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INSIDE UKRAINE

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

The aim of the publication is to provide objective information on current political events in Ukraine and thorough analysis of major tendencies in domestic politics. Such analysis will assist in setting priorities in the process of implementing reforms in Ukraine and in evaluating quality of state decisions from the viewpoint of their impact and sustainability. Special attention is paid to evaluation of political competition in Ukraine and ability of key political players to address challenges.

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1. The Government Policy

For Petro Poroshenko resumption of antiterrorist operation bears both an opportunity for blitzkrieg and the prospect to get stuck in a long-lasting conflict. Cease-fire should have been used to hold negotiations and improve combat capacity of Ukrainian army. Since the talks did not bring any results, we hope that this time was used at least to change the very approach to ATO leadership, to improve logistic support of Ukrainian soldiers and to elaborate plans for special operations. ATO resumption should be based on a new quality of warfare; otherwise, lack of results will show that the President's behavior is nothing but a bluff.

Trust to the government is undermined by lack of systemic reforms and the authorities' inability to communicate their vision of changes in the country. One of the vivid examples is preparation of constitutional reform, which is done in a non-transparent way. No discussion over the constitutional amendments and delay with publishing of the President's variant make the whole process illegitimate and become a ground for the criticism against the government.

1.1. Cease-fire has not achieved its goal

A week-long cease-fire, announced by Petro Poroshenko on June 20, strengthened Ukraine's positions in geopolitical sense and displayed Ukrainian government as a peace-maker, willing to avoid bloodshed. However, those are the only positive results from the cease-fire.

It was expected that the week would be used to improve combat capacity of ATO troops and establish a direct negotiation channel between Ukraine and Russia. As we may see, none of these goals has been achieved.

Names of major negotiators show that neither Russia nor Ukraine perceived the talks as an efficient way to settle the conflict. Russia tried to legitimize status of separatists as another party in negotiations. This aim was partially achieved. Ukraine wanted to prove the world its efforts to stabilize situation in Donbas in a peaceful way. However, in order to set up relations with Russia one needs a more specific negotiations package and a direct communication channel Moscow would trust.

Poroshenko's extension of cease-fire for three days was heavily criticized in the society. It was interpreted as a sign of the President's weakness as Poroshenko was assumed to be not brave enough to start decisive actions after the proposed conditions were not fulfilled. Moreover, terrorists did not do any steps to de-escalate the conflict which could become a reason for cease-fire extension. On the contrary, they used this period to strengthen their positions and constantly attacked Ukrainian soldiers.

Petro Poroshenko was probably waiting for more specific signals from Western countries as regards mutual counteraction against the Kremlin's aggression. At least it is one of the most logical explanations. Some of these signals were received on June 30, when Department of State spokeswoman stated that the US would support any actions of Kyiv aimed at stabilization of situation in the East.

Nevertheless, Ukraine did not manage to receive such an absolute support from the European leaders. For France and Germany continuation of talks is the most acceptable option when names of negotiators or terrorists' conditions for cease-fire do not matter. Leaders of these countries are afraid that the third level of sanctions against Russia will push the Kremlin towards more aggressive actions. Therefore, they prefer to appease the aggressor.

On June 30, Petro Poroshenko declared resumption of ATO active phase. Its results this week will show whether the cease-fire was used to prepare operations against terrorists and improve combat capacity of Ukrainian soldiers. At the same time use of force should be combined with active work with local population, which is more and more willing to end separatists' terror and return to a

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normal life-style.

Information campaign to make a positive image of Ukrainian soldier deserves special attention. Ukrainian military men protect local populations from terrorists and territory of the country – from the aggressor. These messages should be clearly communicated to Ukrainian citizens across the country. It is also important to establish contacts between local people and Ukrainian soldiers and to initiate national dialogue in a broad sense, meaning not only representatives of discredited local elites, but also lay people in the East.

Another important argument to settle Donbas crisis is to conduct reforms in public service, decentralization, law enforcement agencies and courts. Only successful Ukraine which consistently gets rid of Soviet administrative command system will prove people in Donbas that new government strives for qualitative changes in the country. Systemic reforms will also show that Russia's true motives are to weaken Ukraine and to impede its integration towards West, but not to protect local population.

1.2. Constitutional reform is top secret

Preparation of amendments to the Constitution continues in “closed” mode. At first MPs created a special parliamentary commission in Verkhovna Rada. It did not have regular sessions for three months, but managed to provide full text of amendments right before the presidential elections. These changes were not discussed in the society. Some MPs even say that they were not properly discussed in the commission itself.

The President could not ignore preparation of a new Constitution. However, instead of making the process as transparent as possible and setting efficient and what is more important – legitimate mechanism of amendment elaboration, the President repeated mistakes of MPs. Society found out the presidential vision of the Constitution from the information published by MPs in social networks. For a long time it was impossible to get a full text of the draft law.

Elaboration of constitutional amendments is an extremely important task for the Ukrainian government. It will reset state mechanism after the revolutionary events. The elaboration must be socially legitimate from the very beginning, consider views of stake-holders and start a broad public discussion. Work on the Constitution requires a lot of time. Therefore, voting for respective changes is likely to become a task for a new Parliament.

Except for non-transparent way the presidential variant of the Constitution was prepared, the text itself is also criticized. In fact, the President offers facelift repair of the current Constitution, while such important chapters as “Prosecution”, “Judicial power” and “Constitutional court” remain almost unchanged. However, it was these spheres of state functioning that were prone to the most blatant manipulations by the previous government.

Authors of Poroshenko's version of constitutional amendments paid most attention to division of power between the President and the Parliament and to local self-governing authorities.

The text foresees cancellation of so called imperative mandate and possibility to form coalition of individual MPs. This idea is welcomed both by the President and Verkhovna Rada. The President will get an opportunity to form situational majority for specific decisions and thus he will be less dependent on major political parties. It is always easier to strike a deal with individual MPs than with the faction leaders. On their part, MPs obtain more space for maneuver as well as increase their opportunities to have individual political arrangements.

Presidential variant of the Constitution includes a number of speculative statements. For instance, according to the current text, President suggests a candidate for Prime Minister **under proposition** of the coalition. In proposed amendments the candidacy is offered **with consideration** of the coalition proposition. Thus, theoretically, candidates proposed by the President and by the Parliament may be different.

Informational campaign to create an image of Ukrainian soldier as a defender is vitally important

Constitutional reform continues in “closed” mode

The President offers facelift repair of the current Constitution

Presidential variant of the Constitution includes a number of speculative statements

There is another example of manipulation. In previous text the President appoints and dismisses Prosecutor-General under consent of Verkhovna Rada. In proposed amendments the parliamentary consent is needed only for appointment, not the dismissal of the Prosecutor-General. Similar principle is applied in appointment and dismissal of Head of Security Service of Ukraine.

The President does not mind losing direct control on appointment of minister of defense and minister of foreign affairs. On the other hand, he wants to influence the appointments of Head of Anti-Monopoly Committee, Prosecutor-General, President's representatives in regions, Head of the National Bank, Head of Security Service of Ukraine, Head of External Intelligence Service, Head of State Bureau of Investigations, heads of national commissions on state regulation.

One of the most radical changes to the Constitution Poroshenko-style is abolition of local state administrations. In their stead there will be representatives of the President in the regions. Their functions include control over adherence to the Constitution, protection of human rights and freedoms as well as coordination of activities of territorial agencies representing central executive bodies.

Local self-government will obtain broader authorities and they will have more financial resources to realize them. Local self-government will be able to use local duties and part of national taxes. Thus, dependence of local councils from state budget financing decreases.

According to proposed amendments, division of authorities between local self-government and executive bodies of various levels is done under subsidiary principle. However, this principle is not mentioned anywhere in Ukrainian legislation. At the same time, it is one of key principles in the EU. It means that the ground for the EU actions is constantly evaluated with consideration of opportunities at national, regional and local levels.

The President also offers to introduce new principles of administrative and territorial division of Ukraine into regions, districts and communities. Meanwhile, Autonomous Republic of Crimea receives the status similar to oblasts. Earlier an autonomous republic being a part of the unitary state, which is defined by the Constitution, used to be perceived as a legal collision.

Abolition of state administrations is one of the most radical changes

Legal collisions in administrative division are eliminated

2. Economic Situation

One of the reasons for inflation acceleration was considerable increase of utilities prices.

Continuation of trade war with Russia as well as increasing need for army financing negatively influence economy and require budget cut as early as in autumn.

At the same time, gas issue remains unsettled. The situation is aggravated with the lack of consolidated position of the EU members, some of them supporting Russia, namely in construction of “South Stream” gas pipeline.

2.1. Economic forecast becomes more pessimistic

In May 2014 inflation in Ukraine increased up to 3.8% (including temporarily occupied Autonomous Republic of Crimea and Sevastopol). Since the beginning of 2014 consumer prices increased by 10.5% (comparing to December 2013). An important factor which influenced overall inflation index in May was considerable increase of natural gas price (by 62.8%). It resulted in 13% overall increase of prices (tariffs) on water, electricity and gas. In year-to-year comparison in May consumer inflation rate reached 8.8%, which is the highest level since September 2011.

It is expected that by the year end inflation rate will accelerate, namely due to tax increase (increase of tobacco and alcohol excise since July 1) and surge of utilities prices. The latter is one of the IMF requirements for financing.

In general, tariffs grow differently across Ukraine. For instance, since July 1 tariff for cold water in Kyiv increased in 2.3 times (up to UAH 7.46 per 1 cubic m), for hot water – by 58-69% (UAH 23.5-25.1 per 1 cubic m).

Water tariffs also increased in Lviv, Dnipropetrovsk and Zaporizhyya. In particular, in Lviv hot water prices increased by 45.2-55.9% (up to UAH 25.04-26.88 per 1 cubic m), tariffs for cold water – by 38.61% (up to UAH 7.98 per 1 cubic m). In Dnipropetrovsk running water will become 55% more expensive – up to UAH 8.36.

For the last six months it is not the first time utilities tariff were reviewed. On May 1 there were changes in gas price, since June 1 – in electricity tariff.

Average increase of gas prices for population made up 56%. It resulted in higher prices for heating – 40% average. In some regions the figure is even higher: in Donetsk there was 100% growth, in Kyiv - 75%.

Electricity became 10-40% more expensive depending on the volumes consumed.

Higher utility prices will negatively influence volumes of domestic consumption. Their drop will be one of major reasons for GDP decrease this year. It is expected that in 2014 it will be the first time since 2009 crisis when drop of private consumption would make up 10% year to year.

According to the ICPS forecast, yearly rate of consumer inflation in Ukraine will make up 15.4%, GDP drop – 6.5%. However, these figures may be more pessimistic due to military conflict in the East, which is the major destabilizing factor for Ukrainian economy, and due to lack of real reforms. Proceedings to state budget from Donetsk and Lugansk regions significantly dropped, while a number of enterprises had to suspend business activities during ATO. At the same time, pressure on the budget expenditures continues increasing – state covers social expenses in the East and a new budget item appeared – financing of military operation. However, situation in other regions is not optimistic either. Business conditions remain unfavorable which influences budget proceedings. Thus, there are high chances for a new budget cut in the second half of 2014.

Since January 2014 consumer prices increased by 10.5%

Average increase of gas prices for population made up 56%

Forecast of GDP drop deteriorates

2.2. Russia creates barriers for Ukrainian products

Russia referred Ukraine to the category of risky suppliers. Main argument of Russians is deterioration of the products quality, namely dairy products and canned vegetables.

In January-April 2014 Ukraine exported to Russia milk and dairy products (as well as eggs) for a total amount of USD 76.2 mln., which makes 2% of Ukrainian export to this country, vegetable products – for a total amount of USD 52.6 mln. (1.4% respectively).

Comparing to respective period of the last year, export of milk, dairy products and eggs fell by 17.5%, vegetable products – by 17.8%. In case Russia strengthens protective measures, the fall will be even more significant.

Russian association of milk producers (Soyuzmoloko) addressed Eurasian economic commission of the Customs Union with the application for investigation on import of butter, dry milk, cheese, cheese products and dry whey from Europe and Ukraine. If the Commission confirms the fact of unfair competition, it may become a reason for protective measures and 30% duty.

On June 23, Rosselkhoznadzor (Russian Federal Service for Veterinary and Phytosanitary Surveillance) claimed that there was possibility for temporary restrictions on import of Ukrainian greengrocery. The major reason is spread of corn vermin in Ukraine.

After occupation of Crimea and start of military conflict in the East, Russia started trade war with Ukraine through imposing numerous bans on delivery of Ukrainian products to Russia. For instance, since June 16, there have been temporary restrictions on import of potatoes from Ukraine to Russia. In March Rosselkhoznadzor questioned the quality of a number of Ukrainian milk and meat products and warned the producers about possibility to apply restrictions on export of their products.

2.3. Gas issues should be solved in summer

“Gazprom” uses gas as an instrument of political influence and blackmail towards Ukraine. Therefore, it is extremely important for Ukraine and the EU to join their efforts and settle the issue of Russian gas price transparently. It should be done now as in winter “Gazprom” ability to influence gas buyers will increase.

The EU Council persistently urges both parties to sign an agreement and supports the EU Commission in its efforts to promote compromise.

Ukraine actively cooperates with German “RWE” and French “Gaz de France Suez” to find alternative sources of gas supply. Today supplies are done via Polish and Hungarian directions. Talks with Slovakia are ongoing. It is a key route that may cover almost all the needs of Ukraine in gas import.

Slovak operator “Eustream” informed about successful completion of Open Season procedure as regards acceptance of applications for gas supplies to Ukraine through Slovakia. More than twenty European suppliers were interested in the call, some of them being the largest gas traders in the EU.

Open Season results prove that gas supplies from the EU to Ukraine is commercially attractive and legally flawless business. Large Ukrainian market is interesting for Europeans.

At the same time “Naftogaz” continues meeting its contractual obligations, regardless of the Russian decision to suspend gas supplies to Ukrainian consumers and introduce advance payments for Ukraine. The decision was taken on June 16, 2014. Russian Ministry of energy also confirms that “Ukrtransgaz” duly fulfills its transit obligations.

For many times Ukraine offered its Russian partners to change transit agreement in order to make supplies to Europe transparent and to avoid misunderstandings meaning false accusations in unauthorized gas withdrawal. So

Ukrainian products may be subject to 30% duty

It is important to join efforts of the EU and Ukraine in gas talks with Russia

far Russia is against any changes. It is possible that this issue as well as the question of transit tariffs will be considered in Stockholm Court.

Reforms in energy sector are vital for Ukraine. The ground for these reforms was already laid. Today European companies are interested in cooperation as regards joint management of Ukrainian gas transport system. Legal and economic matters as well as needed amendments to legislations are discussed.

Involvement of European and American companies in management of Ukrainian gas transport system will considerably increase the EU trust and it will make “South Stream” project unnecessary for Europe.

It is worrisome that some EU countries continue supporting “Gazprom” in terms of “South Stream” construction. Last week Russia and Austria signed an agreement to construct a section of this gas pipeline. This week Hungary declared its support to the project.

The agreement between Russia and Austria foresees construction of “South Stream” section with transit capacity of 30-32 bln. cubic m from the Hungarian border to Baumgarten (Austria). The parties are going to get all the necessary permits by the end of 2015 and to put the Austrian section of the pipeline into operation by the end of 2016.

***Transit issues
may be
considered in
Stockholm Court***

***Austria and
Hungary support
Russia in “South
Stream”
construction***

3. Political Competition

Poroshenko is at a crossroad. On the one hand, as soon as possible he has to call early parliamentary elections, as required by society and by the necessity to have his own political force in the Parliament. On the other hand, early elections are not possible without stabilizing the situation in the East, while the main political forces in the Parliament even insist on the introduction of martial law. In addition, the dissolution of Parliament will not allow conducting on-time voting for the budget and will postpone the decisions that are necessary for the President.

Meanwhile, Yulia Tymoshenko decided not to criticize the President, waiting until his rating falls. She temporarily disappeared from the information space, focusing on the search for potential allies to return to power.

Simultaneously, the criticism of the government by civil society is growing. Activists should find ways to legitimize their activities, possibly through participation in early parliamentary elections.

The chance of UDAR in the early elections will depend on how the team of Vitali Klitschko will prove itself in Kyiv. However, the concentration of absolute power in the hands of the politician significantly affects his prospects at the national level.

3.1. Petro Poroshenko's dilemma

The President of Ukraine is in a difficult political situation. The first item on his agenda is to settle the crisis in the East. ATO was not efficient enough, while the peace plan was ignored by terrorists at the stage of its announcement. Moreover, the negotiation channels with involvement of Leonid Kuchma, Viktor Medvedchuk and Nestor Shufrych had no significant results.

A part of political establishment requires the introduction of martial law in the East, as a solution to the problem. Under these conditions, early parliamentary elections can be held not earlier than spring 2015. The postponement of the elections will cause a wave of people's indignation and seriously weaken the position of the President. At the moment, he does not have his own political force in the Parliament. Thus, he cannot effectively promote his proposals. A separate item on the agenda is the adoption of the state budget that will affect the fulfilment of the requirements of international donors and the economic situation in the country as a whole. For adoption of the state budget an effective Parliament and the opportunity to adopt necessary decisions are indispensable.

Moreover, the social discontent in a society is growing, caused by the rising cost of utilities, inflation, reduced purchasing power and impoverishment. On the background of falling GDP, the obligations to the IMF and other financial institutions, the government will cut back on all possible items of expenses, including the social ones.

A separate latent problem that the government cannot solve is the uncontrolled migration and refugees. In the eastern regions of the country hundreds of thousands of people remain without water, heating and proper utilities. It can also lead to social unrest and a humanitarian catastrophe.

Another important problem for the President is the lack of reforms. For the last four months the government has not even laid the basis for their implementation. Practically all positive changes are realized in Ukraine under pressure of international organizations and are dictated by the risk to lose their financial support. It turns out that reforms are not needed by government or President; they are needed by foreign entities, which appear to be the most effective lobbyists for the introduction of these changes.

All the above mentioned issues require urgent solution and coordination of presidential actions. A "politics of delay" will only increase the degree of tension in the Ukrainian society.

Settling crisis in the East is top priority for the President

Social disappointment with the government actions will grow

3.2. Obtaining absolute power in Kyiv will “hit” on Klitschko

Having the post of Kyiv mayor and the absolute majority in the Kyiv City Council, Vitali Klitschko remains the leader of the nationwide political force UDAR. However, in order to increase his presence in the Parliament at the next election, he needs to get a maximum result for the reforms in Kyiv, and at the same time to make a minimum number of mistakes. Serious mistakes during mayor tenure will not only early finish the political career of Vitali Klitschko, but also put an end to the prospects of UDAR as an all-Ukrainian party.

Consolidation of the positions of Kyiv mayor and head of the KSCA (Kyiv City State Administration) can be considered as the first serious mistake of Klitschko. Although such consolidation existed during the time of Oleksandr Omelchenko and Leonid Chernovetsky, the combination of functions of a civil servant and elected municipal head leads to usurpation of power at the local level and to the lack of control over the abuse of power. Of course, in this case Vitali Klitschko gets more power to solve municipal problems, but at the same time, he is the only one to bear responsibility towards the electorate.

So far there have been no specific disagreements between Vitali Klitschko and Petro Poroshenko. The appointment of the UDAR leader as head of KSCA, despite the declared policy of decentralization of power and the division of state and local government positions, proves that Poroshenko clearly fulfils the political agreement with his ally. However, if necessary, the President will be able to distance himself from the failed decisions of Vitali Klitschko.

The fact that Klitschko and Poroshenko may eventually take different political paths is confirmed by the ideas to divide the faction of Vitali Klitschko in Kyiv City Council in two different factions: UDAR and “Solidarity”. As a matter of fact, at the moment half of the faction is directly associated with Petro Poroshenko and another half - with Vitali Klitschko. Lack of solidity can seriously affect the effectiveness of Klitschko’s team in Kyiv.

Current expectations from Vitali Klitschko are very high. The politician needs to solve problems in the housing sector, to combat illicit commerce, to counteract the illegal building and fill the city's budget. As the old corruption schemes and opaque “game rules” continue to exist, Vitali Klitschko should monitor his team for possible corruption abuses. This challenge is the main one that can cause a serious blow to the image of the politician.

3.3. Yulia Tymoshenko stands an informational pause

After the presidential elections, Yulia Tymoshenko decided to temporarily disappear from the informational space. Such a change in the strategy becomes even more pronounced, given the fact that during the election process one of the main focuses of her campaign was TV presence. Obviously, she chose a model of behavior recommended right after her release from prison, when she was discouraged from participating in the elections. A temporary pause in public activities will reduce her negative rating, while her opponents in power will become object of raising critic.

According to the official version, the leader of “Batkivshchyna” continues to work on the reorganization of the party. Regional organizations are working with local party activists, updating the lists of the party members and the deputies of local councils. At the same time, the party leadership continues to prepare party activists for the campaign work during the parliamentary elections campaign.

Meanwhile, Yulia Tymoshenko uses the pre-election lull to search for potential political allies. Establishing cooperation with them will define the future configuration of political forces and develop her strategy and tactics of political struggle.

All political players wait until Petro Poroshenko accumulates a sufficient amount of mistakes, which will serve as a breeding ground for crushing criticism.

Mistakes during his tenure as Kyiv mayor will early finish Klitschko’s political career

Sooner or later Poroshenko and Klitschko may split

Temporary pause in active public presence will decrease negative rating of Tymoshenko

Batkivshchyna is looking for political allies

“Batkivshchyna” insists on introduction of martial law in Lugansk and Donetsk regions that would postpone early parliamentary elections. But martial law does not match Poroshenko’s interests as his rating will decrease along with the potential size of his political force in the next Parliament.

Return of Yulia Tymoshenko on political limelight depends on the effectiveness of the presidential decisions and social mood.

3.4. The need for new faces in politics has not disappeared

Social activists continue to show wonders of self-organization. They unite in action groups that are engaged in a wide range of issues: supply of ammunition to the Ukrainian military in the ATO zone; solution of problems of refugees from the war zone; development of draft laws and concepts of necessary reforms etc. However, the civil society cannot take over all state functions. Its field of activity is to exert pressure on officials in order to achieve effective governance. Its goal is to teach the state to carry out its public functions.

Lack of reforms and the government inaction leads to growing public discontent. The Maidan representatives actively begin to put pressure on the authorities, demanding decisive actions in combating the terrorism in the East and conducting reforms.

To influence political process in the state, the revolutionary force of civil society needs to legitimize itself. Community activists can physically renew the composition of the political elites in Ukraine and introduce new quality into the political process by making it more transparent and accountable to the electorate. However, in order to achieve it, they need to form political forces and get ready to participate in the parliamentary elections. Lower election threshold may also facilitate arrival of new faces in Ukrainian politics.

New political forces cannot operate under old rules. The principle of novelty does not mean the date of the party creation, but a new quality of its work. The parties are to be developed on the principle of horizontal relations, replacing the “one-leader-parties”. In addition, in order to get popular support, new parties have to offer a clear vision of changes in the country, aimed at fight against corruption and elimination of the Soviet era remnants in public administration.

It is also important that financing of a party is based on crowd-funding experience. It will prevent new politicians from becoming investment projects of oligarchs. Should these conditions be met, the Ukrainian society will receive political elites accountable to voters and focused on the modernization of the state, rather than filling their own pockets.

***The Maidan
representatives
exert more
pressure on the
government***

***New parties
cannot function
under old rules***