

# **Ukraine 2008**

Report on Transformation

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## FOREWORD

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It is my great pleasure to present the third edition of the report „Ukraine 2008. Report on Transformation” prepared by the Institute for Euro-Atlantic Cooperation specially for the Third Europe – Ukraine Forum (25 – 27 of February, Kiev, Ukraine). This time the main question to be answered during the Forum, how the year 2008 and EU-Ukraine negotiations under the new agreement could bring Europe next step closer to be united.

The EU-Ukraine relations are gaining momentum with the launch of negotiations on a new Association Agreement, set to replace previous Partnership and Cooperation Agreement. Mutual expectations vary, and there are a number of issues to be discussed before the talks are finalized. At the same time, Ukraine is suffering from acute economic crisis that may adversely affect mutual economic cooperation and political stability. In the face of common challenges, it is essential that Ukrainian reforms receive substantial and constant support from the EU countries. The case of Central European states has proved that the most important incentive is the prospect of European integration.

Since its establishment in 1992, the Institute for Eastern Studies has promoted cooperation and dialogue between Ukraine and the rest of the Europe. In this regards the Europe – Ukraine Forum is and will be among our key initiatives, providing the meeting place for prominent politicians, leading businessmen, experts and journalists to exchange opinions on the future of Ukraine – EU relations. To continue the talks of prime importance to the region we hold annually the Economic Forum in Krynica, Poland. Every year for the last 18 years Krynica has been attended by 2000 guests from over 60 countries, which makes the Economic Forum a major event in the region and a renowned platform for discussion on key issues for world economy, politics, international security and society.

We will be pleased to host you at the Economic Forum in Krynica this year. We strongly believe that with your assistance and commitment, we will address the challenges of fundamental importance, which will bring the change.

Sincerely,  
Yours sincerely,



Zygmunt Berdychowski

Chairman of the Economic Forum Program Council

Chapter 1.

**POLITICAL SITUATION IN UKRAINE –  
UKRAINE BEFORE THE PRESIDENTIAL ELECTIONS**

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**Development of a political system and institutions ensuring democracy and supremacy of law in Ukraine in 2008 has been marked with contradictory trends. On the one hand, Ukraine is a free country where freedom of political activities and a pluralistic competitive political system exist, and fundamental civil liberties are generally ensured, in particular, freedom of civic organizations, media, assemblies, religion, etc. On the other hand, there is an obvious shortage of mature democratic institutions, lack of supremacy of law, low effectiveness of state machinery, high corruption level, and problems with social unity and national identity.**

According to a Freedom House report entitled "Freedom in the world 2008" **Ukraine is the only CIS country referred to as a "free country"** according to a rating commensurable with most countries of Central Eastern and South Eastern Europe. At the same time, Georgia and Moldova are referred to as partly free countries and Russia, Azerbaijan and Belarus are considered countries lacking freedom.

The existing constitutional model in Ukraine has been proved to be basically plural and democratic, but consistently challenged with a number of institutional gaps, deficits and lack of efficient system of checks and balances. A constitutional amendment, implemented in 2006, stipulated that the Supreme Rada (Parliament) appoint a Cabinet of Ministers (government), including a prime minister. The constitution requires the formation of a majority coalition by party factions (not less than 226 out of 450 MPs) as a precondition for appointing a government. Unlike before 2006, the president has no power to appoint/dismiss the prime minister or ministers (only nominating candidates for foreign and defense ministers' positions).

There are at least three "cross points" where continuous tension exists due to gaps and different interpretations of Ukrainian constitutional law:

- Formation of a government, where different political entities (president, Supreme Rada, and political parties) compete;
- Appointment and control of heads of regional and district state administrations where the president and the prime minister and their offices compete;
- Appointment of judges of different capacities, including judges of the Constitutional Court and Supreme Court, where several authorities want to control different judiciary elements.

The president, however, remains a strong political figure exercising his power through his leadership in the National Security and Defense Council (NSDC) and

capacity to appoint regional executive chiefs (“governors”). Decisions of the NSDC are obligatory for all executive power bodies, including the Cabinet of Ministers. The president also has the power to suspend decisions of the Cabinet of Ministers submitting an appeal to Constitutional Court if he considers those decisions not in conformance with the Constitution. In practice, the president has consistently overused this opportunity for suspending any decision of the government with which he disagreed.

The current government is more open for public participation. A number of public councils have been established or re-activated under the Cabinet of Ministers and subordinate bodies. Some Cabinet of Ministers’ meetings have been broadcast on TV. At the same time, not all sensitive and important governmental decisions were adopted in a transparent way.

The de facto “dual executive” (with both president and prime minister at the top) model has led to evident institutional competition undermining state power capacity. Instead of sustainable policy and reforms, political actors have been preoccupied with fighting for power and pushing legislative reforms in their favor. For instance, the games around the law on the Cabinet of Ministers are an evident example of political manipulation of basic legislation. This law was changed three times within 2008. The first time, the ruling coalition, fulfilling a coalition agreement, adopted a draft providing extra power to the president to impact government via NSDC, etc. Later, in early September, BYT, one of government parties, made a deal with the opposition Party of Regions to change a law to limit the president’s power. Then, within a month, in trying to revive the collapsed coalition, BYT, together with the pro-president Our Ukraine voted for a return to the previous version of the law.

Contrary to these obvious manipulations of one of the basic institutional laws, **the government submitted no real reformist draft law to the parliament** (such as administrative reform draft, anti-corruption legislation, judiciary reform law, etc.).

Competition for power is evident both in domestic and foreign policy. Institutional gaps and lack of a good governance culture are even more complicated due to the strong personal conflict and distrust between President Victor Yushchenko and Prime Minister Yulia Tymoshenko.

Parliament plays an important role in Ukraine, making principal decisions and serving as a platform for wide political debates on the domestic and international agenda. Both power and opposition parties use the parliamentary tribunal to freely deliver their messages to society. Parliamentary sessions are being fully broadcast by the 1<sup>st</sup> channel of the National Radio Company and “Rada” parliamentary TV

Channel. Parliamentary debates in the 6<sup>th</sup> convocation disclose the evident lack of political consensus on some basic points of the political agenda. The slim majority in the new Parliament (227 MPs out of 450 were from BYT and Our Ukraine factions) was turbulent from the very start (December 2007), was then challenged in June 2008 by the withdrawal of two MPs (the 225 remaining MPs do not represent a majority anymore), and then finally collapsed in September due to the withdrawal of the whole Our Ukraine faction.

In response to events in Parliament, President Yushchenko issued a decree dated October 9 on the dissolution of Parliament. The decree states that the president is following Article 83, Part Six of the Constitution of Ukraine, which sets a requirement for the quantitative composition of a coalition of deputy factions in the Supreme Rada, considering that the SR coalition was not formed within one month according to Article 83 of the Constitution of Ukraine, and according to Article 77, Part 2 and Article 90, Part 2, Paragraph 1, Article 106 Part one, Paragraphs 7 and 8 of the Constitution of Ukraine, Yushchenko resolved the following: to terminate the authority of the Supreme Rada of the VI convocation and set early elections of the Supreme Rada of Ukraine to be conducted on December 7, 2008.

However, the majority of parliamentary forces did not agree with the termination and continued to look for an opportunity to create a renewed coalition. The government and Parliament refused to make changes to the state budget for 2008, which provided for expenses to conduct the elections. Without such a decision, there was no legal technical possibility to conduct the elections.

**Thus, for the first time, the president faced the issue of actual inability to use his constitutional right to dissolve Parliament in conditions where the majority of political forces did not support such a decision, even though it was completely legal.**

In mid-November, Parliamentary Speaker Arseny Yatseniuk (de facto nominated by Yushchenko a year ago) was fired from his position with the participation of the MPs closest to the president, indicating by this the continuing deep erosion of Yushchenko's personal entourage and all of the former "orange" political camp.

The new Speaker of the Supreme Rada, Volodymyr Lytvyn, was elected on December 9, together with an announcement of the creation of a new coalition format. A total of 244 of 422 MPs registered in the session hall voted for this decision. In particular, affirmative votes were obtained from 154 MPs of the BYT faction, 40 votes from the Our Ukraine faction, 27 votes from CPU, 20 votes from



the Lytvyn Bloc, and 3 votes from the Party of Regions. The new Speaker has experience in managing Parliament in difficult conditions (he held the position during the events of 2004). In addition, his candidature did not evoke sharp rejection on the part of a wide range of political forces. The choice of Lytvyn once again evidenced a decrease on the president's influence, as Yushchenko tried to lobby the candidature of Ivan Plusch, who was close to him and was also an ex-speaker, but this had no effect.

After his appointment, Lytvyn announced the creation of a coalition consisting of Our Ukraine, Yulia Tymoshenko Bloc and Lytvyn Bloc.

However, the same evening, on December 9, Our Ukraine's press office announced that the faction did not approve the text of the coalition agreement between Our Ukraine, BYT and Lytvyn Bloc. On December 10, a meeting of the Our Ukraine faction approved the decision to continue working on the text of the coalition agreement between BYT and Lytvyn Bloc. As a result, Our Ukraine faction voted to be part of the new coalition, although with minimum majority of its members; in fact, not all of the members consider themselves to be members of the coalition, and some of them, e.g., the Single Center group consisting of 10 peoples under the obvious influence of Viktor Baloga, the head of the President's Secretariat, are in hard opposition to the government and the coalition.

Today a legal collision exists – there is a formal agreement between the three factions to join the coalition (which makes it legitimate), but not all MPs are taking part in its work. As a result, the real number of coalition members is less than minimum requirement of 226 persons.

This leads to a regular shortage of votes on decisions proposed by the government. As a rule, such decisions are approved by means of informal agreements with the Communist party of Ukraine faction, which is not part of the coalition but supports some legislative drafts proposed by the government. Several opposition party MPs also vote in support of the government.

For instance, on December 26, the Law of Ukraine on the State Budget for 2009 was approved by a minimum majority of 226 votes. When voting for this draft law, the following affirmative votes were given as a whole: 156 by BYT, 46 by Our Ukraine, 20 by Lytvyn Bloc, and 4 by the Party of Regions.

Anyway, the parliament of the 6th convocation is the least productive of all previous convocations, taking into account the number of laws drafted, submitted, debated and adopted.

The Constitution and the Law on democratic control over the military sphere provide for democratic oversight over the military and security services. Since

2005, the Ukrainian defense minister has been a civilian. Parliament has the capacity to investigate cases of misuse of military and security power. At the same time, this capacity has sometimes been used for purely political reasons (not to prevent real violations of the law), such as the case against “illegal” sales of weapons to Georgia in 2008.

Ongoing debates on election legislation were caused by dissatisfaction with the existing election model based on proportional vote, closed party lists and a single national district electoral structure. Opponents of the existing model usually criticize it for its total dependence on party leaders and non-transparency of party list formation and argue for changes to “open” party lists and multi-mandate regional electoral districts. However, in 2008, no draft law aimed at changing the electoral rules were submitted and debated in parliament.

According to Igor Zhdanov, the head of the Open Policy Research Center, the current parliamentary election system with closed party lists significantly limits political freedom and leads to isolation of deputies from their voters and restricts the democratic rights of citizens. It is the party leader and party “sponsors” who determine who will be included in the party’s electoral list and according to which order. Voters give their votes primarily to number one in the list during parliamentary elections. Other candidates are left “off-screen”.

The continued practice of electing the Supreme Rada by closed nationwide lists will further promote the transformation of parties into “autocratic” corporations and lobbyist structures of the most influential Ukrainian oligarchs.

Compliance with the laws of Ukraine on the creation of a Unified Register of Voters is not enforced due to competition between several political structures and corporations for cash flows related to implementation of this governmental project. The question of voter list reliability, as well as accurate counting of their votes remains urgent. Legislative efforts to implement administrative reform are being blocked for the moment. Appointment of state officials often takes place not according to their professional skills but according to political membership and their personal loyalty to the leader.

Attempts to politicize the activities of the state machinery continue due to ongoing presidential elections. Unlike during past years (before 2004), such attempts are diversified.

Each of major political players tries to strengthen its influence on the civil service system: The president of Ukraine does this through ministries under his control, central authorities, and regional and district state administration verticals. The Yulia Tymoshenko Bloc acts through ministries and regional and district

councils under its control. The Party of Regions uses district and regional councils of the Southern and Eastern regions of Ukraine.

In 2008, the National Security and Defense Council (NSDC) did not play the role of a strategic and coordinating center to fight corruption due to its excessive politicization and use as an information and political “platform” for opposing the government.

**Kyiv mayor’s and City Council’s election as an indicative case.** The most indicative electoral campaign took place in the capital city of Kyiv after Parliament’s decision to hold pre-term mayor’s and City Council’s election in Kyiv on May 25.

Both governmental parties (Our Ukraine and Yulia Tymoshenko Bloc) strongly criticized the mayor of Kyiv, Leonid Chernovetsky, accusing him of corruption. However, due to the failure of the initiators of the election to nominate a consolidated candidate, the incumbent mayor was re-elected, obtaining an even better outcome than in his first victory in 2006 – 37.7% of the votes<sup>1</sup>. His closest competitor, Deputy Premier Minister of Ukraine, Oleksandr Turchynov (BYT), lost with only 19.12%. Vitaly Klychko, who was considered to be a favorite of the election, took the third position with only 17.97% of the votes<sup>2</sup>.

Chernovetsky’s personal political bloc also strengthened its positions in the municipal Council (30.45% of the votes), easily getting a majority along with some satellites.

The results of the Kyiv City elections demonstrated substantial losses of public confidence in the largest political forces and political leaders of Ukraine in the capital city. For instance, the Yulia Tymoshenko Bloc (BYT) received 22.79% of the votes (in comparison to more than 40% support of BYT in Kyiv in parliamentary elections in September 2007).

Kyiv City Council elections also indicated a severe crisis in the pro-presidential political party Our Ukraine, which failed to pass 3%-vote threshold (2.01% of the votes) and lost representation in the City Council<sup>3</sup>.

According to the Committee of Voters of Ukraine (CVU), the Kyiv mayor and Kyiv city council election campaign was transparent and competitive, although poorly organized and unfair to voters<sup>4</sup>.

<sup>1</sup> Kyiv City Election Commission <http://www.kmr.gov.ua/divisions.asp?Id=2223>

<sup>2</sup> *ibid*

<sup>3</sup> BBC Ukrainian.com 28 May 2008 [http://www.bbc.co.uk/ukrainian/domestic/story/2008/05/080528\\_kyivrada\\_elex\\_results\\_sp.shtml](http://www.bbc.co.uk/ukrainian/domestic/story/2008/05/080528_kyivrada_elex_results_sp.shtml)

<sup>4</sup> Committee of Voters of Ukraine: evaluation of Kyiv City Mayor and Kyiv City Council election campaign, CVU Press Service, May 20, 2008.

The parties were not ready to form election commissions; they breached organizational deadlines and individual procedures, exceeded the limits of the election fund, bribed voters and cheated with public opinion through the media. Voters' lists were of poor quality. Many Kyiv residents failed to clarify and check their personal data; commissions, in their turn, did not arrange such verifications. At the final stage of the campaign, direct voter bribing became a widespread phenomenon.

The CVU registered "mild forms" of administrative pressure exercised by all political forces, whose representatives occupy positions with central and municipal authorities. Although no direct pressure upon voters was revealed, the majority of candidates abused their positions in the course of campaigning.

CVU experts concluded that the evident shortcomings of Kyiv's local election should push parliament to introduce some important changes to legislation, in particular, to lift the too-restrictive limitation on using the electoral fund, to change the principle of formation of polling station commissions, to speed up compilation of the Voter's Register, and make liability for bribing voters more severe.

## **Society**

**Civil society in Ukraine is quite developed and ramified and has not felt any administrative pressure in recent years. At the same time, it is premature to talk about structural completeness of the civil society. The third sector is rather unevenly developed, and its influence on the process of making important decisions remains limited. Despite promises, the state has not created efficient tools to support civil society institutions.**

Civil society continues to be an important actor in Ukraine; however, it still suffers from outdated legislation and dependence on foreign funds, and therefore is growing only slightly. The number of NGOs registered in Ukraine is quite large: 52693 organizations, including 1791 with national status involving about 20 million members (more than 40 percent of the population). Most of them are trade unions, charitable and religious organizations, ethnic, cultural, youth, professional, human rights, etc. The current authorities do not interfere by levying permanent taxes or creating additional barriers and obstacles to NGO activity.

The change of the Cabinet of Ministers in December 2007 had a positive effect on the general atmosphere of relations between the government and civil

society. For the first time, the chapter “Civil Society” was introduced as part of the Cabinet of Ministers’ official program. Most of the points of this chapter were elaborated by NGOs themselves due to the initiative of the “NGO Conference” carried out by the efforts of the Kyiv-based Ukrainian Center for Independent Political Research and its partners.

The new government made some efforts to involve NGOs more intensively in advisory activity and provide them with a role in government-operated PR programs such as State Programs of Public Information on European and Euro-Atlantic Integration for the period 2008-2011 adopted in 2008. A Permanent NGO Expert Council was established on the Ukrainian side of the EU-Ukraine Cooperation committee.

The number of public councils and commissions with NGO participation continued to work under the president of Ukraine, namely, the National Council for media freedom and information sphere development, National Council on public administration and self-governance, Council on ethno-national policy, National Commission on strengthening democracy and the rule of law<sup>5</sup>, etc. There are a number of public councils under the Supreme Rada and its parliamentary committee.

Civil society remains heterogeneous: the most influential NGOs are concentrated in the capital city of Kyiv. Restrictions imposed by legislation prevent some local NGOs from efficient inter-regional and nation-wide cooperation, as the law allows an NGO to carry out activities only in the territory of the unit where they were registered. For instance, if a certain NGO is registered in the city of Kyiv, it has no rights to operate freely in other cities and regions. To get nation-wide status, an NGO is required to have branches in most regions of Ukraine, which is not the case for the most small and even medium-sized NGOs.

It is still much easier and faster in Ukraine to register a business or a private entrepreneurship than an NGO.

The structure of funds available to Ukrainian NGOs is rather unstable and archaic. Most of them, according to monitoring conducted by Ukrainian experts, are dependent on foreign and local donors (73%), an insufficient number (25%) managed to sell their services in some way, and only 2% declared support obtained from the state<sup>6</sup>. NGOs’ access to public funds is still rather limited, despite some improvements shown in comparison with previous years.

<sup>5</sup> Latsyba, Maksym. Assessment of public involvement to decision making and information transparency of power. Ukrainian Center for Independent Political Research, 2008.

<sup>6</sup> Vinnikov, Oleksandr. Financing of NGOs in Ukraine. Analytical report, Ukrainian Center for Independent Political Research, January 2008.

In the structure of governmental funds, only 0.1% of state budget expenditures were directed to supporting civil society in 2007-2008 (in comparison with a 2-3% average in the EU Member states). In previous years, however, the level of budget funds available for NGOs was even lower (up to 0.05%) of the state budget; therefore, a positive growth trend of growth is detected<sup>7</sup>. On the other hand, a large portion of these budget expenditures has been spent without sufficiently transparent procedures and competition.

Most available procedures of governmental support for NGOs are based on legislation on public purchasing, which provides for quite restrictive and expensive procedures that are not appropriate for most NGOs.

National business is now more ready to support NGOs, with some private funds (such as “Open Ukraine”, “Victor Pinchuk Fund”, “Development of Ukraine”, etc) offering grants for civil society organizations. Among their priorities, to a greater extent, are social projects, charity, medicine and education, and to a lesser extent – public control, advocacy, rule of law, human rights protection, and think-tanks.

Among foreign-funded donors, the International Renaissance (Soros) Foundation (IRF) continued to keep a leading role, providing more than USD 6 million annually to support numerous Ukrainian NGOs, community groups, academic and cultural institutions, etc<sup>8</sup>. Recently, however, IRF became partially national-funded after big businessman Victor Pinchuk started to contribute to its rule of law and human rights programs.

An insufficient number of NGOs have well trained professional staff able to ensure efficient management and fundraising. Parliament has failed again to provide essential improvements to outdated NGO legislation; the definition of “non-profit activity” is still restrictive and does not allow NGOs to receive any income that may look like a profit, even if this profit is to be spent on achieving the aims of the NGO and not for the personal welfare of the founders and members.

Institutions of civil society on the national and regional level show high interest to political life. In 2008, the position of non-governmental organizations and their leaders was aimed primarily at strengthening civilian control of authorities and political elites that were losing social legitimacy due to permanent crisis situations and obvious signs of irresponsibility.

<sup>7</sup> *ibid*

<sup>8</sup> International Renaissance Foundation website, <http://www.irf.kiev.ua/en/about>

The community actively used the media and its own communication channels in order to deliver information on its own attitude, the essence of which was the inadmissibility rocking the state boat for the sake of personal ambitions of separate politicians.

A specific example of such civil attitude may be considered a manifest of the Civil Assembly of Ukraine on the political crisis that took place in September. Specifically, the manifest stated the following: “The political struggle for power authorization between representatives of all branches of government, political parties and blocs of the Supreme Rada are increasingly taking the shape of a “total war”, the consequence of which is destruction of the state. Complete alienation of power from the people and removal of citizens from influence on political processes in the country arise particular worries. Recent statements of politicians as to changes in Constitutional Law and raising of an electoral barrier are evidence of the intention to permanently limit rights and freedoms of the citizens of Ukraine and preserve the unlimited abuse of authority of the “elite” generated by artificial chaos.

The authors urge politicians:

*To stop using the constitutional process to achieve political advantages. To stop any attempts to make changes in the Constitution without wide civil discussion and introduction of the institution of constituent power;*

*To provide for a legislative mechanism to exercise constituent power by the people. To approve new electoral legislation, legislation on plebiscites, associations of citizens and legislation on political parties that provides for dramatic improvement of the quality and transparency of the political process in Ukraine.*

Activists of the Civil Assembly expressed confidence that “further neglect of civil opinion and requirements will lead to ultimate discrediting of the respective authorities, politicians and political forces with their further marginalization. For our part, we guarantee that we will widely inform every citizen about persons and forces that have taken such an irresponsible position. The criterion for evaluating politicians is not the competitive loudness of their statements but solely their attitude to rights and freedoms of citizens and to national security of Ukraine supported by actual activities; and that if there is further artificial straining of political situation, or attempts to change the Constitution in favor of partisan interests or political ambitions of individual politicians, we will make the respective conclusions and call on society for the appropriate reaction”, says the statement of the Civil Assembly of Ukraine.

### **Demographic situation**

The birth rate continues to increase in Ukraine. In 2008, for the first time in many years, the birth rate exceeded mortality in three regions of Ukraine at once.

Specifically, 32,147 babies were born in Kyiv, while 30,067 people; 18,392 babies were born in Zakarpatska region, while 16,155 people died; and 17,188 babies were born in Rivenska region, while 16,245 people died.

In three more regions, the gap between mortality and birth rate decreased to a minimum.

Specifically, 15,380 babies were born in Volyska region, while 15,594 people died; 17,065 babies were born in Ivano-Frankivska region, while 18,385 people died; 11,112 babies were born in Chernivetska region, while 12,195 people died.

In general, 513,997 babies were born during 2008; this is 37,672 more than in 2007. Last year, 754,461 people died, which is 8,416 less than in 2007.

In the majority of regions, according to the minister, there is a trend towards decreasing the gap between births and deaths in favor of births.

In 2008, this ratio was 1 to 1.4. This is the best figure in last decade. For comparison, in 2004–2005 the ratio of births and deaths was 1 to 1.7, in 2006 it was 1 to 1.63, and in 2007 it was 1 to 1.6<sup>9</sup>.

### **Public opinion in Ukraine towards politics**

**Sociologic polling that took place during 2008 in Ukraine showed an ongoing decrease in trust of politicians and political institutions and growing skepticism of the prospects for political and economic development.**

The permanent political crisis that started at year-end was supplemented by a deep economic recession that contributed to growing pessimism in society.

Polling by the Sofia Center of Sociologic Research on April 7-14, 2008 showed the following: the political situation gives Ukrainian citizens cause for concern. Almost half of respondents see the current situation as “acute and argumentative” (33.1 % of respondents) or “explosive” (10.2 %). A significant proportion (48.6 %) of the respondents see it as “tense”. Only 4.5 % of participants consider the political situation as “calm and safe”, while 3.6 % of respondents did not give an exact answer.

<sup>9</sup> State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)



There is a growing percentage of respondents who believe that everything that happens in Ukraine today is going in the wrong direction. In February, this percentage was 60.6 %, while in May it increased to 75.3 %. The May figures exceeded the same indicators recorded in April of the previous year during intensification of the political crisis.

It is important to note that in previous years when the political situation worsened, the majority of citizens wanted stabilization of the situation. In the middle of 2008, the number of respondents considering that Ukrainian society needed stability was almost equal to the number of respondents stating the following: "Society needs radical change and primarily changes of political leadership" (49.1 % and 43.8 %, respectively).

Ratings of leading political forces and political figures during the year had predominantly negative dynamics. Ratings of potential candidates for the post of President of Ukraine are the most interesting, since in February 2009 the probability of an early parliamentary election in the near term is low, and regular presidential elections will most likely take place in January 2010.

Early in the year, Yulia Tymoshenko was the uncontested leader of such ratings, as her popularity was supported by her outstanding start as a prime minister of Ukraine after she took this position again in December 2007.

Partial payment of compensation for devalued savings of Soviet times and an increase in salaries and pensions significantly strengthened her electoral positions at the beginning of the year. However, first inflation, then political chaos, and finally the economic crisis undermined confidence in Tymoshenko, which led to the fact that her electoral positions teetered and by the year-end she conceded leadership to Viktor Yanukovich, the head of the Party of Regions. This also refers to the rating of her political bloc, which is the basis for the governing coalition.

According to a poll by FOM-Ukraine, from January to December 2008 Tymoshenko's rating decreased from 25 % to 18 %, and BYT's rating fell from 28% to 16 %. According to the Razumkov Center, from February to December 2008, Tymoshenko's presidential rating decreased from 25.9 % (of the total number of respondents) to 15.8 %. However, when analyzing the above trend political scientist Volodymyr Fesenko suggested that premature conclusions on Tymoshenko's negative prospects in her struggle for the post of president should be avoided. Taking into account previous experience, it can be predicted that in favorable circumstances, Tymoshenko, as the government leader, will get her leadership back.

**Table 1<sup>10</sup>. Ratings of political forces at the end of 2008**

	R&B (22-30.11)	Sofia Center 102-11.12)	Yeremenko UICI Social Monitoring Center (07-17.12)	FOM- Ukraine (07-20.12)	Razumko v Center (17-24.12)	Democratic Initiative Center and USS (17-28.12)
The Party of Regions	22.5	22.7	21.7	21.5	27.2	31.5
Yulia Tymoshenko Bloc	22.5	20.1	13.8	19	21.6	17.3
CPU	7	8.2	7.1	6	8.5	7.2
Lytvyn Bloc	6	5.9	5.2	5	6.7	4.4
Yatsenyuk Bloc		5.5	3.1	2.5	6.6	5.1
Yushchenko Bloc	5	3.3	3.7	2.5	4.2	3.8
All-Ukrainian Union “Freedom”	1.4	2.3	1.7	1	2.0	1.9
Grytsenko Bloc		1.7	0.4		1.8	
PSPU (N. Vytrenko)	1.2	2.6	1.2	1	1.2	1.0
SPU (A. Moroz)	1.5	1.2	1.6	1	1.0	2.4
L. Chernovetsky Bloc		0.6	0.5	0	1.0	0.7
People’s Self-Defense Bloc (Yu. Lutsenko)			0.8	1	1.0	0.5
V. Klychko Bloc		1.8	1.1	1	0.7	
The United Center Bloc		0.3	0.2	0	0.1	0.2
Other	3.2	2.1	2.0	0	1.0	1.5
Against all	18	11.2	19.3	20	7.8	7.9
No answer	12.6	10.0	16.6	17	7.6	14.8

<sup>10</sup> Here and hereafter - basing on the materials by: Volodymyr Fesenko. Race for high rating position. – Ukrayinska Pravda <http://www.pravda.com.ua/news/2009/2/3/89007.htm>

**Table 2. Presidential Ratings at the end of 2008**

	R&B (22-30.11)	Sofia Center 102-11.12)	Yeremenko UICI Social Monitoring Center (07-17.12)	FOM- Ukraine (07-20.12)	Razumko v Center (17-24.12)	Democratic Initiative Center and USS (17-28.12)
V. Yanukovych	22	24.7	26	23	22.5	22.3
Yu. Tymoshenko	23	20.9	16	20	17.9	13.9
A. Yatsenyuk	7	7.5	5.5	5.5	7.5	7.9
V. Yushchenko	6	5.4	5.5	4.5	5.1	2.4
V. Vytvyn	5	4.4	5.5	4.5	6.1	4.1
P Symonenko	6	7.7	7	5.5	6.0	3.6
A Grytsenko		1.2	1		1.5	1.4
N Vitrenko	1	1.7	1		0.9	1.2
V.Klychko		-		1		
Yu. Lutsenko	1	-	1	.		
O. Moroz	1		2		0.6	1.5
O Tyagnybok			1	1		0.7
L. Chernovetsky		0.9			1.0	
Other	1	5.2	3	1.5		1.3
Against all	15	10.3	16	14.5	14.8	19.1
No answer	12	9.9	9	19	15.7	20.4

In turn, the certain leadership of Viktor Yanukovych in the most important regions is mainly based not on a high level of support and positive dynamics, but on Yulia Tymoshenko's falling rating. Both his own rating and the rating of his party during 2008 also have a negative trend.

However, most rating losses during 2008 were suffered by the current president Viktor Yushchenko, who according to experts cannot even pretend to enter the second round of upcoming presidential elections, as he is not only behind the leaders, Yanukovych and Tymoshenko, but is also losing to some second-tier politicians: Arseny Yatshenyuk, Volodymyr Lytvyn and Petro Symonenko.

Diagram 1. Ratings of political forces in 2008 (Source: FOM-Ukraine)

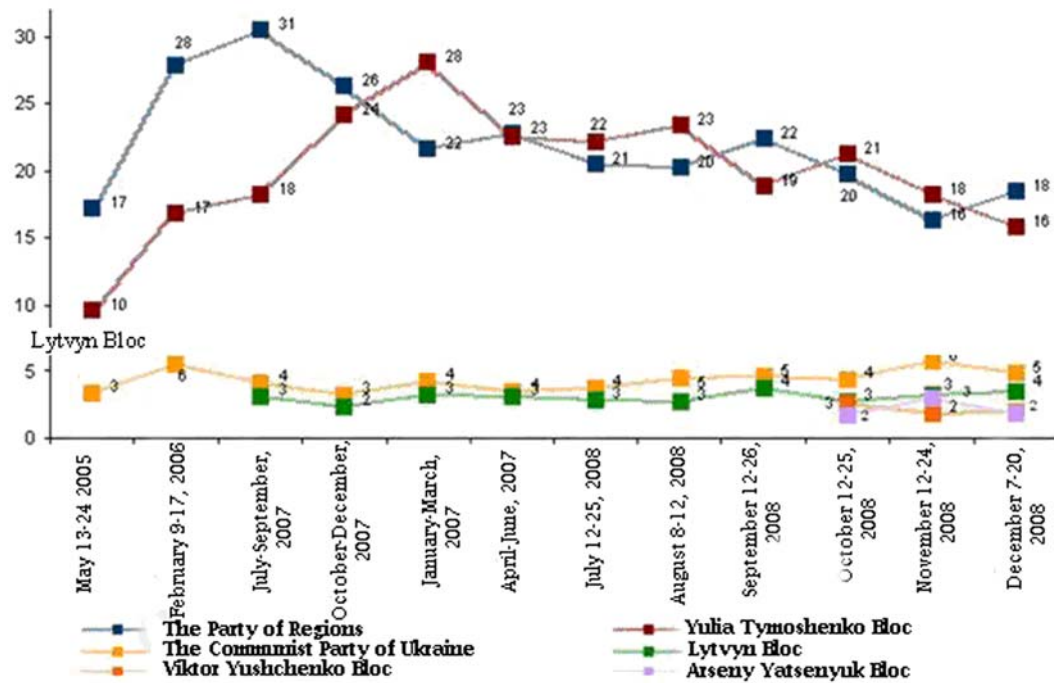
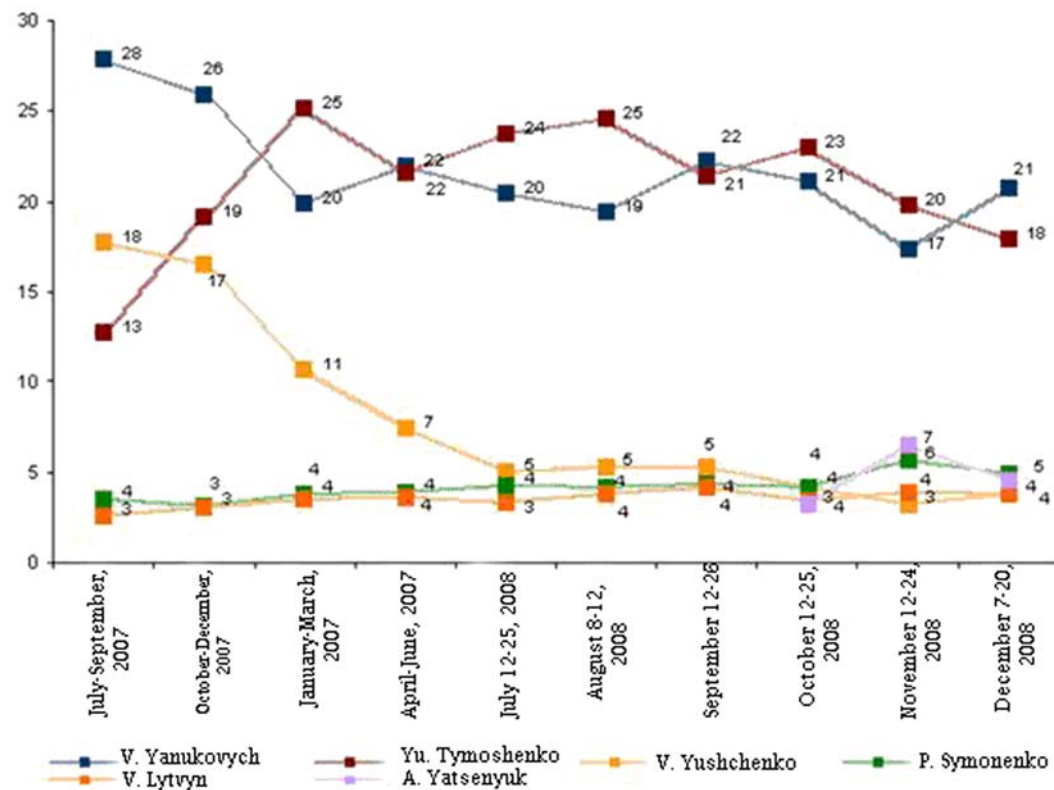


Diagram 2. Presidential Ratings in 2008 (Source: FOM-Ukraine)



The situation with ratings of major politicians and political forces is evidences of a crisis of social legitimacy of the existing political elite and the existence of public demand for a new generation of politicians who personify different values. At the same time, this does not ensure fast and automatic success to a hypothetical new-generation political leader, as the chances of winning the presidential elections in 2010 are more favorable for well-known figures of Ukrainian politics.

## **Mass Media**

Freedom of speech in Ukraine is guaranteed by the Constitution. The current situation in this area allows the existence of pluralism of thought and media information sources in Ukraine, Ukrainian citizens may obtain information on the situation in the country through the media, and political forces have access to the media. Generally, since early 2005 freedom of speech has been at a satisfactory level.

Generally, censorship is absent in Ukrainian mass media. However, the situation is much worse in municipal and governmental media financed by budget money and under pressure from local and certain governmental authorities. Financial dependence leads to dependence of editorial policy, which is often formed not by the media themselves but in the offices of government or local authorities. A good example is the so-called Kyiv Media Holding, whose activities amount to carrying out propaganda tasks and orders in favor of the mayor of Kyiv. This is a direct sign of censorship and lack of freedom of speech.

Lately, a trend towards the appearance of internal editorial censorship in Ukrainian media has been observed (this is not censorship according to Ukrainian legislation, but can still be defined as such according European practice). The preponderance of so-called ordered materials (“advertorials”), the influence of media owners, and withdrawal from information and journalistic programs in favor of entertainment programs are evidence that editorial teams are not free to determine their own editorial policy.

Due to evident fast growth within the last decade, the media market in Ukraine looks successful. As for TV and radio, the total number of currently registered companies is 1,377 (858 broadcasters, 43 production studios, 13 distributors, and 463 program service providers). There are 15 nationwide television networks, 4 regional television networks, 15 nationwide radio networks and 8 regional radio networks. As for printed media, 22,794 periodicals are

registered in Ukraine (with 9,948 being distributed nationwide, regionally and internationally, including 3,809 newspapers and 4,626 magazines, and 12,846 published locally, including 10,740 newspapers and 2,106 journals and magazines). However, according to expert evaluation only about 8,000 periodicals are actually being published, of which the most important are the newspaper Fakty (Facts) - 2.65 million readers, the newspaper Segodnya (Today) - 1.33 million readers, Komsomolskaya Pravda v Ukraine - 1.08 million readers, and Express - almost 800,000 readers<sup>11</sup>.

The legal foundation of freedom of opinion and speech is secured in Article 34 of the Constitution of Ukraine, whereas Article 15 of the Constitution forbids censorship. Some restrictions on freedom of speech are regulated in more detail by the Law on Information, Articles 28–37. Article 10 of the Law On Printed Mass Media prohibits printed media monopolies.

Ukraine's media sector should be considered mostly free but quite heterogeneous. Pluralism of media is fairly well secured. Government censorship is not detected; however, there is some evidence of attempts of central authorities (president's Secretariat) to influence TV coverage of some sensitive events.

The most troubling trend of the recent period is the evident commercialization of content, including political and socially important content. The overall quality and further progress of Ukrainian media, both printed and electronic, is suffering from paid-for subjects and publications, which may mislead public opinion by manipulation of facts and assessments.

Access to information remains an issue in journalists' and media activities. Government and local authorities often ignore information requests or do not give due answers to them. There are also problems with the use of accreditation rules, which served as a basis for refusal by government authorities to provide information to journalists in a number of cases during 2008.

According to an expert judgment by Viktorya Sumar (Mass Media Institute), practical limits on access to information in Ukraine do not meet the requirements of Article 34, Part 3 of the Constitution of Ukraine, particularly with respect to setting limitations exclusively by law, and not by subordinate acts (such a requirement is contained in Paragraph 1, IV, Recommendations of Committee of Ministers RE Rec (2002) 2 dated February 21, 2002. "On access to official documents"). Presently, the concept of "official secret" is not defined at the

<sup>11</sup> Lange, Nico. Current State of Freedom of the Media in Ukraine. KAS Democracy Report. Konrad-Adenauer-Stiftung, 2008, page 1.

legislative level (i.e., as a parliamentary act) in Ukraine, and the “For official use” classification is used by the state authorities on the basis of subordinate acts, which allows them classify documents at their own discretion. The need to limit access to information in a democratic society and commensurability of such limits with the legitimate objective of such a blackout are often ignored. The requirement of commensurability and necessity in a democratic society is recorded in the above recommendation but has not been implemented in Ukrainian legislation, particularly in the Constitution. For example, despite the fact that classification label was removed about 1000 acts of the Cabinet of Ministers, the security blackout practice continues.

The draft law “On access to public information” developed by a coalition of non-governmental organizations and registered in Parliament by MP A.V. Shevchenko is still not included to the agenda. In turn, the Cabinet of Ministers is developing its own draft law “On access to information”, which somewhat narrows journalists’ ability to obtain information. At the same time, there is a need to continue legislative activities in this respect, as the current situation in this area in Ukraine does not meet European Council standards.

The level of confidence in the mass media remains relatively high. According to surveys conducted by the Ukrainian Institute of Social Research and the Social Monitoring Centre, 58 per cent of the population trust television, 50 per cent trust radio, and 46 per cent trust newspapers<sup>12</sup>.

At the regional and local level, state administrations remain players on the media market by owning newspapers and TV channels funded by the budget, thus affecting their editorial policy, including Kyiv municipal media, which was clearly evident during the municipal election campaign in May 2008, when local public media (newspapers *Hreshchatik*, *Vechirnyi Kyiv*, *Ukrayinska stolitsia*) were used by all means to advertise the team of incumbent mayor Leonid Chernovetsky, while at the same time attacking his rivals and their parties<sup>13</sup>.

Nationwide television channels in most cases provided balanced news coverage; representatives of the ruling parties, as well as the opposition, had equal access to the media. Most nationwide media are privately owned by leading financial and industrial groups, which gives grounds for media certain biases and subjective preferences, which allows some experts to say that “state censorship has

<sup>12</sup> *ibid*

<sup>13</sup> The role of media in Kyiv’s election, *Telekritika* website, <http://www.telekritika.ua/media-suspilstvo/expert/2008-05-30/38709>

been replaced by owner's censorship", since "for most media owners the media are not a way of making a profit, but a means of creating favorable public opinion"<sup>14</sup>.

An important TV holding is associated with the name of Valery Horoshkovsyi, formerly a big businessman, now the head of the Customs Service of Ukraine. The holding owns TV channels such as Inter, Enter, Enter-Film, which were recently joined by Dmitry Firtash's channels, such as K1, K2, Megaspot. Novyj kanal, ICTV, STB, M1, 11 kanal (Dnipropetrovsk) are parts of the media empire of Victor Pinchuk. Major newspaper publications are owned by Ukrainian businessmen who want to influence public opinion. For example, the paper Fakty is owned by Victor Pinchuk (Interpipe). The newspaper Segodnya belongs to the richest person of Ukraine, big industrialist Rinat Akhmetov (SCM). Igor Kolomoyskiy (Privat) is a shareholder of Gazeta po-kievski and Komsomolskaya Pravda v Ukraine<sup>15</sup>.

The process of creating public television is still blocked due to the lack of political will. It was only on October 7, 2008, that a meeting of working groups on preparation of the agenda items "On the Creation of Public Television and Radio Broadcasting in Ukraine" and "On the Work of the Cabinet of Ministers of Ukraine to Introduce Digital Television and Radio Broadcasting and Ensuring Access to Television Signals in Ukraine" took place under the leadership of Deputy Secretary of NSDC of Ukraine Borys Sobolev. In his speech Deputy Secretary of NSDC of Ukraine Viktor Tkachuk outlined issues of implementation of digital television and radio broadcasts in Ukraine, as well as the responsibility of state authorities for delays in implementing the resolution of the NSDC "On Urgent Measures to Ensure Information Security of Ukraine" dated March 21, 2008. Information of the State Committee for Television and Radio Broadcasting of Ukraine was heard at the meeting (delivered by the Head of the Television and Radio Broadcasting Department, Sergiy Abramov) on the progress in preparation of a draft concept to create a system of public television and radio broadcasting by the Cabinet of Ministers<sup>16</sup>. Thus, despite 4 years of promises to create public television and radio broadcasting, the process is still at the stage of concept development.

Internet media plays a reasonable role in Ukraine, despite the fact that only 8-10% of the population enjoys regular access to the Internet. There are e-publications

<sup>14</sup> Lange, Nico. Current State of Freedom of the Media in Ukraine. KAS Democracy Report. Konrad-Adenauer-Stiftung, 2008, page 8.

<sup>15</sup> *ibid*, page 5.

<sup>16</sup> Website of NSDC of Ukraine <http://www.rainbow.gov.ua/news/?cat=6>



that have no printed analogues, for instance, Ukrayinska Pravda, Korrespondent.net, Glavred.info, ProUa.com, etc.

The advertising market, which has been fast-growing in recent years, is expected to suffer from the economic crisis that is posing a threat to the financial independence of the media. Only a few good-quality media projects appeared on the national/regional media market in 2008.

The community of Ukrainian journalists understands the essence of issues faced by Ukrainian media. In particular, this is evidenced by the results of a poll of Ukrainian journalists published by the Democratic Initiative Fund in September. According to the poll, journalists rated the freedom of speech situation in Ukraine quite positively: 6.64 points of a possible 10. An absolute majority of media representatives believe that different viewpoints, both government and opposition, are represented in the Ukrainian media environment.

At the same time, none of the journalists believe that freedom of speech is already irreversible in Ukraine. The prevailing viewpoint is that there are positive trends in the area of freedom of speech, but certain pressure is also present in this respect.

Journalists think that a major threat to freedom is the pressure of money and the lack among media representatives of their own position, their corruption and indifference.

A majority of respondents also agreed that journalists were gradually being transformed from “democracy watch-dogs” into “puppies that serve politicians”.

The overwhelming majority of journalists also believe that Ukrainian mass media were partly to blame for the crisis, as they almost never gave in-depth analysis of the reasons for the political crisis. Media have become part of the political conflict, as their owners represent different political groups. Moreover, the media are ready to provide any information regardless of whether it is true or not<sup>17</sup>.

### **Supremacy of law and judicial system**

Despite constitutional guarantees and declarative commitment by all political forces to the principles of supremacy of law, guarantees of the supremacy of law remain in a dissatisfactory state in Ukraine. Politicians methodically use the right as a tool to manipulate and strengthen their own positions in the competitive

<sup>17</sup> UNIAN, 5 September. 2008 <http://human-rights.unian.net/ukr/detail/188319>

struggle. The social prestige of judicial bodies, including the Constitutional Court, Supreme Court, and High Specialized Courts, is continually decreasing.

In spring 2008, during a political struggle to cancel Decree of the President of Ukraine on a early parliamentary election, the media widely highlighted the struggle between the President and the Yulia Tymoshenko Bloc over the judicial decision. This struggle was accompanied by liquidation of the Kyiv Administrative Court by the President of Ukraine for political reasons, removal of judges from their positions, and the physical presence of BYT MPs in the offices of court officials (see the above for details).

Citizens wait for legal proceedings for years, and unfair judicial decisions become the rule rather than the exception. Proceedings have become increasingly less affordable, especially for socially unprotected sections of the population.

A draft law of Ukraine on the introduction of changes in the judiciary was presented for review by the Supreme Rada, which strengthens the dependence of the judicial branch on the President of Ukraine.

In 2008, a large number of cases were registered that evidenced problems in the judicial system in Ukraine. In early February, the head of the Supreme Court, Vasyl Onoprenko, turned public attention to the attempts to approve a draft law on changes in the Economic Procedural Code of Ukraine in Parliament. The draft suggested changing the procedural status of the Supreme Court and Supreme Economic Court. This draft provided for depriving the Supreme Court of the cassational review function in economic cases and giving this function to the Supreme Economic Court only. "The draft provides only two grounds to appeal judicial decisions in the Supreme Court in exceptional cases that may arise only if a lower-instance court used a legislative act acknowledged as non-constitutional, and acknowledgment by an international court that a judicial decision violates Ukraine's international obligations", said the head of the Supreme Court. In his opinion, this significantly narrows the rights of legal entities and persons to appeal and violates the requirements of a number of Articles of the Constitution<sup>18</sup>.

Special attention was focused on the judicial system after an urgent press-conference by Vasyl Onopenko who published an open letter to the President of Ukraine, Viktor Yushchenko. The head of the Supreme Court says in his letter that: "once again, there have been active, legally ambiguous attempts by certain forces to achieve parliamentary approval of laws that provide for radical reform of the judicial system, the status of judges, and legal proceedings in Ukraine". He talked

<sup>18</sup> Legal Weekly, №50, 9 December 2008 roky.

about a draft law on the judicial system and status of judges that would provide for a completely different judicial system in Ukraine if it was approved. The head of the Supreme Court called it a direct attack against justice. “Whereas during last year’s political crisis they “pulled” the courts from different sides in the course of their political struggle, today we see that they are joining forces to disrupt justice and privatize its fragments”, Mr. Onopenko said. “And this is no coincidence, as they have the same motivation and the same view of the court as a ‘hand tool’ to solve political, business and personal questions”.

“Today, as never before, unconstitutional control of courts and judges, a system of illegal interference with their work, and total disruption of judicial system of Ukraine is a reality at the legislative level”, said Mr. Onopenko<sup>19</sup>. The real objective for approval of such a law, according to Vasyl Onopenko, is control of court activities and judges by introducing an unconstitutional mechanism of appointing judges to administrative posts and ensuring the influence of certain persons and political forces on court decisions through illegal methods of regulating issues of the judicial system and courts and elimination of the Supreme Court from the justice system of Ukraine. This is because the court interferes with certain persons’ attempts to illegally solve economic, political and other questions by actually depriving the supreme judicial body of the country of its status. “As a judge, I primarily want to be equidistant from different political forces. But Ukrainian reality suggests that if you distance yourself from politics, then politics catches you and interferes with your activities in a cynical and brutal way”, Vasyl Ostapenko noted.

In turn, Vasyl Ostapenko’s opponents repeatedly asserted the partiality of the head of the Supreme Court, as he was a BYT MP, and Yulia Tymoshenko allegedly continued influencing him.

The actions of politicians concerning administrative courts were also evidence of continued attempts to use the judicial system for political purposes. As is well known, on October 9, the President signed the decree “On early termination of the authority of the Supreme Rada of Ukraine of the 6th convocation and scheduling of early elections”. BYT representatives appealed against this presidential decree to the District Administrative Court of Kyiv, which suspended the validity of the decree. The President, in turn, *liquidated the court itself and removed the judge under whose chairmanship the decision was made from his position*.

On October 14, 2008, the Supreme Court held a plenary meeting resulting in an address to the supreme government bodies: “*The legislative body, the executive*

<sup>19</sup> <http://www.newsru.ua/ukraine/23jun2008/zanich.html>

*bodies and their officials have ignored the constitutional principle of separation of powers into legislative, executive and judicial power. There have been attempts to interfere with the organization of court activities, and resolution of certain legal cases, interference in justice on the principles defined by the law, moral coercion against judges by threatening, blackmailing and other illegal influence, including in the form of blocking court activities by members of Parliament and political parties, approval of unlawful regulatory acts and regulatory acts of individual force, abuse by the bodies of power of their authority, as well as illegal lodgment of respective power to certain government bodies, which intensifies dependence of the courts and judges on such bodies”<sup>20</sup>.*

Before this, on October 11, 2008, the work of the Kyiv District Administrative Court and Kyiv Administrative Court of Appeals was blocked by representatives of political parties and MPs of Ukraine. “Blocking the work of judges was expressed in physical interference with legal proceedings, moral coercion against judges and court employees, and illegal confinement of judges”, stressed the judges of the Supreme Court of Appeals of Ukraine.

In its address to Parliament, the President, the government, the Judicial Council of Ukraine, the Prosecutor General’s Office and the State Court Administration of Ukraine, the plenary meeting stated that “using their immunity and the right to attend the bodies without obstruction provided by Article 17, Part 3 of the Law of Ukraine “On the Status of a Member of Parliament”, about 20 MPs of Ukraine came to the office of the Supreme Administrative Court and without giving the reason for the visit blocked the work of the head of the court and stayed in his office and interfered with his duties, disturbed the normal order of work of the court of cassation by going through the corridors where the service offices of judges and employees are located. Five MPs entered the office of the deputy head of the Supreme Administrative Court, M. I. Tsurkan, and judging by his words, abused the judge, interfered with his work, did not allow him to exit from the office and used violence to gain possession of his two mobile telephones – office and personal ones. This resulted in the hospitalization of M. I. Tsurkan with the diagnosis of hypertonic crisis.

Evaluating the level of respect for independence of judges compared to the results of polling judges, prosecutors and lawyers in 2007 held in the course of the project “Support for judicial reform. Fostering judges’ independence” implemented by Ukraine and Switzerland, the lack of respect towards judges has increased:

<sup>20</sup> Legal Weekly, №50, 9 December 2008.

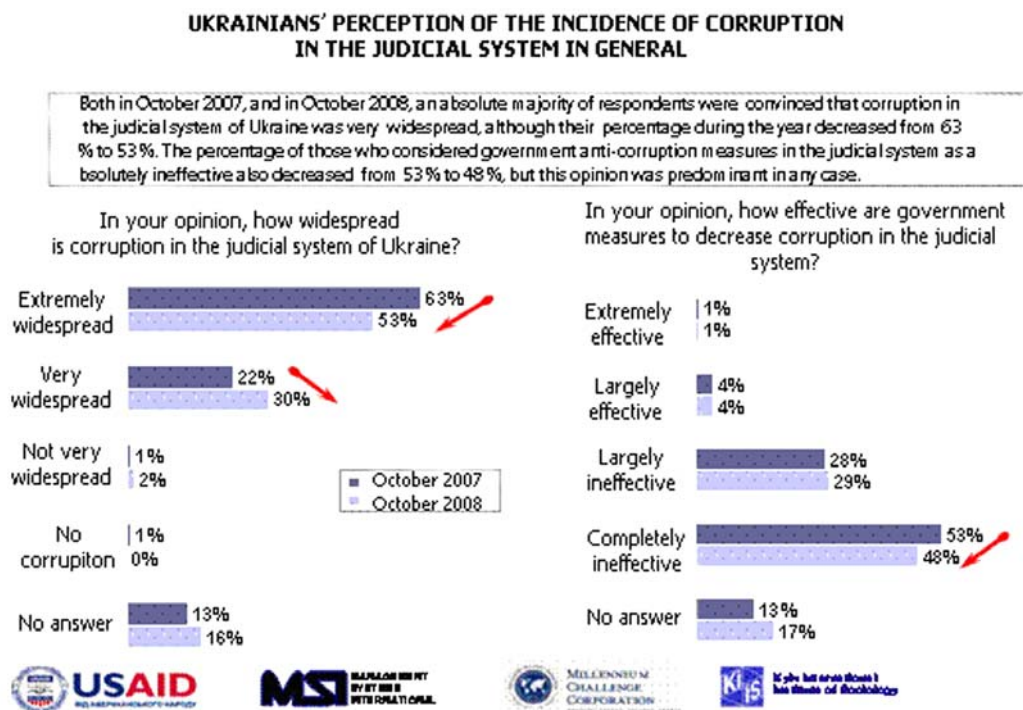
on the part of the president (2007 – 50 %; 2008 – 55 %),  
representatives of large corporations (2007 – 47 %; 2008 – 56 %),  
journalists (2007 – 40 %; 2008 – 45 %),  
enterprises (2007 – 28 %; 2008 – 36 %),  
citizens (2007 – 20 %; 2008 – 45 %).

The results of polling judges, prosecutors and lawyers themselves show that a high level of attempts to influence the court's opinion during legal proceedings is preserved.

Seventy-one percent (2007 – 77 %) of judges, 54 % (2007 – 67 %) of prosecutors, 81 % (2007 – 89 %) of layers who took part in the survey confirmed that *they know about attempts to influence the opinion of the court*<sup>21</sup>.

According to data of a nationwide survey by Kyiv International Institute of Sociology made in October 2008, 53 % of the citizens of Ukraine think that corruption in the judicial system of Ukraine “is very widespread”, and an additional 30 % say that corruption is “widespread”. The number of people who consider corruption in the Ukrainian courts a rare event is close to zero (Figure 1).

Figure 1



<sup>21</sup> Ukrayinska Pravda <http://www.pravda.com.ua/news/2009/1/13/87619.htm>

As in the survey conducted in 2007:

- Residents of Eastern and Southern regions are most convinced of corruption of the judicial system;
- Judges and prosecutors are considered the most corrupt agents of the judicial system;
- Among functions of the judicial system most affected by corruption the respondents named functions related to executing judgments<sup>22</sup>.

Therefore, the main shortcomings of the Ukrainian judiciary, including lack of public respect for court decisions and the judicial system as a whole, insufficient financing of the court system, and an inefficient and non-transparent process for appointing judges, remained untouched during 2008. Growing pressure on the independence of the judicial system of Ukraine from representatives of the executive and legislative branches of government was detected. Misuse of the judiciary for political purposes has taken on an unprecedented wide character. Further reductions of the judiciary's independence may lead to further degradation of the state, economy and public administration in Ukraine.

**International aid.** The European Union continues to support the process of judicial system reform and fostering the supremacy of law in Ukraine. Specifically, in 2008 the EU started two large-scale projects to support the Ukrainian judicial system. The first project, "Transparency and effectiveness of the judicial system in Ukraine", is being implemented and jointly financed by the European Council in the amount of EUR 6 million. The Joint Program is aimed at helping to maintain independent, unbiased, effective and professional judicial branch in Ukraine, as well as ensuring transformation of the Ukrainian judicial system into a transparent and fair one accessible by all citizens and functioning effectively and transparently towards citizens and civil society.

The program is being implemented by the European Council in cooperation with the state authorities and organizations of Ukraine: The Supreme Council of Justice, the Supreme Court, the Ministry of Justice, the State Court Administration, the Supreme Economic and the Supreme Administrative courts, the Prosecutor Generals' Office, committees of the Supreme Rada on justice and legal policy, as well as the Council of Judges, the High Qualification Commission of Judges, the National Commission on Fostering Democracy and Supremacy of Law, the Academy of Judges, the National Academy of Prosecutors, the Union of Lawyers,

<sup>22</sup> KIIS <http://www.kiis.com.ua/cordb/index.php>

the Ukrainian Association of Jurists and other authorities and organizations. The program will be conducted until December 2010.

The program includes:

- Creating a basis for implementation of new court management methods;
- analysis of the main administrative methods of the judicial system and developing recommendations for improving the methods based on best practices of European Union countries;
- Improving communications and the system of advanced training of court employees.

The main objective of the program are:

- creation of a basis for transparent, affordable and effective judiciary power;
- improved access to the judicial system for the community;
- improved effective judicial system and quality of court decisions that meet European standards;
- increased transparency and accountability of the judicial system.

The second project, “Accountability and Effectiveness of the Ukrainian Judicial System (as a Component of the Civil Service)”, has a budget of EUR 5 million. The main goal of this project is to support improvement of staff management in the judicial system, improve operational efficiency of judges, as well as educating and training employees of the state security agencies.

In addition, preparation of another project under a twinning program is underway, the goal of which is to support the administrative and judicial system in Ukraine (its value is approximately EUR 1.5 million).

Along with the above-mentioned EU aid, a significant contribution to the achievement of supremacy of law and independent legal proceedings is being made by the American Agency for International Development together with the Millennium Challenge Corporation within the framework of the Supremacy of Law program<sup>23</sup>.

### **Corruption and Anti-Corruption Policy**

As was the case in 2007, 2008 did not feature a significant campaign to fight corruption in Ukraine. The months-long President – Cabinet of Ministers confrontation put anti-corruption measures on the political back burner.

<sup>23</sup> USAID web-site [http://www.ukrainerol.org.ua/index.php?option=com\\_frontpage&Itemid=1](http://www.ukrainerol.org.ua/index.php?option=com_frontpage&Itemid=1)

On September 3, 2008, the international anti-corruption organization Transparency International published its annual Global Corruption Report with a corruption rating of the world (Corruption Perceptions Index). According to the Report, Ukraine's index was 2.5 this year (on a scale from 10 to 0, where 0 stands for the highest corruption perception level, and 10 is the lowest level; at the same time, an index value less than 3.0 represents "galloping" corruption).

In 2007, the index for Ukraine was higher, with a value of 2.7, while in 2006 it was 2.8. Today, Ukraine shares 134<sup>th</sup> place in the rating of 180 countries with such countries as Nicaragua, Pakistan and Comoro Island, which also have an index lower than 2.5, whereas last year Ukraine was in 118<sup>th</sup> place in the rating. This ranks Ukraine with countries considered most corrupt by Europe; at the same time, it is viewed as a country where anti-corruption methods are ineffective, and the scale of corruption is increasing. Such a low corruption perceptions index for Ukraine is evidence of the negative image of institutional system of Ukraine and its low investment appeal abroad. Political corruption and corruption in state bodies, disappointment of the people in the financial morality of politicians, nontransparent budget management, total corruption of the state purchasing system and bribery in the tax office are considered critical problems. Extremely serious problems include ineffectiveness, lengthiness and non-transparency of bureaucratic procedures, lack of accountability and corruption of the public service, lack of decision-making transparency in state and management bodies, and vulnerability of the public service to political pressure.

Glaring problems in the judicial sphere are: unfairness of courts, their dependence on political and business influence, and lack of guarantees of executing judgments are considered common practice. Enterprises that have to spend a significant percentage of their annual revenue on undue additional payments (bribes) are affected. Factors contributing to the low Corruption Perceptions Index for Ukraine also include: a high level of organized crime, fraud and money laundering, political corruption, corruption in financing of election campaigns, weak support for private property rights, corruption in legislative bodies and distrust of the state anti-corruption policy.

Of the former Soviet republics, the countries with the lowest rating (and thus highest corruption level, according to experts and respondents inside the country and abroad) are Kazakhstan (2.2), Russia (2.1), Tajikistan, Belarus (index 2.0), Azerbaijan (1.9), Uzbekistan, Turkmenistan and Kyrgyzstan (1.8)<sup>24</sup>.

<sup>24</sup> Political corruption in Ukraine – that beats all! – research of Transparency International  
<http://zik.com.ua/ua/news/2008/09/23/150901>



Like local governance, the judiciary and economic policy of the state, anti-corruption policy became a hostage to the high political confrontation between the President and the Prime Minister. The confrontation became known as a “decrees’ war”: in only the first 100 days in power, the Government of Yulia Tymoshenko received 881 directives, instructions, and tasks (almost nine per day) from the President and his Secretariat, whereas the previous government of Viktor Yanukovich received 231 tasks in the same period<sup>25</sup>. Under such circumstances, the substance and relevance of the policy and its importance for the development of the state frequently lost its sense.

The Program of the new Government established anti-corruption measures as one of the priorities. According to the Program, the Government views corruption as “the main threat to the social and economic development of society”. The Program rightly indicated the main factors of corruption in Ukraine. Among others, they include non-transparency of official bodies, lack of political will to fight corruption, high impact of oligarch groups on decision making and appointments in state bodies, lack of security of private ownership, ineffectiveness of the judicial system, and the absence of civil control over income and expenditures of high officials. The Government has devoted itself to providing “maximum transparency of the activities of state authorities”. Separation of business from authorities and facilitating adoption of an “anti-corruption package” introduced by the President to the Supreme Rada (it includes drafts “On changes to some acts (regarding responsibility for corruption crimes)”, “On the basics of preventing and fighting corruption”, “On responsibility of legal entities for corruption crimes” and to draft the laws “On declaration of income by natural persons”, “On state control in Ukraine”, “On state financial control over declaration of income and spending thereof by state officials, members of their families and close relatives”, etc.) are among the Government’s priorities.

In order to further influence the Cabinet of Ministers to adopt these draft laws, the President passed decrees on some measures for improving and implementing the state anti-corruption policy<sup>26</sup> and on measures for preventing corruption in courts and law-enforcement bodies<sup>27</sup>. The decrees order the Cabinet of Ministers

<sup>25</sup> Collective of authors “100 Head-Off Steps” in *Zerkalo Nedeli*, № 12(691) 29 March-5 April 2008: <http://www.mw.ua/1000/1550/62561/>

<sup>26</sup> Decree of the President of Ukraine “On Some Measures on Improvement and Implementation of the State Anti-Corruption Policy” №80/2008, 1 February 2008.

<sup>27</sup> Decree of the President of Ukraine “On Measures on Preventing Corruption in Courts and Law-Enforcement Bodies” №328/2008, 11 April 2008.

to take the appropriate measures, including lawmaking, to increase anti-corruption capacities. The Cabinet of Ministers did not elaborate the proposed draft laws and did not bring them to the consideration of the Supreme Rada; consequently, the “anti-corruption package” was not adopted. Nor has the Plan of Measures on the Implementation of the Concept on a Way to Integrity to 2010<sup>28</sup> adopted in 2007 by the previous Government of Viktor Yanukovich been developed.

The President also adopted a decree on the creation of an Interdepartmental working group on anti-corruption<sup>29</sup>. The Group co-headed by the General Prosecutor and the Head of the Security Service of Ukraine is a subsidiary body under the President of Ukraine with the aim of elaborating initiatives in the fight against corruption, assessment of the main corruption threats and engaging civil organizations to fight against corruption. Starting on April 23, the Group held a number of meetings. On the results of each of them, the Group proposed initiatives of a recommendatory character. Previous experience shows that building additional institutional capacities does not facilitate the elimination of corruption. Rather it creates an additional discussion platform, and practical implementation of its decision remains difficult.

As a grounds for the appropriateness of the above decisions, the President stated: “The most corrupt bodies are the militia, prosecutor’s offices, taxation bodies, courts, medical system, education system, as well as Parliament and political parties. It is hard to name an area where there is no corruption in Ukraine”, stressed Yushchenko. He also added that corruption “has gone so far” that it impeded development of the Ukrainian state and economy. Yushchenko also noted that political corruption at the high level of power fosters the expansion corruption in all spheres of life. The President said that corruption was a primary reason for last year’s parliamentary crisis. “It would be good if political corruption stopped there. But this was in vain. Corruption is even more widespread in Parliament. Today it exists both in Parliament and in political process outside Parliament”, said Yushchenko, stating that today places in party lists of certain parties are bought. The President also said that on September 30, 2008, international monitoring of the corruption situation would be conducted in Ukraine and stressed in his address to the heads of power-wielding structures that “I will evaluate your work based on the monitoring”<sup>30</sup>.

<sup>28</sup> Plan of Measures on Implementation of the President’s Concept on a Way to Integrity for the Period to 2010, Decree of the Cabinet of Ministers of Ukraine №657:15, August 2007.

<sup>29</sup> Decree of the President of Ukraine “On the Interdepartmental Working Group on Anti-Corruption” №370/2008, 17 April 2008.

<sup>30</sup> <http://www.newsru.ua/ukraine/15apr2008/korruptciija.html>

By all appearances, later events did not increase the President's optimism, and the given tasks were not fully implemented. During the year, Yushchenko himself implemented a series of actions, in particular, in the judicial system (see the respective section), which gave his opponents grounds to accuse the President of corruption. Nevertheless, in autumn, the President and NSDC renewed the subject of the fight against corruption. On November 27, 2008, the President approved with his decree an NSDC decision dated October 31, 2008, **"On the situation with countermeasures against corruption in Ukraine"**. Specifically, the document, states:

The National Security and Defense Council is forced to acknowledge that the situation with fulfillment by the executive authorities of the decision dated April 21, 2008, "On measures to implement a national anti-corruption strategy and institutional provision of an integrated anti-corruption policy" and respective acts of the President remain dissatisfactory.

A new edition of a plan to implement measures of the Anti-Corruption Concept in Ukraine "On the Way to Morality" for the period to 2010 was not approved.

Up to now, there has been no legal base for more effective corruption resistance, and issues of higher responsibility for corruption activities, limitation of immunity, and institutional provision for corruption fight and court reformation have not been solved.

At the same time, the first experience of activities by the Interdepartmental Anti-corruption Workgroup should be considered positive in that it made for better coordination of corruption prevention and resistance measures.

NSDC also authorized the Cabinet of Ministers of Ukraine to approve recommendations of the Group of States against Corruption (GRECO) with consideration of the proposals of National Security and Defense Council members on the implementation of the Threshold Program of the Millennium Challenge Corporation with a new edition of a plan of measures to implement the Corruption Prevention Concept "On the Way to Morality" in Ukraine for the period to 2010. It specifically provides a mechanism to coordinate the activities of executive bodies on implementing international technical aid projects in the area of anti-corruption, a monitoring and control mechanism for implementing such a plan; to provide for a yearly update of the plan of measures on implementation of the "On the Way to Morality" anti-corruption concept; to urgently submit draft laws to the Supreme Rada of Ukraine the acceptance of which is determined by Ukraine's joining the UN anti-corruption convention, the Criminal Law Convention of the Council of Europe and its protocol: in particular, on lobbying; on changes to the

Law of Ukraine “On Political Parties of Ukraine” and “On Elections of Members of Parliament of Ukraine” regarding the financing activities of political parties and the electoral process; to analyze the causes of non-fulfillment of tasks of fighting corruption stipulated in a series of earlier decisions”.

NSDC plans to raise the anti-corruption issue again in Q2, 2009.

Initiatives concerning the division of state power and business were notably absent during 2008. Job placement procedures at central- and local-level government bodies still lack transparency and public accountability. In the matter of obtaining a position, professional qualifications were not prioritized over personal or party loyalty. Moreover, with the coming to power of the new Government, 2008 witnessed a growing tendency of firing officials for political reasons. Such “cleansings” first of all concern high state officials of I and II ranks. Thus, the “Ukrainian state is losing the most experienced and qualified personnel”<sup>31</sup>.

In 2008, no examples of authorities limiting media investigations into corruption and bribery arose. At the same time, nontransparent decision making at the local and higher political levels remained a significant problem and made investigations difficult. Furthermore, no changes were made granting civil councils, which hold sittings and consultations with authorities from state bodies, substantial influence over policy development and implementation.

Following the national survey on corruption of 2007<sup>32</sup> several national surveys on corruption in the judiciary and higher education were introduced in 2008. According to the survey on corruption within the judicial system, almost one-third of lawyers and prosecutors believe that corruption is common at all stages of court proceedings; among citizens, 19%, and among businesses, 37% of the respondents indicated that they have personally experienced corruption<sup>33</sup>. The most common is the use of personal connections. In assessing the government’s efforts to curb corruption, the majority of respondents (67% of citizens polled) believe that it has not taken the necessary measures. As for corruption in higher education, the majority of respondents in all survey groups (parents, students, graduates and teachers) view the admissions exam process to higher educational

<sup>31</sup> Tymofiy Motrenko, chief of the Main Public Service Department in “100 Head-Off Steps” in *Zerkalo Nedeli*, № 12(691) 29 March-5 April 2008: <http://www.mw.ua/1000/1550/62561/>

<sup>32</sup> *Corruption in Ukraine, 2007*, Baseline National Survey for the MCC Threshold Country Program, May 10, 2007: [http://www.pace.org.ua/images/survey/full\\_baseline\\_rep\\_2007\\_eng.pdf](http://www.pace.org.ua/images/survey/full_baseline_rep_2007_eng.pdf)

<sup>33</sup> *Survey on Corruption Within the Judicial System in Ukraine: Courts of General Jurisdiction*, by USAID, MSI and MCC, July 2008: [http://www.pace.org.ua/images/survey/jud\\_sys\\_en\\_jun08.pdf](http://www.pace.org.ua/images/survey/jud_sys_en_jun08.pdf)

institutions as very or somewhat corrupted (all groups – more than 50% of respondents)<sup>34</sup>. Much smaller, but significant numbers of respondents view the graduation exams as very corrupted (the results range from 8% to 29% among the respondent groups). On the other hand, very few respondents see the standardized external testing (introduced in 2008 as obligatory) as corrupted (15% of students polled). As in the case with the judiciary, most of respondents (from 45 to 60% from different respondent groups) believe that efforts to fight corruption in the admission process have been very or somewhat effective to date.

In June 2008, the creation of a sociological survey database on corruption in Ukraine was announced. It was presented by the Kyiv International Institute of Sociology (KIIS). The database collects the results of all surveys on corruption issues in different areas conducted in Ukraine during last 10 years, says Volodymyr Paniotto, General Manager of the Institute.

Sociological surveys included in this database cover different areas, such as education, medical system, judicial system, municipal sector, customs office, etc. The main feature of this database is that all resources are located on a special web site with free access. It is planned to publish over 60 surveys conducted by both Ukrainian and international organizations. The database was created with support of the project “Active participation of citizens in anti-corruption measures “Dignified Ukraine”. This project is being implemented with the support of the US Agency for International Development within the Threshold program of the Millennium Challenge Corporation. The database is available for Internet users on the KIIS<sup>35</sup> web site.

Among research published at this site, there are notable data of KIIS nationwide surveys on the frequency of bribery and other corruption activities, as well as on perception of corruption by the citizens of Ukraine.

The number of people who report that they or members of their families paid bribes in the last 12 months is fairly stable: during the monitoring period (from December 2007 to August 2008) this percentage did not change from 11-13 % of the respondents.

Despite some variations, the amount of bribes paid by a household is also fairly stable. According to survey results for October 2008, the minimum bribe

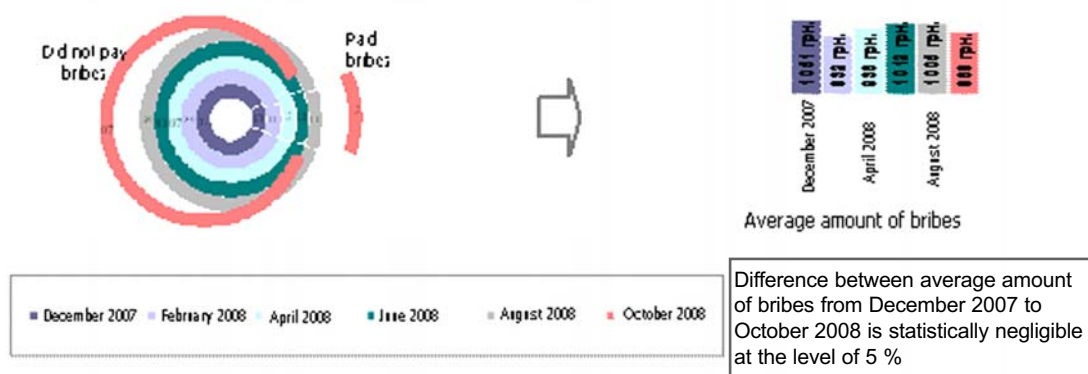
<sup>34</sup> *National Survey on Corruption in Higher Education*, 2008 Baseline Report by MSI in cooperation with KIIS, April 5, 2008: [http://www.pace.org.ua/images/survey/4\\_cor\\_high\\_edu\\_ukr\\_eng.pdf](http://www.pace.org.ua/images/survey/4_cor_high_edu_ukr_eng.pdf)

<sup>35</sup> KIIS <http://www.kiis.com.ua/cordb/index.php>

paid by a household was UAH 2, and maximum amount was UAH 30,000. The average amount of bribe paid by a household during the year with consideration of outliers (elimination of values that do not correspond to the distribution) is UAH 868; the 95 % confidence interval for the average is UAH 692 to UAH 1044 (Figure 2).

**Figure 2**

Incidence of bribery and amounts of bribes paid by Ukrainians during the last 12



According to the recent survey, men and people from 18 to 44 years old are involved in bribery, and persons over 60 and people with junior secondary education and basic education were the least involved.

Despite a years-long fight, corruption remains an intractable feature of Ukrainian society. There was no significant spread of corruption in 2008 or a decrease in its level. The year did not witness any major legislative initiative to fight corruption, and there was no active implementation of the initiatives of previous years. If not changed, further weakening of authorities and growing distrust of people, may lead to rapid and significant worsening of the corruption rates in the country in the following year.

## **General conclusions**

Ukrainian experts consistently note prevailing negative trends in the evaluation of the political process and reform in Ukraine during 2008. Yury Yakymenko, the director of political and legal programs at Razumkov Center, believes that “2008 will be a year of permanent crisis of power and the political elite in general. The main conclusion is that the political and governmental elite showed their inability to consolidate even in the face of very serious internal and external challenges that continue to exist. Political corruption attained a systematic nature. As a result, the process of loss by the authorities of their social legitimacy is ongoing. This is evidenced by the fact that the support level of main bodies of power decreased very significantly. For some of institutions, this level fell by several times. The same is true for politicians. All prominent politicians have a very negative balance of public confidence. The failing trust in judicial power is also a very negative factor. The consequences may be even more negative than just legal nihilism. Society is moving to forms of self-organization and is looking for the means to protect their interests beyond the limits of the law, legislation and state institutions”.

According to Yulia Kiselyova (UNCPD), 2008 was not just a calendar period for Ukraine, when lost opportunities and unimplemented chances for the country's development and reform are counted.

Political events during this difficult period only deepened the contradictions and generally prolonged the crisis of the political system and actualized additional risks to the existence of the state in general. The political year of 2008 once again stressed the excessive personification of the Ukrainian political arena, where active players are not just political parties but rather their leaders. A few people make decisions for all the rest. Such personification and dependency of parties on the popularity of their leaders transforms the significance of Parliament into a folding-screen and cancels the principles of collegiality of decisions and pluralism. The year 2008 was a year of weakening of political parties as collegial institutions.

**The events of 2008 have demonstrated the turbulence of Ukraine's political system, a lack of a consolidated position of Ukrainian politicians as to the choice of geopolitical future and various strategic directions of development of Ukraine in general.**

Chapter 2.

**ECONOMY, STATE OF FINANCES  
AND INFLUENCE OF ECONOMIC CRISES**

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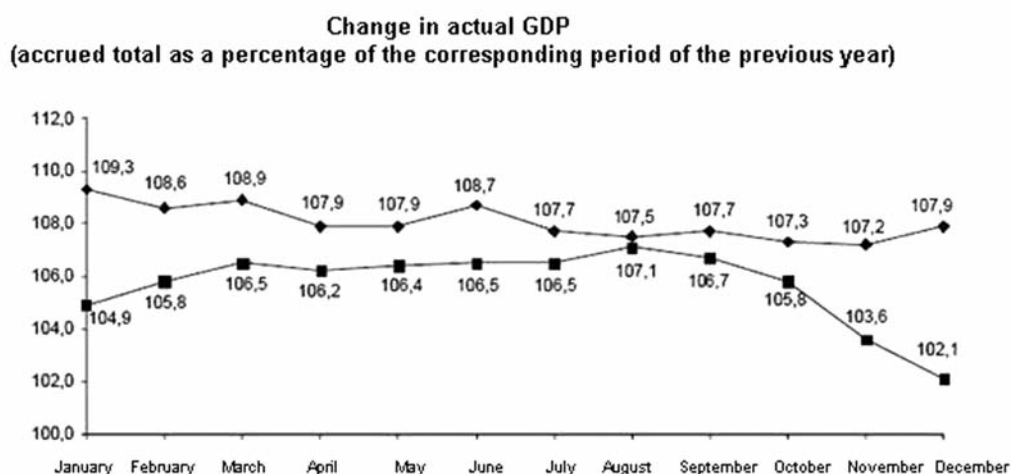


The year 2008 signalled an abrupt change of economic trend. The rapid economic growth of 2000-2007 was replaced with a decline that started in the 4<sup>th</sup> quarter of 2008. Although annual statistics show 2.1% GDP growth, this figure has been achieved at the expense of high growth in the first nine months of the year. **Ukraine, like the majority of European countries, is entering a recession period. However, the first months of the economic downturn demonstrate that this slump is more profound in Ukraine than in other countries of the region.** Based on many significant indicators, Ukraine is showing the worst economic results in Europe of the last quarter of 2008. Accordingly, the 2009 forecast for Ukraine is more pessimistic compared to that of the absolute majority of EU member states and CIS countries.

## Dynamics of Gross Domestic Product

According to the State Statistics Committee of Ukraine<sup>1</sup> actual gross domestic product in 2008 increased by 2.1% compared to 2007 (Chart 1). The highest growth of gross value added took place in the agricultural, hunting, forestry, transport and communication sectors.

Chart 1<sup>2</sup>



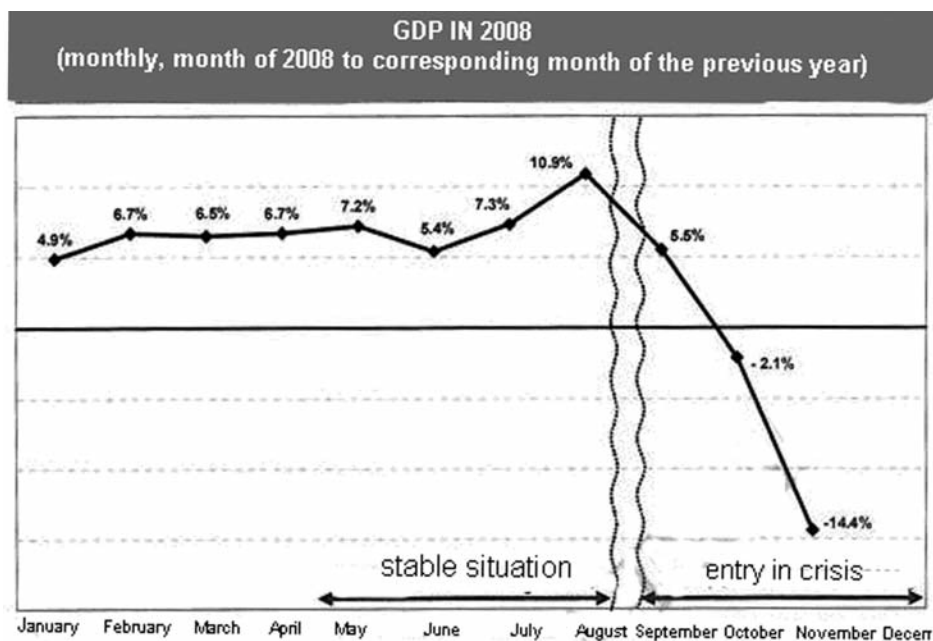
<sup>1</sup> Hereinafter official statistics published by the State Statistics Committee of Ukraine in its report 'Social and Economic Situation of Ukraine in 2008' are used.

<sup>2</sup> State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

As seen from the table below, if the trend of the first three quarters had been maintained, Ukraine would have shown the same rate of economic growth as last year – around 6.5-7%. However, the situation in the last quarter caused a considerable deceleration of the average annual GDP growth rate, and consequently it decreased to the above-mentioned level (2.1%).

The document published by the Ukrainska Pravda Web site containing unofficial but trustworthy information of the Ministry of Finance, as stated by many experts, shows the GDP dynamics in quite a different manner: in absolute percentage of the corresponding month of 2008 rather than on an accrual basis (Chart 2). This method makes more evident the negative tendency of the last months of the year, and especially November, where GDP diminished by 14.4% compared to November 2007. In December, the GDP slump slowed somewhat to 9.9%, yet it remains dangerously fast<sup>3</sup>

**Chart 2<sup>4</sup>**



<sup>3</sup> Finance-UA Web site <http://news.finance.ua/ua/~1/110/all/2009/01/22/149465>

<sup>4</sup> 'Ukrainska Pravda' January 27, 2008 <http://www.epravda.com.ua/publications /497ee1f14c7d6/>

Under such conditions **the 2009 forecasts give no hope** for restoring economic growth in the near future. Although the 2009 State Budget of Ukraine contains the predicted GDP indicator of +0.4% compared to 2008, other professional forecasts predict a drop in GDP. In particular, the EBRD forecast published in January foresees a decline of 5% in Ukraine's GDP in 2009. A similar opinion is shared by the IMF, experts of the Secretariat of the President of Ukraine, as well as the majority of independent Ukrainian experts<sup>5</sup>. Some Ukrainian politicians and professionals believe the situation may be even worse. President Yushenko's assumption that GDP would decline by 5% can be regarded as an optimistic forecast. Victor Pynzenyk, Minister of Finance, after estimating the GDP decline for the 1st Quarter of 2009 only, considers his previous prediction of a 7-10% of drop in the first quarter of 2009 as an "already unrealistic forecast"<sup>6</sup>.

**Table 1. GDP dynamics forecasts for 2009**

	EBRD	IMF	World Bank	Fitch agency	Ministry of Economy of Ukraine (December 2008)	State budget of Ukraine 2009
GDP dynamics	-5	-5	-4	-3,5	-5	0,4

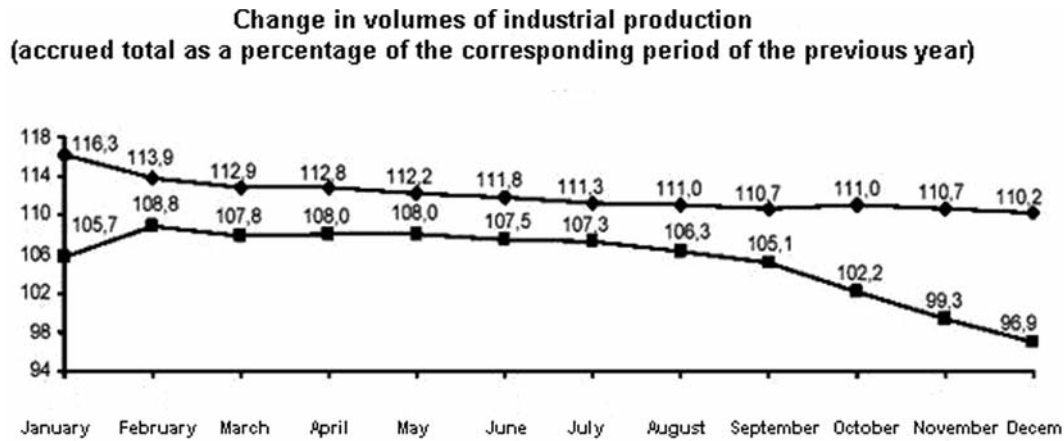
## Industry

Industrial production was one of the first sectors to experience the recession tendencies. Therefore, according to 2008 results, the decline in production compared to the previous year reached 3.1%. This situation was caused by a slump in production volumes in the 4<sup>th</sup> Quarter of 2008 (by 24.9%). The maximum decline compared to the corresponding period of 2007 was observed at enterprises of the mining and metallurgical industry (39–45%), chemical sector (32.5%), and machine-building (29.2%). The 2007 level of production was not reached in the production of non-energy natural resources, light and chemical industry, steel, coke and oil product industries, and generation and distribution of electric power.

<sup>5</sup> Web site of the Razumkov Center [http://www.razumkov.org.ua/expert.php?news\\_id=1034](http://www.razumkov.org.ua/expert.php?news_id=1034)

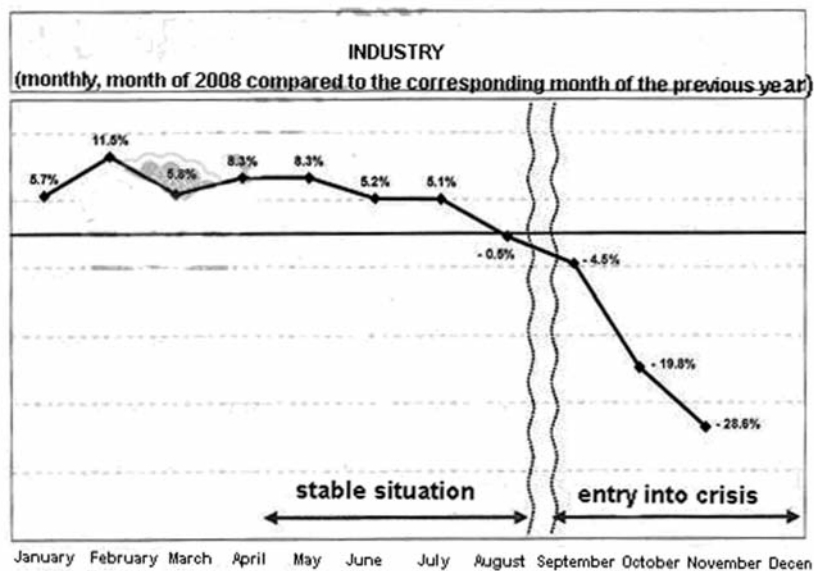
<sup>6</sup> 'Ukrainska Pravda' January 27, 2008 <http://www.epravda.com.ua/publications/497ee1f14c7d6/>

Chart 3<sup>7</sup>



If presented in absolute monthly data, the situation looks as follows (Chart 4). It is seen that a slump in industrial production took place in October-November that has never happened before in Ukraine during the period of independence (-28.6% in November). Although December witnessed some revitalization of industrial production (the metallurgy even started to restore production volumes), a general decline was detected at year-end.

Chart 4<sup>8</sup>.



<sup>7</sup> The State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

<sup>8</sup> 'Ukrainska Pravda' January 27, 2008 <http://www.epravda.com.ua/publications/497ee1f14c7d6/>

The State Statistics Committee of Ukraine published data relating to industrial production dynamics in 2008 by separate sectors (Table 2):

**Table 2<sup>9</sup>**

	Increase, decrease (-) (in comparative prices) ,%			
	December 2008 to November 2008	December 2008 to December 2007	2008 to 2007	Referen ce:2007 to 2006
Industry	3.2	-26.6	-3.1	10.2
Extractive industry	21.7	-20.1	-2.4	2.7
Fuel and energy-related mining 11.2	11.2	0.2	1.0	-2.0
Non-fuel and energy mining	48.3	-42.4	-6.1	8.8
Processing industry, including	0.6	-28.3	-3.2	11.7
Production of food, beverages and tobacco items	-10.3	-4.9	-0.9	10.0
Light industry	-2.5	-17.4	-3.4	0.4
Textile production				
Production of clothes, fur and fur goods	-0.3	-16.9	-6.0	-0.3
Production of leather, leather and other goods	-8.9	-18.9	5.1	2.7
Woodworking and production of woodwork except for furniture	-23.1	-32.3	9.6	22.1
Pulp and paper production; publishing activities	-3.3	-17.9	7.3	10.6
Production of coke and oil-based chemicals	5.9	-6.2	-15.0	3.3
Chemical and petrochemical industry	-5.1	-38.0	-6.2	6.2
Chemical production	-5.1	-40.0	-9.1	3.9
Production of rubber and plastic articles	-5.2	-31.9	3.1	14.1
Production of other non-metallic articles	-29.8	-41.4	4.3	16.9
Metallurgical products and production of finished metalware	16.3	-42.7	-10.6	8.3
Machine building	12.6	-37.1	8.6	28.6
production of machines and equipment	14.1	-20.3	5.2	15.3
production of electric, electronic and optical equipment	25.8	-16.0	8.3	22.6
Production of transportation means and equipment	3.2	-54.5	11.1	42.3
Production and distribution of electrical energy, gas and water	12.9	-14.0	12.5	3.2

<sup>9</sup> The State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

The official Ukrainian statistical data show that production at metallurgical facilities in 2008 considerably decreased. The decline started in 3<sup>rd</sup> Quarter, and in the last three months of 2008 a significant acceleration of this negative process was observed, while production volumes decreased by 43.7% compared to 2007 (by 8.3% in 3<sup>rd</sup> quarter).

For the whole of 2008, production declined by 10.6%, including enterprises producing cast iron, steel and ferroalloys – 12.9%, pipes – 9.7%, other types of primary steel processing – 8%, and non-ferrous metals – 2.9%. At the same time, enterprises producing ready-made metal goods showed a 4.5% increase.

Experts note that while the first part of 2008 appeared to be the most successful in the history of the Ukrainian mining and metallurgical industry, the second half-year set this export-oriented and budget-forming sector of the economy back ten years<sup>10</sup>.

In particular, during the first six months of the year, the price for iron ore and steel at Black Sea ports reached an all-time high of \$120-140 and \$1000-1200 per ton, respectively. Nonetheless, during August/September prices slumped by 300%, which against the background of a reduction in global demand, caused overstocking of the warehouses of all major steel works with further suspension of up to 50% of production facilities. **Taking into account the fact that the Ukrainian metallurgical industry provides up to 40% of export receipts and about 25% of contributions to the Ukrainian budget, the crunch in this specific sector became a cornerstone of the overall crisis situation in the economy and later in the budget sector as well.**

The year-end production of cast iron and steel rolled back to that of 2005. In December many facilities that were suspended in October/November resumed metal production (by 16.3% with respect to November); however it is too early to speak about any tendency. According to forecasts, an improvement in market conditions, which means recovery of this sector, will not start until the spring of 2009; and on the results of this year, production may still drop by 10 to 16%. As far as pessimistic predictions are concerned, the Ukrainian metallurgical industry will operate at 50% load, which corresponds the level of 1999<sup>11</sup>.

Output of products in the extraction industry decreased by 2.4% compared to 2007, including 7.2% at metal ore mining enterprises; production of oil and gas decreased by 0.9%.

<sup>10</sup> Metallurgical industry: results and analysis 2008 <http://birga.org.ua/?rubric=12&article=2118>

<sup>11</sup> Review of the Ukrainian metal products market. 2008 <http://pro-consulting.com.ua/analiz/gmk/bleak/>

Year on year processing industry output decreased by 3.2%.

The machine-building industry experienced a major drop in production in many areas of activity in the 4<sup>th</sup> quarter of 2008 compared to the corresponding period of 2007. The most noticeable reduction was observed in the automotive industry (50.2%), home appliance production (47%), machines and equipment for the agricultural and forest sectors (35.9%), and railway rolling stock (35.8%). Nonetheless, output growth of the entire industry in 2008 amounted to 8.6% as a whole.

In 2008, the food industry failed to achieve last year's output results, while the general loss of production was 1.4%, including oil and fats – 15.6%, sugar – 13%, fruit and vegetable processing and canning – 7.4%, mineral water and other soft drinks – 5.4%, and milk products and ice cream – 2.9%.

Output of tobacco products increased by 7.9%.

The output of light industry enterprises in 2008 decreased by 3.4% in contrast to 2007 due to a reduction in the output of clothing and textile enterprises (by 7.9%) and the textile industry (1.4%).

Production of coke and petroleum derivatives in 2008 shrank by 15% compared to 2007. A slump in coke production (38.9%) was observed during the last quarter of 2008. According to available statistics, the production lag in 2008 was 3.4% in comparison to 2007.

Output of the oil refining industry decreased by 19.3% in comparison with 2007. A total of 19.5 mln tons of coke, 3.7 mln tons of diesel fuel for automotive and railway transport, 3.2 mln tons of gasoline with a lead content of 0.013 g/l and less, and 2.4 mln tons of heavy furnace oil were produced in 2008.

The chemical and petrochemical industry showed a 6.2% decrease in production in comparison with 2007, including basic chemical production enterprises (14.4%), lacquers and paints (1.9%), and rubber products (4.7%).

At the same time, there was an increase in production of pharmaceuticals (3.8%), soap and detergents, cleaning and polishing agents, perfumes and cosmetics (17.4%), and plastic products (5.7%).

In 2008, the output of woodworking and furniture production enterprises increased by 9.6% compared to 2007; profiled beams, planks and parquet or hardwood flooring (by 52%), profiled hardwood (by 22%), unprocessed fiberboard (by 15%). Along with this, there was a considerable decrease in production of profiled softwood products, prefabricated wooden structures, wooden construction products, millwork, and veneer.

In the pulp and paper industry and publishing activities volumes of production increased by 7.3% against 2007. For instance, a considerable increase (42%) took place in book printing.

As for other non-metallic mineral products, output increased by 4.3% in comparison with 2007.

In the electric power generation and distribution sector, the volume of production (work, services) in 2008 decreased by 2.4% against 2007.

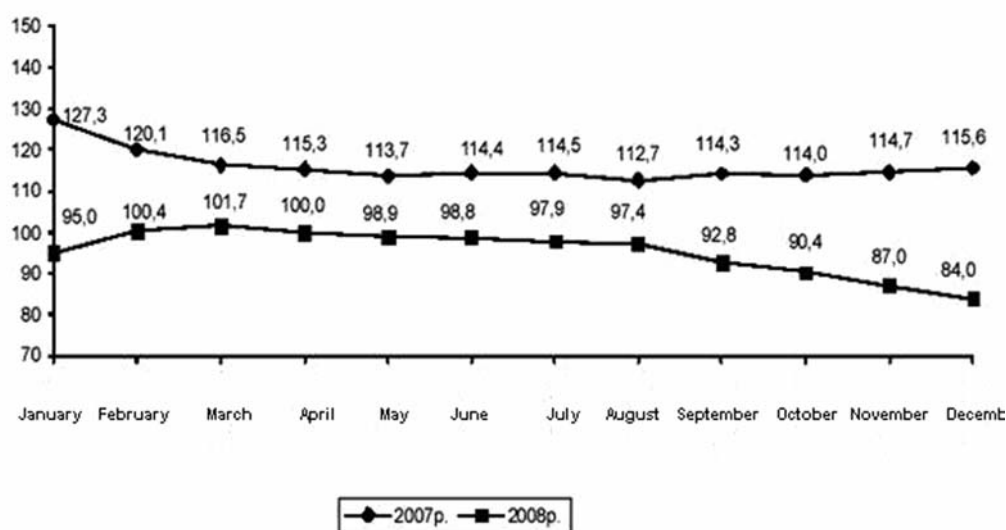
## Construction

Recession in the construction sector began earlier than in other sectors and its nature is somewhat different from that of other production sectors. Construction, unlike other export-oriented sectors of Ukraine's economy, is totally dependant on domestic demand. During the last few years, the construction market experienced a boom accompanied by an unparalleled price surge – up to 60% annually for residential and non-residential buildings. This was promoted through growth of solvent demand caused by the development of mortgage lending.

The mortgage lending crisis and cessation of price increases in the first months of 2008 immediately impacted construction volumes: the recession started as early as the spring, gained momentum during the year, and peaked by the end of the year (Chart 5).

Chart 5

**Change in construction volumes**  
(accrued total as a percentage of the corresponding period of the previous year)





Consequently, construction work for a total amount of 64.4 bln hryvnas was performed in 2008, which is 16.0% less in comparison with the previous year. The industry total was especially adversely affected by a significant reduction in construction work at the end of the year.

The construction slowdown occurred in all main types of construction activities. In particular, the volume of site preparation work, construction of buildings and facilities, and installation of building service equipment in buildings and facilities decreased by 10.3%, 16.3%, and 14.3%, respectively.

**Table 3. Volumes of work performed by types of construction activities**

	Work performed in 2008, UAH bln	As a percentage of	
		Grand total	2007
Construction	64362.6	100.0	84.0
Including			
Preparation of construction sites	2263.6	3.5	89.7
Construction of buildings and facilities	55001.4	85.5	83.7
Installation of building service equipment in buildings and facilities	6372.7	9.9	85.7
completion work	548.8	0.8	83.1
Lease of construction machinery with operator	176.1	0.3	63.1

Among enterprises involved in the construction of buildings and facilities, the most drastic reduction in work was experienced by those involved in construction of roads, airfields and surfaces of sports facilities (by 36.4%) and laying of long distance (by 13.9%) and local (19.9%) pipelines, communication and power supply lines.

Enterprises in 25 regions of Ukraine scaled down their construction volumes against 2007. A major decrease was observed in Vinnytsa (32.2%), Lugansk (30.8%) and Chernigiv (27.2%) regions.

Enterprises of Mykolaiv and Dnipropetrovsk regions, Autonomous Republic of Crimea and Volyn Region scaled down their volume of work by 21.0–23.2%.

Construction companies in Kyiv that performed 28.7% of the total volume of work in Ukraine reduced construction volumes by 15.7%, which is connected with

a reduction in residential building and commercial property assembly work, the installation of other prefabricated structures, as well as construction and overhaul of roads. The crisis is especially visible at Kyiv's construction sites, where a lot of projects, even with 70 to 90% readiness, have been suspended as of January 2009.

Only two regions showed an increase in construction activities: Chernivtsi Region - by 8.4% (due to construction of facilities at Dnister Hydroelectric Pumped Storage Power Station and work relating to disaster clean-up operations) and the city of Sevastopol – by 3.2% (mainly through shore protection and reconstruction of motor roads, construction of housing and a concrete production facility).

Today, the government is making certain attempts to support the construction industry at a time of crisis. Specifically, the Parliament of Ukraine adopted the Law on “Prevention of influence of the global financial crisis on development of the construction industry and housing construction” on December 25, 2008 (the document was supported by 410 deputies). The government's draft law was taken as a model.

The draft law calls for completion of construction of residential buildings with a level of readiness exceeding 70%, the cost of housing in which shall be established by the Ministry of Economy and Ministry of Regional Development and Construction. In 2009, buildings with 50% readiness will be finished and later those with less than 50% readiness.

In addition, the draft law provides for setting up a housing construction program with up to 30% public support and facilitation of construction licensing procedures.

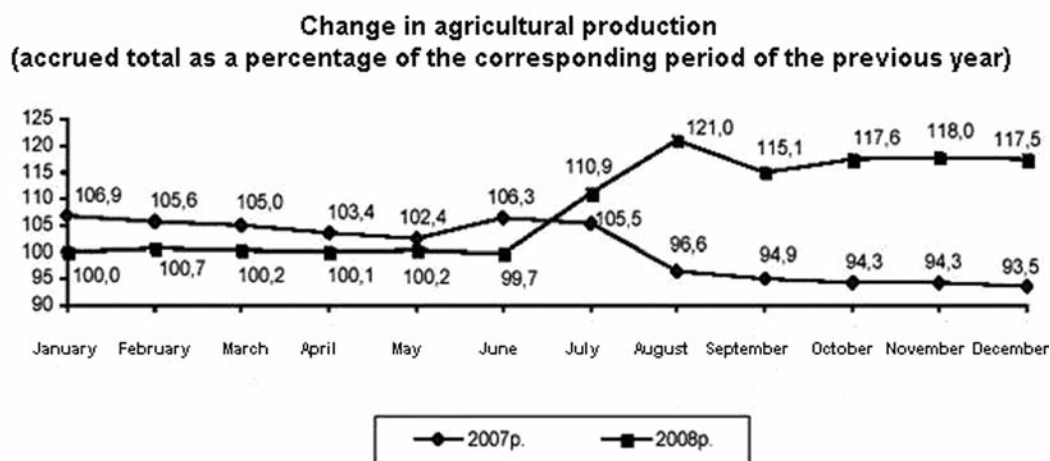
This document also proposes to reimburse the developer or investor for expenses relating to construction or renovation of facilities, electric power and gas supply networks. It is proposed that these costs be reimbursed by the enterprise that is entitled to provide technical specifications for construction of such facilities and networks and to which they are transferred to the balance and use. At the same time, the form of agreement, procedures for determining a reasonable volume of reimbursable expenses, and the form of compensation shall be established by the Cabinet of Ministers.

## Agricultural Sector

The year 2008 was one of the most successful ones in Ukraine during the whole period of independence. First of all, it became possible due to favorable weather conditions that resulted in high yields (Chart 6).

In particular, agricultural enterprises of all categories secured the largest grain crop in Ukraine's history, comprising 53.3 mln tons, which is 1.8 times higher than in 2007 (through an increased yield of grain (by 1.6 times) and a 14% increase in cropping area). Agricultural enterprises and households produced 42.1 mln tons of grain (79% of the overall croppage) and 11.2 mln tons (21%), respectively. The grain yield in agricultural enterprises (35.5 hundredweight per hectare) was 3.6 h higher than that of households.

Chart 6



The 2008 wheat crop (25.9 mln tons) was 1.9 times higher than that of 2007; barley – 12.6 mln tons (2.1 times higher); grain maize – 11.4 mln tons (1.5 times higher); rye – 1.1 mln tons (1.9 times higher); oats – 0.9 mln tons (1.7 times higher); and millet – 220.7 thousand tons (2.6 times higher), due to an increase in croppage and productivity. More buckwheat was produced – 240.6 thousand tons (by 10.7%) owing to an increase in productivity of 1.5 hundredweight per 1 ha (by 21.4%). At the same time, the production of rice decreased in comparison with 2007; the total rice crop amounted to 100.7 thousand tons (6.8% less), caused by

a decrease in its catchment area.

In 2008, production of sunflower seeds reached 6.5 mln tons and thus increased by 56% in comparison to 2007 (owing to a 25% increase in catchment area and productivity); production of sugar beets (factory) was 13.7 mln tons, or 19% less (exclusively due to a one-third reduction in their crop acreage with a 21% increase in productivity).

Production of vegetables (8.0 mln tons) increased by 16.5%; potatoes (19.5 mln tons), fruit products (1.5 mln tons) – by 2% (due to a 5–14% increase in productivity).

Thanks to an expansion of rape acreage (by 0.6 mln hectares or 72.5%) and increased productivity (by 59%), croppage increased by 2.7 times in comparison with 2007 to 2.9 mln tons, of which 98% comprised winter rape.

In 2008, private households produced 98% of the total potato crop, 86% of the vegetable crop, 85% of fruits, 21% of grain, 14% of sugar beets (factory) and 19% of sunflower seeds.

For the 2009 crop of winter grains and green forage of all categories, 9.8 mln ha (176 thousand ha or 1.8% more compared with the 2008 crop) were seeded, including winter grains – 8.3 mln hectares (277 thousand hectares or 3.5% less) and winter rape grain – 1.4 mln hectares (96 thousand hectares or 6.2% less).

According to preliminary data, in 2008 enterprises of all categories sold 2.7 mln tons of livestock and poultry (live weight basis), which is 1.5% less compared to 2007, and produced 11.8 mln tons of milk (4.1% less) and 14.9 bln eggs (6.2% more). Agricultural enterprises increased the sale of livestock and poultry (by 4.5%) and production of eggs (by 11.1%); at the same time, the production of milk decreased (by 4.0%). Private households reduced the production of meat and milk by 6.6% and 4.1%, respectively, while production of eggs increased by 0.4%. The proportion of private households in overall output of these products in 2008 was 51%, 82% and 43%, respectively.

According to estimates as of January 1, 2009, enterprises of all categories maintained 5.2 mln head of cattle, which is 6.1% less than as of January 1, 2008, including 2.9 mln cows (5.7% less); pigs – 6.4 mln head (8.3% less); sheep and goats – 1.7 mln head (1.1% more); and all types of poultry – 176.6 mln head (4.3% more).

Agricultural enterprises reduced the number of cattle by 10.7%, including cows – by 8.0%; pigs – by 4.7%; sheep and goats – by 0.7%; at the same time, the number of poultry stock increased (by 9.3%).

## **Transport**

The transport market depends mainly on the state of industry and export and import operations, since the main profits of this sector of the economy are traditionally generated from transporting industrial products. Thus, the beginning of the economic recession has appeared in the transport sector too.

During 2008, transportation companies carried 891.8 million ton of cargo, or 1.3% less than during 2007. Freight turnover decreased by 0.2%, and was 491.7 billion ton-kilometers.

Compared to 2007, rails cargo transport decreased by 3.0%, including cargo shipping – by 3.9%. Cargo shipping increased on two railways: Odessa – by 16.5% and South-West – by 1.4%. Lviv railway decreased cargo shipping by 12.2%, South – by 8.4%, Prydniprovskya – by 7.0%, and Donetsk – by 4.0%. Shipment of grain and milled products increased by 2.3 times, and black coal – by 6.2%. Shipment of oil and oil products decreased by 23.3%, iron and steel scrap – by 15.6%, ferrous metals – by 13.5%, timber cargos – by 10.7%, building materials – by 9.9%, chemical and mineral fertilizers – by 9.6%, iron and manganese ores – by 5.5%, coke – by 0.7%, and cement – by 0.4%.

The domestic marine and river merchant fleet decreased cargo transport by 19.6%; total of 19.5 mln tons of cargo were transported to customers. Cargo transport by river transport companies decreased by 25.5% compared with 2007; merchant marine – by 9.8%. River cargo transport abroad declined by 21.7%; marine transport – by 7.3%. The volume of cargo processing at commercial and fishing ports, as well as at industrial berths (both sea and river) increased by 4.4% to 184.2 mln tons. Export cargo processing increased by 17.9%, while import processing increased by 12.2%. Handling of domestic cargos decreased by 17.6%, and transit cargos – by 4.1%. The number of processed vessels, both foreign and in-freight, increased by 7.2% to 21300 units.

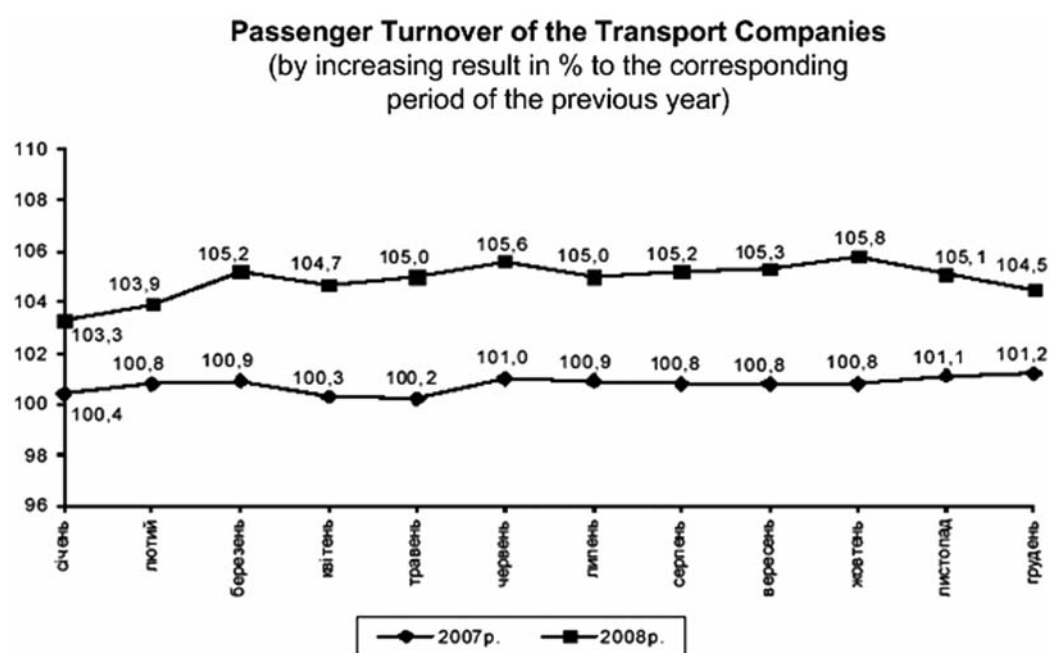
Motor transport companies (including by private entrepreneurs) transported 186.6 mln tons of cargo in 2008, which is 10.3% more compared to 2007; freight turnover amounted to 37.4 billion ton-kilometers, an increase of 27.3% as a result of inter-city and international transportation.

Supply pipelines transported 186.8 mln tons of cargo, which is 47% less compared to 2007. Gas pumping increased by 0.5%, ammonia pumping – by 1.8%, and oil handling decreased by 19.5%. Gas transit increased by 3.8%. Oil transit decreased by 17.4%, and ammonia transit – by 1.8%.

In 2008, air transport carried 101400 tons of cargo, which is 2.6% less compared to 2007. Air transport freight turnover was 378.4 mln ton-kilometers, which is 2.6% less in comparison to 2007.

**In 2008, passenger transport carried 8.3 billion passengers; passenger turnover totalled 147.3 billion passengers per kilometer, which is 1.4% and 4.5% more compared to 2007, respectively.**

**Chart 7.**



In 2008, railway transport carried 445.6 million passengers, which is 0.3% less compared to 2007. Passenger departures increased on Odessa Railway by 1.4%, Lviv Railway – by 1.3%, and South-West Railway – by 1.1%. Passenger departures on Donetsk Railway decreased by 4.1%, Southern Railway – by 1.8%, and Prydniprovskaya Railway – by 0.7%. Motor transport delivered services (including transportation by private entrepreneurs) to 4.4 billion passengers, which is 4.7% more compared to 2007. Passenger transportation by motor transport of private entrepreneurs increased by 9.4%. In 2008, passenger transport by marine transport decreased by 4.3% compared to 2007. In 2008, passenger transportation by river transport decreased by 15.7%, and transportation abroad – by 38.5%. A total of 6.2 mln passengers were transported by air, which is 25.1% more

compared to 2007. Municipal electric vehicles transported 3.5 bln passengers, which is 2.2% less compared to 2007.

The 2009 forecast of transport sector development largely depends on the ability of the Ministry of Transport and Communication of Ukraine to carry out declared objectives, namely:

- Attracting non-governmental investments and credit resources to develop the road system
- Starting implementation of highway engineering projects on concession terms
- Harmonization of national aviation rules to meet International Commercial Aviation Association requirements
- Regulatory and legal provisions for using electronic traffic documents in Ukraine
- Defining boundaries for future airport development, as well as ensuring the intended use of land for further development of airports and building their infrastructure objects
- Restructuring the passenger complex of Ukrainian Railway
- Ensuring adoption of Law of Ukraine “On seaports”, carrying out market reforms at commercial seaports<sup>12</sup>

Development of the transport sector is an integral part of preparations for holding the 2012 European Football Cup in Ukraine. Currently, only airports that will be used during Euro 2012 are planned to be reconstructed; this is where Ukraine cannot keep pace with its Polish partners.

## **Banking sector**

The banking sector has traditionally been considered one of the most dynamic sectors of the Ukrainian economy; for many years it has been growing quite rapidly compared to GDP growth. **Banking sector growth continued in 2008, although at the beginning of the year, the first signs of the credit and financial crisis had already appeared: banks started to increase loan interest rates and make requirements for credit recipients tougher. This soon resulted in a slowdown of crediting, and almost complete freezing at year-end along with deposit outflow and bank staff reduction. As of January 2009, the Ukrainian**

<sup>12</sup> Web site of the Ministry of Transport and Communication of Ukraine <http://mintrans.gov.ua/uk/news/10358.html>

**banking system is in danger of a liquidity crisis, or at least a credit liquidity crisis. Some banks may declare bankruptcy.**

As far back as late September, analysts of the Ukrainian Credit and Banking Union Association noted very dynamic development of the banking system and its stability: “Despite the fact that growth of the main indices of operation of Ukrainian banks slowed somewhat in 2008 compared to the same period of 2007, they outdid the general economic dynamics of other sectors of the economy to a large extent. Bank capital is growing more rapidly than in the previous year. For the period of January-August of 2008, regulatory bank capital increased by 33.2% to 96 billion UAH. This is one of the highest growth rates in the last six years. Bank assets are growing at the same speed, by 23.5% (by 40.3% in the same period of the previous year). In 2008, they increased by 141.5 billion UAH to UAH 740.5 billion”<sup>13</sup>.

Experts of the Ukrainian Credit and Banking Union noted that Ukrainian banks financed the economy and population, although at a lower rate than the previous year. Most positive was an increase in long-term loans. During first 9 months of 2008, they increased by 25.2% to 365.6 billion UAH, which is 59.4% of all issued credits.

According to National Bank of Ukraine information, as of the end of November 2008 the interest rate was 12%.

According to information of the State Committee for Statistics of Ukraine, as of December 1, bank liabilities on assets attracted on personal accounts (including interest) in national and foreign currency totalled 206.3 billion UAH, including 109.3 billion UAH in national currency.

Over the years, the volume of personal accounts has increased to 215.6 billion UAH (by 31.1%), and corporate accounts – by 23% (total of 142.3 billion UAH). This increase, however, was the result of substantial deposit growth during the period before the economic crisis, in January-September.

The deposit outflow that started in October 2008 was the first tangible impact on banking system stability. Deposits of individuals and corporations decreased by 9.1 billion UAH in October, and by 7.4 billion UAH more in November. Thus, **during October-November, the overall volume of deposits in commercial banks decreased by 16.5 billion UAH, not considering devaluation of UAH.**

During December 2008, deposits by individuals increased by 4.3%, and legal corporate deposits by 7.6%. However, this does not mean that deposit outflow

<sup>13</sup> UCBU: Banking sector of Ukraine shows dynamic development and stability [http://www.uabanker.net/daily/2008/09/093008\\_1010.shtml](http://www.uabanker.net/daily/2008/09/093008_1010.shtml)



stopped: the increase in UAH equivalent of the deposit volume is due to the fact that about half of the deposits were placed in foreign currency, and their principal value in UAH increased as a result of devaluation of the national currency.

**The situation on the credit market has changed drastically – the snowballing increase in the amounts and volumes of credits were replaced by almost complete freezing of crediting, of both individuals and corporations.**

In October of the current year, the total debt of borrowers that are residents of Ukraine to the banks totalled UAH 204.7 billion. This includes more than 80 billion UAH of mortgage credits.

According to information of the State Committee for Statistics of Ukraine, as of December 1, Ukrainian bank requirements on issued credits (including interest) were 671.6 billion UAH, of which 280 billion UAH were in national currency.

There are two main factors of the rapid growth of the share of “problematic” credits: UAH devaluation, as a result of which debtors can not pay on credits issued in foreign currency (almost two-thirds belong to this type), and the situation on the labor market: dismissal of workers, reduced or frozen wages, leading to a loss of their solvency.

According to statistics submitted by the International Bureau of Credit History, the share of problematic credits in the general credit portfolio of the banks amounts to 10.35%. And according to the estimate of collection companies, this percentage as of December 2008 totalled 15% and was growing. The peak of “credit non-returns” is expected to be in spring – summer 2009. Altogether, in 2009, the number of defaults as a result of mortgage and other loans could reach 40-50% of all credits, which is considerably higher than the critical boundary of banking system stability.

According to the estimate of a famous expert, Victor Lysytskyy, a member of the Entrepreneurs’ Council under the Cabinet of Ministers of Ukraine, “in Ukraine, default has been declared by thousands, or even hundreds of thousands of citizens who have taken out credit for apartments and cars, along with representatives of small and medium businesses”. According to him, this is the fault of the National Bank of Ukraine and its “completely unclear and irrational exchange rate policy”<sup>14</sup>.

As of January 2008, there have been only single mortgage lending proposals, and these are exclusively on the primary market, and, as a rule, for the products of building companies affiliated with banks. On the car loan market, there is a single offer of credit to buy a new car in national currency.

<sup>14</sup> <http://news.finance.ua/ua/~1/0/all/2009/01/28/150194>

“The bottom of the banking crisis can be expected in April; after that, banks will become more active on the crediting market, since no bank can exist only by deposits”, say analysts of Prostobank Consulting<sup>15</sup>.

In 2009, banks will have to cut expenses considerably, implement restructuring mechanisms, and look for strategic partners. The expert thinks that there is a possibility of banks uniting to get a synergy effect to survive. Investment funds specializing in undervalued assets and buying them with the aim of further reselling, will express their interest in buying Ukrainian banks.

Banking experts think that mechanisms involving the state should be immediately implemented. “These mechanisms can include: stabilizing the exchange rate, buying out the mortgage portfolio from banks (but SII does not have enough resources), selling currency to repay credits at a decreased rate (but with this mechanism expenses should be evenly distributed between the state, banks and clients)”<sup>16</sup>.

According to Eugene Matros (VAB Bank), the Ukrainian banking sector risk group may include the following financial establishments:

- Ukrainian banks that have attracted short-term foreign resources and issued aggressive retail crediting along with active development of a branch network. At the same time, banks with a big mortgage portfolio are in a more serious situation than banks that issued short-term consumer credits.
- Banks whose corporate credit portfolio is concentrated in the economic sectors that are now in the most difficult situation (for example, construction)<sup>17</sup>

In turn, analysts of Concorde Capital estimate that by the end of 2009, Ukraine will have only half of the currently operating banks. The rest will have to leave the market or will be taken over by their rivals<sup>18</sup>.

International rating agency Moody's considers the Ukrainian banking system development forecast 2009 as “negative”. This forecast reflects the possibility of further worsening of the banks' financial indices as a result of the uncertainty that is characteristic of domestic and international capital markets, a decrease in funding volumes, a sharp fall of the UAH rate, and an economic growth rate decrease.

<sup>15</sup> Correspondent <http://ua.korrespondent.net/business/732011>

<sup>16</sup> VAB Bank <http://www.vab.ua/ukr/about/comments/2009/01/19/28/>

<sup>17</sup> *ibid*

<sup>18</sup> Correspondent <http://korrespondent.net/business/economics/731894>

A decrease in funding volumes due to a considerable outflow of clients' assets and restriction of access to international capital markets, along with a possible decrease in financial support volumes provided by foreign parent banks to their Ukrainian "daughters" will force banks to apply a liquidity preservation strategy, which, in turn, will hamper the banks' ability to grow. Competition on the deposits market will become more intense in 2009, with a further funding cost increase and margin pressure increase. The introduction of stricter liquidity and capital standards adopted in autumn 2008 as part of the anticrisis measures could result in a certain consolidation of Ukrainian banking sector.

According to Moody's, the Ukrainian banking sector may face two major risks. First, the probability of a further drop in the UAH rate, which will contribute to further worsening of asset quality, which, in turn, will have a negative impact on Ukrainian bank capitalization. The second is linked to the probability of a further decline in bank deposit volumes, which could be the result of either further loss of trust of investors in the country's banking system or withdrawal of deposits in national currency by investors in order to convert their savings into more stable foreign currency<sup>19</sup>.

## **Budget and state finances**

According to information of the Ministry of Finance of Ukraine, Consolidated Budget income for January-November 2008 was 267.5 billion UAH (30.5% of GDP), which is 89.2% of the annual allocation. Income was largely generated by tax receipts (77.9% of total income).

Consolidated Budget expenses, including crediting after deducting repayment totalled 262 billion UAH (29.9% of GDP), or 79.6% of annual allocations. In Consolidated Budget expenses structure, 57.2% is allocated for financing social and cultural activities, 16% for economic activity, 9.8% for carrying out general state functions, particularly debt service expenses – 1.3% of the total expenses (0.4% of GDP), including foreign debt – 1.1% (0.3% of GDP).

The Consolidated Budget surplus in January-November 2008 totalled 5.5 billion UAH (0.6% of GDP).

The state income budget (considering relations with local budgets) was fulfilled to a total of 208 billion UAH (89.6% of annual allocations), or 23.8% of

<sup>19</sup> RBK Ukraine, 21.01.2009 <http://www.rbc.ua/ukr/newsline/2009/01/21/492609.shtml>

GDP, and 74.5% of it was formed by tax receipts, including 55.5% from VAT and 27.6% from corporate income tax.

In the state expense budget (including crediting after payment), which totalled 207.4 billion UAH (80.5% of annual allocations) or 23.7% of GDP, financing of social and cultural activities (32.7% of overall expenses), economic activity (15.2%), public order, safety and judicial authority (10.4%), and carrying out general state functions (8.6%), including debt servicing (1.4% of all expenses) dominate. The state budget of Ukraine was consolidated with a surplus totalling 0.6 billion UAH (0.1% of GDP).

National currency devaluation in October-December 2008 became a sensitive crisis factor both to the financial system of Ukraine and to the economy in general.

The official average monthly UAH to USD rate in January 2008 was 5.05 UAH, while in December it was 7.58 UAH for 1 USD. The official monthly average UAH to Euro rate in January 2008 was 7.43 UAH, while in December it was 10.24 UAH for 1 Euro.

At the end of December, the UAH to USD exchange rate decreased from the August 2008 rate (when UAH cost most) by 45%, including by 14% for the period of 16-17 December. At the same time, NBU increased the rate from 17% to 22% and declared a suspension of refinancing commercial banks for several weeks.

**As of January 2009, compared to the beginning of 2008, UAH fell in value by 42%. In degree of devaluation compared to maximum indices in 2008, UAH was second in Europe after the Iceland krona.**

Financial results of companies as a result of their ordinary operations before tax (excluding small agricultural companies and institutions that are financed from the budget) during January-November 2008 were 83.4 billion UAH (total profit 139.3 billion UAH, losses – 55.9 billion UAH).

During January-November 2008, 34.9% companies operated at a loss, which is 1.8 percentage points more than for corresponding period of 2007. Most of these companies operate in manufacturing, provision of public and individual services, in the cultural and sports sectors (39.7% each of the total number of companies operating in the corresponding sector), transport and communications (39.5%), real estate operations, rent, engineering and rendering services to entrepreneurs (37.5% each).

On November 5, 2008, the IMF approved a decision to issue standby credit to Ukraine totalling about USD 16.4 billion to solve the problems in the economy. On November 10, 2008, the IMF provided Ukraine with the first tranche of standby credit in the amount of USD 4.5 billion. Further tranches will depend on carrying

out the provisions of the memorandum signed by the Government of Ukraine and IMF.

**Budget-2009** and forecast for the budgeting sector of Ukraine completely depend on the critical state of the economy.

On December 26, the Parliament of Ukraine adopted as a basis and in general the draft of the 2009 State Budget of Ukraine submitted by the Cabinet of Ministers of Ukraine.

The Budget-2009 deficit will amount to 31 billion UAH, or 3% of the forecast GDP level. The government determined that the budget will have an income of 238 billion UAH (compared to 232 billion UAH last year), including income of the general fund of the State Budget of Ukraine totalling 182 billion UAH and income of the special fund of the State Budget of Ukraine totalling 55 billion UAH

Expenses of the state budget 2009 according to the draft should amount to 266 billion UAH (compared to 253 last year), including expenses of the general fund totalling 189 billion, and special fund - 77 billion UAH. However, during the review, the deputies increased the expenditure side by at least 1.5 billion.

Events relating to the expansion of the economic and political crisis in Ukraine made it impossible to review the country's main financial document within the term stated by the Constitution. On November 12, the government recalled the draft of the budget submitted in September, and its updated version was submitted only on December 23, one week prior to the beginning of the budget term. Parliamentary deputies did not have enough time to discuss the draft, to say nothing of any serious discussion or improvement. As a result, the budget was adopted by Parliament on December 26 by 226 votes, that is the minimum required number, although many deputies stated that there were signs of voting fraud.

According to the estimates prepared by the experts of the Institute of Policy, most of criticism, which is completely justified, is drawn by the unrealistic macroeconomic indices fixed by the draft obudget. The GDP (+0.4%) growth rate built in by the Government presents a too optimistic scenario. Most world financial organizations, along with rating agencies, are forecasting a recession in Ukraine in 2009. This can be seen from the economic development indicators in November-December 2008: a drop of GDP by 14.4% and 9.9%, respectively. There is no basis for talking about fighting negative tendencies of the main sectors of the economy today.

At the beginning of December, the Ministry of Economy also forecast a recession, but a far better index of economic growth was built into the budget. This

calls the possibility of carrying out the budget in the volumes defined by the government into question<sup>20</sup>.

One effective anti-crisis measure may be financing some expenses from the Stabilization Fund, the creation of which is provided for by the Law “On the priority actions to avert negative consequences of the financial crisis and on making amendments in some legislative acts of Ukraine”.

It should be filled through receipts from privatization and funds received from selling non-agricultural lands or rights to them owned by the state. Other sources of filling the Stabilization Fund are receipts from special placement of state securities.

At the same time, continuing privatization activities in 2009, when there is mass depreciation of assets, can hardly be considered a justified step in the strategic plan. Responsibility for effective privatization will be one of the key problems that the Government will face.

Expenses of the Stabilization Fund are planned to be used for reducing the cost of credits in the agribusiness industry, investment projects at aircraft building plants and machine building plants, in the coal-mining industry, energy saving in housing and community amenities, construction, and preparing for Euro-2012. The total budget of the Stabilization Fund will amount to 22 billion UAH

Problems that stemmed from filling the budget in January 2009 caused criticism of it, and immediate changes were demanded. On January 30, President Yushenko appealed to Prime Minister Tymoshenko and the parliament in his televised address saying: “On behalf of the whole country, I demand that the government and parliament prepare a fair budget in which expenses will be in line with the capabilities of the economy”. At the same time, the government plans to make amendments to the budget no earlier than May.

## **Inflation and prices**

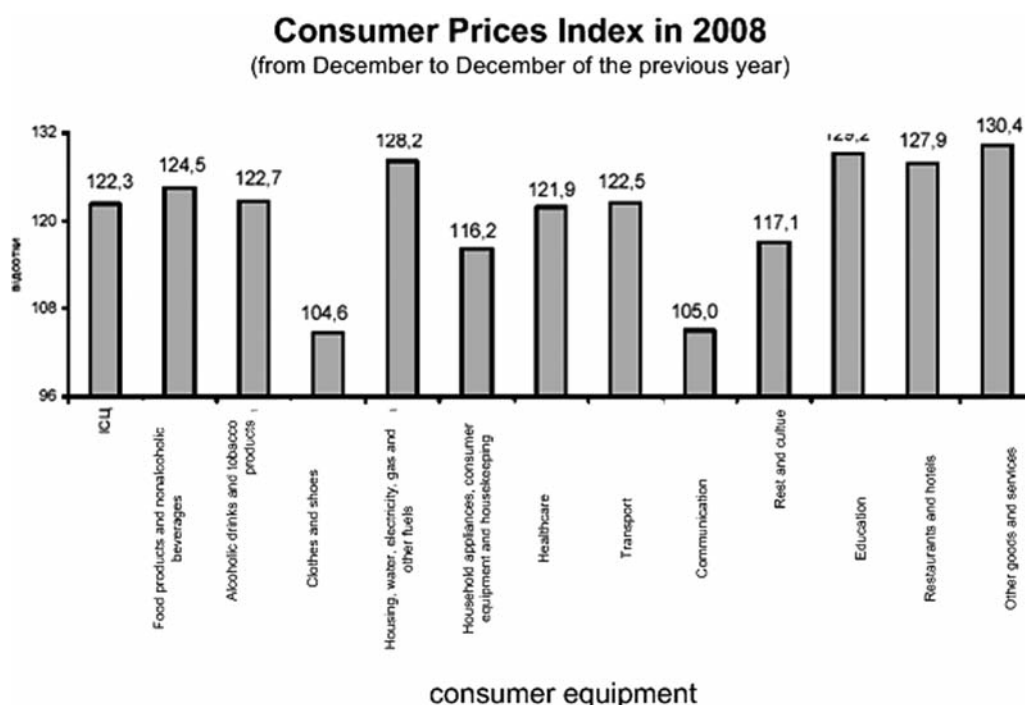
**The inflation rate in Ukraine in 2008 was the highest in Europe at 22.3%,** and the highest in Ukraine since 2000, when inflation reached 24%. The Consumer Price Index (inflation rate) in 2008 was 122.3% (in 2007 – 116.6%).

There is a big difference between the factors that caused the high inflation rate at the beginning and at the end of the year.

<sup>20</sup>Website of the Institute of Policy <http://polityka.in.ua/info/211.htm>

The table shows that inflation reached its peaks in March (3.8%) and December (2.1%). Between these months, the inflation rate was lower and there was even a seasonal deflation in July-August. Whereas during the first months of the year, the main factors causing inflation were a increase in welfare payments (namely, partial compensation of lost savings) and inflation expectations caused by them, the price increase at the end of the year was caused by devaluation of the national currency and the corresponding price increase for imported goods.

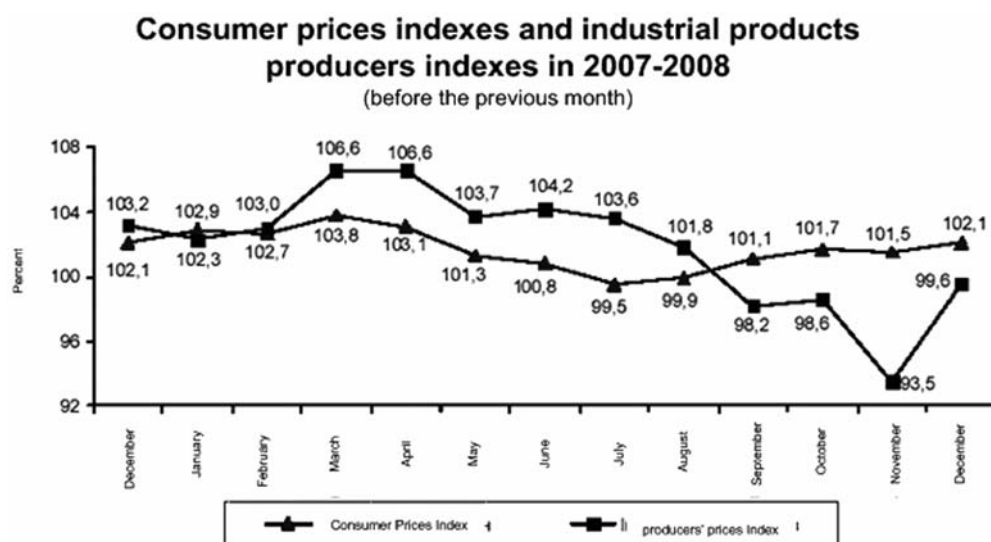
Chart 8



In 2008, prices of food and nonalcoholic beverages increased by 24.5%. Prices of fruit increased by 37.8%, including bananas by 53.0%, apples by 27.4%, and citrus fruits by 24.8%. Prices of meat and meat product increased by 34.0%, including pork by 48.1%, veal by 43.8%, and poultry by 21.7%. Prices of eggs, bread and cereal products, fish and fish products increased by 28.8–26.6%. At the same time, the price of oil decreased by 1.7%. Prices of vegetables decreased by 0.4%, including onions, carrots, cabbage and beets by 48.4–44.0%.

Price increases for alcoholic beverages and tobacco goods totalled 22.7%, including tobacco goods – by 29.6% and alcoholic beverages – by 18.0%.

Chart 9



Prices of housing, water, electricity, gas and other types of fuels increased by 28.2%, including the price of natural gas - by 54.1%, sewerage – by 45.1%, water - by 40.6%, housing - by 35.7%, and hot water and heating - by 30.7%.

In the health protection sector, prices increased by 21.9%, with the largest increase in prices of sanatorium-and-spa treatment and outpatient services (by 26.1% and 23.0%, respectively).

Price increase for transport in general totalled 22.5%, which was mainly caused by an increase in the cost of road transport (by 53.0%) and railway transport (by 25.3%). At the same time, the price of gasoline decreased by 8.3%.

Prices of services of educational establishments, restaurants and hotels, and recreational and cultural establishments increased by 29.2–17.1%.

The price index of industrial product manufacturers in 2008 was 123.0% (in 2007 – 123.3%).

During the year, prices of producing and distribution electric power, gas and water went up by 42.2%, in primary sector - by 22.3%, and in the processing industry – by 18.4%. The price index of building and assembly work in January-November 2008 was 130.5% (in the corresponding period of the previous year it was 122.0%). The highest price increase (by 39.4–31.0%) was observed in construction of primary sector, transport and communications, agricultural project, educational establishments, and facilities for the generation and distribution of electric power, gas and water.



As to the forecast of inflation for 2009, there is some disagreement (Table). Most forecasts, however, state that under conditions of the economic crisis and reduced income and production, the inflation rate may be lower than in 2008.

**Table 4. Inflation forecast for 2009 in Ukraine**

	EBRD	IMF	World Bank	Fitch Agency	Ministry of Economy of Ukraine (December 2008)	State Budget - 2009
Inflation forecast	20	17	13.6	17.5	9.5	9.8

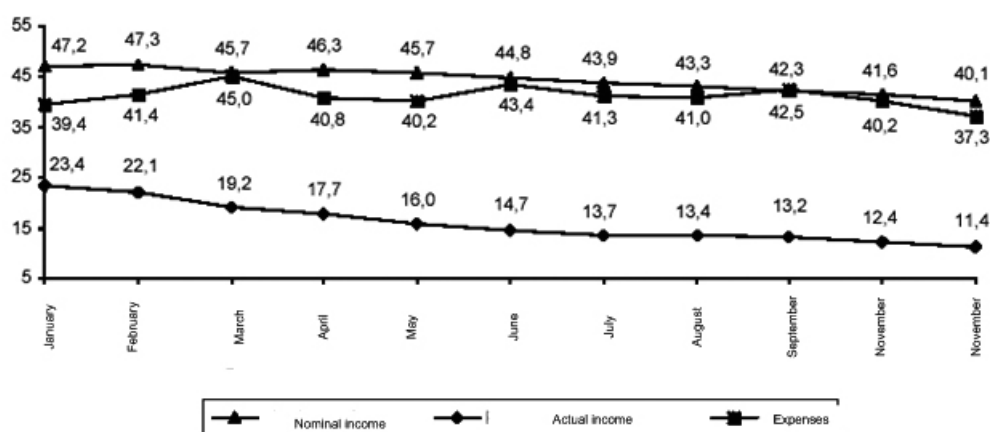
## Household income

During January-October 2008, household income was increasing despite being hampered by the high inflation rate. At the same time, in November-December, actual household income began to decrease as a result of the crisis.

Nominal household income during January-November 2008 increased by 40.1% compared to the same period of 2007. Actual income that can be used for purchasing goods and services increased by 39.8%, but real actual income, adjusted for the price factor, increased by only 11.4%.

Expenses of the population in January-November 2008 increased by 37.3% compared to the same period of 2007. The savings gain was 58600 million UAH

**Income and expenses of the population of Ukraine in 2008**  
(increase/decrease, by increasing results in % of the corresponding period of the previous year)



**Chart 10**

In January-November 2008, the average monthly nominal salary of staff members (not including hired staff of small businesses and private entrepreneurs) was 1790 UAH, which is 35.3% more than in the corresponding period of 2007. At the same time, in November 2008 there was 4.9% salary decrease compared to October. This was caused by the fact that in November there was a decrease in hours worked on average per one employee, particularly due to the fact that company administrations introduced unpaid leaves and a shortened working day (week) regime.

As it was earlier, extreme differentiation of the remuneration level by economic activity types and regions was observed in the country's economy: the difference between the highest and the lowest level among kinds of activity was 4.3 times, and among the regions – 2.3 times.

The highest salary rate was fixed at aircraft companies and financial organizations; and in the coke, oil-refining and fuel and energy resource production industries, salary exceeded the average index in the economy by 1.5–2.2 times in January-November 2008.

At the same time, the absolute wage rate of people working in the fishing industry, agriculture and hunting, health care and social welfare establishments, companies producing textiles, clothes, fur and leather articles did not exceed 65% of the average in the economy.

In January-November 2008, the average remuneration rate in all regions was higher than the living wage of an able-bodied person. However, wages exceeded (by 1–69%) the average wage in the country in only 5 of them and amounted to: in Kyiv – 3033 UAH, Donetsk region – 2014 UAH, Dnipropetrovsk region – 1871 UAH, Kyiv region – 1837 UAH and Zaporizhzhya – 1802 UAH. The lowest wage rate (23–28% less than average) was fixed in Ternopil region – 1291 UAH, Kherson region – 1356 UAH, Chernigiv region – 1356 UAH, Volyn region – 1368 UAH and Chernivtsy region – 1380 UAH.

The actual wage index in January-November 2008 compared to the same period of 2007 was 107.2%. At the same time, the highest index rate was fixed in Zakarpattia region (112.0%) and Ternopol region (110.2%), while the lowest rate was fixed in Odessa (102.7%) and Dnipropetrovsk (103.3%) regions.

Total wage arrears during January-November 2008 increased by 159.7%, or by 1068.0 million UAH; and as of December 1, it was 1736.7 million UAH. It should be noted that two-thirds of its absolute increase (693.0 million UAH) was fixed in November.

In general, at the beginning of December, the amount of unpaid wages totalled 8.3% of the labor compensation fund meant for November, compared to 4.3% for the same time in 2007.

The increase in total arrears was caused by an increase in debts to the employees of economically active companies. During January-November 2008, arrears to these employees increased by 5.3 times (by 1066.2 million UAH); and as of December 1 was 1312.0 million UAH, or 75.5% of the total debt.

In terms of types of economic activity, the most substantial arrears in January-November 2008 were fixed at economically active industrial companies (662.7 million UAH), mostly due to companies producing coal, lignite and peat (344.0 million UAH) and machine-building (204.3 million UAH), transport and communications (151.9 million UAH), construction (138.7 million UAH), as well as real estate operations, rent, engineering and rendering services to entrepreneurs (55.1 million UAH).

An increase in arrears owed to employees of economically active companies was fixed in all regions of the country, most of all in Donetsk region (344.7 million UAH), Lugansk region (143.9 million UAH), Lviv region (89.6 million UAH), Kharkiv region (77.5 million UAH), and Kyiv (72.1 million UAH).

The number of employees of the economically active companies that did not get their wages on time, totalled 672.6 thousand people, or 6.1% of the total number of staff engaged in the economy as of December 1, 2008. Each of these employees was not paid 1834 UAH on average, which almost corresponds to the average remuneration rate in November 2008.

As of January 2009, there are no grounds for a positive forecast of household income dynamics in the current year.

## **Employment and unemployment**

During the first ten months of 2008, the situation on the Ukrainian labor market was stable, although during last two months, some worsening was observed, which resulted in unemployment growth, remuneration arrears, the introduction of unpaid leaves by company administrations, shortened working hours, and other negative tendencies.

According to the results of a random poll of households to determine their average economic activity during the 9 months of 2008, the monthly average

number of economically active citizens aged 15–70 was 22.6 million people, 21.3 million of which were engaged in economic activity, while the rest (1.4 mln) were unemployed, these being people who did not have jobs but were looking for them either on their own or with the help of the state placement service. The employment rate of population was: aged 15–70, 60.1%; able-bodied population, 68.1%. The unemployment rate (according to ILO methodology) among the economically active population aged 15–70 was 6.0%, while among the able-bodied population it was 6.5%, and was lower compared to the same period of 2007 (6.2% and 6.7% respectively).

According to the information submitted by the state employment agency in 2008, it rendered services to 2.5 million people not engaged in economic activity compared to 2.4 million in 2007. During last 2 months of 2008, the situation on the Ukrainian labor market worsened.

The average number of staff members of companies, institutions and organizations, excluding staff of small businesses and private entrepreneurs (hereinafter “companies”) in January–November 2008 was 11.4 million employees. In November 2008, the index decreased by 1.3% (148 thousand people) compared to October and 0.2% (23.5 thousand people) in November 2007; this was caused by both seasonality due to production type in agriculture and an increase in the number of dismissals and reductions in industry (by 51.4 thousand people), construction (by 21.8 thousand people) and trade (by 16.9 thousand people). The most active staff reductions were in Donetsk region (by 17.9 thousand people), Dnipropetrovsk region (by 15.6 thousand people), and Kyiv (by 11.8 thousand people).

At the same time, companies widely introduced the practice of unpaid leaves and shortened working hours.

The number of employees on leave in November 2008 was 649.1 thousand people or 5.8% of staff members. These leaves were mainly introduced by transport companies (30.1% of staff members), forestry companies (12.9%), construction (9.7%), and industry (9.1%). In Dnipropetrovsk, Donetsk, and Zaporizhzhya regions, one in ten employees was on a leave initiated and approved by management (mainly at industrial companies), in Kirovograd and Poltava regions – one in thirteen.

In November, shortened working hours were introduced for 680.5 thousand people, or 6.1% of staff members, two-thirds of whom (414.6 thousand) worked at industrial companies. In Zaporizhzhya region, this regime was introduced for 14.6% of staff members, in Poltava region - for 10.0%.

This situation resulted in rapid growth of the number of unemployed applying

to the state employment agency. Whereas during January-October 2008 131.1 thousand unemployed were registered every month, in November-December their number doubled to 264.7 thousand people. In general, during last 2 months of 2008 there were 529.3 thousand unemployed people registered compared to 317.6 thousand people during the same period of 2007. The biggest increase in unemployed was fixed in Dnipropetrovsk, Donetsk, Kharkiv and Poltava regions - by 10.5–19.0 thousand people.

The number of people seeking jobs with the help of the state employment agency as of January 1, 2009 was 876.2 thousand unemployed (as of January 1, 2008 - 660.3 thousand people).

As of the given date, officially unemployed status was given to 96.4% of unemployed citizens, 77.2% of whom received unemployment assistance. Among the unemployed, every second person was previously a blue-collar worker, every third person was an office worker, and almost every fourth person had a job not requiring professional skills.

The registered unemployment rate in the country in general compared to December 1 2008 increased by 0.7 of a percentage point to 3.0% of able-bodied citizens as of January 1, 2009. This rate increased by 1.3 percentage points in rural areas and was 5.2% of rural able-bodied citizens, while among urban residents, it was 0.5 of a percentage point and 2.1%, respectively. The highest unemployment rate was registered in Ternopil region (5.1%), and the lowest – in Kyiv (0.6%).

Demand for labor is decreasing. In the second half of 2008, there was a tendency to a decreasing number of vacancies, with an especially rapid decrease fixed in November-December. Whereas at the end of October this index was 177.5 thousand, in November and December it was 136.8 thousand and 91.1 thousand, respectively. Almost half of the vacancies were meant for blue-collar workers, more than third for office workers and every seventh vacancy for people without professional skills.

In the last 2 months of 2008, the number of vacancies decreased the most in Kyiv, Donetsk, Dnipropetrovsk and Kyiv regions.

Under these circumstances, the load of unemployed seeking jobs with the state employment agency almost doubled at the end of December 2008 to 96 persons per 10 vacancies compared to 51 at the end of November 2008.

In the regions at the end of December 2008, the load of unemployed per 10 vacancies ranged from 4 people in Kyiv to 767 people in Cherkassy region.

With the assistance of the state employment agency, 1084.0 thousand people, or 43.3% of the unemployed population registered with the agency, found jobs in

2008. Of these, 51.7 thousand people found jobs in December 2008, which is 25.0% less than in the previous month. Half of those who were placed in a job were women and young people under 35.

Compared to November, the employment assistance rate in December 2008 decreased by 3.3 percentage points to 5.3%. This index was lowest during the stated period in Kyiv and Sevastopol.

A total of 540.5 thousand people were taken off the register of the state employment office without job placement in 2008, including 53.6 thousand people in December; in 2007, these figures were 660.8 thousand and 50.7 thousand people, respectively.

UAH 321.3 million was spent to help the unemployed from the Compulsory National Insurance Fund in case of unemployment in December 2008. The average registered number of unemployed that got help during this month was 562.7 thousand people or 66.6% of all people who had unemployed status. The average amount of help in December 2008 compared to November increased by 4.1% to 571.07 UAH, which is somewhat lower than the minimum wage (605 UAH) provided by legislation.

As forecast for 2009, the unemployment rate will increase in Ukraine along with a decrease in vacancies. According to the Concorde Capital forecast, the unemployment rate in 2009 could reach 12%<sup>21</sup>.

## **Foreign commodity trade**

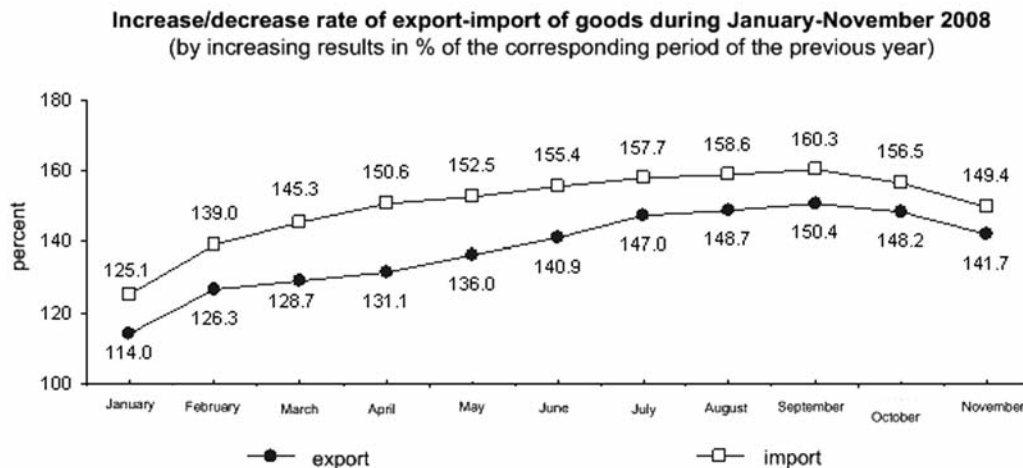
The volume of foreign exports in Ukraine in January-November 2008 was USD 63046.2 million, an increase of 41.7% compared to the same period in 2007; the volume of imports was USD 80757.1 million, a decrease of 49.4%. The credit balance of foreign commodity trade was USD 17710.9 million (in January-November of 2007 it was USD 9555.7 million)<sup>22</sup>. Coefficient of coverage of imports by exports was 0.78 (in January-November 2007 it was 0.82).

In October-November 2008, after a long period of growth, export-import operation volumes started to decrease: export of goods decreased by 16.4% compared to November 2007 and was USD 3723.1 million, while imports decreased by 9.4% to USD 5269 million. The credit balance in November 2008 amounted to USD 1545.9 million (in November 2007, the credit balance was

<sup>21</sup> Correspondent <http://korrespondent.net/business/economics/731894>

<sup>22</sup> The State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

USD1365.4 million).

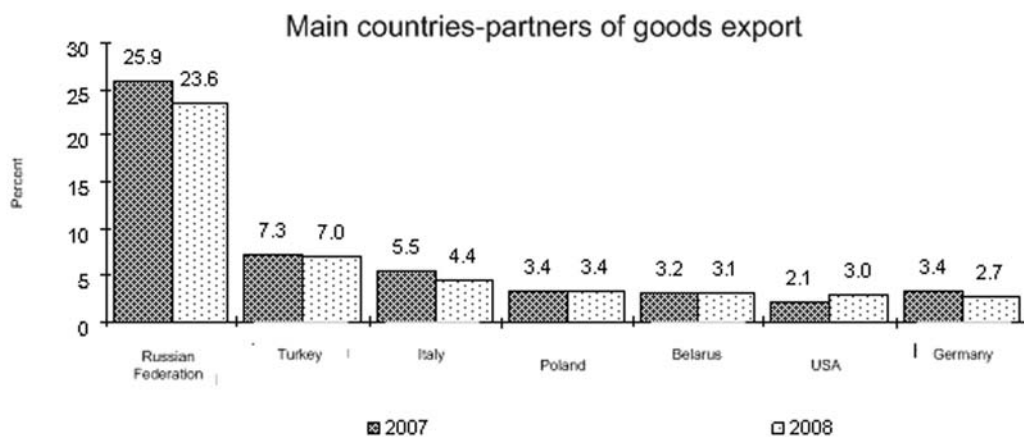


**Chart 11**

Ukraine carried out foreign trade operations with partners from 216 countries of the world. The European market was the main foreign market for Ukraine, since it received 26.9% of Ukrainian exports and it gave Ukraine 33.6% of imports.

Among all countries, the Russian Federation remains Ukraine's largest trading partner (23.6% export and 23.2% import receipts).

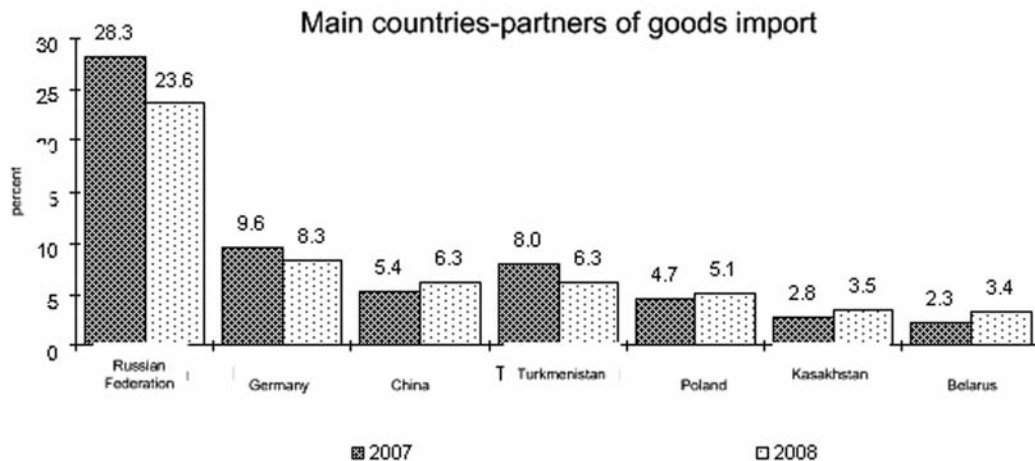
**Chart 12**



A total of 35.4% of all goods were exported to CIS countries and Russia, (in January-November 2007 it was 38%). A total of 23.6% export deliveries were

made to Turkey, Italy, Poland, Belarus, USA and Germany.

**Chart 13**



In January-November 2008, among the largest trading partners, export deliveries to the USA increased almost by two times, Poland - by 45.4%, Belarus - by 41.2%, Turkey - by 36.8%, Russian Federation - by 29%, Germany - by 13.7%, and Italy - by 12.8%.

The basis of the product structure of Ukraine's foreign trade, as before, consisted of non-precious metals and products made from them, mineral products, mechanical and electrical equipment, transport vehicles and road equipment, and products of the chemical and other related industries.

Compared to the same period in 2007, there was an increase in the share of ferrous materials, energy materials, oil and oil products, cereals, railway or tramcar engines, road equipment, ores, chark and slag, fertilizers in the total volume of exported goods in January-November 2008. At the same time, the share of products made of ferrous metals, mechanical machines, and vegetable and animal fats and oils decreased.

A total of 39.7% of all goods were imported from the CIS, (42.6% in January-November 2007). Imports from Germany, Turkmenistan, China, Poland, Kazakhstan and Belarus constituted one-third of the total import volume. Import deliveries increased from all main partner countries.

In the total volume of imported goods, there was an increased share of energy materials, oil and oil products, land transport vehicles, except railroad, ferrous metals, ores, ash and slag. There was a decreased share of mechanical and electrical machines, polymeric materials and plastic.



In January-November 2008, exports of Ukrainian give and take raw materials was USD 67.7 million. Imports of finished products made of give and take raw materials came to USD 62.8 million. At the same time. Ukraine received USD 2383.2 million of foreign customer-furnished raw materials. Exports of finished products made of customer-furnished raw materials came to USD 3796.1 million.

Among Ukrainian regions, the largest volumes of foreign trade belonged to Dnipropetrovsk, Donetsk, Zaporizhzhya, Lugansk regions and Kyiv.

## Wholesale and retail trade

Turnover of wholesale companies in 2008 was 1000.1 billion UAH. The physical volume of wholesale turnover decreased by 6% compared to 2007.

Retail trade turnover (including retail sales of retail companies, calculation data on the volume of goods sold on the markets and by private entrepreneurs) in 2008 was 449.3 billion UAH, which is 18.6% more than the volume in 2007. Organized and informal market share was 30% of retail structure. Agricultural products had a 14.1% share in the turnover of organized markets.

In 2008, the volume of retail turnover of the companies involved in retail trade and restaurants was 243.9 billion UAH, which is 17.9% more in comparable prices than the volume in 2007.

Chart 14



## **Economic reforms**

No substantial changes in economic restructuring of Ukraine were noted in 2008. The time before the crisis was not used effectively to reduce the Ukrainian economy's sensitivity to internal and external challenges.

In January 2009, the *Heritage Foundation* research center (USA) jointly with *The Wall Street Journal* published a regular annual rating of the economic freedom level in 179 countries of the world. The Rating-2009 results are quite negative for Ukraine, which not only worsened its position once again and moved from 133<sup>rd</sup> to 152<sup>nd</sup> place, but also **for the first time in recent years was nominated as an “economically unfree country”**. This was the result of non-transparent state expenditures, interference of the state in private businesses operations and lack of fighting corruption.

The most remarkable positive factor of the year, which influenced integration of the Ukrainian economy into the world distribution of labor, was the end of the process of gaining membership in the World Trade Organization (WTO) on May 16, 2008. Adoption of this decision by the WTO General Council on February 5 was followed by a ratification process.

Among the positive consequences of becoming a member of the WTO for the Ukrainian economy are:

- Integration into the international market economy, creating a legal framework for stable and predictable conduct of business and international trade.
- Forecast increase by 1.5-2 times of direct foreign investments in the first two years after becoming a member of the WTO, with an even greater increase than before gaining membership in the WTO.
- Ukrainian manufacturers will have simplified access requirements to the markets of more than 150 WTO member countries. Product exports of \$1 billion can be expected, and under favourable conditions even \$1.5 billion. Before Ukraine became a member of the WTO, experts of the Institute of Economic Research and Political Consultancy had forecast that its cumulative effect could bring Ukraine an additional 1.9% of GDP growth.
- Industrial companies will be able to apply the mechanism provided by WTO regulations in settling trade disputes, which will enable them to substantially strengthen their position in antidumping and special investigations, as well as prevent other limiting and discriminating actions taken against them.

- Revival of trade and economic relations not only with Western and Central Europe, but also with Eastern Europe and the Baltic countries, most of which became full members of the EU on May 1, 2004, leading to the abolition of the free trade regime with these countries.
- Increase in state budget receipts due to cancellation of exemptions, a quantitative increase in the customs duty payment basis, an increase in production volumes and trade turnover activation (overall positive effect on budget income could be 3-4 billion UAH).
- Greater variety of goods and services. Thanks to an increase in flows of foreign goods, services and investments into the Ukrainian market, manufacturers will have access to cheaper utilities, equipment and raw materials, while consumers will have a wider choice of goods, services and prices. This creates conditions for better quality and competitiveness of domestic products.

Another positive factor of 2008 was the success of the agricultural sector – 50.2 mln tons of corn, which is 1.7 times more than in 2007, and according to preliminary estimates was a record during the last 20 years.

Ukraine has done its best to increase the effectiveness of state economic development policy in general and certain sectors in particular, although these efforts proved to be insufficient for ensuring reliable safety measures to resist the global crisis; hence Ukraine was more sensitive to the crisis than other countries of the region.

According to the estimates published in February 2009 by the experts of Ukraine-NATO partnership network, the main problems of the Ukrainian economy include:

- Lack of transparency of state monopoly operations,
- Tax policy encouraging shady business,
- Wasting energy,
- Progressive corruption,
- External energy dependence,
- Lack of developed domestic markets,
- Lack of diversified foreign markets of main export commodity classifications.

Ukraine has carried out activities aimed at energy saving, although technological modernization of the energy economy is going really slowly. Factors encouraging energy waste instead of saving are still in existence. The government, acting via HKPE, has increased gas tariffs for the population, which

is an unpopular but rather important action, as low tariffs not only encourage excessive energy consumption, but also creates problems hampering and stagnating domestic gas production.

There has been continuous preparation of legislative acts on forming unified energy balance in order to ensure technically safe, stable, economically effective conditions for providing the economy with energy resources. Among successful factors is the transition of the State Statistics Committee of Ukraine to European statistics standards as of September 1, announced by the Ministry of Economy. This is of fundamental importance in terms of the complementary statistical systems of Ukraine and EU countries, as well as creating a mutual methodology platform for statistical comparisons in the economy.

Cooperative work on integrating the unified energy system of Ukraine into the trans-European system has been conducted using the mechanism of cooperation with European structures within the scope of the memorandum of understanding between Ukraine and the European Union on cooperation in the energy sector of December 1, 2005. However, there is no serious progress here. The start of the negotiation process with the European Commission on Ukraine joining the Energy Commonwealth Treaty on November 25, 2008 in Vienna, with Ukraine having been an observer since 2006, can also be considered only modest progress.

State policy regarding the strategic question of increasing domestic energy resource extraction in the Black Sea area is considered ineffective. As Mykhaylo Gonchar, a famous energy expert (NOMOS Center), has stated, “politically motivated actions of the Ukrainian Government to stop foreign investor operations have been regarded by the expert and investment community as inadequate and postponing the arrival of major world companies in this area, hence holding offshore gas production at the present level of 1 billion cubic meters per year. There has been no progress here, and there have been wasted opportunities to implement projects to equip oil-trunk pipelines with oil metering units and gas-main pipelines with gas metering stations at Ukraine’s eastern border with the help of EBRD and EIB”.

Among the priorities of Ukrainian international cooperation are energy resource diversification and safe supply, nuclear safety, energy market reform, energy sector development and modernization, and ensuring effective usage of energy resources and renewable energy sources. Progress here is minimal. Ukraine has directed its efforts to shift the Odessa-Brody oil pipeline to averse mode at the request of Ukrainian refinery companies. However, the non-transparent scheme of averse operation of the oil pipeline suggested by Ukrtransnafta and lack of

cooperation on the part of the President and Ukrainian Government have not brought the expected results. Two refinery companies for Western Ukraine located in Drogobychi and Nadvirna have not got the chance of importing oil from non-Russian sources, despite being ready to do so and provisions of the corresponding memorandum signed between the Ukrainian companies Ukrnafta and Uktransnafta and Azerbaijan's state oil company on June 7, 2006.

The nuclear power sector is still directed towards using a Russian technological basis while building new power units at Rivne and Khmelnytskyi APS. The tender winner was the Russian company Atomstroyexport. Russian cooperation tendency is still present in producing full assemblies from Ukrainian uranium. It is part of the project "Concepts of the State Target Program 'Ukrainian nuclear fuel'". At the same time, one of the positive aspects is the agreement reached between NAEK Energoatom and Westinghouse on supplying American TB3 during 2011-2015, which will ensure diversification of nuclear fuel supply sources in Ukraine. Positive dynamics of Ukrainian cooperation with Canadian partners in the area of mining uranium deposits should also be mentioned.

Lack of transparent operation of energy and transport infrastructure in Ukraine has resulted in shady redistribution financial flows since 1991, which has a negative effect on the budget, generates non-transparent methods of doing energy business, and encourages corruption and instability. The Ukrainian government has taken some measures in this politically sensitive and economically important sector. Naftogaz NJSC has regained the domestic gas market with limited activity of its non-transparent intermediary structures. However non-systematic actions taken by the government while reorganizing the gas market have not given substantial results. In addition, a non-transparent scheme of gas supply and transit, being multinational by nature, has intensified opposition potential, thus taking away the government's chances of succeeding.

Gas trade operations via a intermediary has the potential for conflict, and twice during 2008 it resulted in aggravation of relations with the Russian Federation and their state monopoly Gazprom regarding both current arrears and gas prices. In the situation of the conflict between the branches of government in Ukraine, the Russian gas monopoly has strengthened its position on the domestic gas market after receiving an 11% quota for its subsidiary, which is 25% for 2009 according to agreements reached in January.

However, definite positive factors of the gas crisis of the end of 2008-beginning of 2009 are elimination of the non-transparent intermediary – Rosukrenergo, whose corruption has been widely discussed in recent years – and

a transition to direct contracts between Naftogaz Ukrainy and Gazprom using formula approach to determining gas prices.

As for gas diversification projects, Ukraine has completely lost all chances to join Nabucco project and did not express any interest in the White Stream project suggested by the International engineering consortium.

Ukraine has achieved extremely limited results in developing railroad transport transforming it into a modern sector of the country's transport complex, competitive on the domestic and foreign markets. But rails and rolling stock of the railroad sector do not allow for operating transport at high speeds, as is the practice in Central Europe.

The state's efforts were directed at improving legislation in the field of state procurement meeting EU standards. But introducing transparent regulations has not resulted in creating an effective mechanism of state procurement capable of minimizing the expenses of customers and state procurement process participants. The state procurement system is a mechanism for ineffective use of budget costs, their shady redistribution and generating debt of public companies. All attempts to reorganize the state procurement system face opposition and have been ineffective. The legal sector of the economy is flooded with various organized forms of doing shady business with pseudo agreements, tax evasion, and raiders. The situation is getting more complicated against the background of the crisis in the economy and chaotic actions taken by the government and political forces.

Serious obstacles hampering any systematic economic reforms have long been discussed at both the political and expert level. In particular, Arseniy Yatsenyuk, Parliamentary Speaker at that time, said on July 3, that carrying out economic reforms in Ukraine was impossible in a situation of political confrontation, and political uncertainty in the parliament has a negative impact on reforms. "So, anyone who dares do this (carry out reforms), will be destined to fail", Yatsenyuk admitted.

Thus, 2008 was a year of economic activity with a low performance index. Political processes have intensified the negative consequences for the economy in the situation of the world financial crisis.

## **Overall forecast**

As the Ukrainian economy has dramatically entered the crisis, the state of its dynamics is the worst since the mid 1990s. The GDP of Ukraine could decrease by

5-6% in 2009, and economic growth can be restored no earlier than in 2010.

There is a risk that the State Budget of Ukraine will not be fulfilled, as its revenue side will not be filled, with the pessimistic scenario of a possible default on current obligations.

The inflation rate will depend on the national currency devaluation rate, which, in turn, will depend on the policy of the national bank and its ability to support the rate via regular interventions. A decrease in demand for durable goods and other products that depend on crediting will hamper inflation.

Export-oriented sectors will benefit from a decrease in the national currency exchange rate, although overall demand for their products will not be high. The banking system will be a high risk zone with its problem of credit resource liquidity and deposit payout due to their debtors' insolvency. There will be mergers and takeovers of banks.

Chapter 3.

## **FOREIGN POLICY OF UKRAINE**

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The realization of foreign policy priorities of Ukraine in 2008, as in previous years, was accompanied by political discussions on choosing the correct positioning of essential issues of international relations, which set not only the tactical principles of the country, but also some conceptual points determining its place in the system of global and regional coordinates.

In 2008, such issues for Ukraine included, first of all, Euroatlantic integration (membership in NATO) and an evaluation of the conflict between Russia and Georgia that broke out in August.

In particular, the discussions related to European and Euroatlantic integration of Ukraine, prospects of membership in the European Union, and especially in NATO, have an expressly political character. However, in the context of decisions of the NATO summit in Bucharest (April, 2008), which determines the prospects of membership in the Alliance for Ukraine and Georgia, the issue of Euroatlantic integration of Ukraine is regarded in a practical way.

As the matter of choosing a strategic course, the vector of foreign policy, and the issue of accession to the EU and NATO are part of large-scale national discussions related to choosing a model of further development for Ukraine, any analysis bears an imprint of such discussions and in one way or another is part of the unfinished process of Ukraine's self-determination in the system of regional, civilizational, value and world outlook coordinates.

At a time when European integration, i.e., the process of rapprochement with the European Union, is (at least on a rhetorical level) a matter of broad consensus, as all major political parties declare the priority of European integration, the matter of Euroatlantic integration, membership in NATO and securing a place for Ukraine in the Euroatlantic community and its security system remains questionable.

There are still disputes as to whether Ukraine should regard EU and NATO integration as two parts of one whole or whether there is a possibility of concentrating solely on EU integration, while adopting a policy of neutrality and non-alignment instead of a NATO integration.

This dilemma is also visible in relations with Russia; in particular it remains to be answered whether the need for friendly and neighborly relations means the need to be in the Russia's wake in global and regional affairs? If not, how far can one go in the conflict with Russia without causing additional threats to national and international security in the region?

No matter how the dilemmas above are resolved in the future, it should be noted that the success of transformation processes in post-communist countries in Central and Eastern Europe testifies to the inseparable unity of European and

Euroatlantic integration processes for all countries that have successfully completed transformational tasks. So far, there is no practically tested and effective transformation model that would make a distinction between these processes without damaging the substance and depth of reforms.

## **Relations between Ukraine and the European Union**

As before, integration into the European Union is determined by Ukraine as a strategic choice conditioned by principal national interests of the country and society. In particular, there exists a declared broad consensus of political elites (both the ruling one and the opposition) about European vocation as a major way of reforms and modernization of all spheres of the social, political and economic life. Correspondingly, Ukraine-EU relations are the most important ones among all foreign policy directions. Given the agenda for 2008, these relations comprised the following components:

1. Negotiations on the New Enhanced Agreement, which, by a decision of the EU Council announced at the Ukraine-EU summit on September 9 in Paris, is to be named “Association Agreement”;
2. Completing the process of Ukraine’s accession to the World Trade Organization (WTO) and the beginning of the relevant negotiations in March on an agreement about an deep free trade zone, which must become an integral part of the Association Agreement;
3. Implementation of Visa Facilitation Agreement from January 1, 2008;
4. The announced beginning of negotiations in September on the prospects of symmetric visa-free regime between Ukraine and the EU;
5. The French presidency in the EU in the second half of the year, which marked positive changes in the attitude of the French Republic to Ukraine and allowed, as a result of the active position of the leading country, a number of the political decisions stated above (1 and 4) to be made.
6. Completion of the Ukraine-EU Action Plan signed in February, 2005;
7. Promulgation and the start of realization of the Polish-Swedish “Eastern Partnership” initiative, which creates new framework conditions for more extensive EU cooperation with Eastern European countries, which to some extent exceeds the traditional limits of the European Neighbourhood Policy (ENP).

### **Association Agreement<sup>1</sup>**

The year 2008 marked ten years of functioning of the Partnership and Cooperation Agreement (PCA) between Ukraine and the EU, which took effect in 1998. As far back as March 2007, the negotiation process was started on the New Agreement that will replace the PCA in the medium-term outlook. For a long time, Ukrainian diplomacy has been trying to achieve two political goals: first of all, an upgrade to associated relations with the EU, and secondly, obtaining a formal prospect of membership in the European Union in accordance with the strategic goal fixed in Ukrainian legislation.

It turned out during the negotiating process that at this stage the Ukrainian side will have to allow two different time frames to achieve the two goals set. A political decision was made concerning the associated relations implemented in the future Association Agreement between Ukraine and the EU. At the same time, as a result of internal problems both in the European Union itself and in Ukraine, there are no prospects of membership at this stage. The matter of the prospects of Ukraine's membership in the EU will not be expressly fixed in the Association Agreement, which, however, does not deprive Ukraine of the right to use Article 49 of the Treaty on the European Union in the future and submit the membership application.

The Ukrainian tradition of using the term “association” is based not only on real EU practice but also on some myths related to the meaning of this notion. Their source was the basic legal act in the sphere of the country's European integration – the Strategy of EU integration of Ukraine adopted in June 1998 by President L. Kuchma. In this document, the EU member countries are divided into two categories – full and associated ones, and obtaining “EU associated member status” is defined as the main foreign policy priority of Ukraine. The effective legislation of Ukraine also mentions “concluding an agreement on Ukraine's associated membership in the European Union”.

In reality, there are no notions of associated or full member country in EU legislation. EU foundation agreements only mention “member countries”. That is why Ukraine will never get “associated membership”.<sup>2</sup>

<sup>1</sup> This part uses fragments of the analytical report “*New basic agreement between Ukraine and EU: proposals of Ukrainian experts*” (Kyiv, IEAS – Conrad Adenauer Fund, 2008), prepared by the author of this material in co-authorship with R. Khorolsky, O. Shumylo and I. Shevlyakov.

<sup>2</sup> See section IV of the Concept of General State Program of adaptation of Ukrainian legislation to that of the European Union, approved by the law of Ukraine dated 21.11.2002, No. 228-IV.

The Association Agreement is a notion of EU law; Ukrainian laws do not single out this type of international agreement. In the European Community Foundation Agreement adopted in 1957 (ECFA), the term “association” has two meanings in the aspect of the Community’s foreign relations. First of all, as a specific legal status of non-European countries and territories under the sovereignty of separate EU member countries. International agreements are not concluded with such territories, and the substance of the association is determined by EU legal acts. The second notion includes relations with countries that are not EU members. Article 310 of the European Union Agreement (EUA) empowers the European Community to conclude “an agreement on establishing an association that envisages mutual rights and obligations, common actions and special procedures”.

It is important to note that the name of the association agreement does not always include the word “association”<sup>3</sup>. In reality, the type of agreement is determined by the legal grounds of its conclusion by the Community. Therefore, on the basis of EU practices used many times, it is important that the European party be obligated to ratify the New Basic Agreement between Ukraine and the EU (NBA) as an association agreement, that is, with references to Art. 310 of the EUA.

The value of concluding the NBA for Ukraine as an association agreement is first of all determined by the fact that it is this type of agreement that is used to prepare the future membership of countries in the EU<sup>4</sup>. At the same time, there is no direct legal relationship between associated relations and preparation for membership and the status of a candidate.

Thus, the decision of the EU Council to conclude the future agreement as an Association Agreement is a compromise: association relations can contribute to maximum rapprochement of the country to EU membership; however it does not always contain the obligation to regard this country as a potential member.

In addition, an association agreement establishes special relations of the country with the EU, as it creates “special privileged relations with the non-member country, which should, at least in some way, participate in the Community system”.<sup>5</sup> The intensity of the country’s relations with the EU is important when

<sup>3</sup> Thus, the association agreement with the Republic of South Africa signed on October 11, 1999, is called “On trade, development and cooperation”, and association agreements with Mediterranean Arab countries signed in 1976–1978 were called “on cooperation”

<sup>4</sup> This concerned Greece, post-Soviet countries of Eastern Europe, and now – Turkey and western Balkan states.

<sup>5</sup> The decision of European Communities Court dated September 30, 1987 in the case 12/86 “Demirel” (European Court Reports.– 1987.– P. 3719, para. 9).

determining regulatory acceptability of the international agreement norms in EU laws and member countries' laws, and in particular their possibility of having direct action. In the end, it will allow Ukrainian individuals and legal entities to effectively protect their rights granted by Association Agreement provisions.

Today, Ukrainian diplomacy is trying to obtain principal consent of the EU to fix the possibility of future membership of Ukraine in the Association Agreement. The best achievement would consist in adding a statement to the Agreement Preamble that "the ultimate goal of Ukraine is acquiring membership in the European Union" and that "this association, in the Parties' opinion, will contribute to the achievement of this goal" (as was done in European agreements concluded in the 1990s with post-communist countries of Central-Eastern Europe).

At present, the EU refuses to consider the issue of Ukraine's membership. It is in this context that we interpret the directives of the EU Council for the negotiating delegation of the European party that "a New enhanced Agreement shall not prejudice any possible future developments in EU-Ukraine relations". Also, EU officials insist consistently and at any opportunity on the "neighbour" status of Ukraine within the framework of the European Neighbourhood Policy (ENP), which embraces countries that have no prospects of membership.

The grounds and procedure for joining the EU are regulated exclusively by Art. 49 of the European Union Agreement (EUA), and no EU international agreement can change them. It follows from this Article that neither the Union nor its member countries have the legal obligation to satisfy the membership application submitted by any country. Therefore, the latter has no legal right to membership, even if it fully corresponds to all the criteria set, even if the EU once promised it membership in an international agreement.

Thus, joining the EU depends first of all on the discretion of member countries and their political will, and it is influenced by the logic of political expediency. It is from this point of view that we should regard the possibilities that may be given by the provisions of a new agreement related to the possible membership of Ukraine in the EU.

First of all, mention of membership prospects should reduce the risk that consideration of the "Ukrainian question" in EU institutions will be hampered with reference to the difficult decision-making procedure in the EU. We should rely on changes in the internal organization of ensuring cooperation between the Union and Ukraine – an increase in the amount of financial assistance, more active engagement of EU institutions in realization of the necessary reforms in Ukraine, etc. This provision must also change the perception of Ukraine in the EU, not only

among political elites, but also among larger social groups. Similarly, it must have a powerful influence on the substance of internal political life of Ukraine and its geopolitical priorities. And finally, the presence or absence of such a provision will determine the contents of the Association Agreement, in particular, the scale of integration that the parties have to achieve as a result of its execution.

At the moment, it is evident that the Association Agreement **does not guarantee and does not even envisage the prospect of membership, but at the same time it does not exclude such a possibility in any way**. Thus, conclusion of the Association Agreement in no way obliges Ukraine to refrain from performing the procedures necessary to start the process of membership acquisition, first of all submission of an official EU membership application.

The Ukrainian and European sides insist that the Agreement with Ukraine will become a *new* type of EU agreement that will serve as an model when concluding basic agreements with other neighbouring countries – at least in the “Eastern Partnership” initiative (see below) it is expressly stated that Association Agreements of this type will be concluded with all countries to which the said initiative will be applied.<sup>6</sup>

The so-called “third-generation association agreements”, which include EU “European agreements” with the countries of Central and Eastern Europe in the 1990s envisaged a considerable amount of mutual obligations and reforms in associated countries. However, in practice, their meaning was limited by the fact that in most cases, implementation of this agreement in the short-term outlook (2-3 years) was followed by submission of an official membership application with further attainment of candidate status and the beginning of negotiations about membership acquisition. So the period when the European agreement played the role of an important legal relations instrument was quite limited.

In case of Ukraine, the Association Agreement will perform its direct functions for a longer time, as obtaining candidate status within 3-5 years is not a realistic expectation. Consequently, the Agreement has to contain a toolkit that will function in the longer term (5-10 years).

Practice shows that association agreements usually serve as a means of giving help to the countries that are at a lower level of civilization development than the EU. Therefore, such agreements envisage a considerable number of *unilateral* obligations of the EU contractor countries (although they may be formally

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<sup>6</sup> Communication from the Commission to the European Parliament and the Council. Eastern Partnership. Brussels, 3 December 2008. COM (2008) 823/4, page 4.

expressed as mutual obligations), the fulfillment of which has to contribute to their development using the Western European model. Thus, the peculiarity of the Association Agreement can be found in the *toolkit* with the help of which social transformations in these countries are made. In turn, it is determined by the peculiarities of each corresponding country.

The toolkit of the Association Agreement must ensure effective control over fulfillment of obligations undertaken by Ukraine, which will also envisage cooperation of the EU with Ukrainian social forces interested in the realization of real reforms. For example, implementation of short- and medium-term plans of fulfillment of obligations undertaken by Ukraine and constant monitoring thereof will contribute to this. An active role in this process will be played by Ukrainian organized civil society (in particular, via maximum access to the information related to executing the Agreement and participation in the monitoring process). One more important tool must effective procedures for settling disputes that will arise in connection with executing the agreement (for example, arbitration).

On the other hand, the agreement should allow Ukrainian business and organized civil society to realize their reform potential *without intervention of the state*. In this aspect, *the key* is giving an opportunity to Ukrainian individuals and legal entities to use the benefits of the Association Agreement through *direct application* of its norms. Ukrainian citizens and Ukrainian enterprises must have an opportunity to protect the rights provided to them by the Agreement directly in law courts of member countries or the EU. Not only Ukraine, but also the EU should be interested in this.<sup>7</sup> The fastest possible integration of Ukrainian business into the European economy is perhaps the shortest path to adopting the laws necessary to realize the reforms envisaged in the Association Agreement by the Ukrainian Parliament, and also the most effective countermeasure against the notorious “multivectoral” nature of Ukrainian foreign policy.

The new agreement between Ukraine and the EU should become a “fourth-generation” Association Agreement that will be based on previous EU experience, but it will exceed its limits with respect to stimulating the political and economic reforms necessary for Ukraine to achieve European standards, which will to a large extent coincide with the criteria of membership in the European Union.

<sup>7</sup> In this context, we should give a positive evaluation to the appeal of the Ukrainian Parliament to the EU “to fill the new agreement with direct action norms” (Para. 4 of the statement of the Parliament of Ukraine “On the start of negotiations between Ukraine and the EU about conclusion of a new basic agreement” dated February 22, 2007).

### **Free trade zone**

The negotiations related to the free trade zone began in March, 2008, when the completion of all essential procedures of membership acquisition in the World Trade Organization (WTO) by Ukraine was announced.<sup>8</sup> These negotiations are being conducted within the framework of the general negotiating process related to the association agreement, but on the basis of a separate schedule conditioned by peculiarities of this work trend. The section on free trade will be an integral part of the Association Agreement.

What content of this part should we strive for? The most widespread (classical) variant of free trade within the framework of which export and import duties will be cancelled will not require substantial institutional or legislative changes from Ukraine. However, it will not have any noticeable positive influence on the increase in turnover of goods between the two partners, nor will it become the driving force of integration of Ukraine into EU. At the same time, the “extended free trade” (or FTZ+), besides cancellation of duties, will envisage liberalization of the sphere of services and making the regulatory environment correspond to the European one. Thus, although the “extended” variant of the agreement will require considerable financial and human resources, as well as institutional and legal changes, it may form a basis for the country’s new economic strategy and consolidate the integration of Ukraine into the EU.

Adaptation to new standards and rules of the game will require Ukrainian manufacturers to increase expenses in the short-term outlook. But in the long-term outlook, it will contribute to a better competitive advantage of domestic products and, as a result, to an increase in their exports to world markets. Better quality of products will also strengthen the position of domestic manufacturers on the domestic market. In turn, Ukrainian consumers will have access to better quality and cheaper goods and services. The obligations of the government to implement the reforms necessary to create a free trade zone with the EU will increase the trust of foreign companies in Ukrainian economy, and so will increase the inflow of foreign investments and contribute to the integration of Ukraine into the world economy.

The final format of the NBA section on free trade and its contents will be determined in the course of the negotiating process between the Ukrainian delegation and representatives of the European Committee that will start after

<sup>8</sup> Ukraine became a formal WTO member on May 16, 2008.



Ukraine accedes to the WTO. It is important to see beforehand the possibilities and challenges of the negotiating process that depend directly on the ability of the Ukrainian side to state its position clearly and support it with arguments and do the same with the interests represented by the Committee. The duration and outcome of the negotiations will be largely determined by the quality of analytical and coordination work of the Ukrainian government both at the preparation stage, which is going on now, and during the negotiating process itself.

Not being an official candidate for membership, Ukraine has a certain freedom in negotiations with the EU, in particular, the possibility of choosing the level of correspondence of laws and standards for each sphere depending on its readiness and priority for economic development. This means greater responsibility of the Ukrainian side for clear understanding of which reforms will be required by the country's economy and how one can use economic and trade cooperation with the EU to implement these reforms and what consequences and limitations exist on the Ukrainian side (financial and human resources, positions of interest groups, etc.).

It is common knowledge that opening Ukrainian markets of goods and services to EU companies is impossible immediately after signing the agreement, as Ukrainian manufacturers are not prepared for fierce competition. That is why the EU is ready to discuss transitional periods to open Ukrainian markets at the level of separate groups of goods, services, and spheres of economic activity and reforming the regulatory environment (in particular, mechanisms of state support) in accordance with EU standards. It is clear that harmonization means introduction of EU norms and standards in Ukraine. The work related to reforming laws, adapting norms and standards and building up the necessary institutions will require foreign help. Taking this into account, the EU is promising to provide more technical and financial assistance to Ukraine.

It will not be possible to completely avoid the negative consequences of extended free trade with the EU (for example, closing uncompetitive enterprises). However, the absence of changes will cost the country much more than the losses that certain interest groups may suffer. At the same time, the government will be able to take measures that will help to reduce the losses caused by negative consequences.

**Start of implementation of the EU-Ukraine Agreement  
“On the facilitation of the issuance of visas”**

The EU-Ukraine Agreement “On the facilitation of the issuance of visas” (hereinafter referred to as the Agreement) took effect on January 1, 2008. The procedure<sup>9</sup> of Agreement ratification by the European Union was finished on November 29 at a meeting of EU Council of Ministers, where it was ratified along with the Readmission Agreement. The Council’s decision was based on positive conclusions of the EU Permanent Representatives Committee (COREPER), which were adopted on November 27. The Agreements were ratified earlier (November 13) by the European Parliament.

The Parliament of Ukraine ratified both Agreements (on the facilitation of the issuance of visas and on readmission) only on January 16, but by mutual consent of the parties the agreement took effect earlier, from January 1, at the same time as similar agreements concluded in the 2<sup>nd</sup> half of 2007 with Western Balkan countries and Moldova.

The period of time that elapsed since the time the Agreement took effect is, in our opinion, sufficient to make preliminary conclusions about the state of its implementation. At the same time, it should be noted that, according to EU representatives, the time for giving a public evaluation of the state of Agreement fulfilment has not arrived yet – the European side thinks that, as practical implementation of the Agreement requires changes and modifications to be introduced to a large number of instructions and rules due to the internal laws of EU member countries, the period between formal agreement implementation and its qualitative and full implementation requires more time (which is not specified).

According to the official EU point of view, the Agreement is being executed properly. As Bernard Bogensperger, representative of the Delegation of the European Commission in Ukraine stated, the Agreement is in effect and is being executed properly. To support this statement, he presented the fact that the level of refusals of Schengen visa applicants is now 6%; that is, 94% of persons get visas, which proves that the agreement is working. The opinion that the Agreement is being properly executed is also held by other official EU representatives. For example, on July 8, 2008, during the presentation of the start of the French presidency in the EU, the ambassador of France, Jean-Paul Veziant, expressed his satisfaction with the level of Agreement implementation and said that the French

<sup>9</sup> Agreement between Ukraine and the European Community on simplified visa granting  
<http://www.ukraine-eu.mfa.gov.ua/eu/ua/publication/content/11577.htm>

Embassy grants a fair number of multiple entry and long-term visas, and interpreted the appearance of a large number of publications in the Ukrainian media on the unsatisfactory level of granting visas to Ukrainian citizens as a “planned information campaign”, designed to discredit the EU and the Agreement.

At the same time, in an interview with *Expert* magazine, the German Embassy officer said that the rate of refusals amounts to 8% (in the past – up to 20%), and the number of visas granted for free amounts to about half of all the visas granted (in past years - 12%).

With respect to the opinion of official EU representatives, we still have to note that the arguments they provide are insufficient. First of all, the content of the agreement concerns such parameters as the list of documents to justify the purpose of the visit, limitations on the maximum cost of the visa, and deadlines for considering visa applications, and also the definition of privileged categories that have simplified access to multiple-entry, long-term and free visas. The parameter of percentage of refusal is not directly related to the competence of the Agreement, but merely indirectly concerns its effect. From the whole range of statements and publications where the opinion of official EU institutions is presented, no concrete data were ever given as to the dynamics of the number of visas issued, or to the change in the situation concerning the parameters regulated by the Agreement, namely:

1. The change in the number of multiple-entry and long-term visas issued in comparison with the previous year;
2. The number of applicants (in percent) included in the privileged categories established by the Agreement who have the right to obtain multiple-entry and long-term visas;
3. Adherence to the requirement about maximum cost of a visa – EUR 35 (EUR 70 in urgent cases);
4. Adherence to the 10-day deadline for considering visa applications;
5. Adherence to an exhaustive list of documents to justify the purpose of the visit;

To find answers to these questions, the Center for Peace, Conversion and Foreign Policy of Ukraine, supported by the International Renaissance Foundation, carried out a monitoring study in July and August 2008, by polling respondents leaving the consulates (or visa centers). The selection included 840 respondents and covers applicants of consular institutions of 11 Schengen countries located in Kyiv (10 consulates and visa centers) and other regions of

Ukraine (11 consulates) – 40 applicants from each consulate. The selection includes only those applicants who tried to get a visa independently – from submission of documents to obtaining a decision.

The data obtained revealed the following tendencies:

Positive

1. Decrease in the total (in general for Schengen) number of refusals – to 8%, while in previous years the average figures amounted to 12-14%
2. Appearance of new technologies for processing visa applications that allowed consular institutions of some EU member countries (mostly “old” ones) to reduce the total duration of the visa granting procedure and to some extent do away with the problem of lineups. The deadline for considering visa applications in “old” Schengen states in over 50% of cases is 1 week. The waiting time in lineups in “old” Schengen states in most cases does not exceed 1 hour.
3. “Old” Schengen states issue 23.5% of multiple-entry and 27% of free visas, which is 2-3 times more than in previous years.
4. Most of those polled are quite positive about the general atmosphere of communication with consulate employees

Negative

1. Considerable complication of procedures and conditions for getting visas in “new” Schengen states. Applicants note a worsening of almost all the parameters studied: “longer lineups”, “procedure duration”, “cost of services”, “document requirements”, “clarity of requirements and conditions for granting a visa” and “risk of refusal”. In most cases, the situation with granting visas in “new” Schengen states is worse than in “old” ones, in particular, concerning the time spent in lineups (quite often visitors wait for 2, 3, 4 and even more hours) and the waiting time for a decision (most applicants waited over 1 week)
2. 23% of applicants for “old” Schengen countries say it is necessary to pay additional costs to intermediaries (visa centers), as a result of which total expenses for visa procedures exceed EUR 60 instead of the maximum sum of EUR 35 fixed in the Agreement.
3. In case of a refusal to grant a visa, in 2/3 of cases the respondents were not informed of the reason
4. Duration of multiple-entry visa validity in most cases does not exceed 1-3 months. Only 13-14% of multiple-entry visas issued have a duration of over 6 months.

5. The poll did not show a decrease in the number of documents required by consulates from applicants, which casts doubt on the proper execution of Article 4 of the Agreement, which regulates an exhaustive list of documents to justify the purpose of the visit for certain categories of citizens.

Thus, the Agreement on simplifying the visa procedure marked the first step in the right direction, but it failed to make up for all the negative consequences caused by substantial changes in migration conditions in Eastern Europe for the past 8 years – first of all, the introduction of visas by new EU members and their entry into the Schengen Agreement zone.

The Agreement resulted in a certain improvement in the situation with granting visas to Ukrainian citizens, mostly in “old” Schengen states. At the same time, it still has not become an effective mechanism that can make up for the negative consequences of Schengen zone extension for most Ukrainian citizens that travel to EU countries. De facto, the agreement lacks mechanisms for direct action, as consulates continue to use departmental instructions which either disregard some provisions of the Agreement or interpret some of its ambiguous provisions to the detriment of Ukrainian applicants.

The tool designed to alleviate the consequences of Schengen zone extension for the citizens of Ukraine was the implementation of **small border traffic** – a special regime that covered the residents of border regions, giving them the opportunity to cross the border using a special multiple use certificate that gives a permission to be in border regions of neighboring countries for a limited period of time. However, among the three neighboring countries, only Hungary introduced this regime on time, along with joining the Schengen Agreement, while negotiations with Poland and Slovakia took a long time.

The Agreement on small border traffic between Ukraine and Slovakia took effect in September 2008, and the situation with Poland remained vague for a long time as the European Commission put forward serious criticisms of the agreement signed in March 2008. The most substantial criticism was a requirement that the parties of the agreement limit its extent to a 30-kilometer zone across the border, while in case of Slovakia and Hungary, an exceptional norm of a 50-kilometer zone was used, and this norm did not raise any objections on the part of EU governing bodies. Ukraine and Poland will probably sign the Agreement on small border traffic in the first half of 2009.

In one way or another, the tool of limited border movement failed to work in full measure. Thus, considering the facts above, the negative consequences of Schengen zone extension had a negative influence on the citizens of Ukraine.

### **Visa Dialog**

The prospect of implementing a symmetric visa-free regime between Ukraine and the EU was defined in the Preamble of the Agreement “On the facilitation of the issuance of visas”.

A political decision concerning the start of such negotiations was proclaimed during the Ukraine-EU summit on September 9, 2008 in Paris. In fact, negotiations on the implementation of the symmetric visa-free regime began in Brussels on October 30. The Ukrainian delegation was headed by the deputy minister of foreign affairs, Mr Kostyantyn Yelissejev.

It was decided to divide the dialog into four lines: document security, including biometric data; civil order and security; migration policy, including readmission; foreign relations.

On December 8-9, the first working group dealing with questions of document security and procedures for implementing biometric data arrived in Kyiv for negotiations and familiarizing themselves with the situation.

The other three working groups are to meet no later than the first quarter of 2009 in order to report on the progress of the “visa dialog” to the ministers of the EU countries in April.

The Ministry of Foreign Affairs of Ukraine is aiming at making a decision on abolishing the visa requirements for citizens of Ukraine in 2012 – before EURO-2012 takes place. In our opinion, this goal is too optimistic and will require more time. On the other hand, there is hope that Ukraine will receive visa-free status with the EU before expiry of the ten-year term of the Agreement on Association.

For Ukraine it is important to realize that: the experience of “visa dialogs” started by the EU with different countries shows that the content, intensity and tools used in these cases can differ significantly, depending on the political appropriateness. Thus, the notion of “visa dialog” may mean different policy and, accordingly, different results of the efforts made. At the present time, there are two models of the “visa dialog” offered by the EU – extensive (Russian) and intensive (Balkan).

The Russian model, which was implemented in 2007, does not envisage acceptance of binding documents (road maps) or fulfilling the specified criteria. This dialog is implemented by means of thematic expert negotiations without defining the mechanisms of monitoring and stepwise evaluation.

The Balkan model was started in spring 2008 with publication of the respective “road maps for the visa-free regime” for Serbia, Montenegro, FYR Macedonia, Albania, and Bosnia and Herzegovina by the European Commission.

The structure of the road maps consists of priorities such as:

1. Document security (passports, ID cards), their conformance with European standards, including implementation of the biometric components, fighting corruption in the passport issuing system.
2. Fighting illegal migration and implementing agreements on readmission. Border security policy and procedures for granting asylum.
3. Civil order and security, fighting organized crime, cooperation in the legal and law enforcement domains.
4. Foreign relations and fundamental rights of citizens, including protection of the rights of minorities and refugees.

In the postamble of the document, it is noted that monitoring of progress in the said domain shall be done on a regular basis, and an additional criterion of country's readiness to adopt the visa-free regime is a lower rate of visa denials – up to 3% of the total number of requests (for comparison, in Ukraine the denial rate is currently 6-8% according to the EU, compared with 12-14% in previous years).

The European Union plan offers the Balkan countries technical and expert help for the purposes of the fastest and fullest achievement of the criteria necessary for visa-free regime implementation.

It is stipulated that the European Commission shall report regularly to the EU Council on the progress of each country, and the first report shall be published by the end of this year.

The logic and even the vocabulary of Balkan “road maps” show a major difference with the documents signed with Russia.

Whereas the Russian version states in many forms “the equality of the partners and mutual respect for each other's interests”, the “road maps” of the Balkan countries look more like a list of guidelines and obligatory instructions that the countries that wish to get visa-free access must follow. Moreover, the result of the process will be different: The Balkan countries will receive visa-free access much earlier than Russia.

Ukraine is interested in making its “visa dialog” follow the Balkan model. Structuring of the working groups' themes, which took place before the negotiations, follow this logic. But the actual document, i.e., the “road map”, has not been published so far (recall that in the case of the Balkan countries, these documents were delivered by the EU by the beginning of negotiations and it shows a certain double-standard approach towards Ukraine). It is assumed that in the case of Ukraine, the parties will approve such a document in the first half of 2009.

### **“Eastern Partnership” Initiative**

The European Commission, having obtained approval of the idea at the summit held in June, revealed the Communication on the “Eastern Partnership” on December 3. Proposals for the program cover the relationships of the EU with Ukraine, Armenia, Azerbaijan, Belarus (on certain conditions), Georgia and Moldova. This policy was initiated by Poland and Sweden in May 2008. These two countries have traditionally advocated a more ambitious policy of the EU and favored diversification of the European Neighborhood Policy. It is predicted that final approval of this initiative will take place during the EU-Eastern Partnership summit in March 2009.

Taking into account the state of the cooperation between Ukraine and the EU, the “Eastern Partnership” is an important step forward, which has two major aspects.

Firstly, it is favorable for Ukraine to separate the European component from the general body of ENP; i.e., the group of countries that belong to the Council of Europe and, theoretically, may appeal to Article 49 of the EUD concerning the right to apply for membership in this organization. For a long time Ukraine has been expressing its dissatisfaction that within the ENP it is viewed “in the same boat” as the countries of North Africa and the Middle East. Today the problem has been solved by regarding the Eastern European countries as a separate group.

Secondly, within this initiative an intensive dialog will be held on the visa-free regime implementation based on “road maps”, which will make it possible to achieve important progress and to implement the visa-free regime in the medium-term outlook. During the first stage, as stated in the Communiqué, the EU members are ready to consider cancellation of the consular fees charged for visa-related procedures, which, according to calculations, will cost the EU budget about 75 mln Euros per year.

In the opinion of Sabine Fisher, a senior researcher of the EU Security Research Institute situated in Paris, the importance of this initiative for the Eastern neighbors is due to the following circumstances. “Eastern Partnership” Initiative:

1. it presents itself explicitly as a political message of EU solidarity, unlike the previous, largely technical ENP documents;
2. it suggests that the Partnership and Cooperation Agreements be replaced by Association Agreements (following the Ukrainian model);
3. it suggests the establishment of a new instrument: the ‘Comprehensive Institution-Building Programme’ (CIB), on a bilateral track;



4. it proposes the detailed procedures for the establishment of wide-ranging free trade areas through a proposed Neighbourhood Economic Community;
5. it also provides clear and detailed suggestions as to how to deepen the energy cooperation.
6. the regional/multilateral track is considerably deeper than in existing ENP documents (suggesting regular meetings from senior working level up to heads of state and government)
7. it envisages more funding from the EU budget (additional 350 million Euro for strengthening state institutions, border control etc) <sup>10</sup>

At this stage, the “Eastern Partnership” Initiative does not solve the major question of membership prospects for the Eastern neighbors, but it is still a step forward in the EU policy towards these countries.

Starting from this, Ukraine met the Communication rather favorably. As Hrygoryi Nemyria, the deputy prime minister for European and international integration of Ukraine, stated, the “Eastern Partnership” may create new possibilities for the countries that would like to join the EU: “We think that this initiative and this policy based on respective institutional and financial funding can create new possibilities for those EU neighbors who really wish to become members in the future.”

He also added that a respective institutional program is envisaged within the Eastern Partnership, which, along with the already existing TWINNING and

<sup>10</sup> **Original version:** It presents itself explicitly as a political message of EU solidarity, unlike the previous, largely technical ENP documents;

- it suggests that the Partnership and Cooperation Agreements be replaced by Association Agreements (following the Ukrainian model which is being negotiated now);
- it suggests the establishment of a new instrument, the ‘Comprehensive Institution-Building Programme’ (CIB), on a bilateral track;
- it provides detailed procedures for the establishment of wide-ranging free trade areas and visa facilitation regimes with the ENP neighbours; the former is linked to the regional dimension through a proposed Neighbourhood Economic Community;
- it also provides clear and detailed suggestions as to how to deepen the energy cooperation with the Eastern ENP countries;
- the regional/multilateral track is considerably more political than in existing ENP documents (suggesting regular meetings from senior working level up to heads of state and government and linking them to specific, very political thematic issues)
- it calls for fresh funding to be allocated to new initiatives. 350 million euro in new aid will go towards strengthening state institutions, border control and assistance for small companies, in addition to funds committed previously.

TAIEX programs, will give the opportunity to substantially ameliorate the institutional capabilities of the country for EU integration.

According to Nemyria, Ukraine is interested in deploying the European programs in such regions as the Crimea, the old industrial core such as Donbass, as well as sectoral support of agriculture.

In turn, the Ministry of the Foreign Affairs of Ukraine proclaimed on December 4: “We welcome the Polish and Swedish initiative aimed at creating a viable Eastern European dimension of Eu foreign policy. The Ministry of Foreign Affairs of Ukraine welcomes the decision of the European Commission to take into consideration the Ukrainian approach to the ‘Eastern Partnership’, which constitutes effective political association and economic integration between the EU and partner countries. It is also important that, according to the Communication, the level of ambition within the “Eastern Partnership” will depend on the wishes, goals and possibilities of each of them. This flexible approach is a prerequisite for transforming future EU policy into a working mechanism, as opposed to the European neighborhood policy, which is conceptually imperfect.

At the same time, the ambitious framework of the “Eastern Partnership” requires adequate sources of financing to ensure intensive promotion of the new priorities within the existing financial perspective of the EU.

Ukraine is ready to support and use in a pragmatic way all of the “Eastern Partnership” elements if the new policy is not positioned as an alternative to future membership in the EU but is considered as a tool bringing Ukraine towards this goal.

## **Relationship between Ukraine and the North–Atlantic Treaty Organization**

The relationship between Ukraine and NATO in 2008 was marked not only by completion of previously agreed plans, but also by Ukraine’s intention to receive a new cooperation format – Membership Action Plan (MAP) and fierce debates on the matter which moved far beyond the borders of the Alliance itself and provoked a wave of discussions on the geopolitical future of Ukraine, as well as of Eastern Europe in general. The result of these discussions left its mark on the international position of Ukraine, and within the Alliance it found its form in the decisions of the Bucharest summit (April 2008) and the North Atlantic Council at the level of ministers of foreign affairs (December 2008).

In addition, the relationship between Ukraine and NATO was influenced by the following moments:

1. Internal political turmoil caused by the constant competition between the centers of power and, on a personal level, between the highest government authorities, which left its mark on the quality of coordinated action of the governmental agencies and their institutional capabilities.
2. Aggravation of the situation of the ‘frozen’ conflicts in the Caucasus, which culminated in the Russian-Georgian war of September 2008 and resulted in Russia recognizing the independence of the self-proclaimed territories of Abkhazia and South Ossetia.
3. Increased tension between Ukraine and Russia caused by Ukraine’s intention to become a member of NATO, some humanitarian questions, and Russia’s use of the naval base in Sevastopol in the war against Georgia.

On January 16, 2008<sup>11</sup> the President of Ukraine, the Prime Minister and the Chairman of the Parliament addressed a letter to the Secretary General of NATO where they asked that Ukraine be given a NATO Membership Action Plan.

In their letter, the Ukrainian leaders stated:

*“The Euro-Atlantic integration policy is specified in the Ukrainian legislation; it is not directed against third countries, and it is aimed at Ukraine’s*

<sup>11</sup> Original: On January 16 Ukraine’s President, Prime Minister, and Parliament Chairman made public a joint letter to NATO Secretary General, declaring Ukraine’s readiness to advance to a Membership Action Plan (MAP) with NATO.

The three Ukrainian leaders’ letter states that *“the Euro-Atlantic integration policy is specified in the Ukrainian legislation; it is not directed against third countries, and it is aimed at Ukraine’s prospective membership in the North Atlantic Treaty Organization to be deliberated with the Ukrainian people.*

*Our main priority is deepening the large-scale reforms in the political, economic, defense, security, legal, and other spheres aimed to enhance democratic institutions, wellbeing and security of the Ukrainian people.*

*Activities aimed to raise, in a systematic and resolute manner, the public awareness of the broad range of issues of Ukraine’s cooperation with NATO continue to be significant. It is envisaged to essentially increase budget allocations to this end in the Programme of the Government.*

*We hope that the progress achieved by Ukraine in the framework of the Intensified Dialogue on membership and relevant reforms will be recognized by the Alliance in the near future. Currently, Ukraine is interested in the accession to the NATO Membership Action Plan.*

*We expect that the level of our state’s readiness for new commitments will become the basis for a positive response at the Ukraine-NATO forthcoming summit in Bucharest in April 2008”.*

*prospective membership in the North Atlantic Treaty Organization to be deliberated with the Ukrainian people.*

*Our main priority is deepening the large-scale reforms in the political, economic, defence, security, legal, and other spheres aimed to enhance democratic institutions, wellbeing and security of the Ukrainian people.*

*Activities aimed to raise, in a systematic and resolute manner, the public awareness of the broad range of issues of Ukraine's cooperation with NATO continue to be significant. It is envisaged to essentially increase budget allocations to this end in the Programme of the Government.*

*We hope that the progress achieved by Ukraine in the framework of the Intensified Dialogue on membership and relevant reforms will be recognized by the Alliance in the near future. Currently, Ukraine is interested in the accession to the NATO Membership Action Plan. Now Ukraine is interested in joining the NATO Membership Action Plan.*

*We expect that the level of our state's readiness for new commitments will become the basis for a positive response at the Ukraine-NATO forthcoming summit in Bucharest in April 2008".<sup>12</sup>*

The ambitions of the Ukrainian party are based on the fact that the existing long-term relationship between Ukraine and NATO is fruitful, multilateral and constructive. Ukraine continues to take part in all of NATO's peacekeeping missions and counterterrorist operations in Kosovo, Iraq (NATO training mission), Islamic Republic of Afghanistan and in the Mediterranean region ("Active Endeavors" antiterrorist operation). Ukraine is the only country of all NATO members to take part in all of the Alliance's operations.

By the decision of the North Atlantic Council, Ukraine became the first and so far only partner country to be invited to participate in the NATO Reaction Forces.

Among the detachments included in the NATO database and involved in the planning of NATO Reaction Forces operations are elements of the military transport aviation of Ukraine, national Reaction Forces, including the airmobile detachments and military ships "Hetman Sagaydachnyi", "Ternopil", "Lutsk" and "Kostyantyn Olshanskiy" which have already been certified according to NATO standards. Ukraine offered more than 20 detachments and subunits for the NATO Reaction Forces. They will be deployed in the cantonment areas, but in case of emergency must be able to be used within a short time period according to the Alliance's operative plans.

<sup>12</sup> Web portal of the President of Ukraine <http://www.president.gov.ua/news/8645.html>

Political consultations at the highest governmental level, Ministry of Foreign Affairs and Ministry of Defense were held on a regular basis and were marked by a high level of consensus and mutual understanding.

During the main event of 2008 - the NATO summit in Bucharest (April 2-3) – in the final Communiqué, a historical decision was approved and recorded: NATO welcomes the European and Atlantic aspirations for NATO membership of Ukraine and Georgia. Today we came to an agreement that these countries will become NATO members.” At that time, it was also determined that “MAP will be the next step for Ukraine and Georgia on their way to membership”, and the first evaluation of the progress was delegated to the ministers of foreign affairs of member countries during the December meeting of the North Atlantic Council.

On June 16-17, the NATO North Atlantic Council, including the Secretary General and the ambassadors of 26 member countries, visited Ukraine where it held a succession of meetings at highest level in Kyiv and visited the regions within the framework of contacts with the Ukrainian people.

On November 19-20, the Ukrainian military delegation took part in the meetings of the Military Committee on European Atlantic Cooperation and the Ukraine-NATO Commission at the level of heads of the General Staff of the Alliance members' military forces and their partners.

Finally, on December 2-3, 2008, a meeting of the NATO North Atlantic Council was held in Brussels at the level of ministers of foreign affairs of Alliance members. Within its framework, a meeting of the NATO-Ukraine Commission (NUC) with the participation of the Minister of Foreign Affairs of Ukraine was held. During the meeting, attention was drawn to the progress made by Ukraine and the readiness of the Alliance to assist in the reforms needed for acquiring membership was expressed. The assistance would mainly be provided by using the NUC, whose central coordinating role is planned to be reinforced by adopting changes to the Charter of the Distinguished Partnership between Ukraine and NATO.

With the aim of intensifying the practical relationship, it is planned to reinforce the NATO information and contact offices in Ukraine. The practical mechanism for implementing reforms propulsion is the Annual National Programs, which are to be evaluated annually by the allies. Thus, the Alliance approved a compromise decision, which eliminates the highly politicized MAP issue and gives Ukraine a cooperation instrument that has been used only within MAP before – Annual National Programs, which envisage deep internal reform and enforced monitoring mechanisms. From this time on, the progress made by Ukraine will be

evaluated from the viewpoint of NATO membership. The Ministry of Foreign Affairs of Ukraine, represented by V.Ogryzko, considers the December decision of the Alliance as a “MAP provided de facto”.

As it is stated in the declaration of the Chairman of the Ukraine-NATO Commission Meeting held at the level of the ministers of foreign affairs on December 3, 2008, in Brussels, the parties confirmed that the Ukraine-NATO political dialog is deepening as the number of high-level contacts rose during the intensive attraction period. Among such contacts are a successful visit of the North Atlantic Council to Ukraine in June 2008 and Ukraine-NATO consultations at the level of ministers of foreign affairs in Tallinn in November 2008. They confirmed that the well-structured and mutually cooperative relations between Ukraine and NATO during the last 11 years of Distinguished Partnership have benefited and will continue to benefit regional and North Atlantic security”.

Within the framework of mutual antiterrorist actions in July within the NATO “Active Endeavors” operation in the Mediterranean, Ukraine was represented by three ships: the corvettes “Lutsk” and “Ternopil”, and the frigate “Hetman Sagaydachnyi”.

On August 6, the opening ceremony of the first phase of the eighth activation of the Black Sea naval cooperation group “Blackseafor” took place in Sevastopol in the presence of the representatives of military fleets of Black Sea countries. The headquarters of “Blackseafor” were transferred from Turkey to Ukraine.

Ukraine continued consultations with international partners, NATO in particular, concerning questions of weapons control, export control and non-proliferation of WMD.

Within the framework of military reform during 2008, major attention was paid to questions of defense planning and preparation of Ukrainian specialists for participation in the defense planning projects of the Alliance. The package of Partnership Goals for 2008-2009 approved in May 26, 2008 during the meeting of the NATO Political and Military Steering Committee with Ukraine’s representatives in Brussels was renewed.

In September 2008, the Cabinet of Ministers approved a plan for implementing the National Security Strategy, which was approved in February 2007 with methodological support from NATO. Today, expert discussions concerning the priorities of national security are taking place in view of recent regional events. The Strategic Defence Reform aiming at developing a new vision of the Military Forces by the end of 2009 started. At a time when NATO membership is still considered a discussion question in the country, the European and Atlantic aspirations of Ukraine

proclaimed several times by successful governments during the last few years represent the direct choice – to link up Ukraine's security policy with the common democratic goals and common vision formulated in the Washington Treaty.

In the defense sphere, Ukraine's progress in realization of the State Program 2006-2011 turned out to be insignificant, which is and will be caused by budget cutbacks. In 2008, the defense budget of Ukraine peaked at only 2 billion USD, although the Ministry had requested 3.5 billion. Nevertheless, according to the Law on the State Budget of Ukraine for 2009, this tendency will only get worse. In the current year, defense spending has been cut to 1 billion USD according to the currency exchange rate for January 2009.

Despite the fact that the State Program envisages some very positive initiatives, including the creation of well-supplied and armed Reaction Forces, optimization of the military control and communication system, and full professionalization or contractual service, many of these programs could potentially be hurt if the military budget is cut. Reform of the security section in general is being performed at an even slower pace. Another negative factor is the growing politicization of law enforcement agencies. Nevertheless, some Ukraine-NATO initiatives proved to be successful in resolving such questions as democratic control of intelligence service and parliamentary monitoring.

The process of reforming security sector subjects is ongoing. The Decree of the President of Ukraine of March 4, 2008 No.196 "On urgent actions concerning development of the Military Forces of Ukraine" obliges the executive bodies (such as the Cabinet of Ministers of Ukraine, the Ministry of Defense of Ukraine, the Ministry of Education, the Ministry of Finance, the Ministry of Culture, the state Committee of Television and Radio Broadcasting of Ukraine) to work more actively on implementation of the most important measures of reforming the Military Forces of Ukraine. This act of the Head of State encompasses a wide range of tasks concerning improvements in the management system of the Military Forces of Ukraine, their supply, amounts of financing, modernization of weapons and military equipment, social protection of military officers and their families etc.

The information policy is one of the most important elements of the European and Atlantic integration of Ukraine, because it has been pointed out several times that the lack of popular support of Ukraine's membership in the Alliance is perceived by many members as a reason why Ukraine should not receive MAP.

From this point of view, a lot of hope has been placed on the State Targeted Program of Informing the population about European and Atlantic issues approved in June 2008 for 2008-2011.

It is obvious that in 2008 the number of information measures aimed at highlighting the work of NATO and its cooperation with Ukraine increased (according to different estimates, there were from 500 to 2000 actions at the national and regional level). The respective measures are organized within the framework of both the above-mentioned State Targeted Program and the activities of non-governmental institutions.

As the information obtained as a result of a sociological survey conducted by a consortium of sociology organizations shows, as of November 2008 only about 30% of Ukrainians support the idea of NATO membership, while 60% are against it. Thus we can see a slow progress (previous data showed 18-20% support). On the other hand, it should be noted that the State Targeted Program sets a landmark of 36% for vs. 55% against for 2008. So it is obvious that the failure to reach the set goal for the number of NATO supporters shows the low efficacy of this program and other information measures.

Summing up everything said above, it should be noted that the stability of the political course aimed at reaching NATO standards and, further, acquiring NATO membership for Ukraine, is a quicker and more accessible way to prove the immutability of Ukraine's European choice than the constant focus on its "European ambitions" and accepting the prospects of EU membership while the EU does not have the institutional resources to expand at this stage. And conversely, rejection of the European and Atlantic component of the integration (NATO) as stated by the "beyond the blocs" policy supporters may mean, practically, not focusing on the European component (EU). Their synchronous slowing of the process may lead to rejection of reforms and a return to the post-Soviet practices of political, economic and social life.

## **Ukrainian–Russian relations**

The relationship between Ukraine and the Russian Federation is defined first of all by tight intertwining of social, political, and economic relations, historical myths and stereotyped conceptions, which predetermine the fact that in essence, bilateral relations between the two states exceed the bounds of traditional international relationships: analysis thereof is impossible without consideration of a group of internal factors active in both countries.

On the one hand, the present state of relations between Ukraine and Russia is determined by steady growth of bilateral trade, and on the other hand by tendency



to crises and conflicts predetermined by significant discord in such fundamental national interests as regional integration, military, political and energy security, sovereignty and territorial integrity. Crisis proneness is strengthened by debates concerning information and humanitarian issues: language, church, interpretation of history and modern times, which is extremely over-politicized.

The main positive achievement of 2008 may be the mutual decision to prolong the life of the Treaty of Friendship and Cooperation concluded in 1997 for another 10-year period. The Treaty recognizes the inviolability of existing frontiers and contains assertions concerning non-intervention in each other's internal affairs.

At the same time, in 2008, the Russia's non-acceptance of the Euro-Atlantic aspirations of Ukraine became the main factor of aggravation of bilateral relations. In order to make impossible or at least retard Ukraine's accession to the NATO Membership Action Plan, the Kremlin resorted to unprecedented pressure on both official Kyiv, and Alliance member countries. Kyiv, in turn, did not deny officially announced intentions to become a NATO member. Another aggravating factor was the Russian Federation's military invasion of Georgian territory on August 8, 2008 and Ukraine's position concerning the Russian-Georgian war, in the course hereof official Kyiv supported Tbilisi. In the opinion of Ukrainian and Russian analysts, it is owing to these two factors that the bilateral contradictions reached the phase of what could be called a systemic crisis.

In the estimation of Valery Chaly, Deputy General Director of the Razumkov Center, "the present partnership of Kyiv and Moscow is a bizarre conglomeration of crisis proneness, cooperation, and rivalry. An absentee diplomatic exchange with mutual blame and accusations is practiced, signals about the possible introduction of a visa system, economic sanctions, etc. are being sent. However, there are grounds to believe that such relations will be retained in the short run".<sup>13</sup>

Crisis and conflict proneness has been intrinsic to Ukrainian-Russian relations from the very start of independence due to the fact that the appearance of Ukraine was a challenge to traditional (post-imperial, post-Soviet) Russian mentality, which destroyed artificially created in past centuries, but deeply rooted myths presenting Kyiv as the "cradle of Russian statehood", about "Little Russia", the younger brother of Russia, "historical rights" of Russia to Ukrainian territory or at a least significant part of it, and an ideologically interpreted "common" history of two "fraternal peoples" etc.

<sup>13</sup> Web site of Razumkov Center [http://www.razumkov.org.ua/article.php?news\\_id=655](http://www.razumkov.org.ua/article.php?news_id=655)

Mental and historical myths turned out to be so tenacious that for the present, the principle factors defining the atmosphere of mutual relations include the issue of interpreting the historical role of certain political or military figures of the past (the persons in question are often statesmen of 17th-18th centuries). The dominating Russian thought paradigm treats any Ukrainian historical figure who appeared to be "on the other side of the barricades" within the context of any Russian-Ukrainian or multilateral conflict as a "traitor", painfully perceiving facts of honoring anybody who has merit in Ukrainian history alone. Such persons are, in particular, Ukrainian hetmans of 17th-18th centuries Ivan Vigovsky and Ivan Mazepa, leaders of the Ukrainian nationalist movement and anti-Soviet armed resistance of the 20th century Stepan Bandera and Roman Shukhevich.

Attempts at honoring at the state level the memory of victims of the famine (artificially initiated famine) in 1933, due to which 3 million (minimum estimate) people perished in Ukraine, were also apprehended by Russian authorities as an anti-Russian action of Kyiv.

At the end of 2008 – beginning of 2009, the peak of the conflict situation between Russia and Ukraine temporarily shifted to the energy plane, namely, to issues of Russian gas supply to Ukraine and transit thereof to EU member countries. On October 2, Prime Ministers Tymoshenko and Putin signed a memorandum regulating the process of transition to direct contracts and market prices; however, the norms of this memorandum were later rejected by the Russian party.

Initially, during November-December, Gazprom accused Ukraine of delinquency in gas payments (although it was found out that these were not real debts but usual practice in gas-based relations of 4-6 weeks deferral of payment for gas delivered and consumed). The pretext of non-payment was used as a reason for delaying negotiations concerning supply and transit conditions for 2009. Finally, the parties could not agree until December 31, and the circumstances of the breakdown in the evening of the same day are still not clear: Gazprom's management publicly accused President Yushchenko of blocking negotiations, whereas no integral version was presented by the Ukrainian party.

The indicated circumstances resulted in suspension of gas supply by Russia to Ukrainian consumers from January 1, 2009 and full cessation of transit to the EU from January 7. For 13 days, European consumers did not receive contractual volumes of Russian gas that were supposed to pass through Ukrainian territory. **The gas crisis of the beginning of 2009 was the first serious evidence of Europe's dependence on both Russian gas such and on the state of Russian-Ukrainian relations.**

The average Russian citizen has formed a negative image of Ukraine or at least of the present administration, since entire state propaganda machine keeps cultivating distrust and enmity among the Russian population towards Ukraine and its leaders. According to a survey conducted by the All-Russian Center of Public Opinion Studies in April (2008), Russians named Ukraine (21%) among enemy countries, including Georgia (25%), and the USA. Thus, in the Russian social consciousness, Kyiv, along with Washington and Tbilisi, found itself on the list of principal enemies of Russia.<sup>14</sup>

After the gas conflict in January 2009, the attitude of Russians towards Ukraine worsened, which is confirmed by data of a January public opinion poll conducted by the Levada Analytical Center. A good attitude towards Ukraine was displayed by 29% Russians, which is 12% less than in September 2008. At the same time, the share of respondents manifesting a bad attitude to Ukraine increased from 53% to 62%.<sup>15</sup>

At the same time, the attitude of Ukrainian citizens towards Russia is much friendlier, although the level of positive ratings decreased slightly in August-September 2008 because of Russian war in Georgia. Whereas for the last few years at least 70% of respondents manifested a positive (fully or partially) attitude towards Russia, the survey showed a decrease in this figure to 65% in August 2008, and to 64.7% in September (data of FOM-Ukraine).

### **Policy of the Russian Federation towards Ukraine**

Positions of the Russian Federation towards Ukraine are characterized by completeness and offensiveness. In contrast to previous years, Russian official discourse reveals division into "hawks" and "doves" to a lesser extent. Russia's policy towards Ukraine has become integrally "hawk-like", while the voices of its subjects form some kind of "symphony". The President, the government, the State Duma, Gazprom, the Russian Orthodox Church, and less significant actors are conducting an active offensive course aimed at Ukraine; the short-term objective thereof is to contribute to deepening the chaos and disorganization of the government in Kyiv, strengthening negative influences of the global economic crisis in Ukraine, while the medium-term objective is replacement of political authority in Ukraine.

<sup>14</sup> Web site of the Razumkov Center [http://www.razumkov.org.ua/article.php?news\\_id=604](http://www.razumkov.org.ua/article.php?news_id=604)

<sup>15</sup> Press Agency „UNIAN” <http://www.unian.net/ukr/news/news-298069.html>

Conceptually, Russia sees Ukraine within the sphere of own "privileged interests"; in fact, it means a modernized version of Brezhnev's doctrine of "limited sovereignty", realized after the occupation of Czechoslovakia in 1968. The strategic vision of the Kremlin foresees that the sovereignty of Ukraine (and other states that do not belong to Russia's sphere of "privileged interests") can not be significantly wider than that of the members of Warsaw Pact prior to the collapse of "the socialist camp". Correspondingly, the political approach of Russia towards Ukraine is built.

On September 18, 2008, RF President D. Medvedev, when receiving the credentials from the newly appointed ambassador of Ukraine in Russia, Kostyantyn Gryshchenko, in Alexandrov Hall of the Kremlin, affirmed: "The peoples of Russia and Ukraine are indissolubly tied together by true fraternal relations and special feelings of respect and mutual trust". However, in practice, the rhetoric and policy of official Moscow towards Ukraine are fundamentally different and distant from the principles mentioned.

Back in January 2008, reacting to the appeal of Ukrainian leaders to NATO concerning the NATO Membership Action Plan (MAP), the Ministry of Foreign Affairs (MFA) of Russia threatened: "The possible integration of Ukraine into NATO will dramatically complicate Russian-Ukrainian relations. We will be forced to take adequate measures."

Shortly after, President V. Putin defined the substance of such measures in a more detailed way; an essential part of them should be redirection of the RF missile complexes to target Ukraine. On February 12, at a joint press conference with President Yushchenko, he stated: "Russia is first and foremost concerned about the location of NATO bases in Ukraine. It is terrible to say and even think that Russian missiles in reply to such steps – technically, we cannot exclude this possibility – would take aim at Ukraine. This is what our concerns are about."

Shortly after that, at his press conference on February 14, V. Putin specified that: "our joint staff and our experts are of the opinion, that this (*author's note*: Ukraine's accession to NATO) is jeopardizing our national security... Should it (*author's note*: threat) happen, we would be forced to react adequately. Then we will be forced to redirect part of our missile complexes to target the objects putting us in danger."

The pronouncements of President Putin concerning Ukraine became widely known in the course of the top-level Russia-NATO Council on April 4, 2008 in Bucharest (within the framework of the NATO summit). Then, the Russian had of state, in addressing the US president, said the following: "George, don't you

understand that Ukraine is not even a state! What is Ukraine? Part of its territory belongs to Eastern Europe, and another part, a significant one, has been given by us!”

A typical example of the dominating approach of the RF towards relations with Ukraine, involving virtually the entire spectrum of problematic issues of bilateral relations, is the Declaration of the MFA of Russia of September 11, 2008. In particular, it is stated therein: “We are forced to ascertain the fact that the policy pursued recently by the Ukrainian authorities should be evaluated as definitely unfriendly towards Russia”. It is mentioned in the document that Russia and Ukraine should define their approach to the future destiny of the Treaty of Friendship, Cooperation and Partnership of 1997 by October 1, 2008.

“It is clear that these kinds of strategic decisions are approved on the basis of thorough analysis of the course of implementation of the Treaty clauses and execution of the parties’ obligations to develop the Russian-Ukrainian strategic partnership”. Moreover, MFA of Russia points out that the declared aspiration of official Kyiv for NATO membership “contradicts the Treaty of 1997 and the security interests of Russia”.

Russian MFA also notes that, “in the humanitarian sphere, many negative phenomena have accumulated. The matter concerns attempts by the Ukrainian authorities to revise our joint history in an anti-Russian style, making heroes of the accomplices of fascists, while the rights of the Russian-speaking population of Ukraine are infringed, and purposeful policy is pursued with the aim of excluding the Russian language from public life, science, education, culture and mass media of the country”.

As stated in the document, “We are sure that the presence of the Russian Black Sea Navy in Crimea is a stabilizing factor in Russian-Ukrainian relations, and in the context of regional stability.”

Another sample of official Russian discourse concerning one of debatable issues is a communique of RF MFA “About the failure of Ukraine’s mischief concerning the Holodomor (big famine) in the UN Human Rights Council” of September 25, 2008, where it says, “On September 24, the delegation of Ukraine at the UN Human Rights Council, after it had not received any support, was forced to officially withdraw the previously submitted draft of the resolution “Recollection of the Holodomor (Famine) of 1932-1933 in Ukraine”.” It is stated in the communique, that Russia is continuing and will continue to pursue a policy of non-admission of throwing “confrontational topics and plots that have nothing to do with the promotion and protection of human rights, and are aimed at

achieving momentary political advantages” into the agenda in the UN Human Rights Council and General Assembly.

Ukrainian media published a letter of the RF Minister of Foreign Affairs Sergey Lavrov, where he appealed to his colleagues – heads of MFA of UN member countries – to block the Ukrainian initiative aimed at international recognition of the Famine as genocide of the Ukrainian people.

The Russian party neither sent a letter of compassion to the Ukrainian people nor agreed to participate in official events honoring the victims of the Holodomor, which were held in November 2008 in Kyiv; neither did it permit the Ukrainian Embassy in Russia and Ukrainian NGOs located in Moscow and other RF cities to conduct “Eternal Candle” actions, in memory of the Famine in Ukraine.

Notably, all Russian official documents where this tragedy of the Ukrainian people is mentioned, before the notion of “holodomor”, which appears only in quotations, the expression “so-called” is consistently used, although the mass death of people and the artificial planned nature of starvation have been proven as a historical fact, which allows the use of the term “holodomor” which is a Ukrainian equivalent of “famine”.

The political course of the Kremlin gained special acuteness in the course of and after the Caucasian crisis in August 2008.

As emphasized in the Declaration of RF MFA of September 11 mentioned above “the unfriendly policy of Kyiv towards Russia was especially pronounced in the case of Georgia’s aggression against South Ossetia: We did not hear any words of grief and compassion in connection with the death of the peaceful population of Tskhinvali and Russian peacemakers. On the contrary, the Ukrainian president tried to blame Russia for the slaughter. At the same time, in Kyiv, they persistently ignore the fact that due to their heavy armaments supplied to the Georgian army, the Ukrainian party shares responsibility for the bloodshed.”

In response to attempts of the Ukrainian party to limit the conveyance of Russian military vessels participating in military operations against Georgia, the RF Ministry of Foreign Affairs announced that the Decree of the Ukrainian President concerning regulation of the RF Black Sea Navy on Ukrainian territory “inflicts one more blow against the negotiation process concerning the Black Sea Navy (BSN), and, on a broader scale – the whole complex of mutual relations.” in the opinion of the RF MFA, the innovations are aimed at creating “serious complications” for practical activities of the navy, and are in direct contradiction with basic agreements between the Russian Federation and Ukraine about the status and conditions of presence of BSN on the territory of Ukraine in 1997.

Questions concerning supply of Ukrainian armaments to the Georgian government are still acutely contentious. On the initiative of opposition fractions in the Parliament, a special investigation commission was created on that issue. However, its activities were extremely politicized, and management had not concealed from the beginning that the conclusions would comply with the estimates previously declared by the Russian Federation as to the unlawfulness and inadmissibility of armament supplies to Georgia. However, such estimates do not correspond with international law norms: there were and are no sanctions concerning armament supplies to Georgia. Thus, now, the fact of such supplies, and facts of military and technical cooperation of the Ukrainian armed forces with the Georgian army cannot be deemed violations of regulations on nonproliferation and export control of armaments.

### **Ukrainian Policy towards the Russian Federation**

In contrast to the Russian Federation, the position of Ukraine as to the agenda of mutual relations is not always characterized by integrity and consistency.

Discrepancies are observed and even some conflicts between the president and government administration concerning such issues as the presence of the Black Sea Navy in the Crimea, assessment of the Russian-Georgian war, order of crossing of the state border of Ukraine by BSN warships, some issues of gas supplies and power security, etc. **Ukraine is far from always coming out in a united front with Russia. It weakens its positions as a state, making it vulnerable in view of the offensive behavior of the Kremlin. The Russian party adroitly uses the weakness of Ukraine predetermined by tough competition between the centers of power in Kyiv.**

In Ukraine, there are at least three centers influencing the formation of policy towards Russia:

1. The President's Secretariat and the newly established Interdepartmental strategic group for Ukrainian-Russian relations
2. MFA
3. The prime minister and her circle

The first two belong to the presidential sphere of influence and is pursuing the course predetermined by the position of Viktor Yushchenko, although with different accents and priorities.

The President of Ukraine has traditionally been the principal moderator of Ukrainian-Russian relations on the Ukrainian side, and does not want to lose the

leading role. To neutralize to some extent his own image as an "anti-Russian politician", and to form an alternative channel of communication with Moscow, he issued a Decree on establishing the Interdepartmental strategic group for Ukrainian-Russian relations on December 1, 2008, the tasks of which included "elaboration and submission within a month of a draft of the Main Principles of a strategy for solving actual issues of Ukrainian-Russian relations and General Directions for Ukrainian delegations for negotiations with the Russian Federation; providing for preparation on a permanent basis of proposals on measures for normalizing and further constructive development of Ukrainian-Russian relations."

Rayisa Bogatryyova, the Secretary of the Ukrainian National Security and Defense Council (NSDC), the Secretary of the Ukrainian part of Ukrainian-Russian intergovernmental commission, was appointed Chief of the Group. Kostyantyn Gryshchenko, the ambassador of Ukraine to RF, who also holds the office of First Deputy of the NSDC Secretary of Ukraine, is entrusted with the key communication functions.

Establishing this organization is in the first place a signal for Russian partners, indicative, first, of the fact that key pragmatic questions of mutual relations are to be solved with the president of Ukraine (not the Prime Minister), second, of the tough course of MFA in relations with Russia as not the only possible manifestation of the position of official Kyiv, and the President personally. Not for nothing, the two key persons of the Intergovernmental strategic group, R. Bogatryyova and K. Gryshchenko, recently were stably associated with the Party of Regions.

The Ministry of Foreign Affairs of Ukraine, led by Volodymyr Ogryzko (member of Tymoshenko's cabinet, but nominated, in accordance with the Constitution, by the President of Ukraine), traditionally appears with the toughest statements and never avoids acute angles in relations with Russia. Analysis of actions and statements of MFA of Ukraine on Russian issues within the last year is evidence of this.

On April 15, the Minister of Foreign Affairs of Ukraine handed over to his Russian colleague in Moscow a Memorandum concerning the phases and order of withdrawal of the Black Sea Navy military formations by May 28, 2017 from the places of temporary dislocation thereof on Ukrainian territory. This document caused irritation of the Russian party and no negotiations on the order of withdrawal of the Navy have been conducted since, yet experts maintain that a minimum of five years is necessary to withdraw such military formations along with infrastructure.



In the course of the Russian-Georgian war, it was the MFA that maintained an unequivocal approach of denunciation of Russia's unlawful invasion of the sovereign territory of Georgia. In response to the aforementioned Declaration of MFA of Russia of September 11, MFA of Ukraine stated:

"The prospects of equal and neighborly relations between Ukraine and Russia depend on ability of the Russian party to finally realize the evident fact that Ukraine has been an independent state for 17 years and under no circumstances will be part of the sphere of so-called "privileged interests" of any country whatsoever. The choice of Ukraine in favor of membership in EU and NATO is irrevocable. Realization by official Moscow of this objective fact would promote positive development of mutual relations.

Attempts by Russia to destabilize the situation in Ukraine through a nurtured fifth column have no future. Continuation of this course would definitively undermine the global positions of RF as a reliable partner. This, in turn, can only worsen mutual relations, which is not in line with the interests of Ukraine.

Ukraine as a reliable and predictable member of the global community will steadfastly fulfill its commitments, including those resulting from the Treaty of Friendship and Cooperation between Ukraine and Russia of 1997. The same pertains to our obligations under covenants on the temporary presence of the RF BSN on the territory of Ukraine, the validity thereof, as is known, will expire in May 2017.

Ukraine, like any other country, cares about protection of its state language. Our state also promotes free development of the Russian language and those of linguistic minorities. It is time to stop speculation around this issue.

They should realize in Russia that every nation has the right to its own history and an impartial interpretation thereof. It seems that official Moscow still does not comprehend the fact that the times of ideological screening of historical events have already passed away. We ask the Russian party to grant free access to their archival materials, thus contributing to the issue of restoration of historical justice."<sup>16</sup>

During the conflict around the anniversary of the Holodomor, MFA of Ukraine stated: "The uneasiness of the Ukrainian party is caused by information about pressure against activists of the Ukrainian community applied by representatives of federal authorities in regions of Russia where the "Eternal Candle" action was planned in order to intimidate and disrupt the action. A large-

<sup>16</sup> Website of MFA of Ukraine <http://www.mfa.gov.ua/mfa/ua/publication/content/19967.htm>

scale planned campaign is being conducted, practically aimed at prohibiting the right of RF citizens of Ukrainian origin to their historical memory – honoring the millions of victims of totalitarianism, crimes thereof are recognized in Russia, too.”

Prime Minister Yulia Tymoshenko considers the Russian sector as a certain set of opportunities for demonstrating evident successes, thus strengthening her own electoral positions (including these in the pro-Russian segment of Ukrainian society). As a result, she has pursued the tactics of distancing herself from the whole spectrum of positions and decisions of the president influencing the Russian-Ukrainian agenda.

Yulia Tymoshenko has almost never pronounced anything (or did it quite indistinctly), which concerns contentious security issues, the Caucasian war, Euro-Atlantic integration, terms of withdrawal of the Black Sea Navy, interpreting history, church etc.

After V. Putin became the Russian Prime Minister, Yulia Tymoshenko turned to creating a system of personal connections with the Prime Minister of Russia, forcing the President of Ukraine from the leading roles.

Major disagreements between the President and Prime Minister of Ukraine became evident during the Caucasian crisis in August 2008, when the President demanded urgent arrangements aimed at limiting the participation of the RF Black Sea Navy based on Ukrainian territory in the war against Georgia.

Viktor Yushchenko demanded that the government apply documents prepared by the the Ukrainian party about new terms of the temporary presence of the Russian Navy in Sevastopol. There are two: ”Approval of the order of coordination with competent Ukrainian authorities of redeployment connected with activities of the military formations of RF BSN beyond the place of their stationing in the territory of Ukraine”, and ”Amendments of the order of crossing state boundaries of Ukraine by servicemen, warships (supply vessels) and aircraft of the Russian Black Sea Navy stationed on the territory of Ukraine.”

As Yulia Tymoshenko delayed the decision, at a session of NCSD on August 13, Viktor Yushchenko signed two corresponding decrees. The Head of State approved the order of coordination with competent Ukrainian authorities of redeployment connected with activities of the military formations of RF BSN beyond the place of their stationing in the territory of Ukraine and the order of crossing state boundaries of Ukraine.

Officially, the decision about the obligation of the BSN to inform Ukrainian authorities on redeployments was approved in 1999. However, now Kyiv has

strengthened the rules, having introduced in a unilateral order not informational but an authorization-based system. All that is stipulated by the aforementioned decision of the National Council for Security and Defense of August 13, 2008 "Issues of the order of crossing state boundaries of Ukraine by servicemen, warships (supply vessels) and aircraft of the Russian Black Sea Navy stationed in the territory of Ukraine", which came into effect after approval of the President.

There is a need to introduced an authorization-based system of crossing state boundaries of Ukraine by servicemen, cargo and military vessels and aircraft of the Russian Black Sea Navy, which would enable collection of impartial information on stationing of the RF BSN on the territory of Ukraine", - is stressed in the decision of NCSD approved by the President. In particular, it is stated in the Decree that "vessels and aircraft of the RF BSN are permitted to cross the state boundary of Ukraine only after notification thereof submitted to the headquarters of the Ministry of Internal Affairs (MIA) of Ukraine, said document shall be submitted 72 hours prior to the envisaged crossing." The notification shall indicate number of personnel on the vessel (aircraft), and data about armaments, ammunition, explosives, and military stores available on board.

It is stressed in the decision of NCSD, in particular, that the "simplified order of crossing state boundaries of Ukraine by the Black Sea Fleet of the Russian Federation grants the Russian party an opportunity to cross the boundary and move around territorial waters of Ukraine virtually without control... and concordance with competent authorities of Ukraine." Lack of proper mechanics for control over the activities of BSF on Ukrainian territory, as is mentioned in the Decree, "potentially jeopardizes national security of the state, in particular, in case of deployment of military formations of the RF BSF against third states."

In case of failure to comply with these requirements, the state control authorities of Ukraine shall promptly inform MFA of Ukraine, and, in accordance with the article of UN Naval Law Convention from 1982 "may in the name of Ukraine demand that the warship (supply vessel) or aircraft of the RF Black Sea Fleet leave the inland and territorial waters of Ukraine or airspace thereof immediately."

In turn, Ukrainian Prime Minister Yulia Tymoshenko maintained that the President's Decrees on the order of crossing borders by military vessels of the Russian Federation Black Sea Fleet contradicted the covenant between Ukraine and Russia about basing the Black Sea Fleet on the territory of Ukraine.

At the same time, the Prime Minister made Ukrainians aware of the sad experience of Georgia; i.e., "if we provoke conflict by our own hands, someone may respond inadequately."

Moreover, she spoke out against making the Crimean people unite in protest against the actions of Ukraine, which creates "impossible conditions" for the Black Sea Fleet. "It is the first step towards making them go and receive other passports than Ukrainian ones." The prime Minister called this policy irresponsible.

Such rhetoric in the conditions of world crisis significantly weakened the positions of Ukraine. At the same time, the president's circle exceeded the bounds of correctness at the end of August, accusing Tymoshenko of "high treason", her position in the aforementioned question provoking the political crisis of September-October 2008.

The Caucasian crisis and the consequences thereof revealed discrepancies in the positions of Ukrainian leaders, lack of integrity, coordination, and concordance of actions of the state in such a fundamental element of Ukraine's foreign policy as Russian one. Later, these problems revealed themselves again, in particular, on the eve and in the course of the gas crisis of early 2009, which was the toughest conflict between Russia and Ukraine within the period of independence and obviously did not improve the reputation of either state on the global scene.

## **Relations with the United States of America**

The two indicative events in US-Ukrainian relations in 2008 were the visit of US president George Bush Jr. to Kyiv on April 1 and conclusion of the United States-Ukraine Charter on Strategic Partnership in Washington on December 18.

At the beginning of 2008, the USA was the state that resolutely and persistently supported Ukraine's intention to obtain a NATO Membership Action Plan. The official visit of US President George Bush Jr., which actually happened on his way to Bucharest, where in next three days the NATO summit was held, was regarded within and outside Ukraine exactly in the context of support of Euro-Atlantic aspirations of Ukraine.

On April 1, George Bush had meetings with Ukrainian President Viktor Yushchenko, Prime Minister Yulia Tymoshenko, and brief talks with Arsenyi Yatsenyuk, the Chairman of the Parliament of Ukraine, and Viktor Yanukovich, the leader of the Party of Regions. In addition, in the framework of the visit, a meeting of the Minister of Foreign Affairs of Ukraine Volodymyr Ogrzyzko with US Secretary of State Condoleezza Rice was held.

The meaningful content of George Bush's visit to Ukraine was also the signing of important bilateral documents: a "road map" of American-Ukrainian

cooperation priorities covering the entire spectrum of bilateral cooperation, which will serve as a guide for relations between Ukraine and the USA within the near-term outlook; Covenants between Ukrainian and US governments on trade and investment cooperation, laying, in turn, the proper foundations for beginning negotiations on free trade between the USA and Ukraine in the foreseeable future; a framework agreement on cooperation in investigation and peaceful use of space, which would open new prospects for interaction in the high tech realm.

Although the proposal of the USA about granting MAP to Ukraine at the Bucharest summit of the Alliance was not backed up by all member countries, the USA continued supporting Ukraine in its Euro-Atlantic aspirations henceforth.

United States-Ukraine Charter on Strategic Partnership, signed on December 18 in Washington, is a framework document containing a list of cooperation principles and priorities. This document shall not be deemed the equivalent of security safeguards inherent in legally binding agreements; however, from the international legal point of view, it brings Ukraine-US cooperation to a qualitatively new level, de jure granting the status of strategic partnership.

The principles of cooperation stipulated by the Charter are the following:

- Support for each other's sovereignty, independence, territorial integrity and inviolability of borders constitutes the foundation of our bilateral relations.
- Our friendship comes from mutual understanding and appreciation for the shared belief that democracy is the chief guarantor of security, prosperity and freedom.
- Cooperation between democracies on defense and security is essential to respond effectively to threats to peace and security.
- A strong, independent and democratic Ukraine, capable of responsible self-defense, contributes to the security and prosperity not only of all the people of Ukraine, but of a Europe whole, free and at peace.

The document mentions "Deepening Ukraine's integration into Euro-Atlantic institutions is a mutual priority. We plan to undertake a program of enhanced security cooperation intended to increase Ukrainian capabilities and to strengthen Ukraine's candidacy for NATO membership".

The next Charter clause concerning cooperation in the sphere of power engineering, despite the generally declarative nature of the document, evoked visible irritation in Russia, which considered this as a threat to its interests in the sphere of energy resource transit through Ukrainian territory: "Recognizing the importance of a well functioning energy sector, the parties intend to work closely

together on rehabilitating and modernizing the capacity of Ukraine's gas transit infrastructure and diversify and secure Ukraine's sources of nuclear fuel making Ukraine less dependent on foreign sources of nuclear fuel and nuclear fuel storage".

Following the Roadmap of Priorities for U.S.-Ukraine Cooperation, the United States and Ukraine intend to launch the work of the Bilateral Energy Security Working Group. Consistent with the U.S.-EU Summit Declaration of June 10, 2008, the United States and Ukraine intend to enhance a trilateral dialogue with the European Union on enhanced energy security."<sup>17</sup>

In addition, Ukraine welcomed the intention of the USA to initiate an American diplomatic presence in Simferopol (an American representative office).

At the beginning of October, the first meeting of the Ukrainian-American Council for trade and investment was held. National sections of the Council were led by the Minister of Economics of Ukraine Bogdan Danylyshyn and US Deputy Trade Representative John Verono.

Election of the new US President Barack Obama opens a new window of opportunities for Ukraine, first, indirectly – through the prospects of enhancing the atmosphere of transatlantic relations and improving the general image of the USA in Europe and the whole world.

Crisis phenomena in relations between the USA and EC always adversely influences international standing of Ukraine. Minimization and elimination of such phenomena in these relations will create more comfortable conditions for Ukraine for constructive dialog with Western Europe within the entire range of debatable issues.

Although republicans in their declarations support the idea of Ukraine's integration into the Euro-Atlantic structure more distinctly and consequently, democrats are those who have better "starting position" for support of basis vectors of the foreign policy of Ukraine and chances of convincing European partners to involve Ukraine in more active way. Consistency of new Administration, which has been already confirmed by Obama's recent statements, depends on solving the major problem of the US President – ensuring stability and inviolability of Euro-Atlantic partnership.

In the opinion of Eugene Kaminski, a famous Ukrainian expert on the US, Obama, who is intellectually influenced by Zbigniew Brzezinski, understands

<sup>17</sup> English version of the Charter for strategic partnership between Ukraine and the USA  
<http://www.mfa.gov.ua/usa/en/publication/content/23512.htm>

fairly well the critical significance of the economy for stabilization of the Ukrainian political system on democratic principles of Euro-American space. Since it is economic and energy levers that enable the Kremlin to influence Ukraine for realization of its plans of regional leadership within the post-Soviet space, American policy should provide for strengthening of trade, economic and investment cooperation with Ukraine. Decisions to be taken by the Obama administration in the Ukrainian sector will depend on decisions and actions of Kyiv to a greater extent, than on strategic considerations.<sup>18</sup>

## **Regional relations**

The year 2008 did not introduce any positive innovations in the global situation of Ukraine in the region of Eastern Europe and the Black Sea. Objectively, the situation was not favorable for the progress of regional projects, and Ukraine's capability of consistent leadership was restrained first of all by internal political problems and lack of resources.

The major challenge for regional security and stability has obviously been the invasion of Georgia by the Russian Federation and the consequences of the Caucasian war, which changes the status quo in the region to a significant extent.

Official Kyiv represented by President Yushchenko and MFA resolutely criticized Russia's actions. Already on August 8, on the day the war started, President Yushchenko delegated his special representative, the First Deputy Foreign Affairs Minister Kostyantyn Yeliseyev, to Tbilisi.

On August 9, the Head of State held telephone conversations with Lithuanian President Valdas Adamkus, French President Nicolas Sarkozy, and Supreme Representative of EC on issues of joint foreign and security policy Xavier Solana. On August 10, Viktor Yushchenko ordered the Ukrainian Minister of Foreign Affairs of Ukraine, Volodymyr Ogryzok, to leave for Tbilisi personally for consultations with the Georgian administration.

On August 12, Yushchenko arrived in Tbilisi personally together with Polish President Lech Kaczyński, Estonian President Henrik Ilves, Lithuanian President Valdas Adamkus and Latvian Prime Minister Ivars Godmanis. In his speech in the central square of Tbilisi, Yushchenko stated: "We came thousands of kilometers to demonstrate to the rebellious Georgian people the most sacred emotion, solidarity.

<sup>18</sup> UA Foreign Affairs <http://uaforeignaffairs.com/article.html?id=285>

It means that our hearts belong to you. Liberty is worthy of struggle. We should always remember that the Georgian nation deserves to be independent. We came to confirm your sovereignty, your independence, your territorial integrity.”<sup>19</sup>

According to Director of the Institute of Foreign Policy of Diplomatic Academy of Ukraine at MFA Grygoriy Perepelytsya, the main tasks of Ukraine were:

1. Non-admission of the storming of Tbilisi by Russian troops;
2. Immediate ceasefire;
3. Withdrawal of Russian troops from the territory of Georgia and cessation of military occupation thereof;
4. Raising of the blockade from Georgia;
5. Restoration of the territorial integrity of Georgia.

Within the line of military and technical cooperation, Ukraine granted Georgia some specimens of defensive armaments, in particular, an anti-aircraft land "BUK" missile complex. In addition, the Russian party was notified about the right of Ukraine to close its territorial waters to warships of the RF Black Sea Fleet, which directly participated in hostilities against Georgia. Thus, Ukraine granted real military, political and diplomatic assistance to Georgia.

The actions of the Ukrainian cabinet led by Y. Tymoshenko in the course of the conflict were first of all aimed at the evacuation of Ukrainian citizens from the conflict zone and granting humanitarian aid to Georgia at the rate of about 155 tons, in the amount of 8 million USD (comparable with EU humanitarian aid – 5 million Euros, and the USA – 10.7 million USD). The government also arranged a convalescence program in Ukraine for about 200 Georgian children evacuated from the conflict zone.

The political position of the government and the Prime Minister personally differed from the President's position – Y. Tymoshenko avoided political assessments of the war, emphasizing only that her position coincides with that of the European Union. It was used by the Prime Minister's opponents (first of all, those from the Presidential Secretariat) in order to accuse her of rousing the Kremlin.

As for the opposition, it took up a sharply critical position as to the policy of official Kyiv. The Head of the Party of Regions faction in Parliament, Viktor Yanukovich, was sure that the President of Ukraine Viktor Yushchenko had no right of "unilateral support" of Georgia in its conflict with Russia on behalf of the

<sup>19</sup> Internet representative office of the President of Ukraine <http://www.president.gov.ua/news/10927.html>



Ukrainian state. We may take part in its regulation merely on a peacekeeping basis. Statements of Ukrainian leaders in support of Georgia lead to extremely conflict situation with Russia.”

There was no unanimous reaction of the society in assessing the Caucasian conflict. Most citizens adhered to a neutral position. In accordance with a nationwide poll conducted by the National Institute for Strategic Studies on August 21–26, 2008, **41.9% of citizens were in favor of impartiality towards the conflict.** Another 20.2% considered it reasonable to support Georgia exclusively by diplomatic means, 18.3 % - to support Russia exclusively by diplomatic means, 4.0 % - to grant Georgia military and military-technical support, 2.9 % - to grant Russia military and military-technical support, and 12.7 % respondents had no clear opinion on the matter

The Russian-Georgian conflict turned into a geopolitical war. As a result of de facto annexations of legitimate territories of Georgia – Abkhazia and North Ossetia – and the inability of the world community to achieve restoration of the pre-war status quo, the state of the global relations system has unilaterally changed. The principal consequence of this change is destruction of the consensus existing before, as for legal recognition of the collapse of the USSR within the limits of former republics. This circumstance essentially worsens the prospective prognosis of support of stability in the Black Sea region. Although there are no actual separatist conflicts on the territory of Ukraine, their initiation is possible, first of all, in Crimea, with the further use of precedents tried in the course of the crisis phase of the Caucasian conflict in August 2008.

As for the decision of the Russian Federation to recognize the self-proclaimed republics of Abkhazia and South Ossetia as independent states, official Kyiv is acting on the premise that no proper preconditions were created on either territory for a normal democratic declaration of will that could be treated as a display of “right of self-determination”, whereas references of the Russian party to the “Kosovo precedent” without specification of the essential constituents of this “precedent” sound like political manipulation.

The policy of Ukraine concerning the conflict in Transdnistria of 2008 was determined by joint efforts (inefficient ones) together with the EC as to resumption of the work of the 5+2 negotiation format, and further fulfillment of commitments in the frames of the Memorandum of mutual understanding between the Ukrainian government, the government of Moldova and the European Commission concerning the European Union Border Assistance Mission (EUBAM) – the Mission’s mandate was extended for 2008-2009.

At the same time, stagnation of GUAM development is due to the deficiency of proper leadership on the part of Ukraine and a significant decrease in Moldova's interest to this organization: at the last summit of GUAM in Batumi in June 2007, Moldova was represented by a delegation led by the Minister of Interior. Strengthening of authoritarian tendencies in Azerbaijan also does not favor the organization's statutory function, which is support of democracy and rule of law in the region.

Chapter 4.

## **REGIONS AND REGIONAL DEVELOPMENT OF UKRAINE**

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Ukraine is a country with a historically high degree of regional heterogeneity. Regional heterogeneity in Ukraine is a factor having considerable impact on the political and socio-economic situation. One can distinguish at least two large groups of factors determining the current status of regional differences in Ukraine.

1. Heterogeneity determined by the historical origin of the territories and the dominating native population.
2. Heterogeneity determined by the nature of the regional economy and by the level of economic development.

The first group of factors determines the heterogeneity of Ukraine based on the criteria of the dominant language, identity, prevailing historic myths, and partly confession. These factors have a major impact on voting preferences and geopolitical orientations of people.

The second group of factors influences the way of life of most people, their living standards and social organization.

Regional heterogeneity is part of the established image of Ukraine as a nation and the basis for certain stereotypes. In his time, Samuel Huntington in his work *Clash of Civilizations* pointed out that the border between Western and non-Western civilizations goes through Ukraine. Obviously, various works of literature often give a rather simplified and superficial understanding of the differences between Ukrainian regions. Quite often, such evaluations are exaggerated or plainly politically motivated and challenge the sustainability of Ukraine within its present boundaries.

In fact, regional heterogeneity is one of the strategic factors of the existence of the Ukrainian nation and Ukraine as a state. Differences stop being a conflict factor when political elites stop using them for electoral or mobilization purposes by playing on the dominant stereotypes in certain regions that form their electorate. Regional differences should be perceived more as a strategic resource of Ukraine, and not only as a problem.

## **Regional Administration and Local Governance<sup>1</sup>**

The year 2008 did not bring any change into the administrative territorial structure of Ukraine. It continues to have four levels: the Autonomous Republic of Crimea, oblasts (24), and cities with oblast status (Kyiv and Sevastopol); *raions*

<sup>1</sup> This sub-chapter is written by Olena Prystayko, EU-Russia Centre, Brussels.

(oblast districts) and cities with *raion* status; cities; and villages and townships. Furthermore, each *raion* is divided into a number of local councils (village or small-town councils).

Local governance is represented by a dual system of authorities: state administration and a self-governance council. The President appoints the heads of the executive in oblasts and *raions*. Citizens elect top city officials and heads of local councils. The Constitution does not outline precise divisions among bodies at different levels, including administrative bodies such as urban communities, village councils, and township councils.

The administrative and territorial structure of Ukraine suffers from a number of shortcomings. Inherited from the time of the USSR, it was never entirely reformed with the aim of transforming it to the modern needs of the state. The structure is irrational: administrative entities do not correspond to the number of domiciled citizens; relations of “centre-local” governance are not clear, the subsidiary principle is frequently not adhered to; serious problems exist in the budgeting process of the regions, where local administrations lack the authority to manage local budgets without the approval of central authorities.

Participation of citizens in local government decision-making remains mostly formal. Regional and local authorities remain less transparent in comparison with the central government. The lack of financial and economic independence for territorial communities presents a problem owing to the ineffective structure of local budgeting, which still largely resembles centralized budgeting.

These and other problems were not challenged in 2008 with the introduction of any new reform. Neither was the reform initiated in 2005 implemented. Despite the fact that on 15 January 2008, the Constitutional Court of Ukraine finally issued a decision on the draft law on administrative and territorial changes (a draft Law on the Introduction of Changes to the Constitution of Ukraine on Improvement of the System of Local Government)<sup>2</sup> submitted in 2006. The Court recognized the draft law as partially corresponding to the Constitution. No further steps were taken to introduce the draft law.

The new Cabinet of Ministers of Yulia Tymoshenko in its Programme adopted in January 2008 indicated reform of local administration and

<sup>2</sup> A draft Law “On the Introduction of Changes to the Constitution of Ukraine (on Improvement of the System of Local Government)” Registration Number in the Former Supreme Rada: 3207-1. Registration number in the Supreme Rada of the V convocation – 0900.

administrative and territorial governance of Ukraine as one of the goals<sup>3</sup>. The Programme linked the reforms with adoption of the new Constitution of Ukraine. As the Constitution was not revised in 2008 the Government did not take steps to introduce any new reform, nor was the reform of 2005 implemented. Draft laws “On changes to the Law “On local state administrations” and “On changes to the Law “On local self-governance” were on the list of draft laws to be adopted by the Supreme Rada (Parliament) with creation of the Coalition of Democratic Forces.<sup>4</sup> Both drafts were adopted as a basis by the Supreme Rada in March 2008, but were not adopted finally.

Local governance remains fragile against ongoing confrontations at the national governance level. This negative tendency was reinforced in 2008. Heavy political fighting among the main political parties, as well as a confrontation between the President and the Prime Minister in 2008 negatively reflected on the activities and stability of local administration. Among cases of misuse of the local governance structures for purposes of political fighting, early elections of the Mayor of Kyiv in June and the issue by the President of 15 acts (decrees and directives) on appointments of so-called “acting” heads of local state administrations<sup>5</sup> deserve special mention. The Presidential Decree of 11 February “On Business Trips of Local State Administration Heads within Ukraine”, which obliges the latter to “coordinate their trips with the President” and therefore restricts their freedom of movement, also belong to such cases.

The Decree to hold early elections for mayor of Kyiv was adopted by the Supreme Rada in March 2008<sup>6</sup> at the initiative of the Yulia Tymoshenko bloc against allegations of corruption of then city Mayor Leonid Chernovetsky in

<sup>3</sup> Resolution of the Cabinet of Ministers of Ukraine “On Approval of the Cabinet of Ministers of Ukraine Programme of Action Ukrainian Breakthrough: For People, Not Politicians” No.14, January 16, 2008.

<sup>4</sup> Agreement “On Creation of the Coalition of Democratic Forces in the Supreme Rada of VI Convocation”, Attachment №1.0 “List of Draft Laws to be Considered and Adopted in the Supreme Rada before Considering Appointment of the Prime Minister of Ukraine”.

<sup>5</sup> In December 2007, February 2008, the President issued the Decree “On Appointment V.Cherkaska Acting Head of Zaporizhya Regional State Administration” No.1250, December 24, 2007; and 12 directives of provisional exercise of duties of district state administration heads in different districts of Kyiv, Vinnytsya, Transcarpathian, Kirovohrad, Luhansk, Lviv, Mykolayiv, Kherson, Chernihiv regions.

<sup>6</sup> Decree of Supreme Rada “On Appointment of Early Elections of the Deputies of Kyiv City Council and Kyiv City Head” № 143-VI, 18 March 2008.

corruption actions, was lacking full legitimacy and became possible only due to a political compromise among the main political parties. Adoption of the Decree was part of the Coalition Agreement. Although the results of the elections did not bring substantial changes to the political representation in the city Council, it raised the danger of voluntary appointment of the elections of the mayors in other Ukrainian cities as a result of political fighting at the central level. The Presidential decrees on the appointment of “acting” heads of local state administrations are contrary to the constitutional procedure of appointment of local state administration heads. The heads are to be appointed with the cooperation of the President and the Government.

The confrontation of the President and Cabinet of Ministers in 2008 negatively impacted the local governance level. The year witnessed neither reform initiatives, nor implementation of already existing reform proposals. So far, the existing local system has managed to be maintained under confrontation circumstances.

### **Institutional and Regulatory Support of the Regional Policy of Ukraine**

For a long time Ukraine did not have a central executive body with sufficient authority to pursue regional policy that would comprehensively solve the problems of regional development. Instead, resolution of issues of regional socioeconomic policy was imposed upon the Ministry of Economy of Ukraine. In particular, the Regulation on the Ministry of Economy of Ukraine defined the following as being among its main objectives: “participation in forming of state regional policy, and organization of work related to the pursuit thereof”. The Secretariat of the Cabinet of Ministers of Ukraine also included the regional policy administration dealing with analysis of the regions’ socioeconomic development and facilitation of the regions’ development and effective activity of the local authorities.

The situation changed on March 1, 2007, when the Cabinet of Ministers decreed (Resolution #323) to establish **the Ministry of Regional Development and Construction of Ukraine** and the Ministry of Housing and Communal Services of Ukraine on the basis of the reorganized Ministry of Construction, Architecture and Housing and Communal Services of Ukraine. The Cabinet of Ministers decreed that the Ministry of Regional Development and Construction of Ukraine should be the major (leading) authority in the system of central local

authorities for issues of ensuring implementation of state regional policy and construction, architectural and urban development policy<sup>7</sup>.

According to the Regulation approved by the Government, the key tasks of the Ministry of Regional Development and Construction are as follows:

- Participation in forming and ensuring implementation of state regional policy and construction, architectural and urban development policy, preparation and submission of suggestions for more effective facilitation of coordination of activities carried out by central and local executive bodies and local authorities in this field, and public involvement in the preparation and discussion of the corresponding draft resolutions of governmental authorities;
- Facilitation of effective use of economic, scientific and labour potential, natural and other resources, as well as specific features of the regions, thus achieving improvement of the quality of life and optimal specialization of the regions in producing goods and providing services;
- Preparation and submission suggestions for deconcentration and decentralization of the powers of central and local executive bodies, optimization of the structure of local executive bodies, improvement of the “centre – regions” relationship management mechanism, administrative-territorial division of Ukraine, legal, economic, organizational and other fundamentals of public and local administration development, improvement of work related to providing administrative services to the people by local executive bodies and authorities;
- Participation in the development and implementation of a legal, economic and organizational mechanism for aligning and stimulating continuous development of the regions and their collaboration, taking legislatively feasible measures for coping with depression of particular territories, and ensuring the functioning of special (free) economic zones and priority development territories.

Moreover, the Government established the Council of Regional Development and approved the Regulation on the Council for the purposes of further enhancing coordination of actions of the government and local authorities in the regions while solving daily problems of socioeconomic development of the regions,

<sup>7</sup> Vakulenko V. Regional Development in Ukraine: Current Situation and Future Trends (V. Vakulenko. Regional development in Ukraine: the present situation and future trends) [www.rgd.org.ua/project\\_activities/round\\_tables/third\\_annual\\_forum/Volodymyr\\_Vakulenko\\_2007.ppt](http://www.rgd.org.ua/project_activities/round_tables/third_annual_forum/Volodymyr_Vakulenko_2007.ppt)



which would ensure pooling of state and local interests in dealing with important issues of the social life of Ukraine.

Regional policy issues are constantly monitored by the President of Ukraine. The Secretariat of the Cabinet of Ministers of Ukraine includes the Main Agency for Regional Policy. In 2005, the President of Ukraine issued a decree establishing the National Council for Local Government and Regional Development. The task of this body was to form an effective system of administration and coordination of the whole complex of management reforms: administrative, territorial and budget reform. In 2006, the above-mentioned National Council was renamed the National Council for State Administration and Local Government, and the Regulation on the National Council was approved<sup>5</sup>. The key tasks of the National Council are to develop and submit suggestions on the following:

- a national strategy, priorities and mechanisms for implementing state policy in the field of nation-building, state administration and local government;
  - integrated implementation of administrative reform, in particular, reforming the system of executive bodies, the public service, service in local authorities, administrative-territorial reform, and local government reform;
  - development of a civil society and forms of direct democracy, improvement of the interaction system between government authorities, local authorities, their associations and other unions, non-governmental organizations, and enterprises, ensuring transparency of governance, involvement of citizens and their associations in drafting decisions of national and local significance, evaluation of the performance of government and local authorities;
- implementation of better domestic and international practices in matters of state administration and local government.

**The Regulatory Framework of Ukraine's Regional Development Policy** consists, first of all, of the following documents:

- **Conception of State Regional Policy** (approved by Decree of the President of Ukraine of May 25, 2001, No. 341/2001);
- **Law on Regional Development Promotion** (Law of Ukraine of September 8, 2005, No. 2850-IV);
- **State Regional Development Strategy for the period to 2015** (approved by Decree of the Cabinet of Ministers of July 21, 2006, No. 1001);

- **Regulation on Approval of the Procedure for Monitoring Development Indicators of the Regions, Raions, and Cities of Republican (in the Autonomous Republic of Crimea) and Oblast Significance in order to Recognize the Territories as Depressed** (Decree of the Cabinet of Ministers of June 24, 2006, No. 860)
- **Conception of Improvement of the System of Forecasting and Programme Documents on the Socioeconomic Development of Ukraine** (Instruction of the Cabinet of Ministers of October 4, 2006, No. 504-p);
- **State Program of Cross-Border Cooperation Development for 2007-2010** (Decree of the Cabinet of Ministers of December 27, 2006, No. 1819);
- **Action Plan for 2008 dealing with implementation of the State Regional Development Strategy for the period to 2015** (Instruction of the Cabinet of Ministers of September 19, 2007, No. 745-p).

In the opinion of Ukrainian expert Volodymyr Vakulenko, the following issues need development and improvement:

- Specification of territorial depression criteria
- Guidelines for drafting programmes for overcoming depression of particular territories;
- Guidelines for preparing a draft agreement on regional development;
- Mechanism for establishing contractual relations between central and local executive authorities in the area of state promotion of regional development, implementation of regional development strategies;
- Procedures for calculating the amount of local budget income and expenditures and interbudget transfers;
- Determination of the major principles and criteria of granting a subvention from the state budget to local budgets for implementation of investment projects<sup>8</sup>.

<sup>8</sup> Vakulenko V. Regional Development in Ukraine: Current Situation and Future Trends (V. Vakulenko. Regional development in Ukraine: the present situation and future trends) [www.rgd.org.ua/project\\_activities/round\\_tables/third\\_annual\\_forum/Volodymyr\\_Vakulenko\\_2007.ppt](http://www.rgd.org.ua/project_activities/round_tables/third_annual_forum/Volodymyr_Vakulenko_2007.ppt)

### **Economic Development of Regions of Ukraine**

The regions of Ukraine differ in nature, filling, and volumes of the economy and personal income level. The substance of these differences can be traced in the data of the State Statistics Committee of Ukraine.

Official statistics for 2008 show that **there is a considerable gap between the capital, Kyiv, and the rest of the country in terms of average salary and per capita income**. As of December 2008, the average salary in Kyiv was 3549 hryvnias, which is almost 1.8 times more than the average for Ukraine, and 2.33 times higher than in the “poorest” region, which according to this index is Volyn oblast.

Significantly, apart from Kyiv, only three regions have an average salary index higher than the average for the whole country; these are the city of Sevastopol and Donetsk and Kyiv oblasts. It is clear from the picture that the lowest indices of average salary are observed in those oblasts where rural and small town residents predominate in the population structure, and there are no big cities, regardless of the geographic region of Ukraine; these are Volyn, Chernihiv, Kirovohrad, and Zhytomyr oblasts (see Table 1).

The greatest salary increase in 2008 was observed in Zakarpattia (11%) and Ternopil (10%) oblasts.

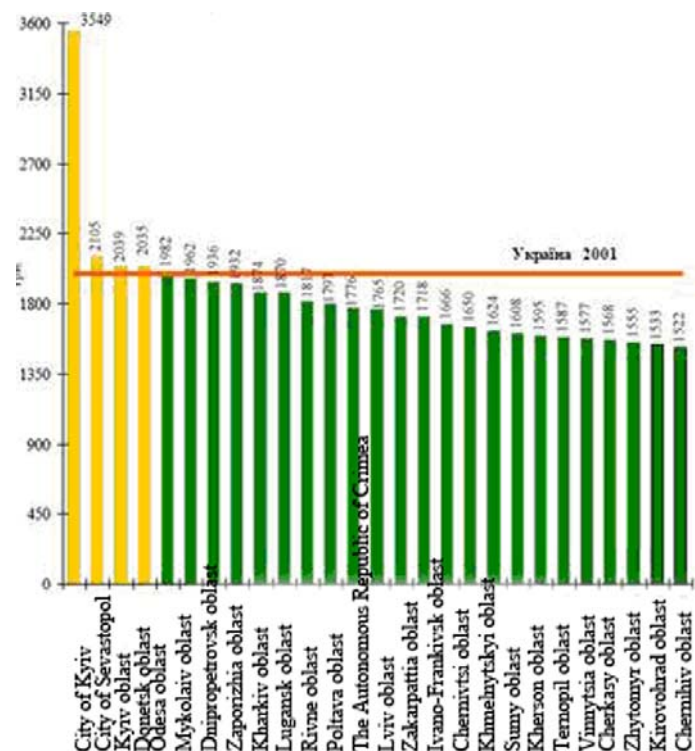
Thus, personal income in the regions remains highly differentiated. The difference between the maximum and the minimum per capita income in the regions reached 54%, whereas, according to international standards, this figure should not exceed 20%. Since salary accounts for almost 43% of Ukrainians’ income, the situation as regards its accounting and payment determines the personal standard of living to a high degree.

Another disproportion is present in manufacturing: **in 2008, more than half of the volume of Ukrainian industrial products were manufactured in only four oblasts of the Eastern region** – Donetsk (20.7%), Dnipropetrovsk (17.4%), Lugansk (9%), and Zaporizhia (8.3%) (see Table 2).

**Table 1<sup>9</sup>. Monthly Average Salary and Nominal Salary in 2008**

Monthly Average Salary (Jan.-Dec.)				
	Monthly average nominal salary, UAH		Rate of increase (decrease) of real salary, in % to the previous year	
	2007	2008	2007	2008
Ukraine	1351	1806	112.5	106.3
The Autonomous Republic of Crimea	1220	1611	111.7	104.2
Vinnitsia oblast	1028	1404	111.9	108.7
Volyn oblast	1013	1330	116.0	108.8
Dnipropetrovsk oblast	1455	1876	106.4	102.3
Donetsk oblast	1535	2015	112.3	104.6
Zhytomyr oblast	1033	1405	116.0	107.7
Zakarpattia oblast	1091	1453	113.6	111.6
Zaporizhia oblast	1394	1812	112.7	102.7
Ivano-Frankivsk oblast	1130	1543	115.4	105.2
Kyiv oblast	1362	1852	114.2	107.7
Kirovohrad oblast	1054	1429	114.3	108.8
Lugansk oblast	1323	1769	109.2	106.2
Lviv oblast	1183	1570	113.4	104.0
Mykolaiv oblast	1202	1621	110.4	105.3
Odesa oblast	1226	1633	110.9	102.8
Poltava oblast	1243	1661	111.9	104.2
Rivne oblast	1133	1523	112.0	106.4
Sumy oblast	1098	1472	109.5	108.6
Ternopil oblast	943	1313	112.3	110.5
Kharkiv oblast	1251	1679	111.1	104.0
Kherson oblast	1017	1375	113.2	104.5
Khmelnyskyi oblast	1045	1429	113.3	106.4
Cherkasy oblast	1035	1459	111.3	107.1
Chernivtsi oblast	1051	1403	113.0	107.4
Chernihiv oblast	1016	1370	112.9	107.5
City of Kyiv	2300	3074	112.3	107.8
City of Sevastopol	1302	1726	113.6	105.5

Nominal Salary (in Dec. 2008)



<sup>9</sup> State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

**Table 2<sup>10</sup>. Volume of Industrial Products Sold from January to December 2008**

	Volume of sold industrial products, work and services in the manufacturers' prices (exclusive of VAT and excise tax), UAH mln		The region's share in the total volume of sold industrial products, %
	total	incl. products of the primary sector and the processing industry	
Ukraine	777859.11	664721.1	1001
The Autonomous Republic of Crimea	12193.4	9625.2	1.6
Vinnitsia oblast	11077.7	8465.1	1.4
Volyn oblast	8814.9	7988.8	1.1
Dnipropetrovsk oblast	135469.2	121138.9	17.4
Donetsk oblast	160880.1	141122.4	20.7
Zhytomyr oblast	8841.2	7588.8	1.1
Zakarpattia oblast	6990.4	6177.1	0.9
Zaporizhia oblast	64284.7	52433.5	8.3
Ivano-Frankivsk oblast	11525.8	7212.6	1.5
Kyiv oblast	22465.4	17756.7	2.9
Kirovohrad oblast	6804.6	5644.0	0.9
Lugansk oblast	70328.8	63263.0	9.0
Lviv oblast	20245.7	17045.1	2.6
Mykolaiv oblast	14490.7	10846.9	1.9
Odesa oblast	28760.5	25587.6	3.7
Poltava oblast	40168.1	37959.9	5.2
Rivne oblast	9719.0	6835.1	1.2
Sumy oblast	12424.7	11066.0	1.6
Ternopil oblast	4368.5	3506.2	0.6
Kharkiv oblast	39202.3	32681.2	5.0
Kherson oblast	6189.9	4920.6	0.8
Khmelnyskyi oblast	10340.7	7716.8	1.3
Cherkasy oblast	19615.8	17862.0	2.5
Chernivtsi oblast	3183.9	2381.2	0.4
Chernihiv oblast	9891.9	8210.9	1.3
City of Kyiv	35462.3	28205.9	4.5
City of Sevastopol	2057.2	1479.6	0.3

<sup>10</sup> State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

The structure of the regions' industrial complex has not undergone essential changes in the last few years, so for most regions one or two industries keep playing a pivotal role. Thus, the priority area of industrial production for 16 regions is the food industry and processing of agricultural products; the Dnipropetrovsk, Zaporizhia and Donetsk oblasts – metallurgy and metalworking; for Zakarpattia and Sumy oblasts – mechanical engineering; for Lugansk and Poltava oblasts – coke, refined products and nuclear fuel production; for Ivano-Frankivsk, Mykolaiv and Rivne oblasts and the city of Sevastopol – production and distribution of electrical energy, gas and water.

Ukraine's regions have very different preconditions for implementation of an innovative growth model. The major potential of scientific manpower and research institutions is concentrated in six major cities where regional departments of the National Academy of Sciences of Ukraine are located; they are Kyiv, Kharkiv, Dnipropetrovsk, Donetsk, Lviv and Odesa. Lately, Kyiv and Kharkiv have been particularly outstanding in terms of scientific manpower and its dynamics. In 2007, in the six oblasts where the above-mentioned cities are the capitals, there were 971 organizations involved in scientific and research and development work, or 64.3% of their total number, as well as 60.1% of completed research<sup>11</sup>.

Ukraine's regions differ substantially in their potential for attracting investments. Thus, foreign investors prefer urbanized regions with a well-developed infrastructure, with skilled labour resources and easy access to office and production facilities. So far the major share of direct foreign investments has gone to the city of Kyiv (about 25%) and Dnipropetrovsk oblast (about 10%), whereas the share of half the regions (Vinnytsia, Volyn, Zhytomyr, Ivano-Frankivsk, Kirovohrad, Mykolaiv, Rivne, Ternopil, Kherson, Khmelnytskyi, Cherkasy, Chernivtsi, Chernihiv oblasts and the city of Sevastopol) does not exceed 1% of their total volume for the country.

The difference between the regions in terms of capital investments per person remains rather significant: 8 times (the highest level recorded in Kyiv, accounting for UAH 4301.3 at the beginning of 2008 compared with the low level equal to UAH 537.6 in Ternopil oblast), but it is decreasing compared with 2006 (when this index equaled 8.4 times).

The differentiation of economic development was influenced by major changes that occurred in the ownership structure at the regional level because of

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<sup>11</sup> State Regional Policy of Ukraine: Peculiarities and Strategic Priorities, edited by Varnaliya Z.S. National Institute for Strategic Studies, Kyiv, 2007.

implementation of new forms of management. As a result of privatization processes, the share of the state sector of the economy considerably decreased. It is also differentiated by region: production of two-thirds of goods and provision of services in half of the regions is carried out by privatized enterprises. Direct administrative impact of local authorities upon economic entities has been practically lost; levers of government interference in their activity have disappeared. Newly created enterprises, non-governmental organizations and their associations have been increasingly rising in the regions. Influence of the non-governmental sector on income generation at the regional level is increasing: more than 65% of revenue of budgets of all levels is provided by its activities.

**Transport Infrastructure.** The greatest density of public highways per 1000 sq. km is in Lviv (374 km), Ternopil (364 km) and Chernivtsi (353 km) oblasts, and the least density in Kherson (172 km), Mykolaiv (196 km) and Lugansk (215 km) oblasts. The average value of this index in Ukraine is 273 km. The difference between the maximum and minimum of this index is almost 2.1 times.

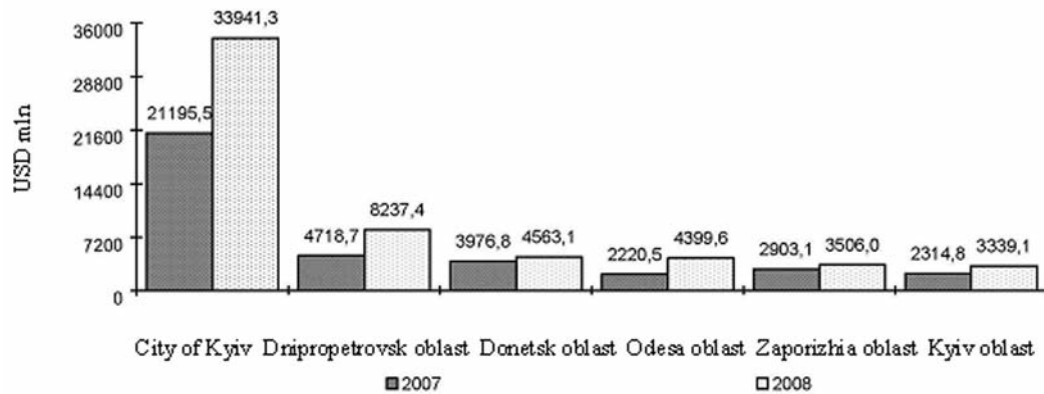
The share of paved roads is relatively low in Sumy (91.4%), Chernihiv (92.9%) and Volyn (92.4) oblasts. The best situation is in the Autonomous Republic of Crimea, Ivano-Frankivsk and Poltava oblasts and in the city of Sevastopol, where 100% of highways are paved roads. Half of the streets and roads in population centers require emergency overhauls or maintenance of the roadway. More than 15% of bridges and pipelines are unsafe and do not comply with national standards and requirements of the European Union in terms of capacity and size.

### **Foreign Trade: Regional Survey**

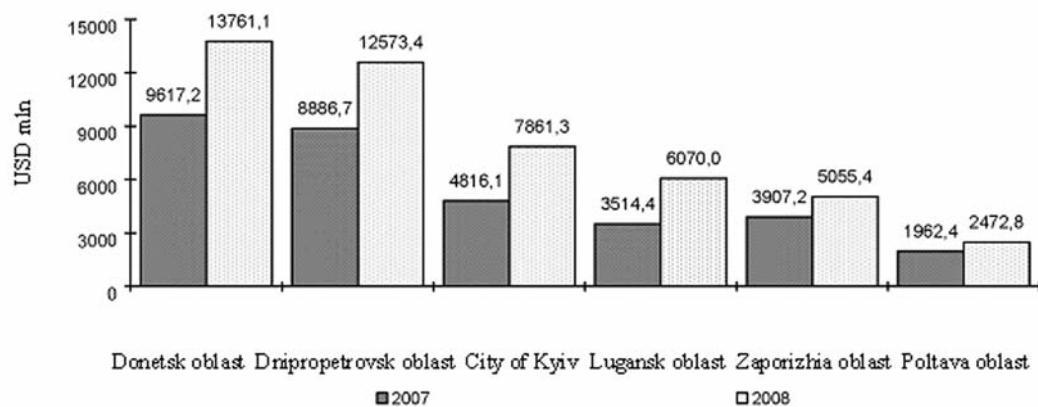
Donetsk and Dnipropetrovsk oblast and the city of Kyiv account for more than half of all exports and imports of goods, whereas the share of such regions as Zhytomyr, Kirovohrad, Ternopil, Kherson, Khmelnytskyi, Chernivtsi and Chernihiv oblasts and the city of Sevastopol does not exceed 1% of the total volume of both exports and imports of goods.

In addition, whereas Kyiv is the leader in imports (see Diagram 1) and has a considerable credit balance of foreign trade operations, Donetsk and Dnipropetrovsk oblasts take the lead in export volumes, whereas Kyiv ranks third (see Diagram 2).

**Diagram 1<sup>12</sup>. Total imports of goods by region**



**Diagram 2<sup>13</sup>. Total exports of goods by region**



### The Problem of Mono-Industrial Towns of Eastern Ukraine

Economic differences are responsible for the feeling of disappointment of those who feel they are poorer than others (regionally), as well as those who are considered to be much wealthier because of the set stereotype according to which “the poorer regions exist at the exist of the richer ones”. This feeling is definitely present in the industrial regions of Eastern Ukraine.

<sup>12</sup> State Statistics Committee of Ukraine [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua)

<sup>13</sup> *ibid*



We should take into account certain specific features of the socioeconomic structure. **Mono-industrial towns** in the East have inherited the social makeup from Soviet times: some of them are still being built around major enterprises, and this fact significantly limits local job markets and suppresses social mobility.

Differences in the socioeconomic development of Ukraine's regions are caused by long-time incapability of the key competition factors – Soviet legislation, undeveloped infrastructure, inability of workers to adapt to the market environment, insufficient business support, insufficient innovative capability of enterprises, polluted environment and the correspondingly low investment prospects of the territory.

The structural disbalance remains the most vulnerable point in Ukraine's economy. Its deformation and high energy and material production intensity is a heritage of the previous administrative system. The situation has not improved in the years of implementation of reforms.

A large number of small and medium-sized towns in the East (mostly in Donetsk, Lugansk and Dnipropetrovsk oblasts) have developed around one major manufacturing enterprise. The most typical example is the Donbas region, where a lot of small and medium-sized towns grew up around big coal mines. Yet another example of mono-industry is metallurgy. As a rule, there were no other enterprises in the town, except for those belonging to the main industry. In Soviet times, all these enterprises were state-owned. After privatization was carried out in the 1990s, private owners (usually local magnates) established total control not only over the property and manufacturing, but also over local job markets and social infrastructure.

The economic crisis of the 1990s caused a severe depression in these mono-industrial towns. Production loss, and, in some cases, plant shutdown has led to growth of unemployment. The most remarkable indicator of the crisis is a substantial drop in local real estate prices. In some Donbas towns (like Snizhne, Kramatorsk, etc), the average price for a standard apartment at the end of 1990s fell to 2-3 thousand dollars.

The economic recovery of the current decade has given mono-industrial towns a chance to recover their own standards of living. However, the social composition of most towns remains completely pegged to the “town-forming industry”. A private entrepreneur has replaced the state, but the essence of the defective social makeup has remained the same. The social composition of a mono-industrial town is built upon hierarchy and subordination. There are no independent economic and social players. The owner of a “town-forming”

enterprise usually plays the role of the owner of the local community. Under such conditions, there is no chance for the emergence of a civil society.

Since the local job market is under total control of the owner(s) of the leading enterprise, loss of a job in these circumstances means loss of the only source of income. People do not have the option to find another job if there is a conflict between them and the owner of the enterprise. Trade unions either do not exist at all or play only a decorative role as an additional tool of the owner for controlling the local community.

As a rule, people in such towns vote for the political forces of which the owner of the enterprise is a member. A case in point is the event in Mariupol (Donetsk oblast), where in the early parliamentary elections held on September 30, 2007, the Socialist Party of Ukraine (led by Oleksandr Moroz, ex-speaker of the Parliament) won 50.02% in comparison with the Party of Regions, while in most raions of Donetsk oblast the socialists did not even reach 3%. Such an untypical event was caused by the strong position of Volodymyr Boyko, an industrial magnate from Mariupol and a member of the Socialist Party of Ukraine. Such industrial barons usually have total control over local authorities and local judicial authorities.

The socioeconomic nature of mono-industrial towns is responsible for the continuous deficiency of social functioning and suppresses the appearance of an independent civil society and alternative points of social and economic growth.

### **Housing and Communal Services in the Regions**

In pursuance of the Law of Ukraine “On the State Program of Reform and Development of Housing and Communal Services for 2004-2010”, before February 1, 2005, the Council of Ministers of the Autonomous Republic of Crimea and local state administrations were to develop and approve in sessions of the Verkhovna Rada of the Autonomous Republic of Crimea, and of oblast, Kyiv and Sevastopol city councils, regional programs of reform and development of housing and communal services and to ensure development of the corresponding raion, urban and rural programs (measures).

However, out of 27 regions only 14 have approved programs of reform and development of housing and communal services. Regional programs have not been approved by the Verkhovna Rada of the Autonomous Republic of Crimea, by sessions of oblast and city councils in Dnipropetrovsk, Mykolaiv, Odesa, Sumy, Lugansk, Lviv, Kharkiv, Kherson, Chernihiv and Cherkasy oblasts, or the cities of Kyiv and Sevastopol.

With the aim of developing competition in the field of housing maintenance, city executive committees are conducting competitive selection of enterprises of various types of ownership for housing maintenance. The towns Dniprodzerzhinsk of Dnipropetrovsk oblast, Komsomolsk of Poltava oblast, Kramatorsk of Donetsk oblast, Oleksandriia of Kirovohrad oblast, Pryluky and Nizhyn of Chernihiv oblast, and Sumy, Ternopil and other cities already have established a competitive environment on the market of maintenance services for residential building and adjacent grounds. A large share of this market there belongs to private entrepreneurs, and this fact has made it possible to improve the quality of housing maintenance and decrease the number of residents' complaints.

In the cities of Ternopil, Oleksandriia (Kirovohrad oblast), Reni (Odesa oblast), and the village of Bilozirka (Kherson oblast), almost all existing housing has been transferred for maintenance to such enterprises. Most of them operate in Donetsk, Odesa, Poltava, and Kharkiv oblasts.

Key factors considerably complicating the financial condition of the industry remain the same. They are: incomplete reimbursement of the production costs of housing enterprises by tariffs and high unit costs of energy and material resources.

In recent years, there have been successful examples of implementation of energy-saving projects in the regions:

- enterprise Lutskvodokanal (water treatment plant) implemented the first stage of modernization of the process flow sheet of the water preparation stage, which allows savings of 2.3 mln kW/h of electrical energy, and replacement of pumps at sewage pumping stations allowed savings of more than 135 thous. kW/h;
- reconstruction of 1614 m of trouble-prone section of heating systems in Rivne raion allowed savings of about 440 m<sup>3</sup> of gas;
- in Zhytomyr region, 1280 tons of standard fuel were saved by replacing 2.9 km of heating systems with pre-insulated pipes and operational tuning of 31 boilers;
- combined heating and electrical energy production projects were implemented by state city enterprise Ivano-Frankivskteplokomun-merezha (heating utility network) and in the city of Khmelnytskyi at city utility company Khmelnytskteplokomunenergo; as a result, more than 30% of electrical energy needs for heat production are provided by cheap electric energy of in-house production.

In addition, investment and innovative projects to adopt energy-saving technologies are being implemented at the local level by means of foreign

investors' funds. For example, in the city of Zaporizhia, the project "Program of Investments and Development of Zaporizhia's Water Supply and Purification System" with a total cost of 42.5 mln USD is being implemented, and practical implementation of the project "Lviv Water Supply and Sewerage" with a total cost of 40.8 mln USD continues<sup>14</sup>.

### **International Cooperation of the Regions**

In March 2008, the European Commission released a "roadmap" for implementation of **the Regional Development Program** for the countries of Southern and Eastern Europe for the period up to 2013, which was approved on December 20, 2007.

The total budget of the Program, which covers a region with a population of around 200 mln people, is 245 mln Euros, 206 mln of which has been granted by the European Regional Development Fund (ERDF)<sup>15</sup>.

The Program covers the territory of 14 countries: Albania, Austria, Bosnia and Herzegovina, Bulgaria, Romania, Croatia, Macedonia, Greece, Hungary, Serbia, Montenegro, Slovakia, Slovenia and Moldova. In two more countries – Italy and Ukraine – the plan is being implemented only in certain fields. For example, in Ukraine the European Commission envisages financing for development of **four oblasts: Chernivtsi, Ivano-Frankivsk, Zakarpattia and Odesa**.

The Program's strategic aim is territorial, economic and social integration processes, establishment of a level playing field, and stability and competitiveness through the development of international cooperation. Among the key priorities of the document are development of innovations and entrepreneurship, environmental protection and restoration, and a joint approach to the development of agricultural regions and towns in different countries. The Program also gives a ranking place to improvement of the transport connection between the region's countries, particularly development of the European transport network, including highway, railroad, river and sea transport routes.

<sup>14</sup> State Regional Policy of Ukraine: Peculiarities and Strategic Priorities, edited by Varnaliya Z.S. National Institute for Strategic Studies, Kyiv, 2007.

<sup>15</sup> Ukrinform, March 28, 2008

## **General Conclusions**

In the opinion of experts of the National Institute for Strategic Studies, who in 2007 published a fundamental monograph titled “State Regional Policy of Ukraine: Peculiarities and Strategic Priorities”, the most important conclusion is that the dynamics of economic factors in the regions have no set trends; sometimes their values are diametrically opposite for two years in a row. It is indicative of the weakness of the economic base of most regions and of their insufficient potential for development.

For economically low-capacity regions, the operation of one or two major enterprises is determinative in the process of formation of effective economic indices.

Growth trends formed after 2000 in most regions have an insufficiently stable nature and are highly dependant on the impact of temporary factors, including subjective ones. It is characteristic that for the last two years the highest growth trends have been typical the regions with insufficient economic potential.

However, revival of the industrial capacity of such regions is accompanied by positive structural changes in the economic complexes.

The cities of Kyiv and Sevastopol, Kyiv oblast, and the Autonomous Republic of Crimea have also been demonstrating high rates of economic growth over the last 4-5 years.

The low level of economic exchange between the regions remains a negative characteristic of regional development. The closest economic ties exist only between Donetsk, Dnipropetrovsk, Zaporizhia and Lugansk oblasts, where the iron and steel industry of Ukraine and everything necessary for its functioning is concentrated.

Notwithstanding the number of positive shifts in the socioeconomic development of the regions, the exacerbation of regional socioeconomic disproportions, which remain the reason for the continuing disintegration of the state's economic space, has not been halted<sup>16</sup>.

<sup>16</sup> State Regional Policy of Ukraine: Peculiarities and Strategic Priorities, edited by Varnaliya Z.S. National Institute for Strategic Studies, Kyiv, 2007.

Chapter 5.

**SCIENCE, CULTURE AND EDUCATION**

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## **Introduction of external independent evaluation system**

The greatest achievement of reforms in the sphere of education in 2008 was the introduction of independent evaluation of the achievements of graduates of general educational institutions who wished to become students of higher educational institutions. Against the background of uncertain and sometimes disastrous results of reforming other socially important areas, the introduction of mandatory external evaluation of applicants to higher educational institutions is indeed a considerable achievement.

External testing took place in Ukraine from April 22 through July 4. During this period, school graduates took tests in 11 subjects.

The experts describe the introduction of the external independent testing system as one of the most systemic and well thought-out innovations in the Ukrainian education system in the last 20-25 years.

The Ukrainian Center for Education Quality Assessment received a “National report based on the results of public monitoring of the entrance “campaign 2008”<sup>1</sup>. This monitoring was initiated by a coalition of regional non-governmental organizations, and general administration was provided by the Best Personal Development Technologies creative association (Kirovograd).

Public monitoring has been conducted within the framework of the “Promoting active public participation in combating corruption in Ukraine ‘Gidna Ukraina’” project, being carried out by Management Systems International (MSI) under the auspices of USAID and Millennium Challenge Corporation.

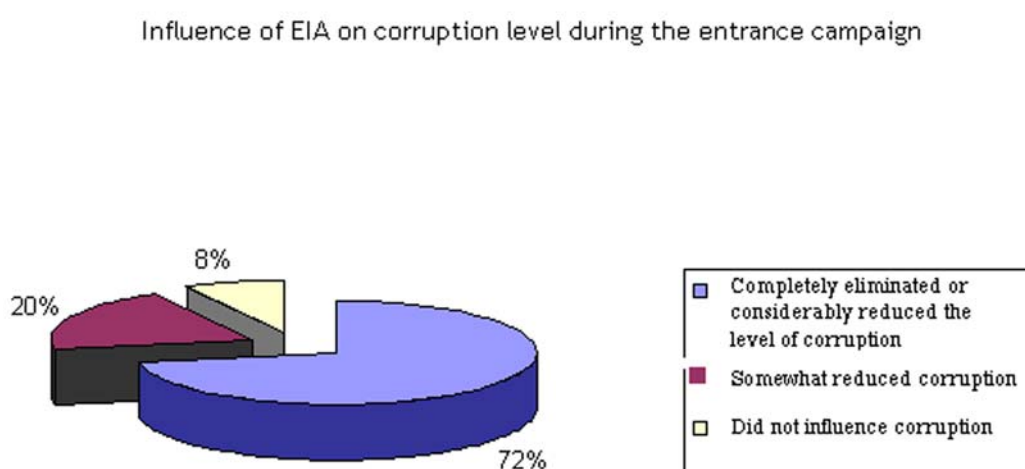
“According to the results of public monitoring, the EIA certificate played a vital role in entering a higher educational institution in 2008. The vast majority of applicants (94.9%) have passed the external independent assessment. Entrance to the majority of higher educational institutions involved no additional tests for applicants.

A insignificant number of applicants (5.1% according to exit poll data) provided college boards with medical statement certifying their inability to take the EIA. Therefore, it may be said this fact could not significantly influence the objectivity of the enrollment campaign and offset the significance of the EIA certificate.

<sup>1</sup> Ukrainian Center for Education Quality Assessment <http://www.testportal.gov.ua/index.php/text/text/494/>

Introduction of an enrollment system with predominant consideration of EIA results has influenced the corruption level during the enrollment campaign. A majority of members of college boards said that the new system used as framework for this year's campaign completely eliminated or considerably reduced the level of corruption during entrance (Fig. 1).

**Fig. 1. Influence of EIA on corruption level during the entrance campaign of 2008**



However, according to members of college boards, corruption has moved to other spheres of social life that in one way or another are connected with entrance to higher educational institutions, e.g., provision of references certifying the preferential status of an applicant, etc.

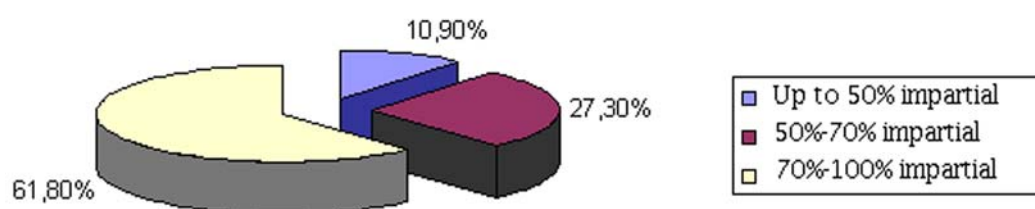
The attitude of respondents to the objectivity of measurement of applicants' level of knowledge on the basis of EIA only is rather ambiguous. On the one hand it is hard for members of college boards to answer this question, and on the other hand they state that EIA results generally provide an unbiased assessment of the applicant's knowledge (70% to 100%) (Figure 2). At the same time, members of college boards believe the EIA results are quite sufficient for admission of applicants to HEI.

To increase the impartiality of knowledge level assessment, the respondents consider it necessary to allow higher educational institutions to conduct additional examinations in core disciplines, improve EIA (e.g., add creative assignments, etc.), and design tests of various levels for HEIs of different categories.”



Fig.2 Impartiality of EIA with respect to measuring the applicants' level of knowledge

Impartiality of EIA with respect to measuring the applicants' level of knowledge



Igor Likarchuk, Director of the Ukrainian Center for Education Quality Assessment, noted that today Ukraine lacks a system of equal access to higher education. According to the latest social studies, the level of corruption during admission to HEI is extremely high. Based on the social research of the International Institute of Social Studies, about 70% of applicants to higher educational institutions (as of spring 2007) entered these establishments owing to illegal practice rather than their own knowledge. Emphasis was placed on the fact that Ukrainian society supported the introduction of EIA. As of April 2008, as many as 513 thousand citizens were registered for entrance, which is much higher than the total number of school graduates; and this is the largest number of those wishing to enter higher educational institutions for the last 10 years.

In 2007, EIA systems managed to cover only 26% of school graduates. This is almost 117 thousand, and 39 thousand of them were admitted to HEI without entrance examinations. Lviv National University, for example, was completely filled with persons who had passed tests; 70% of first-year students of the National University of Economics had passed EIA; and 40% of applicants were admitted to the National University of Trade and Economics on the basis of EIA results. Kyiv Institute of International Relations filled groups for certain specialties solely with those who had passed external assessment.

In 2008, an absolute majority of applicants were admitted to HEI on the basis of EIA only. An exception was made only for those who had to pass a foreign

language examination (this includes only six specialties where such an examination can be introduced) and creative examinations (art and architecture schools).

Igor Likarchuk also said there were groups opposing the innovation and counted four of them. “First of all these are chancellors and deans. Principals of general educational institutions also show resistance, as they don’t want to hear the evaluation of their work (a rather modest level of knowledge was shown by graduates of some prestigious commercial educational institutions of Kyiv). The parents of those children who planned to enter HEI using corrupt methods also show resistance. And finally, officials of various levels who could influence the chancellors and thus satisfy their personal interests.”

Criticisms that the level of preparation of children from rural and urban areas is substantially different turned out to be false. As it turned out, the results shown by rural and urban school graduates were almost identical.

At the same time, it is obvious **that EIA supporters will have to overcome significant resistance in the future**, including in the political realm. On December 17, 2008, during a business trip to Kyiv oblast, the newly elected Speaker of the Ukrainian Parliament, Volodymyr Lytvyn, stated that Ukraine “*should not repeat the previous mistakes of human regress. The entire world is starting to move away from testing, while our country has just begun its introduction*”, the speaker said.

This statement by one of Ukraine’s highest officials was severely criticized, particularly by the chancellors of Petro Mohyla Mykolaiv State Humanitarian University and Pulyui Ternopil State Technical University and the Vice Chancellor of Ivan Franko Lviv National University. According to Maria Zubrytska, Vice Chancellor of Lviv National University, Mr. Lytvyn’s statement is a good illustration that ideas of independent testing are again being regarded from the viewpoint of political expediency.

“What is most impressive is the professional irresponsibility of such a high-ranking official, especially his idea that testing is being rejected worldwide, while in the majority of EU countries, USA, India, China, Russia, and other states, systems of external assessment have been successfully functioning”, said Mrs. Zubrytska.

Yulia Tymoshenko, the Prime Minister of Ukraine, gave unambiguous support to external independent assessment during a plenary session of Parliament on February 5, 2009. Specifically, she said: ‘We would like our children to acquire their knowledge base during all the years they study at school

and be aware that like in any other European country, they will have to demonstrate real knowledge to enter higher education institutions”.

In addition the Prime Minister noted that ‘this program has been much criticized. At the same time, [we] passed the first year of testing and experienced no stress or any serious faults, which altogether resulted in positive results”. In her speech, Yu.Timoshenko touched upon the question of the legal framework for EIA; in particular, she reminded the people’s deputies that “a draft law is being prepared to regulate the external testing systems, creating a universal model where passing both examinations and tests is not necessary”<sup>2</sup>.

The government continues to improve the EIA system. According to the Public Relations Department of the Secretariat of the Cabinet of Ministers of Ukraine, on January 28, 2009, the Government approved amendments to the Laws of Ukraine on “Education”, “General Secondary Education”, and “Higher Education” with respect to regulation of issues related to the introduction of independent assessment.

## **Ukraine and the Bologna Process**

The Bologna Process was officially launched in Ukraine on May 2005 with the signing of the declaration at the Bergen Conference. Now the matter depends on implementing it at the national and institutional level.

Today 45 European countries, including Ukraine, have signed the Bologna Declaration, which emphasizes the necessity of European cooperation to ensure the quality of higher education, increase the quality of professional preparation, enhance trust between educational establishments, mobility, compatibility of qualification systems, and enhance competitiveness of the European education system.

The key concepts within the list of tasks of the Bologna Process that must be performed within the short term for those universities willing to enter or which have already entered the process are those of the European Credit and Transfer System (ECTS) and the concept of a diploma supplement (DS) that utilizes ECTS and its components.

ECTS is a student-oriented system of describing education programs (or curricula) by quantitative assessment of their components in credits. The system

<sup>2</sup> Ukrainian Center for Education Quality Assessment <http://www.testportal.gov.ua/>

of quantitative assessment of education programs (subjects, modules, units) in credits is based on training load of a student necessary to achieve the declared goals (competencies, skills, knowledge) of the respective component of the program<sup>3</sup>.

Ukraine has undertaken obligations to introduce a third training cycle in the domestic system of higher education no later than 2010 to comply with the European Higher Education Area (EHEA), and end with conferral of the doctor of philosophy (PhD) degree.

In the opinion of M.Z. Zgurovsky, Chancellor of NTUU KPI (expressed in his article "Bologna Process: structural reform of higher education in the European dimension") there exists a large number of problems of Ukrainian higher education within the context of the Bologna Process:

- Excessive number of training directions and specialties - 76 and 584, respectively. The best world higher education systems have 5 times fewer.
- Insufficient recognition of the Bachelor's degree by society as a qualification level and lack of demand for it in the national economy. Usually we admit applicants for specialization rather than a bachelor's degree.
- Threatening tendency of large-scale deterioration of higher education quality with an accumulative effect.
- Increasing severance of bonds between academics and employers, between the education sector and the labor market.
- Unjustified confusion in understanding of the specialist and master levels. On the one hand, the respective curricula are quite similar and are equivalent in terms of education and qualification status; on the other hand, they are accredited at various levels: III and IV respectively.
- We have made up our minds to neglect cutting-edge scientific studies in educational establishments, which are the foundation of university education. Our system of academic degrees is rather complicated in comparison with that of Europe, which complicates the mobility of teachers and scientists in Europe.
- The future of such a widespread link of education as vocational schools and colleges is decided inadequately to the needs of society and labor market, while their number in our country is four times higher than that of III and IV accreditation level HEI together.

<sup>3</sup> <http://www.osvita.org.ua/bologna/vprov/articles/30.html>

- A well-organized professional development and retraining system that worked well for a centralized economy has sunk into oblivion. A new system to meet the demands of a market economy has not been established in Ukraine. Therefore, the very important European principle of “lifelong education” cannot be fully implemented under the given circumstances.
- Ukrainian universities do not play the role of methodological centers, innovators, and pioneers of social transformations the country should follow. The level of HEI autonomy in these issues is considerably lower than that of EU countries. While the number of educational institutions with national status has reached 40% of the total number of HEI of III and IV levels of accreditation, they are failing to perform their role as methodological think tanks<sup>4</sup>.

### **State of science and innovation and the intellectual property problem**

The main establishment uniting Ukrainian science potential is the **National Academy of Sciences of Ukraine (NAS)**, comprising more than 160 institutes of science and scientific establishments with 37 thousand employees, including 10 thousand Doctors of Science and Candidates of Science. The Academy has 478 academicians and corresponding members.

The National Academy of Sciences has three sections covering 13 scientific fields: mathematics; computer science; mechanics; physics and astronomy; earth sciences; physical and technical problems of materials science; physical and technical problems of power engineering; chemistry; molecular biology, biochemistry, research and clinical physiology; general biology; economics; history; philosophy and law; literature, linguistics and fine arts.

Every year, NAS of Ukraine reports the results of its scientific and scientific and technical activities and use of funds granted from the State budget to the Cabinet of Ministers of Ukraine.

NAS manages institutions, organizations and companies listed and approved by the Cabinet of Ministers of Ukraine and submitted by NAS of Ukraine. Science and research institutes of NAS of Ukraine and research and development

<sup>4</sup> <http://www.osvita.org.ua/bologna/vprov/>

organizations, research and manufacturing companies and other scientific organizations under the NAS are part of NAS branches by definition of the Presidium of NAS of Ukraine based on their activities.

The expediency of this structure of NAS of Ukraine has been under dispute for a long time. No decision, however, has been made yet, and the system of Ukrainian science still exists in a Soviet format and has a reputation as a conservative bastion .

Ukraine has not overcome the crisis of innovation developments and innovative activity that began in the 1990s.

There have not been any changes in **scientific manpower certification**, with its dominating post-Soviet relic, the **Supreme Certifying Commission**, the operation of which, due to intensifying formal and bureaucratic obstacles in order to get an academic degree or academic status, has been severely criticized. SCC was and still remains a closed body, which shies away from any publicity of its operations.

**Specialized Academic Councils (SAC)** are an important link in the scientific manpower certification system; they are established at level III—IV higher educational institutions and scientific institutions and approved by SCC. There are 750 SACs in Ukraine at present. In addition, the certification system includes 41 expert councils, the presidium of SCC (19 persons), and 45 staff. Five thousand Ph.D. theses and more than 750 doctoral theses are defended every year in Ukraine, which is twice as many as 10 years ago.

In 2008, SCC developed and introduced a draft law “On certification of scientific manpower and educational staff of higher qualification”. The draft law’s developers think that SCC should have a leading role in the certification process. Hence, the principle of “government control of certification” has been proposed as a basis. V. Machuli, the Head of SCC, argues in favor of further existence of the institution he leads: “All discussions about the expediency of government control of certification will make sense only if the government stops making additional payments for academic degrees and academic status and providing scientists with social benefits and a special pension. As long as we have all these in Ukraine, we have to recognize the necessity of government control over budgetary spending”<sup>5</sup>.

According to famous Ukrainian scientists, Ukraine currently is not ready for frontal introduction of structured doctorate programs for “Doctors of Philosophy”

<sup>5</sup> HPLB Newsletter #8, 2008

(PhD) of the European type. This is hampered by both lack of appropriate experience and active legislative provisions based on the natural inertia of traditional views of the leaders of SCC, NAS, MES and some prominent teachers and scientists<sup>6</sup>.

In 2007-2008, there was active discussion of **reviving innovation activity, applied science and related issues of intellectual property protection**.

In particular, on April 16, 2008, the Education and Science Committee of the Parliament of Ukraine adopted the resolution *“On the State of Government Control and Management in in Development, Legal Safeguarding and Protection of Intellectual Property and Innovative Activity in Ukraine”*.

The document presents a detailed analysis of the current situation and gives ways of improving it.

In particular, the Committee noted that central executive bodies have implemented specific measures to carry out the decisions of parliamentary proceedings, develop innovative activity, and increase the level of intellectual property protection:

- the Cabinet of Ministers of Ukraine has adopted some resolutions on registering intellectual property rights objects in the customs register; a fee payment procedure for activities relating to protection of rights to intellectual property objects, and approving a standard of evaluation of intellectual property rights;
- Standard regulations have been approved on a structural division dealing with issues of transfer of technologies, innovative activity and intellectual property of the ministry, other executive body, and National and branch academies of science. Such departments have been established in central executive bodies, National and branch academies of science, all regional administrations, and Kiev and Sevastopol municipal administrations;
- the organizational structure of the customs agencies has been improved: special intellectual property departments have been established at 27 customs houses, and the information-software complex “Customs register of intellectual property rights objects” has been put into operation;
- deadlines for reviewing requests for industrial property objects have been reduced to 2 months for a formal expertise and 16 months for a qualified expertise;

<sup>6</sup> Dzerkalo Tyzhnya, September 27, 2008 <http://www.dt.ua/3000/3100/64193/>

- the number of requests submitted by national applicants for the national procedure has increased: by 1.7 times for utility models in 2007 compared to 2004; for trademarks for goods and services by 1.7 times.

But as a result of the current ineffective system of government control and management of innovative activities, legal protection of intellectual property, and providing the necessary conditions for implementing intellectual property rights, there have been no substantial positive changes in this field. Moreover, the problems pointed out by the participants in these proceedings have become more serious.

The incompleteness of the national innovative system and an ineffective system of intellectual property rights protection hamper the development of innovative activity and the creation of a civilized intellectual property market in Ukraine.

One of the main reasons for this ineffectiveness is management function division and duplication management functions, in particular, organizational functions, among several central executive bodies. At present, three central executive bodies – the Ministry of Education and Science of Ukraine, State Investment and Innovation Agency of Ukraine, Ministry of Industrial Policy of Ukraine – are participating in forming and implementing state innovative policy without harmonizing their activities with each other. Moreover, according to the Decree of the President of Ukraine of October 23 2000, No. 1159, the Ministry of Economy of Ukraine is responsible for developing the strategy and mechanisms of implementing state innovative policy.

Some other ministries and institutions (Department of Agriculture of Ukraine, Department of Fuel and Energy of Ukraine, Department of Transport and Communication of Ukraine, State Committee on Regulatory Policy and Entrepreneurship of Ukraine) have to be involved in implementing state innovative policy “within the scope of their competence”, although in practice they execute activities they are entrusted with autonomously, disregarding the priorities of innovative development of Ukraine.

Established consulting bodies, namely, the National Council on Innovative Development under the President of Ukraine, Cross-Sectoral Council on Investment and Innovative Development under the Cabinet of Ministers of Ukraine, Committee on organizing operation of technological parks and other innovative structures (standing body under the Cabinet of Ministers of Ukraine), Committee on development proposals for improving the system of government control of innovations under the Cabinet of Ministers of Ukraine, are not performing their duties in developing a unique state innovation policy.



Policy implementation in the intellectual property rights protection field is characterized by a lack of proper coordination and ineffectiveness of the bodies in charge of developing intellectual property institutions and intellectual property rights protection. The corresponding functions are partially carried out by the Ministry of Education and Science of Ukraine, State Department of Intellectual Property and its integral part, Ukrainian Institute of Industrial Property. Moreover, the functions of copyright enforcement and taking actions to protect intellectual property objects are assigned to the Ministry of Culture and Tourism of Ukraine. At the same time, the status of the Department of Intellectual Property does not meet the requirements of the Law of Ukraine “On the Cabinet of Ministers of Ukraine”, according to which government bodies can not be created. All of this has a negative impact on making timely and sound decisions, responding properly to time challenges, and developing a complex of mature institutional, legal and economic measures for developing a civilized intellectual property market meeting national objectives.

As a result of a lack of coordination between departments and institutions, their subdivisions in the regions are unable to work in harmony. In some regions there are Scientific, Technical and Economic Information Centers of the Ministry of Science and Education of Ukraine, Scientific Centers of NAS of Ukraine and Ministry of Science and Education of Ukraine, regional branches of the Government Innovative Financial and Credit Institution; new regional innovative development centers have been established by Government investments.

All of this has only intensified the crisis of government control of innovative activities in Ukraine and contributed to excessive government control of this field along with ineffective use of the State Budget of Ukraine.

The General Auditing Department of Ukraine has audited the application of State Budget funds and government investments to innovative activity development and proved the unprofitableness of the Government Innovative Financial and Credit Institution’s investment of government funds in long-term investments, improper follow-up of innovation and investment project implementation and other system flaws of state resources management.

In the last 4 years, indices of implementing innovations in the Ukrainian economy have not changed, and some of them have even decreased.

The state system of scientific and technical information of Ukraine is being destroyed. Regional Centers of scientific, technical and economic information have suffered great losses. In some regions, information funds along with the centers’ premises have been transferred to libraries of higher educational

institutions, which limits access of subjects of innovative activities subjects to scientific, technical and economic information.

The work of subdivisions of executive bodies, state-financed bodies, organizations and companies using industrial property objects is moving very slowly in matters of technology transfer, innovation activities and intellectual property rights.

Ukraine does not have an effective system of collecting and paying bonuses to authors, performers, and record makers, which substantially distorts the copyright market. Due to inadequate legislation and lack of proper control, there are many instances of serious violations in the performance of collective control organizations, which must play an important part in copyright protection. According to the information of the Audit Chamber of Ukraine, only 30 mln UAH in fees are collected annually in Ukraine, which, according to the experts' estimations, constitutes only 3% of the potential sum of returns.

Agreement on establishing a Ukrainian scientific and technological center, drafts of laws bringing national intellectual property legislation in line with the Civil Code of Ukraine, (which according to Final and transitional provisions of the code should have been done before April, 1 2003) and European Union legislation, establishment of liability for submitting applications to foreign countries without their prior submission in Ukraine, protection of trade secrets, efficiency suggestions, data bases, and animal breeds have not been submitted for ratification by Parliament. The Ministry of Science and Education of Ukraine is not conducting proper analysis of the effectiveness of the legislation in the field of intellectual property protection and its enforcement, with the introduction of corresponding changes into the legislation.

As a result, the number of creators of industrial property right objects (inventors and rationalizers) is constantly decreasing in the economy in general, as well as in industry and most sectors thereof. The total number of creators in 2001-2006 decreased by 13.8%; in industry - by 40.7%; light industry - by 14.2%; in the chemical and petrochemical industry – by 37.2%; in metal manufacture - by 34.8%; in machine-building – by 21.6%; and in electrical, electronic and optical equipment engineering - by 30.5%. At the same time, there is still a tendency towards a decreasing number of applications for inventions submitted to the State Department of Intellectual Property; compared to 2005, this number has decreased by 3%. The number of inventions used in production has decreased by 19.8%.

During last two years, a decreasing number of efficiency suggestions implemented in manufacturing has been observed: compared to 2005, this number

has decreased by 5.5%; to 2004 – by 10%; to 2003 - by 13%; to 2002 - by 22%; and to 2001 - by 26%.

Instead of carrying out activities to stimulate invention, develop an intellectual property market and scientific products, the Cabinet of Ministers, on the initiative of the Ministry of Economy of Ukraine and State Department of Intellectual Property, adopted Resolution № 1148 of September 19, 2007, according to which expenses of companies that want to get and keep patents for inventions and utility models are being increased by 35 times (legal entities now have to pay 9100 UAH instead of 496 UAH) and exceed the corresponding expenses of European countries, namely, Great Britain, Germany, France, Spain, by 1.5-3.5 times; they are 3.7 times more than in Armenia (a WTO member since 2003) and 1.5 times more than in Moldova (a WTO member since 2001). Fee benefits for non-profit organizations were introduced only after the corresponding appeal of state academies of science, higher educational institutions and other institutions.

The system of financing in the field of intellectual property protection requires substantial changes. According to the report of the Audit Chamber of Ukraine on the results of auditing the effectiveness of the activities of the Ministry of Science and Education of Ukraine of December 11, 2007 No. 6/30-2, the costs of carrying out activities relating to intellectual property protection were used with serious violations. The reason for this was the non-transparent system of financing in the field of intellectual property in Ukraine and lack of proper control by the corresponding government bodies, namely, the Ministry of Science and Education of Ukraine, the State Department of Intellectual Property.

The executive bodies' dereliction is virtually leading to a loss of intellectual scientific and technical achievements. Institutions, organizations and companies have not made inventory of the inventions of the former USSR with "Confidential" labels and secret ones (about 250000) that have been claimed by Ukrainians, and no details of their declassification and removal from the secret list have been specified. Taking into account that the information about these inventions has not been officially disclosed, it is important to consider ways of using them, including transformation into patents with the aim of commercialization. This is an essential reserve for innovative development of the country. At present in Ukraine there are only 20 700 active 20-year patents, 40% of which belong to foreign applicants.

There is evidence of uncontrolled transfer of scientific and engineering developments abroad and a leak of domestic claims on future inventions from Ukraine.

The question of approval of minimum benefit fees paid to the authors of the technologies, special technology transfer subsidies, maintaining a state register of technology transfer agreements, and liability for submitting claims to patent agencies of other countries without their prior submission in Ukraine has not been settled; and there has been no proper analysis of claims submitted in Ukraine and foreign countries. Provisions of the Law of Ukraine “On State Control of Technology Transfer Activities” are being implemented very slowly.

There are negative trends in privatization of science and technology sector objects, which are sold almost for free without taking into account intangible value, which conflicts Article 7 of the Law of Ukraine “On Valuation of Property, Property Right and Professional Valuation Activity in Ukraine”. According to the information of the State Property Fund of Ukraine, in 2005-2007 six objects of the science and technology sector were privatized, three of which were sold at a price several times less of their nominal value. These were the Special Design Office of Microelectronics in Instrument-making, Ukrainian Research Institute of Agricultural Machine-building, and the Kirovogradagroproekt Design and Research institute.

Contrary to current legislation, there is evidence of unjustified inclusion of science and research institutions that are strategically important for the country’s economy and defence in the list of companies that can be privatized. Thus, among the objects that can be privatized in 2008, there is the Research Institute of Electromechanical Equipment, which is the only leading company in Ukraine and CIS specializing in manufacturing unique high-technology information registering, processing and transfer equipment. Raider attacks and attempts at reshaping high-technology scientific production complexes are becoming a popular practice. One vivid example is one of the best companies of the electronics sector, the Saturn scientific production company, which owns unique radiometry and telecommunications technologies.

Privatization of many scientific and technological facilities results in the loss of unique practices and science schools that took years to form and practically will never be able to be reproduced in full.

There is a lack of coordination of activities of law enforcement and control bodies (Ministry of Science and Education of Ukraine, Ministry of Internal Affairs of Ukraine, Security Department of Ukraine, Prosecutor General’s Office of Ukraine, State Tax Administration of Ukraine, Anti-Monopoly Committee of Ukraine, State Customs Service of Ukraine. Etc.) to fight piracy in the intellectual property sector. This causes many violations of the law, infringement and piracy.

As reported by the International Intellectual Property Alliance (IIPA), Ukraine has been included in the list of the countries with priority monitoring (list 301) as a country with a high piracy level (in 2007, the computer piracy rate was 84%, one of the highest in the world).

One of the reasons preventing a substantial decrease in the piracy rate in Ukraine is a lack of effective punishment provided by current legislation for committing offences in the field of intellectual property.

A draft Concept of innovation system development in Ukraine has not been submitted for review by Parliament (for several years, similar strategic documents have been common practice in Russia, Kazakhstan, Belarus and other countries). A Tax Code of Ukraine that should include provisions encouraging innovative activities has not been adopted.

All of the above is evidence that urgent measures must be taken by the state authorities and executive bodies of all levels to eliminate negative effects in the field of innovation activities, legal protection and intellectual property protection.

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