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INSIDE UKRAINE

**UKRAINE IN 2016:
ACHIEVEMENTS AND
CHALLENGES**

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Public policies:

Implementation of reforms in 2016: achievements and failures



2016 was expected to be a crucial year in Ukrainian reforms process. Relative political stability, sufficient public support, concentration of power in one single policymaking center, low intensity of the conflict in Donbas, strong and solid foreign assistance – all of it created conducive and favorable conditions for a breakthrough in reforms and modernization of the country. While there were some positive developments in the reform process like introduction of e-declaration of assets by officials or a new public service law, overall Ukrainian authorities have not been able to make a breakthrough in reforms, to change rent-oriented practices and to achieve a new quality of governance. Economic decline and deterioration of social standards together with increase of internal political turbulence and changes on international scene create much worse conditions for stability, reforms and modernization of Ukraine in 2017, pose serious threats and challenges to its security. 2017 will be a year to check viability and resilience of post-Maidan Ukraine, its ability to withstand imminent and unavoidable storms, internal and foreign policy challenges, to survive and to change the country.

Civil society and pro-reform forces lost their illusion that old structures can be reformed by cosmetic changes. Pro-reform “new Ukraine” leaders faced real resistance and attacks from corrupt and oligarchic groups and were learning how to fight with rent-oriented elite, which demonstrated in the process of e-declaration their ability to withstand and in other reforms to use to their benefit new legislation and institutions like with introduction of state secretaries. 2016 was a good year of unmasking who is who in the country, mounting experience for pro-reformers on how to fight for change and developing step by step new consensual understanding of what new Ukraine should be. There is a wider and stronger base for change in 2017 and we might see the next year both: dramatic highs and lows, unexpected alliances and disgusting betrayals, victories and failures, which all hopefully will make the country stronger and better.

Meanwhile we have to learn lessons on successes and failures of the year 2016. Below we present our analysis of the progress in key reforms, which will make strong influence on further development of the country.

Overall, 2016 was not a lost year for Ukraine.

Civil service reform

In 2016, the implementation of the civil service reform has not led to a qualitative renewal of the state apparatus and an elimination of political influence on it.

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Despite the implementation of the key provisions of the new law regarding establishing of a transparent remuneration model and the formal separation of political and administrative positions, the fairness of competitive selection procedures is doubtful. Setting the political influence on the Commission for the senior civil service corp has led to the fact that in most cases winners of contests for the positions of state secretaries became current deputy ministers or candidates loyal to the government. This shows the willingness of the ruling elite to continue using the old methods of governance in the new environment by maintaining a manual control of the contests.

Main achievements in the area of civil service reform have been:

- Entry into force of the new law on civil service, despite numerous attempts to postpone it.
- Adoption of the Strategy of public administration reform for 2016-2020.
- Formation of the Commission on senior civil service corps and holding contests for the positions of heads of regional state administrations and state secretaries.
- EU consent to allocate funding for civil service reform that will potentially attract high-quality professional and, increase competition with

current servants and the efficiency of public administration in general.

Failures of civil service reform in 2016:

- Commission on senior civil service corps soon after its establishment lost its credibility by transparent and suspicious activities and decisions, which discredit the whole reform and might pose a serious challenge for the future of reforms. Many decisions were anecdotic like nomination of the head of Mykolayiv regional state administration a candidate who made numerous grammatical errors while preparing a written assignment. Similarly, the winners of the contests for the positions of state secretaries in the ministries became current deputy ministers and candidates loyal to the government. The composition of the Commission on the senior civil service is questionable and even civil society representatives have been now strongly criticized for their alliance in the Commission with representatives of the administration in adopting not credible decisions.
- Attempts to change provisions of the new law on civil service sensitive for authorities. In July 2016, the Ukrainian parliament adopted a bill in the first reading that provides for the transfer of powers regarding the selection of candidates for the positions of heads of regional state administrations from the Commission on the senior civil service body to the specially created commission under the Presidential administration that violates both the law on civil service and the Constitution. The final adoption of the bill will allow the president to usurp local authorities.
- Preservation of low level of wages.

Conducting of contests on the positions of state secretaries in the ministries is doubtful

In order to fulfill the tasks envisaged by the civil service reform, the parliament could review the law, in particular rules of establishment of the Commission on the senior civil service; the Commission must be reestablished and reappoint its members as well as announce new contests.

It is also important to amend the reform with introduction of the public policies by the government. Strategy of the public administration reform looks more as a set of bureaucratic non-actions than a real strategic

document to modernize public administration. There should be a new round of public consultations on public service reform to return trust from the society. Increase a level of salaries for civil servants to ensure prestige and high efficiency of public administration is also important task for the government the next year.

Anti-corruption reform

In 2016, despite numerous attempts to disrupt it, the system of e-declaration was launched. Ukrainian top officials submitted e-declarations, which should be verified by specially authorized bodies to combat corruption. This process should be followed by bringing those responsible for corruption crimes to justice. However, this is hampered by confrontation between the old and new anticorruption bodies, between NABU and SAPO, as well as attempts by NABU management to use this body to begin their own political career, in addition to the limited technical and legal capabilities. Furthermore, a lot of information from e-declarations can be hidden from the public. Next week, the Constitutional Court of Ukraine will consider some provisions of the law on e-declarations on constitutionality. The results of this verification shows whether the fight against corruption will move to the next stage or whether reform will have a declarative character.

NABU management is trying to use this body for beginning their own political career

Main achievements of anticorruption reform in 2016:

- Completion of the first phase of the e-declaration campaign;
- Creation of the National Agency on the detection, investigation and management of the assets derived from corruption and other crimes and the election of its chairman;
- Introduction of state funding of political parties as an important tool to fight political corruption.

Achievements in anticorruption field are limited

However, each of these achievements is limited and does not fully meet the expectations of

the public. Submitting e-declarations should be followed by their full verification and, in the case of finding facts of illegal enrichment and false information, bringing those responsible for corruption offences to administrative and criminal liability. However, such a scenario seems unlikely today because there are no technical capabilities, relevant software or regulatory mechanism of interaction between National Agency on Corruption Prevention with other government bodies. The limited number of staff of anticorruption bodies hampers the possibility to check the 127,000 e-declarations. On a legislative level, specific timing for verification is not mentioned. Under such conditions e-declaration, there is a danger of transforming from a means of public control over the government to a tool of achieving goals by ruling political elite. Similarly, in the area of fighting political corruption, there are no tools for verification of reports submitted by the political parties. The chairman of the newly established National Agency on detection, investigation and management of assets derived from corruption and other crimes became current deputy minister of justice who has been under investigation regarding the presence of the conflict of interests in his position. In addition to the contests for the positions of state secretaries, the transparency and fairness of the selection procedure remains doubtful.

Failures of anticorruption reform in 2016:

- Failure of granting the NABU the right for independent interception of communications despite recommendations of the US and the EU;
 - Delay for the indefinite future the development of a draft law on a high anticorruption court;
 - Numerous conflicts between various law enforcement agencies regarding determination of the jurisdiction of the crimes.
- In 2017, it is necessary to take the following measures in anticorruption area:
- To conduct professional training of the NABU and SAPO in order to increase the efficiency of pre-court investigation;
 - To increase pressure on the government from the public regarding the issue of granting to NABU an independent right for interception of communications;
 - To implement measures for depoliticization of the NABU;

- To start work on developing a draft law on a high anticorruption court.

Health care reform

Old medical infrastructure, despite the extensive network of health care institutions (Ukraine keeps the 4th place in the world in the number of hospital beds – 879 beds per 100 thousand population), does not ensure provision of quality and timely health care for the population or high wages of health care workers, and the low level of financing leads to the need for comprehensive health care reform aimed at reaching European level by Ukrainian



medicine. On November 30, 2016, the Ukrainian government began a health care reform by the adoption of the concept of health care reform financing .

On November 30, 2016 the Ukrainian government adopted the concept of health care financing reform
Achievements in anticorruption field are limited

Main provisions of abovementioned concept:

1. Introduction of the national model of medical insurance, which provides for insurance payments of every citizen through the general taxation system (2017-2020). Due to this, Ukrainian medicine will move to the principle "Money follows the patient", and a doctor or a hospital will receive targeted income to work with a particular patient;
2. Introduction of a guaranteed health care package, including a set of medical services that a patient will receive free of charge;
3. It envisaged the creation of a single national customer who will plan and buy medicine for citizens;
4. Autonomous status of health care institutions,

the establishment of hospital districts in order to ensure effective management of medical infrastructure, development of public health system.

From the January 1, 2017, the government plans to increase the salaries of health care workers by 20% and increase spending on the purchase of medicines by 2 billion UAH .

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Possible risks of disruption of health care reform.

1. The conflict between the Committee of the VRU on health care and the Ministry of health care;
2. Allocation funding for the implementation of reform is not provided in the draft budget;
3. Problems with the launch of the medical insurance market;
4. Pressure from pharmaceutical companies and corruption risks.

Local governance and decentralization reform

The dependence of the regions on the center, their low level of investment attractiveness, infrastructure and financial weaknesses of communities and the degradation of rural communities has led to the need for local governance and decentralization reform. However, it should be noted that this reform is implemented beyond the Constitution of Ukraine . The combination of the decentralization with the issue of introduction a special order of local governance in particular districts of Donetsk and Luhansk regions prevents the adoption of the constitutional amendments that provide for a radical change in the current system of administrative divisions and the introduction of the institute of prefects, who will replace regional state administrations. Notwithstanding, significant progress is observed in other areas of this reform (according to the National Reforms Council)

Local governance and decentralization reform is implemented beyond the

Constitution of Ukraine

With regard to the capacity building of united territorial communities (UTC)

- 184 UTC were formed, in 66 UTC elections were held.
- 320 heads of UTC were elected.
- 159 UTC approved strategies for social and economic development.

With regard to the financial support of UTC and financial decentralization

- 159 UTC received medical and educational subventions from the state budget.
- Revenues to local budgets were increased (as of September 2016, the general fund of local budgets amounted to 103.9 billion UAH).

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With regard to regional development

- At the expense of the State fund for regional development, 2880 projects on social and economic development amounting for 5 billion UAH were implemented.
- 11 municipal councils received competencies in the field of architecture and construction control.
- A process of transferring competencies in the field of registration of real estate, business, place of residence, issuing identifying documents to the centers of administrative services was started.

In order to ensure further implementation of reforms in 2017 it should be taken the following measures.

- To adopt constitutional amendments in terms of decentralization after the exclusion of the provision which provided for a special order of local governance in particular districts of Donetsk and Luhansk regions.
- To ensure the right of the UTC for local referendum and identify issues that could be considered at a referendum.
- To establish a transparent selection process of local governance projects for funding from the State Fund of Regional Development.

Reform of the law enforcement system

Politicized power structures, permanent

interagency conflicts and the substitution of a comprehensive strategy for reforming the law enforcement bodies by inconsistent and subjective changes have led to the need for conducting reform in this field. In 2016, there was a tendency to neutralize the new anticorruption bodies (NABU and SAPO) while strengthening PGO and SBU, which are under political control.

Main achievements in the reform of law enforcement bodies:

- Patrol police has begun its work in 32 Ukrainian cities;
- Within the structure of the National Police staff, an Office of human rights was established, which is incorporated into the department of organizational support of temporary detention facilities;
- Measures for re-attestation of policemen were taken. Re-attestation passed 68135 policemen . 5257 policemen were dismissed for non-compliance, and 4479 people were recommended for promotion.

68135 policemen passed re-attestation

Main failures of the reform:

- Low level of professionalism of police, as evidenced by the tragic death of two patrol policemen in Dnipro in September 2016 and a shooting in Kniazhychi in December 2016;
 - Attempts to expand police competencies while restricting the rights of ordinary citizens.
 - Failure to launch the State Bureau of Investigation (which is called "Ukrainian FBI"), which would take over the functions of a number of other law enforcement agencies, including investigation functions from the PGO;
 - Minimization of genuine reform of the PGO. In 2016, as a result of competition, 84% of former prosecutors have been appointed as the heads of newly-created local prosecutor's offices.
- In order to implement reforms in 2017, the following measures should be taken:
- To launch the State Investigation Bureau and its election of director;
 - To increase the level of professionalism and discipline of police officers through professional training;
 - To reform the PGO and its withdrawal from the political influence.

Economic analysis: Economic trends and forecasts for 2017



According to preliminary calculations, Ukraine managed to tackle recession in 2016 and demonstrated little economic recovery. Annual GDP growth for 9 months amounted to 1.2%. A gradual way-out of economic recession is proved by the fact that a negative gap in GDP has been narrowing since the second half of 2015. It is expected that a positive dynamic in GDP will continue in 2017 since a risk of the armed conflict escalation has decreased and economic agents have become increasingly inclined to investment and long-term consumer-oriented decisions.

GDP

The IMF – Ukraine's key creditor – predicts that Ukraine's GDP will grow by 1.5% in 2016 while inflation rate will amount to 15.1%. The World Bank expects that that GDP will grow by 1% while inflation rate is estimated at 15%. The EBRD predicts GDP growth at 2%. According to government forecast, Ukraine's GDP growth will amount to around 1.5% at the end of the year.

According to the State Statistics Service of Ukraine, the GDP has grown by 1.8% in Q3 2016

in comparison with 1.4% demonstrated in Q2 2016. Thus, a period-to-period GDP has grown by 0.4% in comparison with Q2 2016. According to ICPS calculations, annual GDP growth for 9 months will amount to 1.2%.

According to preliminary calculations, Ukraine managed to tackle recession and demonstrate features of economic growth in 2016.

In Q2 2016 a real GDP growth has reduced to 1.4%. Key factors that contributed to economic recovery were a domestic demand for investments and a positive dynamic of household consumers. The reasons for increasing investments are little improvement in business expectations and increasing capital expenditures of integrated budget. In its turn, a net export resulted in negative contribution to GDP dynamics.

A transit potential remains limited in Eastern Ukraine. Besides, Russia strengthened transit restrictions. Meanwhile, a high harvest resulted in high agricultural production.

In Q3 2016 an economic growth was restricted

by a net export. There was a negative balance of current account in Q3 2016 (\$ 1.7 mln) due to a higher than expected deficit in trade of goods. Reduction in export of goods was facilitated by deteriorating economic state of affairs. Meanwhile, there was a resumption in import of goods resulted by increasing purchases of natural gas and domestic demand.

Key factors of economic recovery were a domestic demand for investments and a household consumption.

Inflation

The National Bank of Ukraine predicts that inflation in Ukraine will amount to 12% at year-end of 2016, the World Bank - 15%. State Budget of Ukraine for 2016 provides for annual inflation at 12% and currency rate around 24.1 UAH per USD. The ICPS forecasts the inflation rate at 12 % under the currency rate at 26.1 UAH per USD.

Consumer prices have grown by 9.4% since the beginning of 2016.



In October 2016, consumer prices rose by 2.8%, accelerating the annual growth in consumer prices in October to 12.4%. CPI growth has been 9.4% since the beginning of 2016. The main factors that contributed to inflationary pressures in Q3 2016 was a significant increase in heating tariffs, increase in water prices, a slight increase in excise duties on alcohol and tobacco products as well as an accelerated seasonal rise in prices of dairy products in October 2016.

There were signs of recovery in economic

activities in Q3 2016 in countries that are Ukraine's main trade partners. However, global price environment for Ukrainian exporters deteriorated primarily due to significantly lower prices for agricultural products - grains and oilseeds. In line with a seasonal increase in demand for foreign currency and reinforced uncertainty in obtaining official external financing from the IMF, this resulted in devaluation pressure on exchange rate in August and early September 2016.

The ICPS expects that a consumer inflation will within 12% by at year-end of 2016.

ICPS expects that consumer inflation will be within 12% at year-end of 2016. However, there are several factors that can cause fluctuations in inflation. The main risks include the following: the abolition of state regulation of social value products, a significant correction in prices for raw foods, increase in administrative and regulatory prices.

Foreign trade

In 2016 Ukraine's foreign trade continued rather radical transformation. It was primarily caused by the military conflict and trade war with Russia that resulted in the loss of Russian market, the economic crisis and the consequences of severe devaluation in 2014-2015. Subsequently, there were changes in the structure of foreign trade, namely a shift from traditional Russian market (and CIS market in general) and an increase of EU countries in a foreign trade share. Generally, this trend is considered to continue in the medium term. These trends were observed amid the fall in foreign trade, especially export.

Ukraine's foreign trade continued rather radical transformation in 2016.

In January-September 2016 export of goods and services has decreased by 7.8% and import by 0.9%. In particular, in Q3 2016 exports fell by 5% while import increased by 8.7%. Ukraine's export mostly fell to CIS countries reaching by 18.7% for 9 months and by 14.4 % in Q3 2016. Meanwhile, import from CIS countries fell by 21.8% in January-September 2016, and only by 9.5% in Q3 2016. Export to the EU for nine months

has increased by 3.3%, while import from the EU has increased by 4.9%. In G3 2016, export rose only by 0.2%, while import had a considerable growth by 13.1%. In Q3 2016 trade deficit with the EU was 1.317 billion USD and 2.394 billion USD totally for three quarters.

Ukraine's export mostly fell to CIS countries by 18.7% for 9 months.

Deterioration of Russian-Ukrainian economic relations affected trade between Ukraine and other CIS countries, resulting in a relatively high reduction of export-import operations with these countries. First, it proved that such countries as Belarus and Kazakhstan are affiliated with the Customs Union, where Russia



plays a leading role. Second, deteriorating of Russian-Ukrainian relations hampered Ukraine's economic relations with countries in the South Caucasus and Central Asia, which are carried out by transit through Russia.

Deteriorating Ukrainian-Russian relations hampered Ukraine's trade with counties in the South Caucasus and Central Asia.

Over three quarters of 2016, export of goods decreased by 8.7%, including by 4.9% in Q3 2016. Export of plant products fell by 1.2%, but there was an increase of its share in total exports (up to 21.3% in January-September 2016 from 19.7% in January-September 2015). Key products in this group are grains and sunflower seeds. Export of sunflower oil increased by 21.3% and amounted to 10.6% of total export. Export of ferrous and non-ferrous metals and its products fell by 17.6% (its share in total export decreased to 23.9% from 26.5%). In particular, exports of ferrous metals decreased by 16.4%. Export of mineral products decreased by 20% (its share reduced to 7.5% from 8.5%) and while export

of machinery and equipment declined by 9.1% (its share remained unchanged - 10.2%).

In January-September 2016 import of goods has not changed in comparison with the same period of the previous year, but in Q3 2016 import has significantly increased by 10.2%.

In the structure of import, vehicles showed an excellent dynamic increasing by 71.6% (its share increased to 7.4% from 4.3%). This was due to the increase in import of cars after a sharp reduction in 2015. Import of machinery and equipment has also significantly increased by 27% (its share increased to 20.3% from 16%). Import of chemical products increased by 11.7% (its share increased to 15% from 13.4%). In particular, import of fertilizers rose by 11.6% (its share increased to 2.3% from 2.1%) due to a reduction in domestic production. Import of mineral products fell by 38.6% (its share totally fell to 20% in January-September 2016 from 32.5% in January-September 2015). The drop was caused by a decline in world oil prices. A physical volume of energy import has also decreased, though it has significantly increased on a year-on-year basis at the end of the period - in August and September 2016.

It is also important to note a high concentration of Ukraine's foreign trade (18 countries provide for over 70% of export of domestic products and over 80% of import). There is a significant untapped capacity for geographical trade expansion. However, it must be precisely based on diversified goods structure of foreign trade in order to make such expansion efficient and sustainable.

Ukraine demonstrates a high concentration of foreign trade activity.

Forecast for 2017

According to a majority of forecasts, it is expected that Ukraine's economy will recover and its GDP will continue growing. However, such expectations are rather modest given the fact that Ukraine's economy has already survived deep recession at 1.5-3 %.

Expectations of GDP growth are too modest given the fact that Ukraine's economy survived deep recession at 1.5-3%.

Recovery of domestic demand is among key factors contributing to economic growth. Private consumption will moderately recover in the medium term as a result of pent-up demand and rising incomes.

| Organization | Expected GDP growth in 2017 |
|----------------|-----------------------------|
| Ukraine's MEDT | 3% |
| NBU | 3% |
| IMF | 2.5% |
| World Bank | 2% |
| ICPS | 3% |

Recovery of domestic demand is among key factors contributing to economic growth.

It is also expected that business investments will rise. However, a substantial increase in investment activity in the near future will stimulate a respective increase in investment imports, including machinery and equipment, which will largely increase in a negative contribution of net export to GDP. A revival of credit activity amid expected reducing interest rates will be an additional factor contributing to growing domestic demand.

A net export will slow down the GDP growth. Slow global economic growth, including a slowdown in China's growth, will curb increase in Ukraine's export.

A net export will slow down the GDP growth.

Thus, the ICPS expects that a moderate economic recovery will continue in 2017-2019 (3%, 5% and 4% respectively). Despite further growth, Ukraine's macroeconomic indicators will remain below the level of 2013.

Despite further growth, Ukraine's macroeconomic indicators will remain below the level of 2013.

Key factors containing inflation in the long-term perspective are external support for reforms (in cooperation with donors, especially the IMF), an absence of negative shocks in foreign markets and of escalated fighting in Eastern Ukraine and, as a result, a further improvement in inflation expectations. The absence of these factors will cause additional depreciation and inflationary pressures. In this case, a return of inflation to a target level will require tighter monetary policy. According to the NBU, a positive shock may result in a faster increase in world commodity prices, more substantial increase in external demand for Ukrainian products and speed-up of reforms. Under these conditions, a recovery of economic activity will be accompanied by strengthening UAH due to increased export revenues and capital inflows in financial terms. This may increase pressure on prices by consumers, but the effects of strengthening UAH will be more significant.

Domestic assumptions:

- The overall public sector deficit (including deficit of Naftogaz) will amount to 4% of the GDP in 2016
- Tax reform will continue. The use of a simplified tax system will continue to shrink.
- Territories controlled by Ukrainian authorities in Donbas, has not significantly changed, and will not be returning of the active phase of military operations. In other regions of Ukraine «hot spots» will not appear and massive military intervention by Russia will not be occurred. Sabotage on the whole territory of Ukraine is possible throughout the forecast period.
- Significant increase in administratively regulated tariffs will not cause a significant increase of debt for housing and communal services. Dissatisfaction of the population because of falling real incomes did not transform into mass protests.
- There will be a gradual transition to inflation targeting and subsequent purification of the banking sector. The exchange rate will remain relatively floating. Because of significant amounts of assets in foreign currency a lot of banks cannot provide the level of capital in accordance with Basel III conditions.

External assumptions:

- The world economy will grow at around 3.5% during the forecast period. There will be a gradual slowdown in China, falling in Russia and a slight increase in the EU.
- Loans will come from the IMF and other macro-financial assistance promised by superstate organizations and the governments of particular countries, which will provide service of external payments, but it is possible substantial delays in obtaining funds.
- Access to capital markets remain very limited

An access to capital markets will remain very limited.

- World oil prices will fluctuate within 40-60 dollars per barrel
- There will be a deepening of cooperation between Ukraine and the EU, in particular in the framework of the Association Agreement, the increase of the EU share in foreign trade and increased investment flows and financial assistance from the EU.
- It will further decrease trade and other economic ties with Russia
- It will continue the diversification of natural gas supplies to Ukraine, but Russia will remain the main supplier (directly and through re-export). Gas price will drop because of falling oil prices.
- It will decrease the flow of funds to the markets of developing countries, and gradually will increase interest rates by curtailing the program of quantitative easing of US Federal Reserve.

The main risks of the forecast include the following factors: possible escalation of military conflict, blatant Russian intervention, the suspension of cooperation with the IMF and other international organizations, populist increase of social expenditures without an adequate increase in revenues, organized mass protests, the collapse of the coalition, early elections, a sharp change in prices on main export or import goods as well as adverse weather conditions in 2017, with a significant impact on harvest.

State budget and taxes

In 2016 the state authorities took measures towards increasing of state revenues through fiscal incentives. The state budget for 2016 is likely to be performed in accordance with its figures.

Performance of the state budget

Restoration of economic activity of enterprises had a positive impact on the state and local budgets. Overall, the budget will be performed by the end of the year, which means that the fiscal and regulatory incentives having used during 2016 showed a certain efficiency. However, it should be remembered that the increase in revenues is also associated with inflation processes, including annual inflation at 12%.

Restoration of economic activity of enterprises had a positive impact on the state and local budgets

According to the State Fiscal Service of Ukraine, following the results of 11 months revenues to the consolidated budget of Ukraine amounted nearly 677 billion UAH, whereas last year – 522 billion UAH, the difference compared to last year constitutes nearly 155 billion UAH. or 6 billion USD. The State Fiscal Service of Ukraine reported that following the results of 11 months of this year the state budget received 545,4 billion UAH, whereas last year – 431,9 billion UAH, 113,5 billion UAH more compared to the previous year.



According to the Ministry of Finance of Ukraine during January-November 2016 the general fund of local budgets (without transfers) received 131,9 billion UAH, constituting 104,6%

of annual revenues, approved by local councils. Increase in revenues to the general fund during January-November 2016 (in comparable terms, excluding areas which are not controlled by Ukrainian authorities) amounted to 49,6% or +43,7 billion UAH. The actual income tax revenues in January-November 2016 increased by 47,9%, and land tax – by 61,7%. Thus, the growth rate was above the average level in 6 regions – Kyiv, Odesa, Zakarpattia, Volyn, Zaporizhia and Rivne regions.

Budget for 2017

1) For the first time in recent years, draft state budget for 2017 was submitted to the Verkhovna Rada of Ukraine on time in accordance with the Budget Code.

2) According to government of Ukraine, draft state budget for 2017 provides for economic growth and raising incomes. Social expenditures, in particular, increases by 23%, and the minimum wage is doubled (from 1600 to 3200 UAH). For this purpose, state budget provides for additional costs in the amount of 28.3 billion UAH. This decision of the government aimed at reducing the shadow economy, but the Ministry of Finance didn't carry out public consultation on this matter. There is a risk that in fact a substantial increase in minimum wages will lead to shadowing of wages and increasing expenditures will result in inflation, although the Ministry of Finance has denied such a possibility.

State budget for 2017 provides for economic growth and raising incomes

3) According to the government, in average the salaries of the government employees increase by 50% since the new year. The level of pensions will increase by 10%.

4) Main budget shares in 2017: defense and security sector expenditures – 132,9 billion UAH, general fund expenditures – 117,4 billion UAH, consolidated budget expenditures on education increased by 35,7% comparing to 2016 and amounted to 168,4 billion UAH, overall spending on health care increased by almost 26% (18.2 billion UAH) to 88.7 billion UAH.

5) Budget expenditures in 2017 will be spent to

support agriculture – next year for support of agriculture producers it is provided 5.5 billion UAH directly from the general fund or 1% of GDP in production agriculture.

6) To ensure sustainable financing of road infrastructure in 2017 it will be created a Road Fund (funding from the budget 14.2 billion UAH). Additionally it is planned to attract 27.2 billion UAH from international financial institutions, first of all, from the World Bank.

In general, there is a likelihood that the budget in 2017 will be performed. Political processes, the general deterioration of the economic situation and business activity, further shadowing of the economy, inflation and devaluation processes could prevent performing the state budget.

There is a likelihood that the budget in 2017 will be performed

Tax reform

In 2016 major tax changes were characterized by a decrease in the social fees to 22%, increase in excise taxes. In general, significant institutional change and improving of tax administration was not observed, but state revenues was provided in accordance with plan.



At the end of the year it is began actively discussions regarding further tax changes that become the basis for the state budget for 2017. Committee of the VRU on taxation and customs policy together with the Ministry of Finance of Ukraine has prepared a so-called "anticorruption bill" No. 5368.

Key changes:

- introduction of the full electronic cabinet of taxpayer – it will increase the transparency of the administration;
- introduction of tax holidays for new enterprises (for 5 years) – it will promote the development of small business ;

Introduction of tax holidays for new enterprises (for 5 years) promotes the development of small business

- introduction of the United register of tax consultations – it minimizes the number of tax disputes by effectively clarification of the law.
- administration of all databases by the Ministry of finance – it reduces opportunities for abuse;
- Acceleration of depreciation for 2 years for manufacturing equipment – it stimulates investment;
- single public register of requests for VAT refund

- it increases VAT refund transparency;
- introduction of a mechanism of blocking the registration of tax bills, which is subject to the risk criteria – it eliminates opportunities for abuse of the VAT ;

The greatest achievement is the establishment of cooperation after a long confrontation of two government bodies – Ministry of Finance and VRU

- Suspension of penalties, exemption from local taxes – it will settle the issue of tax payments on the territory of ATO.

The bill is likely to be adopted and will be the basis for fiscal changes in 2017. The greatest achievement is not the preparation of the bill, and establishing of cooperation after a long confrontation of two government bodies, since the absence of the common position prevented carrying out effective tax reform in 2016.

Political competition:

The analysis of risks and opportunities for development of the political situation in 2017



In 2017, we expect increase of political and social tensions, which will lead to a new wave of political turbulence. There is no effective coalition in the Parliament, governmental structures are mired in political corruption and inside clans compete for financial flows.

Petro Poroshenko is left without political allies and relies for his activities solely on inner business circle, law enforcement agencies and situational oligarchic consensus. The vast majority of political players in Ukraine do not like the political situation, in which Poroshenko wants to be simultaneously a President, a judge and a businessman №1 .

Petro Poroshenko wants to be a president, political arbitrator and businessmen #1 simultaneously

In the new political season, the process of reunion of broad opposition and divided political powers that feel common political threat from Poroshenko activities can be launched. Therefore, there is a risk for the creation of broad anti-presidential political coalitions, which may initiate the impeachment

of President and mobilization campaigns, for instance – “Ukraine without Poroshenko”, in terms of which these coalitions will advocate for early parliamentary and presidential elections. Effective mass protests are possible with the presence of a certain ideological framework that can potentially be provided by the implementation of the political component of Minsk agreements. The protests, organized by political parties on a commercial basis, will not bear a significant threat to the stability of the current architecture of power .

Oligarchs can create a broad anti-presidential coalition

Therewith, the hryvnia devaluation, price increase, a new wave of mobilization in the Armed Forces of Ukraine and possible change in the geopolitical situation might serve as an additional factor of political instability.

The main story lines of the political struggle of «all against all» in 2017:

1. Confrontation line «Government - Opposition bloc»

The Novinsky case is not only a continuation of the old corporate conflict with Poroshenko, but also evidence that the Administration of the President is ready to go to the escalation of other systemic players. Removing the parliamentary immunity of MP Vadim Novinsky can push the fragmented Opposition bloc to more active actions, including the formation of ad hoc alliances with other players, for instance with Yulia Tymoshenko against the President. It is significant that the Batkivshchyna faction will not vote for the removal of Vadim Novinsky's parliamentary immunity.

“Opposition Bloc” may intensify protest activities

2. Confrontation line «Government – Offended oligarchs, bankers and businessmen»

In the fight for access to public monopolies and financial resources, the environment of the President triggered a series of corporate conflicts with other players. The most famous is the case against MP Oleksander Onyshchenko, in which the fugitive people's deputy threatened to publish compromising materials on the corruption of Poroshenko and his inner circle. Thus, the Onyshchenko case demonstrates the scales of political corruption in the government and parliament. Therewith, during the last months of 2016 in front of the building of the National Bank of Ukraine, a series of paid rallies demanding the resignation of the head of NBU Valeriya Hontariva, who closed a set of banks that belonged to known businessmen, were organized. In this context, it is necessary to mention the activity of Savik Shuster, whose TV shows actively covered the protests against Hontariva and authorities in general.

Onyshchenko case demonstrates the scales of political corruption in the government and parliament

3. Confrontation line «Old elites - New projects»

New political projects “National Corps” of Biletskyi, “Life” of Rabinovich-Murayev, “Movement of new forces” of Saakashvili, as well as, perhaps, Nadia Savchenko will actively

participate in political competition in the new season. The above projects will compete for their political niche and try to mobilize their voters by criticism of government policy and parliamentary opposition. There is also a position in influential political circles that socialist, left parties, organizations and movements plan to unite into a single block.

4. The confrontation line between the new anti-corruption bodies «National Anti-Corruption Bureau– Specialized Anti-Corruption Prosecutor's Office - National Agency on Corruption Prevention - Prosecutor's General Office of Ukraine»



Except for the traditional struggle between old and new anticorruption bodies, recently the excess political conflict began to emerge even between new institutions - National Anti-Corruption Bureau of Ukraine, Specialized Anti-Corruption Prosecutor's Office and National Agency on Corruption Prevention. Leadership of National Anti-Corruption Bureau of Ukraine is preparing to march to big politics, as Artem Sytnik and Hizo Uhlava are political partners of Saakashvili. They have launched deliberately hopeless activities that are often politically motivated and have a PR-nature. That is one of the main reasons for the confrontation between the new anti-corruption bodies. In 2017, there is a high probability, that the political leadership of National Anti-Corruption Bureau will accuse authorities of unwillingness to fight corruption as well as resign and join the movement of Saakashvili.

The management of NABU can resign and join the political movement of Saakashvili

5. Latent conflict between “BPP” and “PF”. It also observes the business contradictions between

the main coalition partners with regard to the objects of privatization, tenders in the defense industry, government procurement, etc. Officials in the Presidential administration think about possible ways to minimize Avakov's impact on the power structure. The media is the area of information war against Arseniy Yatsenyuk, Serhii Pashynskyi, Oleksandr Turchynov and other prominent leaders of "PF".

6. The fight between groups of influence in the president's inner circle. Recently, political struggle between different groups of influence, which represents business, law enforcement bodies, bureaucrats and personal friends of Poroshenko has been escalating within the president's inner circle. In addition to intrigues and blackmail materials for getting access to "political body of the president", some political players are working on the possible means for Volodymyr Groysman's dismissal. The struggle within the president's inner circle for resources and monopolies can lead to the deterioration of relations with the group of Groysman. In 2017, there is a risk that the current PM, realizing the political toxicity of the president, will decide to go to independent political voyage .

In 2017 PM Volodymyr Groysman would decide to go to the independent political voyage.

Thus, the new political season will be controversial, and the struggle for power will increase. Political uncertainty in the country may force the oligarchs to take a principal decision on the development of the new rules and find possible alternatives to the current leadership in the country. However, under the present circumstances, the main problem of the political stakeholders is the absence of possible alternative to Poroshenko that could suit all political players. Therefore, developing of a new oligarchical consensus on the possible options of coexistence between government and big business can be intensified depending on how the Russian-Western geopolitical confrontation will be take place .

Political investors still see no possible alternative players who would be able to replace Poroshenko

In this regard, in the narrow circles of the political establishment, a discourse on launching the process of systemic constitutional reform, which provided for rebuilding the country and government institutions, is becoming more and more relevant.

Foreign policy: Outcomes of Ukraine's foreign policy in 2016



Ukraine's foreign policy agenda has been defined by post-Maidan challenges: Russian aggression, conflict in Donbass, European integration aspirations, economic decline of the country. During 2016, Ukraine managed to strengthen its positions in national security area and increased its military capacities but failed to advance any of its priorities in foreign policy. Moreover, there is a deadlock on Minsk, increasing hostilities with Russia, growing challenges with the EU, uncertain US future policy on Ukraine, more problems with neighbors in the region. In 2017, Ukraine's international situation may change for the worse if Kyiv will continue with its current rich militaristic rhetoric and poor reforms records.

Minsk process

In 2016, Ukraine appeared at the crossroads of the Minsk process and has been facing an uneasy dilemma: either to continue implementing political provisions of the Minsk agreements under external pressure or withdraw from such unpopular obligations under public pressure. Kyiv opted for imitating implementation of the Minsk agreements that allowed the government to balance its dependence on foreign and domestic factors, buy time and prolong sanctions against Russia. As a result, there was no significant progress in

the Minsk process throughout 2016. Meanwhile, the war in Donbas remains a low intensity conflict.

Ukraine managed to withstand pressure from the Normandy Group.

First of all, there were no changes in implementing the political provisions of the Minsk agreements. Conducting local elections in uncontrolled Donbas, deploying an OSCE police mission in Donbas and elaborating a roadmap on implementing the Minsk agreements were the most frequently discussed issues during the meeting of heads of state in Berlin (October 2016) and several meetings of foreign ministers in the Normandy format (Ukraine, Russia, Germany, France). The members of the Normandy Group did not meet a deadline to agree on roadmap (November 30, 2016) due to divergent views on the sequence of implementing political and security provisions. In early 2016, Ukrainian diplomacy demanded that conducting elections in uncontrolled Donbas shall be proceeded by deploying OSCE armed police mission along the disengagement line, uncontrolled part of the border and future polling stations. Despite a preliminary agreement on the OSCE police mission, the members of the Normandy Group did not agree on its mandate and areas of presence. Besides,

a pressure by Russian, French and German diplomats did not convince Ukraine to adopt a law on local elections in uncontrolled Donbas before necessary a security environment is met.

Just as elections in uncontrolled Donbas, changes in the Constitution of Ukraine and amnesty for pro-Russian insurgents were not on the agenda in Kyiv due to a lack of parliamentary support and a risk of public anger.

However, regular meetings of the Trilateral Contact Group (Ukraine, OSCE, Russia) produced some results in implementing the security provisions of the Minsk agreements. In particular, the parties agreed to withdraw troops and hardware in Zolote, Petrivske and Stanytsia Luhanska, which has already taken place in the former two settlements. Moreover, a number of Ukrainian POWs were released from Russian prisons or DPR/LPR capture and subsequently exchanged, including Nadiya Savchenko, Yuriy Soloshenko and Hennadiy Afanasiev. At the same time, 109 Ukrainian citizens are still held in prison (as of November 2016). Their future is dependent on Russia's position that binds prisoner exchange with Ukraine's political concessions.

The changing international environment will make it harder for Ukraine to resist the pressure from Russia and the West in 2017 with regard to a new composition of the Normandy Group following presidential elections in France (François Hollande will not run for a second term) and parliamentary elections in Germany (Angela Merkel may lose the battle for chancellor).

Ukraine-Russia relations

There were no grounds for mitigating Ukrainian-Russian confrontation in 2016 as a result of the annexation of Crimea and the war in Donbas. Despite maintaining diplomatic relations, Kyiv and Moscow attempted to compromise mostly by means of multilateral channels (Normandy Group, Trilateral Contact Group, Ukraine-Russia-EU negotiations) or some individual contacts between Ukrainian and Russian politicians.

Crimea issue was back to international agenda

Ukraine managed to revive the Crimea issue

on the international agenda. It was preceded by tougher political persecutions by Russian authorities in Crimea (namely, banning Mejlis of the Crimean Tatar People) and stirred-up efforts by the Ukrainian diplomacy. The militarization of Crimea and violations of human rights in the annexed peninsula were mentioned in the European Parliament resolution 'On the human rights situation in Crimea, in particular of the Crimean Tatars' (February 4, 2016), two PACE resolutions 'Political consequences of the Russian aggression in Ukraine' and 'Legal remedies to human rights violations on the Ukrainian territories outside the control of the Ukrainian authorities' (October 12, 2016) and the annual Report on Preliminary Examination Activities by the Office of the ICC Prosecutor (November 14, 2016). Moreover, the UN General Assembly is expected to vote on the draft resolution on human rights situation in Crimea in the near future that was approved by the Third Committee, which may become the first UN document where Russia is recognized as an occupying power. Besides, higher attention was paid to Crimea due to an incident in Armiansk in August 2016 and the Russian parliamentary election in September 2016, which was held in the annexed peninsula.

A number of documents covering the conflict in Donbas were also adopted. Namely, the above PACE resolutions and ICC Report are the only multilateral documents so far that provide that the situation in Eastern Ukraine has features of international armed conflict involving Russia.

The Ukrainian-Russian enmity has naturally affected Ukraine's foreign economic activity. There was a higher drop in trade between Ukraine and CIS countries in 2016.

It cannot be ruled out that the Ukrainian-Russian conflict may face a transformation in 2017 after Donald Trump is sworn in as US president, the EU becomes increasingly involved in domestic disparities and early parliamentary elections are held in Ukraine.

Ukraine-EU relations

In 2016, Ukraine expected to benefit from the advantages of European integration that were achieved after 2014. However, such expectations were not delivered due to increasing 'Ukraine fatigue' in Europe and the

unprecedented systemic crisis in the EU. As a result, Kyiv and Brussels came closer to a crisis of mutual trust. Ukraine lacks efficient incentives to continue necessary reforms. At the same time, EU domestic problems made relations with Ukraine secondary to Brussels.

The EU increasingly loses interest in Ukraine's European integration.

First of all, the ratification of the Ukraine-EU Association Agreement was not completed due to the Dutch advisory referendum in April 2016, in which 61% of voters were against ratifying the agreement. As a result, the agreement continues to be provisionally applied, while its formal entry into force depends on negotiations between the Dutch government and EU leaders. A way-out of this situation is likely to be postponed until Dutch parliamentary elections in March 2017.

Amid the drastic decline in Ukraine-EU relations in 2014-2015, the Ukrainian economy has not benefited from the Deep and Comprehensive Free Trade Area (DCFTA) so far applied from January 1, 2016. Trade turnover between Ukraine and the EU (both export and import) started to increase in Q2 2016 for the first time since 2013.

Though Ukraine carried out all requirements pursuant to the Visa Liberalization Action Plan (VLAP), including launching e-declaration of incomes, the EU has not granted a visa-free regime to Ukrainian citizens. Migration fears in some EU member-states have made granting the visa-free regime to Ukraine dependent on revising the visa suspension mechanism.

In November 2016, Brussels held the EU-Ukraine summit, which brought modest achievements amid Ukraine's European aspirations. Ukraine managed to receive € 170 mln totally in support for public administration reform, fighting corruption and strengthening the rule of law. During the summit, the parties also signed the Memorandum of Understanding on a Strategic Energy Partnership which assigns Ukraine a role of EU key transit partner. However, the EU-Ukraine summit did not bring any progress in completing the ratification of the Association Agreement and granting the visa-free regime for Ukraine.

Ukraine-EU relations are expected to become even less intensified in 2017 with regard to turbulent political developments in Europe: Brexit talks, elections in the Netherlands, France and Germany as well as far-reaching consequences of the Italian referendum on constitutional changes held in December 2016.

Ukraine-US relations

Though Ukraine has been secondary to US priorities, Washington remains Kyiv's key strategic partner in countering Russian aggression. Under the presidency of Barack Obama, the US never hesitated over prolonging sanctions against Russia. Furthermore, in 2016, the US provided \$335 mln of military-technical assistance aimed at training Ukrainian soldiers, non-lethal weapon and advisory support for reforming the defense sector. Besides, Ukraine held US-led Rapid Trident and Sea Breeze multinational exercises involving a number of NATO member-states.

However, the US has been distanced from conflict resolution in Donbas since 2014, shifting responsibility for European security to Germany and France. At the same time, the 'Ukrainian crisis' was an agenda item during Russia-US channels – Lavrov-Kerry and Surkov-Nuland talks.

The US presidential elections have become a primary source of uncertainty regarding further Ukraine-US relations. The Ukrainian political elite mostly favoured Hillary Clinton over Donald Trump, who has been perceived as the 'pro-Russian' candidate given several controversial statements on developments around Ukraine. Such incautious acts will complicate bilateral relations under the Trump administration.

Trump's policy towards Ukraine is still uncertain.

Ukraine and the whole world await the first steps taken by the 45th US president to understand how Trump's foreign policy will coincide with his election program. The future US president is unlikely to pay higher attention to Ukraine than his predecessor. This may result in diminishing US financial and military assistance to Ukraine under Trump. Moreover, a possibility of 'geopolitical deal' between Trump and Putin is also a subject of debates.

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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