

2nd Ukraine Reality Check

Policy Review

Non - Paper, October 2014 – March 2015

The second Ukraine Reality Check took place on 28th of October 2014 in Kyiv, Ukraine and was organised by the Eastern Europe Studies Centre (Lithuania) in cooperation with the Centre for Eastern Studies (Poland), the Centre for Euro-Atlantic Integration and Democracy (Hungary), the Central European Policy Institute (Slovakia), and Pact (USA). The first Ukraine Reality Check was held in Kyiv on the 18th of June 2013. Top Ukrainian and Western analysts, observers, and practitioners attended both meetings; the aim was to gather insight into the latest political, security, economic, and social developments in Ukraine and provide analysis and a balanced policy advice. The non-paper is the result of those meetings and additional due diligence. Reality Check meetings were held under Lithuanian, and now Latvian EU presidency. Other non-papers about the Eastern Partnership countries are available at [EESC](#) and [CEPI](#).

Summary of Conclusions

The future of post-Maidan Ukraine lies in the political will and competence of the country leadership to undertake necessary structural reforms – the biggest objective of the Maidan. Part of this effort should be to stabilise the situation in the war-torn region of Donbas, the framework for which is outlined in the Minsk agreements. However, now that the fighting has decreased substantially, it seems that the official Kyiv is not seriously considering re-integrating the rebellious part of Donbas back into Ukraine. This is at least suggested by its reluctance to engage in a political dialogue with the current rebel leaders.

Two elections – the presidential election in May 2014 and the parliamentary election in October 2014 – provided the government with a much-needed legitimacy and mandate to launch Western-style reforms. Yet, a year after Maidan, those unfulfilled reform promises are raising concerns about the future of Ukraine. While Maidan “eliminated” Viktor Yanukovich and brought down the central authority, the previous oligarchs-based governance system was more or less restored. Nevertheless, active citizens’ participation in all politics and mobilisation for a Ukrainian identity, partly in reaction to Russia-supported separatists’ efforts to destabilise eastern Ukraine, have created a framework for more substantial and systemic changes.

While Ukraine is now receiving increased Western support and engagement, expectations should be managed by the assumption that any structural changes will entail a slow and painful process for all actors engaged. Ukraine’s fronts are numerous: the pause in Donbas fighting after the Minsk agreements should be used to modernise state institutions, boost the economy, reduce endemic corruption and launch a realistic and inclusive decentralisation process that would further tame separatists’ efforts and may eventually bring the separatist-controlled areas of Donetsk and Luhansk back to Ukraine.

Policy Recommendations

The reforms that the Maidan has vocally called for are listed both in the President’s “Strategy of Reforms 2020” and the coalition agreement of the ruling parties. But Ukraine authorities need to establish more communication channels with society and seek more critical engagement with the European Union (EU) member states. Exchange of expertise should be established not only at the inter-governmental level, but also at the inter-party level, as Ukrainian political parties’ governance remains one of the key, yet constantly overlooked, challenges.

It would be imprudent for Ukraine to follow everyone’s advice blindly though. The country should also incorporate its own local experience when pushing realistic reforms forward. Finally, coordination between

the government, the Parliament and the presidential administration of reform steps and a regular communication is imperative if the reforms are to succeed.

Another key step is the entry of qualified people into public service positions to boost state institutions' competence, reduce bureaucracy and red tape. Inclusion of civil activists into the Ukraine's Rada shows both civil societies' readiness to share responsibility and the struggle to restore the state authorities' legitimacy and hold them accountable to the voters. However, civic actors should be further encouraged to delegate their most qualified people to public institutions. A higher level of civic engagement in the public sector may lead to increased communication of governmental policies to the public, especially when such commitment is expected from citizens.

Ukraine's government should continue embracing assistance from expatriates and foreign experts. At the same time much more emphasis should be put on explaining and educating citizens about ongoing changes instead of high level and often emotional rhetoric (such as theatrical corruption arrests) often heard from the country's top official.

The main prerequisite for a resolution of the crisis is an end to military action in eastern Ukraine. The risk of situation repeating itself, especially in the form of public discontent with the government, will remain unless reconciliation in society takes place. Kyiv needs to invest much more into reducing linguistic, geographical, social, cultural, and economic divisions between its western and eastern regions instead of continuing to propagate the current "winner takes all" policies. Credible constitutional reform and decentralisation, coupled with inclusive engagement and communication are essential in order to ease tensions and re-build Kyiv's relations with the regions.

Beyond establishing lasting socio-cultural links between its regions, the Ukrainian government also has to address the Russian propaganda in Russian-speaking eastern and southern parts of the country, including the Crimean peninsula. Taking into account that Ukrainian citizens in these areas continue to think that the current Ukrainian government is illegal, serious efforts should be made to establish permanent media and information channels with up to date information about the official policies, reforms and their impact as well as the situation on the ground between the Ukrainian army and Russian-backed separatists.

Scarce transportation links between southern and eastern parts of Ukraine is another serious impediment for reconciliation. During the military conflict in Donbass, such obstacles risked being multiplied and, unless addressed in time, Ukraine might eventually face a situation where the western part of the country starts questioning the government's intentions in fighting back the separatist-held eastern territories.

In order to address the Russian propaganda, Ukraine must focus on facts and have a greater disregard of what the other side claims. Unfortunately, independent investigations (for example by the Council of Europe) have not concluded their work concerning the Maidan shooting or the Odessa tragedy on the 2nd May 2014. Only if established on a different, fact and diversity based, approach rather than simply accusing Russia, Ukrainian counter-propaganda efforts would sound credibility.

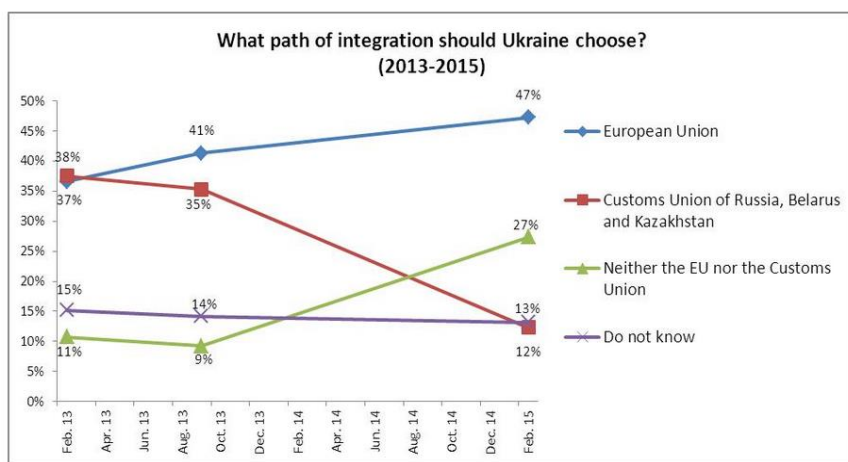
After the winter, one of the key reform priorities of Ukraine should be to improve energy efficiency by smart energy use and further diversification of its energy imports. Economically, Kyiv's main focus should be to reduce red tape and improve the business environment, including reforming the banking sector and allowing home-grown businesses to flourish. Instead of trying to return to pre-Yanukovych oligarchs based status quo (for which there are no longer resources) or expecting solutions from integration with the Western institutions (an offer that is not on the table), Ukraine may use the crisis to modernise the state and decentralise its social contract based on citizens' participation and already existing local solutions. The

government must have the capability not only to formulate better rules but also to provide an example to follow in order to re-build much-needed trust with its citizens.

Domestic Politics: Re-Gaining Legitimacy by Elections

The results of the parliamentary election demonstrated changes within the Ukrainian society. There is a growing number of active people from the civil society who are determined to shape politics and even take decision-making positions. In order to sustain such activity, parliamentary election law should be changed to allow for an open party list. This is favoured by civic activists but is opposed by political parties. Transparent funding of political parties is another key focus: greater attention should be paid to regulating political campaigning and advertising, both of which are currently heavily exploited and misused.

Pro-European and reform policies received a cleared mandate in the October elections. According to data gathered in February 2015 by the Kyiv International Institute of Sociology (KIIS), 47.2 percent of Ukrainians see their country's future entwined with the EU membership, while 12.3 percent favour the Russian-created Customs Union. The remaining 27.3 percent of respondents withdrew from supporting either of these options and 13.1 percent were undecided. The survey findings also revealed that the increase of pro-European attitudes in Ukraine is a result of the Russian aggression towards Ukraine rather than an outcome of the Maidan protests. In September 2013, before Maidan, around 43 percent were ready to vote in a referendum for accession to the EU, while in February 2014 the number was at 42 percent. Only after the annexation of Crimea and the Russian-supported military insurgency in Donbas, did the willingness to vote for an EU accession rise to 51 percent, with 26 percent against.



In the election, Ukrainian voters expressed support for the post-Maidan leaders. However, this trust should not be confused with a merit trust. On the contrary, real reforms were postponed until for after the new parliament was formed. Therefore, it was rather a trust expressed in advance, which will need to be earned by fulfilling the campaign promises.

Based on KIIS data, every previous Ukrainian president, including the ousted President Yanukovich, began his tenure with a majority of people trusting him; this trust was then gradually lost. Currently, President Poroshenko is ahead of his political opponents and, according to March 2015 data, would receive 20 percent of voters' support in presidential elections, leaving former Prime Minister Yulia Tymoshenko and Andriy Sadovyi, the mayor of Lviv, with a little more than six percent of votes behind. While there is no reason to assume that Poroshenko might break the pattern, the incumbent president is better equipped with a strong Cabinet of Ministers and resources provided by the international community. Furthermore, he has been more accountable to both civil society and the international community and under pressure, in different ways, both from Russia and the West.

Another poll shows that government legitimacy is still fragile. Accordingly, the Ukrainians see corruption, oligarchs, and Russian aggression (in this order) as the biggest threats to the country. Only eight percent of citizens trust political parties, compared to the 57 percent that trust civil society. Over 80 percent see corruption as either having remained static or worsened since the formation of the new government. If and when the war in Donbas is over, these challenges will have to be addressed.

War in Donbas: Pause not Peace

The end of the military actions in eastern Ukraine was made possible after the Minsk agreements. Accordingly, active fighting has mostly ceased but a political solution still seems far away. Ukraine cannot accept annexation of its territories (Crimea) or appear as the loser vis-à-vis the Donbas separatists. It is Ukraine's hope that if Odessa, Kharkiv, and Dnepropetrovsk, all with large pro-Russian populations, resisted succumbing to the separatists' rule, a similar outcome can be achieved in eastern Ukraine. Ukraine continues to request military aid and accepts any military advice that can be provided, mainly to increase pressure (or to create an impression of it) on Russia.

At the same time, the Ukrainian army has been improving its fighting capabilities. The volunteer battalions are being integrated (slowly, but still) into the regular army. However the military leadership is largely seen as incompetent while the president's apparent loyalty- (instead of merit-) based micromanagement still limits Ukraine's military efforts and are the largest obstacles for an emergence of a new, compact, and integrated army.

There is ample evidence that the separatists' forces are supported by Russia. There was also an agreement during the Reality Check meetings that Moscow hopes to further destabilise Ukraine, beyond Donbas. But it is hard to imagine how Russia, through intimidation, hybrid war, and sending troops to Ukraine can re-gain political influence over the country. As a pattern, the more Russia engages in Ukraine militarily, the more it loses its political influence. It appears that in this conflict the smaller actors – the rebels as well as Kyiv – are trying to use the larger powers (Russia and the West) for their own benefit. Mobilising Moscow's support was easier for the rebels though than mobilisation of the Western support for Kyiv, particularly in the military field.

The Ukrainian leadership has joined the Minsk talks but does not and will not accept self-proclaimed leaders of the "People Republics" of Luhansk and Donetsk, Igor Plotnitsky and Alexander Zakharchenko respectively. The Minsk II agreement signed on 15 February declared a ceasefire and a withdrawal of heavy weaponry from the front lines. At the same time, the agreement is far from bringing a positive change to Kyiv: it was mainly signed with a hope that it would stop the deaths of Ukrainian civilians and provide a much-needed pause for the authorities to focus on key reforms. A stable political solution, however, seems still far away.

Economy and Reforms: Modernize the State

Economic output is expected to decline by 10 percent in 2015, public debt to rise to 100 percent of GDP, and the currency has devalued by over 60 percent. But the economic crisis Ukraine is facing today – a current level of the country's GDP accounts for only 70 percent of its GDP in 1990 – did not start with the occupation of Crimea or separatism in eastern Ukraine. It is the result of a dreadful Ukrainian governance and the oligarchs influence over economy and politics for the past two decades.

To stabilise its economy, Ukraine launched a comprehensive program of economic reforms, the majority of which was advised and enforced via conditional terms by the International Monetary Fund (IMF), the EU and local civil society. Shortly after the Minsk II agreement in February 2015, the IMF rescue package was replaced by a new four-year extended arrangement providing a better timeframe and financing terms for Ukraine to continue with its reform program. It will provide a \$17.5 billion loan, of which \$5 billion was given for an immediate disbursement. In return, the Ukrainian government has committed to further maintaining fiscal discipline, fully liberalising energy prices, restructuring its banking sector, reforming state-owned enterprises, tackling corruption and money laundering, and strengthening the rule of law. This package – which also depends on Ukraine bondholders agreeing to a haircut— should be enough for Kyiv to stabilise and kick start reforms. This seems the maximum support Kyiv can hope for from a West that is facing its own challenges (such as the euro-crisis). Kyiv’s hope it can further plead for Western solidarity because of the Russian aggression should be gradually replaced by its reform action at home.

The IMF conditional terms have not been applied very strictly, but some still consider the terms too dogmatic, helping the government to outsource the cost of reforms mostly to ordinary citizens (for example, energy bills for households have increased four fold) amid economic hardship that is eating away their savings and rapidly reducing their living standards. This may in the worst-case scenario backfire and help restore and cement the oligarchs’ rule in the country, leading to a growing scepticism and unwillingness to pay what the society at least for now sees as the cost of being pro-European.

Certainly, structural reforms planning and economic prognoses for Ukraine are hampered to unpredictability of the military situation in eastern Ukraine. The conflict has already destroyed an industrial hub in Donbas, reduced tax collection and caused a humanitarian crisis, resulting in the forced relocation of over a million inhabitants. The foreign direct investment fell by 19.5 percent in 2014, from \$45.92 billion at the beginning of 2014 to \$11.14 billion at the end of the year.

The Ukrainian economy also faces trade restrictions imposed by Russia, officially due to incompatible production standards. Furthermore, Russia’s threats to cut off energy supplies to Ukraine could be cushioned by on-going arbitrations between the two in Stockholm. All gas bills were paid so far: in November and December 2014, Ukraine has made payments to Gazprom for natural gas totalling \$3.1 billion.

In attempts to balance the budgetary spending – which has additionally become overburdened by an increase in security spending of approximately 60 percent – the Ukrainian authorities raising the burden on citizens. In 2014, taxes and other payments for citizens were raised significantly, including the raise on household gas prices and heating prices almost four-fold. Further increase of taxes is seen as dangerous to Ukrainian businesses. Therefore, the focus should be on reducing government expenditures, which currently account for approximately 50 percent of the Ukrainian GDP. To do so, the government needs to reduce corruption and its own bureaucratic apparatus, including by closing down a number of ineffective inspection agencies and reducing number of staff, revising rates of public sector salaries, as well as finding new solutions for pension, education and public health systems, many of which currently date back to the Soviet era.

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