

BTI 2010 | Ukraine Country Report

Status Index	1-10	6.55	# 37 of 128	
Democracy	1-10	7.00	# 37 of 128	➔
Market Economy	1-10	6.11	# 55 of 128	➔
Management Index	1-10	4.92	# 66 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	46.5	HDI	0.80	GDP p.c.	\$	6933
Pop. growth	% p.a.	-0.6	HDI rank of 182	85	Gini Index		28.2
Life expectancy	years	68	UN Education Index	0.96	Poverty ²	%	<2
Urban population	%	67.9	Gender equality ¹	0.45	Aid per capita	\$	8.7

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

In the period under review, Ukraine's politics were characterized by continuous constitutional and political crises, hampering political decision making. In April 2007, President Viktor Yushchenko dissolved the Ukrainian parliament (Verkhovna Rada) and called for early elections. The parliament did not accept the dissolution and continued its work. After negotiations between Yushchenko and Prime Minister Viktor Yanukovich, early parliamentary elections were scheduled for 30 September 2007. The elections were assessed as free and fair. The result was accepted by all relevant political forces. A government was formed only in December 2007, when a coalition between Bloc Yulia Tymoshenko (BYuT) and Our Ukraine - People's Self-Defense (OU-PSD) was formed under the premiership of Tymoshenko.

The year 2008 was characterized by institutional and personal competition between Prime Minister Tymoshenko and President Yushchenko. Institutional ambiguities caused by the constitutional amendments of December 2004 (after the Orange Revolution) had not yet been resolved. Both sides used these to widen their power and prerogatives. Moreover, rules and laws were disregarded, as politicians continued to play with, rather than by, the rules. With regard to constitutional changes, Tymoshenko favored a pure parliamentarian system, while Yushchenko sought to widen the competencies of the president. Both attempted to alter the existing framework by passing suitable laws or decrees. Thus, as of this writing, it is not yet clear which form of government Ukraine will have in the future. While the president and the government do not differ on strategic goals such as democracy, the role of a market economy or EU integration, they disagree on the proper way of achieving them, and subordinate politics to short-term goals.

At times in 2008, the Verkhovna Rada was unable to function, blocking the progress of important reforms and political decisions. After months of mutual blockades, the Orange Coalition collapsed in September 2008 after BYuT – working jointly with the opposition Party of Regions – pushed through a number of laws limiting presidential power. After failed attempts

to form a new government, Yushchenko dissolved the Verkhovna Rada on October and announced early elections. The government challenged the legality of the dissolution. However, due to the acute financial and economic crisis, new elections were postponed indefinitely and the Tymoshenko government continued to operate. In December 2008 BYuT and the Party of Regions negotiated to form a governing coalition, but after Volodymyr Lytvyn was elected chairman of the Verkhovna Rada on December 9, 2008, a coalition between his Lytvyn Bloc, BYuT and OU-PSD was created, and a coalition agreement was signed on December 16.

In the economic sphere, Ukraine experienced rather high growth rates, rising household incomes and investment rates until the end of 2008. GDP rose by 7% in 2007, while industrial production increased by 10.2%. In late 2008, the Ukrainian economy started to suffer from the effects of the international financial crisis, and fell into a recession characterized by a strong decline in industrial output and rising unemployment. Structural imbalances and the high external dependency of the Ukrainian economy became apparent. Ukraine and the International Monetary Fund (IMF) signed a stand-by agreement featuring loans of \$16.4 billion aimed at mitigating the crisis. There is a danger of Ukraine failing to pay back its international debt as a result of decreasing tax revenues and growing expenditures in the social sphere.

History and Characteristics of Transformation

Ukrainian transformation after independence (1991) was largely determined by old nomenklatura elite groups, who kept their positions in the state administration and the economy. They shaped the new institutional framework according to their interests. This also led to an economic policy which sidestepped conflict, avoiding hardships for all kinds of influential individuals, and to an inability to mount collective action as crucial actors competed for power and wealth. Simultaneously, new opportunities for individual and group enrichment such as rent-seeking emerged and were partially sustained by support from Russia and the West.

The division of power between the president and parliament remained unresolved until a new constitution was adopted in 1996. From 1996 until 2005, Ukraine was formally a semi-presidential system. Leonid Kuchma's second term (1999–2004) was characterized by increasing authoritarian tendencies and the informalization of power relations. Various protests against the Kuchma regime galvanized a set of opposition movements and served as organizational preparation for the so-called Orange Revolution.

The 2004 presidential elections was contested by two main candidates: Prime Minister Viktor Yanukovich, who was supported by outgoing President Kuchma, and Viktor Yushchenko, former prime minister and head of the National Bank. The fraudulent run-off on November 21, officially won by Yanukovich, led to mass protests. Yushchenko was the victor in the repeat election on December 26, 2004, which was assessed as free and fair. Yushchenko's inauguration

as president on 23 January 2005, along with the parliamentary approval of Tymoshenko's candidature for prime minister in February 2005, marked a significant shift in power. A turn toward more democracy, transparency and accountability on the part of politicians, and socioeconomic change seemed imminent. However, only some of these promising initial opportunities have been seized. Opinion polls since 2005 point to growing disillusionment among the public. On 8 December 2004, constitutional amendments were passed that took effect on 1 January 2006, essentially establishing a parliamentary-presidential system, reallocating power and competencies between president, government and parliament. According to the amended constitution, a new government is formed after parliamentary (not presidential) elections, which take place every five years on a proportional basis. Within one month after the elections, the Verkhovna Rada has to form a parliamentary majority in order to elect a government; if it fails to do so, the president can dissolve it. The parliamentary majority not only elects the government and approves the prime minister, it may also dismiss them, as well as individual ministers. The president proposes candidates for the positions of the prime minister as well as for the positions of minister of defense and foreign affairs.

Tymoshenko's government suffered from internal disunity and divergent policy prescriptions. Institutional competition flared between the presidential secretariat, the government and the Council of National Security and Defense, which were led by rival politicians. Mutual accusations of venality within Yushchenko's team led to the dismissal of Tymoshenko's government in September 2005. A new government was formed under Yuri Yekhanurov, whose election in parliament became possible with the support of Yanukovich's Party of Regions. In January 2006, Yekhanurov's government received a vote of no confidence by the Verkhovna Rada after the "gas war" with Russia. Many expected and announced reforms failed to take place, and the battle lines between the different political groupings became blurred again. The developments in fall 2005 proved that the new leadership had also retreated to political tactics characteristic of the Kuchma regime, if in a milder form.

The parliamentary elections on 26 March 2006 changed the composition of the Verkhovna Rada significantly. The Party of Regions emerged as the winner while the "orange" parties (BYuT and Our Ukraine) fared less well. The Socialist Party and the Communist Party also made it into parliament. No other parties overcame the 3% threshold for parliamentary inclusion. Attempts to establish an "orange" government failed after the Socialist Party defected to the Party of Regions with whom, together with the Communists, they created the Anti-Crisis coalition in July and a government in August 2006. They nominated Yanukovich as prime minister, while the leader of the Socialist Party, Oleksander Moroz, became chairman of the parliament. Thus, the Ukrainian political elite succeeded in its first serious test, that is, a peaceful change in government. Subsequently, political fights about the right to nominate key public officials such as the foreign minister emerged.

Ukraine has conducted foreign policy of balance between Russia and the West, though the government has government drawn closer to NATO and the European Union (EU). Ukraine's request for prospective EU membership was refused by the European Commission, but the country was included in the European Neighborhood Policy. Meanwhile, then-Russian President

Vladimir Putin tried to influence the 2004 presidential elections by supporting Viktor Yanukovich. For the last several years, the relationship between Russia and Ukraine has been marked by repeated conflicts over gas deliveries, transit and payments. Moreover, Russia's Black Sea Fleet, based in Sevastopol, is still a bone of contention.

In 2005, the private sector's share of GDP in Ukraine had reached 65%. Beginning in the mid-1990s, a variety of types of privatization were applied. Mass privatization was only effective in the SME sector. Oligarchic capitalism developed in the second half of the 1990s and was reinforced by large-scale privatizations, especially in 2003 and 2004, before the presidential elections. Due to flawed procedures and favoritism, many large enterprises were sold under market value and ended up in the hands of financial industrial groups or large companies close to the Kuchma regime. In 2005, the much-publicized intention to "reprivatize" a large number of companies spurred doubts about the government's determination to respect property rights. It also compounded investor uncertainty and dampened economic growth rates. In fall 2005, further plans for "reprivatization" were abandoned.

Starting in 2005, the government attempted to subordinate the oligarchic groups to general rules. But large parts of the economy (especially heavy industry) continue to be dominated by financial industrial groups and in some cases by foreign investors. The Ukrainian economy continues to suffer from structural imbalances, which became even more pronounced during the transformation crisis. While light industry was negligible in the late 1990s, it has improved considerably because of the increasing purchasing power of the Ukrainian population and the more sophisticated demands of the consumer market. In addition, simplified rules for registration and simplified tax regulations have prompted many companies to (re-)emerge from the shadow economy.

Socioeconomic development in Ukraine was disastrous until about 2000. A severe decline in production and living standards dominated the 1990s. Since 2000, the economy has been recovering from this downward trend. Poverty was reduced and cash incomes increased. But the gap between the rich and the poor remains pronounced.

Until 2005, serious civil rights violations occurred frequently: murders, attacks on and intimidation of journalists, parliamentarians, members of the political opposition and rival trade union representatives. After the Orange Revolution, freedom of expression improved. State and self-censorship, as well as harassment of critical journalists, became less prominent. The success of the free and fair presidential election on December 26, 2004 was an important step toward ending the former restrictions of civil rights in Ukraine, even though civil society actors continue to have little noticeable influence on politics.

Transformation Status

I. Democracy

1 | Stateness

The state monopoly on the use of force is in place. All territorial units are controlled by the state. Ukraine's territorial unity is not endangered, but the country faces specific problems with regard to its notorious regional diversity, which also relates to the strength of regional elites. In the Donbas region, a nexus of local business actors, the regional administration and the Party of Regions operates like an autonomously managed democracy. In Crimea, a pro-Russian secession movement supported by Russia is active, if not successful. Furthermore, state power is partially impaired by the power of interest groups, even though this influence is channeled into the established democratic framework to a greater extent than in the pre-2004 period. Nevertheless, the influence of special interests weakens the political system through corruption and the filling of key political positions by representatives of various interest groups.

Monopoly on the use of force

The Ukrainian nation-state is accepted by all relevant actors and groups in Ukraine. Identification with the "new" state has been growing in recent years. All citizens enjoy the same civil rights. In 1991, every person residing in Ukraine was entitled to Ukrainian citizenship, regardless of nationality. Ukraine thus emerged as a civic nation. The legitimacy of the nation-state is accepted by all relevant groups. Dual citizenship is illegal, even though this issue has been on the political agenda several times, especially under pressure from Russia. Starting in the late 1980s, Crimean Tatars have returned to Crimea to claim their right to Ukrainian citizenship, but they continue to face legal and financial difficulties. Many (elderly) members of the Roma minority lack Ukrainian passports.

State identity

Church and state are separated and the political process is secularized. The heterogeneous religious landscape combined with the secular Soviet past prevents the impact of religious dogmas on state policy. During election campaigns political parties and single politicians draw on the support of certain religious organizations. There are five major churches: the Ukrainian Orthodox Church (Moscow Patriarchate), the Ukrainian Orthodox Church (Kyivan Patriarchate), the Ukrainian

No interference of religious dogmas

Autocephalous Orthodox Church and two Catholic churches (Greek and Roman Catholic). None of them functions as a state church. In addition, there are Jewish and Muslim communities and a growing number of Protestant as well as Evangelical groups. There are no conflicts between the churches and the state, but rather between the individual denominations. The Ukrainian Orthodox Church (Moscow Patriarchate) has the largest number of parishes of any denomination, but the majority of these are located in western and central Ukraine. Polls show that the Ukrainian Orthodox Church (Kyivan Patriarchate) has the largest number of adherents.

Public administration functions on all administrative levels, albeit with varying degrees of effectiveness and state capture by economic actors. Within the political reform discourse, Ukraine's regional cleavages have repeatedly served as an argument for the reinvigoration of the central executive as a means of holding the country together. However, there have never been any serious, publicly supported separatist challenges, with the exception of a movement based in the Crimean peninsula in the first half of the 1990s and again after the Orange Revolution. Ukraine is a unitary state with four tiers of government: national, oblast, rayon/city and municipal. At the municipal level, mayors are publicly elected while the heads of oblast and rayon administrations are centrally appointed. Dependence on the center is reinforced by the system of budget formation. Despite reform discussions and efforts (2001-2002), lower-level budgets are dependent on higher-level budgets, so that the formal political autonomy of municipal authorities is in truth little more than a farce. Publicly elected bodies (parliaments) at the oblast and rayon levels have few competencies and do not possess their own executive bodies, rendering them dependent on their respective state administrations.

Basic
administration

2 | Political Participation

The distribution of political offices takes place through general and free elections, which are widely accepted as the method of filling leadership positions. According to national and international assessments, the most recent elections (parliamentary elections on the national, regional and local level on September 30, 2007) were almost free of constraints on the freedom and fairness of the process. However, election campaigns are financially uneven playing fields, as many parties are sponsored by "oligarchs" while others – such as the Communists – draw on meager financial resources.

Free and fair
elections

Elected rulers have the power to govern, but lobbyists (mainly the heads of newly emergent business groups) have succeeded again and again in exercising influence over the highest members of the executive branch and their political course of action. In Ukraine, the military does not interfere in politics. Rather, veto players can be found in parliament, within the public administration and even in the

Effective power to
govern

governing coalition itself. Currently, competing interests are partially reflected in institutional duplication, such as the existence of several administrative units with similar (formal) tasks that compete for decision-making power and which can be seen in the rivalry that exists between the presidential administration and individual ministries. The undefined relations between the institutions of the presidency, government and parliament continue to cause friction and contribute to the political crisis, which is exacerbated by the personal interests of top government officials. The veto powers repeatedly try to instrumentalize the formal system and undermine it without questioning the system as such. The mutual blockades of legislative activity led to a very low legislative outcome in 2007 and 2008.

Freedom of association is guaranteed in the constitution. During the period under review, the rights of political organization and assembly were respected. However, rights are often only declarative, lacking supporting legislation or funding for enforcement.

Association /
assembly rights

Freedom of expression is for the most part exercisable, both by individuals and the media. The media coverage of the most recent elections was rather balanced, giving citizens access to a plurality of positions. There was no obvious state censorship in 2007 or 2008, and the space for public political debate has increased. However, journalists refrain from commenting on political events. Many media outlets have changed hands, leading to a broader distribution of ownership. In television, ownership patterns have remained more or less the same. There is a variety and plurality of both print and electronic media. However, low profitability causes the financial dependence of many media outlets on single financial or industrial groups. The announced introduction of a public television company has not been accomplished. The main limitation to this generally positive development is that the easing of state control over the media lacks a solid legal basis.

Freedom of
expression

3 | Rule of Law

In general, the Ukrainian constitution provides for the division of powers and an independent judiciary. However, the constitutional provisions are not deeply anchored in the minds of the political elite. Fights about the rules often take precedence over political competition within the rules. A political compromise in December 2004 brought about the constitutional amendments that became effective on January 1, 2006. Loopholes and institutional frictions remain, as some competencies are not sufficiently delineated between the president, the cabinet of ministers and the parliament. The right to appoint key officials such as the foreign minister or governors is a case in point. In 2008, both the president and the prime minister attempted to widen their powers and to change laws and the constitution according to their power-related interests. Thus, the struggle over the rules of the game is not yet over.

Separation of
powers

A disturbing trend perpetuated secretive practices established during the Kuchma era: President Yushchenko continued to undermine the separation of powers by issuing decrees, some of which were not made known to the public.

The Prosecutor General's office is responsible for the monitoring of human rights, including the compliance of the executive organs. This contradicts the rule of law and the separation of powers.

The constitution stipulates the principal composition of the judicial system. On paper, the functional and regional differentiation of the judiciary is in place. There are local courts of general jurisdiction (combining criminal and civil jurisdiction), appeal courts in different regions and state organizations (such as the military), and arbitration courts. In addition, there are three high courts with specialized jurisdiction (appeals court, administrative court and high arbitration court). The Constitutional Court decides on the conformity of laws and other legal acts with the constitution. Its decisions are final and cannot be appealed. The Supreme Court is the highest judicial body. Although an independent judiciary is anchored in the constitution, its actual independence is impaired. According to the law, all citizens have the right to a fair, timely and open trial. For several reasons, this is not respected in practice. Pressing problems include insufficiently trained judges, low salaries and dependence on the executive branch in matters of enforcement. Moreover, Ukrainian courts are faced with overwhelming and ever-growing caseloads, but the number of judges has remained relatively constant. There is a lack of transparency of proceedings.

Independent
judiciary

Additional serious problems include the lack of funding even for basic equipment, and financial constraints with regard to training. Constantly changing laws (both related to interest politics and the necessity to adapt to international standards and EU law) impair jurisdiction.

Individual courts of general jurisdiction are established and closed by the president. The 18 judges of the Constitutional Court are appointed in equal shares by the Verkhovna Rada and the president. The appointments of judges and court chairmen are subject to political considerations and judges are often politically dependent or affiliated with political camps.

Overall, the judicial system of Ukraine has been systematically misused by various political forces. Top officials often fail to implement court decisions, which indicates the deterioration of this branch of power. The Constitutional Court was not able to provide judicial adjudication of the political conflicts of 2007 and 2008, leading to the worsening of its reputation. On the whole, the independency of the judicial system is jeopardized by the political conflict.

One of President Yushchenko's top declared priorities was to prevent future abuse of power. However, those responsible for the falsification of the 2004 presidential

Prosecution of
office abuse

elections remained exempt from investigations and possible punishment. No high profile case was brought to court. As members of parliament, many of these figures enjoy immunity from prosecution.

A substantial number of anti-corruption regulations and programs exist, but they do not represent a systematic approach or overall long-term strategy. Various state agencies have a legal mandate to fight corruption, but are not sufficiently protected from political interference. Corruption scandals have been publicly exposed, but this has not been accompanied by changes in structural incentives or legal guidelines to regulate the private interests of public servants. Only relatively low-ranking officials have been put on trial. No senior officials have ever been charged in Ukraine.

In the period under review, civil liberties have by and large been respected, though there are some reasons for concern. Freedom of movement and freedom of religion are ensured. In addition, there is no noteworthy ethnic discrimination, with the partial exception of bias against Crimean Tatars and the Roma. On the other hand, there are some worrisome developments with regard to the situation of asylum seekers and refugees. According to Human Rights Watch, the Ukrainian refugee law contradicts the Universal Declaration of Human Rights. Moreover, trafficking in women and children is a serious problem, which the authorities are combating with limited success. The human rights situation in penitentiaries gives cause for concern. People often remain in detention for months or years, and there are repeatedly reports about cases of physical abuse. The most serious problems are overcrowding and lack of adequate nutrition or medical care in prisons.

In addition, there has been an alarming rise in xenophobic violence since 2007, mostly against visible minorities such as foreign students, migrants, refugees and Jews, up to and including assault and murder. Most of the perpetrators belong to neo-Nazi groups. Pressured by international organizations and foreign governments, Ukrainian authorities have started to tackle the issue. Important criminal cases such as the case of Heorhiy Gongadze – the journalist killed in 2000 – have been reopened for investigation, but have yet to be solved. The murderers have been found, but the masterminds behind the killing remain unknown. Many considered progress on this case to be a political litmus test of the seriousness of the new authorities in pursuing the restoration of the rule of law in Ukraine. In general, injustices that were committed under the Kuchma regime are not systematically investigated.

4 | Stability of Democratic Institutions

Democratic institutions basically function as they should. However, the institutional ambiguities and frictions mentioned above impair the effectiveness of government action. The president and the government tend to block each other's decisions and

Civil rights

Performance of
democratic
institutions

make them subject to (personal) power expansion. While a genuine elite change did not take place after the Orange Revolution, there has been little continuity in top personnel. On the whole, it has been rare for a prime minister to remain in office for longer than one year. The changes at the top have led to considerable insecurity regarding the continuation and direction of reforms. Decentralization has not proceeded far, even though President Yushchenko made it one of his political priorities. In 2008, the Verkhovna Rada hardly operated because it was paralyzed by the political crisis. Thus, necessary reform measures were not taken, resulting in a legislative backlog.

At present, all influential political actors accept democratic institutions and regard them generally as legitimate. However, politicians and interest groups have with growing frequency reopened the discussion on political and constitutional rules. The constitutional amendments agreed upon during the Orange Revolution, which came into force on 1 January 2006, have been questioned. In October 2005, the Constitutional Court ruled that the reforms should be put to a referendum. President Yushchenko took up that argument in 2007. Recent attempts to delineate power and competencies between the government and the president have largely been driven by the personal interests of the actors involved (especially Tymoshenko and Yushchenko).

Commitment to
democratic
institutions

5 | Political and Social Integration

There is a lack of clear programmatic differentiation between the party platforms. Parties and voting blocs continue to be primarily political vehicles for individual leading politicians. Their role in aggregating and representing societal interests is not very effective. Election campaigns are characterized by mostly populist slogans. On the whole, battle lines between parties – especially between the government and the opposition, but also within the governing coalition – remain blurred and change frequently, driven by power interests rather than ideology or party programs. The ban on defections from parliamentary factions remains a controversial issue (and was a primary factor behind President Yushchenko's April 2007 decree disbanding parliament).

Party system

The proportional system has contributed to the stabilization of the party system as such. During the September 2007 elections, many parties did not overcome the 3% threshold. Currently, the political landscape is characterized by five major parties or blocs, but a three- or even a two-party system appears to be emerging, composed of two Orange parties, (BYuT and to a lesser extent OU-PSD), and the Party of Regions. The Communist Party has lost support to the Party of Regions, and it is unlikely to survive as a serious political force. The same applies to the Socialist Party, which has lost much of its credibility and is no longer represented in parliament. Electoral volatility is declining, but party membership is at a low level.

Party elites have only weak grassroots connections, and the shift to proportional representation in 2006 led to further centralization of power at the top. Internal democracy is weakly developed. People have little trust in parties, which are considered to serve the self-interest of their leaders.

Despite the change in power after 2004, the political elite has shown little willingness to cooperate with civic organizations. While there was high degree of mobilization during the Orange Revolution, the subsequent disillusionment led to a partial retreat to the private sphere. In general, there is more cooperation between the authorities and civic organizations at the local level. At the national level, the formal channels for communicating societal or group interests are not well defined, and access to government information remains poor. The network of interest groups is relatively close-knit, but their possibilities for wielding real influence are very unequal. Only a few interest organizations possess sufficient intellectual and institutional capacity to influence the government through policy analysis and recommendations. Financial industrial groups and other strong economic groups are well represented in the political sphere. Their heads have often become party politicians and members of parliament.

Interest groups

Other societal interests are less well represented. Independent trade unions are weak and partly reliant on Western support, while the transformed Soviet trade unions continue to collaborate with enterprise directors. Both have lost their influence and potential for (mass) mobilization. During the Kuchma regime, many quasi-NGOs were founded by (local) authorities or companies, with the aim of controlling citizen action and attracting budget resources. Ethnic, national and religious mobilization has played no real role in the constellation of interest groups in Ukraine.

On the whole, the people of Ukraine endorse democratic norms, but with specific connotations. Surveys show that quality of democracy is mainly assessed by the state's ability to deliver social welfare. Respondents attach most importance to social rights, while political rights are mentioned less often. In addition, there is a strong correlation between the assessment of the economic situation and of democratization in Ukraine.

Consent to democratic norms

According to the law "On Associations of Citizens," citizens can form political parties and public organizations. State interference is prohibited by law. There is a developed network of privately organized bodies. However, social and political integration occasionally takes place not via the aggregation and representation of (societal) interests, but rather by the integration of people into vertical clientelist networks. These are hard to dissolve, especially in the countryside and in single-industry towns where people depend on local economic leaders for their socioeconomic wellbeing. Many self-help initiatives have a local character and are directed towards short-term goals, and often disintegrate after the attainment of

Associational activities

those goals. There is a low level of institutionalization. There are about 40,000 registered NGOs in Ukraine, of which only about 10% are active. Many NGOs depend on external funding by international organizations, (private) charity organizations, or international projects related to technical assistance, but the significance of foreign funding is declining. NGOs have little impact in the political sphere as they have difficulty finding willing and reliable counterparts in politics and public administration. Internally, most NGOs are characterized by weakly developed democracy and a lack of financial transparency.

II. Market Economy

6 | Level of Socioeconomic Development

The results of Ukraine's economic and political transformation include a growing segregation between society's rich and poor, reflected by a Gini index rating of 31 (2006). Ukraine's gender-related development index (GDI) is 0.785 (2005), while the human development index (HDI) is 0.788. Poverty reduction started in 2001, when economic growth began to benefit the poor. According to the World Bank, poverty levels have fallen substantially, from 32% of the population in 2001 to 8% in 2008. During the last three years, pensions and minimum wages have been raised, mostly as populist measures taken before elections. In 2008, social benefits constituted about 40% of household incomes. But at the end of 2008, real wages started to decline, for the first time in a decade. The once-substantive pension and wage arrears – both in state and private companies – have decreased, but started to rise again in late 2008. Remittances by Ukrainian labor migrants are becoming an increasingly important factor in the Ukraine economy, both from Russia and the EU.

Socioeconomic
barriers

Because of the large share of the shadow economy there is serious underreporting of household incomes in official statistics. In the period under investigation, the share of in-kind income has decreased, while the share of cash income has increased. Social inequality, however, remains pronounced. Poverty is mostly caused by unemployment and increases in the number of children in a family. Moreover, poverty is increasingly a rural phenomenon.

Overall, there are no specific economic barriers based on ethnicity or religion, with the partial exception of bias against the Roma and Tatar populations. Refugees and (illegal) migrants also lack equal access to resources.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	64883.1	86142	107753.1	142719
Growth of GDP	%	12.1	2.7	7.3	7.9
Inflation (CPI)	%	9.1	13.5	9.1	12.8
Unemployment	%	8.6	7.2	6.8	6.4
Foreign direct investment	% of GDP	2.6	9.1	5.2	6.9
Export growth	%	21.3	-11.2	-5.6	3.2
Import growth	%	15.5	2.1	6.8	19.9
Current account balance	\$ mn.	6909.0	2531.0	-1617.0	-5272.0
Public debt	\$ mn.	10589.5	10458.4	9537.8	10568.2
External debt	\$ mn.	30185.5	33297.2	49886.7	73599.8
Total debt service	% of GNI	7.2	6.9	8.9	8.4
Cash surplus or deficit	% of GDP	-3.2	-1.4	-1.0	-0.6
Tax Revenue	% of GDP	13.3	17.1	17.7	16.5
Government consumption	% of GDP	18.1	18.6	18.4	18.3
Public expnd. on edu.	% of GDP	5.3	6.1	6.2	5.4
Public expnd. on health	% of GDP	3.7	3.7	3.8	-
R&D expenditure	% of GDP	1.1	1.0	0.9	0.9
Military expenditure	% of GDP	2.6	2.8	2.8	2.9

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

With an inherited Soviet framework that is ill-suited to the needs of a market economy, Ukraine has been slow to establish the necessary institutions to use its resources efficiently. Nevertheless the essential elements of free market competition have been established. Most price controls have been eliminated. However, in the summer of 2008 the government introduced price controls on staples to curb inflation, which were then vetoed by President Yushchenko.

Market-based
competition

Inconsistent legislation, anti-competitive practices and widespread corruption continue to impede growth. Direct and indirect state subsidies and the dominance of financial industrial groups result in unequal treatment of market participants and distort the allocation of resources. According to World Bank data, the informal economy's share was 52.2% of gross national income (2003), while national authorities rated it at 34% of GDP (2004). Market entry barriers for small companies were lowered in 2005 by reducing the number of necessary licenses. In some economic spheres – especially heavy industry – strong vertical integration of production chains prevents the market entry of new companies.

Firms working in sectors characterized by monopoly, single-firm dominance, or oligopoly accounted for about 45% of total output in 2004. Many sectors with weak competition are in heavy industry or infrastructure (such as mining and telecommunications), where capital requirement creates high entry barriers.

Anti-monopoly
policy

The Anti-Monopoly Committee (AMC), established in 1994, monitors abuse of market power and prevents unfair competition. In recent years, the AMC has improved the quality of its operations and its reputation. It is vested with law enforcement and advocacy powers and has a wide jurisdiction over all business entities in Ukraine, as well as over all executive agencies below the highest organs of power. The actions of various state bodies, such as courts and the state property fund, are not synchronized and counteract the AMC's efforts. Moreover, existing legislation (such as the Ukrainian Commercial Code) conflicts with the competition laws, and other legislation (such as control mechanisms for state aid) must be passed if Ukraine is to meet international norms. Further critical issues concern budget allocation, autonomy, investigative tools and transparency. Future challenges include competition advocacy, harmonization with the EU's competition laws and the elimination of contradictory terms in Ukraine's Commercial Code.

The Ukrainian economy is highly internationalized. In 2006, exports constituted about a third of GDP, imports more than 40%. According to the State Statistics Committee, Ukraine's foreign trade balance was negative in 2007 at \$10.6 billion and in 2008 at \$18.5 billion, while exports and imports were growing. In 2008, exports to CIS countries amounted to 35.5% of all exports, while the EU accounted for 27.1%. Ferrous metals and associated products dominate Ukraine's exports at 42% (2008). CIS countries account for 39.2% of all imports (mostly energy resources), while 33.7 % come from the European Union.

Liberalization of
foreign trade

After years of negotiations and reforms, Ukraine finally joined the World Trade Organization (WTO) in May 2008. In 2007, Ukraine started negotiations on a new Association Agreement with the European Union, which is to include a deep Free Trade Area. The new agreement, which will replace the 1994 Partnership and Cooperation Agreement between Ukraine and the European Union, will also pave the way for extensive harmonization of Ukraine's regulatory framework with that of

the EU. Ukraine's leaders have indicated willingness to start trade negotiations with Turkey, the Nordic countries, the United States, Canada and several other states.

Foreign trade is liberalized according to WTO rules. However, import tariffs of an additional 13% were introduced in February 2009 for a period of six months – mainly on food products to protect domestic producers and reduce inflation during the financial and economic crisis.

Ukraine has a two-tier banking system, with the independent National Bank of Ukraine (NBU) as a supervisory and regulating body, and commercial banks that serve economic actors and private households. In the period under review, Ukraine's banking sector became much larger and more sophisticated. In March 2008, 176 banks maintained operations in the country. Foreign-owned banks accounted for 37% of banking system capital and have strengthened the sector. Transparency (in terms of ownership) has improved, and by the end of 2007, non-performing loans had decreased to about 13% of the total. The Ukrainian stock market is underdeveloped. Most investment is financed by bank credits, rather than from the sale of stocks.

Banking system

Several banking system weaknesses were revealed and exacerbated by the global financial crisis in 2008. Credit growth, mainly to private households, had substantially accelerated and was mostly financed by international credits – a very lucrative business for Ukraine's banks. Banks became increasingly dependent on foreign funding (mostly short-term borrowing), while possessing little equity capital. Due to the global liquidity crisis, Ukrainian banks and companies lost access to these overseas loans. Mass depositors' demands for pre-term repayment of deposits led to intensive cash outflows in the banking system. The banks simultaneously increased interest rates under loan agreements and stopped issuing loans. In early 2009, credit rating agencies downgraded the country's banks further. Several banks came under direct control of the NBU and received liquidity aid. At the time of writing, close to 40 banks appeared to hold the potential for collapse; others were supposed to receive state support for recapitalization. The European Bank for Reconstruction and Development (EBRD) announced it would provide a €500 million loan to recapitalize Ukrainian banks.

In February 2009, the Ukrainian government tried to restrict the independence of the NBU and threatened to dismiss the NBU's head because he refused to finance the increased budget deficit of 2008, but Yushchenko did not consent. At the time of this writing, the conflict was ongoing.

8 | Currency and Price Stability

In 2007 and 2008, strong credit and wage growth fuelled domestic demand and added to inflationary pressures. In 2007 and from January to September 2008, the inflation rate was about 17%. To slow down inflation, the NBU tightened monetary

Anti-inflation /
forex policy

policy, while the government devised an anti-inflation plan and restricted exports of certain foodstuffs. However, tighter monetary policy did not have a strong impact on prices because of the non-monetary nature of the main factors driving inflation. Price controls, which the government introduced to curb inflation, largely failed.

The NBU faces problems combining price and exchange-rate stability. Throughout 2007, the National Bank of Ukraine (NBU) kept the exchange rate fixed to the dollar. Until 2008, the official exchange rate against the dollar served its function well, sending signals to the public about the desired level of the exchange rate, and the public based its expectations on it. However, large capital inflows undermined this strategy. The NBU could not guarantee stability by targeting the exchange rate, because this strategy is not flexible enough. By keeping the exchange rate fixed, the NBU had to intervene repeatedly, buying large amounts of foreign currency with freshly printed hryvnias, thus increasing the money supply. In 2008 the official and the market rates drifted apart, initially with the hryvnia growing stronger. In the second half of 2008, there was a strong devaluation of the hryvnia against the dollar. At the end of 2008, the official rate has been 7.7 hryvnia to the dollar, in contrast to 5.05 in January 2008.

On December 29, 2007, the Verkhovna Rada approved the country's 2008 budget, setting the deficit at 2.1% of GDP, allowing for a significant increase in social spending, including higher compensation for depositors belonging to the Soviet-era Sberbank. Populist measures were taken before the parliamentary elections in 2006 and 2007, raising minimum wages and pensions, child allowances and other social benefits. About 40% of budget spending is targeted to the social sphere. Tax revenues declined at the end of 2008. Changes in the 2008 budget were approved in late 2008, envisioning a larger deficit. The 2009 budget foresees a higher deficit at about 2.97% of GDP. The IMF has criticized the Ukrainian government for high budget spending, and halted the payment of the second tranche of the \$16.4 billion credit which had been agreed upon in November 2008. Economic policy has suffered due to the political crisis, and might deteriorate further as a result of electoral politics in the near future.

Macrostability

Ukraine's gross foreign debt nearly doubled during the first nine months of 2008, standing at \$105 billion as of October 1, 2008. Ukrainian banks contributed most to the foreign debt growth, with their debt tripling to \$42 billion between January and September 2008. Ukraine's foreign currency reserves amounted to about \$28 billion as of January 2009, down from \$36 billion in early 2008.

9 | Private Property

The Ukrainian constitution and the Civil Code and Commercial Code guarantee private property rights, including that of non-agricultural private land. However, these guarantees remain problematic as long as the executive and judicial branches

Property rights

fail to implement property rights and property protections in practice. In 2007 and 2008, the announced policy of reprivatization of large companies privatized under dubious conditions during the late Kuchma era was discontinued, improving legal certainty and the investment climate.

According to the World Bank, private enterprise is difficult and costly in terms of time and money. Ukraine's standing in terms of the ease of doing business has not improved recently. A 2009 World Bank report ranks the country 145th out of 181 countries. Relevant indicators range from the time and cost of meeting government requirements to the costs of business start-up, operation, trade, taxation, and closure. In particular, tax rates are too high, and there are too many different varieties of taxes. Foreign investors are entitled to repatriate profit, income or other funds relating to investments without any restrictions, after the payment of applicable taxes.

Private enterprise

All major privatization auctions planned for 2008 – including UkrTelecom and Odessa Portside Plant (the country's second largest producer of nitrogen fertilizer) – failed, reducing budget revenues from \$8.3 billion to \$0.6 billion. Conflicts over the strategy of the State Property Fund (SPF) emerged. SPF head Valentyna Semenyuk of the Socialist Party, who was partly opposed to privatizations, was supported by the president, who in turn vetoed some auctions. Timoshenko nominated Andrei Portnov to push ahead with several large auctions and to fulfill the ambitious privatization program for 2008. The government depends on the revenues in order to finance social transfers and to compensate the population for their lost savings at the beginning of the 1990s. These conflicts are ongoing.

10 | Welfare Regime

According to the United Nations Development Program (UNDP) Human Development Report 2007, the human development index (HDI) score for Ukraine is 0.788, which gives Ukraine a rank of 76th out of 177 countries, while its gender-related development index (GDI) score is 0.785 (both numbers are for 2005). Ukraine's position has remained rather stable. The welfare net has been improved, mainly for populist reasons before elections. Nevertheless, surveys in 2008 showed that the population considers state support absolutely inadequate.

Social safety nets

Dynamic economic growth facilitated a sharp decline in poverty levels, which fell from 32% in 2001 to 8% of the population in 2005 according to World Bank statistics. The main causes were the rapid increase in labor productivity, as well as generous increases in public sector wages, social transfers, and pensions. This differs from Ukrainian government estimates that show poverty remaining constant at approximately 27%. Ukraine's social safety net consists of two main components: services and cash transfers. The social assistance system suffers from

several shortcomings that undermine efficiency, burden the budget, and impede equality. The authorities grant many categories of aid and benefits to a wide range of citizens, so that the total financial obligations exceed the country's means. Social transfers are poorly targeted; about 30% of transfers are made to those who do not actually qualify. People receive benefits not because of their individual need but due to their inclusion in a defined social group. The public pension system might be jeopardized by a lack of fiscal sustainability. Poorly designed features on both the revenue and expenditure sides of the system are exacerbated by such threats as an aging population. Ukraine's health care system does not provide universal access to quality health care, spending patterns are inefficient, and informal payments are common. Adequate medical service is in fact available only in the private sector, making it too costly for most people. Ukraine has the most severe AIDS epidemic in the region, with an estimated 1.46% of adults infected. Despite the efforts of the medical community and other interested parties, the coverage and effectiveness of most HIV/AIDS programs in Ukraine remain too limited to have a significant impact on the epidemic. Even though handicapped people are entitled to social benefits, they normally live in poverty.

In general, all ethnic groups – with the partial exception of the Crimean Tatars and the Roma – have equal access to the labor market and to public office. Ukraine's structurally ingrained poverty also leads to exclusion based on place of residence, age, social status and family size. Women are underrepresented in economic and political leadership positions, and earn on average 27.6% less than men for equal work. The 6th convocation of the Verkhovna Rada (after the 2007 elections) has only 34 women among its 450 deputies, or 7.6% of the total. There is a distinct tendency for councils to be more gender balanced the lower they are in the government hierarchy. Disabled persons enjoy equal rights in theory, but these are often not realized in practices.

Equal opportunity

11 | Economic Performance

From 2000 to 2008, macroeconomic data pointed to sustainable and positive economic development in Ukraine. In 2007 GDP grew by 7.6% and in the first nine months of 2008 by 6.9%. Ukraine's highly internationalized economy benefited from high prices for metal products, capital inflows were very high and domestic demand was strengthened by wage increases and budgetary transfers. But the global financial crisis exposed Ukrainian macroeconomic vulnerabilities, including as a one-sided export structure and high capital needs, which in turn largely depend on developments in international markets for metallurgical products and inflows of foreign capital. A tremendous economic downturn took place during the last quarter of 2008 and continued in 2009. Industrial production declined by 34% between January 2008 and January 2009. Production capacities lay idle due to declining

Output strength

(international) demand and prices for Ukrainian products (ferrous metals), as well as to the increasing difficulty of obtaining credit on the domestic and international capital markets. In November 2008, Ukraine and the IMF concluded a stand-by agreement for \$16.4 billion to support domestic and external adjustment and financial sector rehabilitation. At the same time, the World Bank granted the country a loan of \$500 million. Further inadequate policy responses to the crisis might ensue due to electoral considerations.

12 | Sustainability

Ukraine suffers from numerous environmental problems as a legacy of Soviet industrialization and insufficient investment in clean technology and energy efficiency. The recent rise in gas prices has not led to the feared decrease in industrial production. Rather, companies invested in energy-saving technology.

Environmental
policy

The Donetsk-Dnepr industrial region has one of the highest levels of water and air pollution in Europe, mainly caused by the operation of antiquated iron, steel and power plants. Air pollution in the big cities has become a major problem, as have inadequate supplies of potable water and inefficient energy use. The situation improved somewhat due to the economic decline in the 1990s. As a signatory to the Kyoto Protocol, Ukraine can trade its emissions certificates to finance investment in the industrial modernization and reduce dependency on energy imports.

In terms of energy consumption per dollar of GDP, Ukraine ranks as one of the most energy-intensive countries in the world. GDP's energy intensity is nearly nine times higher in Ukraine than the world average. There is thus high potential for improvement both in private households and the corporate sector.

Although environmental objectives are anchored both legally and institutionally, thus far they have been implemented selectively. Despite numerous environmental laws, decrees and regulatory acts, Ukraine lacks a comprehensive national strategy. Because different bodies are responsible for various aspects of environmental protection, coordination and implementation do not always succeed. A drive for sustainability has come both from Ukrainian civil society and the international community. The main donors in this field are the European Union and UNDP; major lenders are the World Bank and EBRD.

State and private institutions for education, training and development exist in all fields and levels, but they vary greatly in quality. As a rule, little quality management exists. The number of private secondary education institutions is growing steadily, with the number of students who pay for their education on the rise. In the 2004-2005 period, 61% of students enrolled in post-secondary education paid tuition fees. Access to high-quality, recognized educational institutions often

Education policy /
R&D

requires significant financial capability or corruption. One might say that there has been an informal privatization of the education sector. Support for lifelong education is outlined in the framework of the Millennium Development Goals. According to the UNDP, Ukraine spent 15.0% of its overall public expenditures on education in 2004. In 2003, the EBRD reported that Ukraine spent 8.6% of its GDP on health and education, which was lower than Poland's 10.9%, but higher than Russia's 6.6%. In 2006, 6.2% of Ukraine's GDP (19.3% of government spending) was dedicated to education. Ukraine is suffering from a brain drain, particularly in technology and the natural sciences, both to Russia and the West. Expense on R&D has decreased, amounting to 1.3% of GDP in 2003 and just 0.93% of GDP in 2007. The number of innovative industrial enterprises continues to fall. Protection of intellectual property rights is a serious problem.

Transformation Management

I. Level of Difficulty

Structural constraints emanate from the ecological, social and economic spheres. The Chernobyl nuclear power plant is still an ecological and humanitarian burden for Ukraine, with lasting social, medical and environmental (radiation) effects. The importance of overcoming the aftermath of the Chernobyl disaster has been defined in Article 16 of the Constitution of Ukraine. In the economic sphere, energy dependency is a structural constraint that cannot be solved quickly. Ukraine depends on Russia as a supplier of both gas and oil, either directly or indirectly, since pipelines (from Central Asia) go through Russian territory. Severe gas disputes reemerged at the end of 2008 and the beginning of 2009. GDP growth partly depends on the natural gas price set by Russia.

Structural
constraints

Ukraine is undergoing a severe demographic crisis, characterized by an aging and shrinking population. According to the World Health Organization (WHO), the average Ukrainian life expectancy was 61 years for men and 73 for women in 2006. At 1.22 children per woman (2008), the country's fertility rate is among the lowest in the world, which will cause economic and social problems in the future. To date, policies and institutions are ill-equipped to deal with the prospective consequences of this development, such as higher expenditures on health care, elderly care and pensions as well as a shrinking labor force. Ukraine has the highest prevalence rate of HIV among the former Soviet states. Since 1995, the virus has spread dramatically, first among drug addicts, but more recently increasingly through sexual transmission. According to UNAIDS, about 1.6% of Ukrainian adults and children were living with HIV/AIDS at the end of 2006. The policy response of the Ukrainian state has been viewed positively, but remains insufficient. The epidemic will itself contribute to higher costs for health care and declining numbers in the labor force.

Ukraine has become a transit country, and increasingly a destination, for refugees and asylum seekers who hope to enter the European Union. These refugees pour in from the former Soviet Union (Armenia, Chechnya), Asia (mainly China and Afghanistan) and Africa (Somalia, among others). The European Union considers Ukraine to be a safe third country. In October 2006, the European Union and

Ukraine concluded a readmission agreement requiring Ukraine to readmit undocumented third country nationals who traveled through Ukraine before gaining access to EU territory, even though Ukraine seems incapable of meeting human rights standards. Support for refugees is negligible and human rights abuses are regularly observed. According to estimates, up to two million undocumented migrants live in Ukraine, mostly in large cities. Simultaneously, Ukraine is a country of labor emigration. Several million Ukrainians work (temporarily) abroad, mainly in the European Union and Russia. Trafficking in women and children also plays a role, with estimates varying from several tens of thousands to half a million victims.

Civil society traditions date back to pre-Soviet times. During the Soviet era, civil society was suppressed and controlled by the party state. However, in recent years, popular acceptance of and individual involvement in civil society each have improved, and the level of civil society participation has overall increased. However, only about 10% of Ukrainian NGOs function on a steady basis. Many civil society organizations depend on support from outside agencies. Legislation, mainly in the field of taxation, continues to be detrimental to the development of civil society organizations. There is only a limited choice of sources from which they can generate income without the risk of losing their nonprofit status. A legacy of distrust – especially on the institutional level – is an impediment to the development of civil society.

Civil society traditions

Even though Ukraine is an ethnically, linguistically and religiously diverse country, ethno-political conflicts are insignificant. None of Ukraine's five major churches constitute a state church. Ukraine has liberal laws regarding religion, which also guarantee freedom of religious practice.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership claims to pursue long-term aims, but these are often superseded by short-term concerns related to political bargaining and office-seeking, regularly resulting in populist measures. Constantly shifting political alliances render prioritization difficult. Therefore, only some of the leadership's long-term goals have been pursued over time, for example EU integration and WTO membership, which are largely uncontroversial among the political leadership. There is no domestic consensus at either the elite or public level on

Prioritization

NATO membership, with public support at just 22%. The Orange parties – OU-SD and BYuT – are in favor, the left opposes NATO membership and the Party of Regions is presently opposed. Similar problems apply to other policy fields such as privatization, which is a bone of contention between the government and the president. Priorities are partly set by external actors which provide financial and other incentives, such as the EU or international lenders.

Although the government is in principle committed to democracy and a market economy, it has had only medium success in implementing its announced reforms. This is partly due to institutional blockades. In addition, the periods between elections are not used productively. Administrative reforms have not been accomplished. Thus, administrations are overstaffed, while employees often go untrained and underpaid. Moreover, public administration suffers from a rather high degree of politicization, with little sense of well-developed professionalism.

Implementation

Although the political leadership has tried to respond to mistakes and failed policies with changes, its policy frequently remains stuck in the same routines. External influence, exercised mainly by the European Union, Russia and the United States, continues to determine policy formulation. The European Union and the United States are also Ukraine's main donors. Recently, there have been two positive examples of policy learning, involving administrative decentralization and the increasingly transparent execution of privatization tenders. However, the former has not yet been implemented, while the latter has not led to more rapid privatizations, and suffered from setbacks in 2008.

Policy learning

15 | Resource Efficiency

The government has used only some of its available resources efficiently. The Ukrainian state remains much too centralized to adequately produce administrative and budgetary alternatives for efficient government action in the regions. Financial autonomy at the local level is limited. There is still a high level of fluctuation of officeholders in the higher political echelons. As a consequence, state action is often linked more closely to special political and economic interests than to the common good. Moreover, recruitment into the civil service does not always follow the principle of merit, but is often determined by politics. The state budget is in deficit, and the social transfers which constitute a large part of government spending are not sufficiently targeted to the poor.

Efficient use of assets

The interpenetration of formal and informal coordination renders coordination in public administration problematic. Policy approaches lack coherence, remaining subject to immediate interests. New institutions are often created, tasked with coordination between various government institutions (ministries, committees or secretariats), but with little effect. Intragovernmental friction was a persistent problem in the period under investigation.

Policy coordination

In 2007, Ukraine placed 118th of 179 countries in Transparency International's Corruption Perception Index; in 2008, it was downgraded to position 134 (of 180). The country lacks strong and clear national policies and a strategic direction against corruption, as well as accompanying programs to increase transparency, strengthen accountability and build integrity. There is no governmental institution empowered to lead anti-corruption efforts in the country. Rhetoric at the highest level about fighting corruption is not translated into a clear message and into deeds.

Anti-corruption
policy

Ukraine remains a classic case of a state in which private interest groups colonize important parts of the state, patronage networks determine the distribution of state resources, and corruption permeates state and administrative culture. During the 2006 and 2007 elections, many business people entered parliament to gain immunity from prosecution. Corruption is sustained by overregulation, which opens opportunities for the extortion of bribes not only for illegal actions but even for timely and proper performance of legitimate services.

16 | Consensus-Building

Since December 2004, the leading political and economic actors have had a basic consensus about general goals, despite frequent government changes and significant political volatility. Market-based economic principles and democratic government as such are not questioned. But these values frequently take a back seat when short-term interests related to power preservation or enhancement are concerned – a tendency that was especially pronounced in 2008. The current government program “Ukrainian Breakthrough: For People not Politicians” provides a medium-term plan for 2008-2012 and focuses on improving the population's living standards. The agenda is extensive, but it lacks prioritization and sequencing of measures.

Consensus on goals

It is essential to distinguish clearly between informal special interests and the introduction of formal regulations in the establishment of democracy and a market economy. A 3% threshold for access to parliament served to exclude some potential veto powers from political representation, and has helped to consolidate the party system. During the period under review, the implementation of reform programs was inconsistent, and often difficult. Some economic interest groups undermine democracy in practice without explicitly fighting or questioning it.

Anti-democratic
veto actors

None of the current social cleavages are mutually reinforcing or irreconcilable, and they do not pose a threat to the state. However, a central challenge for the country is to overcome the sociocultural and sociopolitical cleavages between the different regions, stemming from their different historical experiences and institutional legacies. Varying popular and elite attitudes to democracy, the free market and key issues of foreign policy, often stemming from these cleavages, have inhibited progress or are used as smoke screens to hide specific interests and individual

Cleavage /
conflict
management

ambitions. These cleavages are partly reflected in the party system (with the Party of Regions being especially strong in the east and the south), but to a diminishing degree.

In general, NGOs have little impact on political decisions. The political leadership frequently ignores civil society actors and formulates its policy autonomously. One notable exception was the formulation of the law on gender equality, during which civil society groups were involved. Some scholars or think tanks, which are clearly affiliated with political parties, are consulted more frequently.

Civil society participation

To date, many historical injustices in Ukraine – mostly related to Stalinist or Nazi crimes – have yet to be discussed comprehensively or systematically. The “holodomor,” that is, the famine of 1932–1933 which was induced by man-made causes, and resulted in between three to seven million victims in Ukraine, has become an exception. Although parliament adopted a law on the famine, the Communists and Party of Regions refused to back it. The discussion is directed more at external actors, primarily the other CIS countries, which do not perceive this episode as genocide. The issue also serves as a tool in dissociating Ukraine from its Soviet past. Crimean Tatars and Germans who were forced into exile during the Stalinist period are today allowed to return to Ukraine. A further thorny issue is the role of ethnic Ukrainians in the murder of Ukrainian Jews during the Holocaust.

Reconciliation

17 | International Cooperation

The Ukrainian leadership works with bilateral and multilateral international donors, and tries to make use of international technical and financial assistance. Ukraine receives substantial amounts of aid to improve governance and living standards and ameliorate humanitarian issues. More than 30 donor groups are involved in Ukraine. The European Union is the largest donor to Ukraine, but the country is also one of the major recipients of assistance from the United States. Several United Nations organizations are present in Ukraine, including the United Nations Development Program (UNDP), the United Nations High Commissioner for Refugees (UNHCR) and the International Organization for Migration (IOM). Moreover, Ukraine cooperates closely with and profits from financial assistance from the IMF, the World Bank and the European Bank for Reconstruction and Development (EBRD). External assistance to Ukraine was around \$1.5 billion in 2006, one third of which was technical assistance. Even though Ukraine is a signatory to the Paris Declaration on Aid Effectiveness, aid coordination is weakly developed and harmonization with its own reform agenda is insufficient. In view of the expected change to more direct financial support, the government lacks the strategy, programming, public financial management, procurement, monitoring and

Effective use of support

coordination capacities together with a suitable institutional arrangement. Effectiveness of foreign aid is measured only by donors, not by Ukrainian authorities.

Ukraine's geopolitical situation and energy dependency compel it to perform a balancing act in its foreign policy, and it often appears indecisive as to its strategic aims. After the Orange Revolution, the will for swift integration with Western institutions seemed beyond doubt. However, there have been some setbacks, mainly due to failed internal reforms in Ukraine. As long as the political crisis continues, Ukraine does not appear to be a fully reliable partner, and serious negotiations have been discontinued. In addition, there are some caveats with regard to the reform process. Many political decisions seem to be donor-driven or compelled by conditionality set by international organizations such as the European Union, the World Bank or the IMF.

Credibility

Ukraine declared its intention to seek NATO membership in 2002. Only after Yushchenko's election did this translate into NATO upgrading Ukraine to the status of intensified dialogue on partnership. Ukraine was set to be invited into a Membership Action Plan at the 2006 NATO summit, but since then, domestic political developments in Ukraine have blocked this step. In 2007, Ukraine started negotiations on an Association Agreement with the European Union, which will replace the 1994 Partnership and Cooperation Agreement.

Ukraine has concluded good neighborhood agreements with all of its adjacent states. Ukraine is a member of the Commonwealth of Independent States (CIS) as well as the GUAM (Georgia, Ukraine, Azerbaijan, Moldova) Organization for Democracy and Economic Development, but these organizations are not very active and integration is superficial. Relations with Russia have so far been dominated by the Kremlin's attempts to influence Ukraine's domestic agenda. Controversial issues include the continuation of the leasing agreement for the Black Sea Fleet in Crimea after 2017, Ukraine's energy dependency and Ukraine's desire for NATO membership, which is unacceptable for Russia.

Regional
cooperation

Moreover, Ukraine has been cooperating with many Western neighboring states – first and foremost Poland – with the aim of strengthening its integration into Euro-Atlantic structures. There are also cross-border projects with Poland, Hungary and Romania, mainly within the framework of the European Neighborhood Policy.

Strategic Outlook

Recent political and economic developments in Ukraine have been unsatisfactory. The constitutional and political crises in 2007 and 2008 paralyzed the legislative and political process, though a new coalition was formed on 16 December 2008 and the government survived a vote of no confidence in February 2009. It is not clear how long this coalition will continue and what it will be able to accomplish. Presidential elections are scheduled for early 2010. Almost certainly, Yushchenko, Tymoshenko and Yanukovych will run for office. All political projects and most urgent reform measures will fall hostage to the electoral campaign and related strategies. The global financial crisis revealed many structural imbalances as well as missed chances. The Ukrainian economy is expected to shrink further in 2009 and 2010 before a recovery. There is a danger of Ukraine not being able to repay its external debt due to declining tax revenues and rising expenditures in the social sphere. The economic crisis in turn influences the political situation. On the one hand, it compels the opposing forces to cooperate, but on the other, the crisis is used as an additional argument in the political battle. The economic decline is bound to put pressure on vulnerable groups. Ukraine's population will continue to decline, with the average age rising. EU and NATO harmonization will continue, possibly at a somewhat slower pace. Energy dependency will remain one of the most crucial factors determining economic development.

Ukraine's continued transformation strategy should focus on the following issues:

- **Politics:** The contradictions and ambiguities created by the 2004 constitutional changes must be corrected as soon as possible. This will be difficult, as the president and entrenched interests in the government will try to change the constitution in accordance with their personal interests. Decentralization should be implemented as soon as possible to improve the delivery of services to citizens.
- **Economy:** Diversification of the economy is necessary to reduce Ukraine's vulnerability to external (trade) shocks and to reap higher revenues. Resource and energy efficiency could be improved, as there is high potential for more efficient use in industry and private households. The government should pursue an active labor market policy that takes into consideration the currently idle human and intellectual resources. Moreover, it should invest in human capital.
- **International Relations:** Ukraine should continue with its process of EU harmonization, especially with regard to free trade and the free movement of people. Ukraine should work seriously toward the projected association agreement. To attract additional funds and programs and to ensure a more efficient and effective use of external assistance, Ukraine should in addition develop a more coherent external assistance coordination system.

- Social sphere: The government should protect disadvantaged people according to their individual needs, by improving the targeting of the social security system. The HIV/AIDS epidemic needs to be addressed more seriously. More public awareness campaigns are necessary, as prevention seems to be the only way of slowing the spread of the disease.