

# THE WAR AND REFORMS IN UKRAINE

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Arkady Moshes

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Arkady Moshes  
Programme Director  
The Finnish Institute of International Affairs

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- The military conflict in the eastern part of Ukraine is the main factor determining also the internal political situation in the country. On the one hand, as long as the conflict calls for national consolidation and strengthens the understanding that only a reformed Ukraine may hope to endure, the war should drive the transformation. On the other hand, the conflict poses a major impediment to the changes, not only because it is a drain on resources, but even more so because it tempts Ukraine to blame its own inaction on “objective difficulties”.
- A number of conditions currently favour the reforms proceeding as planned. Ukraine enjoys a sizeable pro-reform majority in the parliament, and the population is still largely supportive of the government. The influence of the anti-reform opposition is smaller than ever. The Association Agreement with the EU, and the IMF programme are in place to serve as powerful vehicles of transformation.
- However, progress to date has been limited. The necessary change is certainly going to be painful for the population, which partly explains the reluctance to undertake radical steps. Resistance from the country’s oligarchs and within the extremely corrupt environment as a whole is apparent, to which a lack of experience can be added. Any further delay will threaten to destroy the existing confidence that has been bolstered among the people.
- In this situation Western assistance for the reforms in Ukraine will become crucial. But it will make a difference only if strict conditionality is applied.

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## Introduction

Ever since gaining independence, Ukraine in general and its governing elites in particular have been reform-averse. In the 1990s the main preoccupation of Ukraine's leadership was not raising the efficiency of the national economy, but retaining Russian energy subsidies. The Orange revolution of 2004 was originally expected to give reforms a boost, but all hopes faded when rivalry between the then president, Viktor Yushchenko, and the prime minister, Yulia Tymoshenko, paralyzed decision-making. Viktor Yanukovich, elected president in 2010, was obsessed with concentrating wealth and power within his closest circle and simply tried to trade Ukraine's geopolitical preferences for financial benefits both in Russia and in the West.

As a result, in 2012, which was the last year when the external macroeconomic environment was still favourable for Ukraine and the political storm had not yet burst, per capita gross national income based on purchasing power parity was, according to the World Bank, approximately three times smaller in Ukraine than in Russia and Poland, and two times (!) smaller than in neighbouring Belarus – a country that neither championed reform nor possessed large energy resources. The population of Ukraine, which stood at 52 million when independence was proclaimed in 1991, decreased to less than 46 million, without wars or other calamities.

Without exaggeration, these figures should be viewed as an indictment of all Ukraine's rulers without exception, as well as a reminder of the price that the Ukrainian nation has paid for its inability to stay the course during political and economic transformations.

The Revolution of Dignity, as the dramatic events of late 2013 and early 2014 in Independence Square in Kiev, or *Maidan*, came to be known, gave Ukraine a chance to break away from this unfortunate pattern. But the loss of Crimea, and especially the bloody military conflict that ensued in the east of the country, quickly became another colossal impediment and put the country on the brink of economic catastrophe. In 2014, Ukraine's GDP decreased by 7.5%. The national currency, the *hryvnia*, fell by over 85% against the U.S. Dollar. Inflation soared to almost 25%. The gold and currency reserves were depleted.

The focal point of Ukraine's economic problems is a gaping budget deficit, estimated to have reached 12% of GDP in 2014 and primarily caused by energy subsidies to gas traders and coal producers (up to 10% of GDP). The war exacerbated this structural problem, but it had already existed for a long time, being itself a primary source of rent-seeking and corruption. Other key deficiencies in the public finance system are unaffordable pension expenditure and an excessive number of civil servants.<sup>1</sup>

Continuing along the old trajectory would no doubt destine Ukraine to a future as a failed state. The question arises as to whether the country's new government will rise to the challenge and eventually prevail. A number of important preconditions for success are met in Ukraine. However, the risks are still strong, and there is absolutely no guarantee of the irreversibility of the change. In these circumstances, the West's commitment to Ukraine's reforms, Western assistance and expertise, but even more so the ability to apply conditionality may become crucial factors.

## A country at war

It is self-evident that in today's Ukraine the military conflict in the east is the single most important factor not only in foreign policy but in domestic politics as well. Addressing the first session of the newly-elected parliament on November 27, 2014, Ukraine's President Petro Poroshenko stated that the country was living in war conditions and that the external military threat would be a long-term reality for the country. Furthermore, he emphasized the existential scale of the threat by calling the conflict the "Patriotic War of 2014", which cannot be underestimated taking into account the power of the reference to the Great Patriotic War of 1941–45.<sup>2</sup>

Sociological data reveals that the president's words echo the views of the majority of the population.

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1 For details see A. Aslund. An economic strategy to save Ukraine. Peterson Institute for International Economics Policy Brief No. PB12-24, November 2014, <http://www.iie.com/publications/pb/pb14-24.pdf>, accessed March 12, 2015.

2 Vneocherednoe poslanie Prezidenta Ukrainy k Verkhovnoi Rade Ukrainy, <http://www.president.gov.ua/ru/news/31656.html>, accessed 3 March, 2015.

According to an opinion poll conducted by Kiev International Institute of Sociology (KIIS) in December 2014, over 66% of respondents considered the conflict in Donbass to be the war for the Motherland, whereas only 6.3% disagreed with this assertion. Almost 40% thought it was a war against Russia, and another 21% viewed it as a civil war provoked by Russia.<sup>3</sup>

The war sets the stage for all the other developments in Ukraine. Its impact in the sphere of economics is telling. The country spends five to seven million dollars a day to wage warfare.<sup>4</sup> It is raising the share of defence expenditure to 5% of GDP in 2015, compared with 1.8% in 2014. It has carried out several waves of mobilization of reservists and has over a million internally displaced persons as of early 2015. Direct damage in the form of destroyed enterprises and infrastructure, and the loss of potential investment are enormous. It goes without saying that in these circumstances Ukraine should not be expected to act and behave like countries that are pursuing a reformist agenda in peacetime.

Consequently, the conflict also defines the priorities – if not the rules – of the political game. The issue of war and peace, of whether or not to continue the conflict, whether to rely on force or diplomacy and how to potentially reintegrate the separatist-controlled territories were the main questions of both the presidential election campaign in May and the parliamentary elections in October 2014.

Sometimes, and especially in the Russian media, the Ukrainian political spectrum is viewed as being divided into “a party of peace”, allegedly associated with President Poroshenko, and “a party of war” linked to Arseniy Yatsenyuk, prime minister since February 2014. As such, this analysis can hardly be fully embraced as it was Poroshenko, as commander-in-chief, who gave the order to resume military operations against the separatists last June. But it should not be wholly rejected either as the differences between a more radical and a more

moderate approach towards the conflict are highly visible.

For the purposes of this paper, it is important to bear in mind that the war has had, and will continue to have, a controversial effect. On the one hand, it consolidates the nation and the governing coalition. Without a uniting threat, the political rivalries would likely be more pronounced, and the pressure from “the street” would be even stronger if radical forces were willing to challenge the new “establishment”. In turn, the unity within the coalition should facilitate the change, provided the coalition’s members realize that only if Ukraine transforms itself significantly will it be able to survive the crisis.

On the other hand, the conflict can also be used as an excuse for the lack of progress. For the domestic audience the blame can be put on the “external aggression” (and, naturally, on the misdeeds of the previous government). As far as the external partners are concerned, they may be expected to support Ukraine simply because they cannot possibly be interested in the geopolitical strengthening of Russia. In fact, this line of reasoning was employed by Ukraine in the past as well, when the rationale was less evident, and it can only be reinforced now.

### Is there a chance?

Arguably, the situation in Ukraine is now more conducive to transformation than ever before during the country’s independent history. To start with, this was the essence of *Maidan*. Eliminating corruption, dismantling the oligarchic empires (with the possible confiscation of property), the reform of the courts and of the national health system, as well as a rise in living standards are the chief expectations of the population.

The best evidence of this are the results of the October 2014 parliamentary elections. Ukrainian voters supported those political forces that promised reforms, while essentially outing from parliament both the Communist party and the nationalists, which says a lot about the maturity

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3 Data available at <http://opros2014.zn.ua/>, accessed 3 March, 2015.

4 An estimate provided by Ukraine’s Minister of Finance Natalya Yaresko on January 23, 2015; [http://www.business.ua/articles/ukraine/Odin\\_den\\_voyny\\_v\\_Ukraine\\_stoit mln\\_dollarov-85222/](http://www.business.ua/articles/ukraine/Odin_den_voyny_v_Ukraine_stoit mln_dollarov-85222/), accessed 3 March, 2015.

of the electorate.<sup>5</sup> The “Opposition Bloc”, largely uniting the representatives of the former party of power, received less than one tenth of the votes, and although it came first in six *oblasts* of Ukraine, its support lagged far behind the aggregate result of the “parties of Maidan”.

Importantly, unlike after the Orange revolution a decade earlier, society is no longer willing to leave the reforms to politicians, but tries to exercise control through the instruments that Ukraine’s vibrant civil society has developed, such as the external expertise of the authorities and interaction with them through various consultative mechanisms.<sup>6</sup>

Thus far, the “parties of Maidan” have been able to maintain a relatively high degree of consolidation and cooperation that is crucial in the parliamentary-presidential system which Ukraine now has according to its constitution. At the time of its creation in November, the five-party governmental coalition included 302 members of parliament out of 423, which constitutes a constitutional majority.<sup>7</sup> Discussions within the coalition and an open political competition between the member parties are ongoing – as is the norm in every parliamentary democracy – but open antagonism or attempts to block the cooperation have been avoided.

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5 Taken together, the so-called “parties of Maidan” (“Petro Poroshenko Bloc”, the “People’s Front” of Arseniy Yatsenyuk, “Samopomich” of Lviv mayor Andriy Sadovyi, the Radical Party of Oleh Lyasko, “Bat’kivshchina” of Yulia Tymoshenko and “Svoboda” of Oleh Tyahnybok) received more than 70% of the vote cast for the party lists. The national-democratic-leaning “Svoboda” did not pass the five per cent threshold, although 6 candidates from the party were able to win in several single-mandate districts, as did 2 candidates from the nationalist “Right Sector” party. Presumably, however, a certain part of the nationalist-minded electorate voted for the Radical Party.

6 For details see, for example, the official site of the Ukrainian Cabinet of Ministers, [http://civic.kmu.gov.ua/consult\\_mvc\\_kmu/news/article](http://civic.kmu.gov.ua/consult_mvc_kmu/news/article), accessed March 12, 2015.

7 The Ukrainian parliament should consist of 450 MPs. However, elections in single-mandate districts in Crimea and in those territories of Donbass which are not under the control of the government were not held for obvious reasons. On a separate note, it is worth mentioning that out of 20 cabinet ministers, 9 do not have a party affiliation, even if filling party quotas.

Originally, one major concern was the uncertainty over the cooperation between President Poroshenko and Prime Minister Yatsenyuk. The latter refused to merge his political force with the presidential one during the parliamentary elections and was able – somewhat surprisingly after the landslide victory of Petro Poroshenko in the presidential elections only five months earlier – to make his “People’s Front” the victor among all party lists.

At the moment, however, it seems that a workable *modus operandi* has been achieved. This became clear in December when Oleksandr Turchynov, the former speaker of the parliament and the acting president after the ousting of Yanukovych and currently a close collaborator of Arseniy Yatsenyuk, was appointed head of Ukraine’s Council of National Security and Defence, which plays a key political role in the country, especially during times of conflict. Moreover, the competences of the body were significantly strengthened. In this sense, lessons from the failures of the Orange revolution have apparently been learned.

A decade ago, the opponents of reforms were able to challenge the post-revolutionary government with a powerful narrative, according to which the painful measures could be avoided in the event that Russia would agree to grant Ukraine preferential economic treatment. Today this is hardly possible, primarily because of the conflict, but also because the potential representatives of this line were in power too recently and are considered to be responsible for the increase in corruption and the economic problems in the country. So these political forces have to structure their message around “peace”, “reconciliation” and “economic reconstruction”, which allows them to score certain points, but not to demonstrate to the people an alternative to reforms.

Finally, and very importantly, Ukraine’s external partners expect reforms. On a more positive note, the country voluntarily committed itself to carrying out the changes as stipulated by its Association Agreement with the European Union. It is no accident that the current governing coalition assumed the name of “European Ukraine”, which should symbolize an imperative to adopt EU economic and legal rules and even technical standards. Meanwhile, the parlous state of Ukraine’s economy does not leave it with much choice but to accept the conditionality put forward by the donors. As of early

March 2015, the Ukrainian parliament adopted all necessary measures to obtain the assistance package from the International Monetary Fund, even though the agreement included such unpopular steps as higher energy prices for the population and a number of other austerity measures.<sup>8</sup>

### Evident risks

Yet, according to a prevailing assessment, the progress so far has been rather modest.<sup>9</sup> It would be unfair to deny it completely. There has been an attempt to “clean the power”, above all by means of the legislation on lustration, which entered into force in October 2014 and is aimed at the medium- and top-level figures of the previous regime. Another legislative initiative currently in process is aimed at lifting the immunity from the members of parliament and judges, which is seen as necessary in order to bring the rule of law to the country. Some economic deregulation measures have been introduced and the local government reform is underway.<sup>10</sup>

At the same time, it has to be admitted that the strong criticism that the Ukrainian government is encountering has serious grounds. Significantly, if at earlier stages the criticism centred on the government’s perceived mistakes and unprofessionalism,

especially in the economic sphere,<sup>11</sup> it was subsequently the very political will that came to be doubted.

The factors that affect the behaviour of the government and that could eventually derail the reform process are many. The most obvious is the risk of social destabilization. Clearly, painful economic reforms can gradually undermine the popular support of the government, which in turn places constraints on the decision-making.

But the immediate risks are of a different – albeit well-known – nature. Ukraine’s economy is highly non-transparent, which gives rise to corruption. An estimated 40–70% of the economy is in the “shadow”.<sup>12</sup> In the 2014 Corruption Perception Index of Transparency International, Ukraine occupied 142nd position out of 175 countries. The above-cited December 2014 poll of the KIIS revealed that only 4.8% of respondents thought corruption had decreased over the past year, whereas 47.3% thought it had stayed at the same level and 31.8% believed it had increased.<sup>13</sup> It is simply unrealistic to assume that the political class can be free from lobbyism and corruption even after the revolution.

Related to this is the role that oligarchs continue to play in today’s Ukraine. The country’s political parties and media have been traditionally dependent on their “sponsors” from big business. With the outbreak of the conflict in the east of Ukraine this dependence acquired a new dimension, as some oligarchs now directly contribute to the defence

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8 The whole assistance package is expected to reach 40 billion US dollars within four years. See O.Varfolomeyev. Will the West Bail out Ukraine? *Eurasia Daily Monitor*, February 27, 2015; [http://www.jamestown.org/programs/edm/single/?tx\\_ttnews%5Btt\\_news%5D=43593&cHash=debac44f0648050bd90d9ebd77741752#.VQALNU10270](http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=43593&cHash=debac44f0648050bd90d9ebd77741752#.VQALNU10270), accessed 4 March, 2015.

9 This assessment must be quite disturbing for Ukraine’s authorities. President Poroshenko challenged it in a TV interview on 9 March. See <http://www.pravda.com.ua/rus/news/2015/03/9/7060962/>, accessed March 10, 2015.

10 On the latter issue, see A. Skorupska, P. Kosciński. Ukraine: Local Government Reform Accelerates, but Slowly. *PISM Bulletin No. 17 (749)*, 12 February 2015; <http://www.pism.pl/publications/bulletin/no-17-749>, accessed 9 March, 2015.

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11 See A. Illarionov. Kak Ukraine izbezhat defolta i nachat ekonomicheskii rost. Available at <http://www.kasparov.ru/material.php?id=54B5966CoCo01>; P.Kuchta. Biudzet krakha, LB.ua, 19 January 2015, [http://economics.lb.ua/state/2015/01/19/291621\\_byudzheta\\_kraha.html](http://economics.lb.ua/state/2015/01/19/291621_byudzheta_kraha.html); V.Dubrovskiy. “Azirovskoi” tropoi k ekonomicheskomu Chernobyliu?, [http://blogs.lb.ua/dubrovskii/291789\\_azirovskoy\\_tropoy.html](http://blogs.lb.ua/dubrovskii/291789_azirovskoy_tropoy.html), all accessed 9 March 2015.

12 Yu.Samaeva, Yu.Skolotnianyi. Budushchee v fiskalnoi petle. *Zerkalo Nedeli*, 12 December 2014, <http://gazeta.zn.ua/macrolevel/budushee-v-fiskalnoy-petle-.html>, accessed 9 March 2015.

13 For deeper analysis, see A. Khmara. Ukraina 2015: god bez Yanukovicha, no s korruptsiei. *Zerkalo Nedeli*, 20 February 2015, <http://gazeta.zn.ua/LAW/ukraina-2015-god-bez-yanukovicha-no-s-korruptsiei-.html>, accessed 9 March 2015.

capabilities of the country, for instance by maintaining volunteer battalions of territorial defence. In its current predicament, Ukraine can hardly afford an open conflict with its oligarchs, but this state of affairs has its price, as the interests of the economic powerhouses do not necessarily coincide with the national interests. A name that often comes up in this connection is that of Ihor Kolomoyskyi, who was, highly symbolically, appointed governor of the key Dnipropetrovsk region in March 2014, but is certainly not the only person who belongs to this category.<sup>14</sup>

A sensitive question which is often asked in this regard is to what extent President Poroshenko, himself one of Ukraine's richest people who made his fortune in the country's general opaque environment, is able to insulate himself against non-transparent influences. During the presidential campaign he pledged to sell his business assets (with the exception of a TV channel), but the promise has not been fulfilled thus far, which not only creates a conflict of interests but is patently unconstitutional.<sup>15</sup>

Finally, notwithstanding what was mentioned above with regard to the cooperation within the governing coalition thus far, its cohesion in the future should not be taken for granted. The coalition agreement – a document of 73 (!) pages which took a month to compile – cannot be implemented in its entirety, which will provide those who are so inclined with a pretext to withdraw their support from the

government.<sup>16</sup> The more unpopular certain steps of the government are, the stronger the temptation, especially among the smaller members of the coalition, to criticize and disassociate themselves from the conducted policy and even to employ populist rhetoric. This could even lead to early elections with unpredictable consequences.

To conclude, for the government that took up office in February 2014 with a pledge to carry out a reformist agenda supported by the population, the demonstrated results have not been convincing. Further delay due to either a lack of motivation, non-transparent influences or insufficient competence may simply become dangerous for the country. The confidence that has been bolstered among the people will be sapped, and the same destabilization which a slower pace of transformation could be aimed at preventing might occur nevertheless.

### Implications for the West

Two points should now be clear to the outside observer. First, only an economically and politically successful Ukraine will be able to resolve the military conflict and reintegrate the separatist-controlled territories. Reforms, therefore, will become a prerequisite for sustainable peace and not *vice versa*. Second, if left to its own devices, Ukraine will be much less likely to implement the change and to restore sovereignty.

In this regard, the US and the EU countries should realize that the failure of Ukraine will also be a failure of the West this time, both in terms of their own, now open, geopolitical clash with Russia and in terms of witnessing Ukraine become a poorly governed territory, and a source of all sorts of security challenges for Europe. In order to prevent that, the West – which currently does not seem to have any appetite for this – will have to commit itself to a long-term involvement in Ukraine. This

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14 On the influence of Kolomoyskui in the parliament, see V. Dergachov. Kolomoyskiy zaimetsya "Vozrozhdeniem", Gazeta.Ru, 6 March 2015, [http://www.gazeta.ru/politics/2015/03/06\\_a\\_6446173.shtml](http://www.gazeta.ru/politics/2015/03/06_a_6446173.shtml), accessed 9 March 2015; Ukrainian authorities have entered into conflict with Kolomoyskiy and tried to deprive his business structures of the de facto control over the formally state-owned largest Ukrainian oil company "Ukrnafta", but the results of the initiative have thus far been inconclusive. See S. Kuyun. Bitvy patriotov. Zerkalo Nedeli, 23 January 2015, <http://gazeta.zn.ua/internal/bitvy-patriotov-.html>, accessed 9 March 2015.

15 See I. Lutsenko. Koly Poroshenko prodast sviy biznes? LB.ua, 10 January 2015, [http://lb.ua/news/2015/01/10/291636\\_koli\\_poroshenko\\_prodast\\_sviy\\_biznes.html](http://lb.ua/news/2015/01/10/291636_koli_poroshenko_prodast_sviy_biznes.html), accessed 9 March 2015. Significantly, the author of the article is a member of Ukraine's parliamentary committee on fighting corruption.

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16 The text of the coalition agreement is available here: [http://samopomich.ua/wp-content/uploads/2014/11/Koalitsiyina\\_uhoda\\_parafovana\\_20.11.pdf](http://samopomich.ua/wp-content/uploads/2014/11/Koalitsiyina_uhoda_parafovana_20.11.pdf), accessed 9 March 2015. Interestingly, the official cabinet programme, of which the agreement is a constituent part, received the support of only 269 MPs, which means that more than 30 coalition members did not vote for it.

commitment may well become a crucial success factor.

The policy should combine carrots and sticks. Ukraine can be saved from economic collapse only if sufficient financial incentives and technocratic advice are forthcoming. But at the same time there should be no impression that the West will be willing to bail Ukraine out simply because it is geopolitically “too big to fail”, and that the West might be interested to support an unreformed and corrupt system of power under any circumstances.

A very strict conditionality policy has to be used towards Ukraine, which implies scrupulous scrutiny of how the money, and not only the donor money, will be spent. In this respect, Ukraine’s Western partners can ally themselves with the active pro-reform civil society, but they should also appeal to the legal commitments which Ukraine has made in the Association Agreement with the EU. Conditionality should be made unequivocally clear to Kiev and adhered to by the West.

Building trust and avoiding mutual frustration to the extent possible will be crucial. The West should be fully aware of the destructive effect that the debate in Europe about lifting its sanctions against Russia – which is proceeding relentlessly despite the fact that the objectives of their introduction have not been met at all – will have on the perception of the EU as Ukraine’s partner.

Unfortunately, as Moscow cannot be expected to simply observe the developments, the progress on reforms in Ukraine may at any stage trigger a new round of military escalation aimed exactly at preventing success. Ukraine’s Western partners must, therefore, decide in advance what kind of policy they would be ready to put in place to protect the results of their own work from external sabotage. Eventually, this will again lead to the question about whether or not it is feasible and desirable to keep Ukraine as an eternal non-member of the EU and NATO integration structures.

The Finnish Institute of International Affairs  
tel. +358 9 432 7000  
fax. +358 9 432 7799  
www.fiia.fi

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