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## INSIDE UKRAINE

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

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

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## 1. The Government Policy

Though the anti-terrorist operation in the East already lasts for several weeks, the Ukrainian Government has not managed to take control over cities and towns taken by separatists. As a result, a pseudo-referendum was held there on May 11. Despite the fact that it has no legal effects, the announced outcomes of the pseudo-referendum will be used to exert pressure on Kyiv. The next goal of separatists is to disrupt presidential elections scheduled for May 25. In order to prevent it, the Government should combine harsh and concerted efforts against separatists with determined informational campaign targeted at the local population.

### *1.1. Pseudo-referendum is meant to increase stakes in the game*

On May 11, Donetsk separatists attempted to hold a referendum to define whether local population supports the idea of creating the so-called Donetsk People's Republic and Luhansk People's Republic. Since supporters of those self-proclaimed entities are in control of only few cities and towns in respective regions, they failed to repeat the Crimean scenario.

Even if to perceive the events of May 11 as a mere public opinion poll, the very way of its organization raises many questions. The voter lists were filled out by hand, while the voting itself was often done on the streets. According to the reports, many people voted several times. The fact that Ukrainian legislation does not provide for local referendums once again demonstrates that this referendum has no legal basis.

At first the separatists announced that the outcome of the referendum did not mean the separation from Ukraine but rather a declaration of their legal right to do so. However, the following day the leader of pro-Russian separatists in Donetsk, Denys Pushylin, appealed to Moscow to accept Donetsk People's Republic into the Russian Federation. The Kremlin stated that it respected the outcome of the referendum, but left the appeal unanswered.

The outcome of the referendum will be used as an additional argument in the hands of the Kremlin and regional oligarchs in order to raise stakes in the negotiations with Kyiv. It is very likely that this advantage will remain out of game until the presidential elections. On the other hand, the West has issued a warning that it will impose the next round of sanctions if Russia helps to disrupt the presidential elections in Ukraine.

For the time being, Moscow is interested in keeping Donbass as the territory of permanent turmoil and civil conflict. Formally keeping away from the conflict, it will let local criminals, Yanukovych's agents and pro-Russian local population do this job. On the one hand, the current situation weakens the position of Kyiv and undermines the legitimacy of the Ukrainian Government. On the other, the events, unfolding in Donbass, provide a clear example for the Crimean population of what might have become with the peninsula if Russia had not taken it under its control.

### *1.2. Absence of Government's information campaign*

The fact that separatists managed to organize voting in a number of towns and cities in Donbass as well as to create a picture of public support

***Donetsk separatists have not managed to repeat the Crimean scenario***

***The referendum will be used to the Kremlin's advantage***

for the referendum indicates the inability of the Ukrainian Government to take preventive steps.

The Government ignored the referendum, while it should have regained control over as many Donbass cities as possible by May 11. The effectiveness of the anti-terrorist operation could have been enhanced if tougher actions against terrorists had been coupled with information campaign targeted at the local population.

As a result of Russian propaganda, there is a negative public image of Ukrainian forces in Donbass where the local population perceives them as an aggressor. In order to counter Russian propaganda, the Government should develop the large-scale information campaign to prove that Ukrainian forces are defenders of the local population, and activities of the so-called insurgents are complete reign of terror.

The information campaign should convince the local population that it is elections rather than referendums that are the most effective democratic mechanism to influence the Government policy. Currently, only half of Donbass residents are willing to participate in the elections. At the same time the local population does not recognize the current Ukrainian Government.

Another mistake of the Ukrainian Government in the informational sphere is that it does not provide a clear picture of the situation in Donbass. It was civic activists that started to create an interactive map of road blocks and towns, which are currently controlled by separatists.

Almost every clash with separatists leads to losses by Ukrainian forces. There is no updated information on the casualties inflicted by the anti-terrorist operation. The last update on this information was made by Head of Anti-terrorist Centre, Vasyl Krutov, only on May 7. As of May 6, the losses of Ukrainian forces amounted to 14 killed and 66 wounded.

These facts prove that Ukrainian forces deal with well-trained and heavily armed hitmen. The Government focus on this message will reduce the negative impact of the Russian propaganda on local population.

### ***1.3. The need for Ukrainian-Ukrainian dialogue***

In order to stabilize the situation in Ukraine, a national dialogue with participants from all regions of Ukraine is needed. The Government may initiate it, but it is leaders of public opinion from different Ukrainian regions that should become major interlocutors.

The aim of the dialogue is to determine common values and common vision for the future of Ukraine. This will help establish the long-term state strategy which will define political agenda in the country no matter what parties come to power.

Preparation of such dialogue requires a lot of time and efforts. The selection of participants for the round table is of great importance as the potential participants must understand their regions as well as enjoy their public support. A thorough analytical work is also needed to map differences and commonalities in the vision of the past and future of Ukraine by different stakeholders at national level. Only then the round table discussion may start.

For the time being, the Government has chosen quite a different path. It seems that the officials just try to fulfill formal obligations to the Western partners, but not to reconcile the nation.

On May 15, the first round table talk was held with participation of

***The Government treated the issue of referendum with negligence***

***The Government does not present a clear pictures of the situation in Donbas***

***Regions, not the Government should participate in the national dialogue***

Oleksandr Turchynov, Arseniy Yatseniuk, Leonid Kuchma, Leonid Kravchuk, foreign diplomats, clergy and politicians. The preparation for this event was done hastily and in a closed regime. Participants in this debate, selection criteria and the agenda were not made public.

Arseni Yatseniuk announced that the Cabinet of Ministers would hold similar round tables in all Ukrainian regions. He also proposed that representatives of the US, the EU and Russia be invited to take part as well.

The current form of the round table lacks legitimacy. In addition, it does not make sense to hold the dialogue before the presidential elections as the political struggle between different political players will negatively impact its results.

Ukraine must not lose the historic chance to reconcile the regions that have been opposed to each other for years. The results of the dialogue should not fall a victim of the politicians who are just eager to get political dividends.

***Current form of  
the dialogue is not  
socially legitimate***

## 2. Economic Situation

Cooperation with the IMF allows strengthening Ukrainian financial system and ensuring solvency under external loans. Besides, this fact is a positive signal for other creditors of Ukraine. Nevertheless, economic growth may be ensured only through large-scale economic reforms.

### 2.1. The IMF restored cooperation with Ukraine

The IMF approved a new financing program for Ukraine. According to its terms, within two years Ukraine will receive USD 17.01 bln. in case it implements a number of reforms. The first tranche expected till the end of May will make up USD 3.2 bln. Out of this amount, USD 1.3 bln. may be used to cover the budget deficit, which is not typical for the IMF loans. The second and third tranches will be channeled based on the fulfillment of the program criteria. Their revision will be carried out once in two months.

The volume of the financial aid is unusually high and it will have a number of positive consequences. The loan will help strengthen the financial system, ensure solvency of Ukraine under external debt within the next two years and stabilize the national currency. Renewal of the cooperation with the IMF will be also positively perceived by other international financial organizations and large institutional investors.

In particular, Ukraine may count on the financial resources of the EU, World Bank, EBRD, European Investment Bank in the amount of USD 15 bln., which will be also channeled to real economy sector. Ukraine and the EU have already signed an agreement on macrofinancial aid in the amount of EUR 1 bln.

The IMF requirements are the following:

- Introduction of floating FX rate;
- Introduction of inflation targeting in order to maintain domestic prices under floating FX rate;
- Changes in the state budget in order to decrease structural fiscal deficit;
- Gradual increase of tariffs on gas and heat for the population and elaboration of mechanism to support vulnerable social groups;
- Transparency of “Naftogaz” activities and its restructuring. The ultimate goal is to decrease the company deficit down to 3% of GDP this year and 1.5% of GDP by 2015;
- Financial stability of the banking sector, in particular – audit of 35 largest banks in order to increase trust to banks;
- A number of structural reforms aimed to fight corruption and improve business climate.

The Government and the NBU started to fulfill some requirements before the financing program was launched. Their steps included introduction of floating FX rate, budget cut, bill on public procurement, freeze in minimal wage and retirement benefit indexation, gradual increase of energy prices for population.

Fulfillment of the requirements will provide a ground for economic growth in 2015 at the level of 2%, while, according to the IMF forecast, the GDP decline in 2014 will make up 5%.

At the same time the fact of the financial aid and fulfillment of

*The IMF approved a new financing program for Ukraine*

*Ukraine has to fulfill a number of requirements*

*The Government has already started to fulfill some of the requirements*

requirements in the budget sphere will not guarantee economic growth unless they are combined with large-scale economic reforms.

Yet there is a question how to implement the IMF requirements as regards structural reforms. Unlike the requirements in monetary, budget, FX and banking spheres, they are not well defined and it will impede evaluation of their implementation.

Fulfillment of the IMF requirements will also have some negative impact in the short run. For instance, tariff increase will result in decline of population solvency and deterioration of consumer demand. However, these measures, which will have negative impact in short term, are an important component to ensure economic growth in a long-term period.

***Requirement of structural economic reforms is not clear enough***

## ***2.2. Introduction of financial ombudsman position***

For the last years number of consumers of banking services has been increasing, the scope of banking products has become wider while population is not well educated in as regards financial matters.

Taking into account crisis in banking sector caused by political as well as economic reasons, the number of disputes between banks and their clients has increased. Despite a number of laws which protect the consumers' rights, in many cases they are not fulfilled due to general inefficiency of the judicial system. Therefore, there is a need to look for alternative ways to settle disputes in the banking sector.

***The number of disputes between banks and their clients has increased***

Some disputes between banks and clients may be settled without court litigation if the position of financial ombudsman is introduced. This idea was discussed by experts after financial crisis in 2008, but it was not implemented. At the same time the system under which financial ombudsman protects consumers' rights in the area of financial services functions in more than 40 countries.

The mechanism is rather transparent and simple. Financial ombudsman may be elected by self-governing bank association. Banks sign an agreement that they recognize decisions of the financial ombudsman. The latter is financed by banks' membership fees and small fee from individual plaintiff. There is possibility for in absentia hearings. The maximum amount of the complaint should be limited to UAH 20-50 thsd.

The financial ombudsman may consider the disputes only when the bank denies satisfying individual claims or the bank does not examine the claims during a definite period of time. The banks which would agree to sign the agreement with ombudsman are obliged to provide necessary documents in time and to implement the respective decision. If the client is not satisfied with the decision, he is entitled to address the court.

***The financial ombudsman considers the disputes when the bank denies satisfying individual claims***

Introduction of the financial ombudsman position would allow settling a number of law suits without courts. It will cover the cases with small amounts when litigation takes more money and time than its positive outcome will bring. All in all, it will also increase the trust to the banking system.

## ***2.3. Issues in the energy sector***

The EU support in relations with "Gazprom" is vital for Ukraine, especially taking into account Russian demand to pay for the gas supplies in advance starting with the next week.

"Gazprom" claims that USD 1.66 bln. is due to be paid by Ukraine



for the gas which is to be supplied in June. The reason for that is disagreement on the gas price and cancellation of the discount. The fact that Ukraine is getting ready to Stockholm court did not prevent Russia from such actions. Introduction of advance payments for the Russian gas by Ukraine also threatens gas supplies to Europe.

Ukraine insists that the gas price for “Naftogaz” should amount to USD 268.5 per 1000 cubic meters. It would guarantee storage of sufficient volumes of gas in the Ukrainian storage facilities and reliability of transit routes to the EU in winter 2014-2015. It should be noted that Russia is not interested in losing the supply volumes to the European market as well as Ukraine is not interested in losing the transit volumes of the Russian gas.

Thanks to the EU support, Ukraine may use part of financial aid in the amount of EUR 1 bln. to repay the gas debt towards Russia.

Ukraine’s dialogue with international financial organizations, which promise to promote modernization of Ukrainian gas transport system as a key part of European network, is a positive signal. It will facilitate introduction of the Third energy package and reconstruction of Ukraine’s gas transport system.

In particular, a deal signed by Ukraine and Slovakia on reverse flow of natural gas to Ukraine is one of the steps in eurointegration process. Also, Ukraine has recently joined AGSI+ European Gas Storage Inventory.

Another positive development is that the Ukraine-NATO commission discussed prospects of creating a consortium to manage Ukrainian gas transport system with participation of the EU and the US. Thus, Ukraine may count on investments and help of these countries in negotiations with Russia.

It shows that the EU is interested in integration of our system into the European one. It also proves that the European companies are interested in using Ukraine’s gas storage facilities.

***Ukraine may use part of the EU aid to repay the gas debt***

***Europe is interested in Ukrainian gas transport system***



### 3. Political Competition

The war of ratings between Petro Poroshenko and Yulia Tymoshenko is ongoing. The Ukrainian billionaire is confident of his victory, while the leader of the “Batkivshchyna” hopes to reverse the negative trend in the second round of elections. A major problem is that the East of Ukraine lost the Party of Regions as the representative of their interests. This niche can be taken partly by the communists that have transformed into the fifth column of the Kremlin in Ukraine. To stabilize the situation in the country, it is essential to provide transparent and democratic elections based on political pluralism and equal opportunities for all participants of the political process.

#### *3.1. Poroshenko is confident in his victory*

The approaching elections clearly illustrate what candidates are supported by mayor political players. Analyzing the sociological survey that forecast the victory of Petro Poroshenko, some representatives of the big business openly took his side.

Ihor Kolomoysky recently joined the group of Poroshenko’s supporters. This conclusion is made based on the active presentation of the candidate’s position on the Ukrainian TV-channel “1+1” that is controlled by the Dnipropetrovsk oligarch. In addition, the channel recently presented the results of a survey where Tymoshenko was ranked not second but third. The promulgation of such ratings two weeks before the election is actually a destruction game, especially given the fact that according to the mentioned survey the difference of Tymoshenko’s and Poroshenko’s support is more than thirty percent.

The Ukrainian billionaire feels very confident in the election race. By all his actions he shows confidence in his victory. Beside his pre-election tour in the South, he holds many meetings with foreign officials. Thus, it shows that his presidency is almost a fait accompli.

At the same time, he stands to his peacemaking rhetoric. One of his key messages is that he is not going to criticize the other candidates because the country currently needs the maximum consolidation of nation.

Besides, the candidate promises to dissolve the Parliament and schedule the early elections immediately after his victory. Other political forces represented in the current parliament try to avoid the issue in their public statements.

#### *3.2. Tymoshenko copies other candidates*

Yulia Tymoshenko's team believes that one should not trust the results of sociological polls. The electoral core of the candidate lives in the countryside which is underrepresented in the polls. Therefore, the level of support on the election day will be higher than the current sociological polls predict. It will give the opportunity to hold the elections in two rounds instead of one, as the leader of “Solidarity” aims.

The problem of the Tymoshenko's election campaign is its chaotic character. It seems that the politician is trying to repeat the successful steps of other candidates, rather than developing something new. Creation of the Resistance movement echoes with the mobilization appeals of Dmytro Yarosh. By focusing on the healthcare reform, Tymoshenko plays on the

***Ihor Kolomoysky supported Petro Poroshenko***

***Poroshenko does not criticize his opponents***

***Tymoshenko’s support is higher than the polls show***

field of Olha Bohomolets. After hearing the peacemaking rhetoric by Poroshenko, the “Batkivshchyna” leader also began to affirm that the unity of the Ukrainian nation is the main weapon against the Kremlin.

### ***3.3. The Party of Regions is in decline***

Sympathizing the separatists in Donbass, the Party of Regions has let the genie out of the bottle. After the so-called referendum the leaders of the Donetsk People’s Republic became another decision-making center that tries not only to resist the Kyiv authorities, but also to minimize the impact of the local regional elite.

The dismissal of mayors, representing the Party of Regions, and intimidation of prosecutors and judges in the cities controlled by the separatists, are the first signs of this process. The gradual loss of Rinat Akhmetov’s control of the region is confirmed by the declaration of the separatists that the billionaire bribed two-thirds of the militias and the requirement to Akhmetov's business empire from now on to pay all the taxes to so-called the Donetsk People’s Republic.

Despite this, the leaders of the Party of Regions recognize the referendum in the Donbas region and apply to Kyiv to stop the Anti-Terroristic Operation. The presidential candidate of the Party of Regions, Mykhailo Dobkin, clearly took a strong pro-Russian standpoint.

Thus, the activities of the Party of Regions in the Ukrainian Parliament marginalized. It seems that Rinat Akhmetov, the main sponsor of the Party of Regions, tries now to influence the situation via direct contact with the political actors, but not through the MPs he controls.

### ***3.4. The fate of the Communist Party to be determined only by the voters***

After the crisis intensification with the Russian Federation the Communist faction turned into the pro-Russian fifth column in the Ukrainian Parliament. They ignore parliamentary voting, yet do not leave the possibility to express on public their pro-Russian position that plays into Moscow hands.

This behavior results in an outright irritation within the coalition. On May 6, the entire Communist faction was by voting expelled from the closed session of the Parliament. On May 13, the acting President Oleksandr Turchynov interrupted the speech of the faction leader Petro Symonenko and accused him of supporting separatists. Various politicians have also repeatedly raised the idea of a complete ban of the Communist Party.

As the result, Petro Symonenko threatened to withdraw his candidacy from the elections. Although the deadline for the withdrawal has passed, his actual non-participation in the elections would lead to the fact that an additional part of the eastern electorate would not recognize the election outcome.

With the decline of the Party of Regions in the East, the influence of the Communist Party may increase, especially considering the pro-Russian sentiment and nostalgia for the Soviet Union. Their exclusion from the political process in the country can adversely affect the public legitimacy of the elections in the East. Banning the Communist Party or its oppression can even raise the rating of the Communists. The fate of this political party should be decided only by the voters, but not its political opponents.

***So called  
Donetsk  
People’s  
Republic  
opposes both  
Kyiv and the  
Party of Regions***

***Communists’  
behavior irritates  
the coalition  
MPs***

***Ban on the  
Communist  
Party will likely  
raise its support***