

BTI 2014 | Ukraine Country Report

	scale	score	rank	trend
Status Index	1-10	5.89	# 57 of 129	
Political Transformation	1-10	6.10	# 58 of 129	➔
Economic Transformation	1-10	5.68	# 62 of 129	➔
Management Index	1-10	4.26	# 87 of 129	

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	45.6	HDI	0.740	GDP p.c.	\$	7420.7
Pop. growth ¹	% p.a.	-0.2	HDI rank of 187	78	Gini Index		25.6
Life expectancy	years	70.8	UN Education Index	0.860	Poverty ³	%	0.1
Urban population	%	69.1	Gender inequality ²	0.338	Aid per capita	\$	15.6

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The period under review coincided with the second and third years of the presidency of Viktor Yanukovich, who won the elections in February 2010 by a narrow margin. Yanukovich's attempts to consolidate power since then have gained traction. In fact, developments in 2011 – 2012 indicate that the president and his team are pursuing an ever stronger concentration of power, feeding all available resources to this objective.

The tension between Yanukovich and his rival former prime minister Yulia Tymoshenko culminated in Ms. Tymoshenko being sentenced in October 2011 to seven years in prison for allegedly abusing her power in signing gas contracts with Russia, in January 2009. Throughout the review period, new cases against her were opened while her close ally Yuri Lutsenko, a former interior minister, and other former members of her government were also accused and convicted of corruption. Subsequently, the opposition was stripped of its most prominent leaders in the run-up to the October 2012 parliamentary elections. Further steps to consolidate the president's power included the adoption in November 2012 of a new law on referendums that enables authorities to adopt or repeal both laws and the constitution and thereby circumvent the parliament.

The circumstances under which the October 2012 parliamentary elections were conducted were subject to strong criticism by international and domestic observers. In November 2011, almost a year before the elections, the electoral code was changed from the proportional system, in place since 2006, back to a mixed system. This was widely seen as an attempt to ensure a pro-presidential majority in parliament: While party-list elections are not easy to manipulate, elections in single-mandate constituencies are vulnerable to administrative pressure. Furthermore, the parliamentary electoral process was marked by severe violations, including Biased media coverage, vote-buying, problems with the registration of individual candidates, the harassment of specific candidates, and the formation of election committees. Vote-counting and tabulation were also subject to major

violations. Consequently, results in five districts could not be established and repeat elections in these districts were scheduled to follow in 2013.

By the end of this review period (December 2012-January 2013), Yanukovich had replaced several ministers in government with members of his family and influential individuals close to him personally. Pursuing a form of regional cronyism, Yanukovich and his son have advanced a clan-like mentality among their associates in an effort to maximize their control. Though large industrial groups and oligarchs remain powerful, their influence on political decision-making has been sidelined in exchange for political guarantees that benefit their business.

Worrying political developments outlined above also put at risk the signing of the Association Agreement (AA) between the European Union and Ukraine during the November 2013 Eastern Partnership Summit in Vilnius. The AA was expected to provide necessary stimulus for the completion of economic reforms and facilitation of growth in Ukraine, which still has not fully recovered from the 2008 – 2009 crisis, and would include a Deep and Comprehensive Free Trade Agreement (DCFTA), paving the way for the mutual opening of markets between the European Union and Ukraine and large-scale Europeanization of Ukraine in various sectors. The AA is designed to trigger competition policy reform, changes in state aid regulation, a reform of public procurement processes, harmonization in technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) spheres, trade, environmental policy changes, and the protection of intellectual property rights.

At the same time, Russia has sought to bring Ukraine into the Customs Union it created together with Belarus and Kazakhstan. However, Yanukovich's initial concessions intended to improve relations with Russia – extending the lease of the Russian Black Sea Fleet's base in Sevastopol and officially abandoning Ukraine's NATO membership aspirations – did not bring the desired results. The prices for Russian gas rose, while Russia demanded that Ukraine pay for the full amount of gas envisaged by the contract, despite the fact that Ukraine imported a lesser amount. Russia promised significant economic benefits resulting from joining the Customs Union, but also threatened to complicate travel regulations for citizens of Commonwealth of Independent States (CIS) countries that are not a part of the Customs Union. In May 2011 and December 2012, Ukraine seemed to be close to accepting the Russian offer. By January 2013, the debates on this option had stopped. Importantly, joining the Customs Union will make it impossible for Ukraine to have a free trade area with the European Union. Given that the latter makes up a substantial part of the Association Agreement, Ukraine would lose the opportunity to sign this important document. This constellation of external factors significantly limited Yanukovich's range of action and made the balancing act between the European Union and Russia increasingly difficult.

History and Characteristics of Transformation

Ukraine's post-independence transformation was largely determined by old nomenklatura elite groups who held on to their positions within the state administration and maintained their influence in the private sector after 1991. These individuals shaped the new institutional framework with their own interests in mind, relinquishing conflict-laden economic policies while sacrificing consensus-based policymaking as they vied for wealth and power. Throughout this period, new opportunities for individual and group enrichment emerged, such as rent-seeking, and were partially sustained by international – both Western and Russian – support.

From 1996 until 2005, Ukraine was formally a semi-presidential system. Leonid Kuchma's second term (1999 – 2004) was characterized by increasingly authoritarian tendencies and the informalization of power relations. Various protests against the Kuchma regime galvanized a set of opposition movements and served to organize the Orange Revolution. The 2004 presidential election was contested by two main candidates: then Prime Minister Viktor Yanukovich, who was supported by outgoing President Kuchma; and Viktor Yushchenko, former prime minister and head of the national bank. The fraudulent run-off on November 21, officially won by Yanukovich, led to mass protests. The repeat election on December 26, assessed as free and fair, was won by Yushchenko. Yushchenko's inauguration as president on 23 January 2005 and the parliamentary approval of Yulia Tymoshenko's candidature as prime minister, in February 2005, marked a significant shift in power. However, few of the expectations and promises raised by the new order (improved democracy, transparency and socioeconomic change) were realized, resulting in public disillusionment. Constitutional amendments that had been rubberstamped on 8 December 2004 took effect on 1 January 2006. These amendments established a parliamentary-presidential system that re-allocated power and competencies between the office of the president, the government and parliament. According to the amended constitution, a new government was formed after parliamentary (not presidential) elections, which took place every five years on a proportional-representation basis. Within one month of the elections, the Verkhovna Rada party had to form a parliamentary majority in order to elect a government. The parliamentary majority not only elected the government and approved the prime minister, it could also dismiss them, and individual ministers too. The president proposed candidates for the positions of the prime minister as well as for the ministers of defense and foreign affairs.

During the "Orange" period, between the 2004 and 2010 presidential elections, most Ukrainian governments suffered from internal disunity and constant competition for power, a development facilitated by the unclear distribution of competencies and a lack of checks and balances in the amended constitution. The first Tymoshenko government received a vote of no confidence in autumn 2005 following a corruption scandal. A new Orange government was formed with Yuri Ekhanurov as prime minister. The 26 March 2006 parliamentary elections changed the composition of the Verkhovna Rada significantly. The Party of Regions emerged as the winner, while coalitions of Orange parties (i.e., Bloc Yulia Tymoshenko, BYuT and Our Ukraine –

People's Self-Defense, OU-PSD), fared less well. Attempts to establish an Orange government failed after the Socialist Party defected to the Party of Regions, with whom, together with the Communists, they created the "anti-crisis coalition" in July and a government in August 2006. They nominated Yanukovich as prime minister, while the leader of the Socialist Party Oleksandr Moroz became chairman of parliament. Prime Minister Yanukovich attempted several times to increase his own powers by informal and extra-legal means, which led to serious conflicts with the president. In April 2007, Yushchenko dissolved parliament and called for early elections. Parliament did not accept the dissolution and continued its work, and two months of confrontation followed. In late May 2007, the situation deteriorated significantly as the armed forces became involved. Only after Yushchenko and Yanukovich reached an informal agreement were early parliamentary elections scheduled for 30 September 2007. The elections were assessed as free and fair. All relevant political forces accepted the result. A new government was only successfully formed in December 2007 when a coalition between BYuT and OU-PSD came together under the premiership of Tymoshenko. The Orange coalition collapsed in September 2008 just as BYuT and the opposition Party of Regions were about to amend the constitution, further limiting presidential powers. As a result, the pro-presidential OU-PSD left the coalition and Yushchenko issued a decree dissolving the Verkhovna Rada on 8 October 2008 and announcing early elections once again. The government challenged the lawfulness of the dissolution. Due to the acute global financial and economic crisis which had hit Ukraine hard, new elections were postponed indefinitely and the Tymoshenko government continued to operate. In December 2008, a coalition between his Lytvyn Bloc, BYuT and OU-PSD was created, and Volodymyr Lytvyn was elected chairman of the Verkhovna Rada. Despite having little capacity to act, the government remained in office until after the 2010 presidential elections.

In February 2010, Viktor Yanukovich won the presidential election with a narrow margin, and Yulia Tymoshenko became leader of the opposition. However, the popular support for the opposition was low, both in Ukraine and elsewhere – there were hopes that after the unstable Orange years, marked by political infighting, Yanukovich and his party of Regions would appear as better managers of the country. The following years showed that the main agenda was to concentrate power and sideline potential threats to this objective. Within the first years of his presidency, Yanukovich repealed amendments to the constitution passed during the Orange Revolution, returning Ukraine to a semi-presidential system. Within the same year the situation of human rights and freedom of expression and assembly deteriorated. Opposition proved to be weak and unable to withstand these developments. It had seemed that pluralism had become a defining feature of Ukrainian political life, but the Orange forces failed to use this window of opportunity to implement genuine reforms and establish irreversible democratic institutions.

Through 2000, Ukraine found itself in a difficult economic situation. Given that only partial reforms were conducted, and many actors preferred the status quo (which offered immense rents), the first 10 years of independence were marked by hyperinflation, high unemployment and GDP reduction. A severe decline in production and living standards dominated the 1990s. National currency was introduced as late as 1997. It was during these years that influential industrial-economic groups of oligarchs were formed and a patron-client relationships between the president

and these groups developed. This was reinforced by large-scale privatization, especially in 2003 – 2004. Due to flawed procedures and favoritism, many large enterprises were sold below their value and ended up in the hands of groups close to the Kuchma regime.

The economy has been recovering from this downward trend since 2000. Ukraine experienced rather high growth rates and rising household incomes and investment through the end of 2008. GDP rose by 7% in 2007, while industrial production increased by 10.2%. By 2005, the private sector's share of GDP reached 65%. Poverty was reduced and cash incomes increased. As the financial crisis hit Ukraine in 2008, industrial production, imports and exports declined significantly, while unemployment and public spending increased. Ukraine continues to suffer from nontransparent, clientelistic politics, which only increased inequality and prevented development of a strong middle class (although simplified rules for registration and simplified tax regulations in the 2000s prompted many companies to emerge from the shadow economy). Large parts of the economy (especially heavy industry) continue to be dominated by financial-industrial groups and only in some cases by foreign investors. The Ukrainian economy continues to suffer from structural imbalances. It continues to be a resource economy, with a large share of primary and resource-intensive products, namely metallurgy, mineral products and agriculture accounting for almost two-thirds of its exports. At the same time, value-based production was not developed.

Under President Kuchma (1994 – 2004), Ukraine conducted a balanced foreign policy between Russia and the West. After the Orange Revolution, the Ukrainian government drew closer to NATO and the European Union, while relations with Russia deteriorated. Ukraine's hopes for prospective EU membership and also for the NATO Membership Action Plan did not materialize. Ukraine was included in the European Neighborhood Policy and later the Eastern Partnership Initiative of the European Union. Meanwhile, then Russian President Vladimir Putin tried to influence the 2004 presidential elections by supporting Viktor Yanukovich. Allegedly, Russia also blocked the decision on the part of NATO to grant Ukraine and Georgia Membership Action Plans, a step preceding full membership. In recent years, the relationship between Russia and Ukraine was marked by repeated conflicts over gas deliveries, transit and payments. Despite the extension of the Russian Black Sea fleet's leases in the Crimea, gas prices increased and Russia made it clear that economic concessions would only be possible in exchange for political concessions. Yanukovich's policy towards the European Union and NATO were rather cool, compared to the Orange years, as he declared a nonalignment status for Ukraine and stopped emphasizing the EU membership prospect.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

The state holds the monopoly on the use of force throughout the territory of Ukraine without exception. Ukraine's territorial unity is not endangered, but the country faces challenges that have to do with regional diversity and ethnic minorities. This especially holds true with respect to Crimea, where a pro-Russian secession movement allegedly supported by Russia is active, but unsuccessful. The Crimean-Tatar minority, although often perceived as a challenge, in reality has been rather loyal to the Ukrainian state and its territorial integrity. Other secessionist movements operate in the Donbas and in Transcarpathia (a so-called Russyn minority), albeit with little success.

Monopoly on the
use of force
9

These factors hardly endanger Ukrainian territorial integrity and stateness as long as those do not become tools of political struggle. From time to time, political elites manipulate these secessionist moods for the sake of short-term political gains, especially during election campaigns. Furthermore, state power is partially impaired by the fact that different interest groups, including the president and his inner circle, do not differentiate between public/state interests and their own particularistic interests. This weakens the political system through corruption and nontransparent decision-making.

The Ukrainian nation-state is accepted by all relevant actors and groups in Ukraine. Identification has been growing in recent years. All citizens enjoy the same civil rights. In 1991, every person residing in Ukraine was entitled to Ukrainian citizenship, regardless of nationality. Ukraine thus emerged as a civic nation, and the nation-state's legitimacy is accepted by all relevant groups. Ukraine does not recognize dual citizenship, but the law on citizenship does not punish it. As a result, there are cases of acquisition of Russian, Romanian and Hungarian citizenship by Ukrainians, especially in the Western Ukraine and Crimea. Starting in the late 1980s, Crimean Tatars have returned to Crimea to claim their right to Ukrainian citizenship,

State identity
9

but they continue to face legal and financial difficulties. Many (elderly) members of the Roma minority do not have Ukrainian passports.

Church and state are separated and the political process is secularized. The heterogeneous religious landscape, combined with the secular Soviet past, prevents the impact of religious dogmas on state policy. There are five major churches: The Ukrainian Orthodox Church (Moscow Patriarchate), the Ukrainian Orthodox Church (Kiev Patriarchate), the Ukrainian Autocephalous Orthodox Church, and two Catholic churches (Greek and Roman Catholic). None of them functions as a state church. In addition, there are Jewish and Muslim communities and a growing number of Protestant as well as Evangelical groups.

No interference of
religious dogmas
9

There are no conflicts between the churches and the state, but rather between the individual denominations. The Ukrainian Orthodox Church (Moscow Patriarchate) has the largest number of parishes of any denomination. Polls show that the Ukrainian Orthodox Church (Kievan Patriarchate) has the largest number of adherents. While President Yushchenko sought rapprochement with the Orthodox Church of the Kievan Patriarchate, Viktor Yanukovich is inclined to support the Orthodox Church of the Moscow Patriarchate. During election campaigns, political parties and individual politicians use the support of certain religious organizations.

Courts and law-enforcement bodies work at all administrative levels in Ukraine; the same applies to tax authorities. With regard to public infrastructure, 98% of the population has access to running water and 95% has adequate access to improved sanitation facilities.

Basic
administration
8

Public administration functions on all administrative levels, albeit with varying degrees of effectiveness and state capture by economic actors. Ukraine is a unitary state with four tiers of government: National, oblast, raion/city and municipal. At the municipal level, mayors are publicly elected while the heads of oblast and raion administrations are centrally appointed. Dependence on the center is reinforced by the system of budget formation. Despite continuous reform discussions, lower-level budgets remain dependent on higher-level budgets, and the formal political autonomy of municipal authorities becomes a farce. Publicly elected bodies (parliaments) at oblast and raion levels have few competencies and do not possess their own executive bodies, which makes them dependent on the respective state administrations. Thus, although the provision of basic services and state competencies function throughout the country, the low level of decentralization hampers more effective administration.

2 | Political Participation

The distribution of political offices takes place through general elections, which are conducted regularly, where universal suffrage with secret ballot is ensured and several parties with different platforms are able to run. However, electoral legislation has remained highly unstable and undergone changes every time before elections. Between 1991 and 2002, the system evolved from a majoritarian to a mixed system (50% of the parliament elected in single-mandate constituencies and 50% according to party lists). The 2007 elections were conducted according to party lists only. Before the October 2012 parliamentary elections, the system again was changed to a mixed one. The Electoral Code to ensure more stable rules of the game demanded by the European Union and other international actors was not adopted.

Free and fair
elections

6

Since Viktor Yanukovich was elected president in February 2010, in mostly free and fair elections, the quality of elections has deteriorated in Ukraine. The local elections that took place in October 2010 were already interpreted as a step backwards by domestic and international observers. The parliamentary elections that took place in October 2012 confirmed this trend.

The Parliamentary Election Law that was adopted in 2011 is not perceived to be legitimate by many stakeholders. The law introduced a mixed system and increased the threshold to 5%, among other changes. The law was initiated by the ruling Party of Regions and is believed to have favored the party, which, through administrative resources and other means, was able to ensure that loyal candidates were elected in single-mandate constituencies.

The election campaign was not carried out in a free and competitive manner. Opposition leaders Yulia Tymoshenko and Yuri Lutsenko were convicted of criminal charges and imprisoned, in what were widely seen as politically motivated trials, and were thus barred from running in the elections. International and domestic observers reported cases of failure to register candidates on the grounds of minor mistakes in registration documents, the abuse of administrative resources by candidates in the single-mandate election districts, widespread instances of indirect voter bribes, incidents of violence and intimidation against MP candidates and campaign workers, hidden campaign funding by MP candidates and parties, and late submission of campaign funding reports to the CEC by two-thirds of MP candidates in single-mandate districts. Monitoring results by the Organization for Security and Co-operation in Europe/Office for Democratic Institutions and Human Rights (OSCE/ODIHR) also show that state-controlled media displayed a clear bias in favor of the ruling Party of Regions, devoting 48% of its campaign coverage to it, while devoting only 13% to United Opposition Batkivshchyna.

Significant irregularities were reported during the vote and vote count. Cases were reported of group/proxy voting, lack of transparency in vote counting, as well as serious problems in tabulation of the election results by some District Election Commissions. This made it impossible to establish election results in five out of 225 single-mandate election districts. The Central Election Committee is not perceived to be impartial, since its members are political appointees. Moreover, its work during the election was not fully transparent. The allegedly manipulated results in several election districts were not remedied by the CEC.

Overall, the OSCE/ODIHR concluded that the 2012 parliamentary elections were characterized by the lack of a level playing field, by the abuse of state resources, by the lack of transparent campaign and party financing, and by the lack of balanced media coverage.

Elections resulted in a rather interesting composition of the parliament. The pro-presidential Party of Regions received 41.11% of mandates – not enough for a majority, but together with the Communist Party (7.11% of mandates) they could pass legislation. The three oppositional parties (United Opposition “Batkivshchyna,” UDAR and Svoboda) together received 49.55% of seats. De jure independent MPs won 9.56% of seats; these MPs can join their votes with either side. UDAR and Svoboda are the new actors in the parliament. The former is mostly known due to its charismatic leader and famous boxing champion Vitaliy Klychko; the latter is a radical right party.

Elected rulers have the power to govern, but big business and politics are not independent of one another in reality. While before 2010, different big-business groups competed with one another and struggled for access to different decision-making centers, after the 2010 presidential elections, a strong center of power emerged around President Yanukovich.

After the initial concentration of power in 2010, two other trends have to be noted. First, Yanukovich and his inner circle, grouped around his son, formed the so-called “family.” These people, often with Donetsk background, managed to effectively take control of the government, which was formed in November 2012. Unlike President Kuchma, who also possessed a large concentration of power, but offered more or less equal access to resources to different oligarchic groups, the “family” of Yanukovich seems to attempt to form its own oligarchic clan, thus distorting the balance among different interest groups. Second, in 2011, President Yanukovich stepped over what was perceived to be a red line and started prosecuting political opponents. Some ten members of the government of Yulia Tymoshenko were persecuted, while Tymoshenko herself and another oppositional leader, Yuri Lutsenko, found themselves in jail. The grounds for their conviction were dubious. As a result, both oppositional leaders were not able to run in the 2012 parliamentary elections.

Effective power to govern

6

Although oligarchs still enjoy privileged and exclusive access to public resources, they now enjoy that access in exchange for clear loyalty to the president. Although attempts on the side of oligarchs to implicitly support political opposition were evident before the 2012 parliamentary elections, open and public opposition to the president is not tolerated.

Despite these developments, the opposition strengthened its base following the October 2012 parliamentary elections, but only to the extent that it has been able to block the work of the parliament as a matter of protest against non-personal voting, widespread among the MPs from the presidential camp. So far, it has failed to mobilize citizens against the current authorities. At the same time, popular support for President Yanukovich shrunk to 15% – 20% by the beginning of 2013. The external environment provides further constraints: The European Union pressures Yanukovich to release political prisoners and carry out reforms in exchange for signing an Association Agreement. The latter will increase Ukraine's access to the European market. At the same time, Russia pressures Ukraine to join the Customs Union with Belarus and Kazakhstan. The latter would significantly limit Yanukovich's and the oligarchs' economic freedom, including trade with the European Union. Against this background characterized by multiple constraints, Yanukovich is working hard to lay down the solid foundations for consolidating his power and winning the presidential elections in 2015.

Freedoms of association and assembly are guaranteed in the constitution. While the Law on Civic Associations was adopted in 1992, there is still no respective law on freedom of assembly. Between 2005 – 2009, rights of political organization and assembly were generally respected.

Association /
assembly rights
6

Since early 2010, however, the situation has changed and courts adopted the practice of prohibiting peaceful assembly upon requests from local authorities. Human rights NGOs have reported that in 2012, as compared to 2009, before Viktor Yanukovich was elected president, the number of such cases grew more than four times. The number of cases in which local authorities tried to prohibit peaceful gatherings accounted for between 200 and 360 annually between 2010 and 2012. In 89% of cases, district courts decided to prohibit demonstrations. During this period, a number of activists were detained or arrested for organizing peaceful protests, some of them still remaining in custody.

No major violations or problems regarding the freedom of association were reported in recent years. In 2010, attacks against civil society organizations took place. Following an outspoken reaction on the part of civil society organizations, those stopped, for the most part. Moreover, a law "On Civil Society Associations" was adopted in May 2012 and entered into force in January 2013. This was the result of lasting pressure on the part of Ukrainian civil society and the international community. Among other provisions, the law simplifies registration procedures for

nongovernmental organizations, allowing them to conduct activities throughout Ukraine irrespective of the place of their registration, and grants the right of NGOs to engage in entrepreneurial activities to support their not-for-profit activities.

After the review period, on 11 April 2013, the European Court of Human Rights adopted an important ruling on the case of *Vyerentsov vs. Ukraine*, in which it called upon Ukraine to “urgently reform its legislation and administrative practice,” to establish the requirements for the organization and holding of peaceful demonstrations, as well as the grounds for their restriction. The case concerned human rights activist Oleksiy Vyerentsov, who complained in particular that he had been sentenced to three days of administrative detention for holding a demonstration without permission, even though such permission was not required by domestic law. The court pointed to “legislative lacuna” concerning freedom of assembly, which has remained in Ukraine since the end of the Soviet Union. Indeed, the only existing document currently establishing a procedure for holding demonstrations is a decree adopted in 1988 by the USSR (the 1988 Decree), which is not generally accepted by the Ukrainian courts as still applicable. Following this decision, Ukrainian civil society has increased domestic advocacy aimed at adopting the necessary legislation.

The prohibition of censorship in Ukraine is guaranteed by the constitution, by the Law on Information, and by the Law on Television and Radio Broadcasting. Between 2005 – 2009, there was no obvious state censorship. However, the situation started deteriorating in 2010. According to the Reporters Without Borders’ Press Freedom Index 2009, Ukraine ranked 89th out of 175 countries of the world, but in 2011 – 2012 it ranked already 116th, and, in 2013, 126th.

In principle, Ukrainian citizens have access to a variety and plurality of both print and electronic media, at least at the national level; the number of Internet users has grown rapidly, to over 50% in 2013. At the local level, many media outlets continue to be owned by the authorities. However, due to low profitability, many private media outlets are financially dependent on single financial-industrial groups, and many of them chose to be loyal to the pro-presidential camp in exchange for protection of their businesses from administrative pressure. For instance, one of the biggest news agencies, UNIAN, found itself under pressure of censorship from its owner, Ukrainian billionaire Igor Kolomoisky. The agency’s editor-in-chief was removed from his post in May 2012; soon after, the pressure on journalists grew.

In the course of 2012, especially in the run-up to the October 2012 parliamentary elections, the pressure on media and journalists increased. Thus, the privately owned national television station TVi, known for its independent reporting, faced constant harassment. Its chief executive faced prosecution for tax evasion; the charges were later dropped. Soon after that, Ukraine’s main satellite-TV package, Volia, dropped TVi from its standard service, making it accessible only to a limited number of

Freedom of
expression

6

viewers. Other cable TV services have also ceased to carry the station, especially in the east of the country.

This trend has continued in 2013; experts claim that authorities are already preparing the grounds for the victory of the incumbent president in the 2015 presidential elections. Thus, in February 2013, the head of the presidential administration, Serhiy Liovochkin, acquired a 20% stake in Inter Media Group, the company that owns Inter TV, one of Ukraine's most-watched TV stations. This information became public only a week after one of Inter Media Group's biggest shareholders, former First Deputy Prime Minister Valeriy Khoroshkovsky, announced that he sold the entire stake to the businessman Dmitri Firtash. Valery Khoroshkovsky decided to leave the country. In the months between the October 2012 parliamentary elections and the acquisition, Inter TV became rather independent and nuanced in its coverage. After the acquisition, the situation changed and the newly launched independent political talk show "Spravedlyvist" was closed down.

There were also several instances in which independent magazines were dropped from distribution networks for having published critical information of the president and his policy. Reports of physical attacks on journalists have become more frequent, and law-enforcement agencies have failed to investigate alleged cases properly. At the same time, no progress in adopting legislation on public broadcasting and on the transparency of media ownership, long demanded by domestic civil society and the international community, took place.

3 | Rule of Law

The Ukrainian constitution provides for the separation of powers. In practice, since Viktor Yanukovich became the president of Ukraine in 2010, he has managed to put almost all institutions effectively under his control.

Separation of
powers
5

Judicial independence was the first to fall victim to the president's consolidation of power. According to two laws on the judiciary that were passed back in 2010, the Supreme Council of Justice, controlled by the president, received broad powers to appoint and dismiss judges. Analysis of judicial cases between 2011 and 2012 having to do with prosecution of political opposition figures or with civic liberties in general clearly indicates that the judiciary is politically controlled.

The government is also strongly controlled by the president. According to the constitution, the prime minister, approved by the parliament, submits the candidates for the members of government. In reality, the government formed in December 2012 consists of people who are believed to represent the "family" of the president and his son. Although several people who are believed to be close to two major oligarchs, Rinat Akhmetov and Dmytro Firtash, can be found in the government, it is clear that

the influence of oligarchs has diminished. First Deputy Prime Minister Serhiy Arbuzov, a close friend of the president's son, is believed to exercise de facto control of the government, while the prime minister is a figurehead.

The parliament remains the only institution in which the president's control is rather unstable and fragile. Before the October 2012 parliamentary elections, a more explicit pro-presidential majority existed and voting without personal presence in the parliament was widespread. The opposition managed to win more seats in the elections, and the presidential Party of Regions does not have a majority to pass decisions unless it joins forces with the Communist faction. Since many MPs miss sessions on a regular basis and the opposition adopted the practice of making sure that the number of votes corresponds with the actual number of MPs in the room, making decisions for the Party of Regions has become increasingly difficult.

The constitution stipulates the principal makeup of the judicial system. Formally, functional and regional differentiation of the judiciary is in place. There are local courts of general jurisdiction (combining criminal and civil jurisdiction), appeal courts in different regions as well as arbitration courts. In addition, there are high courts with specialized jurisdiction (high administrative court and high arbitration court). The Constitutional Court decides whether laws and other legal acts conform with the constitution. Its decisions are final and cannot be appealed. The Supreme Court is the highest judicial body.

Independent
judiciary
5

According to the law, all citizens have the right to a fair, timely and open trial. For several reasons, this is not respected in practice. The judiciary's pressing problems include insufficiently trained judges, low salaries and dependence on the executive branch in matters of enforcement. Moreover, Ukrainian courts are faced with overwhelming and ever-growing caseloads, but the number of judges has remained relatively constant. There is a lack of transparency in proceedings. One serious problem is the lack of funding even for basic equipment, and financial constraints with regard to training.

Although the independent judiciary is anchored in the constitution, its actual independence is impaired. As the result of the 2010 judiciary reform, the powers of the Supreme Council of Judges (SCJ) were significantly expanded, which was strongly criticized by the Venice Commission of the Council of Europe. This body, comprised of politicians and other non-judges (e.g., the prosecutor general – ex officio – and his two deputies), managed in subsequent years to replace a significant number of judges with those loyal to the president. The role of the Supreme Court, whose judges cannot be appointed or removed, was effectively neutralized. The Constitutional Court also proved to be under the control of the president and gave the “green light” to many decisions demanded by the president.

The cases against opposition leaders Yulia Tymoshenko, Yuri Lutsenko and other members of the Tymoshenko government are clear examples of how the judiciary can be used to attack the opposition.

Given that judiciary and law-enforcement authorities are politically controlled, there is no impartial arbiter to decide whether abuse of office took place or not. Opposition leader Yulia Tymoshenko was convicted and imprisoned for abuse of office. The court found that, in her role as prime minister, she exceeded her powers by signing a gas contract with Russia in January 2009 without cabinet approval. This decision was clearly politically motivated, as Yanukovich wanted to remove his major political rival in the run-up to the 2012 parliamentary elections. Another opposition leader, Yuri Lutsenko, as well as several members of Tymoshenko's government, were also convicted of abuse of office. According to Ukrainian legislation, no person convicted of a crime may serve in parliament or become prime minister or president. All cases took place before the 2012 parliamentary elections.

At the same time, a large number of explicit abuses, as revealed by journalist investigations, are not followed up. For instance, according to calculations of nongovernmental organizations, roughly one-third of the public money allocated to prepare Ukraine for the June 2012 European soccer championship wound up in private pockets. Yanukovich himself has become the owner of a huge estate outside of Kyiv, raising suspicions of illicit wealth.

None of the number of anticorruption regulations and programs have taken a systematic approach or articulated an overall long-term strategy. Different state agencies have a legal mandate to fight corruption, but they are insufficiently protected from political interference. Corruption scandals have been publicly exposed, but not accompanied by changes in structural incentives or legal guidelines to regulate the private interests of public servants.

In the period under review, respect for civil rights has not improved. Freedom of movement and freedom of religion are, by and large, ensured. In addition, there is no noteworthy ethnic discrimination, with the partial exception of the Crimean Tatars and the Roma. However, there has been an alarming rise in xenophobic violence, including assault and murder, mostly against visible minorities such as foreign students, migrants, refugees and Jews. Also, the use of the Prosecutor's Office, the Interior Ministry, State Security Service and tax authorities as instruments of repression against the opposition and civic movements increased. Freedom of business enterprise and property rights were consistently violated.

Another important problem still poorly addressed in Ukraine has to do with the rights of people in detention. According to the World Prison Brief 2013, Ukraine has one of the highest arrest rates in Europe – 320 prisoners per 100,000 people. Police abuse and torture remain big problems. According to Amnesty International, out of 114,474

Prosecution of
office abuse

4

Civil rights

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reports of police abuse in 2012, only 1,750 were investigated. Currently, there is no functioning mechanism to address this problem. Institutions created under Yushchenko's presidency, such as the Ministry of Internal Affairs' human rights monitoring department or the Assistant Interior Minister for Human Rights, were liquidated in 2010.

In 2012, the Law on a Unified State Demographic Register was adopted. The law envisages the creation of a database containing personal data used for the issue of biometric travel passports, domestic passports, and driving licenses. Although such a law is demanded by the European Union as a condition for visa-free travel, the substance of the law has nothing to do with European standards and violates the constitution, the Personal Data Protection Act and the right to privacy.

However, there were also a few positive steps taken. For instance, in November 2012, the new Criminal Procedure Code came into force. It is expected that, among other things, it will substantially reduce the number of people in pretrial detention. Human rights NGOs also reported that, in 2012, the prosecutor general spoke repeatedly of the need to fight torture, and, in 2012, more law-enforcement officers were prosecuted for such crimes as in 2010 – 2011. The Human Rights Ombudswoman appointed in 2012 is also positively assessed by the human rights community in Ukraine.

4 | Stability of Democratic Institutions

The effectiveness of most democratic institutions has become seriously impaired as a result of their capture by the president and his "family." Over-concentration of power, often with violation of democratic procedures, took place in the course of 2010 – 2012. Changes were made to the constitution after procedures Following the change of constitution with violations of procedures in September 2010 that increased the powers of the president, other developments occurred in subsequent years. In 2011, the law on parliamentary elections changed the electoral system from proportional to mixed. As a result, it was in single-mandate constituencies that major violations occurred and administrative pressure was applied to secure the victory of loyal candidates.

In November 2012, legislation on national referendums was passed that would allow the constitution to be adopted, repealed or amended using referendums, leaving no role to the parliament. In effect, the conditions set out by this law ensure that cooperation with authorities will be necessary for a referendum to take place. The law not only contradicts the current constitution of Ukraine, but also violates the standards explicitly stated in the PACE Resolutions and Decisions of the Venice Commission. There are fears that the law will be used as an instrument to capture power, especially in the run-up to presidential elections in 2015.

Performance of
democratic
institutions
6

The judiciary has become totally controlled by the president. The majority of court rulings explicitly favored the interests of authorities, whether it came to peaceful demonstrations or cases against the opposition. This was especially evident in the cases against oppositional leaders Yuri Lutsenko and Yulia Tymoshenko.

The parliament remains the only place where pluralism holds sway. In 2011 and 2012, it passed a number of laws. The legitimacy of those laws is questionable, however, given that voting by one MP with several cards was a widespread phenomenon. As result, a lot of laws were passed when only a handful of MPs were present in the room. Following the 2012 parliamentary elections, the opposition acquired more seats and adopted the practice of blocking the work of the parliament to prevent this voting practice. Thus, despite its pluralism, the work of the parliament was hardly effective.

All influential political actors formally accept democratic institutions – at least in rhetoric and in political programs. No political force claims that democracy is alien to Ukraine because it was imposed from outside, as is the case in Russia.

In practice, though, democratic institutions are used by the incumbents to concentrate power and gain uncontrolled access to public resources. All means, including judiciary and law-enforcement institutions, are used to meet these goals. As a result, leaders of political opposition are prosecuted, freedom of assembly and expression is limited, and, in the 2012 parliamentary elections, not only administrative resources, but also special police units were used to ensure the victory of loyal candidates.

Political opposition and civil society have attempted to challenge this situation, but so far with limited success. Similarly, international leverage, specifically from the European Union, has proven to be ineffective in the face of the domestic logic of power.

Commitment to democratic institutions

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5 | Political and Social Integration

There are no clear programmatic differences between party platforms. The parties and voting blocs continue to be primarily political vehicles for individual leading politicians. Their role in aggregating and representing societal interests is not very effective. Election campaigns are characterized by mostly populist slogans. On the whole, the battle lines between parties are blurred and change frequently, driven by power interests rather than ideology or party programs. Despite that, the level of voter polarization remained at approximately the same level during the 2012 parliamentary elections as in 2004, and was characterized by a distinct regional split with the Party of Regions, which was strongest in the eastern and southern parts of the country, while the three oppositional parties – United Opposition Batkivshchyna, UDAR and Svoboda – received more support in the west of Ukraine and Kyiv. UDAR, under the

Party system

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leadership of prominent boxer Vitaliy Klychko, made it for the first time to the parliament. The same concerns Svoboda, the ultra-right nationalist party. The latter surprised many when it received 10.44% of the vote, far beyond the 5% threshold, and received substantial support not only in western Ukraine, but also in Kyiv and central regions.

The 2012 parliamentary elections revealed three interesting trends. First, protest voting has increased, meaning that voters are not happy with either the incumbent party or the mainstream opposition. Thus, the number of voters who supported ideological parties – the Communists on the left and the ultranationalist party Svoboda on the right – has increased. The Communists received 13.18% of votes (as compared to 5.39% in 2007 elections) and Svoboda received 10.44%. Second, people are looking for new faces in politics. UDAR – the new party in the Ukrainian political landscape, received 13.96% of the vote. Third, voters in Kyiv, the capital city of Ukraine, have demonstrated maturity: the Party of Regions lost in every single district in Kyiv.

Party lists and single-mandate constituencies voting combined resulted in three oppositional parties having 49.55% of seats and the Party of Regions holding 41.11% of seats. These could be considered the two major camps, none of them having a clear majority. Yet, the Party of Regions can sometimes rely on Communists (7.11% of seats) to pass laws. Moreover, 9.56% of seats are occupied by independent MPs, who can join their votes with either side.

Electoral volatility is declining, but party membership remains at a low level. Party elites have only weak grassroots connections and intra-party democracy is barely developed. People have little trust in parties, which are considered to serve the self-interest of their leaders. According to opinion polls (September 2012), almost 30% of Ukrainians fully mistrust parties and over 40% mistrust them somewhat, while only 17% somewhat trust parties and a mere 3% fully trust them.

The political elite shows little willingness to cooperate with civil society organizations. At the national level, the formal channels for communicating societal or group interests are not well defined and access to government information remains poor. The law on access to public information adopted in January 2011 marked a significant improvement, but it takes time before different actors learn to use this opportunity.

The network of interest groups is relatively close-knit, but their possibilities for influence are very unequal. Only few interest organizations possess sufficient intellectual and institutional capacity to potentially influence the government through policy analysis and recommendations. For instance, environmental NGOs slightly increased their impact in recent years. OPORA – a pan-Ukrainian network known for elections monitoring – or Transparency International in Ukraine could also be

Interest groups

5

mentioned. Yet the pressure and advocacy they exercise hardly convert into policy changes.

In contrast, financial-industrial groups and other strong economic groups are well represented in the political sphere. With the change in leadership after the presidential elections in 2010, two economic groupings that supported Viktor Yanukovich gained more representation in the presidential administration and the government than the others. One, led by Rinat Akhmetov, is a fairly diversified and increasingly export-oriented financial-industrial group, the other, led by Dmytro Firtash, is active on Ukraine's energy markets and more interested in direct state support. Other oligarchs such as Viktor Pinchuk, Oleksii Kolomoisky or Serhiy Taruta might have much less direct presence among decision-makers, but still are able to make sure that their interests are protected. However, in 2011 and 2012, the influence of oligarchs on the president diminished. A group of people not controlled by oligarchs, but close to Yanukovich and his son, occupied top positions in the government that was formed in December 2012. This group, the so-called "family," has become the most influential interest faction in Ukrainian politics.

Other societal interests are less well represented. Ethnic, nationalist and religious mobilization has not played a role in the constellation of interest groups in Ukraine. Despite relatively high trade union membership, most workers are skeptical about the ability of unions to protect their rights. Their membership is largely formal. The largest trade union confederation in Ukraine is the Federation of Trade Unions of Ukraine (FTU), with origins in the Soviet era and more than 8.5 million members. There are a number of other trade union confederations. Yet, trade unions have played a marginal role in promoting issues important for employees, such as safety at work place or better social conditions. Consumers in Ukraine, although potentially the largest interest group, have not been sufficiently organized to influence policy.

One can also mention an increased number of sporadic and ad-hoc interest groups at the grass-root level. They organize themselves mostly as protest groups against illegal capture of land by individuals and businesses close to local authorities. These groups attempt to protect parks, forests and children playgrounds, yet the success rate is rather low.

On the whole, the people of Ukraine endorse democratic norms, but with specific connotations. Surveys show that the quality of democracy is mainly assessed by the state's ability to deliver social welfare and keep the economy running. Respondents attached most importance to social rights, while political rights were mentioned less often. In January 2013, a representative survey revealed that people consider the rising prices for food and municipal services (58% and 54% respectively), unemployment (34%), delay in paying salaries and pensions (32%), health problems (30%), deepening of economic crisis (27%), growth of corruption (27%) and rising criminality (20%) as the most important issues, while growing authoritarianism

Approval of
democracy

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(8.4%) and the deterioration of democracy and freedom of expression (5.9%) are of less concern.

At the same time, it seems that in the context of growing authoritarian trends in Ukraine and continuous alarms about this from civil society, people became more aware of the value of democracy. In January 2013, 54.6% of respondents agreed that democracy is the most desirable type of a political system, while only 18% agreed that under certain conditions authoritarianism is a better choice. Only 14.2% are indifferent to what kind of regime exists in the country. This is the highest level of support for democracy recorded since 2004. Also, although people believe that a handful of strong leaders can do more for the country than all discussions and laws (54.3%), 76.7% are convinced that those leaders should act strictly within the legal framework. Thus, support for the rule of law is also very high.

The fact that democracy is less prioritized when compared with economic and social issues is probably a natural reaction to the economic crisis and the inability of authorities to cope with it. Large-scale corruption on the highest level, combined with cutting social expenses, is widely reported in the media and logically produces dissatisfaction.

Public trust in political institutions remains low. According to the data of early 2013, over 52.7% do not support the president, 54.9% do not support the parliament, 52.4% do not support the government. The level of mistrust in the judiciary is even higher: 59.8% do not support courts. Of those polled, 27.3% fully mistrust and 42.8% rather mistrust political parties. This data, with minor deviations, holds true for the entire period under review.

In March 2012, the new progressive law on public (civil society) organizations was adopted. It simplifies registration for civil society organizations and allows them to conduct activities throughout Ukraine (not limited to one region) and sell services to provide for internal financial resources. The law entered into force as of 2013, so it is too early to assess its implications for civil society development. Yet, it should be noted that this was the result of lasting and consolidated advocacy and pressure on the part of civil society. In fact, despite deterioration of democracy and over-concentration of power during the period under review, civil society has become more active and consolidated actions on the part of civil society became more frequent. Moreover, ad-hoc advocacy or protest actions became more frequent at the grassroots level. In numerous cases, people living in multilevel houses were able to prevent the illegal capture of land or construction near their house.

Despite this, civil society organizations still have very loose links with the population at large and also have limited impact on public opinion. Only 4.5% of the population fully trusts NGOs. Yet 35% said, in January 2013, that they rather trust NGOs – the highest support since 2001. The level of mistrust is still higher, as it always was:

Social capital
6

17.8% fully mistrust and 27.7% rather mistrust NGOs. According to the World Value Survey, interpersonal trust in Ukraine is on a medium level. According to 2012 data, only 2% of citizens are members of civil society organizations, and 11.6% said they were actively involved in civil society activities. Fully 82% do not take part in such activity.

One can also argue that there is a loose connection between professionalized civil society that became accustomed to grant schemes (in fact, the largest source of financial support to Ukrainian CSOs) and grass-roots initiatives. The latter group is more numerous, but lacks consolidation and long-term advocacy, focusing instead on ad-hoc actions. Bridging this gap might increase the impact of civil society on development in the country.

Overall, there were more than 70,000 registered NGOs in Ukraine in 2012 (growth of almost 20,000 since 2008). Yet, estimates say that only about 10% of those are active.

II. Economic Transformation

6 | Level of Socioeconomic Development

Ukrainian society is not homogeneous, and poverty and inequality are part of the picture, although the situation has been slowly improving. Ukraine is ranked 78 in the Human Development Index (HDI) 2012, belonging to a group of high human development countries. This rank has not changed in comparison to 2011, although it remained lower than it was in 2007. Ukraine's score is 0.740; that is better than in 2011. According to the Human Development Report 2013, the Gini coefficient for Ukraine is 26.4, which is at the level of more developed countries. The Gini coefficient improved as compared to the previous available estimate (2008) when it was equal to 27.5. The inequality-adjusted HDI places Ukraine 13 ranks better than the standard HDI 2012, although the country's score is lower and equal to 0.672.

According to official information published by the State Statistics Services of Ukraine, poverty was somewhat reduced in the country in 2011 as compared to 2010. In particular, the share of population with equivalent total monthly income below the national poverty line (subsistence minimum) was 7.8% in 2011, compared to 8.8% a year before. Real income of households increased by 8.0% in 2011 and 9.7% in 2012.

Despite the officially declared nondiscrimination principle, signs of gender inequality are registered in the country. Ukraine is ranked 57th by the gender inequality HDI 2012, with a score of 0.338, although the score has been improving compared to 2010.

Question
Score

Socioeconomic
barriers
6

Ukraine's rank in the Global Gender Gap Index is 64th in 2012, which would translate into 62nd among 2011 countries. Females have equal access to education, the social protection system and labor force participation, but are not fully included in political life and receive lower wages for equivalent positions.

There are no specific social barriers associated with religion, but social exclusion is registered for some ethnic minorities like Roma and Tatars. Also, disabled people and people with HIV/AIDS experience social exclusion.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	117227.8	136418.6	163422.5	176310.2
GDP growth	%	-14.8	4.2	5.1	0.3
Inflation (CPI)	%	15.9	9.4	8.0	0.6
Unemployment	%	8.8	8.1	7.9	-
Foreign direct investment	% of GDP	4.1	4.7	4.4	-
Export growth	%	-22.0	3.9	4.8	-7.8
Import growth	%	-38.9	10.8	18.7	2.0
Current account balance	\$ M	-1736.0	-3016.0	-10233.0	-14777.0
Public debt	% of GDP	35.4	40.5	36.8	37.4
External debt	\$ M	99280.5	116026.2	134481.1	-
Total debt service	\$ M	22474.0	27429.0	27473.4	-
Cash surplus or deficit	% of GDP	-5.6	-6.5	-2.3	-
Tax revenue	% of GDP	16.4	15.5	18.5	-
Government consumption	% of GDP	20.1	20.2	18.2	19.4
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	4.3	4.4	3.7	-
R&D expenditure	% of GDP	0.86	-	-	-
Military expenditure	% of GDP	2.9	2.7	2.4	2.8

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

Despite the slow progress of reforms, essential elements of market economy are in place. Most prices are liberalized. According to the EBRD Transition Report 2012, Ukraine's price liberalization gets a score of 4 (scale: 1 to 4+). The government intervenes in price-setting for selected products deemed socially important (some food products, medicines). Also, utility, energy and telecommunication tariffs are regulated by special regulatory bodies. The Anti-Monopoly Committee of Ukraine is responsible for the prevention of unfair competition and abuse of market power.

Market-based
competition

6

Market entry is relatively easy. According to the Doing Business Report 2013, Ukraine is ranked 50th in the category "starting business." The country gained 66 ranks compared to the previous report. At the same time, market exit is much more difficult. Ukraine is ranked 157th out of 185 economies in the category "resolving insolvency," shifting only one rank up compared to the previous report. Time and cost of the procedures are much higher than the regional average, while the recovery rate is low.

Ukraine has a rather open trade regime for goods, and the majority of service sectors. Ukraine is open to inflow of foreign capital. Foreign companies registered with local authorities receive important guarantees:

- Foreign investment cannot be nationalized or subject to requisition, except for force majeure, and in this case investors have the right for restitution of losses; and
- Investors have the right to unimpeded repatriation of profits, dividends and investments themselves after all due taxes are paid.

Ukraine's national currency, the hryvnia, is not fully convertible. Ukraine adopted the current-account convertibility under the IMF's Articles in 1997, but foreign investors still face currency control difficulties. The size of the shadow economy is quite significant, distorting allocation of resources and undermining competition. According to the estimates of the Ministry of Economic Development and Trade of Ukraine, the shadow economy was at 34% of GDP at the beginning of 2012.

Formally, rules are the same for all market participants, but de facto it has not been always the case, as the economy features the dominance of financial-industrial groups. The judicial system is weak and unable to effectively protect market participants.

Competition laws are in place in Ukraine, but their enforcement remains rather weak.

Anti-monopoly
policy

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There are several public bodies responsible for the prevention of unfair competition and facilitation of competitive practices. The key authority is the Anti-Monopoly

Committee of Ukraine (AMC), established in 1994. Price-setting in energy, utilities and telecommunications is regulated by special regulatory bodies.

The AMC's responsibilities include the prevention of unfair competition and abuse of market power, control over concentration and collusion, control over price-setting in natural monopolies, and the protection of competition in public procurement.

The AMC is under the aegis of the president of Ukraine, and reports to the Verkhovna Rada. As for other public institutions, since 2005 a public (advisory) council has exercised public control over AMC activities. The council is comprised of 38 members representing Ukraine's major industry associations and NGOs.

Despite operating reasonably successfully, the AMC has several mainly institutional and legislative shortcomings. There are concerns over budget allocation, autonomy, investigative tools and transparency of the AMC. The AMC has not made sufficient use of the imposition of harsh sanctions and fines to deter cartels or prevent abuse of market power. In addition, the actions of different state bodies have not been always synchronized and often counteract the AMC's efforts.

Ukraine's legislation is to be further elaborated, e.g. control mechanisms for state aid should be passed, to meet international norms. Future challenges include competition advocacy, and harmonization with the European Union's competition laws.

Existing shortcomings result in poor scores of Ukraine's competition policy in international ratings. In particular, according to the EBRD Transition Report, Ukraine's score in competition policy is 2+ (scale: from 1 to 4+).

Ukraine's foreign trade is sufficiently liberal, although some exceptions exist.

The country has been a WTO member since 2008. Also, it signed bilateral FTAs with each of the CIS countries, with Georgia and with Macedonia. Recently, Ukraine signed several plurilateral FTAs with selected CIS countries and with the EFTA.

For imports of agricultural products, the average MFN applied tariff rate is 9.5%, while for nonagricultural goods it is 3.7%. The majority of import tariffs are ad valorem. Ukraine uses only one tariff quota, on raw cane sugar.

Export duties are applied to only a few products, including some oil seeds, live animals, raw hides, natural gas and scrap of metals. The rates has been significantly reduced in the framework of implementation of the WTO commitments.

Import and export licenses are required for a limited number of goods. The list of goods requiring licenses for foreign economic transactions is adopted annually by the Cabinet of Ministers.

Liberalization of
foreign trade

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Ukraine applies some quantitative export restrictions. There is a ban on exports of some precious metals and their scrap, and on crude oil, and quotas on exports of slag, ash and residues containing mainly copper or zinc, and natural gas.

To increase predictability and transparency and avoid export bans on grain, a memorandum of understanding between the Ministry of Agrarian Policy and Food of Ukraine and grain market participants was signed in 2012. Traders undertake to carry out the export policy within the approved amounts of supplies, while the government undertakes not to impose restrictions.

Ukraine progressed in reforming trade-related measures that could constitute non-tariff barriers to trade. In particular, Ukraine has been gradually reforming TBT/SPS spheres. In 2012, a new Customs Code was adopted introducing electronic declaration and improving customs valuation.

In 2011 Ukraine successfully completed negotiations of the establishment of a deep and comprehensive free trade area (DCFTA) with the European Union, which constitutes an integral part of the Association Agreement between Ukraine and the European Union.

At the same time, there are signs of an increased protectionist mood in the country. At the end of 2012, Ukraine initiated consultations with the WTO regarding the revision of 371 bound tariff lines that, if successful, could result in an increase in tariff rates.

Ukraine has a two-tier banking system with the National Bank of Ukraine (NBU) as a supervisory and regulating body and commercial banks that serve economic actors and private households. Formally, the NBU is independent, but de facto it remains sensitive to political will.

Banking system

6

There are 176 licensed banks in the country, including 53 banks with foreign capital. Foreign capital participation in Ukraine's banking system fell in 2012 as compared to 2011, although it remained higher than in 2010. Specifically, there were 53 banks with foreign capital as of January 2013, owing 41.9% of statutory capital of the banking system (55 with 40.6% of foreign capital as of January 2011, and 51 with 35.8%, as of January 2010).

The stability of the banking sector improved in 2011 – 2012 after the recent severe crisis. In particular, Ukrainian banks have continued to repay external debt, and its stock reduced twofold as compared to 2008. Thanks to improved trust and attractive interest rates on deposits, banks' deposits grew by 18% in 2011 and 16% in 2012. As a result, banks have become more reliant on domestic resources.

Banks improved the currency balance in the structure of credits, reducing the share of foreign credits and thus sensitivity to foreign-currency shocks. Credits in national

currency exceeded credits in foreign currency by 70% by the end of 2012, while, in 2008, foreign currency credits exceeded national currency credits.

The share of nonperforming loans reduced from 11.2% in 2011 to 9.6% in 2012, allowing the banking system to become profitable.

However, the system remains fragile. The IMF estimated that, in mid-2012, foreign currency assets of the banking system exceeded foreign-currency liabilities, making the system vulnerable to shocks. Also, the financial stance of some individual banks remained difficult.

The stock market remained depressed after the crisis, while the legislative framework has been gradually developing. In 2012, the law on joint-investment institutions was passed.

8 | Currency and Price Stability

Recently, the Ukrainian authorities were quite successful in combating inflation. Both level and volatility of consumer prices reduced in 2011 – 2012. Average consumer inflation decelerated to 8.0% year-on-year in 2010, and further slowed to 0.6% in 2012. Low inflation could be attributed to tight monetary policy, moderate growth of incomes, a good harvest, as well as a tightly managed exchange rate.

However, disinflation seemed to have turned into deflation in the second half of 2012, posing a risk to future economic growth.

The National Bank of Ukraine (NBU) continued the policy of tightly managing the UAH/USD exchange rate. This policy is hardly sustainable. To support the exchange rate stability in 2012, the NBU spent about a quarter of the international reserves and introduced significant capital controls, including, among others, the requirement to surrender 50% of export proceeds, and a reduced period within which exporters are to repatriate proceeds into Ukraine.

Formally, the NBU is independent. De facto independence is contingent on both the commitment of NBU leadership and government pressure.

Despite the officially proclaimed goal of medium-term macroeconomic stability, policy efforts seem insufficient to achieve this goal. The country's economy has faced a double deficit and remained vulnerable to shocks.

The current account (CA) deficit was 6.3% of GDP in 2011 and expanded to 8.4% of GDP in 2012. As inflow of foreign capital was insufficient to cover the CA deficit, the balance of payments deficit was financed with international reserves. The NBU lost \$7.6 billion of reserves in 2012, and, as of the end of the year, the level of reserves constituted \$24.5 billion, which is below conventional sufficiency benchmarks and

Anti-inflation /
forex policy

6

Macrostability

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could cover neither three months of future imports nor one year of short-term external debt measured by remaining maturity.

The consolidated fiscal deficit fell to 1.8% of GDP in 2011, as compared to 6.0% a year before, but grew again to 3.6% of GDP in 2012. The deficit was financed by borrowings and privatization receipts.

Public debt has been growing. In 2012, state and state-guaranteed debts reached \$64.5 billion, an increase of 9% year-on-year. State debt was \$50 billion, or 28.3% of GDP, almost equally divided between external and internal components.

In 2011 – 2012, Ukraine failed to implement policy steps required for getting new disbursements under the Stand-by Arrangement (SBA) signed in 2010. The country received only two tranches at the beginning of the program in 2010. The key stumbling block was a required increase in gas tariffs for the population to improve the financial stance of Naftogaz.

9 | Private Property

The constitution of Ukraine as well as the Civil Code and Commercial Code guarantee the right to private property, including nonagricultural private land.

Property rights
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However, de facto property ownership is weakly protected because the court system is inefficient, corruption is extensive, and the judiciary is strongly influenced by other branches of government. The practice of raiding as a form of hostile takeover has remained frequent in the country.

Ukraine improved its standing in the category “registering property” in the Doing Business Report 2013. The country is ranked 149th out of 185 economies, gaining 19 ranks as compared to the prior year thanks to the sharp reduction in duration of property registration.

The World Economic Forum also places Ukraine at rank 134 out of 144 for property rights, and at rank 120 in intellectual rights protection. In 2012, the International Intellectual Property Alliance (IIPA) urged the U.S. government to withdraw Ukraine’s GSP benefits because of “inadequate and ineffective protection for copyright works and sound recordings” in the country.

Private enterprises dominate Ukraine’s economy by number, but account for a much lesser share of output. According to the EBRD, the private sector accounted for 60% of GDP in 2010. This figure is indirectly confirmed by Ukraine’s officials, as the State Privatization Program for 2012 – 2014 passed in January 2012 claims the reduction in the public sector in the economy to 25% – 30% of GDP as one of the program’s prime goals.

Private enterprise
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The SME sector is quite large and could become one of the future economic growth drivers. According to official information, SMEs and private entrepreneurs accounted for over 99% of Ukraine's private-sector enterprises in 2011, for 67% of formal private sector jobs, as well as for 51.3% of total sales by enterprises and individual entrepreneurs.

In recent years, privatization process has been reactivated. After more than ten years of discussions, Ukraine finally privatized Ukrtelecom, the fixed-line telecommunication operator, in 2011. In 2011 – 2012, several energy generating and distribution companies were sold. Drawbacks of the process include the growing monopolization of the energy market, and low transparency of privatization.

The state has activated changes in the governance structure of state-owned companies. For instance, implementing Ukraine's commitments within the European Energy Community, the state has launched the reforming of Naftogaz, although the progress has been rather slow.

In 2012, the law establishing a joint-stock company on the basis of Ukrzaliznytsya was passed. The state preserved full control over the company.

10 | Welfare Regime

Social safety nets are developed in the country and consist of two main components: services and cash transfers. Still, the system suffers from important shortcomings that undermine its efficiency, burden the budget, and impede equality. The authorities grant many categories of aid and benefits to a wide range of citizens, so that the total financial obligations exceed the country's means. Social protection expenditures accounted for about 22% of state budget expenditures in 2012 (7.8% of GDP).

Social transfers and privileges are poorly targeted. People receive benefits not because of their individual needs but because they belong to a defined social group. As a result, richer households receive considerably more privileges and benefits than poorer ones, while not all poor households are able to enjoy their privilege entitlement.

The pension system consists of two pillars: the solidarity system (first pillar) and a non-state pension provision system, based on voluntary participation (third pillar), although the development of the latter is limited by the weak stock market, low incomes and mistrust in financial institutions. The Pension Fund operates with a deficit that endangers the system and hampers pension reform. Pension reform launched in 2003 has not been completed as the second pillar – compulsory, individually funded pension insurance – has not been introduced. In 2011, under pressure from the IMF, changes in the pension system were introduced including an increase in the retirement age for women to equalize it with men's retirement age, an

Social safety nets

6

increase in the minimum insurance record, and the streamlining of special pensions. These changes somewhat improved the financial stability of the Pension Fund, but insufficiently to balance the Fund's budget.

Pension payments have been growing gradually, although their level is still quite low. As of the beginning of 2013, the average pension was UAH 1470 (approximately €140), and minimum was UAH 894 (approximately €86) per month.

Public expenditure on health was about 4.0% of GDP in 2011 – 2012. According to the constitution, healthcare is to be provided universally, efficiently and free of charge. However, Ukraine's healthcare system does not provide universal access to quality healthcare, spending patterns are inefficient, and informal payments are common.

Ukraine has established a legal framework for the protection against discrimination, both in the constitution and in specific laws. The Law on Principles of Prevention and Countering Discrimination in Ukraine was passed in September 2012. Also, the country joined international antidiscrimination conventions.

Equal opportunity
6

However, implementation of legal provisions against discrimination remains insufficient, resulting in inequality and social exclusion faced by some social groups.

Gender inequality is moderate. Ukraine is ranked 57th out of 186 countries by gender inequality HDI 2012, and 64th out of 135 countries in the Global Gender Gap Index in 2012. Women have full access to education and employment, but receive lower wages for equivalent positions and are much less well represented in politics.

Some ethnic minorities, like Roma and Tatars, experience social exclusion. According to a survey conducted by the Razumkov Center, the social distance between Tatars and other ethnic groups in Crimea was 3.97 in 2011, on a scale of 1 (minimum distance) to 7 (maximum distance), although the situation is better than in 2008 when the distance was 4.31.

Treatment of Roma is much worse. Their distance score in Crimea was 6.02 in 2011, slightly higher than in 2008. Social exclusion of the Roma population involves exclusion from education, the labor market and social services.

Disabled people and people with HIV/AIDS have unequal access to participation in society, including access to education and employment. People with disabilities remain excluded, frequently due to the deficiency of both urban and rural infrastructure, namely the lack of adaptation of buildings, roads, transport, etc. The exclusion of people with HIV/AIDS is largely due to stigma associated with HIV status.

11 | Economic Performance

Ukraine's recent economic performance has been poor. According to official data in 2012, real GDP increased by a mere 0.2% year-on-year (yoy), driven by final consumption of households, while real accumulation of fixed assets dropped by 9.6% yoy, and real exports of goods and services reduced by 7.7% yoy.

Output strength
5

On the production side, major sectors of the economy featured negative growth rates. In particular, industrial output fell by 0.5% yoy in 2012, as compared to 8.0% yoy growth a year before. The reduction was felt in major export-oriented manufacturing industries, partly due to low external demand. Output in agriculture dropped by 4.5% yoy. Construction volumes reduced by 14.0% yoy.

The current account deficit reached \$14.8 billion or 8.4% of GDP in 2012, expanding as compared to 2011 (6.3% of GDP). The inflow of foreign capital was insufficient to cover the current account deficit. At \$6.6 billion, the net inflow of FDI was lower than that in 2011. Thus, the deficit of the balance of payments reached \$4.2 billion as compared to \$2.5 billion a year before.

Unemployment remained quite high, though it gradually reduced after the peak reached in 2009 amid the crisis. In 2012, unemployment was 7.5% of the economically active population aged 15 – 70.

The inflation of consumer prices slowed significantly. The average annual rate slowed from 8% in 2011 to 0.6% in 2012. Problems with the budget persisted, however as the consolidated public deficit, financed by extensive borrowing and to some extent by privatization receipts, reached -2.3% of GDP in 2011.

Summing up, the economy of Ukraine has entered a stagnation phase and has not recovered from the 2008 – 2009 crisis.

12 | Sustainability

Formally, environmental issues are on Ukraine's policy agenda. In 2010, the Main Principles of the State Ecological Policy of Ukraine until 2020 were passed by parliament, and, in 2011, the National Action Plan for Environmental Protection in 2011 – 2015 was adopted by the Cabinet of Ministers.

Environmental
policy
5

However, implementation of environmental policy has remained weak, as reflected in the Environmental Performance Index (EPI). Ukraine's EPI ranking is low. In 2012, Ukraine was ranked 102nd (score 46.3) out of 132 countries. Low EPI ranking is explained by the low ranking of its ecosystem vitality component, in particular due to high CO₂ and SO₂ per GDP.

The government has been constantly delaying implementation of ecological standards. For instance, newer emission standards Euro-4 and Euro-5 were formally enacted in 2012, but their full implementation has been postponed. Validity of obsolete standards Euro-2 and Euro-3 was prolonged until mid-2013 at least.

Renewable energy has been gradually developing, partly thanks to green tariff regulation, but its share is still very low. Energy-saving technologies are gradually making their way into Ukrainian life.

There is an established system of state and private education and training in Ukraine. Primary and secondary education is provided for everybody including citizens, foreigners and stateless persons. Gross enrollment rate for primary education is 99.0%, for secondary education it's 96.0%, and for tertiary education it's 79%. Adult literacy remains high at 99.7% for ages 15 and older.

However, the quality of education varies greatly. Vocational and higher education suffer from a mismatch between labor market demands and knowledge and skills provided by educational institutions. As a result, only 50% of the population are satisfied with the quality of education as reported in the Human Development Report 2012. According to the World Economic Forum, Ukraine is ranked 70th out of 144 in the quality of the educational system, with higher-quality math and science education (34 out of 144). However, significant brain drain partly undermines economic growth potential generated by the educational system.

Insufficient protection of property rights and low expenditures on R&D hamper innovations in Ukraine. According to the State Statistics Service of Ukraine, the share of value added produced R&D decreased from 0.7% of GDP in 2009 to 0.6% in 2010. Financing of R&D measured as a share of GDP also fell, from 0.86% in 2009 to 0.83% in 2010 and 0.73% in 2011.

Education policy /
R&D
6

Transformation Management

I. Level of Difficulty

Environmental, social and economic issues face several structural constraints. The Chernobyl nuclear power plant is still an environmental and humanitarian burden for Ukraine, with lasting social and environmental (radiation) effects. The country's export-dependent economy and energy dependency pose structural constraints that cannot be overcome quickly. Ukraine also depends directly and indirectly on Russia as a supplier of both gas and oil, because pipelines to Ukraine from Central Asia run through Russian territory.

Structural
constraints

5

Ukraine is undergoing a severe demographic crisis characterized by an aging and shrinking population. According to the World Development Indicators, the average life expectancy in 2011 was 66 years for men and 76 for women. At 1.29 children per woman (2012), the country's fertility rate is among the lowest in the world, which is sure to generate future economic and social problems. So far, policies and institutions are ill-equipped to deal with the consequences of this development, which include higher expenditures in healthcare, care for the elderly, pensions, and a shrinking labor force.

Ukraine has become a transit – and increasingly a destination – country for refugees and asylum seekers who hope to enter the European Union (to apply for asylum there). These refugees pour in from the former Soviet Union (Armenia, Chechnya), Asia (mainly China and Afghanistan) and Africa (e.g., Somalia). The European Union considers Ukraine a safe third country. In 2010, the readmission agreement between the European Union and Ukraine came into force, requiring Ukraine to readmit undocumented third-country nationals who traveled through Ukraine before gaining access to EU territory, even though Ukraine seems incapable of meeting human rights standards. Support for refugees is negligible and human rights abuses are regularly observed.

Simultaneously, Ukraine is a country of labor emigration. Several million Ukrainians work (temporarily) abroad, mainly in the European Union and Russia. Trafficking in women and children also plays a role; estimates vary from several dozen thousands to half a million victims.

Civil society traditions date back to pre-Soviet times. During the Soviet era, civil society was suppressed and controlled by the party state. Some major human rights organizations, such as the Ukrainian Helsinki Human Rights Union or the Kharkiv Human Rights Protection Group, have their roots in the Soviet human rights movement. The same applies to some charitable foundations. In recent years, popular acceptance of and involvement in civil society improved, even though few people have become NGO members. However, public trust of NGOs remains low, ranging between 30% – 35% between 2011 and 2012, and the public disillusionment that followed the Orange Revolution led to a fresh retreat to the private sphere. Paternalistic moods are still strong in Ukraine.

Civil society
traditions

5

In general, there are some differences in the history and current formation of civil society across Ukraine's various regions, with the western regions being more exposed to international contacts and experience. Moreover, there is a clear – historically developed – divide between urban centers and the countryside, with the latter having less-developed NGO networks.

Presently, only about 10% of Ukrainian CSOs work on a steady basis. Many CSOs depend on support from outside agencies. The legal environment for CSOs improved in 2012, but it is still unclear to what extent the CSOs can take advantage of it.

Even though Ukraine is an ethnically, linguistically and religiously diverse country, conflicts of ethnic origin remain insignificant. None of Ukraine's five major churches constitutes a state church. Ukraine has liberal laws regarding religion, which also guarantee freedom of religious practice.

Conflict intensity

3

Although they are deplorable, the racially motivated crimes mentioned earlier do not have the potential to develop into serious conflicts encompassing larger parts of society. At the same time, Ukrainian human rights NGOs point to the fact of growing discrimination, racism and xenophobia in Ukraine. According to them, immigrants, Roma, Crimean Tatars, members of the LGBT community, drug addicts, and those with HIV/AIDS are the most vulnerable groups. The east-west political polarization has little conflict potential – even during its peak in 2004, there was no violence.

However, Ukrainian politics are perceived as a zero-sum game and are therefore rather confrontational. This trend became stronger after the 2010 presidential elections. The political style of President Yanukovich does not add much to stability, despite his rhetoric. His fairly successful attempts at monopolizing political power go hand in glove with the suppression of opposition forces.

Another trend worth noting is that the ultranationalist party "Svoboda" entered parliament for the first time following the October 2012 parliamentary elections. The program of the party is rather radical, while its leaders often express anti-Semitic and nationalist views in public. The success of this party can be attributed to protest

voting against the ruling Party of Regions, rather than to growing support for the party's views. Still, there are fears that this party has a destabilizing potential.

II. Management Performance

14 | Steering Capability

Question
Score

Ukraine's political leadership claims to pursue long-term aims, but these are often replaced by short-term preoccupations of political bargaining, concentration of power and office-seeking, which regularly result in populist measures. In 2011 and 2012, the presidential team together with the government was preoccupied by sidelining the political opposition, winning the October 2012 parliamentary elections, and the subordination of public resources to the objective of winning the 2015 presidential elections.

Prioritization
4

Time-horizons for decision-making are in general rather short, while patron-client relationships among the president, his inner circle and the oligarchs demand the constant exchange of economic rents for political loyalty. Therefore, decision-making is not transparent and is guided by short-term considerations required to maintain this equilibrium.

Major decisions adopted in Ukraine during the period under review reflected the following needs: to concentrate power needed to ensure winning presidential elections in 2015 (the law on parliamentary elections and on referendums can be viewed from this perspective); to satisfy economically loyal actors (e.g., large-scale budget spending that bypassed transparent procedures and included constant amendments to public procurement legislation); and to strengthen control over economic activity in the country in order to make sure that more resources could be subordinated to the goal of concentrating power. Some decisions, which do not endanger the objectives outlined above, were adopted mostly under sustained pressure from the European Union and civil society. The new criminal procedure code or the law on public (civil society) associations can be viewed from this perspective.

Implementation of the strategy of economic and social reforms for 2010 – 2014, adopted in May 2010, is difficult to assess, since the document resembles a declaration of intentions, rather than a program with goals, instruments, time frames and criteria for assessment.

Implementation
5

In general, implementation of reforms was rather slow and hardly in the direction of democracy and market economy. Even public administration reform and the new

civil service law passed in 2011 are not considered to be in line with European standards and were criticized by the European Union.

Decision-making was not guided by reform considerations, but rather by particularistic interests and the goal of power concentration.

Policy learning didn't happen under the president and both governments before and after the October 2012 parliamentary elections. There is and was simply no such objective. Significant policy learning resources – whether they come from international donors or civil society experts – are not used. Bills or policy proposals in different areas that were developed by civil society and supported or endorsed by international actors await consideration for years.

Policy learning
5

Nevertheless, policy learning is occurring on some levels of bureaucracy, which are more open to external expertise, be it from international donors or civil society. A number of international assistance or cooperation projects engage bureaucratic actors in policy learning exercises. Yet the system of civil service does not encourage application of this knowledge. For instance, promotion rules are not transparent, and the chances of being promoted hardly depend on whether a particular civil servant is keen to learn. Civil service in Ukraine is politicized and subject to arbitrariness. As a result, policy learning, even if it happens, hardly converts into more informed and effective decision-making. The same holds true for actors from law-enforcement institutions and judges. The latter learn from the cases of the European Court of Human Rights; yet this knowledge rarely finds its way into the rulings.

15 | Resource Efficiency

Civil service personnel was reduced in Ukraine at the end of 2010 and beginning of 2011 as part of an administrative reform, and this hardly improved the quality of civil service. In November 2011, the law on civil service was passed that was recognized both by the OECD/ Support for Improvement in Governance and Management (SIGMA) and the Council of Europe as not in line with European standards. As a result the civil service in Ukraine remains politicized and subject to arbitrariness. The rules of employment, promotion and dismissal are not transparent; there is also no system that encourages policy learning and initiative.

Efficient use of
assets
4

Ukraine remains a highly centralized state, which negatively impacts the use of resources on local and regional self-government levels. In several instances, conflicts between elected mayors and heads of local administrations appointed by the president took place, whereby pressure on elected authorities was exercised.

Budget spending remains one of the most critical issues. Numerous cases of misuse and corruption are reported. A comparison of salaries and assets declared by high-ranking official reveals that large amounts of income beyond declared salaries are

retrieved. Budget procurement legislation experienced major negative amendments in 2012: Major sectors of the economy, including municipal services, are excluded from competitive bidding. Large amounts of misused funds were reported by journalists, especially in the context of large-scale infrastructure projects.

At the same time, the system of internal audit in the government was improved, as internal audit units were established in different executive and budget institutions. It is too early to assess their effectiveness, especially as there is no comprehensive Internal Control Strategy, while interactions between internal control, internal audit and financial inspection are not clear.

Formal changes in this area go back to 2010. The decree on administrative reform Yanukovych signed in December 2010 under pressure from the IMF resulted in the reduction of the number of central executive bodies from 112 to 63 and restructured the public sector according to functional rather than sectoral principles. This should help eliminate redundancies and overlaps. Moreover, in November 2010, four governmental committees to coordinate cross-sectoral policy and a personal list of their members were created.

Policy
coordination
5

In reality, however, this mechanism does not work, and the Cabinet of Ministers conducts coordination to ensure more compliance with the policy goals of the president. In the government that was appointed in December 2012, the actual prime minister plays a rather formal and technical role, while the first deputy prime minister, a member of the president's "family," performs the actual functions.

Better coordination can be expected with the monopolization of power achieved by Yanukovych, and the appointment of a government even more loyal to the president, with interests of oligarchs being less represented. But such coordination will be achieved through personal rule, not through the strengthening of institutions. As such, it remains unstable and vulnerable to changes of personalities in the government.

Ukraine remains a classic case of a state in which private interest groups colonize important parts of the state, patronage networks determine the distribution of state resources, and corruption permeates the state and administrative culture. Corruption is sustained by over-regulation, which opens opportunities for the extortion of bribes, not only for illegal actions but also for timely and proper performance of legitimate services.

Anti-corruption
policy
3

At the level of laws and procedures, things are well in line with European standards. Relevant institutions were also established and they function. But those do not prevent major violations and nontransparent budget spending.

For instance, according to the law, the Accountant Chamber is an independent authority that can investigate activities of executive bodies. In reality, it is very weak. Another example is a special unit called Division on Internal Financial Control and

Audit that was set up in the Ministry of Finance. Starting January 2012, every executive body and budgetary institution set up special units accordingly. The efficiency of those is also questionable.

Although Ukraine adopted a progressive public procurement law in June 2010, throughout 2011 and 2012 numerous amendments were introduced and other laws passed that watered down the original legislation. Requirements for competitive tenders were eliminated for several sectors of the economy, including the Euro 2012 soccer championship. This resulted in public expenses for infrastructure and services significantly higher than those for similar projects in other countries, all for the benefit of a small number of people close to the authorities.

A law on access to public information was adopted in January 2011. This was a major breakthrough and the new law did have an immediate effect. Journalists and civil society activists started using it and usually managed to obtain information. Apparent misuses that were brought to the attention of the public are most often not followed up.

Asset declarations became rather common and even popular. But the numerous cases in which journalists revealed that declared assets do not correspond to the declared income level were not followed up by the authorities.

Finally, party financing is not transparent and not regulated by legislation.

16 | Consensus-Building

Rhetorically, all actors are committed to the principles of democracy and market economy. In reality, this is not the case. There seems to be a tacit agreement between Yanukovych, his inner circle and oligarchs about the rules of the game, where oligarchs have their business interests satisfied, and, in exchange, they offer political loyalty to Yanukovych. This balance might be very fragile, since it is not clear how far the inner circle of Yanukovych (the “family”) can go in capturing resources without stepping on the interests of oligarchs; but for the time being this arrangement seems to be working. The rules of the game include limited democratic freedoms; a poor business climate, aimed at preventing competition from smaller domestic businesses and foreign investors; poor rule of law; and a politically controlled judiciary. The actors do not differentiate between private and public interests and democratic institutions are perceived as a means to satisfy private goals.

Before October 2012, this arrangement worked better, since Yanukovych not only controlled the government, but also had a majority in the parliament. After the elections, although the new government was even more controlled, the opposition

Consensus on goals

7

consistently blocked the work of the parliament and it became more difficult to pass legislation.

The opposition, although more united than it was before, is unable to challenge the state of things, not least due to its limited mobilization capacity. As the 2015 presidential elections are approaching, the division between the opposition and the incumbents will grow. Similarly, divisions within the opposition might grow when it comes to deciding who it will nominate as presidential candidate.

For the time being, reformers can be found only in the opposition. Yet, it is questionable to what extent the entire opposition can be perceived to be reform-minded. Some members of the opposition had decision-making powers before 2010, and violations of democratic norms were rather common, although not to the extent they are now. Moreover, the radical right party Svoboda, which entered parliament in 2012, cannot be perceived as having a democratic platform and views.

Anti-democratic
actors

5

The incumbent elites play the role of veto-players. Rhetorically, they promote reforms, but in practice work on sustaining and strengthening their power base and extracting rents facilitated by a nontransparent system. Although several positive steps in some policy areas were taken, they mainly resulted from strong international and domestic pressure and were not considered to be vital for the survival of the regime.

Political opposition, by the time of writing, failed to challenge the veto players or prevent policy developments that, in their essence, had nothing to do with reforms. It only succeeded in blocking the parliament for some months after the October 2012 elections.

None of the current social cleavages pose a threat to the state. However, a central challenge is to overcome the sociocultural and sociopolitical cleavages between the different regions that resulted from different historical experiences and institutional legacies. Different popular and elite attitudes to democracy, the free market and key issues of foreign policy stemming from these cleavages have inhibited progress or are used as smokescreens to hide specific interests and ambitions for power. These cleavages are partly reflected in the party system (with the Party of Regions being especially strong in the east and the south) and have repeatedly been misused by politicians, who claimed to reunite the country.

Cleavage /
conflict
management

5

According to the new law on language policy that came into force in July 2012, local authorities in a region where more than 10% of the population do not speak the state language (Ukrainian, according to the constitution) should use that language in their work. Although the law mentions 18 languages in this context, the underlying reason was to increase popular support of the Party of Regions in the predominantly Russian-speaking east and southern regions before the parliamentary elections in October 2012. The adoption of the law provoked mass protests in Kyiv and elsewhere. As the

extreme-right party Svoboda emphasizes the use of the Ukrainian language throughout the country, this issue might appear on the agenda again. However, according to an opinion poll in early 2013, less than 6% of the population is concerned with the issue of the status of the Russian language.

In general, NGOs have little impact on political decisions. The political leadership frequently ignores civil society actors and formulates its policy autonomously. Ukrainian legislation foresees the formation of public advisory councils in state agencies that should ensure civil society participation in the policy process. Of the 608 public councils envisaged at different levels, almost all were created. Yet, many of these councils exist only formally, and their effectiveness remains very low.

Civil society
participation
4

Moreover, public debates on draft laws and initiatives are rare, while many important laws were adopted quickly and in a nontransparent way, without texts being available online beforehand. Thus, the 2011 parliamentary election law was submitted to the parliament and passed in a single reading in a single day, with the text having become available only after its adoption by the parliament. Alarming reactions by civil society on numerous initiatives, such as the law on referendums or on language policy were never followed up. Numerous monitoring reports and advocacy campaigns by civil society organizations are also largely ignored. Although there are cases of ad-hoc consultations on the level of civil servants, they affect policy decisions only when it comes to issues that do not pose a direct threat to the regime and its rent-seeking opportunities.

To date, many historical injustices in Ukraine – mostly related to Stalinist or Nazi crimes – have not been discussed comprehensively or systematically. Under former President Yushchenko, the Holodomor (extermination by hunger) became an exception. While parliament adopted a law on the famine in 2006, the Communists and the Party of Regions refused to back it. The new leadership under Yanukovich adopted a new vision and policy, refusing to recognize the Holodomor as genocide against the Ukrainian people. November's annual commemoration of the Holodomor and its victims receives little attention by the current leadership, but is supported by the opposition and by civil society organizations.

Reconciliation
4

Another problem has to do with the status of veterans of World War II who did not fight on the side of the Soviet army, but with the Ukrainian Insurgent Army (Ukrayins'ka Povstans'ka Armiya, UPA), fighting for Ukraine's independence against both Soviet and Nazi forces. Those veterans are not entitled to the same compensation as the Soviet veterans; moreover some representatives of the Ukrainian government call them war criminals. Given that there is no public policy aimed at accommodating this page of the history from the perspective of its contribution to Ukraine's independence, which became possible after the collapse of the Soviet Union, extreme-right parties like Svoboda manipulate the issue. For instance, in October 2012, there were no state-organized activities to commemorate the 70th

anniversary of the UPA, therefore Svoboda seized the opportunity to organize a public commemoration under its auspices. The Communists, in response, organized another gathering to that they consider UPA members to be Nazi collaborators.

Crimean Tatars and Germans who were forced into exile during the Stalinist period have been allowed to return to Ukraine. A further thorny issue is the role of ethnic Ukrainians in the murder of Ukrainian Jews during the Holocaust. So far, the Jewish minority has largely been excluded from Ukrainian historiography.

17 | International Cooperation

The Ukrainian government cooperates with bilateral and multilateral international donors and tries to make use of international technical and financial assistance. Ukraine receives substantial amounts of aid to promote reforms, improve governance and living standards. More than 30 donors are involved in Ukraine, with the European Union being the largest.

Ukraine is one of the major recipients of assistance from the United States. Several United Nations organizations are present in Ukraine, including UNDP, UNHCR, IOM and others. Moreover, Ukraine cooperates closely with and profits from financial assistance from the IMF, the World Bank and EBRD. Total net disbursements of Official Development Assistance amounted to \$738.37 million in 2011; aid per capita was \$16.4.

Even though Ukraine is a signatory to the Paris Declaration on Aid Effectiveness, aid coordination is weakly developed and harmonization with its own reform agenda is insufficient. Related government programs lack prioritization and sequencing of measures. Moreover, aid disbursed for the government sector is mostly not included in the annual budget and is either under- or overestimated. Effectiveness of foreign aid is only measured by donors, not by Ukrainian authorities. Often, donors establish project implementation units because they perceive a lack of capacity within the government agency for effective project implementation. However these units often have a capacity-depleting effect on government agencies. Finally, a comprehensive database or information source on foreign aid is lacking.

The efficiency of resources allocated to the Ukrainian state can be assessed as low. Many objectives promoted by international aid were not implemented. For instance, both the European Union and the World Bank promoted public procurement reform in Ukraine, yet the system of public procurement deteriorated in 2011 – 2012. This forced the European Union to block a part of its direct budget support. Similarly, the European Union supported the development and adoption of the Electoral Code. Not only was such a document never elaborated, but the electoral system was readjusted

Effective use of
support

5

to open up space for manipulations. In sum, the lack of will for reforms and the dominance of particularistic interests preclude efficient use of international aid.

During the period under consideration, Ukraine's credibility with international actors considerably deteriorated. Prosecutions of the leaders of the political opposition were a major blow to Ukraine's image. Growing corruption and the failure to carry out the October 2012 parliamentary elections in a freer and fairer way added to this. Despite the fact that Ukraine hosted the European soccer championship in June 2012; held the chairmanship in the Committee of Ministers of the Council of Europe, in the second half of 2011; and assumed chairmanship in the OSCE and the Organization of the Black Sea Economic Cooperation (BSEC) as of 2013, Ukraine's credibility remained low.

Credibility

5

During this time, Ukraine was subject to continuous criticism by the United States and the European Union. The European Union made it clear that unless Ukraine meets its conditions, the Association Agreement (AA) will not be signed in autumn 2013. The AA entails not only market integration between the European Union and Ukraine, but also legal approximation that comes near to the level of commitments that accession countries normally have to undertake. In May 2012, Ukraine was forced to cancel the summit of Central and East European leaders in Yalta after it was boycotted by a number of European countries.

The European Union initially gave the *carte blanche* to Yanukovich, hoping that he would be able to bring some order to a country marred by political infighting and instability. Thus, the European Union refrained from criticism well until autumn 2010, when undemocratic trends were already well on track. Negotiations on the Association Agreement, which were opened back in 2007, accelerated. The AA was initiated in the summer of 2012. During this period, Ukraine also joined the European Energy Community Treaty and received the Action Plan on Visa Liberalization.

Problems first occurred when clear signs of growing corruption appeared in connection with the Euro 2012 soccer championship and other sectors. This corruption resulted in public expenses for infrastructure and services that were significantly higher than those for similar projects in other countries and benefited a small number of people close to the authorities. The European Union's reaction was to put on hold over €100 million of direct budget support and €10 million of the largest micro-financial assistance to Ukraine. Major problems emerged as Ukraine's leadership started persecuting the political opposition. Numerous criticisms on the part of the European Union and the United States, and extensive work through diplomatic channels, failed to bear fruit. The European Union postponed the signing of the Association Agreement and subsequently linked it to political reforms. The European Union outlined the conditions that presuppose implementation of 11 benchmarks in the fields of selective justice, electoral legislation, and implementation of reforms prioritized in the Association Agenda (bilateral reform action plan). By

the time of this assessment, Ukraine had hardly made any progress along the benchmarks.

Ukraine has concluded good neighborhood agreements with all of its adjacent states. Ukraine is a founding member of the Commonwealth of Independent States (CIS) and a member of GUAM (Georgia, Ukraine, Azerbaijan and Moldova). But these organizations, the latter mainly founded to counteract Russian influence in the region, are not very active, and integration is superficial. In 2011, Ukraine held the chairmanship in the Committee of Ministers of the Council of Europe, and, as of 2013, it assumed chairmanship in the OSCE and the Organization of the Black Sea Economic Cooperation (BSEC). Chairmanship in these organizations is rotating, and although Ukraine's international credibility is low due to domestic political developments, through these positions, Ukraine was exposed to more contacts with neighboring countries.

Regional
cooperation
8

Relations with Russia in 2011 – 2012 were marked by Russia's continuous attempts to tempt or even force Ukraine to join the Russia-orchestrated Customs Unions with Belarus and Kazakhstan. Joining this Customs Union will preclude Ukraine from signing the Association Agreement with the European Union; the latter envisages the creation of a Deep and Comprehensive Free Trade Area.

Also in the course of the years 2011 – 2013, energy relations were not smooth. The prices for Russian gas increased, while Russia demanded that Ukraine pay for the full amount of gas envisaged by the contract, despite the fact that Ukraine imported a lesser amount. Thus, the initial concessions Ukraine made in 2010 – extending the lease of the Russian Black Sea Fleet's base in Sevastopol and officially abandoning the goal of NATO membership – did not bring the desired results.

Ukraine has been cooperating with many Western neighbors – first and foremost Poland – to strengthen its integration into EU structures. Polish support of Ukraine's European integration played an important role ever since Poland joined the European Union (and even before that), but the task for Poland became complicated due to the lack of commitment by Ukraine's leadership to democracy. There are also cross-border projects with Poland, Hungary, Slovakia and Romania, mainly within the framework of the European Neighbourhood Policy and the Eastern Partnership. These include simplified border crossings for people living within 30 kilometers of the border with Poland, Slovakia and Hungary.

Ukraine's cooperation with countries of the Eastern Partnership intensified (besides Ukraine, the initiative includes Moldova, Belarus, Georgia, Armenia and Azerbaijan). Yet, this cooperation was and remains driven by the European Union with little initiative from the ground. In 2011, an important agreement was reached with Moldova over the demarcation of the northern and southern segments of the common border.

Ukraine has also played a constructive role in the settlement of the Transdnistrian conflict, since it proactively engaged in the resumption of official 5+2 talks. Ukraine also continued to participate in the work of the EU Border Assistance Mission to the Republic of Moldova and Ukraine (EUBAM).

Strategic Outlook

Developments in Ukraine between 2011 and 2012 indicate how unsustainable and fragile the democratic achievements of the Orange Revolution were. The period characterized by free and fair elections, political freedoms and respect for human rights, succumbed almost overnight to a high concentration of power in the hands of the close circle around the president, the prosecution of the political opposition, the subordination of the judiciary to political interests, and the suppression of freedom of assembly and expression, among other things. This means that institutional foundations of democracy were not laid down during the Orange period. Moreover, expectations that oligarchs – who were used to political competition, vibrant civil society and the West, most of all the European Union – would serve as safeguards against authoritarianism, did not pan out.

While Ukrainian elites have found it convenient to perform a balancing act between the European Union and Russia for the past 20 years, by early 2013, room for maneuver has become increasingly narrow. Ukraine came close to signing the Association Agreement with the European Union, and it is the lack of political will to fulfill the conditions outlined by the European Union that precludes this from happening. At the same time, Russia has increased its pressure in trying to convince Ukraine to join the Customs Union with Belarus and Kazakhstan. These options are not compatible, and the choice has to be made.

Therefore, Ukraine's transformation strategy should focus on the following issues:

Political transformation: Ukrainian authorities need to ensure that there is a level playing field for all political actors in the country, and that long-term rules of the game exist. For this purpose, the Election Code needs to be adopted, while presidential elections in 2015 need to be carried out in a free and fair manner. Prosecutions on political grounds should be stopped. The judiciary, the system of prosecution, and the law-enforcement system needs to be reformed in line with recommendations of the Council of Europe/Venice Commission, while decisions of the European Court of Human Rights need to be implemented. Freedom of assembly and expression should be respected. Personal voting in the parliament needs to be ensured.

Economic transformation: Ukraine's long-term reform strategy should be in line with reform objectives agreed on with the European Union. Corruption, especially at the level of political elites, needs to be eliminated. In particular, a public finance management strategy needs to be developed, while public procurement legislation should be brought in line with EU standards.

Cooperation with external partners: Ukrainian leadership should fulfill the conditions for signing the Association Agreement with the European Union and refrain from joining the Customs Union with Russia, Belarus and Kazakhstan. A number of impact assessment studies indicate that the implementation of the Association Agreement will serve the long-term benefit of Ukraine and its society.