayment of external debt. This situation will hit the hryvnia.

- Since January 22, 2017, the High Court of London has begun a meeting on Yanukovich's debt. If the court decides that Ukraine has to pay the debt, the government will need to spend \$3 billion to cover it, thus creating an additional burden on the hryvnia.
- The strengthening of the euro against the US dollar may also stimulate exchange transactions and further speculative mood.
- The announced increase in social benefits and wages (primarily the minimum wage increase from 3200 UAH to 3723 UAH and up to 4100 UAH in the second half of 2018) to some extent will stimulate inflation, although not significantly.
- Inflation of 7% and an increase in expenditures by 17.9% (reaching 991.7 billion UAH), while only 3% of the projected GDP growth (provisioned in the budget 2018) , also will not play in favor of the hryvnia.

*In 2018, the hryvnia's exchange rate will be influenced by debt repayments, IMF tranche arrangements, peculiarities of budget policy and market conditions*

- The Stockholm Arbitration Court required "Naftogaz Ukraine" to pay "Gazprom" \$2 billion for the supplied gas. In addition, "Naftogaz" plans to repay a loan of \$300 million in January, which was taken from the European Bank for Reconstruction and Development for the import of natural gas.
- NBU expects gas prices to rise in 2018, which will increase the country's currency expenditures for the purchase of this energy resource.
- NBU is considering transitioning to the calculation of the official hryvnia exchange rate based on Bloomberg and Reuters trade and information systems (TIS) regarding real market transactions, while cutting the transactions with extreme parameters.

- Foreign trade signals that can lead to decrease in the number of foreign currency inflow and, consequently, to the depreciation of hryvnia:
  - USA-Ukraine: there is a risk of cancellation of the regime of duty-free import of goods from Ukraine within the framework of the Generalized System of Preferences program due to problems with the protection of intellectual property.
  - EU-Ukraine: from 1st to 5th of January Ukraine has reached the limits of export quotas for wheat and maize to the European Union countries, and, as of January the 11th, Ukraine has reached the limits of export quotas for honey, wine and apple juice.
  - Russia-Ukraine: prolongation of the ban on the transportation of goods from Ukraine to Kazakhstan and Kyrgyzstan through the territory of Russia until the end of June 2018.

These facts partially limit the profits of exporters oriented towards the EU, USA and Russian markets.

- On January 11th the Cabinet of Ministers allowed the placement of free funds of the treasury account on the deposits in foreign currency. This decision may undermine the confidence in the national currency.

### Consequences of weakening hryvnia and the forecast

Under conditions of floating exchange rate of the national currency, the new year's depreciation of the hryvnia is a seasonal phenomenon caused by the market situation. This is confirmed by the following graph.

**Accordingly, in a positive scenario**, the hryvnia has all the chances to stabilize after importers finish the purchase of resources and has to be strengthened during the intensification of export activities of the agro-sector and the metallurgical industry before the moment of external and internal debt payments.



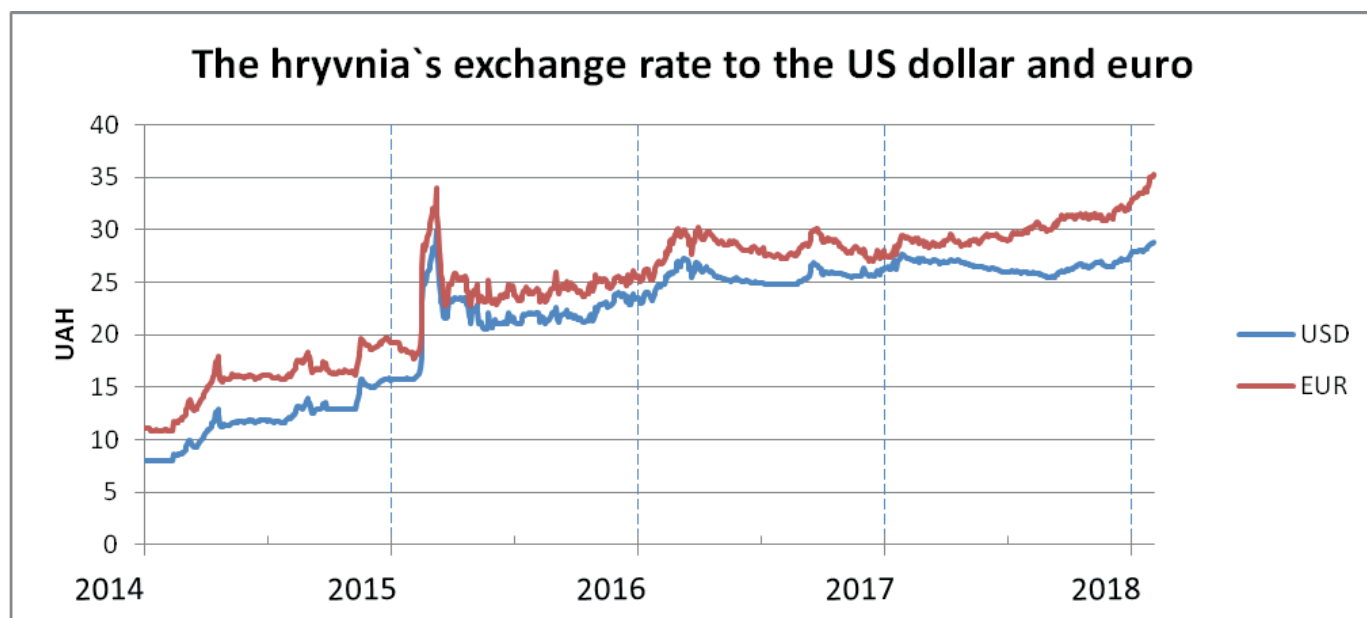
**Under the negative scenario** of a stronger depreciation of hryvnia, which will hit the import-dependent industries, in long-term it may result in its strengthening due to:

- Reduction of imports caused by the poorer purchasing power of the population for foreign products and the acceleration of export growth due to the devaluation of the national currency, which will provide price competitiveness to Ukrainian products in foreign markets. Such "stimulation" of exports, together with the requirement for exporters to sell of 50% of foreign currency, will help to strengthen the national currency and lead to the reduction of the balance of payments deficit.
- Further increase of the discount rate may result in the revival of the banking sector because such changes will help to increase the interest rates on deposits that will push the population to invest more in the financial system, thus providing the economic growth.
- Hidden reserves of the population will also have an important impact. This implies the currency savings that are outside the banking system. In particular, in 2017, the net sales of currency by the population reached a level of \$2.139 billion – not because of the people's faith in hryvnia, but because of the impoverishment of the population, which had to exchange foreign currency for existence. The same trends are expected in 2018.
- Thus, the key measures for ensuring the national currency stability in the new year is



the systematic implementation of reforms and government actions to liberalize investment activity and foreign currency inflow. The improvement of foreign trade activity and lobbying the interests of exporters in the process of entering the external markets will also be the necessary condition, which, in

turn, will make the national currency more backed up by goods and services, while stimulating domestic production, decreasing the share of shadow economy and improving the attractiveness of the country for foreign investors.



Source: the graph is build on the database of <https://minfin.com.ua>

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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