

BTI 2008 | Ukraine Country Report

Status Index	1-10	6.93	# 35 of 125	
Democracy	1-10	7.35	# 35 of 125	➔
Market Economy	1-10	6.50	# 46 of 125	➔
Management Index	1-10	5.25	# 55 of 125	

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

This report is part of the Bertelsmann Transformation Index (BTI) 2008. 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 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	47.1	HDI	0.77	GDP p.c.	\$	6,093
Pop. growth ¹	% p.a.	-0.8	HDI rank of 177	77	Gini Index		28.1
Life expectancy	years	68	UN Education Index	0.94	Poverty ³	%	4.9
Urban population	%	67.8	Gender equality ²	0.46	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Viktor Yushchenko's inauguration as president on 23 January 2005 as well as the parliamentary approval of Yulia Tymoshenko's candidature as prime minister in February 2005 marked a significant shift in power. Indeed, a turnaround in Ukrainian politics – toward more democracy, transparency and accountability of politicians as well as socioeconomic change – seemed imminent. So far, only some of these promising initial opportunities have been seized. Opinion polls since point to growing disillusionment among the public as has the victory of the Party of Regions, led by Viktor Yanukovych (the Kuchma regime's presidential candidate in 2004) in the parliamentary elections in March 2006.

In the long term, the Orange Revolution will carry the legacy of having spurred political change. On 8 December 2004, constitutional amendments were decided upon that took effect on 1 January 2006, essentially establishing a parliamentary-presidential system. The most important amendments are discussed below.

According to the new constitution, a new government is formed after parliamentary (not presidential) elections, within 60 days after the former government has retired. Within one month after the elections, the Verkhovna Rada (the Ukrainian parliament) 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 ministers of defense and foreign affairs. The legislative period of the Verkhovna Rada is extended from four to five years. The election is based completely on proportional representation by party lists. Whether all of the major political actors in Ukraine will accept and internalize the new rules is less clear. This holds true for both the political survivors from the Kuchma era and the supporters of

the Orange Revolution. From the very beginning, Tymoshenko's government suffered from internal disunity and divergent policy prescriptions, especially on economic issues. Institutional competition flared between the presidential secretariat and the government and the Council of National Security and Defense, which were led by rival politicians. The actions taken to rectify the "fraudulent" privatization auctions in 2004, during which Yanukovich's allies had received valuable economic assets for a bargain price, was perhaps the most critical issue. 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 only with the support of Viktor 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 at the beginning of 2006.

Many expected and announced reforms have not yet taken place and the battle lines between the different political groupings have once again become blurred. The developments in fall 2005 – the dismissal of Yulia Tymoshenko and the election of Yuri Yekhanurov as Prime Minister – prove that the new leadership has also retreated to political tactics that had been characteristic to the Kuchma regime, if in a milder form.

The parliamentary elections on 26 March 2006 changed the situation significantly. The Party of Regions emerged as the winner (32.14% of the votes and 186 parliamentary seats), while the "orange" parties fared less well. The Bloc Yulia Tymoshenko received 22.29% of the votes and 129 seats; Viktor Yushchenko's Our Ukraine received 13.95% of the votes and 81 seats. The Socialist Party came in fourth with 5.69% of the votes and 33 seats, while the Communist Party won 3.66% of the votes and 21 seats. No other parties overcame the 3% threshold. All 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. The new coalition nominated Viktor Yanukovich as Prime Minister, while the leader of 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. In April 2007, Yushchenko dissolved the parliament, marking the beginning of a new political and constitutional crisis. After negotiations between Yushchenko and Yanukovich, early parliamentary elections were scheduled for September 30, 2007.

The announced administrative reforms have not yet materialized: the governors continue to be subordinate to the presidential administration and the appointment and political loyalty to the president seems to determine job stability. Socioeconomic development during the period under review showed fairly positive results as poverty was reduced and cash incomes increased. But structural imbalances, that is, the gap between the rich and the poor, remain pronounced. GDP and investment growth

decelerated, but there are rather positive signs for future growth, which need to be supported by further legislative changes and clarifications.

The most positive developments took place with regard to civil society and the media, which were able to flourish more independently from state influence, even though they have little noticeable influence on politics. In sum, for the period under review, developments in Ukraine reveal a mixed picture: on the one hand, there are positive signs of change toward a full-fledged democracy; on the other, troublesome trends that reveal deep-rooted traits of the Kuchma era persist.

History and Characteristics of Transformation

The course of Ukrainian transformation after independence (1991) was to a great extent determined by old nomenklatura elite groups. They shaped the new institutional framework according to their interests, such that Soviet institutional legacies were translated into corresponding forms of state-building. This also led to the relinquishment of a conflict-laden economic policy, avoiding hardships for all kinds of groups and influential actors, and to the inability for collective action. At the same time, new opportunities for individual and group-wise enrichment emerged and were seized. The economic reform policies provide an example of this: they established ample opportunity for rent-seeking, the prolongation and mutation of which were partially sustained by international support. International aid and implicit Russian subsidies (energy supply) played a particularly significant role until about 2000.

Thus, many nomenklatura members kept their positions in the state administration and the economy. When the command structures of the state and the party broke down, informal groups and networks were ready to step into the vacated space. In this situation, the central challenge was to build an independent national bureaucratic apparatus with the necessary regulative capacity. In addition, the new state had to integrate the heterogeneous regions and to gain control over them. State-building meant the creation of state capacity by drawing clear lines between the public and the private as institutionally distinct spheres. The latter was achieved only to a small extent. Instead, personal networks cut across different domains and dominate legal rules.

In the 1994 presidential elections, Leonid Kuchma defeated the incumbent Leonid Kravchuk. The division of power between the president and parliament remained unresolved until a new constitution was adopted in 1996. From 1996 until the end of 2005, Ukraine was formally a semi-presidential system. The president was directly elected for five years. He was the head of state, but not the head of the government. Nevertheless, he influenced the activities of all executive structures and could obstruct laws by a suspensive veto. The president used the so-called “telephone rule”

extensively to circumvent the legislature. He could regulate many fields of executive power by decree, a capacity that Kuchma (1994 – 2004) used liberally. Conflict arose between members of the administration who purported to back reforms and the parliament, which was portrayed as impeding reforms. This conflict was less about ideological cleavages than power politics and rent-seeking.

Kuchma's second term (1999 – 2004) was characterized by increasing authoritarian tendencies and the informalization of power relations. The president controlled the so-called power ministries (esp. of the interior, defense, and secret service). In addition, he appointed and dismissed the heads of the oblast' state administrations: the so-called governors, as well as the heads of the security, law enforcement and tax administrations without parliamentary control and without any accountability. The state was too weak to enforce rules and increasingly became subject to state capture.

Under Prime Minister Viktor Yushchenko (1999 – 2001) new structural reforms and favorable external economic conditions contributed to real GDP growth and halted the economic decline. Formal reform measures, however, were negatively received by interest groups, seriously hampering the sustainability of the changes. In 2004, the upcoming presidential election delayed further reform. Until 2004, an apparent problem of the Ukrainian opposition was the antagonism between its subgroups, which impaired collective action and the pursuit of democratization. Nevertheless, various protests against the Kuchma regime galvanized a set of opposition movements determined to (temporarily) unite against the regime, and served as an organizational preparation for the Orange Revolution.

Ukraine has conducted a balanced foreign policy between Russia and the West. The Russian-Ukrainian agreement on the division of the Black Sea fleet in July 1997 and the Russian-Ukrainian friendship treaty were milestones in the relations between the neighboring countries. At the same time, the government drew closer to NATO and the European Union. The European Union's 2004 eastern enlargement drew a new dividing line in Europe. Ukraine's request for prospective EU membership was rebuffed by the European Commission. Meanwhile, Russian President Vladimir Putin tried to influence the 2004 presidential elections by supporting Viktor Yanukovich. Socioeconomic development in Ukraine was disastrous until about 2000. A severe decline in production and living standards dominated the 1990s. In 1998, industrial production reached only about 40% of 1990 production levels and agricultural production reached only half of its capacity. During the Russian financial and economic crisis of August 1998, the Ukrainian economy hit rock bottom as well. Since 2000, the economy has been recovering from this downward trend. GDP rose by 12.1% in 2004, while industrial production increased by 12.5%. Despite this macroeconomic success, structural reforms remain overdue. Freedom of expression was severely constrained until the Orange Revolution. State and self-censorship as well as harassment of critical journalists were common.

Transformation Status

I. Democracy

After the end of the Kuchma regime, the Ukrainian political system changed significantly. On 8 December 2004, constitutional changes were decided upon, which came into effect on 1 January 2006, establishing a parliamentary-presidential system. During the period under review, democracy as such has consolidated and political actors adhered for the most part to the established democratic rules. Occasionally, the political elite continues to play with the rules instead of by the rules. But they do not question democracy as such. Yet with the implementation of the constitutional changes, new institutional blockades and power struggles have emerged, hampering the pace of reforms and leading to the 2007 constitutional crisis. The Council of Europe's Venice Commission issued a resolution in 2005 outlining ways to improve the hastily adopted reforms, but the recommendations were ignored.

1 | Stateness

The state monopoly on the use of force is in place. There are no territorial enclaves not penetrated by the state. The Donbas region is a partial exception where a nexus of local business actors, the regional administration and the Party of Regions operates like an autonomously managed democracy. Furthermore, state power is partially impaired by the power of interest groups, even though this influence is currently channeled into the established democratic framework to a greater extent than before. 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

All citizens enjoy the same civil rights. In 1991, every person residing in Ukraine was entitled to Ukrainian citizenship, regardless of nationality. After the law was changed in 1997, citizenship was also granted to stateless ethnic Ukrainians living outside Ukraine and to groups that were deported during the Soviet era (mainly Crimean Tatars and Germans). 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

State identity

have returned to Crimea to claim their right to Ukrainian citizenship, but they continue to face legal and financial difficulties.

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. There are five major churches in Ukraine: the Ukrainian Orthodox Church (Moscow Patriarchate); the Ukrainian Orthodox Church (Kyivan Patriarchate); the Ukrainian Autocephalous Orthodox Church and two Catholic churches (Greek and Roman Catholic). None of these churches 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.

No interference
of religious
dogmas

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 re-invigoration of the central executive force as a means of holding the country together. However, there have never been any serious and publicly supported separatist challenges, with the exception of the Crimean Peninsula in the first half of the 1990s. Administratively, Ukraine is divided into 24 oblasts (provinces), the Autonomous Republic of Crimea and the cities of Kiev and Sevastopol. Each oblast is divided into raions (districts). Bigger cities enjoy the same status as raions; rural raions are subdivided into towns and villages. Accordingly, there are four tiers of government: national, oblast, raion/city and municipal. At the municipal level, mayors are publicly elected while the heads of oblast and raion administrations are centrally appointed. Dependence on the center is reinforced by the system of budget formation. Despite reform discussions and efforts, lower-level budgets are dependent on higher-level budgets, a system often referred to as "budgetary matryoshka." Moreover, budget formation continues to be characterized by instability and a lack of transparency, so that the formal political autonomy of municipal authorities becomes a farce. Publicly elected bodies (parliaments) at oblast and raion levels are less relevant as they have few competencies and do not possess their own executive bodies, which make them dependent on the respective state administrations.

Basic
administration

2 | Political Participation

The distribution of political offices takes place through general and free elections; elections are widely accepted as the method of filling leadership positions. However, the second round of the presidential elections of 21 November 2004 was assessed as the most fraudulent in the history of independent Ukraine, by both domestic and international observers. According to national and international assessments, the latest election (parliamentary elections on the national, regional and local level as well as mayoral elections on March 26, 2006) was almost free of constraints on the freedom and fairness of the election process. With the changes in electoral law, the 2006 parliamentary elections took place according to proportional representation, enhancing the role and importance of political parties. This legal change might diminish the role of local bosses who formerly took hold of single-mandate districts. Despite meeting the formal requirements for free and fair elections, the 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

As a result of the presidential election of 2004, elected rulers have the power to govern, but lobbyists (mainly heads of newly emerged 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, the veto players can be found in parliament and within the public administration. Currently, competing interests are partially reflected in institutional duplication, i.e. several administrative units with similar (formal) tasks that compete for decision-making power, for example between the presidential administration and single ministries. The undefined relations between the institutions of the presidency, government and parliament cause frictions. The veto powers repeatedly try to instrumentalize the formal system and undermine it without questioning the system as such.

Effective power to govern

During the period under review, the rights of political organization and assembly have been respected. However, rights are often declarative only and lack supporting legislation and enforcement due to a lack of funding.

Association / assembly rights

The freedom of expression has improved considerably since 21 November 2004, both with regard to individuals and the media. The media coverage of the repeated second round of the presidential elections was significantly more balanced, giving citizens access to a plurality of positions. The administrative guidelines on media content (temnyki) that were previously sent by the presidential administration to media outlets instructing them on what to cover, what to ignore and how to cover events became a thing of the past. There was no obvious state censorship in 2005 and 2006 and the space for public political

Freedom of expression

debate has increased. Property relations in many media outlets have changed, leading to a broader distribution. In television, property relations have remained more or less the same. Furthermore, the resistance of journalists against detailed influence of owners and state authorities has increased. 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 industrial groups, which perceive media less as a business than a political instrument. The announced introduction of a public television has not been accomplished. Moreover, the murder of Heorhiy Gongadze (2000) is unlikely ever to be fully solved even though the Council of Europe has repeatedly called for progress. The organizers of the murder received immunity from prosecution during the December 2004 round-table negotiations (Kuchma), fled abroad or committed suicide. Three lower-ranking policemen are on trial. At the regional level, there continue to be single attacks on journalists. The main limitation to this generally positive development is that the easing of state control over the media lacks a solid legal basis.

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. Until the constitutional reforms following the Orange Revolution, the president enjoyed much formal and informal power that could not be checked by other institutions. In addition, power was often informal and distributed among groups and actors that bypassed the formal separation of spheres. Thus, personal and group interests often prevailed over the application of rules and the formal institutional differentiation. In 2002, Kuchma had started a debate about redistributing power from the president to the parliament. As this was a political move to weaken a possible successor, the project was not translated into political action. But it became part of the political compromise in December 2004, bringing about the constitutional changes that became effective on 1 January 2006. While they have proved to be advantageous on the whole (integrating many different political actors in the political system and bestowing them with responsibility), they are not flawless. 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 the governors is a case in point.

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. This practice was discontinued in 2006. The Prosecutor General is responsible for the control/monitoring of human rights, including the compliance of the executive organs. This contradicts the rule of law and the separation of powers. The 2007 political crisis shows that the 2006 constitution is flawed, as it does not clearly delineate powers between the government and the president. The Constitutional Court has not yet solved this problem, so power struggles between the different actors continue.

The constitution stipulates the principal make-up 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) as well as 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. It has displayed a well-balanced position and played a crucial role in resolving conflicts during the 2004 presidential elections.

Independent
judiciary

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 are 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. In addition, constantly changing laws (both related to interest politics and the necessity to adapt to international standards and EU law) impair jurisdiction. The 18 judges of the Constitutional Court are appointed in equal shares by the Verkhovna Rada and the president. The Constitutional Court, which has built a reputation as a largely effective and impartial authority on issues related to constitutionality and official interpretation of legislation, has been paralyzed and unable to perform its functions since October 2005. Only five of the eighteen positions on the Court were filled, which was insufficient to constitute a quorum for either instituting new proceedings or adjudicating pending cases. The president and the Congress of Judges promptly appointed nine additional justices, but the parliament, in order to prevent the examination of the constitutional changes, refused to conduct a mandatory swearing-in ceremony for these justices. The Constitutional Court remained paralyzed until August 2006 when it began to work, but it made no rulings from August 2006 until the 2007 constitutional crisis, wherein the Court lost its credibility.

One of President Yushchenko's declared top priorities was to prevent future abuse of power. In reality, those responsible for the falsifications during the 2004 presidential elections remained exempt from investigations and possible punishment. No high profile case was brought to court. In September 2005, for the purpose of power preservation, Yushchenko and Yanukovich signed an agreement granting amnesty to the perpetrators of electoral fraud. During the 2006 elections, most of them managed to become members of parliament, either at the national, regional or local level and thus to gain immunity from prosecution. The substantial number of anti-corruption regulations and programs have not taken a systematic approach or articulated an overall long-term strategy. Different state agencies have a legal mandate to fight corruption, but they are not sufficiently protected from political interference. After the Orange Revolution, corruption scandals were publicly exposed, but not accompanied by changes in structural incentives or legal guidelines to regulate the private interests of public servants. Only lower ranking officials have been put on trial. The only senior Ukrainian official charged with abuse of office is jailed in the United States (former Prime Minister Pavlo Lazarenko); no senior officials have ever been charged in Ukraine.

Prosecution of
office abuse

Until 2005, serious civil rights violations occurred frequently: murders, attacks and the intimidation of journalists, parliamentarians, members of the political opposition and rival trade union representatives. The success of the free and fair presidential election on 26 December 2004 was an important step toward ending the former restrictions of civil rights in Ukraine.

Civil rights

In the period under review, civil liberties have by and large been respected, even 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 the Crimean Tatars. 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 and medical care in prisons.

In addition, there has been a rise in xenophobic violence since 2005, against migrants, refugees and Jewish establishments. Though such outbursts have been few, that they did not meet with sharp reactions from the political leadership is unsettling. 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. There has been little continuity in personnel even after the Orange Revolution. 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 repeatedly been linked to massive insecurity regarding the continuation and direction of reforms. Decentralization has not proceeded far even though President Yushchenko made it one of his political priorities. National and local authorities tend to block each other's decisions.

Performance of
democratic
institutions

At present, all influential political actors accept the democratic institutions and regard them generally as legitimate. But time and again, politicians and interest groups re-open the discussion on political and constitutional rules. For example, the constitutional changes agreed upon during the Orange Revolution and which came into force on 1 January 2006 have been questioned. In October 2005, the Constitutional Court had ruled that the reforms should be put to a referendum. President Yushchenko took up that argument in 2007.

Commitment to
democratic
institutions

5 | Political and Social Integration

Until 2004, the party system in Ukraine was seriously fragmented and split between those in the president's camp and those who opposed him. Even after the latest parliamentary elections in March 2006, the party system remains poorly developed, and with the exception of the Communist Party, there is a lack of clear programmatic differentiation between the party platforms. The 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. Currently, the political landscape is characterized by five major parties or blocs, but a three-party system appears to be emerging, composed of two Orange parties, (Bloc Yulia Tymoshenko and Our Ukraine–People's Self-Defense Bloc (headed by Lutsenko) Bloc Yulia Tymoshenko and Our Ukraine–People's Self-Defense Bloc (headed by Lutsenko), and the centrist Party of Regions. Since the 2004 presidential and 2006 parliamentary elections, 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

Party system

credibility. The Verkhovna Rada is a unicameral body, consisting of 450 deputies elected for a four-year term. In 1990 and 1994, they were elected in single mandate districts on a pure majority formula. The 1998 and 2002 elections took place according to the 1997 election law, which foresaw that half of the members of parliament would be elected from party lists. The March 2006 elections were based completely on proportional representation by party lists. In addition, many parties did not overcome the 3% threshold. Due to proportional representation, the present parliament comprises five parties and no more independent candidates, a factor that has contributed to the stabilization of the party system. The banning of defections from factions remains a controversial issue and was a primary factor behind President Yushchenko's April 2007 decree disbanding parliament. The 2006 elections were fully proportional and deputies were not elected individually but from party lists. According to opinion polls, the September 2007 elections will hardly change the composition of the parliament. On the whole, the battle lines between parties remain blurred and change frequently, driven by power interests rather than ideology.

Regardless of the change in power, the political elite shows 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 often access to government information is poor.

Interest groups

The network of interest groups is relatively close-knit, but their possibilities for influence are very unequal. Only 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. Yushchenko has gathered oligarchic allies, including the Industrial Union of Donbas (Hayduk, Chaly), Pryvat (Ihor Kolomoyskyi) and Interpipe (Viktor Pinchuk). The industrialists from Dnipropetrovsk are no longer represented in parliament, as the Labor Ukraine party collapsed after the Orange Revolution and Viktor Pinchuk and Serhiy Tyhipko left politics. At the same time, the Party of Regions entered politics for the first time with the support of oligarchs, including Rinat Akhmetov, Ukraine's richest businessman.

Other societal interests are less well represented. Independent trade unions are weak and partly reliant on Western support while the transformed Soviet trade unions coalesce 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 serving the purpose of

controlling citizen action and complementing budget resources. Ethnic, national and religious mobilization has not played a 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. The human rights respondents attached most importance to social rights, while political rights were mentioned less often. In addition, there was a strong correlation between the assessment of the economic situation and of democratization in Ukraine. The events surrounding the 2004 presidential elections marked a significant (10%) rise in the public's interest in political issues. Institutions that played key roles in the events following the invalid November 21 presidential election saw their public standing receive a significant boost. In February 2005, more respondents said that they had more positive impressions of the Verkhovna Rada, the judicial system, the media and NGOs than before. But the euphoria from the Orange Revolution evaporated: In November 2005, more respondents than not believed that the socio-political situation in the country had degraded since 2004. This is a clear sign that the new government did not meet the population's expectations with regard to socioeconomic development, public welfare and the rule of law. The population's expectations of the government remained the same: reduce unemployment, improve quality of health care and pension payments. In November 2005, 26% of respondents said that Ukraine was a democracy, compared to 50% who said that it was not. About a quarter of the respondents stated that ordinary Ukrainians can influence political decision-making. Trust in national institutions and leaders declined in late 2005, returning to Kuchma-era lows in 2006/2007. The share of respondents expressing a great deal or fair amount of trust in the president fell from 65% to 46% in November 2005. Trust also decreased for the Verkhovna Rada, from 54% to 37%. On the other hand, the experience of the Orange Revolution did not lead to negative attitudes towards public actions: 68% of the respondents disagreed with the statement that greater political involvement by the citizens leads to chaos and instability, while only 13% agreed. To sum up, many people are disillusioned with the results of the Ukrainian democratic system, but they do not disagree with the system as such.

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 self-organizations. But often, social and political integration does not take place via the aggregation and representation of (societal) interests, but by the integration of people into vertical clientelist networks. These are hard to dissolve, especially in the countryside and in mono-industrial towns where people depend on local economic leaders for their socioeconomic wellbeing. Many self-help initiatives have a local character and are directed

Associational
activities

towards short-term goals, and often disintegrate after the attainment of those goals. Many NGOs depend on external funding by international organizations, (private) charity organizations, or international projects related to technical assistance. In this sphere, the legacy of the Soviet era remains strong: trust is often confined to immediate family and friends. Thus, social capital in a wider sense remains weak and was repeatedly undermined by state action during the Kuchma regime.

II. Market Economy

Oligarchic capitalism developed in the second half of the 1990s. Large-scale privatizations in 2003-2004 – before the presidential elections – strengthened this trend even further. Starting in 2005, the government attempted to subordinate these 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 (partly a legacy of Soviet industrialization policy, which had favored heavy industry), which became even more pronounced during the transformation crisis. While light industry was negligible in the late 1990s it has improved considerably (both in quantitative and qualitative terms) 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.

6 | Level of Socioeconomic Development

Ukraine records rather high income inequalities and widespread poverty, reflected by Gini index ratings of 28.1 and 29. The results of the transformation include the growing segregation of rich and poor in society, the decline in life expectancy by an average of two years, and a growing percentage of the population living below the poverty line. According to national statistics, this percentage was 27.3% in 2004, but based on the international poverty line established by European Bank for Reconstruction and Development (EBRD), 45.7% of the Ukrainian population lived in poverty in 2002. According to opinion polls, about half of the Ukrainian population considered themselves poor. The UNDP gender-related Development Index (GDI) with a level of 0.773 in 2004 shows that Ukraine is below the medium development level. Social exclusion is quite pronounced, both qualitatively and quantitatively. The exclusion is structurally reinforced by the massive influence of interest groups. Because of the large share of the shadow economy there is a serious underreporting of household incomes in official statistics. In addition, many Ukrainian families – both in rural and urban areas –

Socioeconomic
barriers

grow their own vegetables and fruit. But in the period under investigation, the share of in-kind income has decreased, while the share of cash income has increased. Poverty is mostly caused by unemployment and increases in proportion to the number of children in a family. During the last years, the once substantive pension and wage arrears – both in state and private companies – have decreased. Remittances are becoming an increasingly important factor in the Ukraine economy, both from within Ukraine and abroad. But they tend to benefit the urban middle class. During the last three years, pensions and minimum wages have been raised. These were largely populist measures taken before presidential and parliamentary elections. Poverty reduction started in 2001, when economic growth began to benefit the poor. Poverty is increasingly a rural phenomenon.

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	42,393	50,133	64,828	82,876
Growth of GDP	%	5.2	9.4	12.1	2.6
Inflation (CPI)	%	0.8	5.2	9	13.5
Unemployment	%	9.4	8.9	8.6	-
Foreign direct investment	% of GDP	1.6	2.8	2.7	9.4
Export growth	%	9.1	10.3	13.8	-11.2
Import growth	%	3.7	16.4	8.6	2.1
Current account balance	\$ mn.	3174.0	2891.0	6909.0	2531.0
Public debt	\$ mn.	8,272.1	8,890.9	10,589.5	10,458.4
External debt	\$ mn.	21,714.4	23,991.4	30,185.5	33,297.2
External debt service	% of GNI	8.3	7.9	7.2	7.2
Cash surplus or deficit	% of GDP	0.3	-0.2	-3.2	-1.4
Tax Revenue	% of GDP	13.1	13.7	13.3	17.8
Government consumption	% of GDP	18.4	19.0	18.1	19.4
Public expnd. on edu.	% of GDP	5.4	5.6	5.3	6.4
Public expnd. on health	% of GDP	3.3	3.7	3.7	-
R&D expenditure	% of GDP	1.2	-	-	-
Military expenditure	% of GDP	2.8	2.9	2.6	2.4

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | 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 controls over consumer prices were eliminated in 1994, and most other prices as well, with the exception of key sectors such as bread and other selected other food products, energy prices and rent subsidies. However, inconsistent legislation, anti-competitive practices and widespread corruption still thwart progress. Extensive 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 is 52.2% of GNI (2003), while national authorities rate it at 34% of GDP (2004). Moreover, a large share of barter transactions reduced transparency and the possibility for taxation. With regard to the regulative framework, some progress was made – but there have also been some setbacks. In 2005, the Ukrainian government intervened in price formation for meat and gasoline, grossly distorting the market and causing shortages. In 2005, the special economic zones and various tax benefits were terminated, but the zones were reinstated in late 2006. Foreign investors are entitled to repatriate profit, income or other funds relating to investments without any restrictions, after the payment of applicable taxes. Market entry barriers for small companies have been reduced. The number of permits and licenses that are necessary for many kinds of economic activity (61 at the end of 2005) was reduced in 2006. One-stop permit centers have been established, but do not yet function as desired. In some economic spheres – especially heavy industry – strong vertical integration of production chains does not allow for market entry of new companies.

Market-based
competition

Rules and appropriate procedures, as well as the institutional framework, have been established. The Anti-Monopoly Committee, established in 1994, has been vigilant in monitoring abuse of market power and preventing unfair competition. But the rules of the game are not consistently enforced and are not strongly oriented toward principles of a market economy. The state has lacked a unified approach to the reformation of the economy in general, and to the problems of the development of competition in particular, which results in inequality for market participants. The formation of monopolies and oligopolies is not regulated consistently. In addition, the actions of different state organs were not synchronized.

Anti-monopoly
policy

According to the State Statistics Committee, Ukraine's foreign trade balance in 2004 was favorable, with a surplus of \$3.7 billion; in 2006 it was negative. After

Liberalization of
foreign trade

EU enlargement, the EU-25 became Ukraine's largest foreign trade partner, comprising 31% of total commodity trade turnover. Russia remained Ukraine's biggest single country trading partner, accounting for 18.0% of Ukraine's exports and 41% of imports. Ferrous metals and products dominate Ukraine's exports at almost 40%. In addition, trade is restricted by frequent changes in ratification and customs processes. In 2005 and 2006, the European Union and the United States granted market economy status to Ukraine. In addition, the U.S. Congress graduated Ukraine from the Jackson-Vanick amendment. The market economy status will help Ukraine defend itself from accusations of the illegal dumping of cheap products in the EU and U.S. markets, which have led to costly punitive damages. WTO accession was expected for 2005 and then for 2006, but had to be postponed until 2007 due to internal political frictions. So far, Ukraine fulfills most of the demands, but cannot yet accede to membership. Most laws have been brought into line with WTO requirements and most bilateral agreements have been concluded. In 2005, many tariff barriers were eliminated. Imports grew stronger than exports. After WTO accession, the European Union will start negotiating a free trade regime.

Ukraine's financial sector is rather small and its capital markets remain vastly underdeveloped. But some positive developments could be observed in the period under review. A growing industry demands and will demand more capital. In 2005, the market grew further. Market capitalization doubled (compared to 2004) and reached about 35% of GDP. The banking system is very fragmented, with about 170 operating banks, many of which are financially weak. 35 banks have foreign capital, 13 banks are under complete foreign ownership. From 2005 to 2006 the share of foreign banks in the balance sheet total grew from 13% to 26%. The share of nonperforming loans in 2005 was officially 25%, although in reality it might be less. The capital profitability of Ukrainian banks rose from 8.43% (2005) to 10.4% (end of 2006). In 2001, the National Bank raised the minimum capital requirements. Nevertheless, there was a slight deterioration in capitalization in 2005 and 2006. In 2005, the amount of credits to companies increased by 41%, which seems to be a persistent trend. The same applies to credits for private households. The rise is financed mainly by the growth of deposits, but also by increasing debts of Ukrainian banks on international capital markets. In addition, large companies take credits on international markets. There are close ties between the Ukrainian banking and corporate sectors. Several banks serve as pocket banks of large conglomerates. There is substantial cross-subsidization within (formal and informal) financial industrial groups, such that the budget constraints in many conglomerates remain soft. A considerable part of trading in shares (80%) takes place outside the regulated market.

Banking system

8 | Currency and Price Stability

After hyperinflation in the 1990s, the Ukrainian currency (hryvnia) was stabilized. The strict currency policy of the national bank and successful management of the external debt-service obligations implemented by the Cabinet of Ministers facilitated the stability of hryvnia. The country moved to a de jure openly floating exchange rate in 2000 – 2004. However, the hryvnia-U.S. dollar exchange rate was closely monitored by the National Bank, which constantly intervened in the market by buying U.S. dollars and thus keeping the exchange rate fixed in reality. External shocks and irresponsible fiscal policy in the second half of 2004 caused CPI to increase to 12.3%. In 2005 and 2006 the inflation rate was about 10%. The state realized relatively high budget revenues in 2005 due to improved tax collection and to privatization receipts. At the same time, populist measures were taken both before the presidential elections in 2004 and the parliamentary elections in 2006, which mainly targeted the elderly population by raising pensions. In general, a large amount of budget spending is targeted to the social sphere.

Anti-inflation /
forex policy

The gross foreign debt of Ukraine (2005) increased by \$8.2 million (26.6%) and as of January 1, 2006, amounted to \$38.8 billion (47.4% of GDP), mostly due to an increase in private debt. Ukraine's foreign currency reserves amount to about \$22 billion. There is a policy of "stability culture," but it has no institutional safeguards for the future.

Macrostability

9 | Private Property

The Ukrainian constitution guarantees the right to private property. In addition, with new basic legislation effective since the beginning of 2002, the opportunity to purchase non-agricultural private land exists. Although property rights are formally guaranteed, their implementation will remain problematic as long as the executive and judicial branches do not succeed in implementing property rights and property protection efficiently in practice. The new Civil Code and Commercial Code that went into effect at the beginning of 2004 should clarify basic property rights, but the codes contain inconsistencies.

Property rights

In 2005, the private sector's share of GDP was 65 %. Since the mid 1990s, different types of privatization were applied. Mass privatization was only effective in the SME sector. During the 1990s, numerous enterprises remained exempt from privatization. After 1999, many large companies were sold in auctions. Due to flawed procedures and favoritism, many of them were sold under price 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

Private
enterprise

“reprivatize” a large number of companies, which had been privatized during the Kuchma era (sometimes under favorable conditions) to politically influential people and financial industrial groups, caused serious doubts about the government’s determination to respect property rights. It also compounded investor uncertainty and dampened economic growth rates. President Yushchenko has continued to review the Soviet era privatizations and has approved the resale of the Kryvorizhstal steel complex, one of the largest privatization deals in the Former Soviet Union, for \$4.8 billion to Netherlands-based Mittal Steel Co. With the agreement between President Yushchenko and then opposition leader Viktor Yanukovich in fall 2005, further plans for “reprivatization” were abandoned. In 2006 the intended number of privatizations and related budget revenues could not be achieved, as the revenues amounted to only 20% of the planned amount.

10 | Welfare Regime

The economic crisis in the early 1990s led to the collapse of the social security system, and thus to an increase in social problems. According to the UNDP Human Development Report 2006, the HDI for Ukraine is 0.774, which gives Ukraine a rank of 77th out of 177 countries, while its GDI is 0.771 (both numbers are for 2004). Ukraine’s position has remained rather stable. Currently, most budget funds are allocated to numerous in-kind social privileges, such as discounted payments for utility services and housing, fuel and gas, electricity, transportation, setting and use of fixed phone lines, purchase of certain drugs, sanatorium treatments, etc. Among those entitled for such social assistance are pensioners, labor and war veterans and their families and persons directly affected by the Chernobyl catastrophe. Other beneficiaries are state employees such as civil servants, policemen and military personnel, as well as individuals with recognized outstanding achievements for the fatherland. In other words, some privileges are provided on the basis of loyalty rather than income status. At present, over 30% of the population is entitled to some type of benefit. However, the current system is vastly inefficient and not sufficiently targeted toward the poor. Adequate medical care in the state-run health sector is often available only through bribes, and qualified medical services are really only available in the private sector, rendering them unaffordable for the majority of the population.

Social safety nets

In general, all ethnic groups – with the partial exception of the Crimean Tatars – have equal access to the labor market and public office. With regard to gender however, one has to note that women are underrepresented in economic and political leadership positions. They also earn less due to the functioning of segmented labor markets, which reflects traditional role models and power relations. Ukraine’s structurally ingrained poverty also leads to exclusion based on place of residence, age and social status.

Equal opportunity

11 | Economic Performance

Since 2000, macroeconomic data have pointed to sustainable and positive economic development in Ukraine. After almost a decade of economic decline GDP started to grow. After 2004, real GDP growth gradually slowed down due to weaknesses in the external markets. There was also less investment by both domestic and foreign investors in 2005, while investments started to grow again in 2006. General improvements in 2006 were largely carried by rising private consumption (16%). Due to a one-sided export structure, Ukrainian economic development largely depends on developments in international markets for metallurgical products, as in 2004 when a 12% increase in GDP was fuelled by high international prices for metals. At the same time, there is internal potential for growth due to booming consumer and real estate markets.

Output strength

12 | Sustainability

Ukraine's numerous environmental problems are the legacy of Soviet industrialization. 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 and steel plants and power plants. Although Chernobyl remains the lasting symbol of environmental degradation, today air pollution in the major cities has become a major problem, followed by inadequate supplies of potable water and inefficient energy use. In terms of energy consumption per dollar of GDP, Ukraine ranks as one of the most energy-intensive countries in the world. There is a high potential for saving both in private households and the corporate sector. The recent rise in gas prices did not lead to the feared decrease in industrial production. Rather, companies invested in energy-saving technology. Although environmental objectives are anchored both legally and institutionally, thus far they have been implemented selectively. A drive for sustainability stems both Ukrainian civil society and the international community. International donors supported the on-schedule closure of the Chernobyl atomic plant with almost \$100 million.

Environmental policy

State and private institutions for education, training and development exist in all fields and levels, but they vary greatly in quality. Quality management is not implemented. The number of private secondary education institutions is growing steadily, i.e. the number of students who pay for their education is on the rise. In 2004/05 61% of those in enrolled in post-secondary education paid tuition fees. Life-long education is planned in the framework of the Millennium Development Goals. According to UNDP, Ukraine spent 15.0% of its overall public expenditures on education in 2004 compared with Russia's 10.6% and Poland's 12.2%. In 2003, EBRD reported that Ukraine spent 8.6% of its GDP on health

Education policy / R&D

and education, which is lower than Poland with 10.9% but higher than Russia at 6.6%. Access to high-quality, recognized educational institutions often requires significant financial capability or corruption. One might say that there has been an informal privatization of the education sector. Ukraine is suffering from brain drain, particularly in technology and the natural sciences, both to Russia and the West. Expenses for R&D amounted to 1.3% of GDP in 2003. The number of industrial enterprises that apply innovations in their activities continues to fall. One major problem is protection of intellectual property rights.

Transformation Management

I. Level of Difficulty

Structural constraints can be found in the social, economic and ecological 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.

Structural
constraints

Ukraine is undergoing a severe demographic crisis, characterized by an aging and diminishing population. At 1.17 children per woman (2006), the country's fertility rate is among the lowest in the world, which will cause political and social problems in the future. The average life expectancy – 64.7 years for men and 75.6 for women – is one of the lowest in Eastern Europe.

Ukraine has the highest prevalence rate of HIV in the former Soviet states. Since 1995, the virus has spread dramatically, first among drug addicts, but lately increasingly through sexual transmission. According to UNAIDS, the estimated percentage of Ukrainian adults and children living with HIV/Aids at the end of 2004 was about 2.6%.

Ukraine has become a transit – and increasingly a destination – country for refugees and asylum seekers who hope to enter the European Union (to apply for asylum there). These refugees pour in from the former Soviet Union (Armenia, Chechnya), Asia (mainly China and Afghanistan) and Africa (mainly Sudan and Congo). Ukraine is considered a safe third country by the European Union. 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. Support for refugees is negligible and human rights abuses are regularly observed. According to estimations, up to two million refugees live in Ukraine, mostly in large cities. Simultaneously, Ukraine is a country of labor emigration. Between two and five million Ukrainians work (temporarily) abroad, mainly in the European Union and Russia. Trafficking in women and children also plays an important role; estimates vary from several dozen thousands to half a million victims. 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.

During the Soviet era, Ukrainian civil society traditions were rather weak or even nonexistent. However, in recent years, popular acceptance of and involvement in civil society have improved, and the level of civil society participation has increased. The end of the Kuchma regime was brought about by the democratic opposition and mass mobilization of the civil society demanding free and fair elections. Only about 10% of Ukrainian NGOs work 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 incomes without risking forfeiting their nonprofit status. A heritage of distrust – both on the institutional and the interpersonal level – is an impediment to the development of civil society.

Civil society
traditions

Even though Ukraine is an ethnically, linguistically and religiously diverse country, ethnopolitical conflicts are insignificant. They are often exaggerated by Western media – and at times instrumentalized by political groups. None of Ukraine's five major churches constitute a state church. Ukraine has liberal laws regarding religion, which also guarantee freedom of religious practice. The conflict in neighboring Transnistria concerns Ukraine. The Ukrainian leadership is engaged in mitigating the problem in cooperation with the European Union, Russia and Moldova, especially with regard to border and customs controls.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership claims to pursue long-term aims, but these are often replaced by short-term interests of political bargaining and office-seeking. Therefore, only some of the leadership's long-term goals have been pursued over time, for example EU-integration and WTO membership, which are rather uncontroversial among the political leadership. At the same time, the Ukrainian leadership pursues free trade integration within the CIS Single Economic Space. There is no domestic consensus at the elite or public levels on NATO membership, with public support declining from 33 to 20%. Orange parties – Our Ukraine and the Tymoshenko bloc – are in favor, while the left opposes

Prioritization

NATO membership and centrists, such as the Party of Regions, remain cautious. Constantly shifting political alliances render prioritization rather difficult.

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.

Implementation

Although the political leadership tried to respond to mistakes and failed policies with changes, its policy frequently remains stuck in the same routines. External influence continues to determine policy formulation, which is exercised mainly by the European Union (and single member states such as Germany and Poland), Russia and the United States. The European Union and the United States are also Ukraine's main donors. Recently, there have been two positive examples of policy learning: administrative decentralization and the more transparent execution of privatization tenders. But the first has not yet been implemented.

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. Rather concrete plans for decentralization have been developed, but they have not yet been implemented. There is still a high fluctuation of office holders 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.

Efficient use of assets

The interpenetration of formal and informal coordination with their ensuing logics renders coordination in public administration problematic. A coherence of policy approaches is not given; it remains subject to immediate interests. In addition, there have been frequent cabinet reshuffles. Often, new institutions are founded for coordination between various government institutions (ministries, committees or secretariats), but with little effect. Intra-governmental friction has been a lasting problem in the period under investigation.

Policy coordination

In 2004, Ukraine was placed 125th of 146 countries in the Corruption Perception Index compiled by Transparency International; in 2006 it had advanced to 99th, which was largely an effect of the euphoria generated by the Orange Revolution. Ukraine however 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

Anti-corruption policy

culture. Corruption is sustained by over-regulation, which opens opportunities for the extortion of bribes not only for illegal actions but also for timely and proper performance of legitimate services. During the 2006 elections, many business people entered parliament in order to gain immunity from prosecution. Before 2005 many different laws attempted to regulate questions of corruption, but they were largely ineffective and often served as blackmail during the intra-administrative power struggle. An institutional and legal base together with accompanying programs has been created, but the effectiveness and the degree of implementation remain questionable.

16 | Consensus-Building

After December 2004, the major political and economic actors have had a basic consensus about general goals. The principles of market economy and democracy as such are not questioned. But they frequently take a back seat when short-term interests related to power preservation or enhancement are concerned.

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. During the period under review, the reform programs were not carried out consistently and could be implemented only with compromises. All of these developments make clear that the reformers have not been able to control all veto powers. Sometimes they became veto powers themselves. A 3% threshold of voter support for access to parliament served to exclude some veto powers and to consolidate the party system.

Anti-democratic veto actors

The involvement of relevant politicians of the Kuchma era in government could be seen as a chance to submit them to the logic of the new political rules, even though some have resisted change. A central challenge is to overcome the socio-cultural and socio-political cleavages between the different regions that resulted from different historical experiences and institutional legacies. Different popular and elite attitudes to democracy, the free market and key issues of foreign policy stemming from these cleavages have inhibited progress.

Cleavage / conflict management

Overall, the political leadership frequently ignored civil society actors and formulated its policy autonomously. One notable exception was the formulation of the law on gender equality, where civil society groups were involved.

Civil society participation

To date, historical injustices in Ukraine have not been discussed comprehensively or systematically. The “holodomor,” that is, the famine of 1932 – 1933 induced by man-made causes and resulting in anywhere from 3 to 7 million victims in Ukraine, could prove an exception. While parliament adopted a law on the famine, only the three original parties supported this; the

Reconciliation

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 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 allowed to return to Ukraine.

17 | International Cooperation

The Ukrainian leadership works with bilateral and multilateral international donors and tries to make use of international technical and financial assistance. EU relations with Ukraine are based on the Partnership and Cooperation Agreement (PCA), which entered into force in 1998. The TACIS program has been the framework for technical assistance since the early 1990s. Ukraine is considered a priority partner country within the European Neighbourhood Policy (ENP). A joint EU-Ukraine Action Plan was endorsed by the EU-Ukraine Cooperation Council in February 2005. Under the EU-Ukraine Action Plan, cooperation focuses on legislative convergence and integration. The European Neighbourhood and Partnership Instrument (ENPI) is set to replace TACIS in 2007. An Enhanced Agreement or ENP+ is set to replace the ten-year PCA with Ukraine, but it will not provide Ukraine with future membership. In addition, several United Nations organizations are present in Ukraine, including UNDP, UNHCR and IOM. Moreover, Ukraine cooperates closely with and profits from financial assistance from the IMF, the World Bank and EBRD. Finally, Ukraine is one of the major recipients of assistance from the United States.

Effective use of support

Ukraine's geopolitical situation and energy dependency compel it to perform a balancing act in its foreign policy and it often appears indecisive on its strategic aims. Ukraine joined NATO's Partnership for Peace (PfP) in 1994 and has been its most active CIS state. In 1997 NATO and Ukraine signed a Charter on Distinctive Partnership, which solidified cooperation. Ukraine declared its intention to seek NATO membership in 2002. Only after Yushchenko's election did this translate into NATO upgrading Ukraine to Intensified Dialogue on Partnership. Ukraine was set to be invited into a Membership Action Plan at the 2006 NATO summit, but domestic political developments in Ukraine (the Anti-Crisis coalition) blocked this step. Ukraine provided one of the largest military contingents in Iraq. In September 2003, President Kuchma signed an agreement on the creation of the CIS Single Economic Space (SES) with Russia, Belarus and Kazakhstan. This step was made without any preliminary consultation with parliament or even the cabinet of ministers. The present government claims to pursue this policy only with regard to the establishment of an area of free trade, in strict compliance with WTO rules, and renounces plans for further integration. Ukraine is part of GUAM (together with Georgia, Azerbaijan and Moldova),

Credibility

which became a full-fledged international organization in 2006 and functions as a counterbalance to the Russian dominated CIS. The Community of Democratic Choice is also an alliance of CIS countries seeking integration into NATO and the European Union.

Ukraine has concluded good neighborhood agreements with all of its adjacent states. Relations with Russia have so far been dominated by the Kremlin's attempts to influence Ukraine's domestic agenda. On the other hand, Kyiv has been cooperating with many Western neighboring states – first and foremost Poland – to strengthen its integration into Euro-Atlantic structures. Ukraine is directly affected by the conflict in neighboring Transnistria. In 2005, the Ukrainian government made an effort to contribute to the solution of the conflict by tightening border controls to curb the trafficking of arms and drugs, some of the main income sources of Transnistria. In 2006, the Ukrainian government concluded a tariff agreement with Moldova. Ukraine is involved in the five party talks (Moldova, Russia, OSCE, Transnistria, Ukraine) and participates in the EU mission to support the border administration and customs control.

Regional cooperation

Strategic Outlook

By and large, recent developments in Ukraine have been rather positive. With the peaceful change in government in March 2006 the country passed the first test of the transformation toward democracy. Nevertheless, some caveats should be mentioned with regard to the sustainability of these changes. Namely, the positive developments concerning the freedom of speech, freedom of association and also monetary policy have thus far been insufficiently supported in terms of legal provisions and detailed directives for implementation and redress.

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

Politics: The inconsistencies and loopholes created by the new constitution should be corrected as soon as possible. This will be difficult, as entrenched interests in the government and the Verkhovna Rada will try to exploit the contradictions and block further reforms. Decentralization should be implemented as soon as possible to improve the delivery of services to citizens.

Economy: WTO accession should be achieved as soon as possible. Ukraine has fulfilled most requirements for WTO membership but cannot yet benefit from membership. Moreover, 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; there is a high saving potential in both industry and private households. In addition, the government should pursue an active labor market policy that takes into consideration the human and intellectual resources that lay idle.

International Relations: Ukraine should continue with EU-harmonization, especially with regard to free trade and the free movement of people, that is, in the form of a facilitated visa regime.

Social sphere: The problem of the HIV/AIDS epidemic needs to be addressed more seriously. More public awareness campaigns are necessary, as prevention seems the only possibility to slow down the spread of the disease.