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# Inside Ukraine

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The logo for the International Renaissance Foundation, featuring a stylized green swirl and the word "Benaissance" in a serif font.  
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# Content

<b>Reforms: A Final Countdown</b> .....	<b>1</b>
Constitutional reform.....	3
Anticorruption reform .....	4
Public administration reform .....	5
Judicial reform .....	6
<i>Georgia's experience in judicial reform</i> .....	7
Police reform.....	8
<i>MOI reform in Georgia</i> .....	9
Deregulation reform.....	9
Tax reform.....	11
Energy reform.....	12

# Reforms: A Final Countdown



The year of 2014 has been a turning point not only for Ukraine, but also for the whole European continent. The post-bipolar era in European history has ended up with Russian aggression against Ukraine. The way in which the conflict in and around Ukraine is resolved will shape not only the future of Ukraine, but also the entire European continent and the currently standing European and global architecture of security and cooperation.

The recent events in Crimea and Donbas were caused by Moscow's endeavours to seize back the status of a key geopolitical player and to contest the results of the Cold War. Ukraine became a geopolitical battlefield not only because of its strategic importance and the conflict between the pro-European choice of most Ukrainians alongside the imperial ambitions of the Russian leadership, but also because of its internal weakness and deepening disintegration. Russia managed to annex Crimea in the blink of an eye and start a war in the east of the country given that the Ukrainian state remains unreformed, political and economic institutions remain corrupt and the political elite remain unable to provide an adequate response to external aggression directed by the Kremlin.

The deepness and complexity of the current crisis, which is simultaneously cross-European, Russian-Ukrainian and internally Ukrainian, is defined by the fact that three complex challenges exist all at once. Taking into account the multidimensional nature of the problem that Ukraine and the inter-

national community face, the solution should be sought at three different levels:

1) geopolitical — the reset of European and global architecture of security and cooperation, the creation of new international security guarantees and punishment protocols for aggression, the elaboration of an inclusive cooperation model in relation with all the former USSR countries, including Russia;

2) Russian-Ukrainian — the settlement of bilateral relations with respect to the territorial integrity of Ukraine and in accordance with the use of European practices and the best international experience in order to regulate the issues of Crimea, Sevastopol and cooperation in the military field;

3) domestic — the implementation of radical political and socio-economic reforms, the initiation of a national dialogue to reach consensus on major issues of further development of the country.

It is impossible to find one treatment for three different diseases. One major task for the country as a whole and Ukrainian civil society is to implement internal reforms. Reforms are even more crucial than counteraction to Russian aggression. The lack of any significant changes undermines Ukraine's state capacity from within, delegitimizes state power and ruins public trust to the project called "Ukraine".

A successful implementation of reforms will allow Ukraine to reverse economic decline, unite the Ukrainian society and increase Ukraine's state capacity to counter external threats.

Without reforms, the economic recession will continue and the Ukrainian society will be further disappointed with its political elite and state authorities, whereas the Ukrainian army and law enforcement bodies will be unable to perform their direct duties, i.e. the protection of statehood.

The responsibility for the institutional transformation of Ukraine, first and foremost, lies with the Ukrainian government, which has received a mandate of trust from the society. However, the international community should also play a prominent role in stabilizing the situation in the region, neutralizing Russian aggression and supporting reforms in Ukraine.

Over the last 20 years, Western partners and donor organizations have provided financial assistance to Kyiv. However, the current system of financial aid has not brought concrete results and has been limited to numerous groups of advisers and financial injections into the state budget. Instead, institutional assistance similar to that which the EU has provided to candidate countries for EU accession would be much more effective.

Public service reform is one of the most urgent and important changes that must be made, given that it provides a mechanism that can either implement or discredit all the other sector and horizontal reforms. Institutional weakness of state bodies and a lack of political will on the part of the country's leadership is both a cause and an effect of difficulties passing reforms throughout Ukrainian history.

The fight against corruption is a key task for the incumbent government. However, the Ukrainian government is on the wrong track given that it currently treats anticorruption reform as a sectoral problem. Fighting corruption is the main precondition for qualitative changes, which need to take place at all levels.

In fact, Ukraine is now waging two wars: one against Russia, and another against corruption. In both cases, the enemy is the same: the Soviet totalitarian legacy.

Because of this legacy, the country's constitution does not at present guarantee punishment for the violation of property rights, law enforcement bodies do not ensure the rule of law and state authorities try to pursue their private initiatives under control through a regulation system.

Because of this legacy, civil servants preach the philosophy of the Communist apparatchiks, while

courts are used by the legislative and executive branches to legitimize political decisions in their favour.

Because of this legacy, the main means to increase budget revenue is to increase tax rates, instead of improving the business climate, and the political elites fear the abolishment of the rent system, as it is a major source of their personal enrichment.

For the last ten months, the Ukrainian government has made the right statements on much-needed reforms. However, political declarations have not been transformed into concrete actions.

The main reasons for the government's lack of action have been:

1) the desire of politicians to benefit from the existing rent system. Any systemic reform will mean that a limited club of privileged people will lose opportunities for fast and uncontrolled enrichment. It is only when the government denies rent monopolies and allows market competition and equal opportunities for distribution of resources that we may have serious talks on reform;

2) the possibility to use an external threat as a justification for a lack of reforms. In fact, the war is not an obstacle, but an additional stimulus for many reforms;

3) the lack of a team of professionals who are determined and resolute to implement reforms. Arseniy Yatsenyuk's government was formed under the quota principle, and most appointees lacked both professionalism and social legitimacy.

In the event of further delay with reforms, Ukraine and Europe will see a doomsday scenario play out: a deepening of separatist tendencies and an increase of social tensions leading to the possible breakup of the state. Taking into account the crisis in Donbas, the West's disappointment with the Ukrainian government's inability to conduct reforms and further Russian pressure, economic and social problems in Ukraine may cause an economic collapse. Hundreds of thousands of refugees will cause waves of migration and humanitarian chaos, leading to the creation of a zone of instability on the EU's borders for many decades.

Therefore, the implementation of reforms in Ukraine is not only a matter of life and death for Ukrainian statehood, but also for the stability and economic development of the whole region. Meanwhile, the window of opportunity for the Ukrai-

nian government is about to close. While reforms should have been started right after the events in Maidan, public patience and readiness to make sacrifices today have almost run out, and trust in both proposed reforms and the government, which will need to implement the changes, constantly diminishes. Therefore, the government should carry out reforms, instead of just talking about them. These reforms should be implemented today, without

waiting for more favourable external and internal conditions.

The eight reforms below are the main indicators of the readiness of the Ukrainian government to change the existing system. They include the fight against corruption, constitutional reform, public administration reform, judicial reform, law enforcement reform, deregulation, tax reform and energy reform.

# Constitutional reform

Constitutional reform is a tool aimed at creating a system of checks and balances in relation between the legislative, executive and judicial branches of power, ensuring the independence of Ukrainian courts and providing local communities with wider authorities.

Public discourse on constitutional reform was especially active in spring 2014, but with the beginning of an antiterrorist operation (ATO), the topic lost its media attention. Meanwhile, two versions of constitutional amendments were proposed: the first one was prepared by the temporary parliamentary commission headed by Ruslan Knyazevych, while the second is a presidential version submitted for consideration to the Venice Commission.

A major concern for both texts is the non-transparent manner of their preparation and the lack of public discussion with consideration of all the stakeholders' views.

For three months, the temporary parliamentary commission held only a few sessions, but managed to provide a full text of amendments right before the presidential elections. These changes were not discussed in open society. Some MPs even say that they were not properly discussed in the commission itself.

Instead of making the process as transparent as possible and setting efficient and — what is more important — legitimate mechanisms of amendment elaboration, the President repeated the mistakes of MPs. Another version of amendments was prepared in a rush, and the President presented it to the public on June 26, 2014. The text was entirely focused on the distribution of power between the President and the Parliament and decentralization,

while such important chapters as “Judicial power” and “Constitutional court” remained unchanged.

In general, the presidential text received a positive assessment from the Venice Commission. Broader authority of local self-government, such as over financial matters, was recognized as one of the most positive aspects in the text. The Commission approved prosecutors losing a function of general supervision, but criticized the President's right to dismiss the Prosecutor-General, the Heads of the Security Service of Ukraine and the State Service of Investigations without the Parliament's consent.

The elaboration of constitutional reform may again be started from scratch as the coalition agreed to set a new temporary parliamentary commission with pro rata representation of parliamentary factions. This format was shown to be inefficient this spring, so it is unclear why policymakers believe that this time things will be different.

The Constitution may be used as a tool for national reconciliation in times of crisis only when its elaboration is moved from the parliamentary to the nationwide level, with active participation of various regions, representatives of NGOs, government units and political parties.

**Constitutional reform should be considered at the nationwide level**

The Constitutional Assembly may represent such beyond-the-parliament levels, but its format is to be changed. This body was established by Viktor Yanukovich in 2012, but for several years of its operation, it has failed to elaborate any constitutional changes. The organization did not have the necessary social legitimacy and was perceived as a puppet advisory agency of the presidential administration. One of the reasons for such a perception was the refusal of the opposition at the time to participate in its sessions.

On December 1, 2014, Petro Poroshenko abolished the Constitutional Assembly, but plans regarding the establishment of a new body responsible for the elaboration of constitutional reform remain unclear.

A format of a new Constitutional Assembly remains unclear

Constitutional reform should be held either through the establishment of the new Constitutional Assembly based on the principles of inclu-

siveness and transparency or through a wide social debate on constitutional matters. From there, the Verkhovna Rada will elaborate a new Constitution draft based on the mentioned proceedings.

If the division of powers is not clearly stated in the Constitution, another conflict between the President and Prime Minister will lead to a repetition of the events from 2005 to 2009, economic collapse and the destruction of the whole state power vertical.

## Anticorruption reform

Corruption is one of the most outstanding major threats to national security, as it undermines the financial system, citizens' trust in the state and the capacity of government officials to defend national interests without using their positions for personal enrichment.

The fight against corruption is not a sector reform. It will influence all spheres of life in society, yet it needs systemic institutional changes to ultimately bring about a transformation in social consciousness. Only a policy of zero tolerance to corruption will induce new behavior standards for civil servants and restore missing trust to state institutions.

Only a policy of zero tolerance to corruption will restore trust to state institutions

This necessary fight will create numerous enemies for the government and destroy its rating in the short term. However, while this step will deprive many citizens of an "economic safety cushion" in the form of shadow income, these measures are vital in order to transform Ukraine into a country that guarantees Western standards of living, personal security and the protection of property rights.

The first step in the fight against corruption was the adoption of the law "On public procurement", in April 2014. The law nearly ended the policy of single-source procurement and made the process transparent for journalists and civil society activists. Some experts predicted that the innovation will help save up to UAH 70 bln. p. a. However, public society has not found out about the implications of the new law, as the government did not explain what the passing of the law had brought about or how efficiently it has been implemented.

The second step was the adoption of an anticorruption package on October 14, 2014. The package

includes laws concerning the anticorruption strategy for 2014-2017, a system of specially authorized subjects in the sphere of corruption counteraction, the National Commission for Prevention of Corruption and disclosure of final beneficiaries of the legal entities.

Anticorruption package created a legislative ground for fight against corruption

Anticorruption measures also include adoption of the law within the prosecutor's office that revokes the agency's power of general supervision. This privilege allowed the Office to carry out inspection of any business, thus significantly increasing prosecutors' punitive actions and corruption risks.

The Verkhovna Rada supported the establishment of the National Commission for Prevention of Corruption as a central executive body responsible for the elaboration and implementation of the state's anticorruption policy. The objectives of the new body are to analyze the fight against corruption in Ukraine, develop anticorruption strategy, conduct research on corruption, introduce a unified register of officials' declarations and people who have committed corruption offences and cooperate with whistleblowers on corruption cases.

On the same day that the package was passed, the President established a similar agency — the National Council on the Anti-Corruption Policy — as an advisory body to the President. Significantly, the roles of the National Council and the National Commission overlap in many cases. However, the bodies differ in formation mechanisms and accountability: the National Commission reports to the Cabinet and selection of the members is based on competition, while the National Council members are appointed by the President and account-

able only to him. The two bodies exhibit a power dualism given that both the President and Prime Minister do not want to lose their capacity to influence such an important sphere as the fight against corruption.

Power dualism creates agencies with similar functions

The above mentioned National Council and National Commission are not a part of the system of specially authorized subjects in the sphere of corruption counteraction, which includes prosecutors, the National Anti-Corruption Bureau and special units of the Ukrainian Ministry of Interior which combat organized crime.

The Anti-Corruption Bureau is to become a major body that will combat high-level corruption. The Bureau executives are forbidden to be members of political parties and be involved in investigations if there is a conflict of interest. At the same time, the internal control units monitor and measure the income of civil servants against their lifestyles. High salaries and significant social packages are designed to decrease corruption risks in the agency.

The Anti-Corruption Bureau carries out search work and pre-trial investigations of criminal violations within its jurisdiction, verifies the officials and candidates for public positions and cooperates with whistleblowers.

Anticorruption laws provide a legislative framework for the fight against corruption, but it is only a beginning. The success of the struggle will depend on how a new government will treat the implementation of adopted laws, the establishment of new institutions, the introduction of new procedures and standards as well as the development of new skills among employees responsible for fighting corruption.

Efficiency of fight against corruption will depend not on laws, but on the way they are implemented

Without specific progress in the area, the Ukrainian government will lose the remaining trust on the part of Ukrainians and the international community. In addition, the cost of inaction will be a further decline in defense capacity, a deterioration in the situation with state finances and a crisis of state governance.

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## Public administration reform

Public administration reform is a tool primarily intended for implementing other reforms. The development of a new policy in public administration does not require significant resources and can be implemented within a short period of time. The implementation of state decisions directly depends upon an effectively organized and legally protected state apparatus and its ability to work concertedly and free from party influence.

The problem of public administration in Ukraine is the Soviet system of linear functioning of state apparatus

Ukraine has preserved the Soviet system of a linear functioning of state apparatus, which can be characterized by:

- 1) a lack of public policies in ministries that leads to manual management in the central executive authorities and their structural subdivisions;
- 2) a low qualification of public servants that directly affects the efficiency and quality of decisions;
- 3) a high level of partisanship of the administrative personnel, which changes dramatically after every election;

- 4) the Soviet system of official duties and terms of reference for public servants, which at present is completely dysfunctional.

After the victory of the Euromaidan, the state power system has been formed at all levels under the principle of party quotas. Such a personnel policy has ultimately weakened the bureaucratic apparatus, which has been unable to transform political decisions into administrative procedures. Political and administrative positions in the public service system remain unseparated. Once again, the parliamentary elections changed the names of government officials, but did not affect the system given that the political winners gave administrative positions to those who supported them during the election process.

The Government of Arseniy Yatsenyuk announced the launch of public administration reform, but a lack of political will and a strategic vision regarding the new policy has once again delayed the process. After the parliamentary elec-

A lack of political will delay the reform process of public administration

tions, the coalition agreement was signed, and it included a separate section on public administration reform. Along with the coalition agreement, the Ministry of Regional Development proposed to discuss its own document, “Strategic document on reforming public service by 2017”. Despite discussions with civil society representatives and other experts, the government officials failed to present a finished draft of the law in the Parliament. According to the action plan, the coalition agreement and the Strategic document, the proposal is planned to start the main legislative work only beginning in the first quarter of 2015. For almost a year, no systematic changes in this area have been carried out.

The authorities’ desire to reform public service depends exclusively on political will. At the same time, the state apparatus potential is almost exhausted, as evidenced by the inability of officials to adequately respond to present challenges, including Russian aggression.

In order to reform the public administration system, the government and the Parliament should:

- 1) adopt European standards of public service;
- 2) adopt legislation in the field of public administration, which will meet the SIGMA criteria of effective management;
- 3) separate political and administrative positions through the introduction of an independent state secretary position;
- 4) establish a process of advanced training for public servants in accordance with best European and international practices;
- 5) establish a system of electronic record-keeping.

Further use of the current public administration system will discredit the topics of reforms and European integration, which will ultimately threaten Ukrainian statehood as a whole.

Absence of changes in public administration will discredit the topics of reforms and European integration

## Judicial reform

The judicial system in Ukraine has never been an independent branch of power. The courts were often used as a convenient instrument for confrontation between the President and the Parliament. During the presidency of Viktor Yanukovich, courts were actively used for the persecution of dissidents, the manipulation of election results and the prohibition of mass gatherings. The inability to protect oneself using legal means, i.e. lack of rule of law, has become one of the driving reasons for the Revolution of Dignity.

The punishment of those judges who were deliberately involved in illegal decision-making, the guaranteed independence of the judiciary system and the prevention of corrupt practices in the system were the main demands of the post-revolutionary period. However, the passing of the reforms was hampered due to resistance in the system and the unwillingness of the political elite to abandon such a convenient instrument for the legalization of their decisions.

On April 8, 2014, the Verkhovna Rada adopted the law, “On restoring trust in the judiciary system

in Ukraine”, which automatically dismissed all heads of courts and dictated that in regards to administrative posts, the judges are to be elected by colleagues. The adoption of the law did not bring forth results, as shortly afterwards, 80 percent of court heads were restored to their posts through collective decision-making. Some judges, who have lost positions in the Constitutional Court and the High Council of Justice, returned to their offices under the decision of the Supreme Administrative Court of Ukraine. In addition, in May 2014, a group of MPs filed an appeal to the Constitutional Court, calling into question the constitutionality of this law.

Pursuant to the law, the Interim Special Commission on examination of judges of general jurisdiction was created. As of November 10, 2014, the Commission initiated 88 examinations of judges. Materials concerning only two of them were submitted to the High Qualification Commission of Judges (HQCJ), while for eight of the examinations, conclusions on the violation of the oath were delivered to the High Council of Justice (HCJ). However, even those few judges have already appealed against the decisions, and therefore the process of purging the judiciary continues to be delayed.

The decision on the punishment and dismissal of judges is to be adopted by the High Council of

The reasons for judicial reform non-implementation are resistance in the system and the unwillingness of politicians to lose control over the judicial system



Justice and the High Qualification Commission of Judges. The law, “On restoring trust”, dismissed the previous members of these bodies, but new members were not appointed.

The High Council of Justice consists of 20 members. The Verkhovna Rada, the President, the Congress of Lawyers, the Congress of Judges and the Congress of Representatives of Higher Legal Educational Institutions shall appoint three members of the High Council of Justice each, while the All-Ukrainian Conference of Prosecutors shall appoint two members and the Prosecutor General, the Minister of Justice and the Chairman of the Supreme Court are ex officio members of the HCJ.

The Congresses of judges, lawyers and academics have been held, but their results were challenged in courts. The reason lies in the interest of some influence groups, such as Serhiy Kivalov, to retain personal control over the judicial system and capitalize this influence in relationships with the new government.

It is impossible to dismiss judges without a decision held by the High Council of Justice, even if they have reached their full retirement age. According to experts, the budget losses from paying salaries to judges who applied for dismissal amount to UAH 30 mln. per year.

Though a public discussion of the concept of judicial reform was not conducted, the authors of the coalition agreement presented quite comprehensive

For almost a year, the HCJ and HQCJ could not function because the decisions of relevant congresses are challenged in courts

elaborations in this field. In particular, it proposes that the selection of judges will be competitive and the requirements for the position will be formulated, based on the need to declare revenues and expenditures for the candidates and members of their families. Judges’ actions will be regularly assessed, and the law will define a procedure for a judge to face disciplinary punishment. Further, the Supreme Court will recover its authorities that it lost during the reign of Viktor Yanukovich. In criminal proceedings, lay courts will be used. The authors of the agreement promised to introduce efficient legal mechanisms to meet deadlines in courts and to improve the procedure of court decision implementation, whereby there will be accountability for a violation of deadlines and stimuli for voluntary fulfillment of court decisions.

At the same time, developers of judicial reform did not explain a number of important issues, namely concerning the professional training of judges, the mechanisms to ensure the independence of judicial self-governance and the assurance of a reduction in the number of cases per judge. Without definite answers to these questions, it will be impossible not only to effectively implement this reform, but to even launch it

The costs of the non-implementation of the judicial reform will include an outflow of foreign capital from the country, a lack of public trust in state institutions and a deterioration of the investment climate in the country.

The absence of changes in courts will lead to an outflow of foreign capital and a lack of public trust in the state

## Georgia's experience in judicial reform

*In contrast to Ukraine, where a citizen over 25 who has a higher legal education and three years of professional experience can become a judge, key requirements in Georgia include an age limit of 30 years and not less than five years of experience. An applicant must be selected to the High School of Justice where he/she will study for ten months. Besides studying theory, he/she will have an internship with an acting judge, who will provide a reference for his/her trainee. Only in the case of a positive reference and passing the internal exam will a candidate be allowed to participate in the competitive selection for the position of a judge. However, even after obtaining the post, each judge must take courses at the Higher School of Justice twice a year.*

*Autonomy of the judiciary in Georgia is guaranteed by the fact that most of the judges of the High Council of Justice are professional judges: nine members are to be elected by the conference of judges, five members by the Parliament and only one member — by the President.*

*Concerning a reduction in the number of cases, the Supreme Court in Georgia was successfully relieved by 35-40% due to the introduction of an admissibility principle whereby an ultimate destination to contest a decision of local court is a court of appeal, and the Supreme Court deals with the interpretation of judicial practice and resolves contentious cases. The number of cases in courts of general jurisdiction has been reduced due to the introduction of a mandatory mediation in disputes between family members and neighbors and regarding inheritance issues.*

# Police reform

The impunity of law enforcement officers and their service as protectors of the government and not the rule of law were two of the main reasons why mass protests transformed into a full-scale revolution in winter 2013-2014. Since February 2014, the system has not changed, and people guilty of crimes against the Maidan and separatism instigation have not been punished. Subsequent changes have been limited to the naming of a new Minister of Interior, the abolishment of the “Berkut” special task force unit, the rebranding of internal troops in the National Guard and the inclusion of volunteer battalions into the Ministry of Interior structure. The fact that the position of the Minister of Interior became a major point of contention in the process of parliamentary coalition formation demonstrates politicians’ desire to continue using the ministry to serve their own interests.

Horse-trading over the position of the Minister of Interior demonstrates politicians’ desire to use the Ministry to serve their interests

Zorian Shkiriak, advisor to the Minister of Interior, claimed that as of November 2014, 20,000 employees were fired from MOI. Out of them, 4,000 were fired due to breaking the oath or not meeting criteria for law enforcement officer. Nevertheless, the average number of law enforcement officers in Ukraine remains one of the highest in the world — 376 per 100,000 people. This ratio supersedes respective indices in some European countries by up to four times.

In late March 2014, the government suggested a cut in MOI employee numbers (from 324,400 to 245,000 people, or a decrease of 24%), but a launch of ATO modified the declarations. Many people were fired automatically as they remained on temporarily occupied territory and actively cooperated with separatists.

The government tried to win some time in police reform, having organized a pilot project in Lviv lasting from July 1 to October 31, 2014. The project foresaw the audit of the Chief Regional Administration of MOI and the re-attestation of 7,000 officers. Patrol units and the State Motor Vehicle Inspectorate were to be united into traffic police, and security services were to be transmitted to security agencies.

MOI organized a pilot project in Lviv in order to win some time before elections

While summing up the project results, even government officials recognized their insufficiency. A major problem about the pilot project was that the experiment was held under current laws on police and did not foresee any institutional changes.

So far, the EU assistance has not brought forth any specific results either. On July 22, 2014, the EU Council established an Advisory Mission for Civilian Security Sector Reform Ukraine (EUAM Ukraine), which started its work on December 1, 2014.

The only actual output for the period was a concept of MOI reform, elaborated in cooperation with a public expert council headed by Yevhen Zakharov and presented by Arsen Avakov a month before the parliamentary elections. Later on, this document was used in the preparation of the coalition agreement.

A concept of MOI reform includes changes in the Ministry structure, but it does not ensure a new quality of employees

According to the concept, the structure of MOI will include police, the National Guard, the State Migration Service, the State Border Service and the State Emergency Service. The Directorate for Combating Organized Crimes will be transferred to the Security Service of Ukraine, and the Department for Combating Economic Crimes will be moved to the State Fiscal Service. Veterinary police, transport police and police for juvenile affairs will be eliminated. Although MOI demilitarization is declared to be one of the reform principles, the National Guard and the Border Service, which currently supervise border troops, remain powerful paramilitary units within the Ministry.

A possible solution is a separation of political and administrative positions at the Ministry-level. The Minister will carry out political functions, while the heads of departments are professional employees in their respective fields. Currently, when the Minister is changed, all the vertical of command down to district units undergoes changes. This trend significantly affects the efficiency of the system and its professionalism.

The State Motor Vehicle Inspectorate and the patrol service will merge into traffic police, which will no longer deal with the issue of driving licenses and vehicle registration. These bodies have previ-

ously been some of the most corrupted spheres of activity. In order to reduce the level of corruption, it is also suggested that the government promotes technical means of traffic control and introduces electronic record keeping.

The establishment of municipal police and its dual subordination to the Ministry of Interior and local authorities is a counterproductive initiative. It is instead suggested that municipal police will deal exclusively with public order.

According to the concept authors, MOI reform may last up to eight years. Zorian Shkiriak claimed that police reform in Ukraine will not be as radical as in Georgia, where 90% of employees were sacked at once.

Taking into account the current low trust in law enforcement bodies, what Ukraine needs is a radical MOI reform based on a drastic decrease in police numbers, an increased involvement of em-

ployees of a better quality, which will become the core of a reformed ministry, the prevention of political influence on the ministry, its demilitarization and a stronger control over its activities. This new control may be ensured either through setting an independent body with broad authorities, which will deal with corruption and office abuse, or through public accountability of police both at national and local levels (some experts even suggest local police heads be elected by the community).

Ukraine needs a radical MOI reform, not facelift changes

The deliberate evasion of radical steps in MOI reform will result in citizens losing faith in \ politicians' seriousness about police reform. Police will continue ensuring the rule of power, but not the rule of law, while a lack of punishment for crimes will foster a sense of impunity among police officers.

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## MOI reform in Georgia

*MOI reform in Georgia started with the liquidation of the State Motor Vehicle Inspectorate, where instead of 16,000 officers, 3,000 were hired. Recruitment was held by a commission, which consisted of famous journalists and civil activists. As a result, society trusted the selection results. The necessary requirements for the new employees were good physical shape, higher education and an under-35 age limit.*

*A major shortcoming of such an approach was that the choice was often based on subjective perception. Though many candidates resigned after a while, in several selection rounds the commission managed to find several thousand reliable employees. As patrol officers need to know two to three laws in their work, two to three weeks were enough to train them. General Inspection tested new employees by offering them bribes. Later on, verified traffic police officers were transferred to other MOI structures, which allowed the reset of the whole system.*

*Radical changes in the State Motor Vehicle Inspectorate became a symbol that the Georgian government wanted to hold real rather than superficial reforms. MOI changes decreased crime rates, and citizens' trust in police became so high that it might be compared to their trust in the church.*

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## Deregulation reform

Deregulation reform is one of the most necessary in Ukraine. Its implementation will directly influence the creation of basic conditions for business development, investment attraction and sustainable economic growth. Taking into account its importance, this reform is regularly mentioned in various programs, agreements, documents and addresses of officials and candidates before elections.

Deregulation reform was also among basic IMF requirements to provide financial assistance to

There has been no real progress in deregulation for ten months

Ukraine. However, there has been no considerable progress in the area so far.

In August 2014, the presidential administration, together with the Ministry of Economic Development and Trade, presented the concept of deregulation. This concept became a foundation for other program documents of the government. Civic activists, business representatives and experts participated in the elaboration of the concept. One of its features is a use of an online platform to discuss the reform, make suggestions and track its implementation. Regardless of its

scale, the reform does not provide for the creation of a new regulatory system based on market economy principles. The concept provides for the cancellation of permits, the decreasing of inspection frequency, and the liquidation of entire state regulatory bodies. In its draft version, the proposal contained over 800 initiatives on deregulation. The authors declared its aim as facilitating business, decreasing costs for entrepreneurs and improving Ukraine's position in the Doing Business rankings. While elaborating the deregulation strategy, the expert group interviewed around 100 organizations and analyzed over 1,000 regulatory restrictions.

The authors claimed that the overall economic effect of the strategy's implementation would make up around UAH 170 bln. by 2020. The expected economic effect as per industry will be around UAH 85 bln., the decrease in dirty cash flows will be around UAH 60 bln. and the decrease in budget expenses will be UAH 16 bln. In particular, it will include:

The strategy authors assured that its economic effect will make up around UAH 170 bln. by 2020

- 1) deregulation in the food industry aimed to adapt industrial processes to EU standards (economic effect around UAH 30 bln., dirty cash flows will decrease approximately by UAH 7 bln.);
- 2) deregulation in the agricultural sector aimed to fight against corruption and stimulate exports (economic effect around UAH 10 bln., decrease in corruption component around UAH 7 bln.);
- 3) deregulation in the construction industry aimed to improve Ukraine's position in the Doing Business rankings and eliminate corruption (economic effect around UAH 16 bln., decrease in corruption component UAH 21 bln.);
- 4) in the oil and gas industry the focus will be on building up the domestic extraction of oil and gas and decreasing dependence on Russian supplies (expected economic effect and decrease in corruption component is UAH 11 bln. each).

A major criticism of the presented concept is that an ultimate goal of the reform should not be a drastic decrease in the number of various permits, but rather a complete abolishment of the Soviet permit system and the creation of a new regulatory system based on the principles of the market economy.

The concept does not offer a new regulatory system typical for market economies

It also should be mentioned that in early September 2014, the government presented an action plan called, "Recovery of Ukraine", which contained provisions on deregulation. The deregulation measures included a decrease in the number of controlling bodies, the cancellation of regulatory acts that go against freedom of entrepreneurship and the review of state control functions. All these steps were intended to be completed before the end of 2014, but no specific actions have been made thus far.

Deregulation reform may be successful only if the following steps are taken:

- 1) instead of accepting the existing Soviet system of economy regulation, it is necessary to introduce a regulation system with a new structure and principles;
- 2) the number of controlling bodies and their employees should decrease through a revision of their functions;
- 3) a wider introduction of e-governance systems will help decrease the corruption level.

Unless deregulation reform is held, there will be an extreme bureaucratization of state institutions and office abuse by controlling bodies. Furthermore, Ukraine will maintain its low position in world rankings, leading to a further deterioration in the investment climate and a continued economic crisis.

Lack of the reform will lead to a further bureaucratization and a deterioration of investment climate

# Tax reform

Tax reform has become one of the main indicators of the capacity of state authorities to implement economic reforms altogether. Over the past months, the Ukrainian government and the President have repeatedly stated that tax reform was a top priority, outlined in the Government's action plan, "100 Days-100 Steps" program, Economic Growth Package program, Action Plan "Recovery of Ukraine", the coalition agreement and now in the action program of the new government. However, real measures to change tax legislation have yet to be taken.

Tax reform was mentioned in many action plans, but it never started

The main change in tax legislation was a reduction in the number of taxes, from 22 to 9. However, political statements on the reduction of the number of taxes are rather exaggerated. Most of them are intended to be included in the existing taxes and levies. Thus, these innovations did not help reduce the tax burden, as they did not provide for the revision of the tax basis.

Almost all action programs stipulated that there was a need to reduce the number of civil servants within the State Fiscal Service alongside the simultaneous need to revise and enhance the functioning of the State Fiscal Service. However, it was only the name that was changed (formerly the Ministry of Revenues and Duties), and the number of unfilled vacancies was reduced.

One of the major problems with the proposed changes is a lack of a systemic approach to the revision of tax administration. In particular, the main focus has been on VAT, income tax and individual income tax. The introduction of changes in tax legislation under the Association Agreement with the EU has not been envisaged. It should be stressed that harmonization of Ukrainian tax legislation with EU law should take place to ensure that the government's actions are clear for business.

One of the biggest problems is a lack of a systemic approach to tax administration

The adoption of the law on the introduction of a VAT management electronic system was the most controversial issue (VAT-invoices), which was heavily criticized by businesses and civil society. This law, which was to come into force in 2015,

would worsen financial conditions of VAT taxpayers. The coalition agreement stipulated that this law should be revoked. However, no effective mechanism for VAT reform, which is considered to be the most corruption-related tax, has been proposed. Most action programs also lacked such proposals. Therefore, the problem with the VAT refund has not been solved and continues to have a negative impact on Ukraine's investment climate.

Some action programs define budget decentralization as a priority sector for reform. In spite of the announced financial independence, it was suggested that taxes and revenues, which were the source of the largest budget revenue, were to be taken away or redistributed from local budgets. In addition, it was suggested that some important functions in the socio-cultural sphere were to be delegated to local authorities, which would include primarily measures in the educational and medical spheres, public support for sports societies and Olympic training bases and state financing of some public institutions. Such changes may bring economic depression to regions instead of giving them financial independence.

Budget decentralization cannot be a separate reform. It should be carried out alongside other reforms and result in a better quality of public services. Sectoral reforms such as tax and administrative reform, which will allow for administrative decentralization, should be given priority.

Budget decentralization should be done along with other reforms

Over the last months, state authorities have failed to go beyond a tax reform concept. Except for public statements on the necessity to relax the tax burden and simplify tax management, businesses did not see the expected changes, and the year of 2014 instead brought a worsening of the investment and business climate. The main reason was a lack of concerted efforts of tax authorities and other relevant bodies alongside a lack of understanding of the tax reform technology and methodology.

First and foremost measures to be taken to ensure the successful implementation of tax reform should include:

- 1) Improving the electronic tax filing system to allow for the reduction of physical contact

between taxpayers and tax officers, increased transparency of tax control and the revision of functions of tax authorities;

- 2) Lowering the tax burden and reducing the number of mandatory payments through a revision of the tax base, which will reduce cases of tax obligations minimization;
- 3) Resolving the problem of the VAT refund exposure to support exports and increase trust of business in state authorities;
- 4) Strengthening the punishment for the use of shady tax schemes and deliberate minimization

of tax obligations.

Non-implementation of tax reform may result in a growing economic decline, increased indebtedness and worsening social and economic indicators. For this reason, the year of 2015 should not only see ambitious political declarations, but also a real implementation of much-needed tax reform.

Non-implementation of tax reform will lead to a further economic decline and increased state debts

## Energy reform

Today, one of the major political risks for Ukraine is a lack of reforms in the energy sector. A combination of reforms and government policy aimed at supporting domestic energy production will enhance Ukraine's national security, ensure the diversification of energy sources and facilitate sustainable development in Ukraine.

A key goal of energy reform is to accomplish three tasks:

### Three tasks of energy sector reform in Ukraine

- 1) To raise the country's energy efficiency by economic methods (the abolition of state subsidies to enterprises and households);
- 2) To diversify energy sources and fully support domestic energy production;
- 3) To liberalize the energy market and create a favourable investment climate through the comprehensive reforming of "Naftogaz of Ukraine" PJSC.

The aforementioned directions of energy sector reform have become the basis for the Ukrainian President's reform concept, «Strategy — 2020», and were subsequently laid out in the coalition agreement.

**Energy efficiency.** On November 26, 2014, the Cabinet of Ministers approved the action plan on implementation of the EU directives regarding energy efficiency, which provided for the abolition of state subsidies for energy-intensive enterprises, the conducting of an energy audit within Ukraine and the introduction of energy management as well as the elaboration of the methodology for assessing energy efficiency of buildings and setting out tech-

nical requirements for the energy-saving capacity of newly-built buildings (energy passports for every building). The resolution of the Cabinet of Ministers No. 676 as of November 26, 2014 extended the functions of the State Agency for Energy Saving and Energy Efficiency (SAESEE) through its proposal to provide public support, develop partnerships between the state and private businesses, take steps to popularize energy saving measures and support relevant information campaigns. The abolition of state subsidies for the largest energy-intensive enterprises is the right political decision and will not demand additional budget expenditure. According to the government's action plan, a full-scale energy audit in Ukraine, the establishment of an institute for energy management and the introduction of technical requirements for energy saving will need some preliminary research. The appropriateness of such measures is doubtful, as the outcome is predetermined. Moreover, it will take highly skilled personnel to conduct such studies, whereas there is a lack of professional energy managers in Ukraine.

**Diversification of primary energy sources.** There have been numerous positive changes in regards to the diversification of primary energy sources: gas imports from Norway; reverse gas flows from the EU; an extended contract on the supply of fuel for thermal power plants and services for specific stages of nuclear fuel cycle signed with the American company Westinghouse; and the introduction of special requirements, according to which an annual amount of energy imports (gas, coal, oil, electricity) cannot exceed 30% from each energy source. However, given a difficult en-

ergy situation caused by armed conflict in the east of Ukraine and Russia's aggressive foreign policy, the Ukrainian government should fully support domestic energy production. Instead, the resolution of the Cabinet of Ministers No. 596 as of November 7, 2014 required certain industrial, energy generating and thermal generating enterprises to purchase natural gas only from "Naftogaz of Ukraine" PJSC from December 1, 2014 until February 28, 2015 (at first there was a total of 90 enterprises but the additional resolution of the Cabinet of Ministers extended the list up to 300 enterprises). In fact, this resolution destroys competition in the energy market and worsens Ukraine's investment climate. Such government policy is against European integration and contradicts Ukraine's commitments in regard to the implementation of the Third Energy Package.

**Liberalization of the energy market and the reformation of "Naftogaz of Ukraine" PJSC.** No measures have been taken concerning the liberalization of the energy market and the reformation of "Naftogaz of Ukraine" PJSC. A combination of government initiatives aimed at ensuring the transparency of the energy market, putting the tax burden on the oil industry in line with world practices as well as improving the legislation and regulation mechanism to attract private investment in compliance with the coalition agreement is set to be implemented during the fourth quarter of 2014 and first quarter of 2015. Under this document, the reorganization of "Naftogaz of Ukraine" PJSC is set for the fourth quarter of 2015.

Today, an important strategic priority in the energy sector should be the promotion of regulatory reforms and the full implementation of the provisions of the Third Energy Package, such as non-discriminatory access for third parties — first

and foremost among them Western companies — and the liberalization of the energy market. A new Ukrainian government should adopt new laws, which would facilitate civilized competition and foreign investment in the energy market as well as ensure reduced dependence on Russian energy sources. A complete reform of "Naftogaz of Ukraine" PJSC through its division into independent subsidiaries should be high on the government's agenda. An important condition is a reform of the energy pricing system on the legal basis by balancing social priorities against economic expediency. An increase in energy prices for households should be well-grounded and correspond to the current economic conditions. Otherwise, it may lead to large-scale social frustration and subsequent political instability. After all, the liberalization of gas prices, fair access to the domestic energy market for foreign companies, a simplified licensing procedure, the "freezing" of tax rules for energy producers for 5 to 10 years and the removal of other obstacles to foreign investment will facilitate domestic energy production. As a result, Ukraine will reduce its dependence on Russian gas.

Without the implementation of the aforementioned reforms, the Ukrainian energy sector will remain a seedbed for large-scale corruption, while Russia will continue to exert pressure on Ukraine by gas blackmail, trying to limit Ukrainian strategic possibilities and thwart the development of Ukraine in general and the Ukrainian economy in particular.

The Third Energy Package liberalizes Ukrainian energy market

Without reforms Ukrainian energy sector will remain a seedbed for large-scale corruption

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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