

Ukraine

Status Index (Democracy: 7.10 / Market economy: 6.82)		6.96	Management Index		4.70
HDI	0.766		Population		47.5 m
GDP p. c. (\$, PPP)	5,491		Population growth² (in %)		-0.1
Unemployment rate¹ (in %)	3.6		Women in Parliament		5.3%
UN Education Index	0.95		Poverty		n/a
			Gini Index		29.0 (1999)
Source: UNDP Human Development Report 2005. Figures for 2003. ¹ EBRD: Transition Report 2004. ² Annual growth between 1990-2003.					

A. Executive summary

The “Orange Revolution” in autumn 2004 marked a turning point in the Ukraine’s transition process. The democratic opposition headed by Viktor Yushchenko and Yulia Tymoshenko, and supported by civil society, fought for free and fair elections on the streets in Kiev and other cities for several weeks. Following Yushchenko’s election victory on December 26, 2004, large segments of the Ukrainian civil society opted for reforms toward democracy and market economy. It soon became obvious that the ruling political and economic powers would not win acceptance for their front-running candidate, then Prime Minister Viktor Yanukovich, even if the Kremlin were to use every possible method of direct or indirect interference on his behalf.

Though it would be premature so soon after the December 2004 elections to ask for sustainable developments on any transition agenda, Ukraine is now in a completely different situation than it was a decade ago. Having established national independence from the former Soviet Union, Ukraine now has the opportunity to develop from a defective democracy and clan economy toward a political system guided by the interests of the civil society and an economy independent of clan structures.

During the decade prior to the Orange Revolution, single reform successes were very often followed by stagnation and steps backward. On August 24, 1991, Ukraine declared its independence for the first time in its modern history. The initial phase of the country’s independence was marked primarily by national consolidation driven by the need to maintain national unity despite regional and ethnic differences between eastern Ukraine, which had been shaped by Soviet Russia, the Crimea, which historically belonged to Russia, and the ancient core of Ukraine in the West. Simultaneously, Ukraine’s independence was threatened by neighboring Russia. The

influence of economic interest groups and clans was negatively linked to ethnic divisions and Russian dominance. Neither President Leonid Kravchuk (1991–1994) nor President Leonid Kuchma (during his first term from 1994-1999) were able to constructively resolve the differences of interest between parliament and the administration to a degree that made implementation of lasting reform policies possible.

Independent Ukraine faced difficulties both in creating a new institutional framework and in distributing power among civil servants. The division of power between the president and parliament remained unresolved until a new constitution was adopted on June 28, 1996. As in many post-Soviet states, however, conflict arose between members of the administration who purported to back reforms, and the parliament, which was predominantly seen as an impediment to reform. This continual conflict was less about ideological interests than power politics; participating interest groups and individual actors focused mostly on political decision-making powers and economic resources. An imbalance between a powerful president and a much weaker executive and legislative apparatus was one of the official reasons given to start a debate in 2002 on constitutional amendments. Just before the presidential election in 2004 the discourse gained political as well as institutional import. At the very moment when personal power was re-distributed, the debate over changing the rules of the game began again.

At the beginning of his second term Kuchma, together with Prime Ministers Yushchenko and Kinach, managed to establish a reform-oriented government, yet by the end of his term in office Kuchma had yet to demonstrate any reform potential. The state was too weak, and while civil society was too powerful to be denied, further reforms were paralyzed by corruption and powerful interest groups. The opposition within the Verkhovna Rada (Ukrainian Parliament) acquiesced, adopting a more constructive stance, and subsequent structural reforms and favorable external economic conditions contributed to real GDP growth and halted the economic downturn. Formal reform measures, however, have repeatedly been negatively received by interest groups, which seriously hampers the sustainability of the changes. In 2004, the upcoming presidential election delayed further reform. During this election, Ukraine became a prime target of Putin's endeavor to influence processes abroad.

The future of market economy and democracy in Ukraine will depend greatly on whether the present opportunity for qualitative transition can be successfully sustained. For these reforms to be successful, Ukraine requires Western support, and the new president will face the challenge of creating a national consensus and prioritizing reforms toward democracy and a market economy.

B. History and characteristics of transformation

When Ukraine emerged from the Soviet Union as an independent state in 1991, it faced numerous challenges from ethnic and national problems. The eastern part of Ukraine was Russian in character, in terms of both its populace and the Soviet structures of heavy industry and raw materials extraction. Western Ukraine, on the other hand, was linked to the historical traditions of Poland and Galicia. The Crimean peninsula presented a special case; after the collapse of the Soviet Union, many Crimean Tatars returned to the peninsula, adding ethnic and economic strain to already existing tensions. In addition to these ethnic divisions, the country's consolidation was also hindered by its proximity to and dependence on Russia, and the country's diverse populace lacked the unity of a Ukrainian state church.

National unity was maintained primarily through the establishment of a strictly centrally-organized state. Governors of the 24 administrative regions are not elected by the people, but are appointed by the president. Only the Crimean Autonomous Republic has been awarded greater regional autonomy. The centralized structure of the state, however, also constitutes a tool for maintaining independence. Ukraine has conducted a well-balanced foreign policy between Russia and the West. The Russian-Ukrainian agreement on the division of the Black Sea fleet in July 1997 and the Russian-Ukrainian friendship treaty were both milestones in this process. At the same time, the government was able to draw closer to NATO and the European Union by strengthening its ties with the West, by signing numerous agreements and expanding cooperation in general.

These well-balanced relations between Russia and the West were threatened in 2004. The European Union's eastern enlargement drew a new dividing line, with neighboring countries and 'good partners' Poland and Slovakia on one side, and Ukraine on the other. Ukraine's inquiries around prospective European Union membership were refused by the European Commission, which was very critical of Ukraine's domestic instability, the power of the oligarchs, "the Gongadze case," the Kuchma gate affair, corruption, and other issues. At the same time Putin tried to influence the Ukrainian election by supporting Viktor Yanukovich. Ukraine's delicate East-West balance also became a battlefield for domestic powers with opposing views about future options for transformation.

The mixture of various ethnicities, languages and economic structures has coalesced after independence into a network of political and economic interest groups. The adoption of the Ukrainian constitution in 1996 was a negotiated compromise that reflected the power relations of the time and protected the country's consolidation. The gas sector in Dnipropetrovsk, the coal industry in Donetsk, and the intellectual center of western Ukraine in Lviv are all crucial to the distribution of power in the

political system. By the presidential election in autumn 2004, civil society had very limited influence on decision-making within the political system. The Orange Revolution demonstrated a paradigm change; the country was no longer driven top-down by economic and political influences or guided by the Kremlin. Instead change was driven from the bottom up, by millions of Ukrainians asking for free and fair elections and a full-scale democracy.

Failures in economic reform were common during the initial years of transformation in Ukraine. Stagnation and crisis were caused not by a lack of ideas, but by political conflict and corruption that hampered reform. Political actors' personal interests remained stronger than their interest in modernizing the country. Political priority was initially given to consolidating the independent Ukrainian nation-state, and consequently the country's border with Russia. In 1998, industrial production amounted to only about 40% of 1990 production levels; the level of agricultural production reached only half of its capacity during the same period. During the Russian financial and economic crisis of August 1998, the Ukrainian economy hit rock bottom as well. Since 2000, the economy has been steadily recovering from this downward trend. GDP rose by 12.1% in 2004. Industrial production has been trending upward, increasing by 12.5% during the period. Despite this macroeconomic success, some structural reforms remain overdue, such as improving the investment climate and imposing greater transparency on bank ownership.

C. Assessment

1. Democracy

1.1. Stateness

Ukraine has formally succeeded in establishing the state's monopoly on the use of force using the 1996 constitution as a foundation. De jure state power has been set up throughout the country and is sufficiently centralized to prevent eastern and western Ukraine from splintering apart. However, state power is noticeably impaired by the power of interest groups. The influence of special interests destabilized the political system through corruption and also because key political positions were occupied by representatives of the various interest groups. To sum up, the state's monopoly on the use of force was established formally nationwide, but does not function completely. The obvious shortcomings of the state monopoly led partially to the Orange Revolution. The growing attempts to rebuild the political system prior to and during the presidential elections in 2004 illustrated the dangerous and growing power of the

office of the president. Reforms that might be perceived as democratic in name, like the shift of power from president to prime minister and parliament, were in fact planned to maintain power. In the end, these plans failed.

The East, West and Crimea areas of Ukraine have strong, competing interests. During the presidential election in 2004, the different interests between the eastern and the western areas became an issue of political tension but did not lead to collapse of the state territory. Further escalations were prevented partly because of a well balanced although over-centralized approach to overcoming regional differences. All citizens have the same civil rights. Certain rights of autonomy have been granted to the Crimean peninsula. Individual rights for national minorities are guaranteed. The Tatars have returned to Crimea to accept their right to Ukrainian citizenship, but they still have legal and financial difficulties due to the prior abandonment of their citizenship.

There are five major churches: the Ukrainian Orthodox Church with a Moscow Patriarchy; the Ukrainian Orthodox Church with a Kiev Patriarchy; the Ukrainian Autocephalous Orthodox Church and two Catholic churches (Greek and Roman Catholic). None of these five major churches functions as a state religion. The lack of a state religion and the ensuing national identity questions, along with intra-church conflicts, have led to friction between denominations. Potential conflict over secularization is not taking place between the church and state, but rather between the individual denominations. The secular past of the Soviet Union and the splintering of denominations are factors in the post-Soviet Ukrainian state being a secular order. Religious dogmas have no noteworthy influence on politics or law.

Until the presidential election in 2004, state power was noticeably impaired by the influence of interest groups. The influence of special interests destabilizes the political system through corruption and reform bottlenecks, and also because key political positions were occupied by representatives of the various interest groups. The political power system shaped by Kuchma and his entourage coupled with the weak state infrastructure led to serious deficiencies in operations. It is too early to assess the administrative structures of the new government, but improving the function of administrative structures should be one of the priorities of future reform.

1.2. Political participation

The distribution of political offices takes place through general and free elections, the accepted method of filling leadership positions. National observers and international organizations, such as the Organization for Security and Cooperation in Europe

(OSCE) and the Council of Europe, criticized the executive branch's handling of the media and exertion of influence on the campaign during the most recent parliamentary and presidential elections. The incumbent elite won the closely-contested election as a result of violations of democratic standards during the second round of the presidential elections on November 21, 2004. The International Election Observation Mission (International Election Observation Mission (IEOM), jointly organized by the OSCE Office for Democratic Institutions and Human Rights (OSCE/ODIHR), the Parliamentary Assemblies of NATO, OSCE, the Council of Europe (PACE) and the European Parliament (EP), issued a critical statement that went far beyond former assessments.

Ukraine was heavily criticized for not meeting international standards for democratic elections. In particular, authorities and the Central Election Commission (CEC) were also accused of a lack of will to conduct a genuinely democratic election. Western actors doubted that the election took place under free and fair conditions, demanding a recall of the election outcome and rejecting Yanukovich as the legitimate president of Ukraine. Thus, the IEOM's criticism was an important factor that led to a rerun of the second round of the presidential election. The way in which the December 26 election process was conducted brought Ukraine substantially closer to meeting democratic standards, including freedom of the media and engagement of the civil society in the democratic process. According to national and international assessments, the latest election was almost free of constraints on the freedom and fairness of the election process.

As a result of the presidential election of 2004, elected rulers have de jure power to govern, but lobbyists have succeeded again and again in exercising influence over the highest members of the executive branch and their political course of action. In contrast to the powerful lobbyist groups, the political parties wield comparatively little influence and are rather fragmented. In as much as it can be assessed at the moment, the Yushchenko-Tymoshenko government is beholden to the lobbyist groups to a much lesser extent. The effective power of the elected rulers will mostly depend on the capability to create a national consensus.

After the second round of the election, the division of political power was to a large extent influenced from bottom up. For almost a month, the people in Kiev and other cities proclaimed that they would not accept elections with low democratic standards. The Orange Revolution did not escalate to a violent conflict with the incumbent elite. This is a positive indicator of the unrestricted freedom of association and assembly within a basic democratic order.

The press freedom in Ukraine has changed dramatically since November 21, 2004. The media coverage of the repeated second round was significantly more balanced, giving citizens access to a plurality of positions. The administrative guidelines on media content (*temnyki*) that were previously used to censor the media are a thing of the past. The two front running candidates conducted a debate which was broadcast by several TV channels. This could be seen as a move toward the unrestricted freedom of opinion and of press.

1.3. Rule of law

In general, the Ukrainian constitution provides for the division of powers and an independent judiciary branch. However, by the time of the elections in December 2004, the former president had too much power and leeway in tightening his grip on power. Other institutions were not able to check the strong vertical power of the executive. As a result, political power was distributed outside the institutional system and dominated by single actors and interest groups with various economic and regional backgrounds. Before the presidential elections, people again began to debate the idea of strengthening the parliamentary system by redistributing power from the president to the parliament. Concerned interest groups were devoted to strengthening democracy, but other personal and political interests were trying to block reforms. To solve the political crises that came after the manipulated second round, the mediators decided a reform of the political system should take place no earlier than September 1, 2005. After this reform is instituted, the position of the parliament should be strengthened. Thus, it is assumed that the upcoming reform will open up a new window of opportunity to create a system of mutual checks and balances.

The legislative reforms of recent years, such as reform in the criminal procedure code, have improved the rule of law in Ukraine. Although an independent judicial branch is anchored in the constitution, its actual independence is impaired. The biggest problems are insufficiently educated judges, low salaries, and dependence on the executive branch in matters of enforcement. As long as the budget and resource problems in the judicial branch remain unsolved, powerful lobbying groups can easily exert influence over the law. The insufficient independence of the judicial branch most severely impacts the fight against corruption. Nevertheless, the Supreme Court has displayed a well-balanced position and played a crucial role in resolving conflicts during the last presidential elections.

An important starting point of the Orange Revolution was charging acting Premier and front-running candidate Yanukovich with having a criminal background. He has even served two terms of imprisonment, never succeeding in regaining a proper

image. The opposition pressed for the prosecution of corrupt officeholders under the established laws. One of President Yushchenko's top priorities is to prevent the abuse of power in the future. From the very beginning of his term in office, he began to root out corruption in Ukraine by replacing the former political leadership on the central and regional levels.

Serious civil rights violations have repeatedly occurred: murders, attacks, intimidation of journalists, parliamentarians, members of the political opposition and rival trade union representatives. The ability to hold a free and fair presidential election on December 26, 2004 expresses an important step toward the end of the former restriction of civil rights in Ukraine. In addition, important criminal cases such as the Gongadze case have been reopened for investigation.

1.4. Stability of democratic institutions

Democratic institutions basically function as they should. However, there is significant tension between the parliament and the administration as well as within the administration. Throughout Ukraine's more than ten years of independent existence, it has been rare for a prime minister to remain in office for longer than one year. The changes at the top have repeatedly been linked to massive insecurity regarding the continuation and direction of reforms. In addition to fluctuations in personnel, there have also been debates about institutional reforms of the system of government. In both personnel and institutional decisions, the lobby groups attempt to assert their influence at the political level.

In this regard, individual institutions of the democratic state are not fully accepted by all the relevant players. The newly elected president is faced with the challenge of implementing democratic institutions and also guaranteeing their continued success. This includes bringing the influence of lobby groups in line with democratic principles.

1.5. Political and social integration

The party system in Ukraine is seriously fragmented and split between those in the president's camp and those who oppose him. The party system is poorly developed, and with the exception of the Communist Party, there is a lack of differentiation between the party platforms. The parties and voting blocs are primarily political vehicles for individual leading politicians and also serve as a way to serve the leaders' interests. The motto "Our Ukraine" stands for the former Prime Minister Viktor

Yushchenko; “For a United Ukraine” is the party of the running power of former president Kuchma and front running candidate Yanukovich. As a result of the Orange Revolution, the democratic opposition will come to office and consequently the opposition will be dominated by representatives of the former regime, while a new democratic opposition still has to be established.

The network of interest groups is relatively close-knit, but dominated by a two-pronged approach of interests. Civil society groups succeed in carrying out a democratic and peaceful revolution against supporters of an oligarchic state. These supporters of the state were linked by clans: the Kiev based clan co-headed by Hryhory Surkis and Viktor Medvedchuk and the Donetsk group including Viktor Yanukovich and the Dnepropetrovsk clan.

The approval of democracy in Ukraine was much higher than expected. During the Orange Revolution, the democratic opposition and the civil society succeeded in conducting weeks of civic non-violent mobilization of more than 250,000 people in support of free and fair elections, marking Ukraine’s emergence as a democratic European state.

During the period of the Orange Revolution, citizens demonstrated a robust but heterogeneous web of autonomous, self-organized groups, associations and organizations, and solid trust among the population.

2. Market economy

2.1. Level of socioeconomic development

Income inequality in Ukraine shows a negative trend in development. In the period between 2003 and 2004, the Gini index ratings point to inequality of income, and the baseline level of inequality of income was already relatively high in comparison to the neighboring countries. In the late 1990s, the country’s social downturn could not be stopped. According to estimates from the United Nations, 25% of the Ukrainian populace was living below the poverty level, and opinion polls at the time indicated that 80% of Ukrainians considered themselves poor. The UNDP gender-related Development Index (GDI) with a level of 0.773 in 2004 shows that Ukraine is lower than the medium development of 0.800. These are clear indicators that social exclusion is quite pronounced, both qualitatively and quantitatively. The exclusion is also structurally reinforced by the massive influence of interest groups.

2.2. Organization of the market and competition

Several elements of free market competition have been established in Ukraine. Some of these elements are the elimination of controls over consumer prices in 1994, and most other prices as well, with the exception of key sectors, such as bread and selected other food products, energy prices and rent subsidies. Despite some reform measures in recent years, such as the introduction of a new basic banking legislation, important institutions for a smoothly functioning market economy remain absent. Important shortcomings are related to inconsistent legislation, anti-competitive practices and widespread corruption. Extensive direct and indirect state subsidies and regulatory business groups result in unequal treatment of market participants and distort the allocation of resources. The informal economy's share is 52.2% of GNI (2003) according to World Bank data.

Generally speaking, the Anti-Monopoly Committee, established in 1994, has been vigilant in monitoring abuse of market power and preventing unfair competition. But the rules of the game are not consistently enforced and are not strongly oriented toward principles of a market economy. This results in inequality for market participants. The formation of monopolies and oligopolies is not regulated consistently.

According to the State Statistics Committee, Ukraine's foreign trade balance in 2004 was favorable, with a surplus of \$3.7 billion. After the EU enlargement, the EU-25 became Ukraine's largest foreign trade partner, constituting 31% of total commodity trade turnover. Russia remained Ukraine's biggest single country trading partner, accounting for 18.0% of Ukraine's exports and 40.7% of imports. Ferrous metals and products dominate Ukraine's exports, accounting for over 37.4% of the total. Foreign trade follows the principles of free trade, but is seriously hampered by non-trade related priorities. In addition, trade is restricted by frequent changes in ratification and customs processes. The Ukrainian government has declared its intention to join the World Trade Organization (WTO). Negotiations on WTO accession have continued with some signs of progress. The main problems that need to be resolved are the need to strengthen customs procedures and to abolish many of the non-tariff barriers. In December 2004, Ukraine's negotiations to join the WTO were also hampered because of the agreement on a Single Economic Space (SES) with Russia, Belarus and Kazakhstan that was ratified in April 2004. However, it is assumed that Yushchenko will give WTO accession a top priority so that Ukraine can be integrated into the international trade system.

The banking and capital market system is very fragmented with more than 150 banks, many of which are financially weak. Corruption and insufficient legislation, along

with a lack of efficient institutions in the fight against money laundering, have also proved to be fundamental problems for Ukrainian capital markets. The implementation of the new money laundering legislation in February 2004 was an institutional reform step leading to Ukraine's removal from the Financial Action Task Force list of non-cooperating countries.

2.3. Currency and price stability

The inflation, which was at a four-digit level in the early 1990s and at around 25% as recently as 2000, has dipped to below 10% in 2003. However, external shocks and irresponsible fiscal policy in the second half of 2004 caused CPI to increase to 12.3% by the end of 2004. The strong currency policy of the National Bank of Ukraine and successful management of the external debt-service obligations implemented by the Cabinet of Ministers has facilitated the stability of hryvnia. The country moved to a de jure openly floating exchange rate in 2000-2004. However, the hryvnia-U.S. dollar exchange rate was closely monitored by the National Bank, which has constantly intervened in the market by buying U.S. dollars and thus keeping the exchange rate fixed in reality. At the end of January 2005, the official exchange rate of hryvnia against the U.S. dollar was 5.30 and against 6.91 the euro. There is a policy of "stability culture," but it has no institutional safeguards for the future. However, Yushchenko's experience and economic knowledge are likely to further strengthen stability and currency prices.

2.4. Private property

The Ukrainian constitution includes the right to private property. In addition, with new basic legislation effective since the beginning of 2002, the opportunity to purchase non-agricultural private land now exists. Although property rights are formally anchored, their implementation will remain problematic as long as the executive and judicial branches do not succeed in implementing property rights and property protection efficiently in practice. The new Civil Code and Commercial Code that went into effect at the beginning of 2004 should clarify basic property rights, but the codes contain inconsistencies.

In the period of 2003-2004, the private sector's share of GDP was at a constant level of 60%. However, privatization of large strategically important enterprises has not been carried out. There has been no further progress with privatization in the power sector, partly caused by the failure of the parliament to approve the debt restructuring law. Lagging privatization was also due to the lack of interest on the part of domestic

and foreign investors. Private companies represent some important backbone of the economy, but there are still state companies as well as oligopolies. State organized crime, corruption, and the power of interest groups restrict property freedom and rights.

2.5. Welfare regime

The establishment of an independent Ukraine and the economic crisis in the early 1990s led to the collapse of the social security system, and thus to an increase in social problems. The results of the transformation include growing segregation of rich and poor in society, the decline in life expectancy by an average of two years, and a growing percentage of the population living below the poverty line. According to national statistics, this was 28.1% in 2002, but based on the international poverty line established by European Bank for Reconstruction and Development (EBRD), 45.7% of the Ukrainian population was living in poverty.

Adequate medical care in the state-run health sector is often available only through bribes, and qualified medical services are really only available in the private sector, rendering them unaffordable for the majority of the populace. Starting in September 2004, the minimum pension payment was increased to 284 Hryvnia, or 39.5 euro. This move implies a rise in and equalization of pensions for 80% of all pensioners. In 2004, additional payments were made by the central government mostly from privatization receipts. In 2005, the payments are supposed to be made by both the pension fund and the central government. One cannot exclude the linkage between the rise in pensions and the presidential election. Instead of carrying out a structural reform, the former government tried to increase its popularity by increasing pension payments. It is not clear at the time of writing to what degree the government's pension reform program, which was launched in 2004, will have a positive effect on the social sector.

According to the UNDP Human Development Reports 2000-2002, The country's performance in the GDI from 1998 to 2000 was largely stable, both in terms of ranking and ratings. Thus, with a rating of between 0.739 and 0.744, Ukraine ranks 74th of 80. Neither a positive nor a negative trend can be detected. Women are underrepresented in economic and political positions of leadership.

2.6. Economic performance

Since 2000, macroeconomic data have pointed to sustainable and positive economic development in Ukraine after the repercussions of the crisis in August 1998 were overcome. GDP has been growing after almost a decade of economic downturn, although it has not yet reached the level of 1990. In addition, official unemployment figures dropped to a tolerable range of 3.6% in 2003, following their increase in connection with the crisis in Russia. According to ILO data, the unofficial employment rate in 2004 ranged between 10-14%.

There was a positive trend observed in the decline of the annual budget deficit when it dropped as low as 0.2% of GDP in 2003. This was somewhat reversed in 2004, when the fiscal deficit exceeded 3% of GDP. However, the new government has claimed it will keep the fiscal deficit within the limits of 2% of GDP in 2005. After peaking in 1999, the external debt stabilized at about \$12 billion. A positive balance of trade, although small, was first noted in 2000. A slight downward trend in 2003 was reversed in 2004.

2.7. Sustainability

Numerous environmental problems are the harsh legacy of Soviet industrialization. The Donetsk-Dnepr industrial region has one of the highest levels of water and air pollution throughout Europe. The main causes of these problems are antiquated iron and steel plants as well as power plants. The Chernobyl reactor catastrophe on April 26, 1986 was the biggest accident in the history of civilian atomic energy to date, and it affects Ukraine on various levels until today. Inefficient energy use is one of the country's greatest environmental problems. Although environmental objectives are anchored both legally and institutionally, thus far they have been observed and implemented selectively. A drive for sustainability is coming from both Ukrainian civil society and the international community. The on-schedule closure of the Chernobyl reactor blocks was supported by almost \$100 million of international actors.

State and private institutions for education, training, and development exist in significant segments, but they vary greatly in quality. According to the UNDP, Ukraine spent 15.0% of its overall public expenditures on education in 2004 compared with Russia at 10.6% and Poland at 12.2%. In 2003, EBRD reported that Ukraine spent 8.6% of its GDP on health and education, which is lower than Poland with 10.9% but higher than Russia at 6.6%. Access to high-quality, recognized educational institutions depends somewhat on financial opportunities. Access is

characterized by some corrupt practices. Thus, corruption has also become a problem in the education sector. Ukraine is suffering from brain drain, particularly in technology and the natural sciences.

3. Management

Important preliminary remark: According to the BTI deadline for the management index of January 31, 2005, the reform policy of the acting government, which came into force in January 2005, can be included only to a very limited extent.

3.1. Level of difficulty

Structural constraints are caused by a list of social problems. The Chernobyl nuclear power plant is still an ecological and human burden for Ukraine, with lingering social, medical and environmental (radiation) effects. The importance of overcoming the aftermath of the Chernobyl disaster has been defined in Article 16 of the Constitution of Ukraine. At 1.2 children per woman (2003), the country's fertility rate is among the lowest in the world, which could cause political and social implications in future. The average life expectancy—62 years for men—is one of the lowest in Eastern Europe. As with other transition countries, Ukraine's labor market is characterized by a high level of emigration of its work force. Ukraine has the highest prevalence of HIV amongst the CIS countries. Since 1995, the virus has spread dramatically, first due to HIV transmission among injecting drug users, but lately increasingly through sexual transmission. According to UNAIDS, the estimated rate of adults and children living with HIV/Aids end of 2003 was 1.4-2.3%.

During the Soviet period, Ukrainian civil society traditions were rather weak or even non-existent. However, in recent years, popular acceptance of and involvement in civil society have both improved, and the level of civil society participation has also increased. At the beginning of 2001, the movement "Ukraine without Kuchma" gathered more than 10,000 people before holding a mass rally, at which leaders of various political camps called for the resignation of President Leonid Kuchma. The politicians and demonstrators claimed that the president was involved in the disappearance of Heorhiy Gongadze, an Ukrainian journalist, and the ensuing endeavors to cover-up this incident. The end of the Kuchma regime was brought about by the democratic opposition and an impressive mass mobilization of the civil society asking for free and fair elections.

The foundation of the Ukrainian state was challenged by the need to consolidate a fragmented and ethnically heterogeneous state. A split between the Russian-dominated eastern Ukraine and the western part of the country could have been tantamount to a dissolution of the country, an end to independence, and new occupation by Russia. There was a potential for conflict because the Crimea was striving for independence and because the peninsula had to absorb numerous returning Crimean Tatars. These problems were successfully solved in the early years.

None of Ukraine's five major churches constitute a state church. Conflicts emerged among the different denominations, most of which relate to claims to particular church buildings. The vast majority of the resulting disputes were able to be reconciled. Ukraine has liberal laws regarding religion, which also guarantee freedom of religious practice.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	2
System of government:	<i>semi-presidential</i>	Electoral system disproportionality:	8.9
		Latest parliamentary election:	31.03.2002
		Effective number of parties:	7
1. Head of State:	<i>Leonid Kutschma</i>	Cabinet duration:	11/02-12/04
Head of Government:	<i>Victor Yanukovich</i>		
2. Head of State:	<i>Viktor Yushchenko</i>	Cabinet duration:	01/05-present
Head of Government:	<i>Julia Timoshenko</i>		
		Number of ministries:	17
		Number of ministers:	17
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.2. Steering capability

The government headed by Prime Minister Viktor Yanukovich from November 2002-November 2004 claimed to pursue long-term aims, such as progress with privatization in the power sector, a new law on telecommunication and a reduction in income taxes. However, these aims were regularly replaced by short-term interests of political bargaining and office-seeking. Nevertheless, reform work had been matched

by new economic growth.

The former government headed by Viktor Yanukovych was formed from a coalition comprising candidates proposed by the parliamentary majority. The main achievements of the Yanukovych government were related to the approval of a realistic budget in 2003 and the lifting of sanctions imposed by the Financial Action Task Force (FATF). In 2003, a growth in industrial output of 15.7% and a growth in GDP of 9.4% were reported. By the end of 2004, Ukraine had signed 30 of the bilateral protocols for WTO accession. Much of the economic growth came from the restructuring of the old heavy metallurgical and machine-building companies by new private owners but also from new companies in light industry, food processing and trade. Despite some achievements, the former government was not interested in implementing reforms toward a market economy and democracy. In 2004, further reforms were also blocked by the election campaign. As a proponent of the Donetsk clan, Yanukovych did not liquidate the region's status as a free economic zone because the status provided considerable tax exemptions.

Guided by former President Leonid Kuchma and Prime Minister Victor Yanukovych, the political leadership demonstrated its ability of complex learning, acted flexibly and replaced failed policies with other approaches to safeguard influence and power. As a result, formal reform progress was very often hampered by undermining informal structures. During the Orange Revolution, the democratic leadership demonstrated its ability to act and at the same time exhibited flexibility and democratic values.

3.3. Resource efficiency

Numerous indicators make it clear that the government has used only some of the available resources efficiently. The Ukrainian state was much too centralized to adequately produce administrative and budgetary alternatives for efficient government action in the administrative regions. There was a high fluctuation of office holders at the higher political echelons. State structures are to a large extent riddled with corruption. As a consequence, state action is often linked more closely to special political and economic interests than to the common good.

The Kuchma-Yanukovych government frequently failed to coordinate between conflicting objectives or interests. At the same time, a system of oligarchic clans dependent on Kuchma had emerged. In September 2004, Kuchma signed an agreement on the formation of a Single Economic Space (SES) with Belarus, Russia and Kazakhstan and withdrew NATO and EU membership from the Ukrainian foreign policy doctrine. The latter did not agree with the government or the

parliament.

One of the biggest difficulties facing Ukraine is corruption, which has a negative impact on both the economy and politics. From an institutional perspective, fighting corruption was one of the priorities of the former government. For instance, on June 17, 2004 the Cabinet of Ministers of Ukraine approved the Anti-Corruption Action Plan for 2004. The Presidential Decree No.175 of February 9, 2004 entitled “On a System of Measures for Eliminating the Causes and Circumstances for Criminal Manifestations and Corruption” set priority areas. They concerned the activities of public authorities and guaranteed protection of citizens' rights and freedoms against criminal encroachments. In connection with this decree and the signing of the UN Convention on Corruption by Ukraine on December 12, 2003 in Merida, Mexico, the Ministry of Justice prepared a Draft Law “On the Basis of Corruption Prevention and Resistance.” Despite important institutional progress, fighting corruption did not become a widespread accepted priority among the former Ukrainian elite. Therefore, Ukraine placed 125th of 146 countries in the Corruption Perception Index compiled by Transparency International in 2004. Ukraine is a classic case of private interest groups colonizing important parts of the state, patronage networks determining the distribution of state resources, and corruption forming an integral characteristic of the state and administrative culture.

3.4. Consensus-building

Before December 2004, the major political and economic actors had a rudimentary consensus about goals, but it did not include major elements of a market-based democracy. The former leadership obviously distinguished between informal special interests and the introduction of formal regulations to create a democracy and a market economy. This mesh of interests was less about the basic rejection or acceptance of democratic and free-market values, and more about personal interests and obligations.

During the term of office of Viktor Yanukovich, reformers were not able to control the veto actors related to the Donetsk or Dnepropetrovsk clan.

It is essential to distinguish clearly between informal special interests and the introduction of formal regulations to create a democracy and a market economy. In the evaluation period from January 2003 to November 2004, the reform programs were not carried out consistently and could be implemented only with some compromises. All of these developments make clear that the reformers have not been able to control all the actors with veto powers. Sometimes they became actors with

veto powers themselves.

By November 2004, Ukraine's people willingness to show solidarity was restricted by corruption and the black economy inevitably limiting cross-group or inter-subject solidarity.

Long before the presidential election, pro-governmental actors started campaigns against Western support to NGOs to discredit their role in the 2004 election-monitoring process. Due to the insufficient domestic sources to financially support civil society actors, Western money was a vital source for Ukrainian NGOs. Overall, the political leadership frequently ignored civil society actors and formulated its policy autonomously. Other restrictions were related to the limited freedom of the media and the influence of political and economic actors who were dominating the country.

To date, historical injustices in Ukraine have not been discussed comprehensively or systematically.

3.5. International cooperation

During the pre-election campaign, the former political leadership of Ukraine changed its previous attitude about working with bilateral or multilateral international donors to make use of international assistance. They decided on a Russia-first approach. An important indicator of Ukrainian authorities seeking Russia's support was the shift of Ukraine's foreign policy in the direction of Russia in 2003. In September 2003, President Kuchma signed an agreement on the creation of the Single Economic Space with Russia, Belarus and Kazakhstan. This step was made without any preliminary consultation with parliament or even the cabinet of ministers.

Other steps included subordination of the Ministry of Foreign Affairs to the administration of the president and the dismissal of a number of people from the government with clear pro-European orientation. This included the Minister of Fuel and Energy Vitaliy Haiduk and the Minister of Economy, Valariy Khoroshkovsky. The steps regarding foreign-policy implications that were taken before the election included the dismissal of Oleksandr Chalyi, First Deputy Minister of Foreign Affairs on European integration. These decisions were taken in the context of pro-Russian rhetoric from President Kuchma, who argued that Ukraine's future lay with Russia and its partners.

Before the change in government, Ukraine tried to present itself as a credible partner,

but was unable to decide whether it wanted to orient itself toward Moscow or international standards. On July 15, 2004, after prioritizing NATO and EU membership for almost a decade, President Leonid Kuchma issued a decree amending the 16th article of Ukraine's defense doctrine. The sentence "Ukraine is preparing itself for full membership in the European Union and NATO" was deleted from the article. Another phrase indicating Ukraine's willingness to join NATO was also taken out. The changes were made public in late July, and Poland, the European Union, NATO, and the United States expressed concerns over these changes, while Russia said it supported the new version.

Ukraine is traditionally following up a two-pronged approach to cooperate with neighboring countries. So far the relations with Russia have been dominated by the Kremlin's influence on Ukraine's domestic agenda. On the other hand, Kiev has been cooperating with many Western neighboring states – first and foremost Poland – to strengthen its integration into Euro-Atlantic structures.

4. Trend of development

4.1. Democratic development

The Orange Revolution can be perceived as a substantial improvement in political participation documented by mass protests demanding free and fair elections and the role of a peaceful negotiated transition. The decision of the Ukrainian Supreme Court became a symbol of regime change.

The divisions of executive authority between president and prime minister, as well as the role of parliament, have been a source of political tension since independence. Awareness of remaining weaknesses in the overall system of democratic and institutional checks and balances has contributed to the debate on constitutional reform. Initial proposals by President Kuchma and constitutional amendments submitted by the former majority in parliament and supported by President Kuchma aimed at a substantial shift of power toward parliament and prime minister, thus, weakening the role of the president. Low levels of procedural transparency and public support, together with the fact that major constitutional amendments were launched in the period immediate preceding the October 2004 presidential elections, raised some concerns among domestic and international observers. To solve the crises of power after the second and obviously un-free and un-fair round of the election, the domestic and foreign mediators opted for a new amendment. The electoral law was reformed to close loopholes that had permitted pervasive electoral fraud. The constitution was amended, effective not earlier than September 2005, to transfer power, especially

with respect to appointment of ministers, from the president to the cabinet. Furthermore, another law was passed, in first reading, that delegated some powers of the central government to regional councils. Again, the latest changes can be assessed as a substantial consolidation of democracy.

4.2. Market economy development

The country's level of development has improved greatly in the past five years; the HDI change is over 0.030.

The institutional framework was marked by a slow but steady progress.

Overall economic development has improved both quantitatively and qualitatively. The government will face important decisions on the future development of elaborating and implementing a market-orientated reform strategy, fighting for the division of economic and political power, and its ongoing negotiations with the WTO and European Union.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in % ¹	5.9	9.2	5.2	9.4	12.1^a
Export growth in % ¹	21.5	3.5	9.1	10.3^a	18.1^a
Import growth in % ¹	23.8	6.0	3.7	16.4^a	13.6^a
Inflation in % (CPI) ¹	28.2	12.0	0.8	5.2	9.0^a
Investment in % of GDP ²	18.6	20.4	18.7	19.3	20.1^a
Tax Revenue in % ²	35.1	35.6	35.3	34.2	na
Unemployment in % ¹	4.2	3.7	3.8	3.6	3.6^a
Budget deficit in % of GDP ¹	0.7	1.9	-0.8	0.2	3.4
Current account balance in billion \$ ¹	1.481	1.402	3.173	2.891	6.804^b

¹ EBRD – Transition Report 2004; ² World Bank – Ukraine at a Glance; ³ Institute for Economic Research and Policy Consulting, Ukraine; ^a State Committee of Statistics of Ukraine; ^b National Bank of Ukraine; ^c Exports (imports) of goods and services growth as presented in national accounts

D. Strategic perspective

Further reforms were partially blocked in 2004 by the upcoming presidential election,

which was perceived as a possible turning point in post-Soviet development. After December 26, Ukraine's strategic perspective has been shaped by democratic election of President Viktor Yushchenko. On the domestic agenda, challenges will include decreasing the gap between successful institutional reform and informal roll-backs driven by oligarchs and key actors in favor of sectoral interests. On the international agenda, the primary task will be combining a clearly Western orientation – including an eye toward WTO accession, free trade with the European Union, and membership prospects in the European Union – while also developing relations with Russia on an independent and democratic footing.