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Content

The Government Policy	1
“Smuggled” elections in the occupied territories	1
The electoral reform is a priority task for a new coalition	3
Economic Situation	4
The NBU returns to a floating exchange rate	4
State debt continues to increase	5
Triple energy dependence of Ukraine	6
Political competition	8
Delay in coalition creation	8
“Volya” hits “Samopomich”	9
Three parliamentary parties may occupy the opposition niche	10

The Government Policy

Election in “separatist republics” is an attempt to legitimize the militants’ leaders and transform that part of the country into a quasi-state formation. Moscow’s support for the elections indicates that the Kremlin has passed no-return point in its policy towards Ukraine and even a threat of tougher Western sanctions in the times of severe economic crisis cannot influence decisions taken by Russian elite. Russia gradually takes full control over the diverse militants’ groups and builds up the puppet power vertical in DNR and LNR. Complete militants’ disregard of the Poroshenko’s peace plan compels the Ukrainian President to

withdraw his initiatives on special order for local self-governance in Donbas and to determine tougher conditions of economic coexistence with the “separatist region”.

Meanwhile, over the past two weeks, the vote counting process cannot be finished at some polling stations. Since there were persistent problems in majoritarian districts, this testifies the need for introduction of a proportional representation system with open lists. The parties, which are discussing their participation in the coalition, have already identified this task as a priority in the agenda of the parliamentary majority.

“Smuggled” elections in the occupied territories



Illegal elections were held on November 2, 2014 in the so-called DNR and LNR (Donetsk People’s Republic and Luhansk People’s Republic). The elections organized by Russia have not been recognized by any international subject other than

the Russian Federation. Under supervision of gunmen people voted for heads and representatives of the “legislative” bodies called councils. Oleksandr Zakharchenko was elected as the head of DNR, Ihor Plotnytskyi — in LNR.

Elections in these self-proclaimed republics failed to meet democratic standards: there were armed people at the stations, which were giving instructions to older people on how to vote, and journalists were permitted only to some polling stations. But the most significant violation was a specific way of raising the turnout at these “elections”. Before the election day, people were informed that they would be able to get a social card at the poll stations where they were registered. Such a card will help to get free medical care, travel and products discount etc. Large amount of food was brought to the polling stations and sold at a price, which is significantly below the market rate. This led to queues at polling stations providing a favorable picture for Russian media.

Elections in separatists' republics failed to meet democratic standards

Another manipulation at the elections was caused by a small number of polling stations. There were 364 polling stations in DNR, 95 — in LNR and plus three stations in refugee camps in Russia. During the elections to the Verkhovna Rada in 2012, there were more than 600 stations in the city of Donetsk only, with other 700 polling stations in the rest of Donetsk region currently controlled by militants.

A small number of stations and distribution of products are a manipulation to justify a falsified turnout rate: 70% in DNR and 61% in LNR. The proof of fake turnout is that it was a typical rate for Donbas in peacetime, but due to the hostilities, at least 10-15% of the population left the territory. Thus, there are not so many people in these regions in order to provide such a turnout.

High turnout rate testifies manipulations

Elections in DNR and LNR have become an important stage for Russia in taking control over these territories. At the same time, since the territories of the self-proclaimed DNR and LNR are large, so far Russia has not controlled grassroots processes. Many leaders of militaristic groups followed their own policy in various cities: Ihor Bezler — in Horlivka, Oleksiy Mozgovyi — in Alchevsk, Pavlo Driomov — in Stakhanov.

In order to start negotiations on Donbas issue, Russia should control the region completely. Over the last month, Russia has increased the level of organization and control over the occupied part of

Donbas. For instance, on October 21, 2014, militants' leaders of Luhansk region Oleksiy Mozgovyi and Mykola Kozitsyn and the “governor” of LNR Ihor Plotnytskyi held a meeting in order to join efforts and coordinate actions.

Russia intensifies the control over diverse groups of militants

Those leaders who do not accept Russian “general line of the party” have been overthrown. For instance, a militants' leader Ihor Bezler had to flee Horlivka and Russian military units “cleaned up” the representatives of his group. Ihor Bezler was not under full control of Russia and even held negotiations with the Ukrainian authorities.

Along with the establishment of control and holding illegal elections, the Russian Federation hopes to further influence the internal politics in Ukraine. Despite the fact that Russia recognized these elections, its representatives continue to call this territory as Luhansk and Donetsk regions indicating that DNR and LNR are not recognized as state formations and there is an intention to further promote the idea of Ukraine's federalization.

Russia adheres to the idea of Ukraine's federalization

“Separatist elections” made the position of the President's administration on Donbas issue tougher. Petro Poroshenko stated that since the Minsk agreements were violated by militants, laws on Donbas adopted this September should be abolished. On November 4, 2014, after a meeting of the National Security and Defense Council, the President made a statement on possible economic and social consequences after the so-called elections in Donbas. The next day the Prime Minister Yatsenyuk made an official statement that Ukraine would not subsidize uncontrolled territories.

If Ukrainian control over the territories is not established, the Ukrainian authorities will be isolating LNR and DNR economically. It will lead to a significant deterioration of the socio-economic level in the region. After all, the Donbas economy is heavily integrated into Ukrainian one and is not self-sufficient in terms of food supplies. Food shortages in territories controlled by militants have already led to mass protests against separatists, particularly in Makiyivka.

Ukrainian government will be isolating LNR and DNR economically

The electoral reform is a priority task for a new coalition

Parliamentary elections 2014 demonstrated all the disadvantages of a mixed electoral system. Over the last week, the CEC cannot finish counting 0.1% of votes as the activities of some district commissions are artificially blocked. Usually, the delay in the DEC operation is associated with determining the majoritarian candidates' results, and not results of the parties.

Activities of some DEC are artificially blocked

The fact is that during the economic crisis, majoritarian component allows businessmen or former officials to get into the Parliament just using the system of direct or indirect bribery of voters without the need to contribute to party coffers. In addition, pro-government candidates may use administrative resources for the purposes of their election campaign. Imperfection of the electoral legislation led to misrepresentation of voting results. For instance, 1400 votes in a district of Donetsk region were enough for Yuhym Zvyahilskyi to obtain a mandate.

Majoritarian constituencies as a ground for electoral fraud

Majoritarian MPs in the Parliament also negatively influence the effectiveness of the Verkhovna Rada as they are often not associated with parties and do not adhere to

Majoritarian MPs affect the effectiveness of the Parliament

discipline even if joining the majority. In addition, they often change their political camps, being more bound to the district, and not to a political project.

All these disadvantages have become the main factors why the civil society and even the parties advocated the introduction of a proportional system with open lists. This system minimizes opportunities for election fraud, develops the party system and makes the Parliament more representative.

However, political expediency came to the fore again, and the corresponding changes were not adopted in July-August 2014. If the system has not been changed before the elections, it should be done immediately after them. Otherwise, amendments to the electoral legislation will become a bargaining chip in political negotiations only before the next elections.

That is why representatives of "Bloc of Petro Poroshenko" and "Samopomich" insist on the introduction of the proportional system with open lists as the first task of a new coalition. Such a decision is aimed at proving the people that the coalition is really focused on changes in the country.

Electoral reform should become one of the first decisions of a new coalition

Thus, despite the fact that electoral reform does not relate to the economic challenges to be faced by Ukraine, the new electoral code remains one of the priority tasks for the new coalition.

Economic Situation

After three weeks of a fixed exchange rate, the NBU decided to return to a floating rate through unilateral auctions. The proposed measures are unlikely to meet currency demand, but they will help reduce pent-up demand.

Ukrainian Ministry of Finance reported the increase in state and state guaranteed debt up to USD 74 bln. The main reasons for that are the increase in foreign borrowing and recapitalization of PJSC “Naftogaz of Ukraine”. According to the IMF fore-

cast, the volume of the direct guaranteed debt in 2014 will reach 67.6% of GDP, while in 2015 it will increase to 73.4%.

Ukrainian energy situation is characterized by triple energy dependence on Russian energy supplies: that is gas, coal and fuel for nuclear power plants. In order to ensure Ukrainian energy independence, Ukrainian government should diversify energy supplies as regards all three energy sources.

The NBU returns to a floating exchange rate



The NBU Head Valeria Hontariva announced that the NBU decided to declare off a fixed rate of hryvnya. The NBU is planning to hold unilateral auctions on a daily basis, starting from November 5, 2014. Later the regulator is ready to enter the inter-bank with bilateral quotes, whereas the auctions for reinforcement of cash desks will not be held anymore. It is expected that a total of daily auctions will be USD 5-10 mln. According to the auction rules, a bid from one bank cannot exceed one tenth of the total volume of received bids.

The NBU will declare off a fixed exchange rate of hryvnya

The proposed auctions are not aimed at meeting all FX demand but rather at reducing pent up demand. At the same time, the FX proceeds in exporters' accounts will increase. According to Valeria Hontariva, for the last two months the National Bank has sold USD 1.3 bln. under a fixed FX rate, which was temporarily introduced three weeks ago. However, FX interventions did not help to cope with excessive demand. Banks still refuse to sell FX through cash offices, while black currency market has not shrunk. There is high likelihood that hryvnya will keep depreciate, which will be a result of reintroduction of a

floating exchange rate. The interim exchange rate is the one established in the black market, that is around 14 UAH/USD.

Also, Valeria Hontariva announced the NBU plans for additional capitalization of banks. In particular, it is expected that the final program on additional capitalization of 15 largest banks will be approved next week. In case this program is not executed by banks' shareholders, two variants of the regulator's actions are possible. For systemic banks, it will mean nationalization, while for small financial institutions payments to indi-

Interim exchange rate of hryvnya for the near future is 14 UAH/USD

viduals will be made through the Retail Deposit Guarantee Fund.

State banks will receive additional capital. The corresponding sums have been already reserved. In addition, programs on cooperation with the IMF and World Bank provide for the possibility of Ukraine receiving necessary funds to support systemic banks. Also, additional mechanisms have been created to increase the Deposit Guarantee Fund. Programs on additional bank capitalization envisage a six-month period for funds contribution.

State banks will be provided with additional capitalization

State debt continues to increase

Under the Budget Code, the total volume of state debt and guaranteed state debt cannot exceed 60% of the annual nominal GDP at the end of the budget period. In case the volume of state debt and guaranteed state debt exceeds the annual nominal GDP, the government is obliged to take measures to bring such volume down to an annual rate. The government waves aside this rule under current difficult economic conditions, whereas foreign debt increases every month. However, loans from international organizations, namely the IMF, help support the economy, which is one of the reasons behind the inaction of state bodies in regard to state debt.

According to the Ministry of Finance's report on the state budget expenditure for the period of January-September 2014, state and guaranteed by state debt amounted to UAH 962 bln., or USD 74 bln., including state and guaranteed by state foreign debt worth UAH 540 bln. (56.18% of the total sum); state and guaranteed by state internal debt worth UAH 422 bln. (43.82%).

The NBU Head Valeria Hontariva noted that the fall in Ukraine's GDP during January-September 2014 amounted to 3.5%. This means that the ratio of state debt to GDP, which already exceeded 60%, increased in September even more.

State and guaranteed by state debt amounted to USD 74 bln. in January-September 2014

The ratio of guaranteed by state debt to GDP continues to exceed 60%

The main reasons for the increase in debt for the last months are the increase in foreign borrowings, namely the IMF loan worth USD 1.4 bln., the World Bank loan worth USD 0.5 bln., Canadian exports agency loan worth CAD 200 mln. (USD 177.39 mln.), as well as "Naftogaz of Ukraine" recapitalization.

The increase in foreign debt creates negative economic effects, with the biggest problem being the administration of foreign loans. In the future this will lead to increased tax burden as the government will need to increase budget revenues to serve state debt and reduce state expenses, particularly to ensure social and economic development. The year of 2014 saw the problems with fulfilment of the state budget: budget deficit in January-October 2014, coupled with two budget sequestrations, reached UAH 27.1 bln. (the budget was fulfilled by 92.5%).

Budget deficit in January-October amounted to UAH 27.1 bln

Another problem is increased financial dependence on international financial organizations and donor countries. Over the next years this problem will aggravate. The IMF forecasts the increase in Ukraine's foreign debt to 102.2% of GDP and such tendency will remain in 2015 (106.4% of GDP). Direct guaranteed debt in 2014 will reach 67.6% of GDP, whereas in 2015 this figure will be 73.4% (the highest figure). It is expected that there will be the reduction of debt load to 71.1% of GDP in

The biggest debt load will be in 2015 — 73.4 % of GDP

2016, to 66.6% of GDP in 2017, to 59.3% of GDP in 2018 and to 51.5% of GDP in 2019.

Also, the international rating agency Moody's forecasts the increase in Ukrainian public debt to GDP to 70% by the end of this year, after revising its previous forecast that put the public debt at 66%. It is expected that Ukrainian economy will deteriorate by 7-8% in 2014, and in 2015 — by other 2%. Moody's biggest concern is the fact that when the

figure reaches 60%, Russia has the right to demand an early repayment of the loan, which was made to Azarov's government.

The problem with increasing debt may be solved by revising the budget expenditure, export and services promotion, which would increase money inflows into Ukraine and attract funds for the implementation of reforms and investment development of the country.

Triple energy dependence of Ukraine

In view of the need for stable natural gas supplies in 2014/2015 heating period as well as prevention of economic losses and risks of technological accidents, signing of interim gas agreements with Russia became a pressing issue for Ukraine. Moreover, this task was complicated by the necessity to hold negotiations, come to terms and pay to the aggressor.

Signing of interim gas agreements with Russia became a pressing issue for Ukraine

The problem here is the triple energy dependence of Ukraine on Russia. In Ukrainian 2013 energy balance, natural gas amounted to 34.8%, coal industry output totalled 34.6%, and nuclear power — 19.2%. Ukraine is heavily dependent on Russian supplies as regards all the three elements of the energy balance. As for nuclear power, 95% of energy supplies for Ukrainian nuclear power stations is delivered by Russian energy company «TVEL». As for gas, around 60% of natural gas was imported from Russia every year. As for coal industry, hostilities in Ukraine's East and occupation of Ukrainian territory resulted in the fact that more than 75% of coal deposits have been lost, which made Ukrainian government purchase coal from the Republic of South Africa and reorient the production of thermal energy towards alternative sources and electricity.

Interim Russian-Ukrainian gas agreements, signed on October 31, 2014, somewhat lessened a sharp energy deficit in Ukraine. According to additional agreements, the total amount of Ukrainian debt for November-January 2013 and the first quarter of 2014 is calculated at USD 268.5 per 1,000 cubic meters and amounts to USD 3.1 bln. The repayment of the debt is made in two stages: Ukraine has to pay the first payment worth USD 1.45 bln. in the near future, whereas

a second tranche worth USD 1.65 bln. should be paid by the end of this year. After the payment of the first tranche and a respective upfront payment worth USD 1.52 bln., Ukraine will begin to pump Russian gas in underground gas storage facilities.

However, every signatory interprets the “debt issue” in its own way. In particular, Russian officials maintain that this is just one part of the debt payment, with a second part to be paid after the relevant Stockholm Court's decision. At the same time, Ukrainian government thinks that “debt debates” with Russia have come to an end.

After signing of the interim gas “winter package”, Russian Minister of energy Aleksandr Novak stated that the signed document is not legally binding but is rather a political declaration of intentions and agreements within tripartite consultations. Taking into account that Russia views interim gas agreements as a political agreement, it can be expected that the Kremlin may unilaterally refuse to comply with the previous agreements. For this reason, Ukrainian government should take necessary preventive measures and increase gas reserves in the short term by purchasing the agreed 4 bln. cubic meters in the next months. It should not be excluded that Moscow may suspend gas transit via Ukraine in winter time by referring to technical reasons and accusing Kyiv of siphoning off Russian gas, or inventing any other reason. In case of the impaired gas transit to Europe, the problem might emerge with the reverse of European gas to Ukraine, which will significantly disrupt Ukrainian gas balance during autumn-winter time.

Russia views gas agreements as an interim political agreement without any legal obligations

The signed agreement with the Republic of South Africa on delivery of 1 mln. tons of coal by the end of the year does not fully satisfy Ukrainian coal needs. Today, Ukraine purchases the coal from the Republic of South Africa at USD 91 per ton, while anthracite Russian coal costs USD 80 per ton. Russian coal is much more attractive as regards prices, but Ukrainian government should critically evaluate Russia as an energy supplier. It is possible that the Kremlin may provoke another gas conflict and eventually refuse to supply coal. The said risks should be taken into consideration and coal sup-

Ukraine needs to diversify its suppliers

pliers should be diversified. For example, coal can be purchased from Poland.

About half of electricity in Ukraine is produced by nuclear power stations, but they all use Russian nuclear fuel. In this regard, the agreement signed with American company Westinghouse can be seen as a success. The use of American fuel TBC-W at Ukrainian nuclear power stations will be prolonged to 2020. The respective change was made in the agreement between “Energoatom” and Westinghouse on April 11, 2014, which was set to expire in 2015. It is planned that in January 2015, there will be the first delivery of Westinghouse fuel, TBC-WR, for the third energy block of South Ukrainian nuclear power station.

Political competition

Coalition formation has demonstrated that infighting between the President and Prime Minister, inherent in Ukrainian politics since the Orange Revolution, is still actual. Almost the same proportional results of “People’s Front” and “Bloc of Petro Poroshenko” add up to the ambition kindling. However, the only choice for both parties would be to foster understanding and quickly launch the work of majority. Otherwise, lack of reforms under the economic crisis and external Russian aggression, as well as society and international community condemnation of inaction may put an end to the political ambitions of both political projects.

“Samopomich”, with a team of civic activists and members of ATO in the parliament, encountered first destructive processes. Yuriy Derevianko

gained control over “Volia”, which was on the same list with “Samopomich”. Now he intends to create his own parliamentary group and vote not in accordance with the faction policy, but according to decisions of “Volia” congress, which is practically under his control.

Ensuring legal rights of opposition and adoption of the law “On the parliamentary opposition” is going to pose one of the first challenges for the coalition. According to this document, the opposition assumes considerable powers. To prevent the usurpation of key positions by “Opposition bloc”, “Batkivshchyna” and the Radical party may join the opposition and support majority in the fundamental reform issues, while expressing constructive criticism against the government.

Delay in coalition creation



Petro Poroshenko planned to form a coalition within ten days after the election, but “People’s Front” high voting results made adjustments to his plans. In addition, both leading parties share different views on the coalition agreement contents, and the final announcement of the election results is delayed.

Although “Bloc of Petro Poroshenko” will be the largest faction in the parliament with more than

150 MPs, it will seem exceedingly difficult for them to form a coalition without “People’s Front”. What is more, both society and international partners expect the parties to find common ground and build a government team aimed at reforms. “Honorary moon” of this team will be brief due to the grow-

Society and international partners expect both parties to find common ground

ing public discontent with no foundation provided for a fundamental change in the state during the first nine months after Maidan.

The weakness of “Bloc of Petro Poroshenko” lies in many self-nominated candidates as its members (over 30). Factions with a considerable number of self-nominated candidates are not strong. “People’s Front” is in a more advantageous position due to its rather monolithic structure.

“Samopomich” is most likely to become the third party in coalition. It does not comprise any former MPs and will adhere to the coalition agreement only if party quotas are refused and a strict schedule of the coalition future actions is arranged. “People’s Front” and “Bloc of Petro Poroshenko” negotiate with the Radical Party and “Batkivshchyna” in order to strengthen their position in a future coalition.

The first stumbling block in the coalition forma-

tion was the format of the coalition agreement. Arseniy Yatseniuk offered his 2.5 page document instead of the President’s 48 page version. In his turn, Petro Poroshenko noted that the more detailed document is, the more efficient and stable coalition work will be.

The first stumbling block was the format of the coalition agreement

The parties accuse each other of excessive ambitions. Nevertheless, all this is done in the struggle for the influence over ministerial posts. Prime minister is already defined. It will be Arseniy Yatseniuk. The government composition still remains open to question. The impact on power vertical was of considerable controversy. “People’s Front” has their candidate for the head of Ministry of Internal Affairs, while Petro Poroshenko strives to control all power vertical.

“Volia” hits “Samopomich”

“Samopomich”, which is considered to be a new political force focused on reforms, faced first destructive processes in the party ranks. Moreover, this happened even before the official announcement of the election results and under extremely arduous negotiations on the future coalition with “Samopomich” being one of key participants. Some members of “Volia” from the list of “Samopomich” announced the formation of their own parliamentary group.

“Volia” announced the formation of their own parliamentary group

On November 2, 2014, “Volia” held the National Assembly and recognized the cooperation with “Samopomich” as unsatisfactory. They emphasized the violation of agreements and disagreements about joint candidates for majoritarian districts. It was agreed that those party members who got into the Verkhovna Rada through “Samopomich” lists would be included into the faction. At the same time, they would create an interfactional informal association or deputy group “Volia” headed by Yuriy Derevianko, who initiated the Assembly and passed in a majoritarian constituency. The party will go to the local elections separately from its former ally.

The congress led to a great resonance in the society because there are great hopes laid on “Samopomich” as regards the political process renewal. This

party tries to make other coalition members play by new rules, moving away from the quota principles in the public office allocation. When “Volia”, as part of “Samopomich”, gradually refuses from cooperation right after the election, naturally it raised questions to the electorate. In fact, de jure it will leave “Volia” representatives in “Samopomich”, and de facto, it will make them completely independent. Already there were statements from Serhiy Taran, who supported Yuriy Derevianko, that these MPs will vote not according to the faction decisions, but according to their assembly resolutions.

“Samopomich” makes the coalition play by new rules

The fact that the congress was held without Yegor Sobolev, one of “Volia” founders, is more than surprising. Immediately after this meeting, he blamed Yuriy Derevianko for an attempt to get a hold on the party. In this case, the latter has all the possibilities to succeed since he fully controls the legal aspects and is able to influence most of the party members.

Such actions of “Volia” might be a deliberate campaign against “Samopomich”. Yegor Sobolev denies any accusations of “Samopomich” dishonesty and notes that Yuriy Derevianko’s goal is not to control “Volia”, but discredit the party ally.

A deliberate campaign against “Samopomich”

The example of “Volia” points out weaknesses of blocs once again. The parties may keep talking about common views but they still remain separate entities within blocs and may have destructive in-

fluence on the political projects positions. The fact that these processes started right after the election made “Volia” example even more illustrative.

Three parliamentary parties may occupy the opposition niche

As the result of parliamentary elections, several political parties may fight for the opposition status. These are the Radical Party of Oleh Liashko, “Batkivshchyna” and “Opposition bloc”. The deputy group of “Svoboda” could be among them as well. Each of these political subjects will do their best to get the largest possible number of positions and controlled government committees.

Several political parties may fight for the opposition status

If to analyse a map of potential opposition, it is obvious that two oppositions may function simultaneously in the parliament.

The first one is situational one, which may include members of the Radical Party and “Batkivshchyna”. These entities could support the coalition in terms of implementing reforms and other legislative initiatives, but criticize most of them on some vital issues.

The second opposition comprises former members of Party of the Regions and business community representatives who unified under the brand “Opposition bloc”. This political force represents the voters from southern and eastern Ukraine and builds its activities by criticizing the incumbent government. The party hopes to wait until the government gets a significant amount of criticism and the public dissatisfaction with the lack of reforms increases. The same position Party of the Regions adopted in 2005, which allowed it to return to Ukrainian politics for a long time and win the presidential election in 2010.

The fact that the legal status of the parliamentary opposition remains unresolved is crucial. On March 19, 2014, the Verkhovna Rada registered a draft law “On the parliamentary opposition”, which provided the parliamentary minority with sufficient leverage over the ruling majority. Under this bill, the parliamentary opposition has the right to nominate the members of the Accounting Chamber, a member of the Higher Council of Justice and four members of the NBU Council. Also, the minority is provided with the position of First Vice-Speaker in the parliament and heads of important parliamentary committees: procedural, budgetary, agricultural, legal policy, social policy, legislative support, law enforcement and health care.

The bill submitted by “regionals” and supported by “Batkivshchyna” passed only the first reading. It is forgotten by everybody now, and the President’s version of coalition agreement offers less for the opposition: position of Deputy Speaker and several heads of parliamentary committees only.

A plausible scenario is that the law “On the parliamentary opposition”, which was voted for in April 2014, will be adopted as a whole, but the portfolios that under this bill go to opposition, will be distributed among three parties: “Batkivshchyna”, the Radical Party, and “Opposition bloc”. It will prevent “Opposition bloc” from abusing the topic of its opposition status and will make the parliament work more efficiently.

Opposition portfolios may be distributed among three parties

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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