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**June 26, 2014**

**No. 17**

## INSIDE UKRAINE

<b>1. The Government Policy .....</b>	<b>3</b>
<b>1.1. Balancing between negotiations and military scenario .....</b>	<b>3</b>
<b>1.2. Army issues require an immediate resolution.....</b>	<b>4</b>
<b>1.3. The judicial system is resisting to changes .....</b>	<b>5</b>
<b>2. Economic Situation .....</b>	<b>7</b>
<b>2.1. The government offers to introduce special period in energy sector .....</b>	<b>7</b>
<b>2.2. The NBU got a new head – from business .....</b>	<b>8</b>
<b>2.3. Crimean goods will not receive European preferences .....</b>	<b>8</b>
<b>3. Political Competition .....</b>	<b>10</b>
<b>3.1. Creation of Petro Poroshenko's team .....</b>	<b>10</b>
<b>3.2. Ihor Kolomoisky may bring his party to the Parliament.....</b>	<b>11</b>
<b>3.3. Fight for Eastern electorate .....</b>	<b>11</b>



The International Center for Policy Studies (ICPS) restores issuing analytic paper «Inside Ukraine», the last issue of which was prepared in September 2010.

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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This issue is made possible by financial support of International Renaissance Foundation. Views expressed in the issue do not necessarily reflect those of International Renaissance Foundation

## 1. The Government Policy

Petro Poroshenko presented a plan for a peaceful resolution of the conflict in Donbas and unilaterally stopped the hostilities. This decision was welcomed by the Western countries and therefore strengthened the geopolitical position of Ukraine. It is unlikely that terrorists will agree to this scenario, but such a move would force Russia to take at least formal steps towards de-escalation of the conflict. At the same time, the President should skilfully balance between holding peace negotiations and preparing a full-scale military operation in Donbas. So far, too little has been done to increase combat capacity of the Ukrainian army.

Another challenge for the President is the implementation of reforms. One of the priorities is the judicial reform since its success could return trust to the government, increase investment attractiveness of Ukraine, and become a safeguard against future political crisis. Over the past four months, no steps were taken towards the judicial reform. On the contrary, representatives of the previous regime try to maintain control over the judicial branch and preserve its dependence on politicians.

### 1.1. *Balancing between negotiations and military scenario*

For the first time over the past few months, Ukrainian authorities, namely Petro Poroshenko, clearly stated the strategy regarding terrorists. The peace plan for resolving the conflict is defined as a priority. If the terrorists do not lay down their arms within a week, Ukrainian troops are ready to implement a plan "B", i.e. a military clean-up of gunmen. At the same time, the authorities should actively promote the idea of a national dialogue with Donbas residents and effectively counteract Kremlin's information influence on the public opinion in Donbas region.

The unilateral cease-fire has an important input on the country's image on the international stage. Thus, Poroshenko has positioned himself as a peacekeeper whose main value is human life. This contrasts with the position of Russia. Its influence on Donbas events is obvious, despite the attempts of Russian propaganda to portray Donetsk separatism as a civil war.

Taking into consideration the behavior of Moscow, which strengthens its sponsor of terrorism image, the German Chancellor Angela Merkel suggested that the European Commission could decide on the third level of sanctions against Russia by the end of June. Putin's answer was immediate – he appealed to the Federation Council on the cancellation of permit to use Russian troops in Ukraine. For the pro-Russian lobby in Europe, this might be enough to declare Russia's active steps on de-escalation of the conflict in Donbas.

In addition to the Western audience, Poroshenko's peace plan is also aimed at Donbas residents who opposed the Ukrainian authorities. While the Ukrainian army ceased its active operations, the terror activities of the separatists against the local population continue. Despite the fact that the majority of Donbas residents do not support terrorists, they are still under the influence of Russian information channels depicting Kyiv authorities as an enemy.

In order to stabilize the situation in the region, the Government urgently needs to establish effective communication with the local population.

*Peace plan is the President's priority*

*Cease-fire gives an important signal not only for the West, but for local population in Donbas as well*

One of the stages of Poroshenko's peace plan is conducting negotiations. This process started on June, 23. Officially, the negotiations' participants are: the special representative of the Ukrainian President Leonid Kuchma, Russian Ambassador to Ukraine Mykhailo Zurabov and the OSCE Representative Ambassador Heidi Tagliavini. In fact, Viktor Medvedchuk, Nestor Shufrych and terrorist leaders Oleksandr Boroday, Valeriy Bolotov and Oleg Tsariov are also participating in the negotiations. The fact that Ukrainian authorities are negotiating with representatives of terroristic organizations has caused a serious criticism against the President. Recognition of militants as a negotiation party legitimizes their status and plays into the hands of Moscow. In addition, the separatists are engaged in establishing their own administration bodies in order to create a visibility of normal functioning of the self-proclaimed republics. Their participation in the negotiations provides an opportunity to reach a new level of recognition – an international one, and partially relieves the Kremlin's responsibility.

Involvement of odious people in negotiations has serious reputational risks for Poroshenko, which would be removed only in case of a successful completion of the negotiations not harming the national interests of Ukraine.

However, the chances that separatists voluntarily lay down their arms are minimal. Therefore, it is important to use the time of armistice for Ukrainian army to regroup their forces, collect operative information and prepare for a special campaign. The rule "If you want peace, prepare for war" could not be more topical.

## ***1.2. Army issues require an immediate resolution***

In a war against experienced and well-equipped terrorists, the problems of Ukrainian military must be solved urgently. However, corrupt and unwieldy apparatus of the Ministry of Defence did very little to improve the combat capability of the Ukrainian army.

Logistical support of the army remains unsatisfactory. Security equipment bought by the Ministry of Defence is generally not reliable and therefore activists across the country independently collect money and buy bulletproof vests, helmets and night vision devices. The risk that the ammunition will be "lost" on the way to the front because of corruption is very high. Thus, activists hand all the necessary goods directly to soldiers bypassing the military authorities. There are cases when the generals put pressure on soldiers, because the latter receive direct support from civilians.

At the same time, the Government's purchases for the army are accompanied by complex bureaucratic procedures and abuse. For example, on June 20, the acting Defence Minister Mykhailo Koval said that the purchase of a large batch of bullet-proof vests was blocked by the leadership of the Anti-Monopoly Committee of Ukraine.

Besides, combatants reported that most cases of Ukrainian military casualties are caused by the leakage of information from ATO leaders. However, authorities did not find or punish people guilty of high treason. As these people continue to hold their positions, it undermines the confidence of the military in their own leadership.

Criticism is also drawn by forced mobilization of the population to be held under overrated quantitative plans and especially actively involving residents from Western Ukraine. Militaries are sent to the front without proper uniforms and trainings. Forced mobilization becomes a source of social tensions, as the protests of family members of the mobilized

***Participation of terrorists in talks with Kyiv legitimizes their status and plays into the hands of Moscow***

***Civil activists provide army with ammunition better than Ministry of Defense***

***Forced mobilization is a source of social tension***

servicemen are rapidly increasing.

Although doubled, the wages of the ATO members remain very low. Financial provision of a soldier is expected at the level of UAH 5400 per month, but after winning the presidential election, Poroshenko promised the payment of around UAH 1000 per day. Taking into consideration the increasing number of deaths and injuries, the issue of financial reimbursement for families, who lost their breadwinner, remains still unsolved.

Special attention is drawn to those officials in the Ministry of Defence who spend more time traveling abroad than to the combat zone. It is also unclear who will be appointed as the Minister of Defence. Among the possible candidates, named by journalists, there are no professional military people, only politicians and businessmen.

### ***1.3. The judicial system is resisting to changes***

Against the backdrop of security threats, territorial integrity of Ukraine and economic crisis, the issue of urgent judicial reforms is ignored by key political players. The judicial branch in Ukraine is unable to reform itself. Judges are interested in preserving the status quo and willing to offer their services to any government, regardless of its “colours”. Maintenance of jobs and financial encouragement is the key to loyalty of judges who make decisions not based on the rule of law, but on the interests of political or business groups. However, such incentives of loyalty destroy the independence of the judicial system and the public confidence in the government as a whole.

The spine of the judiciary in Ukraine has been atrophied throughout decades. The division of powers into the executive, legislative and judicial branches never existed in Ukraine. The courts were a convenient and legitimate instrument of struggle between the Parliament and the President. The relations similar to “client-patron” model completely satisfied Ukrainian judiciary that was accustomed to obey orders from above since the days of the Soviet totalitarian power vertical. A tradition of self-government and an independence from other governmental branches has not been formed in the system.

Speculation with interpretation of legal norms was one of the reasons for EuroMaidan protests. The use of courts for political purposes has led to the distortion of election results, imprisonment of political opponents and a dramatic increase of presidential powers. During street confrontations in the winter of 2013-2014, the courts were obedient executors of the will of Viktor Yanukovich imprisoning hundreds of peaceful protesters and creating a sense of impunity for thousands of police officers and prosecutors.

After the overthrow of Yanukovich’s regime, representatives of the judiciary decided to wait out a period of turbulence being confident that the new government will need their services as well.

In turn, Ukrainian politicians do not offer a clear vision of how to change the judicial system. Obviously, they are tempted to leave unchanged the extremely convenient tool for manipulating laws.

Over the past four months, only a few decisions were taken concerning the functioning of the judicial system. Political prisoners were released. The Parliament appointed four judges of the Constitutional Court, and Olexandr Turchynov appointed three members of the High Council of Justice. On April 8, the Law “On Restoring Confidence in the Judiciary in

***The judicial branch in Ukraine is unable to reform itself***

***Traditions of self-government has not been formed in the system***

***No ground was laid for judicial reform over the past four months***

Ukraine” was passed which automatically dismissed all heads of the courts from office and stated that the judges on administrative posts might be elected by colleagues. These steps neither laid a foundation for reforming the system, nor may they be called “imitation of reforms”.

A corrupt judicial system strongly resists even to cosmetic changes. After the automatic withdrawal of heads of courts from the administrative positions, the judges chose the same individuals as their leaders, now by voting.

Some MPs even want to repeal the law “On Restoring Confidence in the Judiciary” by the Constitutional Court. At the same time, members of the High Qualifications Commission exempted by this Act are wilfully trying to reclaim their positions.

In late April, the Congress of law universities and research institutions elected three members of the High Council of Justice, but after a month the Kyiv District Administrative Court overruled the election results. The same institution cancelled the election results of HCJ members from the Congress of Attorneys.

Various influence groups also fought over the Judges Congress that had to delegate members to the High Council of Justice, the High Qualifications Commission, the Judges Council and the Constitutional Court. The first attempt to organize the congress was disrupted by civic activists, as at that moment there was still no law on lustration of judges. On June 19-20, 2014, the congress was held, but it was ineffective because only members of the Judges Council were elected. This time the civic activists insisted on holding the congress but the resistance was put up by judges associated with Serhiy Kivalov. The reason is the lack of clear agreements between the new President and key players in the judicial system regarding its further existence. Ukrainian courts are not accustomed to independence and are waiting for signals from the executive power.

Waiting till the government reshuffle, politicians who for years have been the architects of the dependence of Ukrainian courts on the executive (e.g. Serhiy Kivalov), are now trying to regain control over the system and appoint their people to positions in the High Council of Justice, the Constitutional Court and the High Qualifications Commission of Judges. By regaining the controlling stake in the judiciary, they will try to capitalize it in the relationship with the executive power.

Meanwhile, the judicial reform is a top priority in Ukraine. Its implementation will avoid political crises, because it would create a system of checks and balances between the three branches of power. As soon as the population feels the qualitative changes in judicial practice, it will result in the growth of confidence towards all state institutions. The judiciary independence is furthermore a guarantee of investment attractiveness of Ukraine, as entrepreneurs have to be confident that their property rights will be legally protected.

A prerequisite for judicial reform is the lustration of judges, which had no results so far. Some of the most odious judges fled from Ukraine, but most continue to perform their functions. In addition, heads of the judiciary that were active during the previous government return to their posts. So, on June 18, the Supreme Administrative Court overturned the decision on dismissal of the Constitutional Court Chairman Vyacheslav Ovcharenko, who was a protégé of Viktor Yanukovych. Such decisions can be taken also regarding other judges representing the old regime.

*Courts cancel decisions of Congress of Attorneys and Congress of law universities*

*Ukrainian courts wait for signals from executive power*

*A prerequisite for judicial reform is the lustration of judges*

## 2. Economic Situation

Due to difficulties in gas talks with Russia, the Government offers to introduce special period in energy sector. Such an initiative will have a contradictory impact on domestic gas extraction.

Valeria Hontariva, who has 20-year experience in financial markets, became head of the National Bank. Experts and market players give a positive feedback to a new appointment.

The EU Council has forbidden import of Crimean goods which do not have a certificate on Ukrainian origin, under tariff preferences. Such a decision is a component of the EU strategy not to recognize the Crimea as a part of Russia.

### *2.1. The government offers to introduce special period in energy sector*

The government elaborated a draft law “On special period in energy sector” and registered it in the Parliament. It defines how enterprises dealing with electricity production, oil and gas will function in a special period. The procedure of their business activities will be defined by the government.

However, the bill has a number of serious shortcomings and requires thorough fine-tuning.

For instance, it does not list specific reasons for introduction of special period in energy sector. As a result, it is necessary to clarify causes for restriction or cancellation of energy supplies to Ukraine and specify type of resources supplies of which are restricted. In its turn special period in energy sector may be introduced either due to martial law in Ukraine or emergency state caused by natural disasters. Problems in talks with supplier (Russia) over the gas price cannot be a reason to introduce a special period.

In case special period comes in force in energy sector, which would result in compulsory sale of domestically extracted gas to the authorized party, there is a need to define the price formula for such obligatory sale. It makes sense to link this price to threshold price of National Commission for Energy Regulation as of the date special period is introduced. Besides, it is necessary to specify who will or may be the party authorized by the government.

It should be noted that Ukraine covers gas needs of households with domestic gas extraction. Potential introduction of compulsory sale price for the gas, which will not take into account the market situation, will lead to outflow of investments from energy sector. It may also result in significant drop of domestic gas extraction, which will have negative consequences on gas supply to population.

An efficient way to solve energy problem is Ukraine actually joining the Third energy package. In this case private companies and their associations, which are large consumers of gas as raw materials, will be able to purchase gas from “Gazprom” without “Naftogaz Ukrainy” being an intermediary. The Ukrainian company will be reorganized.

As a matter of fact, volume of Russian gas import in 2013 made up 28.1 bln. cubic m, which is 15% less than in 2012. Domestic extraction made up 20.9 bln. cubic m, which is 4% more than in 2012. Overall volume of gas consumption was around 50 bln. cubic m, which is 8% less than two years ago. At the same time domestic gas extraction completely covers needs of households. Since 2006 there was a trend for reduction of gas

***The draft law on special period in energy sector has a number of shortcomings***

***Introduction of compulsory sale price for gas will result in reduction of domestic gas extraction***

consumption in Ukraine, yet share of natural gas in energy consumption remains high – 35-37%, which significantly exceeds average indicators in Europe and the world.

## ***2.2. The NBU got a new head – from business***

On June 19, the Parliament approved Valeria Hontariva as a new head of the National Bank. She has 20-year experience in financial sphere and good reputation among the colleagues in banking and investment business.

A key task for the new NBU head is to restore trust to banking system and to launch financing mechanism for real economics sector. For these purposes it is important to elaborate a clear, transparent and consistent development plan for Ukrainian banking sector.

More specific NBU tasks are the following:

1. Stabilization of FX rate, change of outdated FX regulation and gradual introduction of inflation targeting. Meanwhile, it is necessary to establish close communication with banking sector stake-holders and make regulator's actions transparent, public and rational. What is needed is also to abolish the system of FX control inherited from the Soviet times.

2. Improving situation with delinquent banks, consolidation of banking system and decrease in number of “scheme” banks, reduction of pressure on Retail Deposit Guaranteeing Fund while searching for potential investors eager to purchase bad banks (or their assets).

3. Increase of bank reliability through improvement of capital adequacy and stricter requirements to the equity quality.

***A key task for the new NBU head is to restore trust to banking system***

## ***2.3. Crimean goods will not receive European preferences***

The EU Council decided to forbid import of goods from Crimea under special tariffs, which are applied towards Ukrainian commodities. Such decision is a component of the EU strategy against Russia's annexation of Crimea.

At the same time Crimean products which have Ukrainian certificates of origin are allowed for import under special regime. Otherwise regular customs rate will be applied. It is expected that these sanctions will influence chemical industry and agrarian sector the most.

Since April 23, the EU decreased or cancelled duties for most industrial and agricultural products from Ukraine. Tariff preferences will last till November 1, 2014. It is expected that DCFTA between Ukraine and the EU will come in force till that date.

In its turn Ukrainian Parliament passed the first hearing of draft law on tax and customs control in free economic zone in Crimea and on business activities on temporarily occupied territory of Ukraine. This law offers to create a free economic zone in Crimea for 10 years.

It means that on the peninsula there will be a special legal regime for economic activities of individuals and legal entities as well as a special regime for domestic and external migration of citizens. A comprehensive free economic zone will combine duty free zone and ports, customs storage facilities, technological parks, industrial complexes and recreational areas. The draft law suggests cancelling all the taxes, except for individual income tax and deductions to social funds.

It also foresees introduction of multi-currency regime to pay for

***Verkhovna Rada prepared response to Russia's initiative to create free economic zone in Crimea***

goods and services. Inconvertible currencies may also be used for cash settlements.

The draft law is a Ukrainian reply to the Russian law on creation of a free economic zone in Crimea. It is aimed to create legal ground and improve conditions for business activities under the law on occupied territories. However, due to the fact that Crimea is occupied by Russia, implementation of the law is doubtful.

***Implementation  
of the law is  
doubtful due to  
Russia's  
occupation of  
Crimea***

### 3. Political Competition

Petro Poroshenko creates a team of administrators who are not related to political parties. He is especially careful with his appointments, as he has no right for error due to war and acute need for systemic reforms.

Parliament tries to show the President that he may efficiently cooperate with MPs. However, major political parties realize that snap elections are impossible to avoid as society clearly wants them. Therefore, most of them started preparations for parliamentary elections.

Former electorate of the Party of Regions is the most attractive for political parties. Not only Serhiy Tihipko, but also newly created Party of Development of Ukraine will work with people in the South and the East. Socialists will join the fight for workers of the region. All of these parties will focus on problems of refugees and peaceful settlement of the conflict.

#### 3.1. Creation of Petro Poroshenko's team

Petro Poroshenko's appointments are strict and sharp. They are influenced by time limit, small number of positions under presidential quota and high risks in case wrong person is chosen.

All the appointments fit a specific pattern: effective administrators, most of them having successful track record in business and not being related to politics. If at least one person is appointed according to party quota principle or nepotism, it will lead to reputational losses of Petro Poroshenko. Expectations of people are extremely high, while a set of problems President has to solve is enormous. They include stabilization of situation in the East, issue of Crimea, launch of reforms in public service, law enforcement agencies, courts etc.

On the other hand, Petro Poroshenko fulfilled the demands of his major political ally Vitali Klitschko and appointed him the head of Kyiv state administration. This step will negatively affect positions of both politicians. Merger of mayor and head of city state administration is against the nature of these positions and leads to overlap of executive and state functions. It also contradicts decentralization program announced by the President.

Factor of time also plays against Petro Poroshenko. Society urges for early parliamentary elections which would reset the system. The President also underlined their necessity. However, in order to hold elections, it is necessary to stabilize situation in the East. Even in case Russia stops supporting separatists, the border is completely under Ukrainian control and the actions of Ukrainian army are well concerted, it will take weeks to settle the problem due to considerable concentration of gunmen and heavy weapon in the conflict zone.

Meanwhile, it is expected that the President will take decision on early parliamentary elections by late August. Taking into account two months needed for parliamentary campaign, the elections may take place in October-November 2014. The elections require changes to electoral law, which may be taken after consultations with current Parliament.

In their public statements parliamentary factions in the coalition agree that the elections are needed. However, high MPs' support of the President's appointments was aimed to show that Poroshenko may efficiently cooperate with current Parliament. At the same time delay with parliamentary elections will destroy political rating of the President as well

***Strict HR policy  
of Petro  
Poroshenko***

***Merger of mayor  
and head of city  
state  
administration is  
against the  
nature of these  
positions***

***Parliament  
shows  
cooperation  
opportunities  
with the***

as his ability to get his own political party in the parliament, which would become the basis of pro-presidential majority.

***President***

### ***3.2. Ihor Kolomoisky may bring his party to the Parliament***

Ukrainian oligarchs always wanted to have their people in the Parliament. It allowed them to directly influence political process in the country and to protect their business interests. In order to hedge the risks, they invested in different political projects, some of them being in the government, others – in the opposition. Ihor Kolomoisky also used to apply such an approach.

Nevertheless, for the last six months he gets more and more political weight not as an investor in political projects, but as an independent politician. Successful management of Dnipropetrovsk region, efficient counteraction against Russian informational campaign, spread of the influence to other regions in the South and the East drastically increases Kolomoisky's political capital. Media support of "1+1" TV channel, which considerably broadened its audience during the Maidan, serves as a multiplier of the politician's influence.

***Ihor Kolomoisky  
get more weight  
as an  
independent  
politician***

These factors create favorable conditions for the politician getting his own political party in the Parliament instead of individual MPs. According to mass media, in this endeavor Kolomoisky will work with the project of Serhiy Tihipko, who managed to keep part of regionals' electorate in the South and the East. While creating a new political party, Ihor Kolomoisky may also use MPs who came to the parliament under FPTP system and have considerable influence in the regions.

### ***3.3. Fight for Eastern electorate***

Decay of the Party of Regions, loss of positions by communists, deterioration of economic situation in the country increases social demand for leftist ideology. Socialist slogans will be used by both new parties and those that used to be influential, but left the political stage. One of the latter is Socialist party of Ukraine which actively started to appear in the media. A new leader of the party became Mykola Rudkovsky, which was heavily criticized by former leadership of the party. Socialists' statements prove that they will focus on electorate of the South and the East – regions, which are not conventional for the party. So far this electorate is "no man's land". Socialists draw considerable attention to the issues of refugees and peaceful settlement of conflict in the East.

***Social demand  
for leftist  
ideology***

Interestingly, similar ideas are expressed in statements of Party of Development of Ukraine, which also wants to get former electorate of the Party of Regions. Comparing to other political parties, it will be easier for them to do it as the organizational spine of the party is formed by former Party of Regions MPs. Enormous media resource of "Inter" TV channel will also play in hands of this political party, which may be considered new rather formally. Frequent appearance of the party representatives on key TV channels shows that powerful media support will play a prominent role in creation of this party.

***Parties which  
want to get  
support in the  
East focus on  
peaceful  
scenario***

Both SPU and PDU support Petro Poroshenko's approach to peace settlement of the conflict in the East. Thus, in case they make it to the Parliament, they may potentially cooperate with pro-presidential parties.