

Realism About Ukraine

Part I – Internal Conditions¹

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In a remarkably swift period of time, the mood about Ukraine has swung from one of expectation to disappointment. The change of mood has been unreasonably swift. President Yushchenko has only been in office since 23 January, and preliminary judgements might be premature ones. Yet conditions are also unreasonable. Political reforms transferring important powers from the President to the *Verkhovna Rada*, the country's parliament, are scheduled to take effect in the autumn, and parliamentary elections will take place in March 2006. The President therefore has little time to use the current powers, afforded by the country's 1996 Constitution, to launch profound and systemic reforms. 'Irreversibility' cannot be achieved in so short a period, even if it is exploited to the full. What can be achieved is to demonstrate that the new leadership has the will and competence to change the nature and not only the image of the system that has governed Ukraine since 1991. In this, so far, it does not appear to be succeeding.

External support (and criticism) must be grounded in the 'art of the possible' if it is to be constructive and effective. Emphasis needs to be placed on problems (and mistakes) that are remediable within constraints which need to be understood and, over the short term at least, respected. In three respects, the starting conditions present obstacles to radical change:

- Yushchenko and his supporters did not come to power on their own. They were assisted by an ideologically diverse, anti-Kuchma coalition and, at least illicitly, by forces within the country's powerful and resourceful state apparatus.² They were also assisted by money, the donors of which not only have principled aspirations, but concrete interests. For all their repugnance towards the culture of power in Ukraine, President Yushchenko, Prime Minister Tymoshenko and many of their closest allies built their careers inside it. The new leadership, therefore, is exercising power with many of the forces, instruments and instincts of the old. It represents a principled break from the past, but not a clean break.
- Not only is the bureaucracy intact, so is Ukraine's deeply flawed legal system. Law in Communist and post-Communist states has rightly been called a system of 'codified arbitrariness'.³ Ukraine's assortment of laws, codes and 'normative acts', rife with contradictions, gaps, permissive powers and regulative minutiae, has not only stimulated arbitrariness, but criminality and corruption. It has also usurped many of the normal prerogatives of entrepreneurship and management, thus as in Soviet times persuading people that 'initiative is punishable'. The demand to 'respect the

law' is therefore double edged: by some, an earnest appeal against the capricious actions of self-serving authorities; by others a principled defence of the status quo's indefensible abuses and by still more, a weapon against rivals in business and politics. How can reform advance within this legal system? How can legality be maintained outside it?

- Economic conditions are difficult and, in the energy sphere, worsening. During the pre-electoral period, state property and budgetary resources were redistributed and pillaged on an unprecedented scale. Russian oil prices increased 25 per cent between January and March, and steep increases for the price of gas (from Turkmenistan as well as Russia) are likely to take effect in January 2006.⁴ These conditions make tax reform and (legal) wealth generation urgent. Since 1991 state and local budgets have collapsed, yet state and local bureaucracies have grown. That relationship is no longer sustainable.

It should be clear that the very conditions that make systemic change so difficult heighten the necessity for it. A policy of reversing isolated injustices or punishing individuals is unlikely to gain momentum in this framework. Ukrainian and foreign experts now fault the authorities for 'eclecticism', 'ambiguity' and the 'absence of a clearly formulated strategy'.⁵ The faults reflect:

- *Weakness in Leadership and Coordination.* Between his inauguration and the recent oil crisis, President Yushchenko tended to act more as the spiritual than the political leader of the country. He also made twelve trips abroad. When the oil crisis reached the point of peril, he intervened with wisdom and firmness, but it is not clear whether he will now exercise direct and active authority.⁶ His Prime Minister, Yulia Tymoshenko, an electoral ally but a personal rival, is not averse to confrontation and seems determined to exercise authority without limit. If Yushchenko has confused leadership with inspiration, she has confused it with control and, to the astonishment of many in Ukraine's business sector, these controls are taking the form of Soviet style 'administrative measures' which extend to the micro economy. In his other ministerial appointments, Yushchenko deferred considerably, perhaps excessively, to his coalition partners. The result is a 'contra rather than a pro' group of like-minded professionals⁷ and, at the top of the state, a realm rather than a team.
- *Absence of Administrative Reform.* Ukraine's largely Soviet era bureaucracy—opaque, inflexible, meddlesome, jealous of its powers and oblivious to their effects—is a fundamental obstacle to the creation of a state in which 'man is the architect of his fortunes'. If the power and scale of bureaucracy are not diminished, and its working practices not transformed, Yushchenko will not succeed. The keys to reform must be deregulation and cadre (personnel) policy. If the latter is ad hoc, it will invite charges of cronyism and abuse. If it is formalised (i.e. bureaucratic), then the bureaucracy will control it. It is therefore difficult, but essential in this transitional period to form teams of reform-minded professionals who can drive policy and internal restructuring forward. Yet outside the security sector (where the 'human factor' confronts one at every turn), the focus of many ministers remains policy and politics rather than the people and structures that transform principles into practice.
- *State Meddling instead of Economic Reform.* The previous tenure of Yushchenko and Tymoshenko in government gave the West—and much of

the Ukrainian middle class—every confidence that they were committed to the rules and institutions of a liberal market economy.⁸ That confidence has been shaken. The decision (20 April) to revalue Ukraine's currency, the *hryvnya*, was taken without warning to those who would be affected by it, as was the decision to abolish tax privileges of entrepreneurs in free enterprise zones. What conclusions are businesses expected to draw when a tax regime, integrated into marketing, pricing and investment strategies, is replaced without consultation or notice? Tymoshenko's decision to impose temporary caps on oil prices (since reversed by the President) has been defended by some as an anti-monopoly (and hence free market) measure. But this defence cannot be stretched to justify price controls on meat or subsidies on electricity, and the decision to increase public sector salaries by almost 57 per cent flies in the face of economic reality.⁹ Although she has since reversed herself, Tymoshenko also spoke of renationalising, rather than reprivatise some of the state enterprises sold off on dubious terms during Kuchma's presidency. Her reasoning seems to be that since she has the power of the state behind her, she should use it. The reasoning of Valentyna Semenyuk, an ardent socialist and Head of the State Property Fund, is classically ideological. If her appointment is a calculated concession to the Socialists (who have already been awarded the Ministry of Agriculture and the Ministry of Internal Affairs), what is the calculation? These measures, half-measures and reversals (which have come to a head in the reprivatisation issue) have shaken confidence not only in the government's principles, but its competence.¹⁰

Two questions need to be posed. First, is the performance of the President and government justified by the imperatives of electoral and coalition politics? So far, Tymoshenko's interventions have been popular with voters, but why? Is it because of their substance or because she is doing something? So far, Yushchenko's popularity remains substantial, but it is declining. Is it wise for him in these circumstances to 'give her rope'? Or would it be wiser to take the lead himself?¹¹ For how long will Yushchenko or Tymoshenko inspire confidence if inflation mounts, if the petty, daily institutionalised abuses of power are not addressed, and if people begin to realise that nothing has changed? If the opposition is too shattered to deny the coalition victory in March, then is it really essential to hold the entire coalition together, and who will benefit from the attempt: Yushchenko or coalition partners whose vision of Ukraine's future differs from his own? Who will believe that real reform will begin after these elections—entrepreneurs? investors? neighbours?—if no firm direction is set before then? The risks of hesitancy are that friends lose interest and enemies become engaged. The risks of leadership are not only fewer, but better.

The second question is whether today's errors are correctible or whether they are congenital, the product of incapacity and incompetence. In Russia, there are many who claim to know the answer. In the West, the question is being posed. The considered, prudent answer is that today's errors are correctible, but not self-correcting. Two mechanisms are needed to assist the process. First, Western supporters of Ukraine and Yushchenko need to speak clearly and fairly, without exaggerating problems, but without mincing words, and the country's decision makers need to be asked plainly whether they want praise or help. Second, it is imperative that Ukraine's NGOs retain the ability to perform the function they performed so ably in the past. It is already becoming more difficult for them to do so. Many of their most talented experts are being siphoned into government (where some might have less influence than they would outside it). More ominously,

several well established Western donors have already shifted their focus: either to Ukrainian analytical centres tied to government (and hence limited in their independence) or, with less justification, to countries such as Belarus, Azerbaijan and Uzbekistan, where local ‘people power’ and Western ‘soft power’ have yet to triumph. In politics, not to say geopolitics, it can prove very costly to leave the field before triumphs are consolidated. To reiterate a far from novel point, ‘the worst outcome [for Ukraine] would be if [Yushchenko] wins and then fails’.¹² Yushchenko is very far from failure, but it would be unwise to forget that he is also very far from success.

ENDNOTES

¹ Parts 2 and 3 of this series will focus on foreign policy and security sector reform, respectively.

² This support from within the state testifies to the dynamic observed after the parliamentary elections of March 2002: ‘Whilst at one level the growth of civic instincts is sharpening the divide between state and society, it is also creating points of friction within the state and hence, a dynamic of evolution inside it’. (James Sherr, ‘Ukraine’s Elections: The Limits of Manipulation’, CSRC Occasional Brief No 91, April 2002.)

³ As characterised by the French Sovietologist and Russia specialist, Françoise Thom.

⁴ The price of Russian oil sold *in Russia* increased 26 per cent between January and March 2005. During the same period, there has been a 24 per cent increase in Russian export duty from \$83 per tonne to \$102.60 per tonne. At the new price, Russian oil is now sold in Ukraine at \$300 per tonne. Ukraine is almost totally dependent on gas supplies from Turkmenistan (36 bn cubic metres per annum) and Russia (24 bcm per annum). Following Yushchenko’s visit to Turkmenistan, the country’s president Saparmurat Niyazov publicly criticised Ukraine for failing to honour the terms of the existing gas supply agreement under which Ukraine pays for half its imports in cash (at \$58 per thousand cubic metres) and half in industrial goods. (Niyazov alleged that Ukraine withheld delivery on goods whilst unilaterally increasing their unit costs.) (Jamestown Foundation, Eurasia Daily Monitor, Vol 2, Issue 121, 22 June 2005.) According to the chairman of the state company, *Naftohaz Ukrainiy*, Oleksiy Ivchenko, a compromise was reached on 24 June, whereby Ukraine will pay for all deliveries in USD at the reduced price of \$44 per thousand cm for the balance of 2005 and 2006. (RFE/RL Newline, Vol 9, No 121, Part II, 27 June 2005.) Russian imports operate under a different regime, whereby Russia supplies 24 bcm as compensation for transit of gas across Ukraine to customers in Europe (134 bcm in 2004). At present, Russian gas is valued at \$50 per thousand cubic metres which, like Ukraine’s transit fee, is well below the world market price. In June *Gazprom* announced that it would prefer to shift to an arrangement whereby Ukraine would raise its transit fee to European levels in exchange for a revaluation of Russian gas to \$160 per thousand cubic metres. Even with the increased transit fees, the revised price—which is probably an opening gambit for negotiations—would be well beyond Ukraine’s means. (Jamestown, *op cit.*)

⁵ These criticisms, put forward by a number of Ukrainian specialists at the 1 May Kyiv roundtable, ‘Political Situation in Ukraine: 100 Days of New Power and Reforms Strategy’, were echoed by several senior Western representatives at the 16-17 June Kyiv World Economic Forum (‘mini-Davos’), hosted by President Yushchenko.

⁶ On 19 May, Yushchenko emerged as a blunt and tough arbitrator in several meetings between Tymoshenko and senior Russian oil company executives and traders, as well as Ambassador Chernomyrdin and the President of TNK-BP, Robert Dudley. Whilst admonishing Russian traders for imposing artificial shortages, he cancelled Tymoshenko’s price caps (which he criticised as an ‘administrative, non-market measure’) with immediate effect. Simultaneously, he ordered Tymoshenko to cancel VAT on oil and oil products transit. The previous day, he signed legislation cancelling import duties on high-octane petrol and diesel fuel.

⁷ Speech of Volodymyr Malynkovych at the 1 May Kyiv roundtable, ‘Political Situation in Ukraine: 100 Days of New Power and Reforms Strategy’.

⁸ Yushchenko was Prime Minister of Ukraine between December 1999 and April 2001; Tymoshenko served as Deputy Prime Minister between January 2000 and February 2001.

⁹ The lack of consultation stands in ironic contrast to the elaborate public discussion that preceded the *hryvna*'s introduction under Kuchma in 1996. The decision was immediately criticised by the conservative but extremely able First Deputy Prime Minister, Anatoliy Kinakh, who does not appear to have been part of the magic circle that made it. To judge from the comments of President Yushchenko to the newspaper, *Ukraina Moloda*, it is possible that he was not consulted either: 'I negatively assess any shock change of the currency rate, because it undermines the authority of its stability, which was formed for years. Even if the issue is the strengthening of the *hryvnya*, it cannot be settled in one day and by such drastic steps... In fact, revaluation of the *hryvnya* worsens and complicates the conditions of work primarily for the national producer' (cited in *Ukrainskaya Pravda*, 28 April).

¹⁰ By general consensus, reprivatisation, which began as a flagship of the President's programme, has become a shambles. Two fissures immediately surfaced: how many firms should be reprivatised and by what means? should they, indeed, be reprivatised or returned to state ownership? To date, Yushchenko does not appear to have put an end to these arguments.

¹¹ As noted by Oleg Varfolomeyev, '[m]any of Tymoshenko's mistakes as prime minister go unnoticed by the general public. And Yushchenko, wanting to maintain the unity of the governing coalition ahead of the elections, abstains from openly criticizing Tymoshenko.' (Jamestown Foundation, *Eurasia Daily Monitor*, Vol 2, Issue 86.)

¹² James Sherr, 'Ukraine's Elections: The Interplay Between Internal and External Factors', (*Zerkalo Nedeli*, No 40(515), 9-15 October 2004).



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