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INSIDE UKRAINE

1. State decisions	3
1.2. Anti-crisis package focuses on finances rather than economy	4
1.3. Counteracting Russian expansion in Crimea	5
2. Economic situation.....	6
2.1. Anti-crisis package is a key to the IMF financing.....	6
2.2. Amendments to the 2014 budget	6
2.3. Government tax initiatives	6
2.4. Assessment of the approved initiatives	7
3. Political competition	8
3.1. Synergy of Petro Poroshenko and Vitali Klitschko	8
3.2. Regional fate of the Party of Regions	9
3.3. Difficulties the Maidan representatives face	10
3.4. Change in Tymoshenko's rhetoric.....	10



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. State decisions

The government wastes precious time necessary for reforms implementation. The closed inefficient institutions remain the same in all spheres of life. Only managers have been replaced. It seems that the annexation of Crimea and the threat of Russia's intervention in the southeast are used as a cover hiding unwillingness of political leadership to radically change the system. At the same time, sweeping reforms are the only remedy that could save the country from further economic deterioration, political destabilization and the loss of subjectness in international relations. Only quick radical reforms may help resolve internal economic and political problems.

1.1. *The law enforcement system needs radical changes*

In the governmental Program considerable attention was paid to the law enforcement reform and punishment of all those involved in crimes during the protests in November 2013 – February 2014. The Ministry of the Interior and the Prosecutor General's Office, totally discredited during Viktor Yanukovich's presidency, will not be able to enforce the rule of law unless they clean their own ranks and a deep reform of both law enforcement agencies is carried out.

On April 3, heads of major law enforcement agencies reported on the first results of the investigation regarding killings of people on 18-20 February. Though several officers were arrested in this case, most organizers are out of the reach for Ukrainian police. Meanwhile, many security forces officers suspected of illegal actions during protests continue to work in their respective departments.

There is also uncertainty about the investigation regarding the violent dispersal of students on November 30. This incident has become a beginning of the EuroMaidan as a revolutionary phenomenon. Civil society demands to punish the guilty, not only the direct perpetrators, but also the officials who gave the criminal orders. If the Ministry and the General Procurator's Office are unable to conduct an impartial investigation with specific results, the following question will arise: whether the new political leadership aims to restore justice or it intends just to lead discredited law enforcement agencies and use them for their own political purposes.

Both the Ministry of the Interior and the General Procurator's Office needs radical reforms and almost complete staff renewal, as the whole structure – from regional departments to the central office – is penetrated with cases of corruption and human rights violations. Ihor Indylo's death in Shevchenko District Police Station in 2010 or the rape of Iryna Krashkova by local police officers in Vradiyivka in 2013 were some of the most egregious cases of officialdom's arbitrariness. In fact, permissiveness of security forces and use of these special security units to protect authorities, but not the law were one of the reasons for the transformation of mass protests in a full-scale revolution.

Some surface measures or replacement of key officials are not enough to achieve changes in the law enforcement agencies. The society does not care about the name of the Interior Minister. It needs the police it is not afraid of, the police which does not use problems of people for its own enrichment, the police which fulfills basic state functions and guarantees safety of the citizens. Military aggression is not an excuse for the lack of reforms. On the contrary, the current situation is ideal for radical justice reform as it was done in Georgia.

Mutual cover-up does not allow the sick system to reform itself. Therefore, we must change the approaches to functioning of the police and prosecutors, who must turn from the political tool into the guarantor of the rule of law in the country. Law enforcement agencies should be created almost from the scratch as in Georgia, and not to limit this process to a 10 percent reduction in the number of employees. The Georgian experience shows that the justice reform does not require large

Without profound reforms prosecutors and police will not be able to ensure rule of law

Society demands justice

Permissiveness of the police was one of the reasons for the Maidan

financial resources and long-term implementation, while bringing tangible results in the short term, returning public trust in government.

Instead of radical police reforms, the Minister of the Interior Arsen Avakov is fighting against his political opponents. The confrontation with the Right Sector, which has already become a personal one, causes discontent among activists. They believe that the Minister now has other priorities: the punishment of corrupt officials of the previous government and the people responsible for the civilian casualties during mass protests.

Although the Minister uses every opportunity to emphasize his openness to the public, his reaction to the journalists' criticism on the use of cortège questions his loyalty to democratic principles. If the official continues allowing such incidents in every-day life, it will cast doubts on his ability to reform a huge post-Soviet ministry with hundreds of thousands of employees. The justice reform will be the first sign that the whole government is willing and able to implement changes.

1.2. Anti-crisis package focuses on finances rather than economy

Government does not introduce transparent economic mechanisms, which would decrease pressure of the state on the business and improve investment climate in the country. Instead, it makes some general steps to put state finances in order and fulfill the technical requirements of IMF. These actions will not create a basis for long-term growth of the Ukrainian economy, which may be rooted only in internal resources, but not external financial aid.

On 27 March, Verkhovna Rada voted for anti-crisis package of laws which includes amendments to the state budget and measures aimed to reduce its deficit. The latter include external financial aid, increase of excise rates and cut of the budget expenses. Anti-crisis package fulfills two tasks from the government Program: it improves the state finances and facilitates cooperation with the IMF.

The budget expenses are cut through decrease of financial assistance for the child's birth, increase of rates for energy resources and reduction of employees in state agencies and law enforcement system. Increase in the prices for energy resources for population was one of the IMF requirements, as the difference in prices between individual and corporate clients create a fertile ground for corruption.

Increase of excises for tobacco and alcohol, introduction of VAT for grain export, privatization of state property, and tax on FX purchase are supposed to increase the budget income.

Thus, additional tax pressure in the form of excises and FX purchase tax will be spread between fellow citizens and transparent businesses, but not oligarchs and "shadow" economy. At the same time, excise increase will not lead to the growth of the budget income, but to counterfeit and smuggling. In order to be efficient, such steps should be implemented after the consultations with the interested parties. Any excise increase should be gradual and rational.

Government explains that the anti-crisis package includes only immediate measures needed to receive external financing and prevent the default. Elaboration of reform policies and respective legislation requires much more time. At the same time, the officials do not offer calendar plan, map of reforms or list of executives responsible for each action. Meanwhile, precious time is wasted when radical economic reforms may have been implemented in the wake of revolutionary events.

The government efficiency is also influenced by the lack of strict distribution of functions between the officials. For instance, in early March Arseniy Yatsenyuk conducted negotiations with the Western partners while it could have been done by the Minister of External Affairs, Andriy Deshchytsya. Having appointed an unexperienced Minister with even weaker deputy ministers during the military aggression, PM significantly undermined diplomatic instruments to solve the crisis. As it was the case with the Minister of Defence, appointments are based on personal convenience, but not professionalism and efficiency.

Presenting the local self-government reform, again it is the Prime Minister,

The sick system cannot reform itself

Arsen Avakov's ability to democratize the Interior Ministry is questioned

Fulfillment of the IMF requirements will not grant long-term economic growth

Excise increase will not bring pro rata budget income growth

but not the Minister of Regional Development that comes to the fore-front. The Minister of the Finances Oleksandr Shlapak was supposed to play a key role in the presentation of the anti-crisis package, but it was Arseniy Yatsenyuk that held negotiations with parliamentary factions. It means that the PM fulfills the functions, not typical for his position, while he needs to focus on managing the government as a whole.

In general, government initiatives offer only temporary measures to counteract the problems, but they do not start systemic reforming of the most problematic spheres of state policy. Thus, they treat the symptoms, but not the causes of the disease.

1.3. Counteracting Russian expansion in Crimea

Having failed to provide an adequate response to the Russian intervention in Crimea, political leadership of the country continues ignoring problems of the peninsula. It seems that the government came to terms with the annexation and its inaction legitimizes the status quo in Crimea.

Since the very beginning, government stated that the major plan against Russians was to avoid provocations and not to use weapon. In this case, they were supposed to use diplomatic and legal instruments as much as possible. It would have strengthened the negotiation position of Ukrainian officials. However, legal instruments were not used efficiently. Decision of the dismissal of Crimean parliament was taken just one day before so called referendum. Adoption of the law on occupied territories is also postponed. If it had been adopted in early March, it would have given a clear signal that deputies, police officers and civil servants who switched to the Russian side are collaborators and criminals, while all their decisions are against the law.

Even though consideration of the law is quite late, the bill by Sergiy Sobolyev, Batkivshchyna's MP, is taken as a basis. At the same time, the text prepared by UDAR MPs deals with the legal status of occupied territories in a more thorough manner. It explains the mechanism of the military pull-out, ensures electoral rights of Crimea people and supports socio-economic and cultural ties with Ukrainians who remain on the occupied territories.

Meanwhile, Russia intensively integrates the occupied territory, introducing its currency and distributing Russian passports. Under these circumstances Ukrainian government should do as much as it can to maintain the ties between Ukrainians in Crimea and mainland Ukraine. Economic blockade and freeze of any contacts, suggested by some politicians, will only distance Crimea from Ukraine. On the contrary, active informational and cultural cooperation will undermine the influence of the Russian propaganda, as well as it will slow down expansion of the Russian Federation on the peninsula.

The law should guarantee the conditions and transition period for the economic agents to relocate their production facilities. It will allow Ukraine and private investors to minimize economic losses related to Crimea annexation.

Government must create a legal framework for the activities related to the peninsula. The law on temporarily occupied territories should clearly explain the behavior models for the businesses, NGOs and state institutions dealing with Crimea. In case it is not done, the void of state policy on the Ukrainian side will be filled by the Kremlin.

PM fulfills the functions, not typical for his position

Government's inaction legitimizes the status quo in Crimea

Adoptions of the Law on occupied territories is delayed

Ukraine should strengthen ties with the Ukrainian citizens on occupied territories

2. Economic situation

The budget cut and tax increase will help to receive international financial aid, but they will not create conditions for economic growth. The latter may be assured only through systemic economic reforms.

2.1. *Anti-crisis package is a key to the IMF financing*

On 27 March, Verkhovna Rada adopted two inter-related laws – on the amendments of the state budget and on the measures to prevent default and create conditions for economic development.

Their adoption has two reasons. First of all, the indicators of the 2014 budget were unreal and it required fine-tuning. Secondly, Ukraine needs to fulfill the IMF requirements in order to receive external financial aid.

The package confirmed the government intentions to meet strict IMF criteria. Nearly 90% of the budget indicators were agreed with the IMF, which may give launch to a new cooperation program for the amount of USD 14-18 bln. It may also provide access to the aid of international institutions for the total amount of USD 27 bln. At the same time, most initiatives are not systemic, they are aimed at solving current budget problems and do not foresee profound economic reforms.

Most initiatives are not systemic and will not grant economic reforms

2.2. *Amendments to the 2014 budget*

The Ministry of Finances reviewed basic macroeconomic forecasts in the budget. While in earlier version the growth was programmed, the amendments foresee Ukraine's GDP decrease by 3% while the inflation will be as high as 12-14%. The budget expenses drop by UAH 25.5 bln. (by 5,8%) while the income will fall by UAH 22.45 bln. (or by 5.7%). The budget deficit will decrease by UAH 3.0 bln. (down to UAH 68.5 bln.).

The Law also envisages increase of the state debt limit by UAH 78.6 bln. – up to UAH 664 bln., and two-fold decrease of state guarantees – down to UAH 25 bln.

Besides, the Law freezes key social indicators: subsistence expenses at the level of UAH 1176 and minimum wage at the level of UAH 1218.

2.3. *Government tax initiatives*

Anti-crisis law is aimed to cut the budget through introduction of new taxes, revision of current tax rates and decrease of social benefits. According to the authors' estimates, it will provide additional UAH 44 bln. of the budget income.

The tax on passive income will be calculated using progressive scale – from 15 to 30% depending on the income. The tax rate used to be 15-17% and it includes dividends, interests, royalty and investment income.

The Law also introduces a new tax on FX purchase in the amount of 0.5%. Both individuals and legal entities will pay tax regardless of the FX form.

VAT of 7% is imposed on medicines, while in the past Ukrainians did not pay this tax. VAT fixed rate is 20%, while the income tax rate is at the level of 18%.

Alcohol and tobacco excises increased by 25%, and the beer excise – by 42.5%. There is also introduced a fixed excise on diesel fuel. Payment for imported cars, natural resources and radio frequencies will also increase.

Government freezes subsistence expenses and minimum wage

A new tax on FX purchase

The anti-crisis law will cut some expenses in the social sphere. Layoffs of police officers and prosecutors will save additional UAH 1.35 per year. Retirements benefits and flat payments to former civil servants will also be reduced. The volume of financial assistance at the child's birth has also changed and it makes up UAH 41.3 thsd.

2.4. Assessment of the approved initiatives

The adopted laws play a significant role in the short term as they open access to international financial assistance, and thus return the budget 2014 to reality. However, these are all positive assessments.

It is difficult to call the proposed budget changes as reformational. They are rather intended to smoothen 'fiscal fire' and mainly aimed at reducing costs, not mentioning the qualitative growth of state revenues. Tax innovations have clear fiscal nature, but stimulating and social tax functions are actually ignored. Until there is a real basis for strong economic development, a situation of "patching budget need" can occur regularly - every year.

Transformation of the budget to more or less realistic indicators should be accompanied by the start of comprehensive reform. Budget sequestration and the tax burden increase without fighting corruption, obviously, will not give the desired effect, as part of planned revenues will be absorbed by corruptive component.

Delay in economic reforms is leading to a narrowing window. Civil society wants changes and will definitely understand the negative, but necessary social measures. Some forces will not be able to implement their corrupt interests exploiting imperfect institutional structure of the national economy after the shock caused by the Maidan. And they will begin a large-scale reforms sabotage.

The government needs to urgently address the following objectives: to increase efficiency and transparency in public spending, eliminate opportunities for tax evasion and reduce the informal fiscal pressure on the economy. Delays in addressing these issues leads to the fact that obtaining international financial aid without solving the urgent problems will have a significant negative effect in the future - the growth of national debt. At the same time, a comprehensive and systematic development strategy with concrete implementation steps was not offered.

Important observations regarding tax initiatives of the government - the main tax burden is on small and medium businesses, as well as ordinary citizens. Reduction of social payments and general taxes increase will negatively influence the aggregate demand. This will also negatively influence the pace of economic recovery.

Cuts in government agencies funding will have cosmetic effect. Better results could be obtained if systemic administrative reform is applied. Also, reducing the costs for the Defense Ministry and the State Border Service is called into question.

Government cut expenses in the social sphere

Tax innovations have clear fiscal nature

Budget transformations should be accompanied by comprehensive reforms

3. Political competition

Ukrainian political parties decided on their presidential candidates and strategy for the next two months. Major struggle will take place between Yulia Tymoshenko and Petro Poroshenko who was supported by Vitali Klitschko. Rivalry for the potential third place between Serhiy Tigipko and Mykhailo Dobkin, the representative of the Party of Regions, will show what political team is more successful in gaining the Russian-speaking electorate in the South and the East. Polls also demonstrate the Ukrainians' fatigue from "political veterans"; therefore, there exists a large potential for the new political payers to get electoral support.

3.1. Synergy of Petro Poroshenko and Vitali Klitschko

According to the poll conducted by Sotsis, KMIS, Rating and Razumkov Center companies, Petro Poroshenko and Vitali Klitschko were the front-runners of the presidential race as of the last week. They had 24.9% and 8.9% respectively. At this stage, when the candidates have not yet started full-scale election campaign, the survey displays the general trends, but they should not be perceived as an ultimate truth.

The poll results will change

The gap between Petro Poroshenko and the closest competitors is enormous. At the same time it should be noted that a total of the first five names in the rating – Petro Poroshenko, Vitali Klitschko, Yulia Tymoshenko, Serhiy Tigipko and Mykhailo Dobkin – makes up only 53,5%. It means that both major competitors and newcomers in the Ukrainian politics have a massive potential to increase their electoral support. It is highly likely during the campaign, that the figures will change for many times and they will depend on the efficiency of the campaign, and vision of reforms offered for the country.

Even before Petro Poroshenko's starting position was very strong, but after the UDAR convention of 29 March it became even stronger. At the convention, Vitali Klitschko supported Poroshenko's candidacy for the presidential elections and announced that he would run for Kyiv Mayor.

It is the first time in the modern Ukrainian politics, when the second strongest candidate, who had the highest chances to become the next Ukrainian President two months ago, did not try himself in the first round and supported his major competitor. There used to be a common belief that Vitali Klitschko thinks only about the presidential elections and all his actions should be viewed in the light of presidential campaign only. Ability to sacrifice his own ambitions is positively perceived by the voters and it may help to strengthen UDAR's positions as an influential parliamentary faction after the elections to Verkhovna Rada, planned for the autumn.

Klitschko's behavior is surprising

UDAR's electoral support will depend on the efficiency of Vitali Klitschko in case he is elected as Kyiv mayor. Administration of the metropolitan city will give an opportunity to try his team on specific managerial positions. At the same time, there will be less space for direct management of the party. Thus, UDAR, which is still perceived as a leader-type party, will have to re-orient to a more thorough elaboration of the political platform and a more profound ideological work. It is likely that Vitali Kovalchuk, who has an extensive experience of the party administration, will supervise this process and play the key role in the work of the UDAR parliamentary faction.

UDAR will work more on their team and ideology

The Poroshenko-Klitschko coalition provides a synergetic effect for the both political players. Petro Poroshenko has a considerable personal rating and financial resources, while his "Solidarity" party is rather a virtual project, which cannot be used as a driving force in the election campaign. On the other hand, UDAR has an extensive network of regional party organizations and experience of the campaign work, but their opportunities to attract external financing are limited as they are not well represented in the government. Besides, Petro Poroshenko is an influential figure in Kyiv due to his close relations with Volodymyr Bondarenko, a

current Head of Kyiv City Administration, and most Kyiv MPs. Employment of such a powerful resource practically grants the position of Kyiv Mayor to Vitali Klitschko.

Klitschko's support positively influences Poroshenko's chances on the presidential elections, while Poroshenko's aid, including financial one, will allow UDAR to get prepared for the parliamentary ones.

If the cooperation appears to be fruitful, Klitschko's non-participation in the presidential elections may turn into a long-term investment aimed at the party development and gradual build-up of his personal political capital.

3.2. Regional fate of the Party of Regions

After several weeks of uncertainty, the Party of Regions finally made decisions on its future. On 29 March, the party convention defined its collective management body and supported the candidacy of Mykhailo Dobkin for the presidential elections. Besides, Viktor Yanukovych, Sergiy Arbuzov, Mykola Azarov and Oleksandr Klymenko were excluded from the party.

MPs from the Party of Regions wanted to use the idea of the intra-party primaries to underline democratic transformation of the party, which used to be perceived as an authoritarian one. Instead, the manner in which the convention was held showed that the party had not undergone any democratic changes. 3-4 influence groups which earlier existed in the Party of Regions are substituted with one – Rinat Akhmetov.

Out of 402 convention delegates, 120 represented Donetsk, 90 – Kharkiv, Dnipropetrovsk and Lugansk had 60 delegates each. The board of political council is also dominated by representatives of four regions, which are basic for the Party of Regions. This factor shows that at this point of time, the party will not restore their all-Ukrainian influence, but will try to strengthen their positions in industrial regions of the South and the East. Even Odessa, Mykolaiv, Kherson and Zaporizhia regions are ignored in the current leadership of the party, though these regions always provided a considerable percentage of support to the Party of Regions.

In its turn, concentration on four industrial Russian-speaking regions will enable the party to conduct more focused campaign without having second thoughts how their appeals will be interpreted in Ukrainian-speaking West and Center.

The Party of Regions will try to distance itself from the previous leaders and shift responsibility for disastrous political decisions to Viktor Yanukovych and its team. Central Control Commission headed by Yevgen Geller will carry out intra-party lustration campaign targeted against representatives of the Family group and deputies who do not agree with the current policy of the party. Thus, influence of Andriy Klyuyev and Dmytro Firtash groups will be further diluted.

In order to ensure total control over the party, Rinat Akhmetov decided to support Mykhailo Dobkin, but not Sergiy Tigipko as a candidate for the presidential elections. Currently, personal rating of Mykhailo Dobkin is evaluated at the level of 4% and it is focused in Khrakiv region only. Sergiy Tigipko is believed to be extremely independent. He might have tried to take control over the party. Besides, he is directly associated with Dmytro Firtash. Dobkin's candidacy allows the party to participate in the presidential elections though everyone understands that the Party of Regions has meager chances to win. Besides, this candidacy gives time to mobilize the party's electorate before the parliamentary elections at which the top of the party list will be taken by other names.

As for the ideological platform, the Party of Regions will continue using slogans of federalization and Russian as the second official language in the country, even though they play in the hands of the Kremlin. Thus, the Party of Regions did not make any conclusions on the Russian intervention in Crimea.

Poroshenko and Klitschko have what to offer to each other

The Party of Regions fails to become democratic

The party focuses on four regions

Rinat Akhmetov receives controlling stake in the party leadership

3.3. Difficulties the Maidan representatives face

Drop in the support of major political parties in Ukraine opens a window of opportunities for new political players who have positive reputation and were not involved in corruption schemes or office abuse.

Olga Bogomolets, who submitted her documents as a presidential candidate, is one of those individuals. Being a civil activist who organized medical service of the Maidan, she attracts volunteers for her campaign and managed to fund-raise UAH 2.5 mln. for the registration in a short run.

She is a rare example in the Ukrainian politics when the income statement corresponds to the actual income of the politician. Other candidates prefer to indicate lower income than it really is. Moreover, they use transparency of Olga Bogomolets in financial matters as a ground for her criticism.

The fact that she was not allowed to make a speech on the Maidan on 30 March shows that she is treated as a serious competitor.

Except for difficulties generated by her rivals, Bogomolets's major challenge would be to create a team and develop the political program in the short run. Public invitation to participate in its development, posted on the candidate's website, is a positive signal to the civil society.

Dmytro Yarosh, a leader of the Right Sector party, also submitted his documents to the Central Election Committee. Though the party nominated him at the convention, he decided to participate in the elections as an independent. This step is probably associated with the desire to distance oneself from the negative image of the Right Sector, actively supported by media.

Still, at the initial stage of its creation, the party does not pay sufficient attention to the behavior of its members and gives reasons for informational waves against it. Use of Yanukovich's cars for personal purposes, shooting in Kyiv downtown on 31 March and attempt to storm the Parliament on 27 March negatively influence perceptions of the Right Sector as the party eager to bring in a new quality in Ukrainian politics. Military pressure on Verkhovna Rada was heavily criticized by the European community, namely by Catherine Ashton, High Representative of the Union for Foreign Affairs and Security Policy. Except for international impact, such episodes cast doubts on the ability of the Right Sector to control the actions of their radical supporters.

The major challenge for Dmytro Yarosh is to find a smooth transition from revolutionary rhetoric to political work in peaceful times. For these purposes he needs a strict structure of the party and control over its regional units, the political platform which would offer a voter clear solutions to the issues of internal and external politics, and a strong team to implement this vision.

The civil activist may bring in a new quality in the Ukrainian politics

Dmytro Yarosh distances from the negative image of the Right Sector

3.4. Change in Tymoshenko's rhetoric

Yulia Tymoshenko is a major rival to Petro Poroshenko. Though the polls show a considerable difference between the both, for many times Tymoshenko managed to mobilize her electorate and receive the level of support which was higher than the sociologists predicted.

Tymoshenko's problem is that for a long time she was excluded from the Ukrainian politics and does not fully understand the society "mood" after the Maidan. Her approach to communication with the voters did not change while the Ukrainian society has gone through a radical transformation in their political conscience. Besides, she has a considerable anti-rating and the society still remembers her failures while dealing with the financial crisis of 2008-2009.

Another challenge for Tymoshenko is that she does not have a bright antipode to build her electoral campaign on. Viktor Yanukovich always served this purpose in her campaigns. Now she is fighting against a formal ally who participated in the Maidan and is positively perceived in the West and Center –

Tymoshenko's communication with voters did not change, while the society has gone through a radical transformation of conscience

regions which are basic for “Batkivshchyna”. Thus, Yulia Tymoshenko needs to look for new ways to increase her rating and a softer approach to criticism against the opponent.

The foundation has already been laid. In her speeches, Tymoshenko more and more often refers to the struggle against oligarchs, which were not typical for her earlier campaigns. It is likely that she will criticize Poroshenko as an embodiment of all Ukrainian oligarchs.

Though “Batkivshchyna” currently forms the government both at national and regional levels, Tymoshenko will be unable to use administrative resource to boost her support. Such attempts will provoke scandals in the society which just went through a democratic revolution with many casualties.

In general, the presidential elections will be unconventional for Ukraine. The struggle will take place not between Russian-speaking politicians of the East and Ukrainian-speaking politicians of the West, but between two representatives of the democratic camp who share the electoral base. A new type of the presidential elections may bring a new quality into the electoral campaign itself.

The presidential elections will be unconventional for Ukraine