

ever, supporters associate EU accession mainly with the right to free movement and an overall improvement of living conditions.

EU and Russia

Nonetheless, the prospect of EU membership for Ukraine is not yet acting as a unifying factor in Ukraine. Polls conducted between 2008 and 2011 already indicated sharp regional differences in Ukraine, with much opposition in southern and eastern Ukraine⁶. The Ukrainian crisis has further polarised national opinion on the right way forward, as shown in an opinion poll in March 2015. Still a majority of Ukrainians would rather not have to choose between Russia and the EU⁷. This situation will remain a challenge, both for the EU and for Ukraine itself.

The EU does not regard the association with Ukraine as directed against any other European country. Furthermore and in line with long standing EU policies the AA commits the partners to developing good neighbourly relations and regional cooperation, which is of course very difficult to achieve under the present conditions of ongoing crisis and deep conflict with Russia. The implementation of Minsk II is crucial to finding a lasting solution that ensures peace and stability in Ukraine. In the longer term Ukraine and Russia will need to define their relationship. Healthy neighbourly relations with Russia would help Ukraine to manage the shift from being a current European hotspot towards being a place that is predominantly seen as an emerging opportunity to invest in and to partner with. If the EU would be able to clarify its future relations with Russia and the Eurasian Union this would substantially assist Ukraine. Although the strategic partnership with Russia is now openly called into question inside the EU⁸, the EU has no strategic interest in isolating Russia forever, because lasting European security and prosperity cannot be guaranteed without Russia. Since last year the EU has acted increasingly as a mediator between Ukraine and Russia. A functioning EU-Russian dialogue has already been beneficial for Ukraine, as demonstrated in the trilateral trade and energy talks. Moreover, the EU is reconsidering its approach towards those Eastern neighbours that prefer joining the Eurasian Union or, as Azerbaijan did, staying away from the two integration blocs alto-

6 <http://dif.org.ua/en/publications/press-relizy/dfefwgr>

7 http://www.public-consultation.org/studies/Ukraine_0315.pdf

8 European Parliament, Resolution on state of EU-Russia relations, June 10 2015



Ukraine Modernisation Programme

Milestones for Tomorrow

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view should include priority-setting and a feasibility check for the agreed deadlines for the application of EU legislation in Ukraine.

Striving for EU membership

Even during the negotiations on the AA, Ukraine wanted to be acknowledged as a potential candidate for EU membership. For many reasons the EU did not find itself in a position to respond positively to this request, but welcomed ‘the European choice of Ukraine’. Instead Annex XVII-1 of the AA stipulates: ‘Whenever the acts referred to contain references to EU institutions, committees or other bodies, it is understood that Ukraine will not become a member of such institutions, committees or bodies.’ Even the Maidan Revolution did not change the EU mind-set. Still, many in the EU regard the association just as a special policy instrument that is not linked to the enlargement process. For the time being, a consistent reform policy would serve as the most convincing argument for Ukraine being offered a membership option. On the other hand, it is very hard to imagine that Ukraine will be able to settle its internal conflicts and carry out the whole envisaged reform process without a clear EU perspective. The necessary changes and reforms will entail hardship and the overall gains will become visible only much later. It should also be kept in mind that Ukraine will face a democracy problem. The AA integrates the country to a large extent into the European rule system without giving Ukraine any substantial influence on the EU decision-making process. The country does not even have to be consulted about new EU legislation, merely informed, but needs to take over and follow up EU legislation with action as agreed in the AA in order to achieve and maintain ‘internal market treatment’. At the moment there is no discussion about this matter in Ukraine but there will be sooner or later, because it represents a far-reaching constraint on national sovereignty. Although legitimate from the EU’s perspective, this situation holds an inherent political risk for populist exploitation and public concerns, not least because the association was not backed by a referendum in Ukraine. Even more mature democracies such as Switzerland or Norway are struggling with the tensions arising from such sovereignty losses. In the case of Ukraine, the EU may also need to think about the risks arising for the whole of Europe if this matter becomes a burning issue in Ukraine. It would be by far the best solution for the EU to grant early qualification of the association as a step towards EU membership.

For many years a pro-European policy enjoyed considerable public support in Ukraine, in particular among the younger generation, across all regions. How-

of relationship, which is referred to as a 'new generation association'. There is no blueprint for mastering the transformation process in Ukraine, which cannot be compared at all to that of Poland or the three Baltic countries. At least the latter had a prospect for EU membership. Ukraine is subject to support from an extended IMF programme approved in 2015 and its main assumptions have already turned out to be overly optimistic. In addition, Ukraine is not only a result of the breakup of the Soviet Union and carries on a complex and difficult heritage but it is also still in the process of defining its national identity, a challenge in itself. Of course, the AA has inbuilt flexibilities for dealing with unforeseen events; however, the EU lacks comprehensive knowledge and sensibility for the sheer magnitude of the tasks in Ukraine, notwithstanding its enormous support and solidarity for Ukraine. Together with its financial institutions the EU is the biggest international donor for Ukraine and has mobilised more than 11 billion euros since 1991. As a result of the political changes and the crisis Ukraine will receive up to another 11 billion euros in loans and grants.⁴ However, public EU money is no substitute for FDI.

Overall, the risk is high that Ukraine may soon be seen as not delivering positive reform results, which will affect the credibility of the country. This could limit the readiness of the EU to provide further support and significant assistance. More importantly, low delivery performance on needed reforms will have a negative impact internally but also on the readiness of the EU to deal with the ultimate nature of the relationship with Ukraine.

The AA contains provisions to facilitate the market entry of EU businesses at a moment when Ukrainian businesses are in bad shape and a level playing field is out of the question for a rather long time. For example, the foreseen rapid opening of the public procurement market, an 'unprecedented example of the integration of a Non-EEA-Member into the EU Single Market'⁵, is theoretically good for businesses and consumers from Ukraine and from the EU. Under the current circumstances, however, it will unavoidably create disadvantages for Ukrainian competitors. EU legislation, however, does not provide for any preferential treatment of competitors, or countries, which are in severe crisis.

In conclusion the EU should be asked to accept a political review of the whole process of the envisaged implementation of the AA by Ukraine. The political re-

⁴ http://europa.eu/rapid/press-release_MEMO-14-159_en.htm

⁵ http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150981.pdf, S. 6

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The AA also offers comprehensive orientation on how to develop a modern functioning market economy with an efficient governance structure. Generally, the broad approximation to EU legislation that is foreseen is meant to assist Ukraine in breaking down inefficient monopolies, to drive competition and to get modern legislation and efficient institutions in place. The free trade provisions are designed to create a win-win situation in the long term, fostering welfare and social progress and creating a level playing field.

However, the situation in Europe has fundamentally changed since the AA was initialled at the beginning of 2012. The EU has still not yet overcome its multifaceted crisis. Ukraine was severely hit by the global financial and economic crisis of 2008 and its economic and social situation was further aggravated from 2013 on. Instead of the assumed FDI inflows needed to finance the EU approximation process, the country has experienced massive outflows of FDI. The conflict in Ukraine since 2014 and the very tense relations with Russia have added another heavy burden. The outlook for the overall economic, financial and social situation is rather gloomy. Apart from the fighting and massive destruction in eastern Ukraine and the looming economic and financial collapse, today's Ukraine is also confronted with a high unemployment rate and one of the highest numbers of internally displaced people in global terms. In the meanwhile it is experiencing a humanitarian crisis 'of untold proportions'. Moreover, poorly designed reform efforts lacking the close involvement of social partners have increased the burdens for businesses and likewise the potential for social unrest.³ Systemic corruption and corporate raiding are still dominant features holding back the exploitation of the rich potential of Ukraine. All these developments limit the capabilities of Ukraine to live up to the commitments enshrined in the AA, because the latter are based on a completely different scenario, assuming peace, stability, healthy economic relations and a continent bound together in partnership.

Delays in urgent reforms in Ukraine have already occurred and are likely to persist. As long as the internal crisis in Ukraine lasts, there will be severe restraints for the full use of the potential that the EU association offers. The whole approximation schedule as agreed appears now overly ambitious and in part, out of balance against the backdrop of the current crisis in Ukraine. There is a need to carefully reconsider the matters that should be given immediate and short-term priority and those that can wait to be addressed at a later stage.

Furthermore both the EU and Ukraine have entered new territory with this kind

³ See Labours Ultimatum of Trade Unions, representing 8 million employees in Ukraine

The AA was ratified both by the Ukrainian Parliament and the European Parliament in September 2014. Meanwhile most EU countries¹ have completed the ratification, which is an impressive record in itself. It already entered provisionally into force in November 2014, with the exception of its free-trade provisions. The EU already applies these provisions unilaterally, while Ukraine will most likely apply them as of January 2016. The provisional entry into force has generally kicked off the process of Ukraine's regulatory approximation towards EU legislation and binds Ukraine to the agreed time schedule as stipulated in the AA and its annexes.²

Nothing in the AA prevents the EU or Ukraine from developing close relations with other international partners. The agreement also does not prevent the parties from protecting their essential national security interests, including in times of war.

A major reform policy agenda

In essence, the AA represents a major reform agenda for Ukraine. Together with the reform programme agreed with the IMF in 2015, it offers guidance for transforming Ukraine into a modern European democracy and a fully functioning market economy, with substantial long-term societal benefits. Politically it will be vital for Ukraine to complete the democratic transition and to fully guarantee civil liberties, minority rights according to international standards, the rule of law and to overcome the systemic corruption. These steps are crucial for ensuring political stability and a central precondition for mastering the economic reform agenda; including attracting international investments (see relevant chapters in the paper). The overall quality of Ukraine's relations with the EU largely depends on full compliance with EU expectations in these areas. The EU will not tolerate the persistence of major weaknesses for long and this attitude is backed by public opinion. It is worth remembering that the EU originally refused to sign the AA in 2012 for political reasons.

¹ Based on new Dutch legislation about holding consultative referenda on international treaties that have not yet entered into force, there is an initiative for launching such a referendum on the EU-Ukraine Association Agreement. This initiative is delaying the entry into force of the Dutch ratification to September.

² See Art 486 of the AA. For trade and trade related measures, the provisional application will start on January 1, 2016. However for some services, such as financial services or postal services, covered by Annex XVII of the AA foresees even the date of the signature as the starting point for the implementation deadline.

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1 The Association Agreement – the road towards EU integration

Introduction

With the enlargement of the European Union (EU) in 2004 and 2007 Ukraine has become a direct neighbour of the EU, sharing borders with now 4 member states (Hungary, Poland, Romania, and Slovakia). This changing geopolitical reality has pressured both sides to strengthen the mutual relations, which date back to 1994. Ukraine has accepted the political offer of the EU to establish a political association, combined with a far-reaching economic integration of Ukraine into the EU's internal market. Although the negotiations started back in 2007 and were concluded by the end of 2011, the two years thereafter were overshadowed by a difficult relationship between the EU and Ukraine and increasingly also towards Russia. The whole process was only able to be drawn to a close following the ousting of the previous Ukrainian government, an act accompanied by sharp tensions with Russia.

With the Association Agreement (AA) the EU and Ukraine have bound their destinies together. The agreement is based on shared values. It foresees close political cooperation in important policy areas, ranging from foreign policy to space. It envisages closest possible economic integration and cooperation. The agreement aims at abolishing important obstacles to the four freedoms of movement: visa-liberalisation (subject to the fulfilment of preconditions as defined outside the AA), free movement of goods and services (with restrictions, mostly on the EU side) and free movement of capital (with restrictions on the Ukrainian side). Free movement of persons and the freedom of establishment of self-employed persons are not covered by the AA. Strategically the economic EU-Ukraine relations will be nearly comparable to the relations the EU has established with Norway, Iceland, Liechtenstein and Switzerland. Georgia and Moldova have also entered into a similar relationship. Politically, the AA establishes cooperation structures at parliamentary and governmental level and also between the civil societies of the partners. It opens the way to the participation of Ukraine in EU programmes and agencies.

inclusive process. The civil society as a whole and the stakeholders in relevant sectors need to be involved in the design and the implementation of association commitments, not least to ensure ownership and responsibility. It goes without saying that the integration of Ukraine into the internal market of the EU cannot be seen as a stand-alone policy. It is connected to the predominant political tasks of Ukraine, which have to be fulfilled irrespective of the EU association. Those tasks are as follows: achieving peace and internal stability; reforming the governance system and carrying out overall economic and social modernisation. The AA can serve as an enabler and facilitator. In the best case scenario the AA will help Ukraine to transform itself into a stable democracy and prospering economy but in the long term. In the short and medium term, the needed overall reform process will entail a lot of hardship in Ukraine.

Given the importance of Ukraine for the future of the EU the whole association process needs constant political attention and guidance at the highest level to live up to the partnership the EU has promised. Consequently, political leaders need to be in the driver's seat.

The research in this paper is based on the most recent figures from Ukraine, the EU and other international institutions. Many experts have contributed with valuable input and advice, for which we are most grateful. Nevertheless, the responsibility for the analysis and the recommendations as well as for possible errors stays entirely with us.

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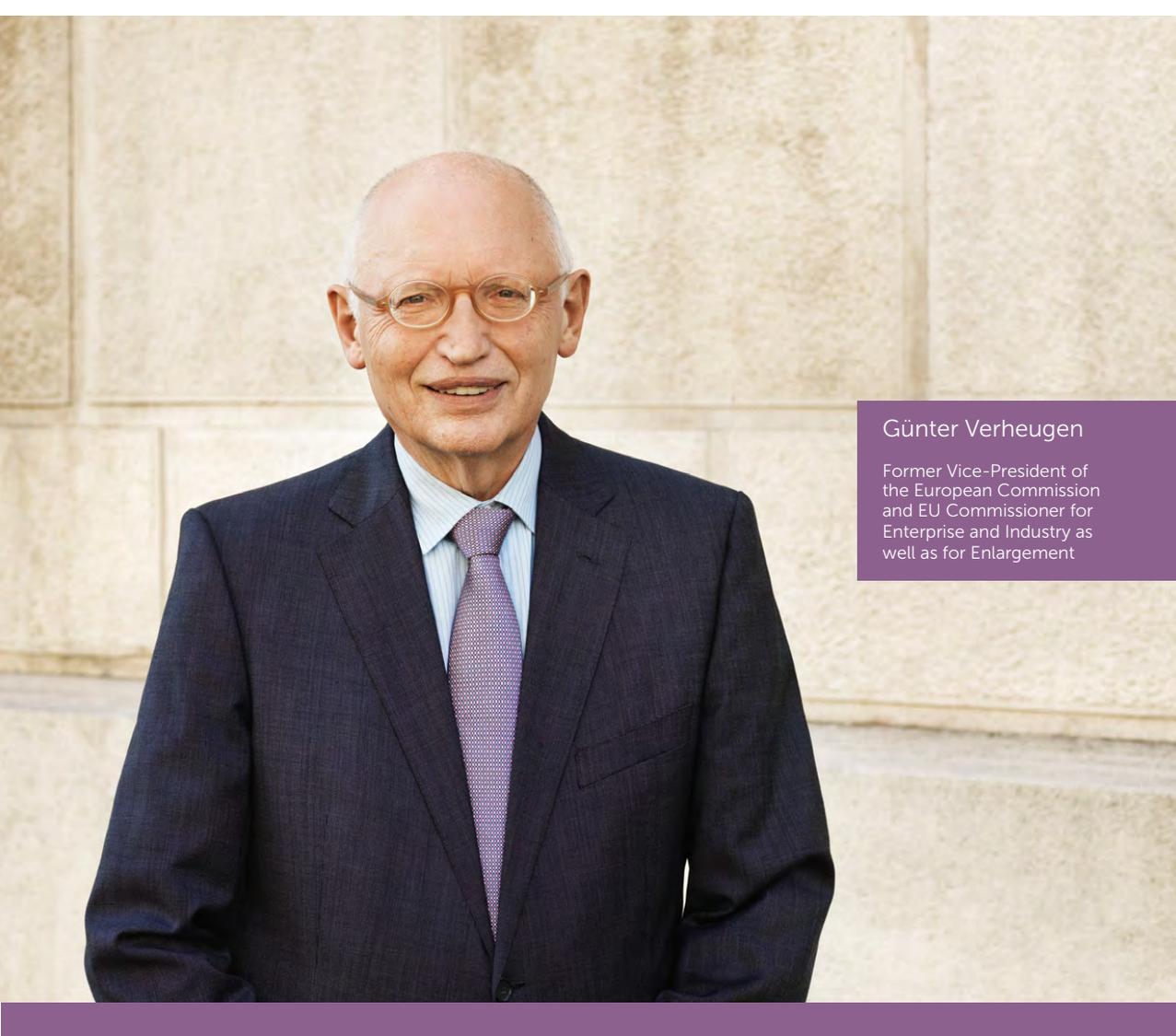
Management Summary

This paper looks into the Association Agreement (AA) between the EU and Ukraine from a strategic perspective. It is not an abbreviated version of the text of the agreement but an analysis of its political and economic objectives and the challenges and opportunities that it creates for policy makers in Ukraine and for Ukrainian society as a whole.

When signing the AA, Ukraine made an irrevocable political choice to become part of the European integration process. The analysis confirms that the EU-Ukraine AA does indeed constitute a new type of EU association, comparable only to the status of the members of the European Economic Area and Switzerland. There are also striking similarities with accession treaties of Central and Eastern European countries that joined the EU in 2004 and 2007. However, the AA does not explicitly open the door to EU membership for Ukraine. Nevertheless it cannot be considered as the final step in EU-Ukraine relations. The finality of the process will depend largely on the level of ambition on both sides with respect to its sound implementation. Indeed, implementation is the elephant in the room.

The result of many meetings and four workshops, which were held in Kiev with representatives of civil society, policy makers, the business community and trade unions from Ukraine, showed clearly that Ukraine is not yet sufficiently prepared to deal with the sheer amount of commitments enshrined in the AA and its annexes. The main reason for this appears to be that it is still widely unknown, even within the elites of Ukraine, that the established association is not a kind of voluntary cooperation but a binding obligation that entails a considerable loss of national sovereignty. Policy making in Ukraine will be to a large extent predetermined by the EU agenda. That is the reason this paper looks into some of the politically important areas of cooperation and discusses methodology and the most urgent needs.

A general weakness is the fact that the AA was negotiated and concluded already in 2011 under very different conditions than those prevailing in Ukraine today. Many assumptions, in particular economic expectations, are now overly optimistic. Under the given circumstances the whole project appears to be too ambitious in terms of timing and funding. There are Ukrainian voices asking for renegotiation. Instead, this paper recommends undertaking a common political review to adapt the envisaged implementation schedule in its entirety. Findings also show that the process of EU integration in Ukraine is not yet organised as an



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IV EU Integration

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- the conduct of the state’s economic policy is often directly controlled by business elites, moguls, and powerful business interests, which continuously take part in degrading and corrupting the independent operation of the rule of law. Also media resources and several key state enterprises are controlled by so-called oligarchs;
- owing to the desolate economic situation, Ukraine is currently experiencing a massive brain drain of well-educated (young) people moving abroad. Their know-how and commitment is just what Ukraine so urgently needs for successful economic development. Back in the 1990s, hundreds of thousands of well-qualified citizens also left the country. Consequently, the population dropped from 52 million inhabitants in 1993 to 45.5 million today. The so-called ‘contemporaries of independence’ are leaving university. They are too young to have played a role in the Orange Revolution and therefore too young to be disappointed by its failure. Their talents, aspirations and idealism need to be forged into a high-powered generation of graduates capable of leadership in bringing about modernisation;
- educational institutions are insufficiently prepared for the innovation economy. University R&D has limited links to industry; vocational training has not been upgraded to modern standards;
- there are large regional disparities in access to and the quality of education. The quality of and access to education is undermined by the high prevalence of bribery to gain admission to better institutions or to pass courses.

Outlook

In spite of the challenging situation faced by Ukraine, AMU sees realistic chances for the country to achieve positive economic development in the medium term. The key to success will be to convey modernisation policy in a civil society dialogue jointly supported by civil society, the business community and the political sphere. A fresh start for Ukraine under the above premises would open up opportunities for stability, growth and prosperity for Ukraine and for Europe as a whole.

Dialogue with the EU and with national governments

EU support for Ukrainian modernisation is a crucial factor for success, so AMU also arranged numerous meetings with representatives of the EU. The deliberations revolved around a strategy for forging closer ties between Ukraine and the EU and around requirements and prospects for investments in Ukraine. In their contacts with states and institutions in Europe, the representatives from AMU and the participating experts will continue to be advocates for Ukraine and its concerns.

Challenging tasks

The country's current situation is attractive neither for commitments by domestic entrepreneurs nor for investors from abroad. The following highlights illustrate the fundamental need for the modernisation of the country:

- the conflict in the east causes human suffering and has profoundly negative consequences in that it is devastating the broader foundations of society and the economy in Ukraine as a whole. Moreover, it inhibits much-needed political reforms by diverting attention and personnel resources away from them. These resources are essential for modernisation;
- Ukraine at the moment has a business environment that suppresses prosperous development. Economic growth was -8.2 % in 2014. Civil society and young people are given no perspectives on what a flourishing country might look like;
- according to official statistics, about 10 % of the populace is unemployed. That means 1.9 million working-age people have no income of their own. The percentage of unrecorded unemployment is estimated to be much higher because many of the jobless do not register in the first place or have to work within the overpowering shadow economy. Others estimate that one in four Ukrainians is without work;
- based on rankings of 210 countries for the Worldwide Governance Indicators of the World Bank in 2013, Ukraine ranked 185th for the indicator 'Control of Corruption' and 147th for the indicator 'Government Effectiveness'. Corruption is not a breach of the norm rule, it is the norm rule in Ukraine. Corruption in any form prevents Ukraine from making optimum use of its assets. Also substantive foreign assistance and investment will only be forthcoming if corruption is stopped, which would also favour closer ties with the EU;

I Executive Summary

Ukraine is a European nation rich in cultural diversity and human and natural resources. Her peaceful and prosperous future should be valued and respected by everyone. Lasting external and internal peace is the precondition for everything. Today the need for stability, growth and prosperity is compelling. Humanitarian suffering and drastic economic decline are taking place before the eyes of the world. Action cannot be delayed. Support from the international community cannot be denied.

That is why the Agency for the Modernisation of Ukraine (AMU) has been founded as a non-governmental organisation dedicated to assisting Ukraine in successfully mastering its modernisation and to preparing the country for eventual membership of the European Union. The whole reform process should be coherent and not follow a piecemeal approach. People need to know how the turnaround of the country will be achieved and what their contribution should be. The necessary transformation process will take time and resources. While the European Union and others have already made substantial contributions, further engagement is absolutely crucial. It can take the form, inter alia, of Ukrainian business elites taking urgent steps to support transformation, including by making arm's length investments in their country's future and by avoiding behaviour that is anti-democratic, anti-competitive or that in other ways undermines good governance and the rule of law. The purpose of this report is to propose concrete ways of achieving positive economic and institutional development in Ukraine in a modernisation programme flowing from high-calibre, independent international expertise.

To that end AMU has commissioned eminent European experts who have held prominent positions in their own countries and the EU to produce studies focusing on EU integration, anti-corruption, modern government, rule of law, constitution, economy, taxation, finance and health.

The experts have made detailed recommendations in their separate fields that appear in the respective chapters. The core recommendations are as follows:

Economy

An economic emergency package is required to consolidate the budget, fight inflation, achieve currency stabilisation and procure debt relief. This list is a bare minimum, a prerequisite for the country to go forward to implement the other reforms. While restructuring is unavoidable, appropriate steps must be taken to counteract social hardship.

It is imperative that new jobs be created and that existing jobs be brought out of the shadow economy. Employers and foreign investors must be given fiscal and other incentives. The creation of 'prosperity zones' will provide preferential conditions for foreign and domestic investment. Such zones would become front-runners in creating a business friendly environment. Utilisation of the country's competitive advantages should aim at the development of innovative, high value added industries and the creation of quality jobs. Ukraine has the opportunity of becoming a key production hub in Europe.

The opportunity for all, and not just some, of the people to enjoy the benefits of privatisation of public property is now long overdue. To avoid a new level of oligarchism, ongoing privatisation should cease under a moratorium in order to provide time for proper strategies and structures in partnership with international experts to be developed. This approach is a prerequisite for ensuring that any further privatisation in Ukraine will be fair, transparent and rational.

A constitutional amendment is needed to guarantee rights to private property. It should include the abrogation of special state protection of land deemed to be the 'wealth of the nation'. These changes are the preconditions for the appropriate privatisation of state land and sustainable liberalisation of the land market.

The creation of credibility in the banking sector is essential. This step requires overall consolidation, the full independence of the National Bank of Ukraine and progress towards the incorporation of EU legislation on financial services. The Ukrainian market would benefit from cooperative banking, especially with regard to the needs of small and medium-sized enterprises in the agricultural sector.

Comprehensive healthcare reform is indispensable, but has a long way to go. A starting point would be to create a College of Physicians of Ukraine as the mechanism for setting and monitoring standards of medicine in all specialities and to supervise the licensing of doctors and hospitals. This body could also act in a leadership capacity to achieve the necessary restructuring of medical care and treatment.

'Healthcare' was led by Prof. Illya Yemets, former Ukrainian Health Minister, and Prof. Paul Robert Vogt, founder and president of the EurAsia Heart Foundation, both leading cardiac surgeons.

Although the key topics of the workstreams do not claim to be exhaustive, the participating experts do consider them to constitute the immediate challenges and modernisation requirements in Ukraine.

Civil society dialogue

In drawing up the modernisation programme for Ukraine, AMU has relied not only on the use of international expertise, international benchmarks and scientific studies but also on a definite civil society approach. This is the second thrust of AMU activities and it distinguishes AMU markedly from other organisations.

This approach is in keeping with how AMU views itself, namely as a non-governmental organisation (NGO) intent on developing approaches and solutions for the modernisation of the Ukraine independent of the Ukrainian or other governments. The AMU mission therefore revolves around listening, understanding and devising joint solutions. With the events it has staged thus far in Ukraine, AMU has also helped to heighten awareness in the country about the need for reforms.

AMU believes that high-calibre international expertise combined with the active participation of civil society is indispensable for tackling the challenging tasks facing Ukraine.

In the course of developing the Ukraine Modernisation Programme, AMU staged a huge number of meetings and events in Ukraine in order to lend an attentive ear to Ukraine. All workstream leaders visited Ukraine several times and for that reason more than 20 field trips throughout Ukraine were organised – to Charkiv, Odessa, L'viv, Kyiv and many other cities as well as to many venues in rural areas such as farms or production plants. During these field trips 155 meetings with various experts and members of civil society took place. And finally five round-table talks with more than 300 participants from the fields of science, public administration, politics and civil society were held in Kyiv. The motto of these talks was 'We want to listen, to understand and to learn' and was intended to encourage a broad and open discussion.

- the potential and the resources of Ukraine for successful economic and social development must be mobilised strategically and purposefully;
- government and civil society should be the engines of the modernisation process in Ukraine out of a sense of joint responsibility for the country;
- the combination of independent international expertise with civil society know-how from Ukraine can give substantial fresh impetus to the modernisation and transformation of the country.

Independent international expertise

One thrust of AMU activities is to combine the knowledge and findings of outstanding experts and experienced politicians from throughout Europe in order to assist Ukraine with its further development.

Top figures with excellent political and professional experience were selected to develop the different workstreams of the programme and contribute their own independent expertise on a contractual basis:

- the workstream 'EU Integration' was led by Günther Verheugen, former Vice-President of the European Commission and EU Commissioner for Enterprise and Industry as well as for Enlargement (Germany);
- the workstream 'Anti-Corruption' was led by Senator Włodzimierz Cimoszewicz, former Prime Minister and Minister of Justice (Poland);
- the workstream 'Rule of Law' was led by Ken Macdonald QC, member of the House of Lords and previous Director of Public Prosecutions Deputy High Court Judge (Great Britain);
- the workstream 'Constitution' was led by Otto Depenheuer, professor of constitutional law, public law and the philosophy of law at the University of Cologne (Germany);
- the workstream 'Economy' was led by Waldemar Pawlak, former Prime Minister and Minister of the Economy (Poland);
- following initial contributions by and the withdrawal of former Finance Minister and Member of the Bundestag Peer Steinbrück (Germany); the workstream 'Tax and Finance' was led by former Vice-Chancellor, Foreign Minister and Finance Minister Michael Spindelegger (Austria);
- following initial contributions by and the withdrawal of Bernard Kouchner, former French Minister of Foreign and European Affairs and founder of Médecins Sans Frontières (Doctors without Borders); the workstream

EU Integration

The EU and Ukraine have decided to bind their futures together. Their association is decisive for the social, economic and political future of Ukraine. The country urgently needs its own implementation strategy to move from commitments to actual delivery. A Deputy Prime Ministerial Office for EU Affairs should be created with strong powers to ensure leadership and responsibility for Ukraine's full compliance with the association agreement. Closely coordinated cooperation with the EU and its member states is needed and experts should be invited to provide advice and support.

The association agreement will establish a new and challenging regulatory environment, which will affect all sectors of the economy, and full compliance will be a highly demanding task for all businesses. In addition, specific sector strategies are needed. Their quality and usefulness will depend on the full participation of the relevant social partners, which in any event is required by the Agreement. The time frame for implementing the obligations of the Agreement – originally set in the different circumstances of 2011 – should be reviewed in order to establish both priorities and realistic capacities for delivery. As important and extensive as the Agreement is the need for integration in the EU market and policies. This would not prevent Ukraine from developing fruitful and good relations with all its neighbours and international partners.

Finally, since 1991 the energy sector has been the source of periodic economic and political crises. The current situation is unprecedented and engenders genuine vulnerability from a humanitarian standpoint. Therefore a new national energy strategy is urgently required to address the complexity of the problems, the challenges of liberalisation and the paramount importance of ensuring energy safety and security of supply. Due consideration must be given to the safe operation of nuclear power plants and nuclear waste disposal.

Constitution

The role of the constitutional court in protecting the constitution and in acting as the ultimate guardian of the rights of the citizens of Ukraine should be enhanced. The independence of its judges and the right for individuals to bring complaints to the court should be guaranteed. Therefore constitutional amendments are needed and must be implemented immediately. If a more fundamental constitutional settlement in Ukraine is to occur then society must be engaged in this process as broadly as possible. Major constitutional questions must be settled on a political level before the solutions can be implemented in a constitutional form. The obvious example awaiting ultimate resolution is the recurring conflict of constitutional power between the office of president and the office of prime minister.

Rule of Law

There should be a re-evaluation of all judges and all law enforcement personnel – as opposed to selective lustration of only some of them. Any such assessment must include their legal and professional ability, their integrity and the extent to which they can justify financial and other assets in their possession and control.

The structure of the court system as a whole must be reformed to limit the number of courts. The enforcement of court orders must improve drastically, partly through the creation of a private bailiff service and partly through the courts gaining and using new powers to ensure compliance. While trust in the quality and dignity of the judiciary is being restored, methods of alternative dispute resolution should be enhanced and made far more widely available. There must be a fundamental reform of legal education. Teaching of legal science should be uncoupled from law enforcement. The concept of the rule of law should be taught as the central organising principle of all legal analysis. EU legal studies must be introduced as a comprehensive subject for the first time in Ukraine and as an essential aid to EU association.

perts in conducting analyses and devising concrete recommendations for modernisation measures. As a next step AMU suggests that the effects of the recommendations be evaluated with a macroeconomic model used by the European Commission;

- the second phase should involve the implementation of concrete reform projects referred to as 'lighthouse projects'. These projects serve as examples of how recommendations can be implemented;
- in the third phase, plans for the Ukraine Modernisation Fund should be implemented. With this fund, Ukraine seeks to make accessible the resources necessary for investments in modernisation and in the future of Ukraine. This fund is directed not only at foreign investors but also at the 'oligarchs'. The huge economic power they hold gives them a special responsibility toward the country. AMU therefore proposes that the modernisation fund for Ukraine be endowed by the oligarchs and other players in the Ukrainian economy. Steps are to be taken to halt the further outflow of capital from Ukraine to other countries.

Underlying hypotheses of the modernisation programme

The AMU Programme is to be understood as an offer to Ukraine to develop an independent Ukrainian path to stability, growth and prosperity.

It is based on the following hypotheses:

- ending the military conflict in the eastern part of the country is the vital prerequisite for positive economic development in Ukraine;
- Ukraine has its future in Europe. Membership in the European Union should become a common objective, shared both by Ukraine and the EU member states;
- the support of the European Union (EU) in the modernisation of Ukraine is essential. Democracy and the rule of law in keeping with European standards provide the necessary foundations for Ukraine to develop successfully both economically and socially;
- the necessary modernisation process can, and in some areas will, further aggravate the economic situation for civil society in the short term, so citizens must be given a positive perspective that modernisation can succeed;

III Preamble of AMU

Milestones for tomorrow

The Agency for the Modernisation of Ukraine (AMU) was founded as an NGO in March 2015 at the initiative of two Ukrainian social partners: the Federation of Employers of Ukraine (FEU) and the Federation of Trade Unions of Ukraine (FPU). The founding of AMU was brought about by Bernard-Henri Lévy, French philosopher; Richard Risby, member of the British House of Lords; and Karl-Georg Wellmann, member of the German Bundestag. Michael Spindelegger, former Austrian Vice Chancellor, Foreign Minister and Finance Minister and his deputy Udo Schulze Brockhausen were entrusted with the office of President of AMU.

Mandate and goal of AMU

The mandate and goal of the Agency for the Modernisation of Ukraine (AMU) is to point out concrete ways of achieving positive economic and institutional development in Ukraine in a comprehensive economic-political modernisation programme based on high-calibre international expertise.

If the necessary steps are taken, Ukraine would then be able to stand on a strong economic foundation in future and continue its development as part of the European family on an equal footing with Europe. The successful introduction of European standards is fundamental to Ukraine's independent decision regarding its accession to the European Union. A strong relationship between Ukraine and the European Union is the common thread in all recommendations of this programme.

A Ukraine with full capacity to act and enter into legal transactions would profit not just its own citizens and companies but Europe as a whole. The modernisation of Ukraine is therefore meant to guide the country out of a lose-lose situation into a win-win situation – for the people and the economy, for prosperity and democracy.

Three phases

The work of AMU covers three phases:

- the first phase involved developing a comprehensive modernisation programme for Ukraine. Priority workstreams were formed, within which major figures from business, academia, and politics led international ex-

Modern Government

The concept of public governance – where citizens and various groups are seen as partners and stakeholders and not as subjects – is the route to modern consensual government. This would include realigning the relationship between central and local government, so the latter can enjoy political and financial autonomy, the essence of decentralisation. Government and administration at all levels must become more efficient. The introduction of a new model for the civil service, enshrined also in the constitution, would create an ethos of administrative personnel who are independent of politicians but dedicated to the common good.

Ukraine must end the burdensome hostility of the commercial environment for both local and foreign business by adopting principles of smart regulation based on EU best practice. Removing undue barriers and fostering entrepreneurial activity can be achieved through extensive deregulation of private sector conduct, coupled with strict codification of public servant conduct.

Anti-Corruption

Corruption is the bane of Ukraine's misfortune. It must be eliminated. Political will is fundamental to doing so. A fully democratic society can only be achieved with a set of new standards for electoral procedures, a new system for financing political parties and anti-monopolisation measures. Oligarchic conduct cannot continue. Radical measures must be introduced with an eye to eliminating the unofficial influence of some of the richest entrepreneurs on the functioning of the state, including high political offices, the legislative process and law enforcement. The National Anti-Corruption Bureau and the National Agency for the Prevention of Corruption must begin their work without further delay. A campaign of anti-corruption awareness through media, education and civil society should start now to persuade the public that life without corruption is possible, easier and better. It must become a criminal offence for public officials to withhold knowledge of corruption.

Based on the result of this report AMU recommends the establishment of Lighthouse Projects, examples designed to demonstrate how selected reform proposals set out here might be implemented swiftly, cheaply and effectively. Ultimately, AMU suggests the setup of a substantial international investment fund combining public and private investment to facilitate the modernisation of Ukraine.

II Preface of the President of AMU

As president of the Agency for the Modernisation of Ukraine (AMU) I am pleased that we succeeded in drawing up this Programme for the Modernisation of Ukraine within 200 days under challenging circumstances.

It is a welcome signal for Ukraine and for Europe that first-class international experts with their teams and representatives from Ukrainian civil society have come together to develop well-founded perspectives on the modernisation of Ukraine.

This collaboration involving vast expertise, personal commitment, esteem and a joint focus on solutions is exemplary for the future.

My special thanks therefore go out to the international experts who led our workstreams. They made available their independent expertise, showing great commitment to and superb professionalism in this outstanding project.

Of course, I also express my considerable gratitude to the Ukrainian social partners and all other representatives of Ukrainian civil society that not only initiated this modernisation dialogue but also actively fostered the shaping of it. Their forward-looking attitude emphasises the positive potential for change that has to be activated in Ukraine for the modernisation of the country. AMU's countless discussions and meetings in Ukraine left us convinced that there is a great readiness to go forward with the transformation of the country, which is certainly a demanding task for the future.

I would also like to thank the teams at our AMU offices in Kyiv and Vienna. Their dedication has allowed the ambitious AMU modernisation programme to be drawn up across national and linguistic borders and to be made available in an illustrative online presentation.

After an introductory preamble about the mandate and work of AMU, the workstream leaders present the results of their subject areas. The content of these workstream contributions is the responsibility of the independent experts and has been created in an environment of full independency. The ongoing coordination of content from the individual workstreams allowed a consistent and balanced overall programme to be prepared. The outline of the identified lighthouse projects can be found in the annexes.

This jointly developed Ukraine Modernisation Programme marks an initial step in laying the groundwork for a stable, economically and socially successful future for Ukraine. The necessary first steps are indicated for each workstream. Many further steps and efforts at implementation will undoubtedly have to follow. AMU is convinced they will be worthwhile for Ukraine and for Europe.



Michael Spindelegger

A suitable deputy Vice Prime Minister for energy with strong coordination powers should be considered.

All previous energy strategies have turned out to be unrealistic. Therefore the decision about the new energy strategy 2035 should be based on mapping both production capabilities and consumption needs in the shorter period and by successively developing a coherent view about its energy needs in the longer term, up to 2035 and 2050, while taking into account climate change policies. A coherent industrial strategy, a clear vision about the future of the mining industry in Ukraine, a sober risk-benefit analysis about the extension of the life span of nuclear power capacities in Ukraine as well as the role of energy in the export strategy of Ukraine would form a reliable basis.

Ukraine needs to ensure that the planned market liberalisation does not undermine the market rationale and that the design and the implementation are based on competence and impartiality. Full sector involvement is absolutely crucial to avoid economic and social stress. Regulatory oversight should be done fully independently, ideally by persons beyond reproach, broadly respected and with outstanding skills and knowledge about the relevant sector.

Ukraine must find lasting solutions for its gas imports. Issues include the settlement of its conflicts with the Russian gas provider, which may only be achievable in a tripartite format supported by the EU after the ruling of the Stockholm arbitration procedure. Part of this lasting solution is early clarity about the future of Russian gas transit through Ukraine.

Ukraine should treat nuclear safety of its nuclear power plants (NPPs) as a matter of utmost political priority and should not allow further delays in enhancing the safe operation of its NPPs and maintain a high inspection rate.⁴³ The same goes for the treatment of nuclear waste on the territory of Ukraine. Ukraine must actively communicate with its neighbours and with the EU as a whole to demonstrate that all choices made, including the extension of the life span of existing NPPs are scientifically and technically sound and not merely a function of distorted Ukraine-Russian relations.

Fighting energy intensity should also rank very high in the revised energy strategy of Ukraine. Similarly, small-scale alternative energy projects, carried out at

⁴³ Accidentally Ukraine has eliminated on spot inspections of its NPPs at the end of 2014 (as part of its attempt to reduce administrative burdens for enterprises, see <http://bankwatch.org/publications/letter-ebrd-nuclear-inspections-must-continue-ukraine>)

gether. The previous 'either with us or with the Eurasian Union' policy no longer holds true, as the EU is now ready to explore more intense relations also with Armenia. In the longer term, the issue of building strategic links between the EU and the Eurasian Union will re-emerge because such a continental network would be the most reasonable tool to respond to the challenges of globalisation. Integrating Europe on a continental scale in such a way would also facilitate the settlement of regional conflicts that have remained frozen for many years.

Towards visa-free travel with the EU

Visa-free travel plays a central role for the deepening of relations between the EU and Ukraine, not least because it is one of the main expectations of the Ukrainian public. It would allow ever more people-to-people contacts and deepen the public knowledge about the EU and about Ukraine, which is, for many West Europeans, still a blank on the European map. It would also place Ukrainian businesses on equal footing with EU partners and strengthen economic and commercial ties. Therefore this issue is rightly seen as a priority. However, given Ukraine's overall economic and social situation, it is unlikely that many Ukrainians could now profit from visa-free travel. The establishment of many cost-free visiting schemes on the part of the EU and other international partners of Ukraine would be needed to change this situation profoundly in the medium term.

At the moment both sides are working towards a solution in 2016. The conflict in Ukraine has injected new risks into the process, notably as a result of the substantial increase of illegally possessed weapons in Ukraine. While this issue has not yet been publicly discussed, the security threats linked to it are obvious and it therefore urgently needs to be addressed by all sides.⁹ There are also concerns in some quarters of the EU that visa-free travel would be misused and would lead to illegal immigration.

Reform and stakeholder engagement

The AA entails a detailed, very tight schedule for the adoption of major parts of EU legislation by Ukraine. Progress has to be reported regularly, at least twice a year and will be collectively evaluated in the framework of the association

⁹ See <https://www.europol.europa.eu/content/european-union-terrorism-situation-and-trend-report-2015>, page 7

institutions at governmental, parliamentary and civil society level. The Ukrainian government has adopted an Action Plan comprising 487 measures to comply with association requirements until the end of its electoral term.¹⁰ These measures are of a different nature and level of ambition and lack priority setting. The Ukrainian Parliament has formed a pro-European network to foster the process. However, the coordination on EU affairs within the government is very complicated and even confusing. Both the distribution of responsibilities and the hierarchy structure show ample room for improvements (see Annex I), a fact also reflected in the Action Plan. Reports on its implementation do not allow a proper evaluation of the progress achieved. The Parliament has not yet developed a culture of good law making and passes unrelated pieces of legislation in packages, without proper preparation and parliamentary consideration. This practice contains high risks. Furthermore Ukraine lacks a firm political commitment to the inclusion of the social partners and of civil society in the envisaged reform process. Although the AA urges Ukraine to set up dialogue and consultation structures and to publicly develop and discuss its reform agenda (see Annex II), most of these requirements are not followed up in the Action Plan.

Normally broad stakeholder inclusion is seen as a prerequisite for high quality legislation. It would also enhance responsibility and ownership for the individual reform steps. Ideally, society should be involved both in developing legislation and in monitoring whether the new legislation is properly implemented and functions according to the expectations. This broad societal involvement is of utmost importance because the envisaged regulatory alignment with the EU has never been evaluated in Ukraine; a reality check has never been conducted.

Public involvement now might also help to identify wrong assumptions and better ways to carry out the reforms. It may help to address social issues at an early stage. Quality matters more than speed when transposing EU rules into Ukrainian legislation. In addition, the involvement of all stakeholders and civil society at large has an immense policy dimension. Up to now, the process of nation building in Ukraine has been driven by the desire of separating from Russia and the Soviet heritage, which is an understandable but not forward-looking process. The big question is whether the association and the aspiration of EU membership could become the forward-looking part of the nation-building

10 Action Plan on the Implementation of the Association Agreement
http://www.kmu.gov.ua/kmu/control/en/publish/article?art_id=248402403&cat_id=248402399

Strong safeguards that ensure the safe use of new IT tools should accompany transition towards the information society. Ukraine should remain vigilant against cybercrime as it undermines the trust of the society in new media.

Furthermore Ukrainian media and TV should be encouraged to develop a vibrant corporate social responsibility culture. Part of the latter could be the provision of regular objective information about the EU by Ukrainian media.

Ukraine should ask the EU to begin the negotiations on the road transport agreement without delay. It should be put in place concurrently with the full approximation to EU road transport legislation.

Ukraine should develop a coherent strategy on its transport network, identifying priority axes for road and rail transport to develop its infrastructure as part of the Trans European Transport Networks.

Ukraine should improve substantially its road capacity through modernisation and new construction and prepare for the increased traffic from east to the west.

Ukraine should find incentives to ensure that road vehicle fleet modernisation is driven by high safety and environmental standards. To that end Ukraine may wish to look into the Turkish experiences, as the Turkish fleet is now one of the most modern in Europe.

Ukraine should closely consult with the EU before liberalising the railway sector, notably concerning needed transitional arrangements, the tariff structure and the general question of infrastructure financing.

Ukraine should ask the EU Council and the European Parliament to include Georgia, Moldova and Ukraine among the countries that are to benefit from training by the European Railway Agency.

Ukraine is encouraged to pursue its ambition to develop inland waterway transports, as this would substantially lower costs for agricultural businesses as well as for industrial companies. There is also a need to discuss these plans early on with the EU Commission because EU environmental legislation and recent rulings of the European Court of Justice should be taken into consideration.

The whole energy sector should be treated as a top political priority, given the unprecedented crisis and the complexity of the tasks. Strong political leadership would be advisable, so that the energy challenges could be coordinated across the government. The sector would benefit from professionalism and impartiality.

to be below potential, as renewable energy sources would also help Ukraine to address the challenges of climate change. For now, Ukraine belongs to the most energy-intensive countries in the world. Apart from the large share of energy-intensive industries in Ukraine's economy, the room for substantial improvements in energy efficiency is particularly high in the building sector and also in heating distribution. The membership of Ukraine in the Energy Community already required the country to take over relevant EU legislation from 2013 on; however, these deadlines have not been met so far.

The situation on the ground looks rather gloomy, because Ukraine has not yet managed to set up all the preconditions for ensuring a full-fledged market-based system, which is a pre-requisite for properly addressing also the issue of enhancing efficiency in the energy and utility sector. Ukraine has set up an independent regulator and has started installing meters to get a proper overview of the consumption levels and the potential losses in the system. Once meters have been rolled out across the country, which is foreseen for 2017, Ukraine will be able to map the strengths and the weaknesses of the system on an informed basis. This will be equally true of consumers, who have had up to now only limited incentives to actively contribute to behaviour showing an awareness of energy and climate change. As long as there is no clear knowledge about the realities in the sector, investors will be hesitant to commit, although the requested unbundling of energy generation and distribution as well as privatisation in the energy sector offer ample room for substantial private investment.

3.4 Recommendations for the three key sectors

The further development of the telecommunication sector should be fully encouraged and therefore driven as an inclusive process, with strong stakeholder involvement and a fully independent regulator, acting under clear rules. Civil society institutions should be encouraged to act as watchdogs, protecting human rights and freedoms while entering the digital era.

Ukraine should approach the EU to arrive at an early understanding about how to best ensure stable and foreseeable framework conditions for the telecommunication sector and how to approach further sector liberalisation in legal terms, with close attention to ethical questions, consumer and data protection requirements.

process, bridging divisions within Ukraine and mobilising a majority for pro-European reforms. This would definitely stabilise the country and also prevent excessive nationalism, which, in itself, is not compatible with universal and European values.

Better regulation and proper implementation matter

The implementation of EU legislation in Ukraine is a challenge but also an opportunity to apply modern regulatory principles to make legislation more understandable, reduce burdens for businesses and consumers and to narrow down the margin for administrative misbehaviour. Today Ukraine is suffering under 'a stifling regulatory burden'¹¹

Besides being adopted, legislation must also be implemented. This step is crucial. The EU closely monitors the implementation process, as demonstrated also during recent enlargement rounds. Consequently, Ukraine cannot count on any political rebate in case of major implementation flaws, even if relations are politically now closer than ever before. That places the European Commission and experts of the member states as monitors in a very strong position. Of course, Ukraine may also profit from assistance from the European Commission and member states to ensure full compliance. Unlike for other countries, there is a dedicated team established within the Commission to assist Ukraine. Member states also have ample experience and Ukraine could team up with some of them, ideally relying on the regulatory traditions of a few countries with strong administrations and a sound but not too heavy administrative culture, such as the UK.

Education and language skills

The Ukrainian administration is prepared in part to deal with European integration issues. However, notably the higher education system is not adjusted to the fact that within a few years a big part of the regulations in Ukraine will be driven by European legislation. There are no full-fledged European studies in Ukraine, neither in politics nor in law, although Ukraine needs to equip a new generation of Ukrainians with sufficient skills and knowledge. Communication between Ukraine and the EU and its member states will pose another challenge, because Ukraine must always use one of the official languages of the EU. The announce-

¹¹ <https://www.imf.org/external/pubs/ft/scr/2015/cr1569.pdf>, S. 30

ment that 2016 will be the 'Year of English' acknowledges the role of English as the predominant working language across Europe and will make it even stronger. Building up sufficient foreign language capabilities across the whole education system in Ukraine is indeed a must. Nonetheless, citizens in the EU are entitled to access European legislation in their own language. This is regarded as an indispensable part of guaranteeing the rule of law. The AA does not address this fundamental issue, although the European Court of Justice will finally rule on all major disputes. Instead the EU has placed the full burden of translating the EU acquis on the shoulders of Ukraine, just as it had done in previous enlargement rounds. Under the given conditions the EU should reconsider this selfish approach and instead provide significant assistance to the public availability of EU legislation in Ukrainian and Russian.

Recommendations

Ukraine should deal with the following questions as a matter of the highest political priority:

- Full implementation of its own commitments in Minsk II
- Full compliance with all political criteria of the AA (democracy, rule of law, civil liberties, protection of minorities);
- Future EU membership: through pro-active diplomacy in the EU member states, strengthening of people-to-people contacts; improved information activities within the EU to raise awareness and support.
- Visa-free travel to the EU

Sustaining public approval of the AA and the prospect of EU membership.

Ukraine should devote the greatest political attention to the sound implementation of the AA and nominate a deputy prime minister, directly answerable to the prime minister, as the coordinator of the internal work, including the relations with parliament and president and the relations with the EU. The coordination on EU affairs should be streamlined and simplified. For the public the appointee should become THE 'Mr or Mrs Europe' of Ukraine. The process of alignment with EU legislation should be transparent and publicly monitored.

Ukraine should urgently request the EU to conduct a common political review of the whole legal approximation process in order to achieve a common political understanding on what should be urgently addressed, where revised implementation schedules should be envisaged and how unwanted disadvantages for Ukrainian competitors could be avoided, for instance in the field of public procurement. The Action Plan 2014-2017 should be reviewed.

all 15 nuclear power plants⁴¹. Overall project implementation will be completed in 2020, whereby 2017 had originally been set as an end-date.⁴²

Ukraine must be aware that the continued operation of nuclear power plants, even when upgraded with Western technologies, can also create public resistance in neighbouring countries, as has been the case between Austria and the Czech Republic concerning Temelin. Up to now Austria has actively monitored the performance of Temelin. Every incident is immediately communicated to the public and meets with concern. The Espoo Convention (UN), ratified by the EU, requests consultation with neighbours regarding projects that may have transboundary effects. This convention has not been ratified by Ukraine but has been translated into EU legislation, which Ukraine is obligated to respect already after three years (2017).

Indigenous resources

Ukraine has substantial shale gas potential. For a long time, it was assumed that the production of shale gas would be an important stimulus to the overall economic and energy prospects of the country. In 2014, however, the two major investors in envisaged shale gas projects in Ukraine dropped their plans, constituting an estimated loss of potentially more than US\$ 20 billion in US investment. Now it is hard to imagine that investors will ever commit to such a huge investment again, not only given the uncertainties surrounding Ukraine. The overall prospect of shale gas production in Europe has been significantly downgraded, not least due to cost-efficiency concerns and to the legislative environment of the EU, which will soon apply to Ukraine.

Strengthening renewable energies and fighting energy intensity

Ukraine may have no choice but to speed up the development of renewable energy sources and to invest substantially in energy efficiency to ensure a stable energy supply for the years ahead and to bring its deficit under control. Current considerations to achieve a share of 20% renewable energy in 2035 seem

41 <http://www.ebrd.com/work-with-us/projects/psd/nuclear-power-plant-safety-upgrade-program.html>

42 <http://www.world-nuclear-news.org/RS-Ukraine-aims-to-complete-safety-upgrade-program-in-2020-07081501.html>

production capacity by 2030, which means the prolongation of the service life of existing capabilities and also the possible creation of new nuclear capacities. Existing The extension of the lifetime of existing nuclear capacities is not without risks³⁹ and an environmental NGO has already urged the Commission to look carefully into the subject.⁴⁰ Ukrainian nuclear power plants are built with Russian technology and have been predominantly operated in close Ukrainian-Russian cooperation, both with regard to services and fuel supply, although Ukraine has also cooperated with the US in the past.

Not least due to the crisis, Ukraine has started looking for US and French technology to reduce its current dependency on Russia. Part of this strategy is the partial privatisation of nuclear power assets and the US may have the best chance to win the bid. Furthermore Ukraine has prolonged an old contract on fuel from the US, which had raised security concerns in 2010. It is not the ambition of the authors to evaluate here whether the decision to lower dependency on Russian imports would increase the risk for the safe operation of Ukrainian nuclear power plants, as former Ukrainian and now Russian positions on the matter suggest. It is clear that Russia provides integrated, rather cost efficient packages, which are technically very difficult to replace. It is equally clear that the European Commission clarified its position in 2014 only with reference to newly built nuclear capabilities 'with non-EU technology' and stated: 'The possibility of fuel supply diversification needs to be a condition for any new investment.' Furthermore Ukraine will need to find an EU-conforming solution for nuclear waste disposal in case new suppliers do not take the waste back.

The EU and Ukraine are addressing the issue of the safe operation of nuclear power plants outside the scope of the AA, in a separate dialogue. The 'Joint Project on Nuclear Safety Evaluation of Ukrainian Nuclear Power Plants' was set up between the EU, the International Atomic Energy Agency (IAEA) and Ukraine in 2007 and it was agreed in 2013 to continue the cooperation arrangement on the implementation of the project results. The EU, being already the biggest donor for the decommissioning of Chernobyl, is also providing financial support with the help of the 'Instrument for Nuclear Safety Cooperation'. The most recent financial support came from EBRD/ EURATOM in 2014, allowing the implementation of a huge € 1.45 billion project to improve the safety features in

³⁹ See <http://bankwatch.org/news-media/for-journalists/press-releases/new-study-sounds-alarm-safety-ukrainian-nuclear-power-plan>

⁴⁰ See <http://bankwatch.org/sites/default/files/letter-EC-UAnuclear-10Aug2015.pdf>

Ukraine needs to carefully choose where to look for assistance and advice in EU matters and ideally always give the EU and its member states priority, as this is the main precondition for building up mutual understanding, trust and support for the political objective of eventually becoming an EU member state. It is also the most cost-conscious solution.

Ukraine should make use of the process of legislative approximation to EU rules and adopt a mandatory set of modern regulatory principles to achieve high quality legislation, while minimising undue influence on the legislative process and reducing corruptive pressures. Major elements are:

- Public consultations (12 weeks in length) with full transparency about the contributions received;
- Use of comprehensive impact assessment, including SME-test, likely impact on growth, employment, health, and environment as well as estimated administrative (short- and long-term) and regulatory costs and administrative staff. Impact assessments should be publicly available;
- Conduct of social partner consultations as a rule;
- Prohibit adding additional legal requirements (no 'gold-plating');
- Establish lean procedures for further administrative decisions as much as possible;
- Use the process of EU alignment to cut red tape and reduce costs for businesses and citizens in national legislation;
- The Parliament should develop a mechanism that allows the proper evaluation of all draft legislative acts, which are presented as implementing acts of the AA.

Ukraine should review the higher education curricula and pay particular attention to EU related studies in law, administration and economy as well as for teachers. Universities in Ukraine should be encouraged to establish new partnerships with higher education institutions in the EU to step up knowledge and skills about European integration issues among the graduates.

Ukraine should request immediate EU assistance for the translation of EU acquis (as covered in the AA) into Ukrainian and potentially also into Russian.

2 Deep and comprehensive free trade arrangements

Introduction

The deep and comprehensive free trade provisions¹² form an important part of the AA. They are built on the WTO membership of Ukraine and foresee the establishment of a free trade area within 10 years. In addition to the abolition of duties and other barriers to trade in goods and services, the AA also opens the capital markets to a large extent. It grants gradual reciprocal access to public procurement (within a matter of years). It deals with competition issues and state aid (full approximation to EU legislation foreseen by 2021) as well as with the protection and defence of intellectual property rights; the latter mainly backed by the application of international conventions and GATT provisions. These far-reaching arrangements are bolstered by the inclusion of further sectors of economic cooperation and legal approximation into the AA, such as environment, social policy or taxation issues. It is expected that closer cooperation in all these areas will not only enhance the mutual benefits arising from the liberalisation of trade in goods and services and increasing capital market penetration but also ensure a level playing field. The EU Commission concluded in 2009 that such a comprehensive approach would deliver the most benefits for both sides, with larger per capita welfare effects for Ukraine than for the EU, while the EU would win in absolute terms.

The trade provisions of the AA have triggered severe tensions between the EU and Russia, the latter claiming that free trade would lead to distortions on the Russian market, because Ukraine also enjoys a free trade arrangement with Russia and nine further CIS countries. Originally the EU regarded the Russian concerns as merely driven by the rivalry between the EU and the Eurasian Union. However, in early 2014 the EU acknowledged the need for consultations with Russia on the subject, thus also recognising that Russia has been and remains the largest single trading partner of Ukraine. As a result of trilateral consultations between the EU, Ukraine and Russia, the EU and Ukraine finally decided to delay the provisional application of the free trade arrangements by Ukraine for one

¹² For communication purposes called "FTA" in the AA

function safely. Essentially the future of Ukraine as a transit country of Russian gas may now be at risk. The transit contract will end in 2019. Gazprom and the Russian energy ministry have declared their intention to develop an alternative transit route. It may well be that such statements echo only the severe deterioration of the political relations between Ukraine and Russia and are not founded on any economically viable alternative plans. This is at least the current thinking inside the European Commission and also in Ukraine. However, this point of view is not fully shared by the International Energy Agency (IEA). The IEA has observed a strategy of Gazprom to diversify its transport routes, which has already diminished the prominent role of Ukraine as a gas transit country. Ukraine is also a major transit route for crude oil to the EU. Three EU countries (and Bosnia) receive up to 100 % of their crude oil imports from Russia via the Druzhba Pipeline, which crosses northern Ukraine. Generally, however, the significance of Ukraine as a transit hub for Russian oil has diminished over the years. The whole infrastructure (18 pipelines with a total length of 4,569 km, pumping stations and tanks) requires substantial modernisation.

Energy production (coal and nuclear power)

Energy production of Ukraine is predominantly based on coal and nuclear energy. The crisis and the fighting in eastern Ukraine have dramatically affected coal production. Nearly all profitable mines are located in the conflict zone. This fact had severe impacts on heavy industry, on the railway as well as on energy generation in Ukraine, resulting in coal and energy imports being channelled via Russia in 2014 and lower reserve capacities. The future of the mining sector is more than uncertain. On the one hand, Ukraine needs to modernise it, as production is neither competitive nor safe, which is also requested by EU legislation (within five years). On the other hand, the long-term outlook for coal as a major energy source is not promising and the coal power plants in Ukraine are basically outdated. They may come under severe pressure from EU climate change legislation on greenhouse gases, which also need to be implemented by Ukraine (within two years). Available research also indicates that all major energy companies in the EU with substantial coal capacities have sustained losses of 100 billion euros since 2007 and that the appetite to invest in coal in the EU is dramatically shrinking. The European Commission assumed in 2009 that the coalmines in the East will have to close down and forecast negative social consequences.

Ukraine will and must remain a nuclear energy producer for a long time to come to ensure a stable supply of energy. The plan is to more than double nuclear

Generally, the application of EU legislation, which is already overdue, provides correct orientation for sector liberalisation, but the whole process is now being done under much pressure and holds huge potential for sector tensions and social unrest. Stakeholders point to the problem that current regulatory efforts run counter to the needs of the market and notably undermine the financial position of the gas distribution network. Monopolies are under attack but with the aim of switching ownership rather than cracking down on them.

Notably gas remains a backbone of Ukraine's industrial development. Ukraine – and the EU – will remain highly dependent on gas imports from Russia although recent Ukrainian legislation prohibits a dependence level of more than 50% from one single source. This dependency was always a cause of friction between the two countries because the contracted gas prices were also politically motivated. In particular, the gas contract of 2009 led to mounting gas debts that Naftogaz owed Gazprom, which amounted to 3.3 billion US dollars, nearly one-third of the general import volume of 10 billion US dollars in 2013. In 2014 Ukraine could only ensure the stability of supply with imports from the EU, however, at a price level, which was on average above the price of Russian gas.³⁸ The EU has also acted as mediator in the complicated gas talks with Russia but was not always successful in brokering a deal. This led to a halt in Russian gas imports in July 2015. In August 2015, however, Ukraine underlined its willingness to arrive at an agreement on gas deliveries from Russia for the winter of 2015.

Ukraine is also a net importer of oil and oil products (80%) and has experienced a decline in its local production in recent years (20%). Ukraine is dependent on imports from Russia but has managed to diversify its import sources in recent years. In 2014 oil imports from Russia declined by nearly half. The whole sector is characterised by monopoly structures.

The transit of oil and gas

Gas trade and transit is part of the trade provisions, which prohibit dual pricing and also the illegal extraction of gas. The crisis has further weakened the role of Ukraine as the major transit country for Russian gas and crude oil to the EU. Although the period 2010-2013 already saw a decline in Ukraine's role as a transit country of Russian gas, nearly half of the EU's gas imports from Russia transited Ukraine in 2013. The transit volume reached a historic low in 2014. Together with the exchange rate decline, the reduced income from transit deprived Ukraine (Naftogaz) of an important source of budgetary income. It also created additional strains on the operation of the network, which needs huge investments to

³⁸ <http://www.naftogaz.com/www/3/nakweb.ru.nsf/0/C38E06F745F884A2C2257E9F005C-912D?OpenDocument&year=2015&month=08&nt=Новости> (data July 2014-June 2015)

year until January 2016. Further trilateral consultations between the EU, Ukraine and Russia in 2015 have indicated, that with good will from all parties, solutions can be found to ensure that there will not be any undue influx of EU goods via Ukraine into Russia (and other CIS countries) as of 2016. It is understood by all parties that the free trade arrangements between the EU and Ukraine must not lead to an abolishment of the free trade regime between Ukraine and the ten CIS countries.¹³

Impact of the deep and comprehensive free trade provisions

Ukraine's foreign trade is still largely influenced by the structures and economic ties developed inside the Soviet Union. CIS countries were the most important export market for goods for Ukraine up to 2013. In fact, between 2003 and 2013 the export performance of Ukraine on CIS markets was stronger than on the EU market, while the EU gained ground as the most prominent source of imports during this period. As a result, the Ukraine has had large trade deficits with the EU since 2004.

Due to the economic crisis, Ukraine's general volume of trade (in goods) started declining in 2013 by 8% for exports and 9.9% for imports. This negative development continued in 2014, with a 13.5% decline in exports and a sharp contraction of 28.2% in imports. Trade contracted even more sharply in the first semester 2015, cutting exports and imports down by more than one-third compared to the same period 2014. Regarding the trade relations with the EU, it is worth noting that the exports of Ukraine to the EU in 2014 declined by only 0.9%, while imports from the EU fell by 28.3%. During the first semester 2015 Ukrainian exports displayed a high volatility, falling to 63.7% of what they had been in the first 5 months in 2014, while strongly picking up in June. Compared to the first semester 2014 the exports to the EU declined by only 17.2%, while the overall exports fell to 65% of their previous level. Imports from the EU decreased by one quarter.¹⁴ This development suggests that the unilateral applica-

¹³ Formal conclusion of the tripartite negotiations still not achieved by the end of August 2015.

¹⁴ See European Commission EU - Ukraine Trade Statistics http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf as well as State Statistics Service of Ukraine, Ukraine's Foreign Trade in Goods, multiple years, including January-June 2015 and own calculations

tion of the free trade arrangement by the EU has had some stabilising effects for Ukrainian exports in 2014/15, which however have not been sustainable. In parallel Ukrainian exports to CIS markets contracted already sharply in 2014, with the exception of Turkmenistan (market value similar to Ukrainian exports to Belgium). Exports to all CIS markets continued to shrink in the first semester 2015 to less than half of the value of the exports in the same period of 2014. The crisis has now firmly established the EU as the biggest trading partner of Ukraine, although not as a result of a healthy development.

Nonetheless CIS countries continue to play an important role for the Ukrainian economy. Ukraine has a positive trade balance with seven of these countries, while the overall CIS trade balance is negative, mainly due to the trade patterns with Russia and Belarus. Ukrainian exports to Russia in the first semester 2015, although in free fall, were still nearly four times as much as its exports to Germany. In 2014 Belarus was still the second largest CIS export market for Ukraine, only being topped by its exports to six countries (Turkey, Egypt, China, Poland, Italy and India). Even Ukrainian exports to Azerbaijan greatly exceeded its exports to 18 out of 28 EU member states, including such countries as the UK, France and Austria. Ukraine has a positive balance of trade in services, with a strong export performance on CIS markets, in particular on the Russian market (which is nearly equivalent to the EU market as a whole). Overall, the trade in services also declined in 2015 compared with 2014 with the performance of Ukraine in exports being slightly better to CIS markets than to EU markets.¹⁵

All recent trade figures need to be explained with caution, because Ukraine is in the middle of a deep economic and financial crisis. Nonetheless, it seems evident that the benefits of the deep and comprehensive free trade arrangement between the EU and Ukraine will only slowly materialise. This would be in line with original estimations by the European Commission in 2009, that the potential welfare and employment gains of trade liberalisation were strongly linked to the massive influx of foreign direct investment in Ukraine, which was seen as a prerequisite for financing the transformation of the country and for bearing the approximation costs, which the Commission qualified as 'extensive' in the short term.

15 See Trade in services 1HY 2015; https://ukrstat.org/en/operativ/operativ2015/zd/ztp/ztp_e/zt-p02_15_e.html

the Ukrainian electricity market already in 2017; Ukraine, backed by its nuclear capacities, could become an exporter of electricity to the EU market.

The agreement opens up energy trade and aims at a substantial legislative approximation with all major pieces of EU legislation on energy matters. The longest transitional period in the whole agreement, 11 years, deals with improved energy security through oil stocks (until November 2025). The agreement also covers some nuclear energy safety requirements, to be fulfilled after two years. However, it does not touch on the safe functioning of nuclear power plants in Ukraine although the EU considers this matter 'an absolute priority' and substantially strengthened its legislation after Fukushima. Given the already huge nuclear capacities in Ukraine, which will be further expanded, the issue of nuclear safety adds to the burning energy question in Ukraine.

The unprecedented energy crisis

The safe, secure and cost-efficient provision of energy is fundamental to any sound and sustainable economic development. That is why energy is one of the most sensitive areas for the future of Ukraine. The International Energy Agency (IEA) saw Ukraine's energy future at a crossroads in 2012, with huge challenges and equally huge untapped potential. Crisis and war in Ukraine have since dramatically worsened the situation and the outlook for Ukraine. Now the country is confronted with an 'unprecedented energy crisis', as the IEA concluded in spring 2015. Meanwhile Ukraine is in a situation of absolute emergency. Official statements since July suggest that heating and electricity provision is no longer guaranteed in Ukraine for the coming winter.

The oil and gas market

Ukraine must rapidly restructure the whole oil and gas sector and put it on a viable development path, not least to alleviate the budgetary burden for the country. This is why the IMF has requested the restructuring of the Ukrainian major gas company Naftogaz, still state-owned, by 2017 and also the termination of subsidised energy prices in Ukraine to achieve market price levels. Naftogaz as 'a key fiscal anchor of Ukraine' is the main reason for the Ukrainians cash deficit with an accumulated deficit of 5.7% of GDP in March 2015. According to IMF projections the Naftogaz deficit should be eliminated by 2017.³⁷

37 see IMF Report 15/69, page 24

ditions in this sector in Ukraine. For the time being, some important steps have been taken to foster competition in the market, but a general strategy is not yet clearly visible. This may be explained by the fact that Ukrainian authorities rely in their work on the advice of the Mc Kinsey & Co office in Kyiv, which is highly reputable but has not yet completed its work.³⁵ De-monopolisation is clearly an issue. Although there are three airlines in Ukraine, the market is currently dominated by one big private player, Ukrainian Airlines. The plan now is to open the market to a second big-scale Ukrainian player (Atlasjet; with Turkish roots). The relations between airports and carriers will also have to be defined on a sound basis. Currently the biggest cost factor for Ukrainian carriers, the price of fuel, differs between the three major functioning airports in Ukraine, a matter that is under investigation. Obviously there is a lot to be done to break up monopolies and free the sector from corruption. These efforts are a must for channelling substantial new investment in the sector, including for the reconstruction of the most modern airport, Donezk, when this becomes possible again. Security concerns and legal income in Ukraine put major burdens on the development of this sector.³⁶

3.3 Energy

Introduction

The national energy mix is a sovereign choice of every member state of the EU and the AA follows this logic. It builds on the membership of Ukraine in the Energy Community. The latter was founded to achieve a European network for electricity and gas among all members, which means enhanced energy safety and a secure supply. Therefore members of the Energy Community (essentially the EU, the Balkan countries, Norway and Ukraine) are requested to fully implement major parts of the relevant EU legislation on energy and also related parts of legislation on environment and competition. Ukraine must carry out full-sector liberalisation and was expected to do so already in 2013, both for gas and for electricity. Given the plan to establish an interconnection between the EU and

³⁵ See http://en.cfts.org.ua/articles/how_to_revive_air_transport_operations_in_ukraine_seven_components_of_the_new_market_model_by_andrii_pyvovarskyi

³⁶ See http://en.cfts.org.ua/news/world_response_to_ukraines_request_to_lift_flights_restrictions_revealed

Structure of the trade relations

The current trade structure between the EU and Ukraine reflects the relatively low level of economic activities in Ukraine, which predominantly imports high quality industrial goods from the EU. In contrast primary products (agriculture, raw materials) dominate Ukraine's current exports to the EU. Machinery and transport equipment account for only 10% of its exports to the EU. There are temptations in the EU to associate the future strength of Ukraine largely with its agricultural potential and raw materials. However, the AA entails some precautionary measures against such a narrow-minded division of labour.

Trade in agricultural goods is not yet fully liberalised. Moreover the AA does not foresee the inclusion of Ukraine into the common agricultural market. Both sides are allowed to protect the agriculture against export pressures, with the aim to ultimately eliminate the restrictions within ten years. In particular, both sides maintain import quotas for certain agricultural goods that are considered sensitive. Here the EU list is much more comprehensive than the Ukrainian list. The latter indicates only four market sensitive products. This quota system effectively limits the opportunity of duty-free trade for Ukrainian agricultural exporters and prevents them from short-term gains. Available research on the functioning of these trade provisions after one year indicates that the quota regime may have a potentially limiting effect on exports of some products (tomatoes, wheat, poultry) from Ukraine. For a number of other products the quota was only partially utilised. The reasons for that ranged from health concerns over non-compliance with SPS standards to low demand or no trading partners in the EU¹⁶. Furthermore, an overall safeguard mechanism allows Ukraine to apply additional export duties for a maximum of 15 years in case of undue export increases of some specified products, such as sunflower seed, waste, steel or scrap.

Therefore the real benefits of trade liberalisation with the EU for the Ukrainian economy and society will largely depend on the progress made in the modernisation of the Ukrainian economy, ranging from industrial and services sectors to agricultural undertakings. This progress can be driven by the approximation to EU legislation; however, substantial investment will be needed. Opening up new market opportunities in the EU and shifting the trade patterns towards modern trade flows, dominated by the exchange of modern industrial goods and inno-

¹⁶ See http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2014/06/PB_06_2015_en.pdf

vative services, will be a much longer and very complicated process and also require massive foreign engagement in the economy of Ukraine.

Trade across borders

Lean trade procedures and efficient customs services are major factors for the sound functioning of free trade flows. The doing business indicator 2015 ranks Ukraine's current performance very low (rank 154 out of 188 countries), thus suggesting that the overall legal and administrative environment is not conducive for international trade promotion. Consequently there is huge potential for efficiency gains and improved logistics, which could, according to estimations of the World Bank, add up even to a few percentages of GDP.¹⁷ The underperformance of Ukrainian trade-related administration and procedures is intrinsically linked to the performance of customs in Ukraine. Sadly enough, Ukrainian customs authorities are considered to be part of the systemic corruption and involved in illegal trade and crimes. Ukraine needs to address this situation in a comprehensive manner, starting with combating the most serious crimes first. It will not suffice to merely take over European rules, procedures and IT tools as requested in the AA (within 3 years) without properly cleaning the customs and the whole supply chain. (See also chapter on corruption.)

Opening product markets

The trade provisions are driven by the aim to ensure efficient and safe trade flows in industrial and agricultural goods and services, which will not undermine the EU's high level of consumer and health protection. Therefore the agreement rightly prioritises the broad alignment of product markets and product safety, including the safety of toys and legislation on Genetically Modified Organisms (GMOs). Only one year after the entry into force of the agreements, Ukraine should already comply with the general product safety framework and establish the needed surveillance structure. This process also includes the takeover of European standards, a process, which just started but is as challenging as 'switching from 110 to 220 Volt'. The application of EU standards is a precondition for entering the EU market as these standards are enshrined in EU legislation for industrial products. These standards do not apply to Ukraine exports outside

¹⁷ <http://www.worldbank.org/en/news/press-release/2013/01/23/report-reducing-supply-chain-barriers-could-increase-global-gdp-6-times-more-than-removing-all-import-tariffs>

Air transport

The common aviation area agreement aims at the full integration of Ukraine into European air space (Open Sky), which currently stretches across the EU, the EEA countries and Switzerland. This agreement will substantially improve security and services for passengers and should facilitate trade and tourism between the partners. As the number of passengers flying between the EU and Ukraine has progressively grown during the past decade (four million passengers in 2012, with an annual growth rate of 17% between 2002 and 2012) and cargo services have nearly doubled,³⁴ this agreement will facilitate both the business-to-business and people-to-people contacts. It is an important achievement for Ukraine because the EU accounted for almost 43% of Ukraine international traffic over the past four years.

The agreement largely replaces the existing bilateral agreements with individual member states and ultimately aims at nearly unrestricted market access. It foresees an 'extensive alignment of Ukrainian aviation legislation with European legislation and regulations on aviation safety, security and air traffic management, as well as on economic regulation, competition laws (EU state aid rules will apply), environment and consumer protection' (source: UK government), which will happen during two transitional periods, however, without precise timelines for the requested transposition of EU legislation.

Generally the implementation of this agreement should inject competition into the Ukrainian market and also strengthen fair competition. It should also improve industrial cooperation and investment in the sector, not least because both parties accept majority ownership. Furthermore the agreement will also surely improve interconnections between the EU, the EEA countries, Switzerland and Ukraine.

Both partners will be allowed to operate flights from every point without any restrictions, which is already a major improvement over the present situation. The rules on cabotage, however, clearly favour EU carriers, providing them with the unique opportunity to provide cabotage services within Ukraine, while Ukraine is allowed to engage in cabotage only if the service in the EU is connected with a service point in Ukraine.

Overall, the agreement is an important pillar of future EU-Ukraine cooperation. How it works out will now largely depend on the further development of con-

³⁴ See <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014PC0017>

is the more profitable part of its operations. That means it will have suffered a cargo loss of more than 25% within two years. Overall the reported losses in passenger and freight transport amounted to 8 billion Hryvnia (around 40 million dollars) in 2014.³³ Ukrzaliznytsia had to rearrange its traffic lines due to the events on Crimea where it ceased its operation in November last year, thereby sustaining a loss of 2 billion Hryvnia per year (10 million dollars). Around 1,800 infrastructure points and pieces of equipment have been destroyed during the fighting in the east. The overall infrastructure and the fleet are in 'deplorable condition' and local replacement of locomotives seems out of reach at the moment, because the producer is located in Luhansk.

Liberalisation is not without risk. Competitors might pick only highly profitable routes, which would immediately weaken the operating branch of the emerging privately organised operator Ukrzaliznytsia. The future tariff structure will be equally crucial, because the sector needs to remain competitive compared to road transport, but at the same time infrastructure costs occur. Furthermore, substantial investment in infrastructure is needed, both for safety and for efficiency reasons, but it is unclear, how to finance it. It is worth remembering that certain defined railway operators in the EU have been entitled to certain compensation in the form of state aid since the sixties, which has continued even throughout the liberalisation process. This entitlement will most likely be abolished in the 4th railway package (Regulation on railway accounts (EEC) 192/62). Although due to its limited scope this regulation would never have applied to Ukraine, it raises the question of whether state aid might not be needed, available and acceptable to steer the process of liberalisation in a sound manner. According to the state aid provisions in the AA, Ukraine has a time allocation slot of only five to seven years to grant state aid before it needs to fully respect EU rules, subject to available state funds.

The functioning of the European railway market is supported by the European Railway Agency. Ukraine will be allowed to participate in the work of the agency but without voting rights (EC 2013/0014 (COD), Art. 68) once the 4th railway package is adopted. This is a welcome move by the EU, because early participation in the work of the agency is important to foster mutual understanding and cooperation. The same proposal also foresees training opportunities for institutions from candidate countries (Art. 38), but not for institutions from Ukraine, Moldova and Georgia.

³³ http://en.cfts.org.ua/news/ukrzaliznytsias_draft_financial_plan_approved_deputy_prime_minister

the EU. However, the alignment with EU standards entails the withdrawal of conflicting GOST standards (developed before 1992)¹⁸. Once Ukraine will have fully aligned its EU legislation for the identified industrial products, it will be treated as a de facto EU member in the respective area of trade (so-called internal market treatment). There will no longer be any difference between the rules for the Ukrainian home market and the EU export market.

The implementation of these rather technical provisions is of utmost political importance, because this process catapults Ukraine out of the Eurasian cooperation approach and binds it ultimately to the EU system of rules and standards. It is important for the industrial future of Ukraine. The emerging market opportunities could translate into substantial employment and welfare gains for Ukraine in the medium to long term. Along this road Ukraine needs to pay sufficient attention to the sound implementation of the rules, notably with regard to product safety issues. It would be no boon to the long-term market chances of Ukraine on the EU market if the free trade arrangements led to a major incident involving product safety issues. Playing by the rules will be equally important, because the agreement does not prevent the EU from applying anti-dumping measures, if necessary.

Currently, big companies dominate the Ukrainian economy, while small and medium sized enterprises (SMEs) are the backbone of the EU economy. Consequently the AA encourages Ukraine to promote the development of SMEs. Indeed, the trade and trade-related provisions would facilitate the entrance of Ukrainian SMEs into the EU market, provided that Ukraine develops an SME-friendly policy, as requested in the AA. The alignment of the Ukrainian SME definition with the EU definition, which is still missing in the Action Plan, will have to be considered. This alignment would have consequences for the application of EU legislation to state aid and competition, which would entail preferential treatment for SMEs and would also facilitate access to EU funds.

The issue of sanitary and phytosanitary measures

Generally, sanitary and phytosanitary measures (SPS) are designed to ensure that food is safe and diseases do not spread through plants or animals. This is a fundamental concern shared by all WTO parties. SPS measures are also accepted as effective barriers to trade as long as they are solidly based on scientific evidence.

¹⁸ see Art. 56.8. AA

Consequently the SPS provisions play a prominent role in the AA, being treated as a high priority issue, and compliance with SPS requirements will become the litmus test for successfully exporting to the EU. SPS requirements affect the whole agriculture but are of particular importance for export opportunities for meat, beef, poultry, eggs or dairy products. Of course the agreement foresees a provisional approval of establishments that would be allowed to export into the EU without prior inspection. However, even the procedure of 'provisional approval' could lead to very detailed verification by the EU. Moreover, individual member states could also undertake such inspections. Furthermore international audits may also be used to evaluate the functioning and the reliability of the Ukrainian authorities and rules and as a means of supervising the sector. Once the legislative approximation in Ukraine has made substantial progress or even been completed, Ukraine could request the recognition of 'equivalence'. That would place Ukrainian producers on an equal footing with EU producers and Ukraine would be treated like every EU member states in the area. However, there is a long way to go, given the quota regime that massively restricts Ukrainian food producers from entering the EU market. First, the administration of the quota, notably "first come-first serve principle", entails a lot of uncertainties. Secondly, the combination of a low duty free quota and a high tariff protection for a certain product may have definitely prohibiting effects. On the other hand, the pressures for restructuring are very strong, with winners and losers along the way. The Commission clearly warned in 2009 that there may be negative short-term employment effects, notably in rural areas of Ukraine.

Recommendations

Ukraine should establish the two dialogues as foreseen in the AA with competent and moral personalities by the end of 2015.

Ukraine should pursue a triple approach in its trade policies and strengthen its exports to CIS, to the EU and to other important trade partners. It should discuss with the EU and the EIB innovative trade financing schemes to stimulate the replacement of outdated industrial equipment in order to be able to modernise its economy and strengthen its trade in industrial goods.

Ukraine should pay close attention to the development of SMEs and align its legislation on SMEs with EU rules. The principle 'think small first' should become the guiding principle in all governance issue and in the design of programmes.

under far better basic conditions and are still not fully completed. Furthermore the EU is currently discussing a whole package of new rules (so-called 4th railway package), which will again change the conditions in the sector for the years ahead.

The situation for Ukraine is therefore very complicated. The 4th package, which is still not adopted, contains changes in legislation that Ukraine is expected to transpose. However, the package also proposes new legislation as well as changes to legislation that was adopted in 2012 after the end of the negotiations on the AA. By their very nature these EU proposals are part of the creation of a single European railway area. Ukraine will need to transpose the package within a time frame yet to be negotiated. This situation points to a general problem of the AA that is currently underestimated: Ukraine will constantly have to deal with a changing legislative environment while also catching up with the approximation of its legislation at the same time but has no formal right to be consulted. The EU assumes that it has sufficiently dealt with this fact by defining procedures on how to transpose changes in EU legislation. However, this has only been done in a purely technical and legalistic way. Generally new EU legislation responds to identified remaining obstacles for the already existing internal EU market. Ukraine, by contrast, is at the starting point of liberalisation. Such a process needs to be carried out in a very well-structured and well-thought-through manner without creating chaos in the sector, not least since railways constitute the major mode of transport in Ukraine.

The Ukrainian government has now prepared legislation to introduce key elements of the liberalisation process in line with the European philosophy: establishment of an independent regulator, reorganisation of the state-owned railway company Ukrzaliznytsia (division into infrastructure management and carrier operations) and opening the market for new competitors. This is an important but equally brave step under the current circumstances.

Ukrzaliznytsia is now fully exposed to the crisis and had to restructure its external and internal debt.³¹ It needs to swallow the negative impact of the economic crisis on passenger and freight services, with almost 25% decline in cargo and a 9.4% decline in passenger travel in July 2015 compared to July 2014 alone.³² For the whole year 2015 Ukrzaliznytsia assumes a decline of 13.9% in cargo, which

³¹ http://en.censor.net.ua/news/335802/ukrzaliznytsia_declares_technical_default

³² http://en.cfts.org.ua/news/ukrzaliznytsias_passenger_transportation_by_rail_falls_by_9

aged approximation schedule is rather ambitious given the terrible conditions in the sector. It is estimated that the sector is still driven to a large extent by the shadow economy (up to 90%). Moreover, the system is regarded as highly corrupt, overregulated and not transparent. This is particularly true of licensing and certification, which are spread across various regulatory bodies.²⁸ Road safety is a burning issue. The lack of legislation on the weight of vehicles leads to road destruction and burdens the railway sector.²⁹

Preparations are underway to adopt EU legislation that addresses problems in the sector; however, adoption will not be sufficient if major activities in the sector remain in the shadow economy. The national road transport strategy sounds ambitious. But fundamental planning tools are missing, such as a coherent vision as to how the road network in Ukraine should develop and which priorities should be set. The adaption of EU legislation will have to be accompanied by efficient and transparent supervision and control procedures. Finally, even before the military conflict in the east most of the road infrastructure (totalling nearly 170.000 km of highways)³⁰ was in need of modernisation to ensure safe and efficient transport flows. Now the challenge is even bigger and Ukraine has started to look also for private investments in its road infrastructure. The AA does not explicitly bind Ukraine to the transposition of European emissions legislation in the transport sector; however, the European air quality legislation (to be transposed within five years) and the climate change legislation will force Ukraine to look into the subject.

Railway sector

Over the course of the past decades, the EU liberalised the railway sector. Ukraine must now complete this task within a maximum of only eight years (so-called three railway packages). Sector liberalisation and modernisation will therefore have to go hand in hand. This is a rather ambitious approach, considering that the EU's own liberalisation efforts have taken more than 20 years

28 Overview of road transport regulations and enforcement bodies, Ukraine 2014, International Transport Forum; <http://www.internationaltransportforum.org/IntOrg/road/ctrlbodies/rdukraine.pdf>

29 See http://en.cfts.org.ua/news/ukraines_international_road_carriers_supports_introduction_of_weighing_systems_on_countrys_roads

30 See Ukraine's road network; <http://dlca.logcluster.org/display/public/DL-CA/2.3+Ukraine+Road+Network>

Ukraine should carefully evaluate the opportunities and barriers of the trade arrangement for agricultural goods based on a full-sector screening of the situation in agriculture to balance off the findings against the envisaged equivalence of SPS standards to those of the EU. Here are the most immediate threats for losing businesses and employment opportunities in rural areas.

Ukraine needs to step up its marketing efforts on EU markets, potentially also by using the exiled community in the EU. In this context Ukraine should consider the full integration of Ukraine into the European enterprise network in order to equip the local trade chambers with sufficient knowledge about the functioning of the EU markets and the applicable rules as a priority.

Ukraine should also promote the integration of its businesses and the trade unions into European structures.

Strategically Ukraine should look into the experiences of some developing countries, which have adapted their production in most innovative ways to local needs/and preferences, which turned out to be a springboard for entering new market segments globally (so-called frugal markets).¹⁹

Ukraine should vigorously address the problem of trade barriers in a comprehensive matter and across the whole supply chain (logistics, procedures), as this would translate into substantial wealth gains.

Ukraine should request a special EU mission, including the deployment of EU professionals to support its efforts to combat corruption and fraud in customs.

19 See <http://aheadofthecurveblog.blogspot.de/2013/04/the-frugal-business-how-developing.html>

3 Key sectors

Energy, transport and telecommunication are strategically important for any economy. They are the arteries for growth and job creation. These three sectors are heavily regulated in the EU and are specifically covered in the AA. Moreover these sectors have a trans-European dimension. Ukraine, being a focal point of major Trans-European Networks, therefore needs to pay particular attention to their sound, market-based development and competitiveness.

3.1 Telecommunication

Introduction

In the digital era, telecommunication belongs to the critical infrastructure needed to stimulate growth and job creation and efficient trade across borders. It affects each and every user, businesses and consumers and its services can glue societies together. Consequently telecommunication belongs to the sectors that will be fully integrated into the EU's internal market once the regulatory approximation and harmonisation has been completed. To that end the AA identifies all legal acts that have to be transposed into Ukrainian legislation, including the envisaged time frame. The latter is very ambitious and requests that Ukraine complete the legislative approximation within a maximum of four years. As with all other sectors to be integrated into the EU's internal market, Ukraine must also fully comply with any new EU legislation in this area. Once Ukraine considers itself to have fully met all contractual requirements, the EU will evaluate whether all conditions are fulfilled to integrate Ukraine ultimately into the internal market in telecommunications.

Although the EU-Ukraine Association Council in March 2015 made no mention of telecommunications as an immediate priority, it did underline the importance of a fair and competitive telecommunication market and the need to manage the transition towards an information society. Apart from relevant legislation, Ukraine has been encouraged to promote broadband and network security as well as the use of telecommunication technologies for fostering the competitiveness of its economy. Based on this mutual agreement between the EU and Ukraine, the political foundations are laid to guide the Ukrainian reform efforts.

afore-mentioned agreements are in place and the regulatory approximation to EU legislation has reached a sufficient level, Ukraine would enjoy the same rights and responsibilities as EEA countries and Switzerland in their relations with the EU and would become part of the EU/EAA/Swiss transport market. Nonetheless, the Commission considers the opening of the transport market as very beneficial for the EU.

The Ukrainian transport sector, both road and rail, is in very critical condition. 'The market of passenger road transport is destabilised, has not developed for several years and is now "on the verge of becoming non-existent".²⁷ This was the finding of an inter-agency meeting, published by the Ministry for Infrastructure of Ukraine in March 2015. Moreover, infrastructure suffered enormously from the fighting in the east. As a consequence between 80 and 90% of the infrastructure there has been destroyed according to estimations, although some repairs have been undertaken in the railway sector. Together with the overall reform and modernisation requirements this situation poses a nearly unbearable burden for Ukraine. The corrupt environment, however, makes European and international financial engagement extremely risky.

Road transport

Currently Ukraine provides transport services as a third country on the EU market. The EU market is rather fragmented due to shared competencies between the EU and its member states. Even the full transposition of all relevant EU legislation by Ukraine would not suffice to abolish the severe obstacles stemming from different administrative and financial barriers at member state level. Therefore, only the envisaged transport agreement would eventually offer Ukraine the same treatment that Community operators and operators from Switzerland and the EEA already enjoy. Moreover, once the agreement is in place, Ukraine would enjoy an ever better status as an operator on the EU transport market than Turkey, which is also presently treated as a 'third' country.

The general approximation towards EU legislation by Ukraine has to be completed within five years. An immediate priority is given to safety and security concerns in international road transport for goods, and Ukraine must comply with all relevant EU legislation within only one year (by November 2016). The envis-

²⁷ See <http://www.mtu.gov.ua/uk/discussion/49887.html>, Protocol of an interagency meeting, March 17, 2015 (in Ukrainian)

The roll-out of broadband across the country is definitely a substantial challenge for Ukraine because doing so is a pre-requisite for entering the digital era. To encourage private investments, the regulatory approach needs to take into account the interest of the investors to have a sufficient return before the infrastructure is opened up to competitors. There is a fine line to be drawn to avoid lasting monopolies on the one hand yet to drive investments on the other.

The development of the telecommunication market and the envisaged cross-border provisions of electronic services will foster competition and the emergence of new business opportunities in Ukraine. ICT tools may substantially change the way of doing business and the interaction of the society as a whole. Notably there must be many more SMEs and start-ups than at present. However, this process also entails substantial new challenges and vulnerabilities, which need to be addressed simultaneously. Data protection, protection against cyber war and crimes are among those challenges. Other issues to be considered both in the EU and in Ukraine are respect for privacy and the dignity of people, protection of children and enhanced cooperative responsibility across the sector.²⁶

3.2 Transport

Introduction

The geographic location of Ukraine makes it strategically important for the sound development of the trans-European network. It is a clear transit destination, as major network routes pass through Ukraine.

Generally the AA aims to integrate Ukraine fully into the European transport market. Therefore it foresees the broad alignment of Ukrainian legislation with the Community acquis and deals also with international maritime transport. Furthermore it envisages a separate transport agreement for road, rail and inland waterways, which still needs to be negotiated. In addition, the EU and Ukraine have concluded a Common Aviation Area Agreement. The agreement was initialled at the summit in Vilnius in 2013. However, its signing has been delayed by internal quarrels on the EU side and is now scheduled for 2015. Once all the

²⁶ See European Parliament, Resolution on connected TV, 2013; <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0329+0+DOC+XML+V0//EN&language=EN>

Within a period of only two years, Ukraine needs to ensure the monitoring of fair competition in the electronic communications markets, notably concerning cost-oriented prices for services. Moreover Ukraine should adopt the relevant EU legislation to prevent illicit access to conditional access services and to contribute to combating piracy in this area. In doing so, Ukraine would also comply with the European Convention on the legal protection of services based on, or consisting of, conditional access. This is fundamental to the protection of the interests of consumers as well as the interests of European cross-border service providers. Once implemented, EU pay TV or Internet services would find a level playing field in Ukraine, although it is clear that the EU itself has thus far struggled to ensure the effective implementation of this legislation. The postal services sector must be liberalised within two years. Already after three years Ukraine is expected to comply with the relevant EU legislation in the area of e-commerce. After four years the general framework based on EU law is to be completed. The latter implies a strong regulator, which carries out market supervision in full independence, ranging from ex-ante regulation to rules for operators with significant market power with regard to access to, and use of, specific network facilities, price controls on access and interconnection charges, including obligations for cost-orientation. Ukraine was also given the maximum period of four years to establish public consultation procedures for new regulatory measures and to put in place effective procedures for lodging appeals against the decisions of the telecommunication regulator. The short time frame envisaged for integrating Ukraine into the internal telecommunication market appears overly optimistic because the Ukrainian telecommunication sector – although a success story – is still in an early stage of development.

Ukraine has already set up a regulatory framework aimed at introducing market principles and fostering the development of the sector. The enhancement of structural, financial independence and administrative capacity of the national regulator is among the identified priorities for 2015. To date there is no regulation on e-commerce, although a draft²⁰ has already been tabled in the Rada. This draft, however, is not meant to transpose EU legislation, a task that would also require substantial legislation to protect the interests of consumers (scheduled for 2017). The Central Bank recently removed some obstacles to international e-commerce. The transferability of mobile numbers to foster competition in the sector is also in the pipeline.

²⁰ <http://www.nkrzi.gov.ua/index.php?r=site/index&pg=1&language=en>

Moreover, as part of the so-called digital agenda, the EU is preparing new legislative initiatives to stimulate growth and job creation. Consequently Ukraine will be confronted with substantial legislative changes in existing EU legislation and with new EU legislation over the next three years. Even with best efforts such as changing legislative environment may well prevent Ukraine from successfully transforming the telecommunication sector by the agreed deadlines.

Telecommunication – a potential growth market

Telecommunication is among the rapidly growing sectors in Ukraine. Revenues quadrupled between 2003 and 2014, notably driven by mobile phone services and computer services. The mobile phone market, in particular, has rapidly expanded and revenues have increased almost nine-fold in the period mentioned. The market is well developed with 142.4 mobiles per 100 persons in most regions. The mobile phone market in Ukraine generates nearly five times more revenue than computer services and nearly 15 times more revenue than the market for TV and radio. Business in fixed Internet services is also very well developed in the meanwhile with nearly 39 million users. ICT services are growing and have reached a share of 4% of GDP in services.

The sector's shortcomings mirror the high growth potential, which needs to be mobilised. The number of fixed telephone lines is still very high, although declining. Broadband access is rather limited and predominantly concentrated in urban areas, while rural areas still seem to be decoupled from that trend. According to estimations of the International Telecommunication Union, Ukraine ranks 79th as regards broadband penetration and 101st for mobile Internet penetration.²¹

Equally, Ukraine needs to adapt to the newest technological developments in communication. Ukraine is currently struggling to introduce 3G and 4G technology. 3G – due to high-speed data transmission – paves the way for mobile video services and broadband Internet access and opens new commercial and social applications. Based on licensing auctions this year, the biggest Ukrainian mobile operator is now providing 3G services to 10 out of 25 regions in Ukraine, covering 200 cities and agglomerations, while its competitors are also speeding up their own switch to 3G and competing for best quality services. The next-generation network, so-called 4G technology, will be introduced in Ukraine in

21 See news Ukrtelecom; 14 May 2015; http://en.ukrtelecom.ua/press_center/news/archive?id=133767

2017. 4G would bring the sector up to the current technology level in the EU. However, the EU is already preparing for the successor generation (5G), which is supposed to lay the foundations for applications in real-time environments, such as robots and artificial intelligence.

Due to the current political and economic situation, the transition to 3G faces complications. Polls suggest that 85 % of the Ukrainian population cannot afford to buy a smart phone immediately, which prevents this market from rapid development.²² However, the sector has shown some robustness in the present crisis with 6.5% nominal revenue growth in the first semester 2015 compared to the first semester 2014, predominantly driven by mobile phone and computer services.²³ Nonetheless the toll on the sector was high, with damaged and interrupted infrastructure in the east and the exodus of all Ukrainian operators from Crimea.²⁴

The effectiveness of the regulatory efforts in Ukraine is difficult to judge. A recent telecommunication forum in Ukraine in May 2015 revealed weaknesses in the relations between the regulator and the industry. While the administration seems to have failed to develop a coherent vision about the future, stakeholders view regulation with hesitation and would prefer to be left alone. The protection of copyright does not yet play a prominent role in current discussions but is an issue that has to be addressed rather urgently to develop IT based services further and to integrate them successfully into the European market. Equally, substantially enhanced protection of consumers against unfair business practices or even unlawful behaviour is a major precondition for the sound development of the sector. This includes the vigilant fight against cybercrime, which is clearly an issue in Ukraine, ironically because of its extremely skilled work force and a weak legislative environment²⁵.

22 http://www.iri.org/sites/default/files/wysiwyg/2015-08-24_survey_of_residents_of_ukraine_july_16-30_2015.pdf, See part demographics; 50% indicated that they cannot afford a smart phone at all presently.

23 https://ukrstat.org/en/operativ/operativ2015/tz/dnp/dnp_e/dnp0215_e.htm and archive; own calculations

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25 See Council of Europe, http://www.coe.int/t/dghl/cooperation/economiccrime/cybercrime/cy_Project_EaP/Default_EaP_en.asp

5.3 School education

Until recently, the most widespread corruption scheme in this context was 'facilitation': parents customarily paying for good grades. To avoid corruption, it would be enough for the child to learn well. This model was not coercive; nobody was compelled to give a bribe. In recent years there has been a definite improvement thanks to the introduction of an independent state examination, the results of which are decisive for admission to university. The facilitative bribe has not disappeared completely, as marks obtained during school continue to count in admissions, but the extent of bribery was clearly limited.

The second corruption scheme is parents' financing parties/dinners or gifts for teachers to celebrate the end of the school year. This custom is quite durable, and participation in it is enforced by social pressure from parents and from teachers.

The third scheme involves parents putting up money to purchase necessary items that are missing in a school. There is strong pressure on anyone trying to avoid participation in co-funding. The corruptive problem here consists of the lack of transparency of the process and the custom of not reporting on the budgets involved.

Recommendations

Formal rules on parents' financial contributions should be imposed in such a way that transparency and accountability would be guaranteed in this process (e.g. all the collected money must pass through the school accounting system). The tax system could allow parents to deduct such contributions in their tax declarations, which would be a double check against corruption.

Information on good practices should be widely disseminated through mass education, social campaigns and via NGOs. This could embrace such issue as, for example, limiting 'zastillya' or teaching parents how to check school budgets.

local or regional level, should be considered as a matter of priority, as should the application of state of the art technology in new public buildings.

Ukraine should actively seek out dedicated EU advice and assistance on energy matters and not solely rely on the Energy Community and international expert advice. This would benefit sector development but also help the EU to gain a better understanding of the particular needs and problems in Ukraine, which is vital for successful cooperation in the future.

4 Developing a true partnership with Ukraine

The EU has shown political, economic and financial solidarity with Ukraine. The Commission (and the EIB) has set up a dedicated working team to support the transformation and reform process of the country. In addition member states are engaging bilaterally in Ukraine in multiple ways. But more needs to be done. All services across the Commission will have to be activated to work for a success of the association. During the enlargement rounds, up to 2000 people from the Commission staff were involved in that process on a daily basis. The new approach to association might turn out to be even more challenging.

The predominant logic of the EU, 'more (reforms) for more (assistance)', reveals that the EU does not fully appreciate the need to review its own policy approach in the light of the AA. In fact, the EU bears a bigger responsibility for its ultimate success than assumed. In substance, the AA is not merely a 'new-generation AA'. It is about sharing 'everything but institutions' with a country from Eastern Europe and to that extent, a true experiment.⁴⁴ It needs to be ensured that a win-win situation occurs, not only in the long term.

EU member states have been at the forefront of nurturing a solution for the internal conflicts in Ukraine through Minsk II. Once a reliable path towards peace is achieved, it would be equally important that the EU again be at the forefront of organising an international donor's process for reconstruction in eastern Ukraine. The needed resources should be used in a manner that is conducive to Ukrainian business development.

Overall the EU has to measure its own development against developments in the countries with 'new-generation' association agreements. The creation of stable and predictable framework conditions in Ukraine and the other countries remains important for the ultimate success of their reform process. Of course the EU cannot and will never accept a slowdown of its own rule-making process. But the EU should acknowledge that the unprecedented scope of the association needs to be better reflected in its own decision-making process. Up to

⁴⁴ See Romano Prodi, speech, December 2002, http://europa.eu/rapid/press-release_SPEECH-02-619_en.htm

There is no coercion here – a student is usually not forced to pay bribes if he/she studies well and does not need to 'buy' a good degree. This custom of bribery is very strong, however, and there is social pressure to conform to it. Lecturers can be pressured on pain of losing a promotion if they refuse to give higher grades in response to bribes. There are universities where this behaviour is not accepted – social rules are different in different places.

Recommendations

This type of corruption should be subject to NACB actions and possibly penalised.

All exams should, as a rule, be carried out in the form of a written test, guaranteeing the anonymity of their participants until the announcement of the results (e.g. the files should remain anonymous while being checked by the professor and should be correlated with the students' names in dean's offices; the evaluating schemes and the final results should be published on universities' intranets; the files should be kept in dean's offices for sufficient periods to allow for appeal procedures). The competent ministry should impose that pattern on all universities.

Universities should be encouraged to elaborate and implement their own formal rules of conduct and anti-corruption policies, as well as to adopt their own ethical codes of conduct for university teachers.

A public awareness campaign should be launched to show that bribery at universities is a shame and to tell students how they could behave if confronted with a demand for a bribe. This campaign should be the first in a series of campaigns since students are the most probable 'agents of change' in this regard.

Also NGOs could be addressed to initiate activities encouraging students to disagree with bribery.

The swift implementation of a pilot project at one of the selected universities could play an important role and help to promote the concept across the country.

(healthcare), or simply from having a certain formal or informal power (institutions of administrative control vis-à-vis an entrepreneur). In this model, a transaction is not a market-type deal – it is not in any way voluntary and is more like a criminal extortion.

In cases where a bribe is offered by a group of persons, there are two types of corrupt behaviour:

- a group of people who depend on the good will of the corrupted official may finance a 'zastillya' (a dinner in a restaurant) or a gift for the recipient;
- a group of people may pay for something themselves to supplement the budget of a public institution, as in the typical practice of organising parental contributions for the purchase of needed but missing equipment at schools. The way of managing the collected money is entirely non-transparent: it is not usual to present the budget, settlement expenses and utility bills.

A detailed sociological analysis of everyday corruption in Ukraine can be found in the annexed AMU Sociological Study.

Recommendations

In general, any payments, donations, gifts, etc. to individuals employed in public offices and agencies must be prohibited. Any contributions made to support public entities (schools, hospitals, museums, etc) must be disclosed, documented and subject to public scrutiny. Any contributions supporting state services (armed forces, police, offices, courts, prosecution service) may be made only through the intermediation of the state budget and must be publicly disclosed.

5.2 Universities

The predominant and widespread type of corruption in this context is 'facilitation', where a student buys good marks from a lecturer in exchange for money or gifts. It is commonly accepted that a representative of the students' self-government agrees on behalf of the group on the amount of the bribe with the lecturer, collects the money and hands it over. The custom of giving bribes is widely accepted, and lecturers take bribes openly without any shame. In addition, they are not afraid of any consequences – bribery in this case remains entirely unpunished.

now the EU tables internal market proposals with a clear reference 'Text with EEA relevance'. The fact that there has not yet been any proposal referring to likely impacts on relations with Ukraine, Moldova and Georgia indicates that the EU has not fully grasped the nature of the association itself. But adding a title such as 'Relevance for candidate countries and for the Association with Georgia, Moldova and Ukraine' would not suffice. Instead the EU should go much further and assess the impact and likely consequences of new legislative proposals and policies on the enlargement process and on the countries with new-generation AAs. This would surely improve the knowledge of all EU institutions about the real situation and particular development needs of the partners. It could help to better target financial assistance and to develop innovative and smarter forms of financial support. It would also minimise dispute and frustration potential on both sides. Predominantly, however, it would send a clear signal that the EU is seriously approaching a 'partnership', where everything is shared except institutions (at least not yet). A clear Ukrainian focus on the closest possible cooperation with the EU would be of utmost importance. Next to Ukraine, the EU holds the other key for transforming the association into a real partnership, not driven by the lines but the spirit of the agreement.

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5 Every-day, small-scale corruption. Education and social campaigns. Public involvement.

5.1 Every-day, small-scale corruption

From a sociological point of view, corruption is a complex phenomenon. There are various types of corrupt behaviour with different structures and different consequences for an individual and for the social order. In Ukraine, when a bribe is offered by an individual, there are three 'pure types' of corruptive practices:

A 'thank-you-gift' is a case when an official fulfils his/her professional duties, but is given - on the sole initiative of the giver - an extra 'reward', in cash or in kind, usually rather small. Handing it over is not a condition of executing the work; it is a courtesy or expression of gratitude and not a purchase of a service. The 'thank-you-gift' is not perceived as a bribe and is generally not considered to be something wrong; but the existing habit exerts pressure on people. This type of a 'bribe – not a bribe' is widespread wherever a citizen has a contact with a person who has some power but not a significant advantage, for example, in dealings with low level officials.

'Facilitation' happens when a person buys a valuable item for a bribe, which otherwise could not have been obtained or would have been more costly. Basically there is no compulsion – one could receive the desired good or asset in a different way but thanks to a bribe it is received faster or cheaper. This model is of a clearly commercial and market nature. Since the giver is not forced to pay and a 'facilitation bribe' is basically voluntary, both sides are more or less equal in terms of 'bargaining power'; negotiating the amount of bribes and 'haggling' in quite an open way is common.

There also are situations of 'extortion' - when a recipient demands a bribe and delivers a service only if the bribe is agreed upon or paid. As the service is of vital importance for the giver, he or she has no choice and no 'way out'. The giver cannot by-pass this request because the recipient has a very strong advantage, stemming either from a specific monopoly on the provision of certain services

ance and pensions system, e-government, public registries), decisions of high financial value taken by the largest municipalities, and public-partnership projects.

In decisions on the allocation of EU transfers to Ukraine, at least those of substantive value, representatives of the European Union should participate on an equal footing with representatives of appropriate Ukrainian authorities.

All institutions and agencies should introduce the 'single-window' system, where an entrepreneur can submit any application and receive the decision in a formal way and does not have contact with the bureaucrat handling it. A broad range of e-government and ICT solutions has to be introduced.

Any inspection of an enterprise by a public agency should be preceded by a formal notification that also includes the exact scope of inspection. The general part of the post-control report, containing no sensitive company data, should be publicly accessible (on the website).

A 'know-how' campaign should be launched as soon as possible in order to give business people the necessary knowledge and competence they need to fight against corruptive requests.

The companies should be encouraged to adopt their own codes of conduct. The cornerstones of such internal regulations should include establishing ethical standards that all employers must respect and follow; refraining from paying bribes; and reporting situations where a bribe is demanded.

The employers' and business organizations should be encouraged and empowered to offer assistance to their members.

An outline of a manual for entrepreneurs on behaviour in corruptive situations based on a similar publication of the Polish Central Anti-Corruption Bureau is attached in Annex 5.

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The management of state-owned enterprises seems to be an important area for corruption and for the capture of public money. These practices will eventually cease after the privatisation of many state companies, following a moratorium allowing the elaboration of proper strategies and procedures that will guarantee fair, transparent and rational practices (see chapter 'Tax & Finance', section 'Tax' - subsection 2.). Until that time the management of state companies has to be under the thorough control of the NACB. See also remarks on reform of the 'Centre' in the chapter 'Modern Government', '4. Streamlined Government Structures'.

Owing to the scale of government spending, the public procurement process is particularly sensitive to corruption. Since corrupt practices and bid rigging can take place at any stage during the procurement cycle, from the project design phase onward, there has to be close co-operation between the NACB and a strong, independent central public procurement office (CPPO), which must be constituted. This agency – not procuring entities – should have the final say in preparing the documentation of each bid. The entire process has to be conducted in line with the best international practices, including its transparency and the bidders' right to complaints. The NACB and the CPPO should elaborate analytical capabilities to detect 'red flags', indicators of anomalies in the procedure. The public procurements web portal, managed by a public institution, should be run in a manner that would in practice allow all interested parties to prepare their bids.

An outline of a handbook on public procurement anti-corruption practices based on a publication of the Polish Central Anti-Corruption Bureau and the World Bank is attached in Annex 4.

In most vulnerable areas, where big public resources are at stake, 'anti-corruption shields' have to be installed for preventive purposes. In order to eliminate the risks of collusion, of avoiding competition, bid rigging, inflating the prices for purchased services or equipment, selling public property to private entities at undervalued prices or other frauds, the NACB, the Security Service of Ukraine (SBU) and other agencies should, also with the use of covert operation instruments, check the legality of the process, as well as the integrity of members of bodies deciding on large public expenditures and private companies participating in large-scale tenders. They should also guarantee the confidentiality of the procedures. This relates to such areas as large infrastructural projects, privatisation of public property of huge value, production and purchase of armaments (especially under war conditions), large digitalisation projects (e.g. social insur-

elaborating and implementing the strategies aimed at combating the corruption. On the other hand, it seems that entrepreneurs could be among the first to break the compact between the giver and the receiver of a bribe and thus act as 'agents of change'. They can form powerful organisations and find ways to finally achieve fair decisions/judgments. This will, however, require a change of attitude on the part of the business community itself: corruption has to be seen as a distortion of the market and not as an instrument for enlarging profits.

Recommendations

The quality of regulations setting the rules of the functioning of the economy and the conditions of conducting business activity has to be improved. Legal norms must be clear, easily understood and not allow different interpretations by officials of administrative bodies and agencies. This relates in particular to the tax system, which must ensure equal business conditions for all, independently of individual decisions of bureaucrats.

Ukrainian legislation on business activity needs a quick and sharp 'regulatory guillotine' in line with international best practice that would dramatically reduce the number of permits, licenses and business regulations. It is obvious that the fewer decisions that are in the hands of the bureaucracy, the fewer possibilities there will be for corruption. More detailed proposals to that effect can be found in sub-section '11. Fostering Entrepreneurship' of chapter 'WS Economy' of this Report.

'Transparency' is the key term when speaking of eliminating corruption in the economy. Access to all documents related to business regulations should be guaranteed by law and in practice. Within the legislative process all proposed amendments should be made public and clearly linked to the names of MPs, representatives of the ruling government or experts who have tabled them. A special law on public information can be considered. All formal procedures must be made public, available, inter alia, on the Internet and must always be handed in, in writing, to each and every entrepreneur addressed by the public administration. It has to be precisely defined what public institutions can require and what they cannot require.

All draft legal acts should contain, in their impact-assessment section, a corruption-risks analysis prepared by a competent authority (the NAPC or the NACB at best) rather than by the Ministry of Justice. Anyhow, Article 55 of the Act on the Prevention of Corruption cannot remain a 'dead letter'.

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One-third of such situations ended in actual corruption; 37% of the surveyed companies were convinced that they had not been given a contract or a necessary licence because they had been unable or unwilling to pay a bribe.

Small- and medium-size enterprises (SMEs) are particularly helpless. In their case, the typical corruption scheme consists of requests for a bribe from a number of officials in administrative and supervisory bodies. It is believed that the officials in these institutions, especially in smaller cities, know and support each other and that the police and the judiciary are also in on the deal. The word used to describe the system is ‘krysha’ or ‘the roof’: the protection given by high level administrative officials to lower level officials in exchange for a share of the bribes the latter collect. The lower level officials are the actual touchpoint – they meet businesspeople, talk to them and collect the money. People believe that this hierarchy of bribery exists and is a common reality, and that an average small/medium entrepreneur cannot avoid paying. With the uncontrolled power of public administrative bodies, the system has all the necessary instruments to force the business to pay.

The survey reported that respondents perceived some improvement in the problem of corruption in the economy since the change of regime in 2014: 25% of foreign investors noticed progress. Among Ukrainian companies, 41% noticed a ‘slight decrease’ in the scope of corruption; 6% described the decrease as ‘considerable’; while on the other hand, 17% of them thought that the extent of corruption in the Ukrainian economy had increased. 45% of the Polish and 32% of the Ukrainian respondents were of the opinion that the scope of corruption had not changed.

61% of all those surveyed assessed the current Ukrainian authorities as ‘ineffective’ in fighting corruption (more than one-fifth considered the authorities to be ‘extremely ineffective’). Only 12% of respondents expressed the view that the authorities were fighting corruption effectively, and only one (!) company rated the effectiveness of the authorities as ‘highly effective’. Furthermore, only 11% of all respondents pointed out one of Ukraine’s political institutions – namely the president, the government or political parties – as key actors in fighting corruption. The business community rather envisaged that corruption would be fought by the private sector itself (23%). Foreign investors believed that the media could play a significant role, while the Ukrainian entrepreneurs put an emphasis on non-governmental organisations and international organisations. This should be seen as a strong manifestation of distrust toward the state. Political institutions and public agencies should take this distrust seriously into account when

4 Transparent economy and public sector

The recovery of the Ukrainian economy and the introduction of fair market mechanisms will be impossible unless corruption is eliminated. In the AMU Business Survey³, only 48% of entrepreneurs declared that they had not given any bribes in the preceding 12 months (in a usual business environment the overwhelming majority should fall into this category); 39% of them openly admitted that they had done so; 10% refused to answer; 3% did not remember. Altogether, in 39% of cases in which there were contacts between entrepreneurs and officials in state institutions, there was a suggestion of or demand for a bribe from employees of these institutions. Business people give bribes in order to accelerate the process of having a matter settled, to obtain a service to which they are entitled, or to avoid problems with the authorities. Most often this happens in contacts with offices and officials in charge of property-related issues (in 59% of cases, a bribe was suggested), courts (this happened in 55% of cases), institutions issuing permits, concessions and licences (53% of cases, of which 58% were actually paid), inspection services such as sanitary inspection, work inspection, fire service, etc. (50% of cases involved bribe demands, paid in two out of three such situations). In contacts with the tax administration bribes were not demanded as frequently (29%), but actual corruption took place in as many as 64% of such cases.

The picture looks somewhat less dramatic when it comes to contacts with service providers (telephone, electricity, water, etc.), where a demand for a bribe was reported in 10% of all cases; with various bureaus and offices that need to be contacted to commence or register business activity (21%); border services (but not customs officers – this case is described below, in section 5.6 of this report), where corrupt requests were noted in 29% of all situations; and local administration (33%).

The scale of market distortion is manifested by the fact that in 14% of all contacts between producers/providers of services and their contractors (recipients of goods and services), the buyers suggested the bribe to conclude the contract.

³ All data quoted in this section come from the AMU Business Survey, op. cit.

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Co-operation of Ukrainian agencies with Interpol, Europol and police of EU Member States should be enhanced in order to prevent transfers abroad of money acquired as a result of corruption.

Lobbying must be strictly regulated by law. Lobbying activities should be conducted openly and officially by individuals and entities registered as lobbyists. Such individuals or entities may not combine lobbying with any other activity. All contacts that public officials of all ranks have with lobbyists should be officially documented and made public. Lobbying may only involve the sharing of information and presentation of substantive arguments. It must be prohibited to pass on any gifts, benefits and services to public officials. Whenever this rule is violated, both public officials and lobbyists involved should be subject to penalties.

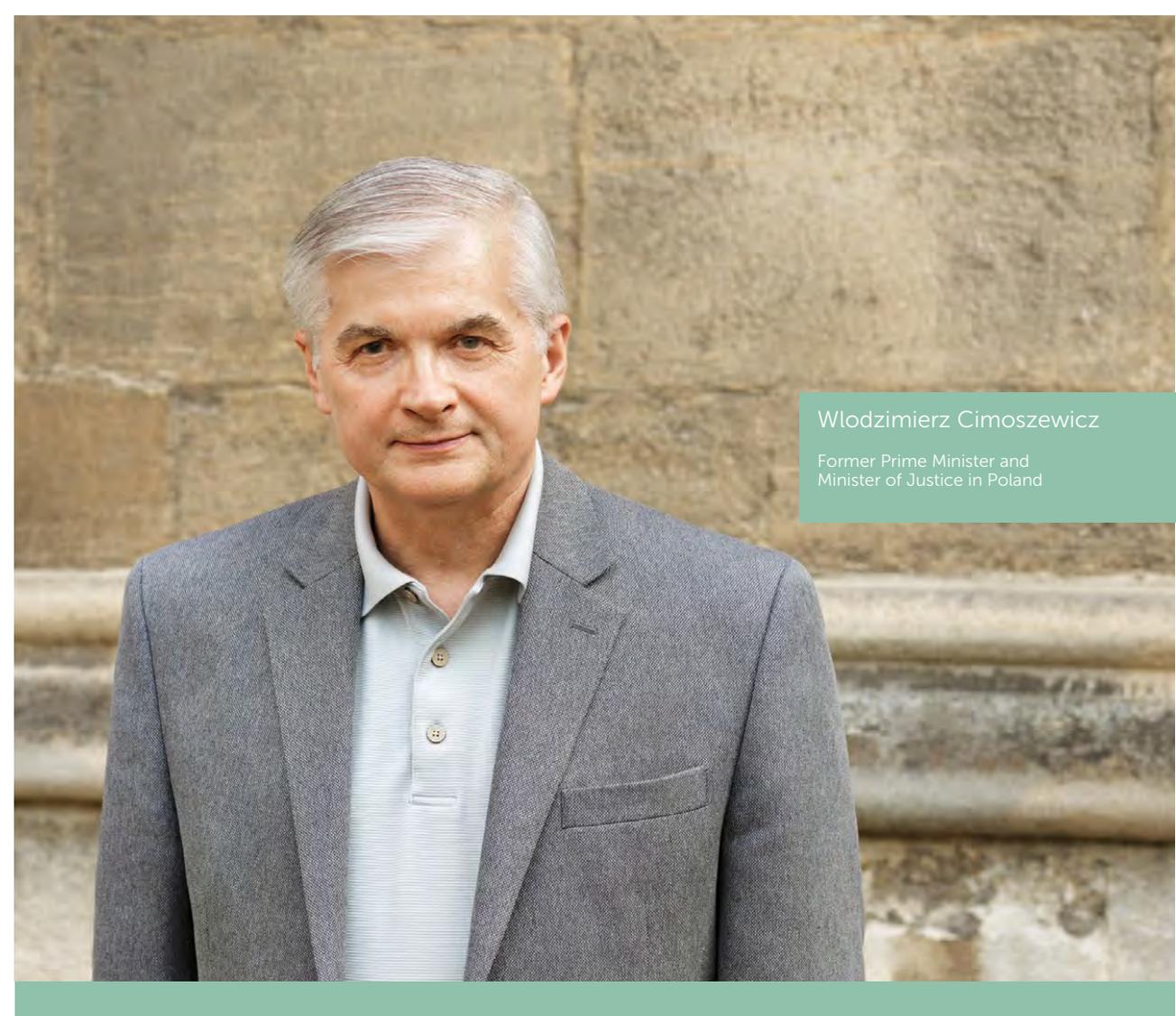
There must be a restructuring of the order of electronic media. This market, too, must be de-monopolised and must cease to be dominated by TV channels owned by oligarchs. It should be forbidden for private media companies to operate over a longer period of time without making profit (which would mean that these are political, not commercial, ventures). The public media company that is to be newly established should be a strong player supported by stable funding from public money. It should operate independently and its management should not be subject to any control by public authorities or political parties. The supervisory board members, the management board and the executive and non-executive directors of the public media company should be protected by law against any form of political pressure. The key role and objective of such media is to provide citizens with impartial information to enable their active and informed participation in public life. Public media should not be engaged in advertising.

The entire administration must have a strong anti-corruption focus. The process of creating a new civil service (see chapters 'Constitution' and 'Modern Government' of this Report) would give a good opportunity to launch the process of 'bureaucracy-cleansing'. The civil service corps will have to be recruited in a transparent and merit-based procedure. Candidates should be trained in order to be aware of what precisely would constitute breaching the anti-corruption law and what would be the consequences thereof – this could be a condition of entering the civil service. With time, they would also have to be adequately rewarded in accordance with clear and stable remuneration schemes adequate to the scope of tasks assigned to civil servants. An outline of a manual for the administrative personnel based on a similar publication of the Polish Central Anti-Corruption Bureau is attached as Annex 3.

All persons occupying official positions as listed in Article 45 of the Act on the Prevention of Corruption (rectors of universities and directors of health care institutions also should be added) must fill out not only yearly asset and income declarations, but also statements on conflicts of interests. Institutions that employ those persons should also run 'Registries of Benefits' where the officials would state, without delay, any gifts with a value higher than a precise sum, as well as goods and services obtained at a lower-than-market price. The asset declarations should list goods of a determined value purchased during the year. It should be possible to compare the acquisition of these goods with the content of the tax income declaration. All these declarations, registries and statements need to be made public, inter alia, by posting them on the Internet, and must be thoroughly checked by specialised institutions (NAPC and NACB) in full accordance with the Council of Europe's GRECO standards.

In institutions whose representatives and personnel are required to submit asset and income declarations, and statements on conflicts of interests, there should be a special independent adviser who would confidentially advise persons in question on unclear matters.

Injection of money acquired from illegal or undisclosed sources into the financial market must be rendered impossible. The National Bank of Ukraine should act vigorously in this respect. One strong instrument would be comprehensive software that enables the tracking of financial transfers throughout Ukraine and that, on the basis of network tracking and advanced analytics, triggers alerts on suspicious events that might identify money streams possibly resulting from corruption (as well as money laundering and other frauds). This software must in no case lead to a violation of financial privacy laws.



Włodzimierz Cimoszewicz
Former Prime Minister and
Minister of Justice in Poland

V Anti-Corruption/ Modern Government

Results and proposals of the workstream

Fighting Corruption: Red Alert

Any financial support to politicians or political parties in excess of the applicable limits should be deemed an offence and subject to very high fines, which should be set as a multiple of the actual payment that was made against the rules.

Also the regional and local elections should be held in accordance with the new legislation.

The exclusive public funding of political parties has to be introduced, and its transparency guaranteed. By principle, political parties should be financed from the state budget. The funding right may be limited so that only the parties which are represented in the parliament or received a certain percentage of votes during elections may be eligible for funding. The amount of funding should be defined by law. The only other acceptable source of party finance is membership fees set at moderate rates and paid by individual party members. It should be forbidden to pay membership fees on behalf of other people. No other forms of financial support for political parties should be allowed. Any violation of this rule should be subject to severe punishment. Income and disbursements of political parties must be open and transparent and subject to an audit by the central election commission. Whenever a political party violates any of these rules it should lose eligibility for state funding. In the event of notorious and repeated violations of the funding rules, the violating party should be declared illegal.

In the Verkhovna Rada there should only be professional MPs, who are not allowed any additional income (with the exception of earnings from activities linked to the intellectual property rights, such as lectures at universities and scientific publications, or from membership in organs of non-profit foundations or associations etc.; these activities could be undertaken only with the consent of the speaker of the house – but in those cases the parliamentary salary would be reduced by the appropriate equivalent). This measure could be lifted when corruption is eliminated. Remuneration for parliamentary work should be equal to that of a deputy minister.

In order to avoid conflicts of interest and risks of influence peddling, MPs must not act as advisers/counsellors to the president or cabinet ministers, or be part of their administrations (apart from certain political positions defined by law). They cannot be allowed to employ their relatives as members of their parliamentary staff. While running for their seats they should be prevented from giving 'gifts' to public institutions or individual voters during the campaign, especially if these gifts would not be listed in campaign ledgers.

3 The meta-level of political corruption

Any attempts to free Ukraine of corruption will prove ineffective if the action plan does not include radical measures aimed at eliminating the unofficial influence of a small group of the richest entrepreneurs on the functioning of the state, including legislation. Combating corruption must start with these actions, also because public confidence in the overall policy of the state with regard to corruption must be restored.

Recommendations

De-monopolisation: Ukraine needs precise and implementable anti-trust regulations that effectively result in the decartelization of her economy. The concentration of a huge economic asset in one hand should be legally limited. As in the EU, dominant positions in all sectors of the economy should not be allowed.

Public and private interests must never collide. If an entrepreneur is elected/nominated to a government position, he or she must either resign from his/her economic activity (by selling all his/her assets in a transparent procedure) or temporarily transfer all rights linked to his/ her companies to an independent trustee fund (blind trust).

A new electoral law must be enacted and new parliamentary elections should be carried out as soon as this is done. The new law should be based on the principle of proportional representation and each vote should be cast for one candidate selected by a voter (which will at the same time be a vote for the respective election committee). The list of candidates should be in alphabetical order without any indication of preferences by the political party or election committee who will have registered the list. Financing of the election campaign must be absolutely transparent and audited by an independent central election commission. Limits should be set for campaign costs as well as for contributions made to election funds. When these fundamental principles are violated, the Member of Parliament who committed the violation should be removed from office and his political party or election committee should no longer be eligible for financial support from the state budget.

Management summary

The chapter on Anti-Corruption contains 73 recommendations in the following areas: counter-acting the meta-level of political corruption; making economy and public sector transparent; curbing every-day small-scale corruption; education and social campaigns; public involvement; detection, investigation and prosecution of cases of bribery. Their full and swift implementation would reduce corruption in Ukraine to a bearable level.

1 Introduction

Despite the fall of the previous regime and the proclamations of its replacement, in Ukraine – as well as in other countries – the belief that corruption has not been curbed is becoming more and more common. Should this opinion become prevalent, it would have far-reaching deleterious consequences politically and economically.

Corruption in Ukraine is a systemic phenomenon. It is not a breach of a rule - it is the rule. It is common and obvious for everybody and constitutes a functional framework of the society – it substitutes regulatory and redistributive systems. When laws and institutions do not work properly, corruption replaces them and 'helps things to get done'. In this situation, corruption becomes deeply rooted in political culture in every-day life and at high institutional levels. Some forms of corruption are hardly accepted by the society but others are perceived as 'normal'. This has been confirmed by a sociological study carried out for the purpose of preparing this report (hereinafter referred to as the AMU Sociological Study – see Annex 1)¹.

Corruption prevents Ukraine from making optimal use of her assets. It distorts

1 'Every-Day Corruption in Ukraine. A Sociological Study' by K. Nowak and W. Marchlewski. Report on a research project and a sociological analysis on patterns of corruptive practices in Ukraine based on in-depth interviews and focus groups conducted in May – June 2015 in Kyiv, Dnipropetrovsk, Ternopil, Kherson, Vinnytsia, Odesa and Lviv

the functioning of the market, makes competition unfair, halts the inflow of foreign investments, reduces state revenues, and – in general – creates uncertain and insecure conditions for living and doing business. It dramatically undermines the citizens' trust in and respect for their state. The World Economic Forum's 'Global Competitiveness Report 2014-15' indicates corruption as the most important negative factor influencing doing business in Ukraine, ranked at 17.8 points (whereas, for example, the inadequate supply of infrastructure was ranked at 1.7 points, restrictive labour regulations - 3.4 points and tax regulations - 4.3 points). In a second study commissioned while preparing this report - a survey among Ukrainian and foreign companies (hereinafter referred to as AMU Business Survey² – see Annex 2), 86% of entrepreneurs expressed the view that corruption hindered business activity in Ukraine (40% of whom said that it was a considerable hindrance), and only 4% thought that corruption was not an obstacle. As many as two-thirds of the foreign respondents declared that a failure to improve the situation with respect to corruption might result in a reduction of their business activity in Ukraine or even their complete withdrawal from the Ukrainian market.

Substantive foreign assistance will not be forthcoming until corruption is combated. As long as it is not eliminated, or at least as long as the donors are not convinced of the Ukrainian authorities' determination in this respect, concerns that transferred funds might be misspent or abused will be strong. This will also be an obstacle on the Ukrainian road towards closer links to - and possibly eventual membership of - the European Union. The EU has had tough experiences with having admitted countries that had not successfully eliminated corruption before their accession.

When speaking about corruption in Ukraine, one must take into account not only the abuse of public office for private gain. Solutions must also be sought for eliminating practices such as solving problems with state authorities in unofficial ways, trading in informal influence, and favouritism.

2 'Corruption in Ukraine – Perceptions and Experiences of Domestic and Foreign Entrepreneurs'. Report on the results of a survey conducted by MARECO POLSKA, a member of WIN/Gallup International Association, between June 3d – 26th, 2015

Recommendations

In the case of Ukraine - where corruption has a systemic character and involves the vast majority of population, anti-bribery ethics are extremely weak, institutions malfunction - four categories of solutions must be applied at the same time:

- all procedures applied by public institutions must be written down in a very detailed manner, as little as possible should be left to practice and ethics;
- all personnel in public institutions (administration, courts, police and prosecution, schools, hospitals, customs, border control, etc.) must be trained in anti-corruption behaviour; but also, over time, a substantial percentage of office holders must be replaced;
- cases of corruption must be revealed by the appropriate agencies. People involved in bribery have to be promptly prosecuted;
- social campaigns, education and media should convince the public that it is possible (easier and better) to live without corruption.

The first of the above solutions can be implemented relatively quickly. Within twelve months, exact written procedures could be drawn up to cover all domains of social, economic and political life if the task is done with sufficient determination. Also the third of the above solutions, namely, actions aimed at prosecution, seizures and clawbacks can bring visible results soon. The reorientation of public personnel, the second component, must start as soon as possible, but the whole process will last at least several years. The fourth component should also start immediately, but it will not bring lasting effects (new patterns of social behaviour) until the longer term.

the bureau or the agency will be treated as illegal and prohibited. Officers/employees of the bureau cannot be members of political parties or take part in their activities. Also any activity of political parties within the bureau and the agency is prohibited. Both institutions have their own budgets, another condition of their independence. However, the amended version of the Law on Prosecution which, inter alia, introduced the procedural supervision of the National Anti-Corruption Bureau, may weaken the latter's independence due to the appointment of all administrative positions in the specialised anti-corruption prosecution by the prosecutor general. In any event, the way in which the above-mentioned provisions are implemented in actual practice will determine whether those institutions will indeed serve in an impartial and independent manner.

Concerning the investigation procedures, the new legislation gives the National Anti-Corruption Bureau the power to conduct pre-trial investigations in criminal proceedings concerning crimes ascribed to the jurisdiction of the bureau and in other cases if so requested by the prosecutor supervising the bureau's activities. Upon a written decision of the head of the NACB or his deputy, agreed with the prosecutor, the bureau has the right to create joint investigatory groups. The National Agency for the Prevention of Corruption, in turn, has a right to audit the organisation of the work on corruption prevention and detection in state and local self-government organs and to initiate an official investigation.

The legislation does not contain precise clauses concerning the possibility of and civil control over the use by anti-corruption institutions (first and foremost, the NACB) of instruments of covert operations, such as controlled purchase, agent provocateur, wiretapping, observation of suspects, correspondence checks, access to bank accounts, acquiring information from telecommunication companies on telephone connections and text messages, witness protection programmes, etc. This is a serious deficiency.

The civil control and accountability of the NACB and the NAPC seem to be well described in the new Ukrainian legislation as far as general terms are concerned, but they certainly require very detailed and precise procedures, since human rights and fundamental freedoms are at stake here.

Although many months have passed since these regulations were adopted, they are still awaiting practical implementation. This may imply a lack of political will to enforce new laws and suggest a dissonance between words and deeds in the fight against corruption.

Three levels of corruption can be identified, each requiring special measures.

- Actions to curb corruption must start with the meta-level of political corruption. Until now it has been spoiling the functioning of the state, has led to poor and ineffective legislation and has caused citizens to be highly distrustful of their state. One example of the unacceptable malfunctioning of the state is that a vast majority of the members of the Verkhovna Rada, the Ukrainian parliament, are financed directly by the richest entrepreneurs who unofficially influence the public decision-making process, commonly known as oligarchs. These MPs take part in the adoption of regulations that affect their sponsors' interests. Instead of aiming at satisfying the common good, the legislative process has become a terrain of struggle between different groups trying to multiply their profits.
- Corruption is absolutely common at all intersections between business and the authorities, the second level. Therefore, the market mechanisms do not function properly; there is no fair competition and no protection of the consumer.
- The third level of corruption - day-to-day bribes - is common, rooted in tradition and in many cases functional. Bribes take various forms. They often facilitate everyday transactions, for instance, when a bribe helps to obtain certain goods more cheaply or quickly (e.g. paying a bribe to traffic police or to a teacher for a better grade). On other occasions they take the form of extortion, for instance, as exercised by doctors on patients or by local administration on small businesses. Bribes put an additional burden on family budgets, cause losses of public (state) finances, contribute to the malfunctioning of state institutions and public services, and result in degradation of the quality of life of regular people.

There must be a political will to fight corruption. All parties must back these efforts. This is indispensable for success. This political will would be manifested in quick decisions on enforcing anti-corruption law in all areas, actually forming institutions empowered in this area and making them fully operational, guaranteeing independence of the judiciary and of anti-corruption agencies, and dismantling the oligarchic system in the economy and in politics.

It is inevitable that the problem will be aggravated after the necessary self-government reform and after the decentralisation of power and public money in accordance with the constitutional reform in Ukraine. There will be many more people all over the country with substantive powers involved in decision-mak-

ing. It will be much harder to have specialised anti-corruption agencies keep them under control. Remedies for this new situation must be elaborated ex ante.

Many countries have had severe problems with corruption and elaborated efficient measures to counteract them. There is a wide reservoir of know-how both on a national scale and within international organisations: the European Union, including its European Anti-Fraud Office (OLAF); the Council of Europe and its Group of States against Corruption (GRECO); the World Bank and the International Monetary Fund; the Organisation for Economic Co-operation and Development; Interpol and Europol. Yet, each case has its own specifics; in particular Ukraine, where the problem is especially grave, requires a set of measures tailored to her specific needs.

The framework of the European Union's 'Eastern Partnership' could be used to support Ukraine in actions taken to combat corruption.

Today Ukraine is ranked as the 142nd country (out of 175) in the Transparency International Corruption Perceptions Index 2014. The reasonable and feasible aim should be to achieve: 70th place by 2020 and 55th by 2025. This would correspond to the pace of Poland's advancement in the TI ranking in the years 2001–2011 from a position in the middle of all classified countries to one in the upper one-fifth.

2 Anti-corruption strategy

An analysis of decisions and measures thus far

In October 2014 a package of anti-corruption laws was adopted. It consisted of: (i) the Anti-Corruption Strategy for 2014–2017, which is, strictly speaking, a list of planned measures formulated in a general manner and covering a great number of areas; (ii) the Act on the Prevention of Corruption, as the legal basis for the creation of the National Agency for the Prevention of Corruption (NAPC), whose crucial power is to manage the process of collecting asset declarations; (iii) the Act on the National Anti-Corruption Bureau (NACB). Furthermore, on 21 April 2015 amendments to the Law on Prosecution were introduced; they provided inter alia for establishing a specialised anti-corruption prosecution. Also amendments to the Criminal Code were made; in particular, the code was appended with a new section: 'Crimes in the sphere of professional performance and activities related to providing public services'; in this section new types of offenses that can be considered as corruption were introduced: abuse of power by persons who provide public services, bribery, improper influence, illegal enrichment. The list of pieces of anti-corruption legislation is continuously evolving (e.g. the NACB was given new powers through two acts on 5 August 2015).

Apart from that, some provisions (on financial control) of the Yanukovych-era Law on Principles of Corruption Prevention and Counteraction remain in force. They will lose validity when the system for the declaration of assets for persons performing state or local self-government functions (as foreseen by the Act of 14 October 2014) enters into force.

In terms of the law itself, the independence and apolitical character of both the NAPC members and the Head of the NACB seem to have been safeguarded: They all are selected in special competitive procedures; will serve for defined terms without a possibility of holding the position for two terms successively. Possible reasons for an earlier termination of the term are also stated. Any person who was politically active in a political party in the defined period before applying for the position of NAPC member/head of the NACB is not eligible to be appointed to these positions. Any interference of state bodies, local self-governments, their officials and officers, political parties, etc. with the activities of

panel of independent experts could be convened to forecast main macro-economic indicators, as well as set out proposals for priorities in the forthcoming year and reforms needed to ensure stability and growth; they could also issue alerts on possible imbalances. Long-term strategies should be taken into account and investment projects should be prioritised. Only on that basis can the ministry of finance, the ruling government and the parliament work on a detailed budget.

Internal control and internal audit procedures should be streamlined. The new version of the Act on the Accounting Chamber must take legal effect rapidly. The chamber has to confirm its fully neutral status and ability to perform its tasks independently from the government. It should audit and evaluate the spending of public money, have enforcement authorities in order not to depend on other state bodies or controlled entities as to taking the chamber's suggestions into account, and possibly investigate individual cases (provided it would not duplicate the work of other agencies). Best practices can be found in the state audit offices of Poland and Hungary. The latter benefited from twinning projects with the Dutch Court of Audit from 2007–2011; in the wake of those projects, better audit practices were developed, changes in the administrative culture were introduced; also the state audit office established its own methods to assess corruption risk in public administration. A similar exercise could be requested by Ukraine.

Public-private partnership projects – long-term contracts between local/regional authorities or the government of Ukraine and private-sector companies – would give enhanced opportunities for developing infrastructure and increasing the quality of public services (health, education, culture). These projects would require an improved legislative framework (inter alia, the law on the public-private partnership, other acts, decrees and orders).

There could be different standards of public procurement procedures: those for a minor scale concerning local purchases could have less strict requirements in order to allow the small- and medium-size enterprises to take part in the process.

5.4 Healthcare

The healthcare corruption scheme strictly falls into the category of 'extortion'. It evokes the greatest opposition and indignation among patients, as well as the greatest sense of helplessness. Patients in hospitals have to pay or promise to pay a bribe to get medical care, and have no choice and no way to by-pass the corrupt request. This also happens when an immediate threat to life occurs. Patients believe that doctors have strong connections with one another and that they are protected by their superiors, mainly on the grounds of common interest. The system is corrupt from top to bottom – not only doctors take bribes, so do nurses and the cleaning personnel. The ways of delivering bribes are either totally informal – giving money to a doctor at his request or without it; or semi-formal – paying a fee to a foundation or an NGO which is connected to the medical institution.

Patients do not have any institution – neither a state one nor for instance a non-governmental organisation – to which they could address a complaint. To some degree they justify doctors' corruptive practices, because doctors (especially the younger ones) or nurses earn very little money. That is why people would be ready to accept some additional fees for medical services, but they do not accept the current situation, in which they are put in a humiliating position.

One problem is that the fight against corruption in the health care system will have to involve a confrontation with the majority of the medical staff.

Recommendations

If a comprehensive and obligatory system of health insurance were introduced, patients would become aware that their treatment is financed from contributions they have paid and not from some anonymous money.

A transparent system of co-financing medical services should be introduced in order to move additional payments from the 'black market' into the formal sphere.

All the medical personnel should be informed about legal consequences of bribery. The NACB should launch operations aimed at revealing cases of bribery in hospitals, and corrupted doctors should be placed on trial and eventually sentenced without delay. These trials would certainly get heavy media coverage, thus playing an informative and educational role.

Procurements of expensive equipment, as high value tenders, pose great risks of corruption. The same is true of entering medicines onto a list of subsidised pharmaceuticals. These areas will require particular attention from the NACB, in the form of 'anti-corruption shields'. Attention should also be paid to prescribing medicines and issuing certificates for sick leaves or certificates of disability.

A public awareness campaign teaching patients how to behave in a corrupt situation (what is justified and what is not) is sorely needed.

NGOs keen on encouraging patients to say no to bribery and on helping those who suffer medical abuse should be supported. This would in particular include publicizing shameful examples of medical staff behaviour.

5.5 Traffic police

In the case of the traffic police there are purely 'facilitation-type' bribes. A prevailing scheme is that instead of paying a fine, a driver pays a bribe which is lower (and faster). He/she is not forced to pay the bribe – the fine can always be paid in a legal way, usually there is no pressure from the policeman. The main problem is that nobody is afraid or ashamed to bribe and that bribing is quite common.

There is some evidence that the situation with traffic bribery has slightly improved in recent times.

Recommendations

Since it is possible to train new personnel fairly quickly, an urgent task would be to replace the traffic police personnel. It would be advisable to consider whether police officers from other EU countries may serve in this police force during the transition period. It is very likely that Ukrainian citizens would welcome such measures and view them as a signal of upcoming changes.

A number of strict rules of procedure should be introduced into traffic police practices – for instance: fines should only be paid by transfers to bank accounts or by credit card, never in cash; traffic policemen should be forbidden to have with them, while being on duty, sums larger than what is needed for basic emergencies that may occur within a span of several hours (e.g. equivalent of 1/10th of the subsistence level, which would today correspond to UAH 122). This would be easy to monitor through internal checks.

The system of duplicated administrations – the government ministries and the presidential administration – is dysfunctional. It fosters rivalry that is unrelated to the interests of the state. It dilutes responsibility and in fact abolishes any objective rules of the game. As a consequence, citizens search for loopholes, unclear provisions and the influence of one or another competing bureaucracy instead of basing their actions on the rule of law.

Recommendations

It is indispensable to separate the functions of the executive authority from those linked with the ownership of state property. Ministers responsible for different sectors are to be in charge of regulation and should not act as owners.

The office of prime minister should be vested with strong powers clearly written into the legal system. The constitutional assumption that government always acts as a collective body has the capacity, as a rule, to be propaganda serving to blur the precise limits of liability. The ministers, while maintaining their prerogatives resulting from the law, should be prime minister's auxiliaries, implementing state policies in the respective branches of public administration.

It is indispensable to eliminate any overlaps in the powers of the executive (the president and the cabinet of ministers) and to consistently adapt administrative structures.

4.3 Management of public finances

A well-organised state must operate in accordance with cost-effective, clear and transparent financial procedures.

Recommendations

When the war in eastern Ukraine and the economic crisis are over, Ukraine should incorporate in her constitution and laws the criteria of healthy public finances identical to those enshrined in the EU's Fiscal Compact and rigorously observe them.

Ukraine should strive to adopt budgets in accordance with performance-based budgeting rules. The budgetary procedures could be based on the EU model (Ukraine could ask for a joint procedure, parallel to the European semester). A

politicians from all political parties represented in the parliament as well as by experts.

After passing the appointment procedure, including proper tests, a candidate to the civil service will be nominated to the first professional rank. During the formation period of the civil service some people will have to be appointed also to higher ranks (positional model). The general rule should be, however, that civil servants are promoted according to a transparent and merit-based system (promotional model). This model has to be built from the early stage, especially if the original formal professional entrance requirements for newcomers are set at a relatively low level to encourage new people and use their new enthusiasm. Such a system of promotion should take into account not only the acquired experience but also results of the participation in the (obligatory) in-service training, provided together with the National Academy of Public Administration.

There will be no professional and reliable civil service without a certain level of independence – up to the right to disobey illegal or irrational orders. Otherwise, reliability would be replaced by blind obedience, opportunism or negligence. Procedures allowing such ‘noble disobedience’ should be precise and known to all civil servants. The NACS should strive to nominate to leading posts appropriately strong personalities capable of defending such a rule with the highest level of integrity.

With time, the remunerations within the civil service will have to be substantially increased. To strengthen the integrity of the civil service, reasons and situations in which a civil servant can be dismissed must be clearly enumerated in the law.

4.2 Reform of the ‘centre’

The structure of the Ukrainian government and the prerogatives of individual ministers are proof of the continuation of the Soviet system where the executive authority of state institutions was intertwined with authority coming from the ownership of state property. Such a system leads to a lack of transparency in decision-making procedures, to unequal treatment of companies in the economy, and to abuse of vested powers in order to attain narrow political and party goals. In practice, it usually means weak coordination and inefficiency in the use of material assets. It is also conducive to large-scale corruption and waste of public property.

Road police patrols should be obligatorily equipped with cameras and should perform their duties only if their intervention is recorded. This would not only prevent policemen from demanding bribes but also drivers from offering them.

All policemen leaving service in the aftermath of proven corruption offenses must be deprived of their pension privileges.

Mass education campaigns should be launched and grassroots activities by NGOs supported – with an eye to encouraging people to oppose traffic police bribery (e.g. one could encourage people to record corrupt requests with smart-phone cameras and then make such situations public).

5.6 Customs and border control

Customs control is listed as one of the most corrupt fields of activity in Ukraine. In the AMU Business Survey one-third of respondents who had had contacts with customs offices within the previous 12 months met with suggestions of bribes from employees of these services. In 42% of these situations, the bribe was actually paid. Not only companies are confronted with corruption at the borders, but also individuals are.

Recommendations

The European Union should be lobbied with a view to creating an EU mission to help Ukraine in managing the movement of people and goods through Ukraine’s border (both in the sense of border control and customs), with a special emphasis on eliminating corruption. Customs and border control officers from EU countries could temporarily serve in and have command of these units. There should also be an efficient internal control unit for such a mission.

This could be a response to President Petro Poroshenko’s earlier call for a EU police force to help re-establish Ukraine’s control over the part of the border with Russia that is now controlled by the self-proclaimed ‘republics’ in Eastern Ukraine. Although the proposed EU mission would not take responsibility for the uncontrolled part of the border, it could assist in creating an important corruption-free agency, which could also serve as a model for transforming other institutions.

The AMU could address the European Commission and EU member states with the details of the initiative of the EU mission, and act as its advocate.

EU member states bordering Ukraine should organise common control of the frontier and the customs control by their national agencies and their Ukrainian counterparts.

The Ukrainian customs administration should strive to establish a client-oriented approach in relations between customs officials and citizens or business. To accomplish this objective, it ought to implement a transparent mechanism for defining the price of goods for customs purposes; introduce the e-customs procedures in full, including the on-line preliminary declarations (entirely); and procedures of selective post-audit should replace the full-coverage auditing of all goods crossing the border as it is applied today.

5.7 Social campaigns to raise awareness

The work on changing societal attitudes should be conducted at two levels – a general public awareness campaign and specific ‘know-how’ campaigns.

Recommendations

A public awareness anti-corruption campaign – an ‘umbrella campaign’ targeted at the general public – should:

- explain to people ‘why bribery is bad’. It should focus on the following insights: ‘I do not want to live in such a country, I want to live in a European way.’; ‘I am against them stealing my money’; ‘Bribery is destroying my country.’; ‘Bribery is destroying my children’s future.’
- show that people can take various approaches to a life without giving bribes. They can: (i) not participate, (ii) disagree, not tolerate bribery (in their own local milieu), (iii) fight and protest bribery (on a wider scale).

The ‘know how’ or mass education campaigns should supplement the one aimed at general public awareness. Targeted at specific target groups (students, drivers, business people, parents, patients), these campaigns should:

- show concrete ways to counteract or avoid (by-pass) bribery in specific situations,
- show concrete ways to ‘replace’ corruptive behaviour with other means of action,
- mobilise, encourage and empower people to engage in many forms of grassroots anti-corruptive activities.

deep administrative knowledge and experience, the personnel of the old Derzhavna Sluzhba should not be discouraged from taking part in the procedure. Yet, it must be clear that a person’s involvement in corruption does constitute an obvious reason for disqualifying him or her from entering/remaining in the civil service (if proof of such involvement is uncovered, the person will be dismissed from the civil service immediately and deprived of all privileges).

Already the first appointees to positions of the head of the civil service staff at all levels of administration (director general/secretary general in a ministry, head of a central agency, executive director/secretary in a regional or local administration) must be persons of the highest possible reputation and unquestionable professionalism. They must be selected in open competitive procedures organised by the NACS without any interference from politicians (ministers, heads of regional and local executive bodies). Candidates must be eligible on the basis of all other regulations, including the law on lustration.

Directors general should ensure that civil service officials discharge their duties to the best of their abilities irrespective of the political composition of government. To do so, directors general must be appointed for a fixed term that cannot be shortened, have full official command over all staff and must be irremovable from office in case of a political shift in the government, especially after general elections.

All management positions in the civil service must be filled as a result of competitions organised by heads of the civil service personnel in respective institutions, acting in the capacity of representatives of the National Agency of the Civil Service (NACS) and in coordination with the central staff of agency. Procedures established by the EU’s EPSO could serve as a model. The political heads of the institutions, their deputies and advisors must not be allowed to interfere with the process. These remarks are especially relevant to the phase in which selection criteria are set (they should always be approved by the NACS). It should be prohibited to refrain from appointing any candidate that wins the competition unless irregularities are discovered in the application process.

The scope of responsibilities of the National Agency of Civil Service will be vast and should be accompanied by appropriate resources. It is crucial to guarantee the sustainability of this agency. This should not be misinterpreted as isolation or total independence from the government – which would sooner or later lead to mistrust and/or the feeling of a lack of control over the civil service. As in the Polish model, the head of the civil service should be appointed by the ruling prime minister, but must be ‘overseen’ by a civil service council composed of

4 Streamlined government structures

4.1 Creating a modern civil service

Duties of public administrations must be executed by members of the civil service. They should be perceived, and perceive themselves, as servants of the entire population, not of a political party or any other group. Civil servants have to perform their official duties and carry out their tasks professionally, impartially and irrespective of the person or party and be personally and fully liable for the legality of their official actions. Every citizen of Ukraine must be equally eligible for any public position according to his/her aptitude, qualifications and professional achievements. Members of the civil service should be appointed for life and provided with appropriate conditions for work and granted remuneration consistent with the dignity of their office and the scope of their duties. Their status should be protected by judicial procedure. For details, see the chapter of 'WS Constitution' '4. Public service' in this report.

The pattern of behaviour where a politician appointed to an executive position treats with full confidence any civil servant independent of the latter's political convictions is fundamental to any stable state. All civil servants must be required to give loyal advice to every government even if the government's political programme is contrary to their own ideas and beliefs. Members of the civil service must also abstain from seeking familiarity with political leaders.

Recommendations

The timing for forming the new civil service (CS) and the initial phase of its operations will be decisive for winning public confidence and for establishing the CS's image as apolitical and entirely devoted to the public, prepared to serve all. Recruitment procedures have to guarantee, from the outset, that only candidates with a (minimum of) professional knowledge and high personal character are taken into account. To enter the civil service, all candidates should have to pass a general exam prepared, carried out and assessed by experts from the National Agency of the Civil Service (NACS). Since the civil service will need

5.8 The rise of whistle-blowers and watchdogs (reinforcing the NGOs, networking them)

Transfer of know-how and good practices from foreign NGOs to the Ukrainian ones and exchange of knowledge and experience between the Ukrainian NGOs should be promoted and supported. In particular, the watchdog model of NGO activity should be popularised.

Various models of 'grassroots activity' – at schools and universities, in the healthcare field, in the business world – should be developed and disseminated. They will help to activate ordinary people and thus achieve relatively quick results.

Investigative journalism is a powerful weapon in the fight against corruption. Articles revealing bribery situations and practices may not only unseat corrupted officials, but also raise awareness of the problem and have a preventive effect.

Recommendations

A pilot project involving a 'medical watchdog' could be created and promoted. It should be a non-libellous website (prudence is called for) that has a ranking of corrupt doctors and offers advice to people who have suffered from abuse.

Civil society organisations themselves should attempt to integrate the dispersed and uncoordinated activities of Ukrainian NGOs into a national anti-corruption project. Networking the NGOs would help to exchange experience and good practices, facilitate coordination of activities, and provide the institutional framework for such cooperation. As a next step, a national 'Anti-Corruption Congress' could be considered, which would gather in one place anti-corruptive NGOs, social movements and grassroots initiatives. If successful, it could adopt a joint programme of action. This would be a way to break through the 'alienation of power' syndrome, which is an important barrier to fighting the corruption.

Legal guarantees for investigative journalists should be strengthened (protection of their sources, the right not to disclose their informers). The prosecution or the police should launch investigations ex officio on the basis of media information if the latter is based on facts and data.

The AMU could support non-governmental organisations active in fighting corruption and strengthen their capabilities and their networking.

6 Detection, investigation and prosecution

The state must be determined and efficient in revealing actual cases of corruption, placing people involved in it on trial and eventually sentencing them. Raising anti-corruption awareness of officials and rigorously fighting cases of corruption are two sides of the same coin. The recent example of Romania shows that such determination brings immediate effects: businessmen, politicians, bureaucrats, etc. are prevented from continuing corruptive practices because they are in fear of being caught red-handed; and public trust in the state is starting to be restored.

Impartiality and independence of specialised institutions to fight corruption and of the judiciary must be guaranteed (for details see chapter 'WS Rule of Law', '2.7. Recommendations' in this report).

Judges and prosecutors, as well as the NACB and police officers must have grounds to believe that they are backed by the state. Courage is needed to take action against prominent and influential individuals (politicians, public officials, business owners).

The process of replacing judges and prosecutors will take a few years, even on a fast track. A 'zero option' is not feasible nor is bringing in foreigners to serve as judges or prosecutors.

Confidence in newly created anti-corruption agencies is crucial. Here some involvement of citizens from third countries could be considered.

The military prosecution service and the military courts as well as the military police also play an important role (high value tenders). Any procurement made to acquire military equipment for the armed forces is at the greatest risk of corruption.

Recommendations

The NACB and the NAPC must start their activities with no further delay. It should be the individual responsibility of the president, the prime minister and the speaker of the Verkhovna Rada to guarantee that the process of recruiting personnel, preparing necessary legislative regulations and financing the operations is no longer protracted.

social importance and related to the strengthening of civil society. The objective of institution-building should be one of the highly valued criteria. There is a high probability of support for such actions from the EU and some of its member states, as well as foreign NGOs.

A special programme encouraging bureaucrats to search for jobs in this third sector could be elaborated. If the programme coincides with the cutback in public administrative personnel, it could result in an accelerated process of building up the competence of NGOs in different fields.

'Politicisation' of the NGO sector must be prevented.

Special legislation is needed to establish privileged conditions for social firms (such as cooperatives or mutuals), which could give jobs to the socially excluded. The third sector can also embrace spin-offs from (usually local) government, continuing to operate as public service delivery organisations (e.g. housing communities or associations).

Some areas of public services could even be privatised, while the government would still maintain strict control over the functioning of companies that would take over the responsibilities. This could happen, for instance, in healthcare (private hospitals and first-contact clinics run as private entities, where treatments would be available to every patient and financed from national health care funds; dental care in full), veterinary services, or partially, in the pension system (if a part of retirement benefits was covered by private investment funds to which employees would pay social security contributions).

3.4 Civil society

The 'public governance' concept is not possible without a well-functioning third sector alongside the private and public sectors. This third sector consists of various non-profit, non-governmental organisations with appropriate knowledge and high motivation to take responsibility from the public administration and local governments for the delivery of some public services. A number of European states have managed to introduce such a system (the Netherlands, Sweden, the United Kingdom, Ireland are good examples), but it is also well-developed in countries like Israel or India. As a result of conveying some tasks to NGOs, public services are delivered precisely to those who need them and at a higher level and lower cost.

This system could be applied in Ukraine in particular in the following areas: assistance to the unemployed in their search for new jobs, poverty relief efforts, assistance to the disabled, human rights advocacy, primary education and pre-school education, cultural institutions. The NGOs entrusted with prerogatives in those fields would get sufficient financing from the government, would be financially accountable to and under the strict supervision of the power-delegating institutions.

Today Ukraine lacks the assets needed to introduce such a system. Although it has excellent examples of activism, civil society in Ukraine is still developing and does not have sufficient skills in those sensitive domains. Public services are generally of poor quality. Therefore it would be a long process which would have to start with continuous state-sponsored efforts to strengthen the entire NGO sector. Organisations will have to be assisted in their efforts at institution-building and strengthened financially. They will need time to recruit qualified personnel and acquire the needed know-how. Following the implementation of such a strategy, NGOs could assume some responsibilities. It would be a real success if this process could be completed within around 15 years from now: three full terms of local authorities plus two years before the self-government reform is introduced.

Recommendations

The Ukrainian government should launch a multi-year programme involving a fair and transparent competitive procedure for allocating grants (preferably on the basis of contracts for three or more years) to NGOs in various domains of

The size of the NACB staff should be increased and the ratios of officers to civil servants changed. The posts in the NACB that are to be approved by the cabinet of ministers upon the proposal of the head of the agency must be adequate to their functions (procedures for collecting and checking the asset declarations will require enormous staff).

There is a risk that the number of personnel in both of the newly established institutions will be insufficient. There will be 700 people serving and working in the bureau, and, within that number, no more than 200 officers. The efficiency of operations would be guaranteed, according to our estimates, with 1,400 employees. What is more, there seems to be a twist in the ratio of officers to civil servants (in the case of the Polish Central Anti-Corruption Bureau, the number of officers is close to 90% of the total staff, whereas in the NACB it is slightly more than one-fourth).

If an uncorrupted corps of border control and customs officers is built up as a result of the engagement of nationals from EU member states as part of a possible EU mission (see point 5.6 of this chapter), Ukrainian officers with appropriate knowledge and morals could join the NACB several years from now.

The NACB should perform all four types of activities. The first type is analytical, i.e. identifying domains of possible corruption and gathering information from open sources on possible cases of bribery. This is important as a starting point for other activities, as well as a basis for decisions by state bodies. The bureau should regularly forward such analyses to the president, the ruling government and the parliament. The second type of activity is operational, i.e. intelligence. Third is control of public institutions or public persons e.g. within the process of assets declarations checks. Fourth is investigative.

The NACB should use all known legal and operational instruments: controlled purchase, agent provocateur, wiretapping, observation of suspects, correspondence checks, access to bank accounts, acquiring information from telecommunication companies on telephone connections and text messages, witness protection programmes, etc.

Since these prerogatives might interfere with human rights and fundamental freedoms, rules on their use must be embedded in precisely formulated clauses in the Act on the National Anti-Corruption Bureau, in an exhaustive directory of cases where such operations may be pursued during the course of an investigation.

Prosecutors under the supervision of the courts should oversee the preparatory and criminal proceedings. In particular, operational instruments must be subject

to very thorough prior controls by prosecutors and judges who always must take final decisions on their use (the best solution is to entrust this prerogative to one department in a selected court with experienced judges specialising in criminal proceedings; this would also preclude leaks of restricted information). Also post-factum oversight should be executed by a special Verkhovna Rada committee. Generalised information on the use of those tools should be regularly presented to the general public.

The system of effective control over operational activities cannot be limited to the NACB alone – it must encompass all the agencies that could be engaged in fighting corruption (the Security Service of Ukraine, the police, other special forces).

There is a need to ensure efficient coordination of actions of various agencies responsible for fighting criminal offenses, in particular when operational instruments are used. It is inevitable that overlaps will occur. The 2014 Act on the Anti-Corruption Bureau includes a list of certain state authorities the bureau may cooperate with. The Act on Corruption Prevention stipulates that the National Agency for the Prevention of Corruption shall cooperate with state and local self-government bodies through authorised departments (or persons) with a view to both prevention and detection of corrupt practices. The optimum solution would be to entrust coordination responsibilities to the head of the NACB.

In all institutions designed to fight corruption, strong autonomous inward-operating inspectorate systems must be created in order to continuously check and guarantee that the force itself is free of corruption.

In the NACB (as well as in the police and other police-like forces) the hierarchy of service and promotion policies should be defined in pertinent statutory laws (as it is, for instance, in the Polish Act on Police) and implemented accurately and literally in order to exclude the possibility of appointing incompetent individuals.

The public should be widely informed about the principle of pardoning individuals who confess to giving a bribe (active corruption), provided that they report this act to the competent institutions and disclose all relevant circumstances before relevant agencies find out about the crime (Article 369 para. 3 of the Criminal Code). This provision should be generally applied by courts (if necessary, the High Council of Judges could be addressed by the minister of justice with a request to convey to all judges such a recommendation). This is needed to break the conspiracy of silence.

It is of utmost importance to guarantee that data contained on the e-government platform are secure, especially in light of the high risk of a cyber-attack. This must be the responsibility of a state agency, which has to show the highest diligence in its work. This agency must establish system architectures that incorporate security and privacy principles plus raise security and privacy awareness and create clear accountabilities through to executive levels. Government information systems will require regular audits and penetration testing. The old government certification of data security must give way to international risk-based standards and practices.

Although Ukraine is at present technically prepared to ensure access by a substantive part of the population to an (initially rather simple) e-government platform, investments in infrastructure, especially in fibre optics networks and broad band Internet, should be an objective. This was the approach chosen by Sweden, 4th place among European countries in the UN Survey. Each new infrastructural project should obligatorily foresee the fibre optics component. Since these would generally be costly investments, access to the Internet in less populated rural areas can initially be offered in the form of WLAN networks. Establishing special local public points with access to the Internet (e.g. public libraries, post offices, and banks) has not proven cost-effective in Poland, although it is assessed as positive in Georgia.

The IT audit function in government bodies should be established to check efficiency of IT spending, procurements, IT security, etc. Large-scale IT projects financed by the state ought to be audited by independent auditors at every stage (strategy development, architecture development, tenders, vendor selection, and implementation). The audit results should be presented to the parliament and made public.

Ukraine could realistically advance to around 45th place in the UN e-Government Survey within ten years if a comprehensive strategy is elaborated and continuously implemented.

the foreseeable future supplement – not substitute – traditional public administration. Quality of face-to-face interaction with public administration will remain crucial.

One of Ukraine's assets is the existence of dynamic groups of people, NGOs and ICT companies that could help to develop e-government tools. The UN survey attributes quite a high figure to Ukraine's Human Capital Component – 0.8616, above the average. Volunteers have created an electronic iGov.org.ua platform, today offering access to 25 services (46 more are to be available soon and work continues on 397 procedures). The final platform cannot be built without the involvement of government agencies.

Recommendations

In order to effectively build up an e-government platform that is helpful to the citizens, a coherent system of competent institutions, a precise strategy and a specific plan of action (including a plan of expenditures) is needed. Uncoordinated measures might be harmful to the overall project.

The strategy should take into account the Digital Agenda for Europe (a Europe 2020 Initiative) and the EU steps to foster the digital single market.

The establishment of an effective model for IT management in the public sector, including the switch from outdated Soviet-time standards (GOSTs) to international standards, is another precondition for the successful implementation of e-government, which should be introduced in legislation.

A reasonable platform for online public services could be created relatively quickly. The best solution would be to have one platform where all services would be integrated. Constructing separate platforms by various public institutions would tend to lead to chaos. Should that approach be taken, however, users should be granted easy access to all platforms with a single and inexpensive authentication procedure, such as those used by banks for financial operations (an electronic signature is too expensive for individuals, the so-called certified profile requires unnecessary actions by users). Eventually, access to e-government services could be granted through a new ID with an electronic chip.

Services uploaded on the platform must include those most expected by the population. Payment of taxes and fines or payments for utilities, registry of medical certificates for sick leaves and access to public registries should be included first, also because they are relatively simple and inexpensive.

An article should be added to the Criminal Code stating that any public person (i.e. president, prime minister, ministers and deputy ministers, MPs, heads and the personnel of all public agencies, judges, prosecutors, mayors, members of regional, county and local councils and their executive organs, civil servants, officers and non-commissioned officers of all police-like forces, armed forces and secret service, etc.) who withholds information on a corruptive offence will himself be deemed to have committed an offence and will be subject to prosecution and punishment (see further the 'WS Rule of Law' chapter 2.7. Recommendations in this report).

The application of Article 368 of the Criminal Code, providing for the forfeiture (to the state budget) of money given as a bribe by virtue of the fact that it was an element of an offence, should be a rule and a standard (if necessary, the High Council of Judges could be addressed by the minister of justice with a request to convey to all judges such recommendation).

When initiating actions to prove corruption, e.g. following a whistle-blower's intervention, arbitrary decision making by the NACB or police officers, prosecutors and judges has to be limited to the maximum possible extent. Relevant procedures must be described in detail. During the initial period in particular, the system must not allow cessation of the proceeding (prosecutor's opportunism). Each case must be registered and brought to a close. It must be possible for a citizen to lodge a complaint or appeal to a higher instance or another institution if his/her report on a possible corruption offence is ignored.

A system of 'multiple checks' must be developed. Any irregularities in the activities of one agency should be detectable by other agencies. This will also offer more confidence to citizens when they come in contact with the judiciary and will encourage citizens to use the services of the institutions and agencies mandated to enforce the rule of law.

Judges and prosecutors committing corruption offences should face an extraordinarily increased liability. The statute of limitation for their corruption crimes should be substantially extended. Their right to immunity must not be abused (the same applies to MPs). There must be a possibility to lodge a complaint against them to a special verification committee or disciplinary court. This could be done to the High Council of Judges and the forthcoming High Council of Prosecutors (or possibly to a national independent oversight body of the type suggested in the section 'Law enforcement', '3.4.Recommendations' in the chapter 'WS Rule of Law' of this report) if such procedures prove efficient. If it is determined that the law was violated, the violation should be subjected to

criminal proceedings and the perpetrator should be automatically expelled from his profession and lose his special retirement rights (consequently, retirement benefits would be calculated based on general rules).

Corruption cases against judges could be directed to a specialised court consisting of highly esteemed judges who are beyond reproach (to avoid accusation of intra-corporate solidarity and protection).

Special amnesty clauses enabling judges who in the past committed corruption offences to be pardoned, under certain conditions, from the consequences of their breach of criminal law should be created (see section 'Judges' '2.7. Recommendations' in chapter 'WS Rule of Law' of this report).

A special ombudsperson's office for victims of unfair courts proceedings should be set-up, headed by a high-ranking lawyer from abroad of international renown. His/her role would be to issue opinions and make general recommendations on the basis of repeated cases. Appealing to the ombudsperson would not exclude the possibility of recourse to a legal system of appeal, including to the European Court of Human Rights. Any individual could lodge a complaint both to the international ombudsperson and to internal structures within the judiciary (verification committees, disciplinary courts, the National Council of Judges), where each and every complaint would have to be treated individually.

Communities of judges and prosecutors should adopt their own professional codes of ethics; any violation of the code should lead to disciplinary proceedings and possibly expulsion from the profession.

All court decisions should be made by a panel of judges instead of one judge individually. If this turned out to be impossible due to insufficient numbers of judges, the idea of involving well-trained and highly ethical lay judges could be considered.

A public opinion representative indicated by a prestigious NGO (e.g. Transparency International, Helsinki Human Rights Foundation) should always be able to participate in court proceedings.

The judiciary must be open to the media in a responsible way - also to perform its educational function to help fight corruption. There should be an obligation to inform media about cases of interest. All court proceedings should be open to the public, except for cases/circumstances identified by law, where hearings must be held behind closed doors.

collected fees was; also what the structure of the agency is, how many clerks it has, what its expense structure is. Each government entity providing public services should be subject to a regular external audit. The quality of administrative services must also be monitored (by means of mystery shoppers, questionnaires, etc.).

Civil society should be encouraged to monitor the quality of administrative services.

3.3 E-government

E-government has to consist of e-services, e-democracy (which has to come at a later stage to complete the process), electronic document flow and information flow among government bodies, electronic IDs and authentication of legal entities (electronic signature). Ukraine must create a single electronic platform (or several intertwined platforms) that enables citizens to submit applications to local or central administration, make declarations to public authorities, pay taxes, and make arrangements concerning their health and social insurance or retrieve documents from public registries, etc. Parallel to those efforts, the quality of all bureaucratic staff must be improved. Introducing ICT solutions would allow personnel levels in public administration to be reduced (which in itself will be important when the time comes where bureaucracy has to be dramatically streamlined) and help it to function more cost-effectively. ICT would also reduce the time that citizens devote to settling their life problems in interaction with official institutions and increase citizens' satisfaction. On the other hand, e-government can only be implemented when all procedures within the administration are precisely defined and efficiently executed; otherwise it could add to the chaos, and the whole idea might be discredited for some time.

Ukraine lags behind in this regard. In United Nations e-Government Survey 2014 it is ranked 87th among the countries surveys, more or less at the level of Albania (84th) or Macedonia (96th), or – if referring also to non-European states - Brunei Darussalam (86th) and El Salvador (88th). In Europe, Ukraine has the second worst value for Telecommunication Infrastructure Component (0.3802, only Albania is slightly worse; usually the indicator ranges from 0.56 and 0.8, the average is 0.6678). Only three countries in Europe (Bulgaria, Monaco and Macedonia) have Online Service Component worse than Ukraine's 0.2677. In nearly three-fourths of all European countries this variable is higher than 0.5 (the average - 0.5695). Taking that into account, the e-government solutions could in

3.2 A much more efficient administration

The local administrative body is where a citizen enters into contact with his/her state most often. There the state ceases to be something abstract. Bureaucrats must always bear in mind that the citizens are their 'employers'. They must show empathy and competence. Applications must be processed immediately, and decisions must be taken without delay. Also members of the administration who do not have direct relations with citizens must work at maximum efficiency.

Recommendations

A new corps of bureaucrats has to be created in local and regional administrations. Before entering this service, candidates should pass a general competence test and aptitude/personality check that would give them the right to apply for specific positions. Posts would be allocated in an open competitive procedure under the supervision of the National Agency of the Civil Service. All employees in local and regional administrations should belong to the Civil Service corps.

All procedures set up within any regional or local administration should be precisely described and allocated to individual employees. A general template for such a description should be elaborated centrally and then adapted to local conditions in consultation with the Civil Service Office. The template will then enable heads of administrative bodies to see how effectively decisions are prepared and taken, and on that basis to impartially assess the work of all personnel.

The allocation of all procedures to individual bureaucrats at all stages of the process of dealing with an issue will at the same time offer citizens a possibility to track over the Internet how their applications are progressing.

Each public service should be provided according to the 'end-to-end' formula, i.e. the citizen should address one public institution and obtain the decision from it without having to make any additional effort (eg presenting documents issued by another public agency). The whole process should be the responsibility of the competent public institution.

Each public administration agency should have an obligation to report regularly and transparently on its activities, i.e. how many services it provided, how many rejections there were, what the reasons for rejections were, what the volume of

The complete course of court proceedings should be audio and video recorded. Access to recordings should be ensured, also over the Internet.

Judges and prosecutors should be offered fair remuneration. As a result, the propensity for corruption in these professions would be reduced. In order to encourage young people to join these professions, a set of special social benefits might be elaborated.

Modern Government

In all regions, counties (район/ rayons), cities and rural communes (hromada) the councils should be elected in a purely proportionate ballot in accordance with the new electoral legislation (see section '3. The meta-level of political corruption' in chapter 'Fighting corruption: red alert' of this report). The right to propose candidates should belong to political parties, non-governmental organisations and groups of citizens that are formed on an ad hoc basis ('voters' electoral committees'). Heads and members of executive organs should be appointed by the majority in the councils. The executive organs must always be fully subordinate to the councils. Direct elections of mayors are not recommended, at least as long as corruption is not eliminated.

The regional and local authorities must be independent in the exercise of their duties. Administrative supervision by central state institutions may only be carried out according to precise procedures and in cases which will be provided for by the constitution. Supervision should aim only at ensuring compliance with the law and with constitutional principles. One representative in each region (not in the counties) of either the government or the president should be responsible for this task, and the ultimate decisions must belong to the courts. Supervision may also be exercised with regard to tasks, the execution of which is delegated to regional/local authorities. The intervention of the supervisory authority must be kept in proportion to the importance of the interests which are to be protected.

The regional and local authorities should be allowed discretion in adapting the exercise of powers transferred to them to local conditions. They should, inter alia, be able to determine their own administrative structures taking account of local needs and ensuring effective management.

Citizens must also have recourse to local referenda, including on the cessation of the term of councils (and, as a consequence, mayors and executive organs).

Regional and local authorities should have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for the principles of local self-government. They should be consulted in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them directly. Local authorities should be entitled, in exercising their powers, to co-operate (form consortia) with other local authorities in order to carry out tasks of common interest, and to have contacts with their foreign counterparts

100,000 inhabitants) would perform the functions of a commune and a county at the same time. Authorities of all three levels must be complementary and not form a hierarchical structure.

The status of Crimea as autonomous must be preserved.

Police should remain a unified force, but there should be a mechanism of coordination with the county authorities. Communes might have the right to create their own local guards with limited prerogatives (maintenance of the public order), which would need to be strictly defined by the law.

The responsibility for ensuring citizens' access to culture would be transferred to local or regional authorities with the exception of a small number of cultural institutions of genuine importance to national heritage, which would remain within the purview of the central government.

Powers given to local and regional authorities should be full and exclusive. The question of which powers are to be transferred to which levels of self-government must be answered precisely in the process of reviewing all legislation and determining the delimitation of powers. If organised responsibly and efficiently, this task would take no more than one year; the *vacatio legis* should last an additional year.

Transfer of powers to respective levels of self-government must be accompanied by the necessary funding. The decentralisation of public finances leads to the rationalization of expenditures and a more accurate allocation of expenditures from the standpoint of the needs of communities and individuals. The resources at the disposal of regional/local government have to be commensurate with the responsibilities provided for by the law. The whole regional budget and a larger part of local resources should derive from central taxes (personal income tax, corporate income tax, VAT). However, a smaller part of local budgets should come from local taxes and charges. In this context, the councils must have the power to determine the rates. Grants to regional/local authorities should not be earmarked for the financing of specific projects unless they are reimbursement for performing tasks delegated to these levels by the central government. For the purpose of borrowing for capital investment, regional and local authorities should have access to the national capital market. A special system guaranteeing the protection of financially weaker regions and local communities (financial equalisation procedures to correct the effects of unequal distribution) will certainly be needed.

Management summary

In the chapter on Modern Government 56 recommendations are formulated that would allow Ukraine to build an advanced system of relationships among the central institutions, regional and local authorities and non-governmental organisations, with NGOs taking over some of the governmental functions. This would require: the removal of barriers to business, the decentralisation of powers and finances, a much more efficient administration, the introduction of e-government, the state-sponsored strengthening of NGOs, as well as streamlined government structures, including the creation of a modern civil service, reform of the 'Centre' and better management of public finances. Such a system of public governance would be conducive to favourable business conditions, and would provide public services of higher quality at lower cost. It would also streamline the decision-making process in the country.

1 Introduction

In the immediate aftermath of the fall of the former regime, the political system of Ukraine in 2014 regained the confidence of the vast majority of citizens of the country who widely manifested activeness in public affairs (e.g. formed new political parties and NGOs, including those of a watchdog character; participated in public debates, also by newly established media and civic journalism). There is no guarantee that this will last long. The system has a tendency to alienate itself and to focus on internal struggles between various factions seeking to satisfy their own interests, thus neglecting the expectations and the will of society. If the political system follows this tendency, citizens will reject it again. Symptoms of their distrust are already clearly visible.

Public administration responsible for providing public services to society is one of the key elements of a democratic state. Ukraine has an ineffective, old-fashioned and citizen-unfriendly bureaucracy. One of the possible ways of changing this situation is to gradually develop the concept of public governance, where citizens and various groups are seen as partners and stakeholders and not subjects.

This concept is based on the following rules: openness, participation, accountability, effectiveness, coherence. The hierarchical organisation structures ought to evolve into intertwined networks. There would be less control, dispersed powers, collective decision-making based on social consultations and shared responsibility. However, to achieve this model, a mature civil society is indispensable. Public governance requires the increased participation of the population. Therefore, Ukraine will need a road map to try to install it in approximately 15 years.

This road map would indicate what steps should be taken in all areas (government-to-business, government-to-citizens and government-to-government) in various sub-periods of this time-frame and could look as follows:

2015 – 2017

The necessary powers of the state should be precisely delimited; legal acts on the decentralisation of public powers and finances would be adopted. The central administration would be reformed. The Civil Service would be instituted along with an overall test for candidates wishing to join this service. Following the 2015 local elections, work would commence on building new local and regional administrations. A state-assisted (also externally-assisted) process should be launched to build civil society institutions that could in future take over some responsibilities in areas such as the labour market, social welfare, primary education, pre-school education, culture. The business environment has to be comprehensively improved. The Accounting Chamber should gain real independence. The process of bringing ICT solutions to public administration should start, including the instalment of e-taxation. At the end of this period new elections to local and regional councils would be held, so that there could be a 'new opening' on the basis of the legislation just adopted.

2018 – 2021

This will be the first phase of the transfer of powers from state agencies to local and regional governments. Overlaps will have to be clarified. Local and regional administrations will have to be streamlined in order to accommodate the exercise of new powers. The process of civil institution-building should continue with elements of cooperation among NGOs and local governments. New budgetary rules would be applied. All e-government tools should be made operational. By the end of this period all public services should be provided through a specialised portal.

3 Providing better services to citizens

3.1 Decentralisation

It is a primary responsibility of a state to guarantee that its citizens enjoy public services, such as healthcare, education, social welfare, social insurance, housing, public transport, individual security etc of the highest quality, at the lowest price and in an equal and just manner. Nearly all of these public responsibilities can be best exercised by authorities who are closest to the citizen. This is the main objective for a self-government reform, the decentralisation of powers and of public finances. While Ukraine has to firmly maintain her unitary character, the functioning of the state should be based on the principle of subsidiarity.

Recommendations

It is recommended that the decentralisation be based on the Polish model, which has proven to be efficient and be carried out in full accordance with the principles enshrined in the European Charter of Local Self-Government.

There would be a three-level structure of self-government, consisting of the following: 1) regions, responsible for regional development, adopting regional strategies and allocating resources in the process of implementing those strategies (in future, also for decisions on how money from EU structural and cohesion funds, if made available, is to be spent); 2) counties (powiat / rayons), which would be supra-local zones for public services (hospitals, secondary education, interventions on the labour market, a large number of inspections); 3) communes in towns and rural areas (hromada), in charge of all public services that can be provided at local community level, e.g. first-contact health care, primary education and pre-schools, social welfare, housing, citizens' affairs (as, for example, IDs), business support and business environment institutions (registry of entities of economic activity by individuals, legal and consulting advice, local tax allowances, business incubators, etc.), local taxes. Some responsibilities would be shared among all three types of self-government, e.g. the construction and maintenance of roads, depending on their status. Big cities (of more than

national jurists could be invited to participate in proceedings, as an assurance of its impartiality and professionalism. This could also be a good opportunity for young Ukrainian lawyers to acquire experience and high ethics, which could be an asset if they then were transferred to regular courts.

At the same time it is to be noted that an electronic court, although enabling quick judgements, might not be a solution since it de facto puts small- and medium-size enterprises in an unfavourable position; and this is a sector that requires a special support.

The rights of consumers need strong legal protection. To that end a specialised state agency should be entrusted with vast prerogatives, including imposing severe penalties on companies applying abusive clauses in contracts with consumers or abusing their monopolistic or quasi-monopolistic positions. The Antimonopoly Committee should be radically restructured, or abolished and replaced by a new institution with strong prerogatives, so that it could vigorously stand up for fair competition in the Ukrainian market.

The AMU could prepare draft legislation on the streamlined system of mediation and arbitration and help to set up an arbitration court, possibly together with the Federation of Employers of Ukraine. In the initial period of its operation, the arbitration court would be managed by lawyers invited from abroad. They would have an unquestionable reputation, appropriate knowledge and experience and thus guarantee impartiality and the highest professionalism. They would also take part in the proceedings. Young non-corrupted Ukrainian lawyers would also act as auxiliary arbitrators (for details, see the description of Lighthouse Project 2.3 of this report).

2022 – 2025

This would be the second phase of the transfer of powers in regions and counties (район/ rayons) from state agencies - which would then be dissolved - to regional and local governments. At the same time some powers would be transferred from the local governments to NGOs (actions aimed at their strengthening should be continued).

2026 – 2030

This period would be devoted to the final transfer of selected powers from local authorities to the so-called third sector (NGOs).

The framework of the 'Eastern Partnership' could be used to support Ukraine in actions aimed at building a modern government.

2 Removing barriers to business

In today's world the role of a state in the economy is to efficiently regulate the functioning of the market, create favourable conditions for business activities, act as the guardian of fair competition, protect the consumer and, where appropriate, initiate large-scale processes that are perceived as beneficial for satisfying the needs of society (e.g. big infrastructural projects, innovative character of the economy). For the time being, Ukraine does not meet those standards. In the World Bank's 'Doing Business 2015' report, it ranks 96th out of the 189 countries analysed. Some reforms were implemented and they resulted the country advancing by 16 positions as compared with the 2014 report; a year ago Ukraine, being 112th, was named 'the top improver in 2012/13', reforms had been implemented in 8 of the 10 areas measured by 'Doing Business'

The situation is dramatic, according to the 'Doing Business' report, as regards getting electricity for the companies. In this category, Ukraine is ranked at the very bottom, as the 185th country! There are also enormous problems with cross-border trading (where Ukraine ranks 154th) and resolving insolvency (142nd). Substantial progress was noted in paying taxes (49 positions upwards but still ranking 108th) and in registering property (29 positions upwards to 59th place). The best situation is with getting credit (17th) and enforcing contracts (43rd).

If reforms are continued, Ukraine should have a 'Doing Business' rank of around 55 to 60 in five years' time.

Recommendations

'Better regulation' principles have to be introduced. The legislation has to be clear and easily understood. All regulations at the lower level, including those by the cabinet of ministers must have precise authorisation in statutory laws.

In the present situation of Ukraine, 'better regulation' does not mean, however, a reduction of the number of legislative acts regulating relationships between the business community and public administration. On the contrary, all possible situations should be described in detail to guide public as well as private players. A broad deregulation process should not be carried out until corruption is eliminated.

On the other hand Ukrainian legislation concerning business activity has to be reviewed thoroughly and swiftly in order to reduce the number of permits, licenses and unnecessary regulations. This should be done in the next 12 months. These actions can build on projects of non-profit organisations. (For more detailed proposals - see section '11. Fostering entrepreneurship', in chapter 'WS Economy' of this Report.)

The consultative process on new legislation has to be improved. It would be best to base it on the EU practice of public green papers and white papers, including a legal obligation to give all stakeholders sufficient time to submit comments and proposals, organise public hearings and create a formal framework guaranteeing that stakeholders' views will indeed be taken into account and analysed.

ICT solutions should be widely applied to, inter alia, registration of companies and applications for permits and licenses. There should be a possibility to register a start-up on-line, in no time and free of charge. The Internet-based library of all business related requirements should be available at no cost and should be continuously enlarged and kept up to date.

The number of public institutions within the business environment can be easily cut, and the number of people involved substantially reduced. Declarations on reducing the number of supervisory agencies (to 26) and their functions (from more than 1,000 to 680) should be issued without delay. The process should continue in the forthcoming years, under no circumstances should these numbers increase in the future.

A quick remedy has to be found to the problem of protracted and overburdened procedures to provide electricity to investors. The number of required procedures needs to be reduced from ten to at most five procedures (as is the case in Spain, Slovakia or Slovenia; in Poland, Sweden or Switzerland three procedures are needed). Decisions on investors' applications must be taken much more promptly (today they take an average of 277 days). The energy supply market should be liberalised and open to competition, which would bring rapid improvement.

An efficient judiciary, guaranteeing fair and rapid resolution of disputes between companies, as well as between the business and public institutions, is an indispensable element for any favourable business environment. Since courts in Ukraine cannot be expected to meet these criteria in a short period of time, the system of mediation and arbitration should be streamlined so it becomes common, easily accessible and trusted. To get it off to a good start, reputable inter-

4 Lawyers

Lawyers can do more to be part of solution rather than the problem: The independent legal profession must become an ethical and positive agent of change

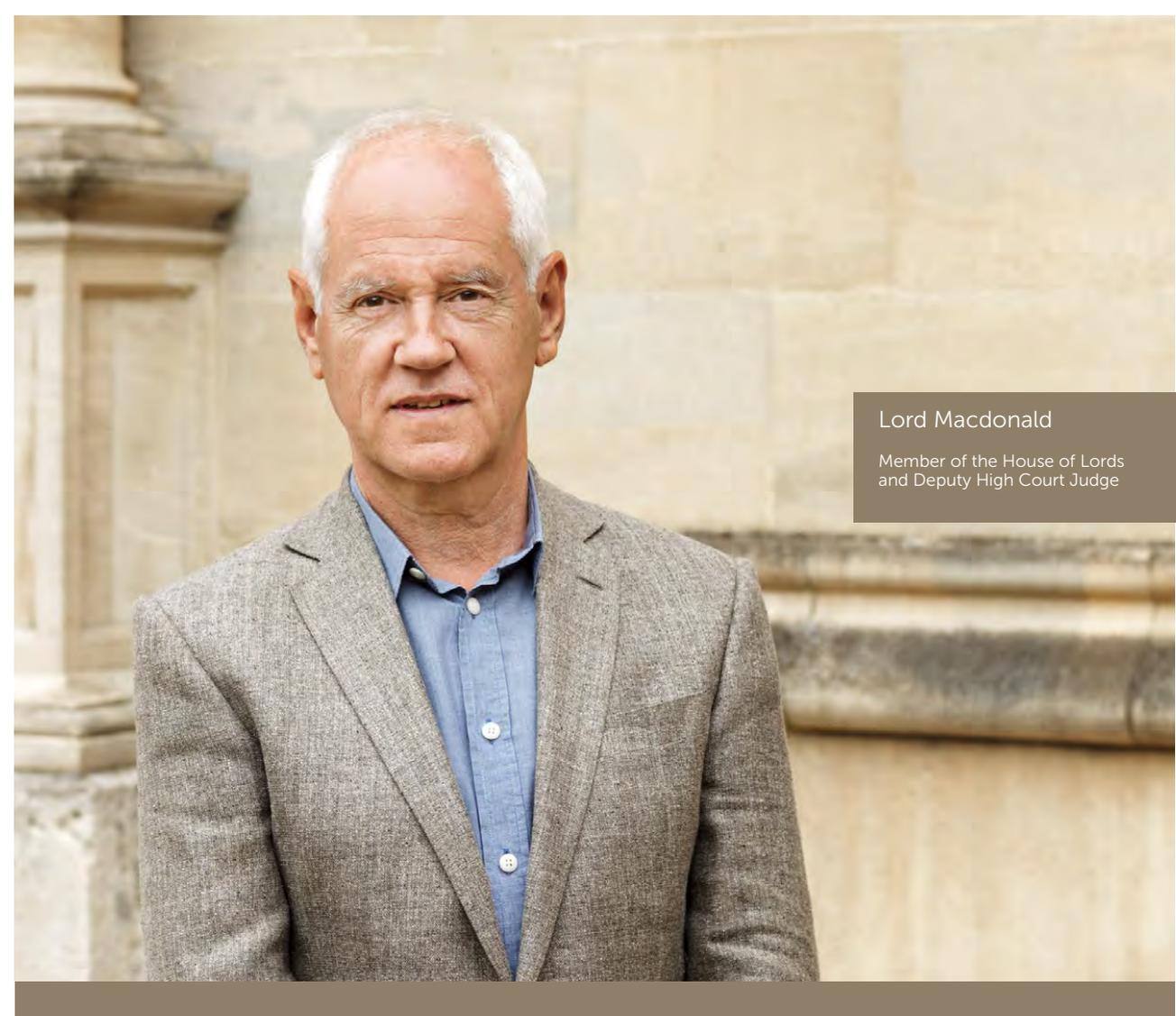
4.1 Officers of the rule of law

The heritage of the legal profession in Ukraine is a rich one. It combines the best part of the universities and private practice that led the human rights dissident movement in Ukraine in the 1970s and 80s. It includes the lawyers who were in the forefront of the Rukh independence movement for independence, together with the generation of jurists who wrote the Constitution and facilitated Ukraine's original nation building at short notice and under great economic pressure and embryonic post-Soviet governance. The heritage also extends to a diaspora in Western Europe, Canada and the United States. There are judges and prosecutors, especially in North America that strongly identify with their Ukrainian heritage.

4.2 Lawyers are part of the problem

This veritable heritage is emphasised, because the Workstream has been compelled to conclude that the legal profession bears a substantial responsibility for the spread of corruption into the justice system. It is almost impossible to conduct litigation unless you are involved in corruption to some extent. Others make a business of it. Even apparently principled lawyers will intermittently turn a blind eye to important clients who tell them they will bribe the judges for insurance purposes. A previous head of the Higher Qualification Commission for Advocates told the Workstream that he had stopped being involved in commercial litigation because the likelihood of bribery or improper influence on a case was too great. This was a common refrain.

The Workstream had the opportunity to meet the elite pool of lawyers. However, there is no quality control on rights of audience before the courts, to in effect require that only those who are certified as an Attorney-at-law can participate in litigation. In practice this means that a very high percentage of litigators who



Lord Macdonald

Member of the House of Lords
and Deputy High Court Judge

VI Rule of Law

Results and proposals of workstreams

Management Summary

Without the proper functioning of the rule of law, Ukrainian independence is an unfinished project. Its absence has led to impunity and corruption. It has ruined peoples' lives and compromised the reputation of a whole generation of judges, law enforcement agents, public servants and private lawyers. None of these participants has done enough to protect the rule of law. The political and business classes have been too willing to denigrate it. The illiberal legacy of the Soviet past exposed Ukraine to this fate, but the problem lies in the institutional and cultural failures of transition. A country that lacks the rule of law cannot win external investment confidence, and it cannot be a place of internal freedom and human dignity. This is not simply an issue of EU integration, but national realisation. Its correction serves the protection of human rights, but also national security and geographical integrity. Institutional reforms are required, but structural change will not be enough without social change. Ukraine does not lack a vision of a just and lawful society or a pool of people of significant talent to realise that vision. However, the valuable human capital risks being wasted, and reform without true re-evaluation of the independence and quality of the judicial and law enforcement professions, will be another false dawn. As promised by its Constitution, the recognition and effective protection of the rule of law must therefore become a central aim of Ukrainian society. Lawyers – as judges and advocates – must play a fundamental role in this endeavour. Politicians and businessmen must do everything they can to create a country that appreciates the value of losing a case fairly before an independent court, over and above procuring victories through corrupt means. The people – as subjects and beneficiaries of the rule of law – must have cause to appreciate it, as well as being required to comply with it.¹

¹ The work is based on a review of the academic literature, some of which is footnoted below, but also extensive field studies across the country between June and September 2015 that included over a hundred meetings in Lviv, Odessa, Kyiv, Kharkiv and in Donetsk region in Slovyansk, Druzhkyivka and Kramatorsk. While the Agency for the Modernisation of Ukraine facilitated the logistics of the meetings, the authors of this chapter remained entirely free to choose who they met with and what they discussed. The authors are grateful to the many and varied Ukrainian experts who spoke with them.

ed was not just military volunteers, but experts in public sector skills that were willing to move east in order to assist in state reconstruction.

The forthcoming High Commission of Qualification and High Council of Prosecutors (introduced by legislative amendment in 2014) must create rigorous examination standards to test legal reasoning, integrity and financial transparency. There must be continuing education and assessment. However, a Qualification Commission (based on the supervision model that currently exists for the judges) cannot be fully responsible for investigating a prosecution service that even if reduced in its numbers and functions, is far more complex than the judiciary that sits in courts and deals with cases. As with the police, there must therefore be a National Independent Oversight Body that investigates disciplinary misconduct by Prosecutors.

Overall, the prosecution system must become culturally more responsible for presenting itself as the servant of the people rather than the servant of the state. Ukrainian prosecutors, enhanced by a new generation of lawyers into their ranks, must take this opportunity to create a genuine independent national amenity that provides the people with a sense of justice, safety and trust.

The common law jury system

At present Ukrainian law, including its constitution at Articles 124 and 129 recognises the capacity to use lay persons as jurors. To date, juries have not been used in the common law sense as the sole tribunals of fact, leaving the judges to manage the proceedings and adjudicate exclusively on questions of law. Many experts met by the Workstream pressed for consideration to be given to the common law system of jury trial, at least for cases concerning the risk of prison for a substantial period of time (for instance 5 or 10 years +). Notably the Constitution Commission has not recommended the abolition of these Articles and the 2015 Fair Trials contain sections dealing with remuneration of jurors on the assumption that they will play a part in the future administration of justice. The function of the jury in this regard would be to enhance not only the fairness of the proceedings, but because it will further involve civil society in the processes of legal society. The central arguments of the advocates for this type of jury system are sound. What is needed is further exploration, including by way of pilot scheme, of how the jury system could be adapted to the Ukrainian environment. The introduction of a jury system could certainly boost both the actual and perceived fairness of proceedings. In the current Ukrainian situation, one judge is considerably more amenable to bribery and dependency, than twelve random citizens. However, it would require considerable resources to accommodate juries in many existing district courts. It will also be important to ensure that during the course of a jury trial there is responsible reporting of the case by the media so as not to prejudice a jury against a defendant.

right at the bottom of the career hierarchy. After recruitment there must be continuing assessment of competency and training.

There is a pressing need to find a range of mechanisms that can insulate operational policing decisions from political interference, but at the same time maintain the overall accountability of the service. This balance can be facilitated through the creation of independent police Commissioners/Ombudsmen at the local level, who will have the power to call the police to account and if necessary dismiss. As in the UK, there will be questions about the benefit of making these Commissioner appointments through election, or some other means. The primary goal must be to choose people who can enhance the trust in the police, by their capacity to responsibly call them to account.

Even if the above Commissioner system is not introduced, there must be a National Independent Oversight Body, to which complaints can be made and which has the power to require information and investigate disciplinary matters.

Prosecutors

While numbers must be cut and salaries increased, it is equally important to introduce competitive and open recruitment at every level. Although open recruitment is being considered, at time of writing it is not known how wide the process will go. Further nothing has been said about the appointment of the national General Prosecutor's Office that has historically been compromised by the prerogative of presidential appointment; as well as undue influence.

The reason for arguing for a much broader open competition is that the opportunity to reinvigorate a genuine national public service must make every effort to reach out to new people from private practice with outstanding legal skills, integrity and financial transparency. There must be an opportunity for more junior prosecutors to fast track up into more senior positions in this transitional phase. All of this is essential to attracting new personality types into public service (see section 4 below), but also ensuring that the most promising will not leave because they are unduly held back by the conventional career trajectory. The potential candidates need to know that an extraordinary recruitment process is taking place; and civil society must be made equally aware of that fact. In this way a Post-Maidan generation of prosecutors can be born who will enjoy a period of enhanced trust during which time they can prove themselves, especially in the realm of prosecuting corruption. As to the liberated areas of Donbas, it is essential to attract 'volunteer' talent from around the country who will take up public service roles, particularly as prosecutors. Government interviewees in the liberated parts of Donbas made it clear to the Workstream that what was need-

This Chapter identifies the following six areas of action:

(1) Developing the rule of law as a transformative idea: Ukraine must realise the content of its own constitutional commitment to ensuring the recognition and effectiveness of the rule of law: This is not simply about compliance with rules, but recognising a system of fundamental values and human rights that only the proper operation of the law can protect. This might appear overly philosophical to some, but ideas impact on society, just as they do on economy. The recognition of the meaning of the rule of law and its relevance to Ukrainian modernity is a precondition for the other reforms that follow.

(2) Judges: The judiciary must embody independence, dignity and quality: The reputation of the judiciary is at an all-time low. With raising salaries and cutting numbers, improved judicial training and continuing assessment of judges, the standard of justice can be improved. However, this will not be enough. It is necessary to have a one off complete re-evaluation of the entire judicial population, which requires every judge to satisfy a rigorous independent evaluation of their legal ability, integrity and financial assets. This task is much more important than the selective lustration of some judges. New criminal offences must make it unlawful for judges to withhold information concerning corruption; and for litigants to make any unofficial contact with a judge about the subject matter of a case.

(3) Law Enforcement: Law enforcement agencies must be open to competitive recruitment, accountable, professional and autonomous: The protection of the rule of law and human rights by judges will not be possible without law enforcement agencies committing to these higher values. Again raising salaries and cutting numbers is not enough. A re-evaluation process of all law enforcement personnel similar to the one for the judicial system is vital. In addition, both the police and the prosecution services must be given local operational autonomy provided that they are subject to corresponding accountability.

(4) Lawyers: The legal profession must become an ethical and positive agent of change: Lawyers have become integral to the system of corruption. They must be included in the category of persons, along with all law enforcement personnel, who are required to provide information concerning corruption or face criminal prosecution. Private lawyers of excellent ability and standing should be given the full opportunity to enter state service at higher levels commensurate with their experience, even on a temporary secondment basis. Law and business clusters, that are determined to evade the current system of corruption, can be copied and networked around the country. As with judges, the quality of

legal services will improve as a result of the long overdue transformation of legal education.

(5) Improving the commercial law environment: The commercial law environment must become simplified, deregulated, enforceable and amenable to alternative dispute resolution: The structure of the court system as a whole needs reform, limiting the number of courts, both horizontally and vertically. The enforcement of court orders has to improve drastically, partly through the creation of a private bailiff service; and partly through the courts gaining and using new powers to ensure compliance. Voluntary mediation and arbitration offer the opportunity for immediate circumvention of the problems that face the civil justice system.

(6) Preventing counter-reformation: Ukraine must reconcile with its past and protect its future: The ultimate rite of passage for a maturing state is to be capable of constructively criticising itself. The principal tasks lie in investigating human rights abuse and corrupt practices in a manner that is effective, but also prompt and reasonable. Going forward, Ukraine must protect its future by limiting the role of corporate power in politics, but at the same time developing a culture of corporate responsibility. It must prioritise the creation of a fast-track generation of post-graduate public service, education and opportunity that will guide the country for its own sake, but also act as a guide for the sake of others. And amidst unavoidable and understandable anguish it must comply with the law of armed conflict, not only because it is right to do so, but also as a means to the protecting the broader reform process.

and a staged re-evaluation of each of the entire professional sectors at every level. If the July 2015 mass dismissal of prosecutors is anything to go by, there is an opportunity to ensure that the core competencies of ability, integrity and assets disclosure that have been commended for the judges are properly institutionalised for all law enforcement positions for both new recruitment and promotion going forward. This would deal with quality. However, what is also needed is a full audit of necessary numbers and potential salaries for police, prosecutors and judges across the country. Most experts report that each of these groups is massively overinflated. The requirements and finances need to be looked at holistically, because cuts will invariably enable the raising of salaries. International financial assistance will also be more readily forthcoming to support the implementation of such a detailed study. While this can be part led by the Ministry of Justice and Ministry of Interior, there would be benefit of conducting an open competitive recruitment for those personnel who are to carry out this national auditing exercise. Aside from being good practice it would avoid vested interest from frustrating the process.

The spirit of renewal generated by the Kyiv Traffic police reform is to be welcomed, but more substantial policing and state prosecution service will require a higher level of legal and forensic ability than traffic policing. It follows that the competency of legal ability will have to be evaluated accordingly; and the new generation of recruits will need continuing training. Previous office holders must be subject to the assets disclosure competency outlined above.

Police

The wide cross-section of experts in Ukraine who emphasise the importance of cutting numbers and raising salaries are correct in their analysis. The perennial problem of cutting large amounts of corrupt police is what to do with them; or more pertinently how to avoid them joining the ranks of organised crime. As well as the need for disciplined analysis of where to cut the numbers, it will also be necessary to find funding for redundancy and re-training packages. The challenges of job creation identified in the Economy Chapter of this report will also include a considerable population of ex-policemen. Thereafter there must be an introduction of competitive and open recruitment at entry level, as well as at higher levels where appropriate. The issue of higher level open recruitment is important to underscore, because it will be essential to attract new talent throughout the police force. Major reforms of policing in England were partly indebted to graduate recruitment that did not require people to necessarily start

as a result of the 2012 overhaul of the Criminal Procedure Codes and further reforms to the prosecution service in order to dismantle its Soviet legacy control over both investigations and administrative law. Both of these changes were integral to the negotiated move towards EU-Association; as well as the efforts of Ukraine to respond to the Council of Europe's Committee of Ministers as a result of the large number of judgements against it by the European Court of Human Rights with regard to the misconduct of law enforcement state agents. At time of writing Ukraine has more complaints pending against her before the European Court than any other country in Europe.

What happened to the Kyiv traffic police after Euromaidan is often referred to as a potential model for the reform of the entire justice system. This particular force was famously corrupt and had been targeted by the Auto-Maidan movement. As a result there was a mass dismissal of officers last year. Competitive recruitment for vacancies carrying enhanced salaries then took place with particular emphasis on attracting women and all people who desired a change of career. The intention was to cut numbers, but improve quality. The recruitment process tested integrity and psychology. Some 2000 new recruits have now graduated and have been on patrol this summer. The change of atmosphere is something that is noticeable on the streets. This has also been widely commented upon in the social media, not just by the technocrats responsible for the changes, but the general population of Kyiv that have responded positively to the promise of an ostensibly new and diverse form of policing. The spirit generating from these young police officers, is that they represent post-Maidan public service. Whether it will generate long term change, it is too soon to tell with any certainty.

The Kyiv traffic police model is destined to be implemented in other parts of the system. In July 2015 it was announced that 3,000 prosecutors at local district and oblast levels were to be dismissed and that a similar model of open recruitment and innovative assessment would be adopted to create a new generation of personnel.

3.4 Recommendations

A comprehensive audit of quality, salaries and numbers

The principal recommendation is that the reforms that have been described in section 2 above as necessary for the judiciary should follow for both police and prosecution. This should include a duty to report any interference in their work

1 The rule of law as a transformative idea

No manner of institutional change can substitute for the recognition that the rule of law is a valuable thing in its own right. Ukraine must realise the content of its own constitutional commitment to ensuring the recognition and effectiveness of the rule of law.

1.1 The law of rules and the rule of fundamental values combined

The 'rule of law' as a concept is often referred to as a desirable thing, without defining it, or considering how it is particularly relevant to the needs of a given country. The notion of "Rule of law" is not necessarily or automatically synonymous with that of "Rechtsstaat", "Estado de Direito" or "Etat de droit" (or the term employed by the Council of Europe: "prééminence du droit"). Nor is it synonymous with the Soviet-legal notion of "Rule of the laws/of the statutes" (verkhovenstvo zakona), nor with the term pravovoe gosudarstvo ("law governed state").² At the very least, it can be said that the rule of law refers not just to the law of rules, but to the rule of essential values that are fairly protected by independent courts that view all people as equal under the law. Beyond that, the Workstream began its study without preconceptions about how Ukrainian lawyers should view the subject.

That does not mean that the approach adopted here is neutral as regards the fundamental importance of the rule of law to democracy in every country and its implications for other features of modernisation, especially economy, trade, security and human rights. Grasping the importance of the rule of law is not merely a philosophical endeavour. The country needs to attract large scale foreign direct investment, but investors will inevitably seek confirmation of demonstrable compliance with international rule of law standards as a precondition for

² For a key discussion of these issues, see Venice Commission Report on the Rule of Law, adopted by the Venice Commission at its 86th plenary session (Venice, 25-26 March 2011).

this. EU-Ukraine integration has a considerable rule of law component, as evidenced by both the terms of the EU-Ukraine Association Agreement (September 2014) and its accompanying implementation Association Agenda (March 2015). Compliance with both documents will be inextricably linked to the continuation and higher levels of financial assistance.³ The standards referred to in these documents and in the European Convention of Human Rights, which is directly binding in Ukrainian law, do not simply reflect EU technical requirements. They embody a global-value-consensus that regards it as an unqualified public good for states in all countries to guarantee the separation of powers, the independence of the judiciary, the effectiveness and legality of law enforcement and the equal access of everyone to the courts. The function of judges (with the assistance of lawyers) is to identify and protect those values, thus enabling the rule of law to become a transformative mechanism in society that is both descriptive of the basic parameters of justice and normative in the sense of constructing the norms by which justice can be desired, expected and implemented.

1.2 From the general to the particular

The foundation for viewing the rule of law as a fundamental value in Ukraine can be found in Article 8 of the 1996 Constitution that states that “the principle of the rule of law is recognized and effective”. Merely to recognise the rule of law in Ukraine was truly transformative, because up until then the Soviet system of governance and jurisprudence had prioritized the rule by laws. The effectiveness of such recognition was secured by the other innovation of the Constitution that was to underscore in the second paragraph of Article 3 that “the main duty of the state” is to ensure the protection of human rights. That is what “determines the essence and orientation of the state”. The Constitution itself therefore embodies a humanist closure to the binary distinction between individualism and statism that had previously dominated the Soviet worldview. This is also underscored by Article 3 not only in redefining the relationship between the state and the individual and what is to serve whom, but also in recognising that “human

³ The EU-Ukrainian Association Agreement, which has a core aim “to enhance cooperation in the field of Justice, Freedom and Security with the aim of reinforcing the rule of law and respect for human rights and fundamental freedoms” (see also Arts 4(2), (4) and 14). The promotion of the Rule of Law is also intricately woven into the detail of the EU-Association Agenda (see Part III), which provides concrete standards that Ukraine will seek to achieve in terms of complying with its European and other international human rights obligations.

intimidation of complainants, and the subsequent low level of prosecutions all fuel this lack of accountability for human rights violations”.¹⁷

3.2 Criminal injustice impacts strongly on the middle class

Injustice in the field of criminal law degrades the rest of the law enforcement process and undermines respect for the rule of law more generally. In Ukraine the system of corruption especially embroils the middle classes. It affects small and medium businesses, which must establish a network of bribes and protection simply to survive (see the description of ‘Krysha’ (the roof) described by the Anti-Corruption Workstream Chapter 4). There is also a phenomenon of so-called ‘corporate raiding’. It occurs in various shades, but at worst involves private actors taking the possessions of competing businesses, sometimes with the aid of friendly judges that provide search warrants, with local prosecutors also providing cover for the operations. Even if court orders are gained to remove these ‘self-help’ raiders, the authorities will often not enforce them because they are prevailed upon by corruption. The poor quality of its criminal justice is a significant contributor to Ukraine’s reputation as a hostile commercial environment.¹⁸

3.3 Can the current climate of reform be truly transitional?

It is important for outsiders to understand that that there was a considerable amount of institutional reform taking place even prior to Euromaidan, especially

¹⁷ UN Human Rights Monitoring Mission in Ukraine, Report on Human Rights Situation in Ukraine, 15 April -29 August 2014, p. 12 ¶52.

¹⁸ See Legal Department of the IMF, Government of Ukraine Report on Diagnostic Study of Governance Issues Pertaining to Corruption, the Business Climate and the Effectiveness of the Judiciary, 11 July 2014, p. 20. See also the excellent overview of the issue in Mathew Rojasky, Corporate Raiding in Ukraine: Causes, Methods and Consequences, 22 Journal of Post-Soviet Democratisation, Issue 3 (Summer 2014).

3 Law enforcement

Law enforcement agencies must be open to competitive recruitment, accountable, professional and autonomous.

3.1 Vradiyvk justice

One of the broader catalysts for Euromaidan was the failure to investigate the rape of a woman by two policemen in the village of Vradiyivka in Mykolaiv oblast, in Southern Ukraine. The “Vradiyivka” phenomenon’ became a byword for ‘selective justice’ in Ukraine. There is the widespread belief based on objective fact that judges and police can be bought. Another Euromaidan phenomenon was the so-called Auto-Maidan that grew out of the original ‘Road Control’ movement in which motorists started filming the corruption of Traffic police on their phones and posting the evidence on Youtube.

There are high profile examples of the shortcomings in Ukrainian law enforcement, such as the state collusion in the killing of the journalist and founder of the internet journal Ukrayinska Pravda, Georgiy Gongadze. Less well-known internationally are the repeated findings of widespread ill-treatment of suspects in police custody and the attendant failure to investigate complaints with any meaningful effect. The European Court of Human Rights has identified these matters as “systemic problems at the national level which, given the fundamental values of democratic society they concern, call for prompt implementation of comprehensive and complex measures”.¹⁶ The United Nations Human Rights Committee has in turn expressed its concern about the high rates of deaths in custody, delayed investigation of such cases and the lenient or suspended sentences imposed on those found responsible. The UN Human Rights Monitoring Mission in Ukraine that has been investigating human rights abuse in the country since April 2014 describes “a culture of effective impunity..., including torture and extortion, often committed by the police in the course of their work..., close functional and other links between prosecutors and police, non-existent or flawed investigations into criminal acts committed by the police, harassment and

¹⁶ Kaverzin v Ukraine, App. No. 23893/03, 15 August 2012, ECtHR. See especially §§94 and 172-182.

dignity”, together with “life, health and honour” must be accorded the “the highest social value”. These might seem like abstract ideas, irrelevant to the real world, but to lawyers they are as important to the evolution of society, as the concepts of private property and free market are to the evolution of economy. Indeed the latter cannot evolve properly without protection of the rule of law. What is at stake is the final de-construction of the Soviet system.

The best example of the living constitution establishing its norms in Ukrainian life can be found in the popular name now given to Euromaidan, namely the Revolution of Dignity. This very naming of a social movement has implications for the role that the rule of law must play in the modernisation of Ukraine. On paper, as just noted, the dignity of the person is accorded the highest social value, and it is expressly protected as a right under Article 28 of the Constitution. The latter parts of the Constitution, especially the protections of equality and fairness contained in Articles 24, 29 and 55-64, give further expression as to how the rule of law and human rights can be recognised and rendered effective. Yet Maidan (at least in its primary impetus) was an uprising against the recurrent theme of last two decades of the failure to implement those values via institutional mechanisms.

1.3 An idea that has never properly launched

The rule of law is chronically malfunctioning in Ukraine in terms of both the dependency and negative status of the judiciary and the incapacity of other law enforcement agencies to be viewed as a truly public service. This has led to what local writers describe as the ‘selectivity of justice’. There is impunity for human rights abuse, ongoing corruption, further entrenchment of oligarchy, economic stagnation, diminishment in foreign investment confidence, and alienation and cynicism of civil society. People who could take responsibility for change in certain sectors tend to blame the hierarchy above them. The corruption of others becomes a justification for ones’ own [lesser] corruption and an excuse for maintaining the status quo. ‘Selective justice’ has also prompted a syndrome of ‘selective responsibility’.

The rule of law as a value system that is meant to guide the country as a whole is still qualified by the Soviet theories of rule by law (that over-privileges State power as the ultimate good) and post-Soviet theories (that under-values the re-

sponsibility of the State to nurture and enhance the rule of law). Hence both the 'recognition' of the rule of law in Article 8 of the Constitution and the positive obligation to make it 'effective' have never been properly realised. The symptoms of this problem can be found in the dominant tendency in judicial writings to analyse cases from the strict positivist question of what is contained in the statute or Code, and not to apply broader principles derived from the values of the rule of law. There is judicial caution and uncertainty about international legal standards, especially amongst those judges that cannot read the English language versions of the case law. Human rights contained in the Constitution are not seen as gateways into international sources to illuminate their content. Gaps or unintended consequences in statutes are not remedied by recourse to rule of law standards.

Given that so many studies of Ukraine's present predicaments lie in the failure of implementation of otherwise sensible reforms and policies, the first major change needs to take place in the realm of ideas. However philosophical this might seem to some, it is vital to gain a broad audience that appreciates its concrete consequences. It is the major change that most informed modern judges and lawyers in Ukraine would point to when asked. It is vital to securing EU integration, and ultimately membership. It can only be reiterated that reform in legal methodology and discourse will impact on society, in much the same way that reform in economic theory impacts on economy.

1.4 Recommendations

Apply the Constitution

Independent Ukraine must realise its Constitutional foundation that values and protects dignity (Arts 3.1, 28.1), equality (Art 21), and due process rights (Arts 29 and 55-64) as part of the overall composite of what it means to live in a society that recognizes and protects the effective existence of the rule of law. The rule of law must also be recognised as the dominant value system that binds the state and society together in the sense promised by Article 3.2 of the Constitution.

all communication about a case to be sent via an administrative channel, preferably a secure IT system, with an accompanying power to strike out proceedings and fine parties in the event of non-compliance without reasonable excuse.

However, it is unlikely that the situation will transform until it becomes a strict liability offence to contact a judge ex parte in order to discuss the content of a case, notwithstanding that the purpose of the contact is neither to improperly influence or interfere with the outcome. Even if the penalty is small there has to be a profound change in culture. Only criminal law can have a chance of doing this. Furthermore, the reporting obligation of judges must extend to the duty to register all contacts about the procedure or substance of a case that are made by parties or third parties on their behalf, and not just those instances when an attempt is made to interfere with the outcome. If Ukraine is serious about protecting the integrity of its legal proceedings, this is the level of statutory safeguard that the situation now mandates.

this supervisory body that could issue advice as well as producing public reports on the work being done. The members of this Extraordinary Interim Supervision Body could act as mentors to the judiciary as large, helping for their part to develop the rule of law culture.

Regulating ex parte communication with judges

In the post-communist states a strong tradition of informal private (ex parte) communication with judges exists. Steps must be taken to deconstruct this tradition, because it provides the opportunity for so-called telephone justice and/or bribery; as well as causing others to suspect such interference even when it does not occur. The end of this tradition can be achieved in the following ways.

Publicising the new duty to inform

The new law places a duty on judges to report all attempts at "interference". The key terms of the new law should be publicly displayed in every court house and on court documents made available to participants to proceedings. Potential sanctions should be specified. Judges who fail to report the interference could face suspension, and dismissal. Those who seek to interfere with the judge could have their case struck out, and be fined and/or imprisoned.

A criminal offence of withholding information

While the disciplinary duty of judges to report efforts of ex parte "interference" in the work of the judiciary is a positive advance, it is further commended (in agreement with the Anti-Corruption chapter "6. Detection, Investigation and Prosecution") that there must be created a criminal offence of withholding information concerning corruption. It would apply to judges, law enforcement agents, lawyers and other public officials. The offence could both prevent actual corruption and create very considerable deterrence against the presently tolerated culture of ex parte communication about cases. If these changes to the criminal law are made they must be very widely publicised.

Ending all ex parte communication about the case

Given the scale of the problem, and the extent to which judges repeatedly confirmed that they would not feel comfortable reporting such interference, these changes would still not be enough. Further amendment to the law must require

Judicial leadership

A paramount responsibility for cementing the rule of law in Ukraine lies with the judges. It is their identification and implementation of rule of law values that enables the rights contained in the Constitution to become actual agents of transformation. Herein lies a key reason for Ukraine's arrested development; that the Courts have failed to emerge out of the system of centralised state power, in order to act as a symbolic and practical means of transformation. Judges need therefore to mark out pre-eminent areas of judicial territory that are part of their constitutional function to protect. On any argument these areas include legality, fairness, liberty and equality. It is the courts that create this rights culture. Through transformative adjudication, it is its judgments based on activist principles of judicial review that create normative change; and ultimately a more liberal rule of law system.⁴ Although Parliament can serve the above judicial process by creating law to aid it, it is the judges (from Constitutional to District court) that create this rights culture itself. They do so by reading every law and evaluating every administrative act as subject to these values, unless the law expressly provides otherwise.

European values

The relevance of European human rights law should not be underestimated in this context. It has always sought to protect fundamental rights in a way that is practical and effective, with particular concern to balance the interests of the individual with that of the wider community. The European Convention of Human Rights and Fundamental Freedoms (1951) was primarily constructed to be a post-totalitarian philosophy (for instance protecting free speech, but not at the expense of minority rights; and valuing privacy and autonomy, but not as a license to cause harm to others). The jurisprudence of the European Court of Human Rights (not least because it is binding in Ukrainian law) must be translated into the Ukrainian language literally (for far too many judgments not involving Ukraine itself remain untranslated), and intellectually through the cultural expression of judgments of the Ukrainian courts. The actions required are therefore a coordinated translation project of the key cases pertaining to each of the

⁴ For a helpful analysis from the point of view of Post-Communist society in Central and Eastern-Europe and Post-Military dictatorships in Latin America that might be applied to the current Ukrainian situation, see Ruti G. Teitel, *Transitional Justice*, (Oxford University, 2000).

rights. There must be dedicated courses for judges at both the entry level and by way of continuing education to instil and update knowledge of the case law. Judges at all levels must perform their duty to apply the protections of this Convention and the jurisprudence of the Strasbourg Court.

Global values

There is no need, however, to characterize the rule of law value system identified here in purely Eurocentric terms. The relationship between the rule of law, due process and human dignity that is contained in the Ukrainian Constitution is central to the United Nations Declaration of Human Rights and accords with a broad common law of all mankind or humanity's law (*ius gentium*) that was expressed to govern all civilized nation-state-communities in the aftermath of the Second World War. This is practically exemplified by the fact that the European Court of Human Rights increasingly draws on other international law sources; just as domestic law judgments in many countries have developed their indigenous human rights cultures, by reference to international sources. While citing foreign law in domestic courts reflects shared values it can also be understood by way of analogy with public health and medical science. If one wanted to find a cure for cancer, neither the doctor nor the patient would be content to limit their exploration to the insights of the scientists working in one country.⁵ But there is something deeper at stake. In the aftermath of total war, the world chose human rights as a discipline to ensure fundamental limits on human and social behaviour. Human rights constitute the ultimate commitment to modernity and enlightenment.

The teaching of Constitutional and European Human Rights law in Ukraine must therefore emphasise the extent to which that body of humanity's law is part of a global international human rights corpus. This includes the decisions of the various United Nations Treaty compliance bodies to which Ukraine is subject to: for instance, the Covenant of Civil and Political Rights, the Covenant of Economic, Social and Cultural Rights, the Convention Against Torture, Cruel and Inhuman and Degrading Treatment and the Convention on the Elimination of All Forms of Racial Discrimination. It also includes the jurisprudence of the other regional

⁵ Jeremy Waldron, *Foreign Law and the Modern Ius Gentium*, Harvard Law Review Vol. 119, No. 1 (Nov., 2005), pp. 129-147. He ends up defining *ius gentium* as "a body of law purporting to represent what various domestic legal systems share in the way of common answers to common problems". See, generally, Ruti G. Teitel, *Humanity's Law*, (Oxford, 2011).

Immunity from prosecution and qualification for future employment

Given that it would be beneficial for the overall restoration of the dignity of the judiciary to expose previous corruption rather than to suppress the truth about it, serious consideration must be given to providing judges with immunity from prosecution based on full and frank disclosure that does not prove from subsequent investigation to amount to perjury. This would not mean that a judge who admits to taking money to produce a favourable outcome could necessarily avoid dismissal from office for life. In all but the most exceptional cases he would. It may be that admissions to lesser faults, such as delaying justice because of a pressure from the head of a court to do so, could allow for the candidate to re-apply for judicial office. In agreement with the Anti-Corruption Workstream, there are definite benefits in encouraging truth and actual restoration of the dignity of the judiciary, by providing an extraordinary transitional justice opportunity to make admissions that would not be grounds for loss of pension, provided that the admissions are made within a limited transitional period; and that there are automatic repercussions for criminal liability, dismissal and loss of pension if the corruption is discovered at a later stage. It may be that these incentives will not be sufficient for many, but some judges will take the opportunity to break the silence about corruption and they will have the cover of the amnesty to take this redemptive step. As a counter-intuitive as it may seem to some, the most patriotic thing that any Ukrainian judge could do today would be make admissions of previous corruption, even if his or her own corruption was comparatively slight.

Interim supervision of senior jurists

It has already been suggested that the Ad Hoc Evaluation Mechanism should contain foreign and highly regarded Ukrainian jurists. The compromised reputation of the judiciary in Ukraine is so bad that the public need to see senior internationally recognised judicial figures conducting a supervisory role. There must therefore be an extraordinary temporary oversight body that would have a limited existence for the duration of the re-evaluation process. This body could include the first members of the 1996 Ukrainian Constitutional Court, previous foreign and national judges of the European Court of Human Rights, and possibly members of the Ukrainian diaspora, and/or international jurists. Both the Ad Hoc Evaluation Mechanism and the High Qualification Commission would report to

To date assets disclosure has been a source for cynicism in Ukraine because judges have for some time been required to provide annual income and assets disclosure, only for a mockery to be made of a system that rarely, if ever, investigates the perjury and obfuscation contained in the disclosure returns. There must be very in depth disclosure obligations for judges including the requirement to provide details of all dependent family members' assets, as well as property that has been assigned to others by virtue of power of attorney. Given the sensitivity attached to judicial integrity at this time, this requirement can easily be justified as a proportionate interference with privacy rights. Once the declaration is made there must be an interview in which the judge is required to answer questions concerning the declaration. Both a failure to answer and the failure to provide a sufficiently clear answer will be a basis for failing the assessment. If necessary, the assessor can ask the judge to provide additional information by way of evidence.

An enhanced Higher Qualification Commission

It is the High Qualification Commission that should carry out the extraordinary Qualification Assessment, including the interview process. It is this existing disciplinary body that must be allowed to develop the capacity to evaluate the judiciary, rather than waiting for some third party state agency to take up the task; but it will not be able to do so effectively without considerable financial and personnel resources. In order to gain the broadest possible trust in the process, there must be an Ad Hoc Evaluation Mechanism that is established within the current Qualification Commission to carry out the assessment both quickly, but also with a world class degree of competency. This can be done by employing respected foreign judges (for instance retired judges and officials of European countries) and investigators (for instance senior police officers seconded from European countries) to be part of the composition of the Ad Hoc Evaluation Mechanism alongside well-respected Ukrainian judges, lawyers and academics. Foreign composition will not only remove the risk of corruption, it will also publicly demonstrate the quality and objectivity of the process. The process for appointment to the Mechanism, as with the Commission itself, will need to be transparent and independent.

human rights courts, and where relevant, foreign national courts. Translation of case law and dedicated academic texts must render the jurisprudence more accessible. Judges must be willing to utilise these global studies as part of their duty to interpret and apply the Constitution. This approach in Ukraine is already associated with the work of Serhiy Holovaty,⁶ but it must now be carried out on a far more extensive scale so that it can be available to every judge and applied in every court room.

Ukrainian values

At the same time, the idea of the rule of law will never become transformative of Ukrainian society until it is grounded in local culture and heritage. By way of example from the United Kingdom, the ground breaking 2005 judgment, which held that torture evidence could never be admissible in any proceedings, even to justify preventative detention of terrorist suspects, made sure not only to cite unconditional norms of international law, but also the English constitutional settlement of the 17th century that abolished the royal power of kings to issue torture warrants and thereby provide an immunity from the common law rejection of torture dating back to 14th century.⁷ The UK 'Torture case' demonstrates how all countries have to develop indigenous human rights reasoning to command empathy and legitimacy for such rights. A good Ukrainian example of the same endeavour is that we came across was the essay of Judge, Volodymyr Kravchuk *The Roots of Law* that traces the pre-Biblical rules of Prav ('right') and looks also at the etymological links between right (прав/ prav), law (право/ pravo), truth (правда/ pravda) and justice (справедливість/ s-prav-ed-lyvist).⁸ Any such rule of law narrative grounded in national history and culture would presumably have to engage with the terrible legacy of human rights abuse during the 20th century; and the importance of protecting minority rights today and in the future. The action

6 See the 3 volume Ukrainian language work on the rule of law by Serhiy Holovaty, *The Rule of Law*, (Kyiv, Phoenix Publishing House, 2006) LXIV,1747, (Vol. 1: The Rule of Law: From Idea to Doctrine; Vol. 2: The Rule of Law: From Doctrine to Principle; Vol. 3: The Rule of Law: The Ukrainian Experience).

7 *A and Ors (No 2) v Secretary of State for the Home Department* [2005] UKHL 71.

8 Downloaded at <http://www.vkksu.gov.ua/ua/about/visnik-vishoi-kvalifikatsiynoi-komisii-sud-div-ukraini/roots-of-law/> on 13 July 2015.

required is that judges must self-consciously style a language and symbolism of human rights discourse in their judgments that is appreciably Ukrainian while at the same time grounded in European and global indices of justice. In this way, the rule of law as an idea can help to de-Sovietise national culture and provide a principled foundation for future integrity of state and society.

Legal Education

Any transformation of the jurisprudence of the rule of law will be dependent upon the transformation of legal education. This was also the conclusion of a ground breaking study the OSCE and Kyiv-Mohyla University in 2010.⁹ There is an imperative to introduce both quality control and curriculum amendments into legal education across the country. There are also far too many courses, often failing to distinguish between law enforcement and legal science, and which do not begin to teach the type of constitutional-human rights foundational ideas that have been identified in this section. EU studies are barely taught at all; and not on a systemic basis. Only at the centres of excellence in Kyiv, Odessa, Lviv and Kharkiv, have these changes begun to be made at the undergraduate and post-graduate level. The answer to that lies in a revised approach to judicial education and continuing professional training that guides judges and lawyers into being the intellectual as well as practical guardians of the rule of law as a transformative idea. The initiative will have to come from the legal profession and the Universities working together with the Ministry of Education to transform curriculum. At the very least, legal science and law enforcement must be severed from one another; courses must be cut and subject to quality control; and the legal science curriculum must include the European, Global and Ukrainian (rule of law) values components outlined above. As underscored in the Chapter on EU Integration, EU legal studies must be introduced as a comprehensive subject for the first time in Ukraine and as an essential aid to EU association.

⁹ OSCE/National University of Kyiv-Mohyla Academy study on The State of Legal Education and Science in the Ukraine, (Research findings, 2009-2010).

Qualification Competencies

The statutory criteria for the assessment, as we have seen from 2015 reforms, will consider 'professional competence', 'personal competence', 'social competence' and 'the ability to administer justice'. In terms of developing the content of these criteria, it is recommended that three core competencies be identified as essential. These are (1) legal ability, (2) integrity and (3) the capacity to justify the source of one's wealth.

On legal ability, it is imperative that the assessment tests the competence of every judge to understand not only the written law and codes, but the underlying values and principle of the rule of law in the sense described in section 1 above. In order for judges to have a fair opportunity to pass the assessment, the National School of Judges will need to provide short courses for examinees to study these matters (sometimes for the first time in their judicial careers). Both new curriculum and translated human rights materials will have to be produced. Foreign experts should be commissioned on a temporary basis to support the initial training.

On integrity, there must be testing of psychological strength to deal with stress and communicate skilfully as foreshadowed in the statute (as mentioned in the current statute), but also evaluation of the moral and ethical qualities. This would require particular focus on the capacity of a judge not to relent to political interference or bribery. Examinees should be required to answer questions as to how they have coped with such pressures in the past. They should also provide a list of referees (both judicial and non-judicial including people from their community) who can give examples to demonstrate their integrity. The Workstream has refrained from endorsing one way or another whether the qualification age for judges should be raised from 25 years or not. The key issue at present is to seek out people with high personal integrity when it is believed by so much of the population to be in short supply in the court rooms. The judiciary needs judges with post-Soviet mentality who are not reticent about acting independently of the state, or cliques of power, where the rule of law requires them to do so. That quality, rather than age, should be the most important thing to test.

On assets disclosure and explanation, for a society that suffers from endemic corruption it is critical that judges (above all others) must be able to explain their wealth. No one should doubt that this is an essential qualification for a judge to continue in office in Ukraine right now, and at present this is not sufficiently dealt with in the list of qualification criteria in the 2015 reforms.

Transparency

Transparency must involve publication of judgments, tracking of cases in terms of allocation, pleadings, outcomes and orders and video streaming of cases, especially ones of public interest. This process has begun and if anything the Workstream trips to courts and meetings with judges confirmed that there is a strong commitment to promoting greater transparency so that the 'white' system of justice can gain more coverage. Examples of good practice include the efforts made by the Supreme Economic Court to publish its judgements that practitioners confirm has led to a far greater degree of continuity and coherence in that area of the law in recent years. At the Kyivsky District Court in Odessa, there is a policy of making the courthouse open and welcoming to the general public, as well as a press officer system that has sought to publish accurate and informative stories about court cases in the local media.

Especially, while the quality of the judiciary is being enhanced, it is important for controversial cases to be televised. It deters improper conduct by the judge and the parties and enables civil society to better understand legal society. Amendments introduced by the 2015 Law on Fair trials allow for the video recording and broadcasts of court hearings in the courtroom provided that they refrain from "obstructing" the proceedings and the exercise by the parties of their procedural rights (Article 11.3). Subject to that caveat there is a strong case for allowing responsible journalists and NGOs to choose what to film and what to televise. The NGO, Open Justice Initiative, is right to argue that the broadcasting cannot be left to either state or commercial television, because neither could be presently relied upon to provide objective editorial coverage.

A broader re-evaluation of the entire judiciary

The major opportunity to truly transform the status of the judiciary lies in the introduction of the mandatory qualification evaluation by the Law on Fair Trials in 2015 (Article 83, see above). This process offers the chance for a fundamental re-evaluation of the competencies of the entire judicial population. If done correctly it would enable a transformation that would go far beyond specific lustration that itself cannot be a proper answer to the problem.¹⁵ The key features of the recommendation are dealt with below. They seek to develop upon current reforms rather than reinvent them.

¹⁵ See further Maria Popova, *Why Kiev's Plans to Purge the Judiciary Will Backfire*, Foreign Affairs, April 15 2014.

2 Judges

If the rule of law is to play a role in the positive transformation of the country then the judiciary must embody independence, dignity and quality.

2.1 Restoration of the dignity of the judiciary is a national imperative

The reputation of the judiciary is massively under attack in Ukraine. Mistrust in them tops all of the published state-of-the-nation surveys, although the surveys of court users tend to be more positive than those who have never used the court system. Euromaidan has let loose a dire frustration towards the judiciary because of its incapacity to protect and enforce the rule of law. Many of the judges met by the Workstream were understandably sensitive. Some spoke of a witch hunt. They were critical of the political establishment and the media for undisciplined attacks upon them. They did not believe that judicial reform – which itself had been in a constant state of flux for many years – could or would work without political and media restraint in the rule of law field.

2.2 Current reform process

It would be wrong to accuse the current Government of doing nothing; or indeed the previous regime (when it was still seeking EU integration) of complete neglect. The basic reform ideas are already the subject of broad consensus and have been the subject of legislative reform, often assisted by a rolling body of opinions that have been commissioned from the Venice Commission and are integral to the current work of the Ukrainian Constitutional Commission.¹⁰ The law now requires that judicial examination and dismissal should be controlled by

¹⁰ For the latest opinion of the Venice Commission, see European Commission for Democracy Through Law, *Preliminary Opinion on Proposed Constitutional Amendments Regarding the Judiciary of Ukraine*, 24 July 2015, Opinion No. 803/2015, CDL-PI(2015) 016. The Constitution Commission was convened in 2014. The Workstream was able to meet with several of its members.

bodies predominantly made up of independent holders of judicial office, rather than a majority of political appointees and non-independent jurists, such as the Prosecutor General. Non-interference in case allocation can be secured by the resource and logistical development of objective automated systems that are now mandated by statute. Although still under procedural design, there is now a statutory foundation for the development of disciplinary procedures and ongoing inspection mechanisms have to be developed, albeit in a manner that is not itself subject to political interference, or generative of new layers of corruption. Despite the wish of the authorities to see incompetent and corrupt members of the judiciary removed from office, the Lustration law recognises that if this is to be achieved it has to be carried out in a fair and proportionate manner, which does not itself compromise judicial independence.

There are two key issues of structural independence still under discussion. The first is the initial probationary tenure of new judges for their first five years in office. Article 128.1 of the Constitution requires a review of the tenure of these judges and a recommendation to the Verkhovna Rada pending a vote on their appointment for life. There is a strong currency of opinion supported by the Constitutional Commission and emphatically endorsed by the Venice Commission, that this provision should be abolished in so far as it involves Parliamentary control over the status of judges once appointed. Both in appearance and in reality, it has unduly interfered with the independence of those judges. The issue is particularly relevant now because more than 450 judges have been recommended for life tenure appointment by the previous composition of the High Qualification Commission of Judges, but the Rada has refused to act on the recommendations for more than 18 months, leaving that group of judges suspended from practice.

The second issue concerns the appointment of judges. The proposal of the Constitutional Commission, again supported by the Venice Commission, is that the President (and on the current recommendation, not Parliament) should appoint judges, but his role should be that of a notary (i.e. sanctioning whether the procedures has been complied with) rather than as a substantive appointee. The principal advice on appointments should be the responsibility of an independent judicial appointments Commission. Only in exceptional circumstances would the recommendation of the Commission not be followed by the President. If implemented properly this approach would be concordant with international standards, although it is equally permissible for the President and Parliament to combine in endorsing the appointments process. The discrete position of the appointment of Constitutional Court judges is given special treatment by the Constitution Workstream in their Chapter "2.3.1. Power to appoint".

2.7 Recommendations

Salaries, numbers, resources

Raising judicial salaries is clearly required, not simply as an alternative to illicit subsidizing of very low incomes (often not more than \$500 per calendar month), but also to attract talented people from private practice. In line with the Anti-Corruption chapter in this report it is agreed that judges and other law enforcement agents should be offered fair remuneration. This should be at least 2.5 times the current salary level (for action required to assess the correct numbers and salaries see section 3 below). However, bearing in mind the huge sums of money that judges could make from bribery, the application of this simple economic interest formula would not be enough in itself. Presiding judges of several courts also told the Workstream that improper financial pressure often came through threats to cut limited budgets. Resources therefore need to be increased and presiding judges need to be given autonomy over their use.

Judicial training and continuing assessment

Judicial training must be pedagogically freed from the Soviet system that was overly positivist and formalistic; and its essence must focus on identification and promotion of rule of law values (see section 1 above). That cannot happen without the provision of the international case law in the Ukrainian language with appropriate commentary. An editorial committee must be established accordingly to select the corpus of outstanding materials that need translation. At the same time the quality of training must also be enhanced by modern techniques of case studies, peer assessment, integrity and diversity awareness. Judges are not there simply to be lectured at; they are there to discover the right paths to judicial reasoning. The reform of the curriculum of the National School of Judges that is now underway must be strongly supported by academics, legal practitioners and current judges, as well as being given the benefit of lessons learned by the reform of judicial training from around the world. The National School must be given the funding to make these changes, but it should also have the best intellectual capital available to it from around the world in order to create paradigm shifting education.

ry. Contrary to some modernisation theories, the development of competitive electoral politics, with changing governments, has not previously led political and economic elites (even reformist ones) to fully support the insulation of an independent judiciary that is capable of standing as a neutral arbiter regardless of who is in or out of power.¹⁴ Hence the paradox that judicial independence may now be greater in Russia, notwithstanding its entrenched authoritarianism, because political elites and their client-business allies are less bothered about fixing judicial outcomes.

The fault of the judges

Nevertheless judges find it difficult to publicly recognise their own responsibility for the problem. In Workstream interviews there were frequent attempts to blame the politicians, prosecutors, police etc., in what is referred to above as a syndrome of 'selective responsibility' that mirrors the country's problem of 'selective justice'. As an exercise the Workstream interviews repeatedly asked the judges it met to respond to what they believed would happen in their court buildings if an undercover agent, pretending to be a lawyer, sought to offer bribes in a case. Everyone the Workstream spoke to thought many, if not most, judges in the current climate would refuse to take a bribe from a stranger. However, everyone spoken to confirmed that it would be highly unlikely that the same judges would report the attempted bribery even though it is now their professional obligation to do so. There was considerable discussion about the still significant sensitivities in post-soviet society of about being perceived as an informant (stuckach) who provided information (stuckachestvo). That particular historical and cultural context cannot be disregarded, but it still seemed a profoundly insufficient explanation to justify judges withholding information concerning acts of bribery in circumstances where the society is disintegrating under the pressures of corruption. They are confined by an intricate culture of kompromat, in which every official has some sort of document or piece of information that can be used against them. There was an evident added dimension that most judges were somehow compromised by previous involvement in and/or toleration of corruption and therefore feared retaliation. This was not simply a legacy of totalitarianism.

14 This is essential thesis of Maria Popova, *Politicized Justice in Emerging Democracies*, (Cambridge, 2012). See also Alexei Trochev, *Meddling with Justice, Competitive Politics, Impunity and Distrusted Courts in Post-Orange Ukraine*, *Demokratizatsiya: Journal of Post-Soviet Democratization*, 2010, 18:2, 122-147.

2.3 Structural independence is not enough

No informed person in Ukraine would dispute the importance of structural independence and insulation of the judiciary from political interference. However, there is also a broad consensus that structural independence alone will not repair the damaged reputation of the judiciary; nor will it abolish actual dependencies. There must be behavioural independence based on judicial culture and values and decisional independence based on political and economic elites refraining from bribery and political pressure (referred to in the academic writing as 'telephone justice'). Again, the present Government has introduced important reforms, but the key concern is whether they will suffer from a failure of implementation.

2.4 The 2014 Law to enhance the status of the Judiciary

The 2014 Law to enhance the Status of the Judiciary has created the following changes to the process of appointment and dismissal, The composition of the High Commission of Qualification of Judges (dealing with entry) and the High Council of Judges (dealing with lustration¹¹ and dismissal) have both been the subject of reconstitution in terms of personnel and organisation. Both now have a significant majority of judicial members, rather than political appointees. The 2014 Law also creates a partial lustration system based on judicial support for the state during the Maidan protest period. The hearing of 300 tabled cases began in June 2015.

11 'Lustration' derives from the Latin term *lustrare* meaning 'purification', and it refers to a process designed to 'shed light' on the past.

2.5 The 2015 Law on Fair Trial Reforms

The Law “On ensuring the right to a fair trial” that came into force in March 2015 has introduced reforms aimed at transforming the culture, education and quality of the remaining judiciary.¹² The recommendations in this Chapter that follow below particularly build upon the specific provisions in the 2015 Law:

Article 48.3 of the new law created a discrete duty upon judges to report all outside attempts to influence the Court process. “The judge shall be obligated to report interference in their work as a judge for the administration of justice to the bodies of judicial self-government and to law enforcement agencies”.

Article 83 introduced a mandatory qualification evaluation for all levels of the judiciary. Although the methodology is to be established by the High Qualification Commission in consultation with the National School of Judges, the criteria for qualification that the assessment must test will include “professional competence (knowledge of law, ability to conduct a court session and pass decisions), personal competence (ability to cope with the given volume of work, self-organization), social competence (equability of mind, stress resistance, communication skills) and the ability to improve their professional level and to administer justice in a court of the respective level”. In addition to the (now [anonymous]) assessment tests, the High Qualification Commission will go on to interview each individual judge.

Articles 87-88 have introduced continuing education and evaluation for the first time. Judges under 5 years must complete 30 hours training per year. Judges with tenure for life must complete 30 hours training every three years (Article 87). Assessment by the trainers will enable judges to identify individual needs for future professional development (Article 88).

¹² The full citation of the amending legislation is the Law of Ukraine “On ensuring the right to a fair trial” of 12 February 2015

2.6 Corruption and broader challenges

The problem is systemic

Corruption in the justice sector is systemic (see Anti-Corruption Workstream Chapter “1. Introduction”). It includes pure bribery, direct communication with judges based on threat and manipulation and indirect communication via the court hierarchy or powerful intermediaries. The Workstream repeatedly met judges that explained that they had been the subject of attempted bribery or professional duress at different stages in their career. It also met some judges who by their own admission had secured their positions through nepotism and with a view to gaining considerable financial advantage through illicit payments. Lawyers and judges confirmed that there were local tariffs for purchasing court orders.

This does not mean that all litigation in Ukraine is compromised by corruption. A five year empirical study by Tatiana Kyselova followed the legal fortunes of a number of small and middle ranking businesses in Eastern Ukraine. According to their own reporting, these business-litigants normally enjoyed relatively expeditious and proper (‘white’) justice. However, the study also found that with little predictability an ordinary business, such as a café, could be subject to another (‘black’) form of justice with corrupt influence on litigation, including the delayed enforcement of court orders and the initiation of bogus criminal proceedings that nevertheless took many years and acute psychological strain to bring to an end.¹³ For all these reasons, she appositely describes the justice system in Ukraine as a ‘zebra’.

The fault of the political and business elites

Without doubt considerable blame for this situation must lie with the political and business elites that have in the past been prepared to corrupt the judicia-

¹³ Tatiana Kyselova, Dualism of Ukrainian Commercial of Ukrainian Commercial Courts: Exploratory Study, *The Hague Journal on the Rule of Law*, 6(2) 2014, 178-201.

the people. With this fact in mind subsequent proposed changes to the current constitution are intended particularly to strengthen 'confidence in constitutional law' by protecting the integrity of the constitutional court (see section 2. below). These changes are intended to transform the constitution into a constitution of the people by introducing a constitutional complaint (see section 3.). These changes are proposed in order to provide constitutional guidance to strengthen the integrity of public services (see section 4.) and to create predictability in legal decisions by putting in place a constitutionally consistent guarantee of private property and thereby to support economic development (see section 5.).

1.3.4 Procedure of constitutional amendments

These necessary constitutional amendments should include a small but not negligible change, namely in the constitutional amendment process itself. According to Article 159 CU, the constitutional court shall investigate, in the course of constitutional amendment processes, if the presented draft is consistent with 'the requirements of Articles 157 and 158'.

This involvement of the constitutional court is virtually without substance (1); moreover, it is contrary to the principle of constitutional jurisdiction (2) and in practice has served no responsible function (3). It therefore should be abolished without substitution (see the opinion of the Venice Commission No. 599/2010 on this matter).

(1) Substantial regulatory content is not recognisable. The constitutional court should only verify the compatibility of the draft amendments to constitutional law with the 'requirements of Articles 157 and 158'. The constitutional court should not verify their compatibility with the overall constitution, which would demand expertise from the constitutional court, but only, as mentioned, with the procedural requirements of Articles 157 and 158 CU. The scope of this assessment is so limited as to verge on the superficial; it tends towards zero, so the inclusion of the court seems to be needless and useless.

(2) The inclusion of the court is furthermore contrary to a constitutional system. A constitutional court conducts its judicial review on the basis of a given constitution. It serves constitutional law and by principle should not be a contributing factor during its amendment.

(3) Finally the inclusion of the court in the process for amending the constitution has a dysfunctional effect, as it enables parliament to shift its responsibility partially to the court. In addition the court itself is precluded by its preliminary

appear before the courts are barely qualified legally. Historically there was also a practice of bribery to obtain the certificates to be an Attorney-at-Law. It may well be that these so-called 'grey' lawyers are more prone to corruption, especially if they act as in-house lawyers for private businesses. It would certainly be wrong to conclude that it is these lawyers alone who are responsible for the prevalence of corruption within the legal system.

4.3 Lawyers make a difference

The legal profession has not done enough to protect the rule of law in Ukraine. The political and business classes may have been too willing to denigrate it, but when it comes to using law to behave unlawfully, it is lawyers that are crucial to that operation. Corruption lies at the heart of Ukraine's contemporary human rights predicament. Yet unlike the Soviet dissident movement lawyers have not played the role that they could and should have played in engaging with the problem. Those in a position to make a difference have not done so, largely because of the financial incentives that maintain the status quo. Those who want to make a difference have not done so, because they are reluctant for ethical reasons to enter the private or state positions where they could in fact do so. So it has come to pass that Ukraine enjoys a population of potentially world class lawyers, who are practising in a country with a world class corruption level. The transition from illiberal to liberal society is incomplete and the pre-eminent human rights issue of this generation is not being fully engaged with.

4.4 Recommendations

Lawyers to enter public service

There are outstanding lawyers in the country who are capable of leading the reform process from within the state system, as well as challenging it from without. This would partly involve entering public office, as politicians, civil servants, judges and agents of law enforcement. The broader reform process must find ways to harness new constituencies of lawyers who are prepared to enter public service. Although open and fair recruitment is a standard of equality and diversity merited in its own right, it is so strongly recommended in this chapter because it provides both a positive message and an opportunity for members of the private sector to apply for jobs. A system of fast track entry into the public

sector is also crucial, because a highly experienced lawyer in private practice should not be required to enter at the lowest point of the state sector. It would also enable lawyers to make money in private practice as part of a first career therefore enhancing their predisposition against corruption in the necessarily lower paid public sector second career. The Ukrainian Bar Association has also helpfully argued that private firms, perhaps on the basis of tax incentives, should enable their employees to take 3 year periods of sabbatical secondment into public service, such as the prosecution office, before returning to their practice.

Private practitioners must develop virtuous networks

Lawyers in private practice must look to create virtuous circle outlets to break out of vicious ones. This would lead to the development of parallel structures that are not reliant on reform from the top down; or an improvement of the system prior to them yielding positive effect. In that sense, they are 'virtuous networks' that contrast with current corrupt or compromised practices. These networks are developing in Ukraine right now, with varying degrees of formality. By way of simple example, in Odessa the Worskstream met a lawyer who described how his firm and another firm had made an agreement to effectively avoid corrupt dealings with one another in terms of their client-litigants and that a discussion was afoot amongst a group of firms towards extending such agreements into a broader local alliance. The next step would be to declare such an alliance in a non-corruption charter of independent lawyers. The Bar Associations must be willing to follow such examples as part of a national renaissance. They must work towards the creation of extraordinary charters of non-corruption that every lawyer must be required to sign. Yet this should not be done quickly, in circumstances where a signature would be superficial. These kinds of Charters should only come after a period of internal critical discussion and as an outgrowth from the range of more locally successful network efforts as outlined below.

There is also a growing phenomenon of entrepreneurial associations, such as the Lviv Entrepreneurial Committee (the KPL), in which lawyers and local business have joined together to demonstrate and take legal action against the tax, police and state enforcement authorities with regard to unlawful searches and/or the refusal to execute court orders. During corporate raids, members attend the premises, film the conduct of the authorities and lawyers seek early access to their clients. The strategy is similar to the Auto-maidan model, with the product being placed on youtube. This strategy needs to be adopted by way of local

constituent act would give the Ukrainian people the legal possibility to become the 'source of all governmental power', to strengthen their integration through participation and thereby to secure the legitimacy of the future constitution.

The purpose would be to formulate a legally binding constitution, with a commitment to provisions that are unambiguous and coherent. Only then would the constitution provide society with fundamental order that would be supported and accepted by all political forces. Insofar as the constitution decides on certain matters, these decisions are no longer subject to but nevertheless fundamental to the resolution of political controversies. In this way, the constitution reduces political complexity and variability without, in principle, prohibiting amendments to itself. It unburdens the business of politics and enables currently desired political challenges to be tackled.

As regards the formal process by which the people exercise their constituent power, numerous forms have arisen in the history of contemporary constitutions. They range from a constitution imposed by a dominant power or passed by constitutional bodies to an over-all revision in compliance with the current constitution to constitutional conventions of the people (Waldhoff, Christian. 'Entstehung des Verfassungsgesetzes'. *Verfassungstheorie*. Ed. Depenheuer/Gra-benwarter. 2010. p. 289–348). In the present circumstances a new constitution of the Ukraine cannot be established in any other way than by an act of self-determination on the part of the Ukrainian people. Therefore the new constitution has to be accepted democratically and has to be legitimized by referendum.

The process of drafting a new constitution should include experts who are not bound to a previously decided outcome but who can support this process independently. It should also include a broad common discussion in which the Ukrainian people can participate. The prepared draft then needs to be adopted by a referendum of the people.

1.3.3 Partial revision of the constitution

Until this constituent *καιρος* occurs, the only promising strategy will be to begin gradually reformulating constitutional deficits. These efforts would strengthen the 'confidence of the people in state and law' step by step, building some constitutional 'islands of trusts'. This is even more urgent for Ukraine. Unlike its successful neighbour Poland, Ukraine never underwent a rapid and sustained transformation of its outdated institutions, ie property rights, independence of courts, public service, which could have otherwise fostered certainty and trust in

just short-term answers to the growing pains of its early history as an independent state.

The process described below on how to amend or replace the current constitution with a new one (see section 1.3.2.) is therefore not designed to structure or assist in finding answers to the above questions, however important they may be. The country itself must move towards a basic consensus of what is wanted politically and, above all, democratically. That is a social process and discussion that cannot be fitted in a tight and predetermined structure. Instead, it must emerge from within the society. Real and realistic constitutional solutions can only grow from within a country.

An example of a social process of this kind can be seen in the demands of the Orange Revolution and the Maidan Revolution. However, even then not every citizen supported those demands. Consensus does not rule out questioning or opposing a movement, but it does require overall participation.

Consensus arrived at in this way can and must be transferred to the formal process of amending the constitution. Whatever solution is agreed upon to resolve the marked issues, its implementation in the constitution must be clear-cut and coherent. And first and foremost it must be taken seriously. A solution will not have any of the desired effects if it is treated with disrespect, ie if people do not comply with it completely or if it is implemented incoherently. Instead, it will most likely create even more problems and raise even more new questions.

The reader is referred to section 3.1. and 4.2. of 'Modern government' in this report for concrete recommendations on the current questions of decentralisation and on separation of powers for the office of president and the office of prime minister.

1.3.2 New constitution

The moment the question of power is resolved would be the *καιρος*, the supreme moment, to formulate a new constitution. Doing so would transform the political aims of the Maidan Revolution by an act of constituent power on the legal foundation of the Ukrainian state. At the same time, many deficits of legitimisation embedded in and associated with the current constitution would be overcome and Ukraine could get off to a fresh constitutional start liberated from the unsettled political past. The Ukrainian people would have reached a fundamental consensus on this matter, thereby leading all political differences towards being cloaked in a civilised, democratic and constitutional form. Moreover, this

organisation across the country. It should also be sponsored by organisations such as the Federation of Employers, but not at the expense of ensuring that it is local initiatives and personalities that are in the forefront of growing the strategies organically depending on local needs.

In Lviv, the Workstream met lawyers who had constructed their practices to expressly offer non-corrupt services to international clients looking to invest in Ukraine. From this USP, the firm had established a bespoke market leadership for providing similar services to local businesses. The example embodies an arguably crucial lesson. Lawyers across the country confessed the extent to which puritanical non-corruption in private practice was not commercially possible. If this was sadly realistic in one sense; it also lacks imagination in another sense, because it ignores the considerable European and modern business opportunities that could be available in providing non-corrupt practices.

Individual business sectors, with the sponsorship of EU and European business, should combine with the legal services market to promote alternative network conduct. If international businesses have left the country, they should be given the forum and opportunity to provide frank advice to the local legal service industry as to what support they would need to come back in. This can be done by conferences for legal practitioners and follow up network support that investigates the practical arguments and strategies for actually making money out of doing legal business in a non-corrupt fashion. These conferences should be jointly sponsored by Bar and business organisations in partnership with the EU. It would help to include partners from the major international law firms. The follow-up network support could include an element of mentoring from foreign lawyers and entrepreneurs. Relatively small amounts of seed money could then be provided from the private sector for local 'Law Clusters' that wish to develop non-corrupt and higher quality legal spaces, working together with the 'Rule of Law Units' that should be established in the local Universities (see below). These law clusters, that are determined to evade the current system of corruption, can be copied and networked around the country.

Legal education as a platform for virtuous networks

Legal Education has a critical role to play. It provides both the foundation training for these reformist lawyers, as well as the opportunity for continuing professional development later in their careers. Shortcomings in legal service in Ukraine are obviously not just about corruption; they include the extent to which lawyers, like judges, are often limited in their own rule of law education (see

section 1 above) Graduate courses are being developed to enable new industry sectors to comply with international legal standards. There is an impressive example of the IT industry course being run by the Law Science Research Institute in Kharkiv in conjunction with Cornell University. It offers the opportunity to impact on the entire legal culture of a sector of industry, and in that respect should be copied in other areas, particularly new business sectors that are not necessarily subject to entrenched practices.

Beyond teaching law in terms of the broader rule of law values system, the Universities could facilitate access to virtuous networks for future professional life. A pre-requisite for them playing this role must, of course, be an end to the University existing as a key site of corruption in Ukrainian life (see Workstream Anti-Corruption chapter "5. Every-day, Small-Scale Corruption. Education and Social Campaigns. Public Involvement"). Many of the Universities, even the excellent ones, continue to be overly hierarchical in a sense that is counter-productive to intellectual creativity. The Deans, Academic Board and Professors, should stop being patricians (of the Soviet or Post-Soviet variety) and start being mentors and partners of the student body.

A discrete way of creating virtuous learning platforms in Universities is achieved by the creation of 'legal clinics' or 'rule of law units'. They are developed within the precincts of the present university system, with a short mandatory course to attend the units in the freshman year, and the opportunity for selected courses and extra-curricular activity connected to the units in the subsequent academic years. These are pro bono organisations with relative autonomy from the University governing structure in which the teaching faculty, students, and local practitioners focus on an area of public interest law (for instance human rights protection). The Units not only sponsor lectures for the students and the public, but actually enable students to be involved in the bringing of cases. The students therefore provide an NGO service, but they also learn from and have access to local, national and international rule of law initiatives. Often, commercial law firms will sponsor the units, as a means of marketing, but also as an opportunity for their younger employees to gain helpful practical experience on challenging cases. As the students will work for free, and the younger practitioners can be seconded on a pro-bono basis, these are low funding ventures. All that is needed is office space (either on campus or potentially offered by local firms) and contributions for the appointment of some full time case workers and administrative staff (all of who ideally should be recruited from the student body). The projects often work best when students, as well as their teachers and local private practitioners, sit on the Board together. Alumni of a law unit often continue

1.2.2 Misuse of the constitution

After 25 years of independence there have been four prominent political shifts in direction and subsequent constitutional changes. Under these political conditions confidence in the 'rule of law' cannot grow; instead, constitutional law is considered a plaything of politics. The various constitutional changes, questionable decisions by the constitutional court and defective procedural changes have all accelerated this process of the delegitimization of the prevailing constitution. This fact likewise supports the recommendation to free the constitutional foundation of the state from this inherited burden that is ruining its legitimacy and to draft a whole new, politically unencumbered constitution. This step could succeed in strengthening the trust people have in the law, in the constitution, in the courts and judges.

1.3 Recommendations

In the context of the unresolved question of power, the issue of a new constitution can only be addressed if two essential events transpire: If the outside independence of the Ukrainian state and its inner stability consolidate and the military conflict ends, a constitutional new beginning can be recommended, the *καιρος* for a new constitution will have come. Until then only a few constitutional deficits can be identified and improved upon.

1.3.1 Current constitutional conflicts and questions

Over the course of many years, Ukraine has seen trenchant disputes arise, some of which are perceived to be linked to its constitutional arrangements. At the same time, profound constitutional questions are very much part of public discourse. Among them is the question of whether to decentralise the current distribution of power between central and local government and if so, how; the question of whether to introduce a two-chamber system of legislation and if so, how; and the question of how to resolve the recurring conflict of power between the office of president and the office of prime minister.

These matters are not only highly political, they also cannot be resolved from the outside or based on an expert's view of the inherently correct constitutional solution. Ukraine will have to find its own answers to these dilemmas recognising that it is choosing ultimate arrangements for the life of the nation and not

not only a semantic one, with hollow words and norms that can be exploited, merely camouflaging the real balance of power. Confucius stated 2500 years ago what is absolutely necessary: 'If language is not correct then what is said is not what is meant. If what is said is not what is meant, then what ought to be done remains undone. If this remains undone, then morals and acts deteriorate. If morals and acts deteriorate, justice will go astray. If justice goes astray, the people will stand about in helpless confusion. Hence, there must be no arbitrariness in what is said. This matters above everything.' The short step from false language with lies and misconception via dishonest law (semantic law) to being without rights (arbitrariness) and to the perversion of law (corruption) cannot be explained more concisely.

Anyone who talks about a constitution must also want a constitution, taking it and its words seriously. Anyone who wants to take a constitution at its word has to accede to the authentic interpretation of it by independent courts. Anyone who postulates the independence of the courts has to guarantee their independence. This however means, very precisely, a judge cannot be called to account for a judicial decision, except in the case of a punishable and intentional violation of the law. In other words, defective judgements, whether actual or putative, have to be respected by state and citizens. Defective judgements have to be and can be prevented with sufficient qualification requirements for judges. Incorrect decisions can be criticised and corrected by means of legal steps or an open discussion in public and among experts. Finally a panel in which a number of judges participate – at the constitutional court there are 18 judges – increases the probability of correct and legally convincing decisions.

All of these efforts of course do not guarantee the 'correct' decision, because people can always make mistakes. But true independence of judges enables impartial and fair decisions on legal questions by a non-political judiciary. If these requirements are provided, the accuracy of a court decision cannot and may not be questioned, and the decision has to be accepted. This applies in particular to decisions of the constitutional court, the highest judicial body.

Only this institutional arrangement of an independent judiciary can gain the sustainable trust of the people and guarantee it for the future. Otherwise, the judicial system would be a continuation of politics; the law would be demoted to a maidservant of politics. The separation of the executive and legislative branches from the judiciary would be undetermined and blurred. To use the words of the French Declaration of Human Rights: such a state would not have a constitution at all.

their association with its work throughout their professional lives. These rule of law units could be an integral part of the law clusters outlined above.

Rights of audience

The premise that (subject to the availability of legal aid) in order to raise the standards of advocacy there must be a higher certification threshold for rights of audience before courts is a correct one. In the United Kingdom this monopoly used to exist in the division of the profession between barristers and solicitors, with the former enjoying rights of audience and the latter not. This system has been replaced in recent years by the capacity of both parts of the profession to gain advocacy certification. Either way, a qualification threshold is in place; just as the United States requires attorneys to take the state bar exams. At the same time, corruption in obtaining the certificates and the more general probity of the Bar must be strictly policed. In order to check that the original certificates were genuine; and that the lawyers are complying with other duties, there should be an annual requirement to renew practice certificates by way of online procedures. Declarations should be made concerning original bar exams, continuing professional development courses that have been taken and the annual income of a legal practice. A positive affirmation that the lawyer has complied with their corruption reporting duties (see below) could also be made. A failure to renew the practice certificate; or a failure of candour in the online entries could result in the lawyer being struck off.

Reporting duties

The same duties upon judges to report improper interference with the progress of cases cited in section 2 above should be adapted to the legal profession. It would require lawyers to both withdraw from proceedings where they know that their client has or intends to use external means to interfere with or otherwise improperly influence the outcome of the case, and to report it. The duty would relate to actual proceedings and not to previous historic conduct.

For reasons well established in the theory of legal professional privilege and lawyer-client confidentiality, there has always been a crime/fraud exception that prohibits lawyers from sheltering behind the veil of confidentiality in order to conceal the commission of an actual crime that arises during the services they provide to their client. Under the common law the privilege does not extend to communications which are made for the purpose of obtaining advice on the

commission of future crime, or which are themselves part of the crime.¹⁹ It is essential that the principle of confidentiality must continue to prevail absolutely in relation to information that a client gives to a lawyer in relation to past conduct, but this need not extend to knowledge of corruption during the course of the legal proceedings that the lawyer is involved in. Any new offence must respect these distinctions. The state of mind ingredient for the offence must be limited to 'knowledge' of a client's conduct or future intention, as opposed to 'belief' about it.

¹⁹ R. v. Cox and Railton (1884) 14 QBD 153; and Bullivant v Att.-Gen. for Victoria [1901] AC 196, 200.

1.2 Constitution without authority

The current status of the constitution is burdened by several circumstances. The constitution is widely semantic. Instead of channelling political power, it is actually exploited by it. Therefore it lends itself to misuse and abuse, thereby constantly losing its legitimacy and undermining its own authority. The result is a lack of trust in the constitution.

1.2.1 Semantic constitution

The present constitution deals with this concern only to a certain extent. Based on external form, the constitution contains all standards of western constitutions (fundamental rights, democracy, and rule of law). However, these standards are continuously foiled by opposing regulations, which have counter-effects on the implementation of constitutional standards. Based on external form, the constitution of 2004 could well meet western standards in terms of system, structure and fields of regulation.

However, in central and politically sensitive fields of regulation, it appears to be a semantic constitution. It is exposed to political exploitation and is interpreted according to politics in such a way that desired political decisions can be proved to be compliant with the constitution. Furthermore, the politically crucial sections of the constitution are malleable and vague. They do not clearly separate and define the powers among the different state bodies, e.g. president or parliament. Consequently there is a constant political temptation to increase one's own powers and respectively decrease those of others. The constitution does not provide a reliable and approved foundation for all the constitutional actors, state bodies and political parties. That is why it is qualified as being only a semantic constitution, not an acting one.

The constitutional changes that have been adopted since 1996 are sometimes merely on the brink of constitutionality and are implemented in a crude manner, incongruous to the idea of any constitution. One example is Decision No. 20rp/2010 handed down by the Constitutional Court of Ukraine on 30 September 2010, which was probably triggered by political decisions and pressures. Based on formal legal errors this decision led to the abolishment of the 2004 constitution and the reintroduction of the 1996 constitution.

Consequently, one of the most important objectives of constitutional amendments has to be that the constitution can be trusted; that the constitution is

regarding the violent annexation of Crimea and the protracted military conflict in the east of the country. On the other hand there is widespread mistrust of law and state, administration and jurisdiction, which can be seen simultaneously as a result of omnipresent corruption. Both findings indicate the country's desire for national unity and independence, for a fundamentally new beginning politically. All of this could be expressed in a constituent act by which the nation defines itself politically.

Yet constitutional law cannot become the real 'basic legal order of the community' (Werner Kāgi) from one day to the next. The concept of western constitutions has indeed an easy and clear core as paradigmatically shown in Article 16 of the French Declaration of the Rights of Man and of the Citizen of 1789: 'Any society in which the guarantee of rights is not assured, nor the separation of powers determined, has no constitution.' However this simple core of the constitution relies on numerous and demanding requirements which cannot be decreed from above and its implementation cannot be forced. A constitutional culture has to grow slowly to take root in the consciousness of the people. Only then can the constitution provide a stable and reliable foundation for a liberal society and become an institution that is truly trustworthy. The Maidan Revolution, like the Orange Revolution before it, already seems to be an expression of ongoing social change now seeking adequate constitutional expression.

1.1.2 Not a *καιρος*¹ for constitutionalising

On the other hand the current position of Ukraine favours neither substantial nor fundamental changes to its constitution. Nor does it support changing the wording of the constitution. Economic difficulties, social disintegration, political division, vague constellations and separation of public power and the conflict in eastern Ukraine, all of these factors turn the constitution, along with its application, interpretation and amendment, into a pawn in the political game. The constitution cannot fulfil its designation and provide a reliable and respected basis for resolving political discussions, supported by all political movement.

Consequently it is not the moment, not the *καιρος* for constitutionalisation.

1 ¹ "Kairos", Ancient Greek word meaning the right or opportune moment (the supreme moment).

5 Improving the commercial law environment

The commercial law environment must become simplified, deregulated enforceable and amendable to alternative dispute resolution

5.1 An end to hostility

External investment confidence in Ukraine is impeded by the perception and reality that it has a hostile commercial law environment. Local capacity to develop (lawful) smaller business is fundamentally underdeveloped because of the same hostility. Larger business has essentially migrated to international arbitration that is conducted outside of the jurisdiction. Smaller business cannot afford such a luxury.

5.2 Complex, unenforced and overly regulated

The complexity of the court structure is frequently criticised for being horizontally unclear in terms of the boundaries between general, commercial and administrative divisions. By international comparison the system also has too many vertical tiers, through the levels of District, Oblast, Cassation (as a High Court) and Supreme Court.

The justice system – and in particular the courts – are brought into disrepute because of the failure to enforce court orders. The fault largely lies with the separate state enforcement agency, with the courts retaining less power to enforce orders than they did through imprisonment for default under the Soviet system. However, the courts presently have power to grant interim payment orders, and to freeze assets. These powers are rarely used, with apparently far too much willingness to allow obstructive and weak legal cases to be pursued to their dying conclusion. When the powers are used, they are used selectively, for instance to protect powerful political, business or state elites in the face of much stronger cases brought by less wealthy litigants. Bribery is the obvious explanation as to why this occurs.

Closely aligned with the failure of the legal system is the byzantine body of regulations that are time consuming to comply with and are rife with the opportunity for corrupt practices, and which have been commended for abolition by the package of 'smart regulation' reforms outlined in the Anti-Corruption, Economy and EU Integration Chapters.

5.3 Recommendations

Reform of the overall Court structure

The general arguments concerning the need for a reorganization of the Court structure are correct. This would involve simplification both vertically (in terms of limiting the number of tiers of appeal) and horizontally (in terms of removing the multiple and duplicating civil and commercial law jurisdictions and reconstructing them as different divisions within the same high court system). The complexity of the present structure multiplies both the number of judges and initiated cases, consequently multiplying cost and opportunities for corruption and obstruction of justice.

There is a sound argument to reform the first instance court system, so that depending on the value of the claim, some cases start at the regional level, whereas others start at the district court level.

Although the Economic Court system may have been needed in the early period of corporate law in the country, it is difficult to see the long term logic of having a parallel commercial court appeal structure, rather than the specialist Economic Court judges forming expert divisions within an ordinary civil jurisdiction. A single civil jurisdiction with a precedent system of higher court decisions binding lower courts would enable the harmonisation of case-law and the uniform application of the law; thereby avoiding conflicts between courts. This is the view of the Venice Commission.²⁰ The one caveat is that judges, practitioners and parties often praise the comparative expertise of the Economic courts. Any reforms must not destroy this higher quality aspect of that part of the judiciary.

²⁰ For the latest opinion of the Venice Commission, see European Commission for Democracy Through Law, Preliminary Opinion on Proposed Constitutional Amendments Regarding the Judiciary of Ukraine, 24 July 2015, Opinion No. 803/2015, CDL-PI(2015) 016. The Constitution Commission was convened in 2014. The Workstream was able to meet with several of its members.

1 Ukraine on the road to a new constitution

1.1 Significant expression of the will of the Ukrainian people for a new constitution

1.1.1 Orange Revolution and Maidan Revolution

After 25 years of independence Ukraine is searching for its own identity. The Maidan movement (like the Orange Revolution before it) clearly came about by decision of the Ukrainian people, which is typical of political and – subsequently – legal revolutions. Constitutional theory thus reflects on such key political events of national history as acts of the constituent power of the people (*pouvoir constitué*) that set the general political direction for a (new) constitution. This ground-breaking decision indicates that the country has committed itself to freedom as the fundamental value for society in the Ukrainian state. Freedom implies national independence of the country from the outside world as well as the individual independence of citizens within their country. The latter is expressed in the democratic right to vote as the fundamental right to self-determination. These achievements have to be implemented as the constituent decision of the Ukrainian people in favour of:

- the state under the rule of law (constitutional state), i.e. legal independence of courts and the integrity of the law,
- constitutionally guaranteed freedom (liberty) and property rights,
- democracy as the fundamental legitimation of the state and
- separation of powers as a system of checks and balances.

These findings are most evident in the Ukrainians' vital patriotism, domestically expressed by 'Euromaidan'. Euromaidan embraces the 'mythology of Europe as an area characterised by the rule of law, social justice, freedom of movement and expression' (historian Andriy Portnov). This is enforced by foreign policy

the long-term success of the state and the constitution. That is why explicit regulation of public service is recommended on a constitutional level and in a form that defines the basic principles involved.

Constitutional enforcement of private property

There is an urgent need to strengthen the protection of private property under the constitution. The effective guarantee of private property is of crucial importance for both the liberal quality of the state and for the economic prosperity of the country. The constitutional guarantee of private property should therefore clearly always have priority over every form of state, public or national property. The current equal status in the constitutional provisions of the protection of 'private' and 'public' property, with a distinct leaning towards the latter, is creating legal uncertainty and distrust. It impedes the willingness of companies to invest and the development of economic success. This does not mean that state, public or national property should be illegal. However, it is important in any case to justify why the state and not the citizens should have ownership of certain goods.

In particular, the state does not need to own land to ensure the common good. The state can meet its individual and social responsibilities solely based on its territorial jurisdiction. Ukraine can and must fulfil its responsibility to put in place an appropriate system of property ownership in particular in the agricultural sector. In doing so, it must take into account economically reasonable sizes of enterprises yet at the same time prevent the development of oligarchic structures in the agricultural sector.

At the very least, these noted standards of commercial law should travel with its judges into other parts of the system.

Enforcement

Enforcement must be reformed, including by privatising the process into a bailiff service where a percentage of the debt recovered is paid to the bailiff. The process is not without problems, particularly if it involves the commercialisation of force to effect payment and gain entry to property. For that reason, the law and contractual arrangements must strictly prohibit any conduct other than requesting the payment of debt, with additional requirement for the vetting of the criminal character of the actual debt collectors.

One of the key problems at present is that powerful companies in the corporate raiding scenario simply take over business premises and ignore the authorities when they try to reclaim the buildings in accordance with court orders. The State Enforcement Agency (or the police) will still need to have a 'reasonable force' power to enforce repossession orders.

The courts must be compelled by amendment to the civil procedure rules to give interim consideration during the life of the proceedings, and in the aftermath of its judgment, as to whether enforcement protections orders must be made to guard against judgment in default. These include orders of assets freezing, payment into court of sums as security for costs, and interim payments to the successful party at interlocutory stages in the litigation. Ultimately the Court must have the power to imprison parties for failure to comply with its judgments.

Deregulation and privatisation of application processing

It is the vast and overlapping system of regulations, in need of urgent guillotine and approximation with EU standards, that almost more than anything, renders businesses vulnerable to extortion and requires them to engage in bribes. Current proposals based on successful use in other post-Communist states correctly argue for simplified regulations involving E-applications. The issuing of more complex licensing and registration documents should also be privatised to notaries.

Alternative Dispute Resolution

Mediation

Mediation, as a required consideration prior to the continuation of an issued claim, must be developed in Ukraine. First and foremost this means creating national awareness about what mediation is: a dispute resolution method, in which an intermediary (mediator) helps the parties in a conflict to establish a communication process and analyse the conflict situation in a way that allows them to make a decision on their own that will satisfy their interests and needs. The parties are their own judges. The mediator facilitates their better judgment as to best way to resolve their dispute. If mediation was mandated for consideration in certain areas of litigation, it would not obstruct ultimate access to court. It simply requires the parties to demonstrate that they have investigated the less costly and time consuming option. The requirement exists in many EU countries with regard to family law, but it is now being introduced as a required component in civil law disputes. Completed mediation agreements can then be endorsed by the Court, or a notary. In the event of non-compliance, this leads to simple breach of contract litigation, and not the required determination of the original dispute.

The major problem at the moment in Ukraine is the lack of adequate training in mediation. This can begin to be remedied by networks of lawyers and related professionals, including notaries, procuring the training on a private basis. The Ministry of Justice should also look to develop the training in conjunction with local Universities and the National School of Judges.

As with arbitration (see below) there is ample opportunity to develop voluntary mediation schemes in Ukraine today, whether it is designed to create less hierarchical means of resolving disputes inside state agencies and Universities, as part of business networks, or within single companies, and even as a way of resolving high social tensions between local communities in the liberated towns of Donetsk and Luhansk. These kinds of initiatives have begun to occur. They need the benefit of international expertise and training.

By establishing a constitutional complaint the state facilitates and guarantees ultimate legal protection from itself. It acknowledges anticipating the possibility of its institutions acting illegally. Thereby it provides a possibility for the citizens to defend themselves against state bodies acting contrary to the constitution.

By introducing a constitutional complaint the state self-confidently demonstrates that it can be controlled by the courts it has established itself, that their rulings will apply against it, and that it accepts the outcome. The state would truly be a state 'ruled by law', one which sees itself really bound by (constitutional) law. This would be a profound cultural achievement of legal-historical import.

The citizens can – without any fear of reprisals – sue the state based on those fundamental rights guaranteed by the state. The constitution of a state, which implements such an institutional arrangement would become the 'constitution of its citizens', would really strengthen the integration of the people by law, and would stabilise the state as one by the people because the people can by virtue of their trust believe in its constitutional promises.

Integrity of public service

In applying its executive powers the state shows its true colours. The state directly encounters its citizens only through its agencies and offices, its civilian officials and judges. The way it behaves towards its citizens and the expectations it has of them reveal whether the state understands itself to be an 'attorney of the common good' or acts as a 'band of robbers' (Augustine of Hippo), simply exploiting its citizens; if it sees itself as the servant of the citizens or if it merely treats them as subjects without rights. Literally, the way the state exerts its power demonstrates whether the constitutional provisions and statutory law are being put into real practice or, instead of being the law of the state, masquerading, leading a semantically independent existence without practical relevance and just being a cover-up for arbitrariness, corruption and partiality.

Therefore the integrity of public service is of vital importance for the stability of any state. It is crucial for the confidence the citizens should principally have in their state. That is what any state needs for stability and prosperity. The best constitution and the best statutes, the noblest ideals and the highest aims become meaningless if the 'servants of the state' lack technical competence, motivation and moral integrity. Ukraine's 'way to Europe' therefore requires dedicated cooperation from everyone, from citizens as well as public officials. The effectiveness, efficiency and integrity of the national administration will decide

Furthermore a fundamental constitutional amendment on modernisation is necessary because in its current form, the constitution is in large parts purely semantic, a pseudo-constitution. It is an effective instrument in the hands of politics rather than an expression of the 'rule of (constitutional) law'. Its legitimacy has been undermined by numerous questionable interpretations by the constitutional court and by a set of erroneous procedural changes. In the 25 years of Ukrainian independence, it has become too much a tool for political power and is therefore hardly able to procure legitimation, ie to establish legal confidence in the calculability, reliability and predictability of politics.

However the current political challenges provide only unfavourable basic conditions for a new constitution. The military conflict in the east and the unclear domestic political balance of power will most likely lead to political instrumentalisation of the constituent procedure. If those disturbing factors were mostly dispelled, an opportune moment (*καιρος*) for a new constitution could suddenly occur. In the meantime some of the urgent deficits of the current constitution have to be changed in the course of modernisation.

Independence of the constitutional court

One of the most urgent tasks of the Ukrainian constitution is to set up a legally secured and effectively operating independence for the Ukrainian Constitutional Court. Although constituent power could freely decide in favour of or against the establishment of a constitutional court, constitutional states may, but need not necessarily, have a constitutional court with wide-reaching power. However, the moment Ukraine decides to establish a constitutional court (Articles 147 – 150 UC) it must ensure its independence from the influence of the executive branch effectively and on a lasting basis. In particular, any form of dismissal of the constitutional judges by the executive branch must be abolished. Furthermore, any such dismissal may only be adopted by the qualified majority of the constitutional court itself and only in extreme individual cases.

Implementation of an individual constitutional complaint

The introduction of a constitutional complaint is explicitly recommended. The establishment of constitutional jurisdiction is regarded to be the keystone of every development of a constitutional state, and the introduction of a constitutional complaint is regarded as the 'crowning glory of the constitutional state'.

Arbitration

Arbitration provides an important mechanism for justice, especially in the interim period where the ordinary court system will be subject to its much needed reform. Domestic and international arbitration should be developed, not least, because Ukrainian Courts have improved in terms of enforcing arbitration awards.

Some domestic arbitration schemes are themselves open to corruption. In the real estate sector this caused the procedure as a whole to be brought into disrepute. The banking sector often mandates account holders to submit to private arbitration schemes, of the bank's choosing, therefore removing the choice of the customer and (at the very least) creating a conflict of interest for the arbitration provider who will enjoy significant business of their own by being the named arbitrator in the customer contracts.

International arbitration will continue to be the mechanism of choice for big business, not least because of worldwide enforceability and the quality of the off-shore arbitrators and practitioners. Yet the international system in its current form remains presently beyond the reach of the less affluent.

It is recommended that non-corrupt networks of businesses and lawyers should create autonomous and voluntary arbitration schemes that the network can trust in. There is no reason why discrete business sectors, especially beginning locally in the major cities, cannot create demonstrably independent and effective arbitration services of this kind. National business organisation, such as the Federation of Employers could also set up its own arbitration court. It should also be possible to employ foreign lawyers to sit as arbitrators, or act as the local arbitrator's adviser. This would enhance the confidence of the participants and help to develop the arbitration method as an alternative dispute resolution brand within Ukraine. If necessary there should be amendment to the current law to expressly enable foreign lawyers to sit as arbitrators and regulate the enforceability of their awards.²¹ Equally international arbitration can be brought onshore or closer to Ukraine in order to provide the same benefits to smaller businesses. As a first step it is recommended that Ukraine should seek advice from a group of respected international arbitrators who have had experience in dealing with Ukrainian cases in one of the international arbitration courts.

²¹ The present Law on Arbitral Courts 2011 simply requires that if a single arbitrator sits alone, s/he must be legally qualified under Ukrainian law. If there is a panel, then the chair must be legally qualified.

Arbitration is only as good as the system that enforces its awards. Therefore the general recommendations on enforcement above apply equally here, with the added dimension that it must be the responsibility of the National School of Judges, the Ministry of Justice and the Universities to ensure that judges are capable of understanding their (limited) role regarding arbitration awards and equally able to prevent mischievous litigation designed to undermine those awards. It is not uncommon for domestic litigation to be initiated during or in the aftermath of arbitration proceedings. This practice must be guarded against by the courts.

Management summary

Currently Ukraine is experiencing a myriad of conflicts and questions, some of which are perceived to be linked to its constitutional arrangements. They include, for example, the question of whether to decentralise the current distribution of power between central and local government and if so, how; the question of whether to introduce a two-chamber system of legislation and if so, how; and the question of how to resolve the recurring conflict of power between the office of president and the office of prime minister.

Although constitutional in nature, the above conflicts and questions will not be covered by this report. That is not because they are of lesser importance but rather because they are highly political and cannot be decided from the outside. Furthermore, there is no perfect model that could serve as the one and only answer. In Europe a diversity of models exists, e.g. the mostly centralised presidential system in France, or the mostly decentralised model of parliamentary government in Germany. Ukraine must first decide the direction in which it wants to go before this decision can be implemented in the constitution. A decision always precedes constitutional implementation.

This report focusses on issues that can be solved in the short term. Other questions, like the ones mentioned above or the coherent implementation of human rights, need social discussion and consensus in advance. They can be answered in the medium term. This report covers solely constitutional jurisdiction; ordinary jurisdiction is covered by the report of the "Rule of Law" Workstream.

Not the opportune moment for a new constitution

The domestic political situation in Ukraine after the Maidan Revolution calls for a new constitution. This revolution of the people includes an unambiguous decision to institute a constitution incorporating liberal constitutional thinking as established since the French Revolution: 'Any society in which the guarantee of rights is not assured nor the separation of powers is determined has no constitution.' (Article 16, French Declaration of the Rights of Man and of the Citizen) This decision requires an act by the 'constituent power of the people' to illustrate constitutionally the dawn of a new era, the road to Europe and the will to a comprehensive modernisation of Ukraine.



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VII Constitution

Results and proposals of the workstream

6 Preventing counter-reformation

Ukraine must reconcile with its past and protect its future.

6.1 Confronting the past

The Orange Revolution is perceived as failing largely because of the inability of the State to confront the actors and activities associated with the ancien regime of human rights abuse, corruption and unfettered oligarchy. There is an inescapable obligation under international human rights law for Ukraine to investigate the violent events of Euromaidan, especially in Kyiv in November 2013-February 2014 and Odessa in May 2014; but also those on both sides who are alleged to have committed war crimes during the separatist occupation of Donetsk and Luhansk. It is not open to a state to provide broad amnesties in relation to gross human rights abuse. There is also an undeniable need in the country for ordinary people to see extraordinarily powerful people brought to justice. The analogies can be found in the trials of senior mafia and political leaders in Italy and in Latin America that took a long time to come, but have now seen very senior figures brought to justice. Elsewhere in the report it has been suggested that limited amnesties could be used as a means of promoting profound social change rather than sweeping problems under the carpet. How far this should go is a matter for Ukraine to decide, but it should certainly involve a dynamic approach to providing immunity from prosecution to those who are bold enough to break the silence about the relationship between law, business and crime in the post-independence period.

More generally, Ukraine must continue to engage with the European Court of Human Rights as a means of correcting its past and acquiring international confirmation of where it is mandated to improve its rule of law protection, regardless of domestic political will. It is a significant disability for democratic countries involved in conflict and transition not to have the benefit of a corrective communication with an international court, which is well positioned to act a neutral arbitrator with regard to domestically difficult subject matter. The conversation may not always be easy; but a steadfast commitment to remaining in the conversation is crucial.

6.2 Limiting the role of corporate power in politics

There is great antipathy in the country toward the so-called oligarchs for past conduct and for destabilising the political system. What is referred to in this context is the unofficial influence of some of the richest entrepreneurs on the functioning of the State, including the high political offices, the legislative process and law enforcement. The country has reached a stage where it must limit the role of corporate power in politics. However, this can only occur in conjunction with the business elites developing a self-denying culture of corporate responsibility.

The corruption of the rule of law is partly based on the choices that corporate power elites have made to manage the unpredictability of competitive democracy. Some of them have a regrettable tendency to create multiple clients in the state sector (as judges, lawyers, politicians and various law enforcement agents) that denigrate the rule of law rather than supporting the development of long term institutional stability. The alternative scenario in Russia involved competitiveness amongst the business elites being forcibly disbanded, most notably by the attack on Yukos, only for the faction of 'Putin's friends' to prevail. This is not a better option. Ukraine must therefore reach a point where its politicians and most powerful businessmen appreciate the value of losing a case fairly before an independent court, over and above procuring victories through corrupt means.

Limiting the role of corporate power in politics will come from electoral reform, campaign finance reform and media transparency (see Workstream Anti-Corruption Chapter "3. Recommendations with regard to Meta-Level of Political Corruption"). A new role for corporate power must be found in political society that enables it to lobby and advise the state, rather than capture it. Dynamic developments in the international legal scene also provides an inescapable source of advice that procuring corrupt legal services and opacity today will not assist such oligarchs in a global market economy of the future that will increasingly be

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governed by greater financial regulation, mutual legal assistance between states and more exacting extradition procedures and prosecutions based upon extra-territorial criminal conduct.²² There is no longer a prospect of oligarchy-in-one country, and it is for that reason why powerful businessmen in Ukraine should look to reform their practices not simply because it would help the country, but because they may not survive without doing so. They certainly will not be able to diversify and expand their businesses without doing so.

6.3 Conflict in the East

However challenging and complicated, Ukraine must protect its future by complying with the law of armed conflict as a value in its own right but also as a means to the protecting the broader reform process.

The prospect of the conflict becoming 'frozen' will carry with it greater pressure on government to resort to populist measures, with additional risk that some security and military services may be allowed to commit war crimes without effective investigation. All of the major international bodies, including the UN Human Rights Monitoring Mission in Ukraine and the OSCE have warned against this risk; as have the other NGOs operating on the ground. The anti-terrorist measures that have derogated from the European Convention of Human Rights as it applies to the Anti-terrorist zone in the Donbas region allows for 30 day periods of preventative detention for terrorist suspects captured in the area. The detention is ordered by the prosecutor and supervised by a judge by virtue of him being informed of the decision. The judge has little autonomous control over the decision and does not preside over any hearing to investigate the necessity of detention. Based on decisions concerning armed conflict in South East Turkey, this measure is unlikely to be upheld by the European Court of Human Rights.²³ Even the more flexible standards of international humanitarian law that would

²² This Workstream can give that advice based on independent professional experience, but see more generally Anders Åslund *Ukraine – What went wrong and why* (Peterson, 2015), p 32 ('Ukrainian state and civil society have never been as strong in relation to the tycoons as they are right now'). For further analysis of the need and potential to reform the oligarch system, see Taras Kuzio, *Ukraine: Democratization, Corruption and the New Russian Imperialism* (Praeger, 2015), Chapters 9-10; and Taras Kuzio, *Political Culture and Democracy. Ukraine as an Immobile State* (2011) 25 *East European Politics and Societies*, 88-113, 99-102 (analysing by analogy recent Italian history).

²³ *Aksoy v Turkey*, App. No. 21987/93, 18 December 1996, ECtHR ¶¶71-84 that found a 14 day delay to be a disproportionate derogation.

apply to an international armed conflict require proceedings before a review board exercising judicial qualities to take place with the least possible delay.²⁴

Beyond this concern about the legality of the derogation provisions, experience in other conflicts indicate that there is a risk that exceptional measures in armed conflict will migrate into civilian law enforcement scenarios (e.g. police investigations of IRA suspects in the 1970s). There is also a risk that in the 'fog of war' unlawful practices will be tolerated. This is not acceptable in law, but it will also undermine an important moral high ground that Ukraine should be in a position to capitalise upon in geo-political terms. As part of that high ground, Ukraine should engage with international monitoring of the conflict, submit itself to rigorous examination of its conduct before the European Court of Human Rights, just as it should not flinch from pursuing rigorous complaints against the Russian state before the Strasbourg Court and the UN bodies. Ukraine should also fulfil its commitment in Article 8 of the EU-Association Agreement to ratify and implement the Rome Statute of the International Criminal Court (ICC) of 1998 and its related instruments.²⁵ As a prelude to ratification the Constitutional Commission has recommended that Article 124 of the Constitution be amended so as to recognise the jurisdiction of the International Criminal Court. The stance is strongly supported by the Venice Commission.²⁶

Of equal importance, is that the thousands of people who have fought for Ukraine's future, as well as those who have been bereaved as a result of the fighting or damaged by the efforts at separatism, will not tolerate the continuation of a justice system that is selective and does not protect their rights. The most powerful means of combatting separatist propaganda will be the introduction of independent judges, police and prosecutors that are committed to the

24 IACHR, *Coard et al. v. United States*, Report No. 109/99 Case 10.951 September 29, 1999, Annual Report ; and *Marab v Israel Defence Force*, HCJ 3239/02 (5 February 2003).

25 Ukraine signed the Rome Statute in January 2000, but is yet to ratify. The issue is dealt with discretely in the Association Agenda (III.2.4). The Rome Statute would expand the extent to which war crimes can be carried out in a non-international armed conflict (see Rome Statute, Art. 8(2) (c-e)).

26 For the latest opinion of the Venice Commission, see European Commission for Democracy Through Law, Preliminary Opinion on Proposed Constitutional Amendments Regarding the Judiciary of Ukraine, 24 July 2015, Opinion No. 803/2015, CDL-PI(2015) 016. The Constitution Commission was convened in 2014. The Workstream was able to meet with several of its members.

safety of the people and not to their coercion, or capacity for bribery. As much as the recommendations contained in this chapter are designed to enhance international investment in the country, the reforms detailed above are highly pertinent to the existential integrity and national security of the country as a whole.

Finally it should be emphasised that the authors of this Report did not encounter, amongst the many lawyers that they met throughout the country, any evidence of a developing balkanisation between ethnic Ukrainian and Russian origin citizens that is sometimes presented in the international and domestic media. On the contrary, they discovered, particularly in the younger generation of lawyers, a disinterest in identity politics and a far greater commitment to kick starting the country as a viable nation in which talent might prosper and just and effective public services might prevail. The Workstream found this to be an important indicator of the promise that lies in store for Ukraine despite its present predicament.

1 Introduction

The modernisation of the Ukrainian economy is an undisputable imperative. But to do things right it is necessary to find the answer to a crucial question - Why? Our answer is this: 'Modernisation for Prosperity'. This phrase was a beacon to us as we prepared the WS Economy chapter to this report. Ludwig Erhard, the father of the economic miracle in the Federal Republic of Germany, argued that prosperity for all and prosperity through competition are inseparably connected. The first postulate identifies the goal, whereas the second indicates the path that leads to it. This same approach constitutes the Ukrainian development strategy that is presented in this chapter. We strongly believe Ukraine can win by following this programme.

The economy is very much like a living organism, ie it has several interconnected parts that react to any change in the surrounding environment. Therefore, every decision made, solution provided, recommendation introduced, piece of legislation passed and idea presented has to be subject to constant evaluation in light of continuously changing external factors. Even in the type of extremely turbulent situation with which Ukraine is now contending more than ever, the indispensable preconditions for prosperity can be identified. As emphasised at the beginning of this report, pace is crucial for the entire modernisation and restructuring process. From an economic point of view, next in line is to stabilise inflation and the currency. Business development and job creation cannot be achieved without stability in the basic economic environment. Creation of such an environment requires an effective dialogue and the participation of all stakeholders in the country. One of the key elements constituting the foundations of the European Union is a dialogue between various interest groups and state authorities. It is justified to say that Ukraine has followed its neighbours' example and introduced adequate legislative measures that theoretically allow social partners to be far more present in the legislative process than is the case in other European countries. Good in theory, wrong in practice. The problem is that the social partners' role should not be limited to a mere presence. Instead, they should actively participate and have an actual impact on the final shape of the bills in order to create a growth-enhancing environment. Regrettably, there is a lack of true dialogue in Ukraine and unfortunately foreign partners (eg the IMF or the EU) fail to provide a good example, limiting their contacts to social partners and focusing on the Ukrainian government. Involvement of the trade unions,

rulings and therefore cannot conduct an unbiased judicial review of new constitutional law. The omission of this quite needless hearing of the constitutional court, can lead, whether intentionally or unintentionally, to a constitution being abrogated completely. This turn of events already happened in the short history of independent Ukraine and brought the former constitution of 1996 back into effect.

The provision creates a constitutional tinder box, which can be ignited if politically desired, constitutional camouflage for a revolution. Quite correctly, the disregard shown a needless procedural provision cannot be a constitutionally sustainable reason justifying the complete or partial abrogation of a constitution or an amendment thereto. The obligation of the constitutional court to participate in the process for amending the constitution has to be abolished completely.

1.3.5 Recommended constitutional amendments

Prevailing constitutional norms	Recommended constitutional norms
Article 159. A draft law on introducing amendments to the Constitution of Ukraine is considered by the Verkhovna Rada of Ukraine upon the availability of an opinion of the Constitutional Court of Ukraine on the conformity of the draft law with the requirements of Articles 157 and 158 of this Constitution.	Article 159. [cancelled]

Explanation

./ = provisions are to be taken over and remain unchanged
 abc = provisions are to be cancelled

2 Reform of the constitutional court

2.1 Fragile independence of the constitutional court

The Ukrainian Constitution establishes the constitutional court and expressly and repeatedly commits itself to the independence of the courts in general and the constitutional court in particular (Articles 126, 149 CU). Yet no state is obliged to establish constitutional jurisdiction. If, however, the state in its sovereignty decides to introduce constitutional jurisdiction, then this step must be seriously intended and cannot be allowed to lead to a kind of masquerading, where the court is nothing more than the extended arm of politics. A situation of this kind is conveyed in practice and by the constitution and simply by any other rules pertaining to constitutional jurisdiction.

Notwithstanding the provisions on the independence of the constitutional court, this institution has gained a reputation of being an obedient political tool. Confidence in the independence and authority of the constitutional court is low. In fact, some decisions can only be understood when the respective political interests are taken into consideration. This characteristic alone indicates serious structural flaws in Ukraine's system of constitutional jurisdiction.

2.2 Pawn in the political game, not a guardian of the constitution

2.2.1 Political influence on the constitutional court

Individual provisions of the Ukrainian constitution allow the executive branch to interfere in the independence of the constitutional court in numerous and sometimes doubtful ways. The dependence of the constitutional judges is further increased by the minimal requirements for their appointment. Besides undermining their authority as constitutional court judges, this low standard

at the reduction of superfluous obstacles to business activity and based on a dialogue with employers' representatives. Further steps should include introducing the concept of a cluster-based economy supported by the creation of Ukraine 'prosperity zones' (industrial parks). The latter will play an important role in the self-perpetuating process of producing innovations and external economies of scale. An essential part of improving Ukraine's innovativeness should be a special programme designed to develop human capital. This strategy of securing prosperity through competitiveness also envisages promoting the implementation of a modern software system for the agricultural sector. All these measures will translate into the greater transparency and efficiency of Ukrainian companies.

The third part of the chapter recognises the importance of ecological issues in Ukraine's economic development strategy. Therefore, a first step to address these issues should involve the establishment of a national fund for environmental protection, which would promote eco-friendly initiatives in the Ukrainian economy. Key elements of the above strategy ought to embrace the improvement of energy efficiency and better use of local energy sources, as well as underpinning the institutional capacity for environmental administration and eco-awareness in society. Additionally, the Ukrainian government should consider the following measures in order to satisfy the sustainable development goals: implementing a system to support renewable energy micro-installations; establishing an energy efficiency fund to integrate efforts to improve energy efficiency in industry and in the construction sector; introducing a new sustainable natural resource policy and a green jobs initiative as well as supporting the idea of sustainable public transport.

Management summary

The measures to mitigate economic issues should receive special attention in this process of designing the package of reform proposals, as these measures directly affect the lives of ordinary people and if mishandled could thwart the entire transformation process. To a certain extent the recent economic downturn is a consequence of the global economic crisis, an imperfect institutional environment, as well as political and military unrest.

The first part of the chapter provides recommendations on setting the stage for robust and sustainable economic growth as well as on enhancing the competitiveness of the Ukrainian economy to allow for job creation. Exchange rate stabilisation by means of introducing a crawling peg regime should be treated as a precondition for an economic recovery alongside the stabilisation of inflation. It has to be stressed that Ukraine has the finest conditions for becoming a key production hub for Europe, having labour cost and geographic location advantages over China and India. Another important issue is to utilise the untapped potential of Ukrainian industry, which in some sectors has already gained recognition on the global market. A significant role in accelerating economic growth should be played by the Business Ombudsman Council, whose prerogatives shall be substantially extended to effectively support the development of the sector of small- and medium-sized enterprises (SME sector). A great opportunity for improving financial inclusion and creating jobs on a massive scale would be a programme of microfinance development. Increasing the competitiveness of Ukraine's economy is inevitably associated with attracting FDI. The leading role in this field will be played by the Plenipotentiary Office for Foreign Investors in Ukraine. This office will not only promote Ukraine as an attractive place to invest, but will also offer far-reaching support for foreign investors in their dealings with the state institutions, preventing their exit due to problems in the day-to-day conduct of business. It is important to recognise the necessity for improving banking sector profitability through a consolidation process. An additional source of economic gains could be generated through the establishment of an agency for the modernisation and development of agriculture.

The second part of the chapter emphasises the importance of making the Ukrainian economy more innovative. First and foremost, Ukraine should create a business-friendly environment by implementing a deregulation process aimed

encourages political obedience and thus runs counter to their duty to judge politics according to the standards of constitutional law and, where required, to revoke political decisions as unconstitutional.

Executive authorities may influence the formation of courts only when appointing judges. In a democracy the power to appoint judges is vested only in state bodies with direct democratic legitimisation. In case of Ukraine these are the president and the parliament (Verkhovna Rada of Ukraine). They have to make personal decisions and be publicly accountable for their decisions. No other kind of state executive authority is entitled to become involved in the formation of the constitutional court or any other court. That is why the procedure of appointment under the current constitution of Ukraine (CU) raises questions. The Congress of Judges has a diverse hybrid structure that does not meet the requirements of either democratic legitimation or the foreseeable formation of attributable responsibility.

2.2.2 European requirements regarding the independence of the constitutional court

Ukraine has received abundant advice on constitutional matters. Along with an undefined number of non-governmental, international and governmental organisations, the Venice Commission, an advisory body of the Council of Europe, should be mentioned first and foremost. Also the European Court of Human Rights applied European standards in several rulings, thereby providing a guideline for Ukraine to get closer to Europe. From the latter the following quotations regarding the constitutional court of Ukraine are cited as examples.

The statements of the European Court of Human Rights as of 9 April 2013 (Volkov v. Ukraine, No. 21722/11, ECHR 2013) on the 'breach of oath' demand new provisions to appoint constitutional judges: 'The applicant contended that there had been interference with his private life as a result of his dismissal from the post of judge of the Supreme Court. That interference had not been lawful, as the grounds for liability for "breach of oath" had been drafted too vaguely; domestic law had not provided for any limitation periods that were applicable to the dismissal proceedings and had thus not provided adequate safeguards against abuse and arbitrariness; moreover, it had not set out an appropriate scale of sanctions for disciplinary liability ensuring its application on a proportionate basis. For those reasons, it had not been compatible with the requirements of the "quality of law".' (§ 163)

Furthermore: 'The Court notes that the text of the judicial oath offered wide discretion in interpreting the offence of "breach of oath".' (§ 174)

'Finally, the most important counterbalance against the inevitable discretion of a disciplinary body in this area would be the availability of an independent and impartial review. However, domestic law did not lay down an appropriate framework for such a review [...].' (§ 184)

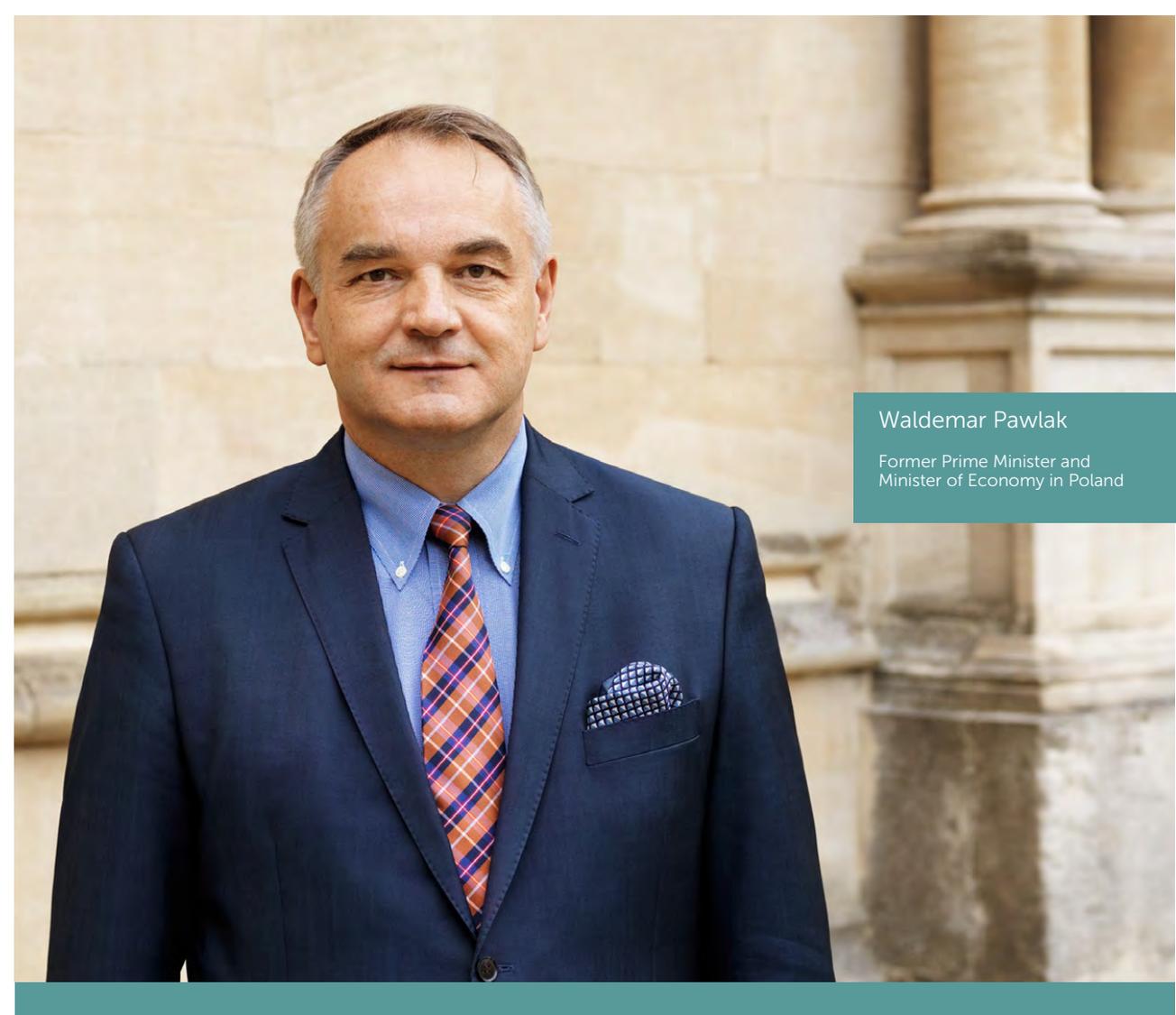
So far the Ukrainian constitution does not fulfil these elementary preconditions to establish independent constitutional court jurisdiction. The procedure of appointing judges is questionable. The constitutional provision regarding the dismissal of judges and various applications of this provision border on scandalous and might have done lasting damage to the reputation of the constitutional court as an institution.

The infamous provision on breaking an oath is a blanket rule that has already led to multiple intrusions on the independence of the constitutional court. As a result the constitutional court is quite a willing instrument for the leading political players. This trait is contrary to the 'independence of court jurisdiction' previously promised by the constitution.

2.3 Recommendations

In respect of these obvious deficiencies the following proposals aimed at strengthening the independence of the constitutional court should be implemented:

- limit the power to appoint constitutional judges to directly democratically elected state bodies;
- have both the president and the parliament appoint each of the nine judges to the constitutional court;
- have the president's appointment confirmed by the parliament;
- establish a qualified majority for the appointment and confirmation of constitutional judges in order to strengthen judicial authority;
- require that six of the eighteen judges have at least five years of work experience in one of the highest courts of Ukraine;
- exclude in principle the possibility of dismissing constitutional judges.



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VIII Economy

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2.3.1 Power to appoint

In a democracy, as Ukraine, according to Articles 1 and 69 UC sees itself being, 'the people are the bearers of sovereignty and the only source of power.' This is equally applicable to judicial power. Judges do not appear out of the blue; they cannot and may not appoint themselves, but they require democratic legitimation. Their judicial position and powers have to be based on the will of the people. Therefore, only the highest among the democratically elected state bodies may appoint constitutional judges. Only these authorities possess the direct and immediate legitimacy of the people. Therefore, the authority of the president and of the parliament to appoint constitutional judges (Article 148 UC) is quite rightly uncontested.

The constitution of Ukraine as currently formulated also stipulates the Congress of Judges as a third authority to appoint constitutional judges. The Congress of Judges is considered a self-governing body of Ukrainian judges. This approach meets with deep concern, because the authorisation of this executive power can hardly be reconciled with democratic principles. Direct democratic legitimation is required for filling positions in the highest state bodies – including the constitutional court – and for exercising fundamental state functions. This legitimation exists in the case of the president and the parliament, but not in the case of the judiciary self-governing Congress of Judges.

The Congress's argumentative recourse is the idea of judicial self-government but this concept cannot override the lack of democratic legitimation. Self-government constitutes a particular form of state administration. It is assigned to self-governing bodies on a legal and democratic basis and within the framework of self-governmental autonomy to the persons concerned for dealing with 'their own matters'. Self-government provides a legal framework of sorts for civic involvement within cities and communities, an autonomous regime for specific, professional or social interest groups with partially transferred jurisdiction. Self-government, however, is always limited to a group's own sphere and can take legally binding decisions only with respect to its own members.

Self-government is therefore fundamentally different from the democratic self-determination of the Ukrainian people. The 'Ukrainian judges' and thus the 'Congress of Judges' are not 'the people', but rather merely a sum of all judges. The people are the sole source of all state power. If the judges are empowered to take decisions on factual circumstances or on the filling of positions, it is not a democracy, but a 'rule of judges', ie the Ukrainian people are subject to a form of undemocratic external rule.

In a democracy, all key political decisions must be vested in the directly democratically elected state bodies. This rule applies in particular to the filling of positions within the institutions of the three branches of government – legislative, executive and judiciary. Non-democratic participation of other organizations and individuals in decisions would likewise be incompatible, eg 'self-government of the police' or 'self-government of the secret service'.

The label 'self-government of judges' does not change anything. Self-government establishes 'partial power of management for an entity in its own matters', but not political decision-making authority with general legal binding force. A non-democratic 'state within the state' must not and cannot exist as long as a state considers itself democratic. Self-government is not a surrogate for democracy; it only involves the respective parties in the practical implementation of democratically agreed law.

Therefore, the Congress of Judges must not possess the right to appoint constitutional judges. It may possibly be vested with the right to submit its proposals on filling one-third of the positions on the constitutional court. This proposal would then have to be voted on by a qualified majority of the parliament. The latter would provide democratic legitimation in this way and assume responsibility for the selection of the individuals (see more in the section below).

2.3.2 Strengthening judicial authority

Constitutional questions in a constitutional state are always questions of power. There is a constant temptation to try to influence the constitutional court politically and a constant challenge to resist this temptation. One strategy for immunizing judges of the constitutional court against such temptations is to strengthen their authority by having them be elected by a qualified majority of the parliament. In a democracy, a simple majority is sufficient in most of cases. However, a qualified majority is politically recommended in cases where officials thus elected are to enjoy special authority. This voting procedure ensures their appointment is the result of a broad cross-party consensus among citizens as reflected in their parliament. This is the case with the appointment of constitutional court judges.

The constitutional judges must make decisions based on the constitution that may have existential importance for the state and that must be accepted in particular by those who oppose the content of the decisions. The necessary willingness to accept even unpleasant, unpopular, or supposedly erroneous court

	Property entails responsibility. Property shall not be used to the detriment of the individual or the society. The State of Ukraine shall ensure the protection of the rights of all holders of property rights and economic operators, and the social orientation of the economy. All the property rights holders shall be equal before the law. [= old Article 13 clause 4]
The right for private property shall be acquired in compliance with the procedure established by law.	./.
Citizens may use the objects of state or communal property in accordance with law in order to satisfy their needs.	./.
No one shall be unlawfully deprived of the right to property. The right to private property shall be inviolable.	./.
The expropriation of private property objects may be applied only as an exception for reasons of social necessity, on the grounds of and in the order established by law, and on terms of advanced and complete compensation of the value of such objects. The expropriation of such objects with subsequent complete compensation of their value shall be permitted only under conditions of martial law or a state of emergency.	./.
Confiscation of property may be applied only pursuant to a court decision, in the cases, to the extent, and in compliance with the procedure established by law.	./.
The use of property shall not prejudice the rights, freedoms, and dignity of citizens, the interests of society or aggravate the environmental situation and the natural qualities of land.	The use of property shall not prejudice the rights, freedoms and dignity of citizens, the interests of society or aggravate the environmental situation and the natural qualities of land as defined by the law of Ukraine.

Explanation

./. = provisions are to be taken over and remain unchanged
abc = provisions are to be cancelled

5.3.3 Recommended constitutional amendments

Prevailing constitutional norms	Recommended constitutional norms
Article 13. The land, its subsoil, atmosphere, water and other natural resources within the territory of Ukraine, natural resources of its continental shelf and of the exclusive (maritime) economic zone shall be the objects of property rights of the Ukrainian people. State authorities and local self-government bodies shall exercise the ownership rights on behalf of the Ukrainian people within the limits determined by this Constitution.	Article 13. [cancelled]
Every citizen shall have the right to utilise the natural objects of the people's property rights in accordance with the law.	[cancelled]
Property entails responsibility. Property shall not be used to the detriment of the individual or the society. The State shall ensure protection of rights of all property rights holders and economic operators, and the social orientation of the economy. All the property rights holders shall be equal before the law.	[cancelled]
Article 14. Land shall be the main national asset and as such shall be under special protection of the State.	Article 14. [cancelled]
The property right for the land shall be guaranteed. This right shall be acquired and realised by citizens, legal persons, and the State exclusively in accordance with the law.	[cancelled]
Article 41. Everyone shall have the right to own, use, or dispose of his property and the results of his intellectual or creative activities.	Article 41. ./.

decisions is higher when the appointment of judges is the result of a cross-party consensus that also includes the opposition. The authority so acquired strengthens the independence of individual judges and of the whole court. It is of secondary importance whether the cross-party qualified majority comprises two-thirds or three-fifths of the members of parliament. The numbers making a quorum can hardly be discussed rationally but must be decided politically; the crucial point here is to require a qualified majority.

If judges are appointed by the president, it is recommended that the additional approval of a simple majority of the parliament be obtained. The authority of these judges is strengthened by the common consensus of both state bodies. Otherwise, they could be classified as 'judges by the grace of the president' with corresponding damage to their authority.

The authority of the court would be strengthened if the parliament were able to reject the candidates of the president by a qualified majority vote. This would also ensure that the presidential appointment of judges is based on a broad political consensus; in any case, the judges do not face wide democratic rejection.

If, however, the political powers that be choose to keep the Congress of Judges vested with the right to appoint constitutional judges, additional approval of those candidates by a qualified majority of the parliament is required, as with presidential appointments.

2.3.3 Strengthening legal quality by requiring selection of at least six judges who previously served on the highest Ukrainian courts

In addition to the qualification requirements of constitutional judges as set forth in Article 148 clause 3 of the UC, it is recommended that a certain number (suggestion: at least one-third) of the constitutional judges be appointed from the group of judges with at least three years of work experience in one of the highest courts in Ukraine. This approach would strengthen the legal competence and judicial authority of judges by engaging judges with longstanding and proven legal experience.

With six judges, chosen from the highest courts of the Ukraine, both the president and the parliament ought each to nominate three candidates from this vital group of judges. If the Congress of Judges continues to be involved in the appointment of constitutional judges, it would similarly be proper to limit its right to making proposals from this circle of persons.

2.3.4 Exclusion of dismissal by the executive power

As a matter of principle, constitutional judges and general judges have to be irremovable for the duration of their term of office. The premature termination of a judge's service can only be executed on the basis of constitutional and legally standardized procedures and well defined arguments. In no event can this decision on dismissal be made by policy-makers. In addition, in all cases any dismissal should become subject to the control of the courts. It is preferable to have the decision on the dismissal of constitutional judges assigned only to the constitutional court itself, excluding the judge concerned.

The current dismissal procedure only partially complies with the principles of rule of law. As per the assessment of the text the grounds for dismissal as stipulated by Article 149 in conjunction with Article 126 UC are partly redundant (death, expiration of term), and partly far too vague, making them largely open to abuse. In particular, the infamous 'breach of oath' has served repeatedly in the past as a welcome vehicle to recall unwanted judges at political will. The multiple cases of such dismissals in the recent history of the constitutional court, in particular as a result of changes in political direction, find no comparisons in the history of other constitutional states. This clearly demonstrates the lack of independence of the constitutional judges in Ukraine. In this context, numerous improvements to the 'Law on the judicial system and the status of judges' and amendments to the 'Law on the High Council of Justice of Ukraine' were adopted in February of this year (2015). The law however does not apply to the constitutional court (Article 3 clause 3). In this respect the provisions on the judicial system still have to be applied in particular to the constitutional court.

The next revision of the constitution should therefore in any case eliminate compulsory dismissal because of the oath breach. It is preferable to have a new wording of the reasons for dismissal of constitutional judges, without regulations on dismissal but rather only provisions on the termination of office of a constitutional judge. The proposed new wording is based on the German example. As an expression of the separation of powers the dismissal of a constitutional judge remains at the sole discretion of the constitutional court itself, which makes a decision by a qualified majority. The fact that this procedure has never been used in Germany emphasises the trust there in constitutional judges and in the stability and independence of the constitutional court.

Under constitutional law, this objective can only be achieved by establishing a clear-cut constitutional legal structure of fundamental property rights. Guaranteeing private property leads structurally to private property remaining in the hands of private owners and to the state or public property becoming an exception that requires separate justification. Therefore the guarantee of private property implies an objective task for government bodies to dispose of property that is not required for particular state needs of citizens. Privatisation underlies the logic of guaranteeing private property. The state must sell excessive property positions within a reasonable time to private owners. This has to be done in accordance with a system of property ownership of land that prevents excessive land ownership, allows competition in the agricultural sphere and thus contributes to the common welfare.

5.3.2 Private property excludes public property

This structure for the constitutional guarantee of private property is incompatible with simultaneously acknowledging public property. Public property is appropriate in a liberal constitution neither as fact nor as concept. It undermines the constitutional decision in favour of the property of individuals and merely conceals the true decision-making powers. Public property evokes irresponsibility and creates an El Dorado for transferring public resources into private pockets.

However, not every piece of state property has to be released as private property. Special public objectives can justify the withdrawal of an asset from private legal ownership and its assignment to a public purpose. The introduction of public property of this kind does not violate as such the guarantee of private property; it should however remain an exception.

Freedom of action in the field of property rights, on the one hand, is necessary to acquire property. As a result of one's own effort, property can be accumulated through 'congealed labour' (Karl Marx), 'coined freedom' (Fyodor Dostoyevsky), the continuation of freedom in the area of the regulation of goods. The effort of the individual serves as the ethical foundation of private property. On the other hand property is a source of responsibility. There is a higher commitment to personal possession: one has to care for it, cultivate it, maintain, secure and manage it, to preserve it for tomorrow and for future generations. For an owner to own something he has acquired he must constantly reacquire it (Johann Wolfgang von Goethe). Property binds a person to an owned object, to which he sacrifices his freedom; it binds a citizen to the state, which has to guarantee the property. Property disciplines and calls for concrete accountability. The guarantee of property gives the citizen a chance to acquire property, to maintain it, to multiply it and to pass it on. Right of disposal – responsibility – liability – this triad alleviates the guarantee of property from an objective with a welfare function: the owner is first servant to his property. Anyone who abolishes or minimises the importance of property deprives the citizens of any incentive for commitment and activity. Property and inheritance motivate and commit the individual to take care of himself and his family. The constitution paves a solid foundation by providing the guarantee of property: the individual can feel confident that his concrete efforts are respected and protected by the legal community. Thus, property not only optimizes the beneficial economic effect but also forms the integral basis of a liberal social order.

Additionally the guarantee of private property provides the individual citizens with a special position of trust and allows them freedom through property. Property is 'potential freedom'. Property gives citizens independence from the state, makes them politically self-aware and provides them with a way of actually exercising their freedom and living their lives responsibly. Above all, property imparts self-protection to the right-holder, a safeguard against the uncertainties of life: acquisition of property is a precaution against risks. This is especially applicable to those who do not own much: protection of property in a welfare state should also be accepted, particularly for the socially disadvantaged. This is because these citizens are primarily in need of this protection for the sake of their freedom. The guarantee of property has to be maintained particularly for them, to preserve and expand freedom, to allow the possibility of social advancement and not to make individual citizens playthings of state and private economic powers.

2.3.5 Recommended constitutional amendments

Prevailing constitutional norms	Recommended constitutional norms
Article 147. The Constitutional Court of Ukraine is the sole body of constitutional jurisdiction in Ukraine.	Article 147. ./.
The Constitutional Court of Ukraine decides on issues of conformity of laws and other legal acts with the Constitution of Ukraine and provides the official interpretation of the Constitution of Ukraine and the laws of Ukraine.	./.
Article 148. The Constitutional Court of Ukraine is composed of eighteen judges of the Constitutional Court of Ukraine.	Article 148. The Constitutional Court of Ukraine is composed of eighteen judges. At least six judges shall have had at least five years of prior work experience in one of the highest courts of Ukraine.
	The judges of the Constitutional Court shall be independent in the exercise of their duties and subject only to the Constitution of Ukraine.
The President of Ukraine, the Verkhovna Rada of Ukraine and the Congress of Judges of Ukraine each appoint six judges to the Constitutional Court of Ukraine.	The President of Ukraine and the Verkhovna Rada of Ukraine each appoint nine judges to the Constitutional Court of Ukraine. The judges appointed by the President of Ukraine are subject to approval by the Verkhovna Rada, which can reject individual judges with a majority of 2/3 of its constitutional composition. The Verkhovna Rada elects the judges to be appointed with a majority of 2/3 of its constitutional composition.
A citizen of Ukraine who has attained the age of forty on the day of appointment has a higher legal education and professional experience of no less than ten years, has resided in Ukraine for the last twenty years, and has command of the state language, may be a judge of the Constitutional Court of Ukraine.	Judges who are citizens of Ukraine and who have attained the age of forty years on the day of appointment are eligible to the Verkhovna Rada and qualified to hold judicial office. They may neither be member of the Verkhovna Rada nor of the state government authorities. When appointed to the position of judge, they shall terminate their employment with such authorities.
A judge of the Constitutional Court of Ukraine is appointed for nine years without the right of appointment to a repeat term.	[cancelled]

The Chairperson of the Constitutional Court of Ukraine is elected by secret ballot only for one three-year term at a special plenary meeting of the Constitutional Court of Ukraine from among the judges of the Constitutional Court of Ukraine.	[cancelled]
Article 149. Judges of the Constitutional Court of Ukraine are subject to the guarantees of independence and immunity and to the grounds for dismissal from office envisaged by Article 126 of this Constitution, and the requirements concerning incompatibility as determined in Article 127, paragraph two of this Constitution.	Article 149. A constitutional judge shall be dismissed from office on expiration of the term for which he was appointed or in case of death or permanent disability. He is entitled to request a dismissal at any time, with such dismissal to be approved by the President of Ukraine.
	The judge of the Constitutional Court shall be provided with working conditions and remuneration corresponding to the rank of his office and the scope of his duties.
	The judges of the Constitutional Court throughout the term of their office shall neither belong to political parties nor trade unions nor take part in any activity incompatible with the principles of independence of courts and judges.
	If a judge of the Constitutional Court is sentenced to imprisonment exceeding 6 months or has committed a serious breach of duty that is incompatible with his service in the office, the Constitutional Court may, by a majority of 2/3 of its statutory composition, authorize the President of Ukraine to dismiss such a judge.
	A judge of the Constitutional Court may not be held criminally liable or deprived of freedom without the prior consent of the Constitutional Court. The judge may neither be detained nor arrested, except if he is caught committing the infringement and the arrest is aimed at ensuring the proper course of proceedings. The arrest shall be immediately reported to the Chairman of the Constitutional Court, who may demand the immediate release of the detained person.

Explanation

./ = provisions are to be taken over and remain unchanged

abc = provisions are to be cancelled

5.3 Recommendations

Considering the above remarks, the Ukrainian constitution must make a basic decision regarding property ownership and thus meet its function of establishing a stable, reliable system of property ownership. In this way it creates constitutionally legal certainty, without neglecting legitimate state interests. Consequently, public property should neither be an object of a constitutional guarantee nor the 'major national asset'. Rather, the guarantee of property should only apply to the property of citizens. With this provision, the constitution makes the citizens practically responsible for their 'own' land by granting them property rights and at the same time creates a basis for them to exercise their freedom responsibly. It thus motivates citizens to engage in economic activity and defines a necessary condition for economic growth of the Ukrainian state, particularly in the agricultural sector.

5.3.1 Property as the foundation for liberty

The constitutional system of property ownership is of fundamental importance to society, to the structure of the economic system and to the status of individuals within the system. The guarantee of private property provides the citizens with independence from the state, assures private and political self-confidence and enables true exercise of constitutionally guaranteed liberties. In other words, the foundation of freedom is property. At the same time, private property ensures a market economy system in correlation with the freedom of the individual to choose an occupation. Private property is a condition for the economic prosperity and stability of society as a whole. By guaranteeing freedom and property, the constitution gives citizens the opportunity to increase their own wealth and to ensure the welfare of their families. Furthermore citizens achieve independence from the state as well as gaining recognition and political self-consciousness. The guarantee of private property enables individual and collective prosperity in which everybody can participate. As the basis and indicator of individual productivity, private property, on the other hand, also permits a legitimate approach to taxation in order to bear the burdens of the larger community. So, the guarantee of property is a requirement for obtaining tax revenues. Therefore, in a fundamental sense, private property constitutes modern statehood as such. A state that does not respect the private property rights of its citizens will have no future.

Protection of property rights is fundamental to the market economy. The moratorium on the sale of agricultural land accompanied the introduction of the Land Code of Ukraine in 2001 and remains in place today. According to the above definition of the land market and observed prohibitions in transitional provisions of the Land Code of Ukraine, the agricultural land market does not fully function in Ukraine today. The factual protection of property in Ukraine desperately needs improvement.

5.2.3 No inadmissibility of public, state property

For the sake of clarification the following should be noted: a constitutional guarantee for private property does not imply the inadmissibility of public, state property. It only means that in a liberal society this state property is not an unquestionable basis for state actions, but instead an exception which requires justification. The state may possess goods, land, buildings and businesses, where legitimate reasons in the interest of the public good outweigh private ownership. This is the case for state institutions, military facilities, financial assets, and in the areas of infrastructure (roads, airports, etc), education (schools, universities, etc) and culture (museums, opera etc) etc.

It is state property only for its own sake that is incompatible with a liberal property system. In addition, the state does not necessarily have to be the owner of the land in order to effectively manage and secure its territory. In the medieval world, political power came with ownership of land. However, the gradual division of private property rights from the sovereign and political power in the 18th century led to apolitical ownership of the land and to political power that did not depend on property. Today the state, as a consequence of its internal sovereignty, does not need private property. The territorial sovereignty of the modern state covers all private property rights. Therefore the state reserves the right to elaborate and enforce a system of property ownership of land that prevents excessive land ownership, allows competition in the agricultural sphere and thus contributes to the common welfare.

3 Individual constitutional complaint

3.1 Missing keystone of the constitution

A constitutional complaint is currently not possible in Ukraine. The establishment of a constitutional complaint appears helpful, given the widespread distrust of the citizens towards the state and its institutions, specifically towards the judiciary. Together with the guarantee of truly independent constitutional jurisdiction the Ukrainian state could, by establishing a constitutional complaint, regain lost trust from the people. A truly independent and professionally staffed constitutional court could become a trustworthy partner for the citizens, thereby becoming an "island of trust".

3.2 Citizens without constitutional participation

In order to strengthen the trust of the state in its citizens (fundamental rights) and in its civilian officials and judges (independence), the introduction of a constitutional complaint is highly recommended. This step would empower citizens to defend their fundamental rights against national measures – legal statutes, administrative acts, judgements – through a complaint before the constitutional court. Simultaneously the constitutional court would be entitled to the role of safeguarding the citizens' fundamental rights and protecting the independence of civilian officials and judges.

The admission requirements of a constitutional complaint would have to be regulated in detail within the statute governing the constitutional court, and would surely put an extra burden on the court. This however could be kept within limits by procedural requirements.

3.3 Recommended constitutional amendments

Prevailing constitutional norms	Recommended constitutional norms
Article 150. The authority of the Constitutional Court of Ukraine comprises:	Article 150. ./.
1) deciding on issues of conformity with the Constitution of Ukraine (constitutionality) of the following: <ul style="list-style-type: none"> laws and other legal acts of the Verkhovna Rada of Ukraine; acts of the President of Ukraine; acts of the Cabinet of Ministers of Ukraine; legal acts of the Verkhovna Rada of the Autonomous Republic of Crimea. 	./.
These issues are considered on the appeals of: the President of Ukraine; no less than forty-five People's Deputies of Ukraine; the Supreme Court of Ukraine; the Authorised Human Rights Representative of the Verkhovna Rada of Ukraine; the Verkhovna Rada of the Autonomous Republic of Crimea;	./.
2) the official interpretation of the Constitution of Ukraine and the laws of Ukraine.	./.
	3) the decision on the constitutionality of the acts proclaimed by the authorities of the legislative, executive or judicial power, following the complaint of any person who claims that an act violates his constitutional rights (the Constitutional complaint). A constitutional complaint shall be admissible only after legal remedies are exhausted. Details are regulated by the law.
On issues envisaged by this Article, the Constitutional Court of Ukraine adopts decisions that are mandatory for execution throughout the territory of Ukraine, that are final and shall not be appealed.	./.

Explanation

./. = provisions are to be taken over and remain unchanged

abc = provisions are to be cancelled

bodies with reliable guidance and legal certainty. It is exactly this function that is not fulfilled by the property provisions of the Ukrainian constitution.

The fact that it is not only the Ukrainian constitution that explicitly gives state property priority over private property does not change this alarming analysis. It has been observed that many countries of Central and Eastern Europe that underwent a tremendous transformation after the 1990s also emphasised the importance and protection of state property in the same way as the Ukraine. This constitutional echo of socialist legal thinking in respect to state property and the corresponding antipathy towards private property cannot remain without negative consequences both legally and economically. Where legal borders between private and state property become indistinct/vague, executive powers are in effect widely freed from any constitutional limitations. This leads to legal uncertainty as a predictable consequence and therefore the constitutional guarantee of private property is understandably widely distrusted. Thus, where there is no trust, the willingness to take responsibility for something, the willingness to invest in a venture can neither develop, nor can it be expected.

The ideology of the primacy of state property is historically understandable. However it is outdated and from a legal standpoint, creates confusion and uncertainty. The concept of public property is an antiquated way of trying to protect the people's fundamental needs. It misjudges the fact that a state does not need ownership of the land to do so. By having sovereignty over the whole territory the state can still control it. Public property is no precondition to protect the interests of the state and the common good, it only inhibits the economy.

5.2.2 Foundation for the economy

The contrariness of public and private property entails an uncertainty for the basic concept of ownership. It also inhibits the economy as a whole, because land, which is not only needed for farming but also for factories, cannot be acquired through ownership. A typical example of the old-fashioned property concept is expressed in the moratorium on the sale of agricultural land that is still in place today. For a period till 1 January 2015, individuals and legal entities could acquire no more than 100 hectares of agricultural land. This legislative order means that a farmer cannot finance his business by collateralizing his land. Despite 74% of all land being 'private', these restrictions make it much more difficult to exercise one of the most fundamental aspects of property rights, the act of freely disposing of property as the owner sees fit.

5.2 No stable foundation for economic prosperity

Wide-spread mistrust in the current system of property ownership and the lack of land reform are both consequences of a necessary and predictable causality: Constitutional law allows a contradictory decision and thus de facto no decision at all on the system of property ownership. The resulting legal uncertainty understandably raises distrust in the failed system of property ownership. This distrust is reinforced by land reform being state-blocked and constantly delayed. Stable fundamental trust in the reliability of the system of property ownership serves as a necessary precondition for economic initiatives, investment and prosperity. Given that fact, the establishment of a straightforward constitutional system of property ownership is of utmost constitutional concern.

5.2.1 Contradictory and inconsistent set of rules

The legal assessment of the Ukrainian constitution regarding property reveals a contradictory and inconsistent set of rules. State property does not merely stand in contrast to private property; it is also awarded a higher rank. Not only is it considered the 'major national asset' constituting 'fundamental national wealth', it also enjoys special state protection. The declaration that ownership of land is declared a reserved domain for the state authorizes the executive power to disable the guarantee of private property under the constitution and to let it come to naught. That is because in case of a conflict between private and state property, the constitution gives preference to state property.

The decision to have both private and public property in the Ukrainian constitution results in legal uncertainty on a constitutional level regarding one of the fundamental questions of the economic system. It also gives the administration vast, legally unstructured and unlimited liberty to develop the system of property ownership. The lack of predictability of state actions on the constitutional level undermines the fundamental condition of a successful economy: trust through legal certainty. However, as things stand, private ownership rights cannot unfold their liberal, economic effects. Consequently, the constitutional guarantee of private property remains largely ineffective. Once again the Ukrainian constitution is in this respect irresolute and counteracts the purpose of a written constitution. A written constitution ought to define basic principles of the state and society that are beyond dispute, in order to provide the citizens as well as state

4 Public service

4.1 The true colours of the state: public service

The Ukrainian constitution does not cover the principles of public service. These are found scattered about in special individual laws. This alone would not be a reason per se for a pertinent constitutional amendment if public service in Ukraine were basically reliable and effective, neutral and impartial, efficient and focused on the main issues. But according to the general assessment exactly these features do not apply.

4.2 Widespread distrust in the integrity of public administration

The constitutional reality in Ukraine in this respect can only be described as disastrous. In sum, corruption is everywhere and the people have no confidence in the integrity of the administration – and waste no more words on it. See the comparable disillusioning descriptions of the Workstream Rule of Law (Lord Macdonald) and Workstream Anti-Corruption (Cimoszewicz).

Furthermore unclear responsibilities obstruct the classification of concrete personal accountability. The administration appears to be a black box, a bottomless pit. The citizens find themselves powerless in the face of those who are actually obligated to serve them ('service'). This administration is 'the face of the state' and the consequences for the reputation of the political system are devastating: people do not believe it, people do not trust it and civil loyalty cannot grow. A legitimacy gap divides politics and society. A state in this situation always teeters on the brink of a revolution. It only requires the right time and place for the appropriate charismatic personalities to explode unrestrained.

4.3 Recommendations

4.3.1 Tasks on many levels

This issue can only be successfully tackled through simultaneous interventions on various levels, e.g. especially through an immediate intervention involving a direct political, administrative fight against corruption (see the report of the Workstream Anti-Corruption) and steps to strengthen the rule of the law (see the report of the Workstream Rule of Law). However, comparable provisions in constitutional or statutory law can only yield long-term effects if applied in actual administrative practice.

Constitutional and statutory law can especially bear in mind the principles of elementary mutual obligations that exist between a state and its servants. It can define standards of behaviour and thus stipulate public responsibilities for the selection of public servants, and similarly for their rights and obligations. It can enforce the obligation to verify requirement criteria and thereby constrain the dangers of corruption. Yet at the same time all subsequent recommended regulations will require legal-practical implementation, in every case, through statute, regulation and single case provision. Nevertheless constitutional legal standardization seems recommendable in the case of Ukraine to make matters of course in a constitutional administration obvious for every citizen and public servant.

4.3.2 Principles of public service

In detail, first of all and above all a regulation regarding the limitation and exclusiveness of public service, including mutual obligations of state and public servant, seems necessary and reasonable. State duties in a narrower sense should only be performed by members of the public service. Only these individuals are 'servants of the state' in a specific sense and as such underlie special rules (see the first paragraph of the appended wording proposal). Adequate structures, adequate procedural rules, mechanisms of control, rewards and sanctions are the factors crucial to safeguarding administrative activity orientated to public interest. The major structural issues below should be reflected and acknowledged in the constitution:

Public servants should be selected according to their expertise and performance. These qualifications are an effective mechanism to prevent any form of nepotism and patronage.

- Until at least 1 January 2016, land shareowners have no right in principle to contribute their shares to the statutory fund of business associations/ commercial companies.
- For the period till 1 January 2015, individuals and legal entities could acquire agricultural land plots with the total area not exceeding 100 hectares. However, this area could be increased in the case of legitimate inheritance of these land plots by citizens and legal entities.

Although a large percentage of agricultural land (74%) is 'private' property, owners are not allowed to exercise their property right at their discretion. The right of land ownership lacks a crucial liberty, i.e. the power to dispose of property freely.

Overall, a strategically and economically important factor of economic development in Ukraine remains, so to speak, 'uncultivated' because of this dysfunctional constitutional situation, literally on hold and uninvested. This potential cornerstone of a functional and economically profitable agricultural sector remains unused and property cannot gain importance as an economic resource. For a country in an economic situation like that of Ukraine, such a dysfunctional system of property ownership is a redundant and expensive luxury.

5.1.3 Distrust in property rights

It is not surprising, in a legally and factually uncertain environment, that there is little trust in the constitutional guarantee of property rights according to numerous polls. Although the constitution of Ukraine guarantees ownership rights, the factual protection of property is caught up in the old categories and is one of the most serious barriers on the road to economic prosperity. This finding is reflected in property protection being rated so poorly. According to the International Property Rights Index (IPRI 2014) the country was rated no. 94 of 97 Global Rank and no. 10 of 10 Regional Rank.

5 Private property

5.1 Unclear status of private property

5.1.1 Deceptive guarantee of private property

According to its current wording the constitution of Ukraine guarantees private property and contains a legal reservation regarding state interventions as well as the guarantee of full compensation for expropriation (Article 41 CU). Up to that point the constitution meets the standards of contemporary protection of property on the constitutional level.

But appearances are deceptive: parallel to the guarantee of private property the constitution also contains fundamental and far-reaching provisions for the protection of state property in Article 13 and 14 CU. This spirit is most prominently reflected in Article 14 CU: 'Land is the major national asset; it is under special state protection.'

5.1.2 Socialist 'state ownership structures'

Fundamental land reform in Ukraine remains long overdue because of the clear decision to consider land the major national asset of Ukraine and fundamental to its wealth. The system of property ownership in fact favours the socialist 'state ownership structures' and has remained largely untouched.

This national importance attributed to Ukrainian land aims at preventing the sell-out of land to and by Ukrainian landowners and foreign investors.

The corresponding laws have to be considered precisely in this respect. At present, the Land Code of Ukraine (2001) is the main legislative act regulating the market for agricultural land. The transitional provisions, which were amended and prolonged several times, read as follows:

- Individuals and legal entities who have land plots in private ownership for family farming and other agricultural production have no right to sell or alienate in any way their land plots and land shares, except by inheritance or withdrawal for public needs till at least 1 January 2016.

Any person exercising a public function and office is obligated to act on behalf of the common good. A civilian office holder must act and decide impartially and focused on the issue regardless of the features of the client involved. To ensure this he has to take an oath of office (see the third paragraph of the appended wording proposal).

Impartiality is primarily safeguarded by making every public servant personally liable for the lawfulness of his acts. Particularly the order given to him by a superior does not discharge him of this liability. An illegal order (instruction) can only bind a public servant if the superior confirms it after remonstrance and takes responsibility for the consequences himself. But in any case a public servant is committed to the constitution, which cannot be overridden by any other state authority. Any order in conflict with the constitution has to be refused. The explicit setting up of statutory obligations is equivalent to creating personal liability (see the fourth paragraph of the appended wording proposal).

The altruistic behaviour of public servants is based on their interest for the common good, which ensures appropriate material indemnification for public servants and their family. Constitutionally guaranteed lifelong indemnification serves as security for their lifelong and extensive duty of loyalty. Public servants are basically not subject to dismissal and enjoy permanent employment status (lifelong employment) as well as an appropriate and sufficient salary. The latter ensures that the public servant does not accept additional income or other benefit from selling his national services as state authority (corruption) to make a decent living. Corruption and other serious neglect of duty will result in immediate and permanent removal from public service. The requirements for entering or leaving public service moreover need to be legally formulated in a clear and specific manner. Recourse to the courts should remain open to public servants in all cases (see the fifth paragraph of the appended wording proposal).

The final recommendation is a constitutional obligation to establish a system of ombudspersons within the administration. Every citizen and civil official can approach an ombudsperson who is sworn to confidentiality, so that the anonymity of the complainant remains protected. They can request intervention in particular cases or express grievances about administration. The ombudsperson is allowed to instruct those responsible to mediate in individual cases or he might develop strategies as a precaution against recurrence, (see the sixth paragraph of the appended wording proposal).

4.3.3 Recommended constitutional amendments

Prevailing constitutional norms	Recommended constitutional norms
Article 118. The composition of local state administrations is formed by heads of local state administrations.	Article 118. [cancelled]
	Article 120.1 [new]. The exercise of sovereign authority on a regular basis shall, as a rule, be entrusted to members of the public service who have a relationship to service and loyalty as defined by the law of Ukraine.
	Every citizen of Ukraine shall be equally eligible for any public position according to his aptitude, qualifications and professional achievements.
	Members of the public service are servants of the entire population, not of a party or any other group. They shall perform their official duties and carry out their tasks professionally and impartially irrespective of the person or party. Every official shall swear the following official oath: 'I swear that I will perform the official duties assigned to me to the best of my knowledge and ability, protect and defend the constitution and the law, conscientiously fulfil my duties and exercise fairness in my dealings with everyone.'
	The public servants shall be personally liable to the full extent for the legality of their official actions. In case of concerns about legality of official matters, a public servant shall promptly raise his concern to his immediate supervisor. Should the official matter be upheld and the official servant still has doubts about its legality, he shall refer it to the next higher supervisor. Should the official matter be approved, the public servant shall have to perform it and is thus exempted from liability. Upon demand, the approval shall follow in written form.

	Public servants shall be appointed for lifetime and provided with appropriate conditions for work and granted remuneration corresponding to the rank of their office and the scope of their duties. Public servants appointed permanently to full-time positions may be involuntarily dismissed, permanently or temporarily suspended, transferred or retired before the expiration of their term of office only for the reasons and in the manner specified by law. Their status shall be protected by judicial procedure.
	An ombudsperson office shall be set up in every administrative unit and all officials and citizens may confidentially address their concerns to it. The ombudspersons shall be assigned by and report solely to the central office responsible for the integrity of the administration, which shall in turn be established by the President of Ukraine and the Verkhovna Rada of Ukraine. The ombudspersons shall be bound by the obligation of secrecy and shall submit proposals relating to the improvement of the integrity of administrative activities.

Explanation

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12 Ukraine 'prosperity zones' (industrial parks)

Ukraine suffers from the low levels of and the poor quality of its foreign direct investment (FDI). The FDI figures presented in the statistics could be deceptive in fact. Often it is just Ukrainian capital being reinvested through tax havens. This type of 'FDI' rarely brings innovation to local communities or significantly improves their prosperity. Moreover, Ukrainian export capabilities are underutilised and hindered by problems with its complicated tax regime (especially VAT reimbursement), customs (corruption) as well as intricate and incoherent legislation.

Ukraine has negative past experiences with special economic zones because they led to large-scale tax fraud. Implementation of the idea should be based on both European and past Ukrainian experiences. The concept of economic zones/industrial parks has actually won wide acceptance and proved to be successful in attracting FDI inflows. Its failure in Ukraine was largely due to poor execution. In the past, political considerations tended to outweigh economic justification for granting special privileges to economic zones in Ukraine. Political lobbyists managed to obtain privileges for certain regions, which on purely economic grounds should not have been granted tax exemptions. Therefore, Ukraine needs other, more efficient and tailor-made legislation for economic zones.

Recommendations

The creation of Ukraine prosperity zones should serve three purposes:

- foster foreign direct investment inflows
- establish business-friendly communities
- reduce export barriers

For these purposes, preferable conditions for investors should be established throughout the country as a whole. Given the negative experiences that Ukraine has had, however, it is recommended that the country take a stepwise and determined approach to give examples showing that it is possible to make investments and run businesses in Ukraine. Afterwards, it might be easier to apply the

employers' organisations and the broader civil society is crucial for the sustainable development of Ukraine.

There is an urgent need to create new jobs, attract FDI and foster domestic investment development. Reaching these objectives requires implementation of concrete measures in the real economy. It cannot be done without the real participation of employers and trade unions and without their impact on the legislative process. Three-time Polish Prime Minister Wincenty Witos said 'Let's decide the big things and the small things will take care of themselves'. This chapter is aimed at recommendations leading to the creation of sound economic policy in Ukraine and favourable conditions for economic development. Ukrainians are now like the Polish in the 1990s, doing very well outside their homeland yet unable to manage dynamic development at home. This is due to a lack of proper order in the country. Unbridled capitalism was appropriate in the Wild West; today countries with well-organised structures are the ones that are successful. Weakness in state institutions and in management culture leads to economic downfall and is an obstacle to development.

Our efforts aim at the development of an entrepreneurial civil society in the ordoliberal fashion (Порядний лібералізм, Poriadnyj liberalism - this is the basis of German economic success) with respect to community, tradition, custom, and last but not least, local diversity. The acknowledgement of a Ukrainian heritage encompassing various influences could be the cornerstone of effective solutions. We believe in taking solutions that worked in other countries and then modifying and developing them in order to fit local conditions and not merely replicating models existing in foreign countries. The latter approach has already proved to be ineffective in Ukrainian reality and has resulted in overregulation that stifles entrepreneurship. If proper conditions are created Ukrainians will be able to manage the development of their economy and create strong and competitive enterprises that will bring jobs and prosperity to the nation.

Ukraine is certainly capable of becoming a powerhouse in the global economy. Any counter-argument could be easily dismissed by recalling the example of Ukrainian agro holdings, which are major players on extremely competitive global markets. The country should therefore promote the global presence of its largest enterprises by opening its economy to international competition. The strong and competitive enterprises will flourish, whereas those lagging behind will inevitably fail. The goal for the Ukrainian economy is to reach its neighbours' productivity levels in all sectors. Under the present circumstances only tough decisions could put Ukraine in the top league of the most productive economies.

Competitive advantages over China or India are clearly visible and must be utilised. Ukraine can become a production hub for Europe as a whole and benefit from its position to grow on the global market as a strong player not only in grain production. There is enormous potential in many sectors: for creating large value-adding processing chains in agriculture and the food sector; for developing the textile and chemistry industries; for modernising traditional heavy industries; for conducting business in the already expanding IT and software industry; and for introducing innovations in the energy sector with huge untapped potential in renewable energy sources both in equipment application and production. The development of the economy's most innovative sectors will bring tangible benefits in the form of high value added production and of new jobs and quality jobs, also for underprivileged groups, without the need for special retirement schemes. This translates into greater tax revenue and reduced social spending.

However, there are obstacles on this path to prosperity, the biggest ones being the mind-set and habits currently prevailing in Ukraine. Rampant corruption is one example. For economic growth it is important not only to combat corruption but also to promote and reward positive behaviours and remove opportunities for illicit ones. 'Opportunity makes a thief'. We are supremely confident that reducing opportunity for illicit behaviour and stimulating positive actions will inevitably yield the desired effects.

The implementation of sound economic policy requires the development of properly functioning administrative infrastructure. The following chapters give examples of what the proper division of policy making and policy implementation can look like, including the need to delegate power to specialised institutions that act independently and effectively in their field. This delegation of power must be in line with a consensus among the leaders of Ukraine that the subsidiary principle is the foundation for the development of modern countries. This issue relates not only to the need for decentralisation (elaborated in other WSs) but also to the transfer of prerogatives and power to specialised agencies, social partners and NGOs.

Only with proper order in the country can one expect sustainable development and successful investments in the Ukrainian economy. However, no economy can flourish without financing; hence making Ukraine bankable again is an extremely important goal. Achieving it is a process that must inevitably begin with the stabilisation of inflation and the currency market, followed by the consolidation and restoration of confidence in the banking sector plus the introduction of a cooperative banking system. The latter should provide support to agriculture

Recommendations

There is no easy and quick solution under these circumstances. However, first and foremost, the Ukrainian government and legislators have to change their attitude towards entrepreneurs. An open and sincere dialogue should constitute the foundation for stimulating entrepreneurship. The key is to enable and encourage entrepreneurs to participate in preparing legislation from the very beginning. Furthermore, it is essential to change the incentive mechanism in existing legislation from repression and control-orientation to a more business-friendly approach. Growth-enhancing changes should not be hindered by the argument that these changes might create new fields for potential corrupt activity. Positive incentives to support law-abiding entrepreneurs must be introduced simultaneously with penalties and punishment for those who abuse the system.

The national review of licences, permits, regulations and reporting obligations should be launched as a continuous process aimed at the consistent reduction of superfluous obstacles to business activity. Transparently conducted deregulation in a dialogue with organised interest groups will stimulate business development in a more competitive and cost-effective manner and generate benefits for the entire economy. The role of state agencies that supervise and control business entities should be limited due to the afore-mentioned review and deregulation processes. The reduction of the excessive number of controlling and licensing institutions will yield savings that will allow the introduction of positive incentives, eg simplified VAT return procedures for honest tax payers. If an entrepreneur is proven to be at fault in performing his tax duties, he will not only be punished but will also lose the afore-mentioned privileges. Illicit behaviour is a matter of habit and every change in people's habits takes time but it is more effective to use positive incentives and social peer pressure rather than to apply penalties. One should not underestimate the impact of social campaigns showing common disparagement of illicit behaviour and promoting honest entrepreneurial spirit.

11 Fostering entrepreneurship

After 25 years of market economy Ukrainians are rediscovering their pre-Soviet entrepreneurial potential. Considering that not more than 40,000 people in the country had any entrepreneurial experience at the beginning of the transformation process, the fact that the current number of private entrepreneurs equals about two million may surprise some people. By way of comparison, Poland managed to preserve a vibrant tradition of private entrepreneurship and land ownership throughout the entire Soviet period. Unfortunately, the persistently deteriorating business environment in Ukraine inhibits this development. The recent political and economic turmoil is just the tip of the iceberg. For years entrepreneurs have had to struggle with incoherent regulations (often mutually contradictory) leading to arbitrary decisions by state clerks and officials that fuelled corruption on a massive scale. It should be noted that corruptive practices fall on fertile ground in Ukraine due to the increasingly cumbersome bureaucracy (ie a growing number of permits, licenses and inspection services).

At first glance Ukraine may seem to have adopted sound a regulatory framework and solutions concerning entrepreneurship issues. Regulations allowing for the quick start-up of a business are already in force; the state runs electronic registries (although access is not free of charge). Moreover, the law allows computer printouts to be treated as official documents, and the framework for simplified tax regulations is quite decent as well. The problem is the constantly changing regulatory environment and the abrupt changes that usually occur without real consultations. The preferable taxation system for SMEs is under constant pressure from the government looking for additional streams of revenue. The number of state agencies with authority to control the SME sector has risen from the original six to twenty. Many preferable regulations are being sheared, thereby changing the conditions of running a business (eg recent cuts in RES support). This regrettable situation is further exacerbated by a poor judiciary system, which fails to tackle business environment problems due to endemic corruption. This is also an explanation for a recently observed tendency of Ukrainian small- and medium-sized entrepreneurs to register their business activities in Poland, whereas the bigger ones have already found their place in tax havens.

and SMEs, especially in rural areas, in order to foster the development of the food processing industry. Under stable economic conditions, Ukrainian competitive advantages would attract FDI inflows. If the government demonstrates a positive attitude, favourable institutional reforms attracting high quality FDI inflows will be implemented and prosperity zones allowing for collaboration in clusters will be created. Ukraine will then finally be able to realise its potential in full. The Polish example shows that just within the zones, US\$ 30 billion have been invested and almost 300,000 new jobs have been created by domestic and foreign investors within just five years. If order is restored in Ukraine, proven solutions can be implemented. Actions have to be taken right away, so that when the armed conflict is brought to an end the country can be prepared to properly absorb the amount of FDI and capital inflows that are now on hold. It is unfortunately an undisputable fact that the military unrest is a serious obstacle, especially to infrastructural investment. Pace and order are two factors most needed by Ukraine right now.

Ukraine should be aware of its position on the political and geographical map and use it as an opportunity that few other countries have. It is important to strike a balance between different spheres of influence, a lesson that Ukraine should have learned well. Its participation in the Asian Infrastructure Investment Bank could be an exceptional opportunity to benefit from being an important part of the New Silk Road. Ukraine should look for new and diversified sources of capital to finance the improvement of its infrastructure. Private-public partnership and investment from commercial institutions and funds are opportunities for the transportation network but also for the energy transportation networks, including gas pipelines and transmission grids. The broader approach to infrastructure is covered by WS EU Integration. There is an urgent need to finance the development of processing plants that can create high value added exports to replace current unprocessed raw material exports, not to mention to generate new jobs. These factors are crucial for Ukraine's prosperity. Particular ideas for possible investments and actions are listed to a limited extent as Light-house Projects in each Workstream chapter of this report.

Unconventional times require unconventional actions. Ukraine needs smart solutions to make a leap forward on a path to stability and prosperity. Traditional actions did not bring the expected results and the present unstable situation, even the military conflict, cannot be an excuse. Instead, all this must be an incentive for a dynamic approach to reforms and new solutions. We believe that Ukraine can emerge as a winner in this process. We are therefore presenting guidelines and instructions on the assumption that there is a profound openness to reform in society at large. Whether Ukraine follows these ideas is a choice for the Ukrainians to make.

2 Preconditions for development

Stable inflation and currency exchange rates are preconditions for development in all sectors of the Ukrainian economy. Rampant inflation brings instability to the banking sector and takes a significant toll on the entire economy. To a certain extent, skyrocketing inflation was brought on by exogenous or one-off events (currency depreciation and liberalisation of energy prices as a result of the recently implemented energy sector reform, a factor that will have an effect in the years ahead). The other factors responsible for an abrupt upsurge in prices are linked to Ukrainian foreign trade policy (imposition of import tax, which makes the imported goods more expensive and increases inflationary pressures). This import tax is one of the key economic issues calling for immediate concern, as it hurts investment, impairs economic growth and thus needs to be addressed as soon as possible. Driving down inflation to a level well below 20 % p.a. (and bringing it down to a single-digit figure as a long-term goal) is essential for restoring fundamentals for economic growth. The reduction of inflation and the stabilisation of the currency are two most important and urgent issues for the Ukrainian economy. Possible solutions for the problem of rampant inflation are extensively covered in the Workstream Tax and Finance.

The Ukrainian currency was kept strong in relation to the US dollar, interrupted at times by rapid devaluations. In light of Ukraine's current difficult situation and the low currency reserves, this approach is a very risky one. However, it should be noted that the problems with stabilising the hryvnia exchange rate are, to some extent, a consequence of severe economic depression, which has been further exacerbated by political and military unrest. As a result, the Ukrainian currency has been under pressure from speculators and foreign investors, who then leave Ukraine. Besides that, Ukrainians 'think in dollars' and all bigger amounts are always measured and counted in US dollars. Society must reclaim trust in its own currency. Right now, the US dollar is the only asset in which the Ukrainians put their trust and in which they put their savings for safety's sake. Converting any amount of UAH that does not need to be spent right away for day-to-day needs to US dollars is considered the best way to protect one's assets.

The destabilisation of the UAH has severe consequences. Firstly, inflation soared due to a substantial drop in the value of the UAH (about 75% on a year-to-year basis). Secondly, the National Bank of Ukraine has already sold a large part of its foreign-exchange reserves in an effort to stabilise the exchange rate. In fact, in

od of time. This approach would enhance the effectiveness of the lending process, as well as increase the farmers' trust in their relations with the agency. These loan officers should also serve as trained advisers in agricultural techniques.

Furthermore, the agency should:

- offer training to farmers to raise their financial literacy and their awareness of the food production process;
- offer advice on any issues associated with running the agro-business (eg paying taxes, applying for bureaucratic approvals etc).
- To ensure that the agency performs its duties, it should be required to publish its set goals for a given year and at the end of that year it should reveal the results of its work and assess its own performance. A report of this kind should also be presented to the parliament and the prime minister for approval.

The above changes will introduce transparency and emphasise productivity improvement in the effectiveness of the agency and of the producers of agricultural products. The creation of an agency directly focused on aiding farmers can help to build up the spirit of change and boost the farmers' own efforts towards modernisation and prosperity, which is of the utmost importance. Moreover, on the road to European Union membership, Ukraine will start to reap the benefit of EU support for agriculture. Having an agency for the implementation and supervision of such support funds is an absolute must once this point is reached. It could be highly advantageous for Ukraine to have prior experience and an institutional network to handle this task. A prerequisite for the entire modernisation process in agriculture is a sound land reform policy and a gradual and sustainable liberalisation of the land market.

Introduction of direct payments should be considered as it is reported that around 15 million hectares are being cultivated in the shadow market and state land registries are often incomplete. Direct payment can be a measure that can remedy these problems.

Ukraine needs a diverse approach to its farms and farmers that corresponds with local conditions. It seems reasonable to divide farms into three groups: small farms up to 1,000 ha, medium-sized farms up to 10,000 ha and large farms over 10,000 ha. The large farms and agro holdings should be treated like ordinary enterprises in the national economy and be subject to all corresponding regulations. No state subsidies or special relief seem to be necessary. For medium-sized farms, it is advisable to provide support for modernisation and to adopt full accounting procedures for tax burden calculation. Small farms should enjoy the highest level of state support. A simple tax based on the number of hectares of farmland and related to grain price should be appropriate for this group. The agency should be a good tool for the introduction of new policies and for supporting farmers during this transition period. The agency could also be responsible for the state-owned agrarian companies. Their restructuring and privatisation could be a source of income to the agency in the initial phase.

Through its local divisions such an agency should:

- supervise land trade (to facilitate land market development);
- offer preferential loans for land accumulation/purchases and any other activities aimed at increasing farm sizes (eg non-cultivated land) and productivity;
- mitigate excessive risk (and the cost) of financing small farms. It should be considered whether farmers could receive fertilisers (or funds to increase mechanisation of their farms). Then, the farmers could pay back their debts by selling their crops at previously set prices, ie there would be no risk of farmers buying the fertiliser for instance for USD 100 and then not being able to afford to pay back the loan due to a slump in crop prices. If they paid back in food products, they would not incur any risk of adverse price changes, which would markedly improve the stability of the cost basis of their business. Moreover, such an approach should also reduce the shadow economy, as swap trade transactions are executed with a state agency;
- the loan officers designated to collaborate with farmers should know the financial situation of their clients and cooperate with them for a long peri-

January 2015 the reserves amounted to a mere USD 6.4 billion, a ten-year low. It should be stressed that the shortage of foreign-exchange reserves mentioned above must be taken into consideration before the decision can be made on selecting the appropriate exchange rate regime.

Recommendations

As the Polish experience in this area seems to offer a good example to follow, Ukraine should introduce a crawling peg exchange rate regime. Ukraine's foreign-exchange reserves have been substantially reduced by the central bank's recent interventions whereas the crawling peg regime would require fewer reserves to defend the exchange rate than a fixed exchange rate would. The crawling peg exchange rate should be pegged to a currency basket which, in turn, should be composed of the currencies of Ukraine's largest trade partners (i.e. EUR, USD, CNY, PLN, RUB). The key issue here is to set the appropriate level of the UAH so that it will be stable in the short term and then gradually be adjusted to changes in the macroeconomic environment. The current free float regime, although in line with IMF, leaves the UAH helpless in case of any shock, which could lead to further rapid devaluation of the UAH.

The introduction of the crawling peg would create more efficient pricing in trade transactions and simultaneously foster foreign trade volume growth as well as ease speculation pressure on the Ukrainian currency. Moreover, this strategy should also provide the Ukrainian currency with some stability and with the time required to implement other growth-encouraging reforms. The next step should be to switch from the crawling peg to a crawling band, where the bands are gradually widened, as was done in Poland. However, the range of bands should be determined based on future macroeconomic performance and on the overall situation on financial markets. Finally, a full free floating exchange rate should be introduced.

Some research on fixing the exact level of the exchange rate is required, because the exchange rate should meet the following three conditions:

- 1) it should not be artificially low or high, so that it will be relatively stable in the short term to demonstrate that it is playing its role in stabilising foreign trade growth;
- 2) it should not be too low, so it will not fuel inflation and impede servicing external debt;

3) when implementing the solution, the relevant policy mix (both fiscal and monetary policies) should be carefully considered, as it will influence the effectiveness of the crawling peg strategy.

The economy of the Ukraine and the government sector suffer from the large shadow economy. The current macroeconomic instability – especially high inflation – may contribute to a further expansion of the informal sector and thereby undermine the basis for economic recovery and macroeconomic stability. Important measures to combat the shadow economy would be to simplify the overly complex tax legislation; comprehensively reform the tax administration (autonomy of tax administration, consolidation of tax administration and administration of social security, performance-based management, internal and external audit etc); and take consistent action against fraud and tax avoidance. In addition it seems essential to introduce powerful incentives for people to pay their contributions into the social security system. This objective can be achieved by introducing strict links between contributions to and benefits from social security.

approach is to give preference in plot acquisition to active farmers living in the vicinity of the land being sold. This rule in a transition period should apply to both privatised state land and plots already in private hands. This would give a chance for the sustainable development of small- and medium-sized farms and for the preparation of rapid land privatisation. The sector of small- and medium-sized farms struggles with insufficient funding, low investment and problems with land accumulation (caused by both institutional issues associated with the land trade market and a shortage of financial resources). It also suffers from a low level of expertise, which results in low margins on the products produced by these farmers. These factors, combined with volatile prices for agricultural products, translate into high uncertainty and hamper further potential for increased profitability. This sector could especially benefit from the development of a cooperative banking sector that would provide financing in local markets. In the case of large farming operations; funding and production profitability do not constitute a significant obstacle, but these farms should increase their productivity, which is now lower than the European average. One way to do so would be to promote animal farming. Ukrainian farms often focus on crops that result in low value added production. The simplest addition to the value adding chain would be farm livestock that can be fed field crops. This must be combined with support for meat processing facilities. Such an approach would create new jobs, as livestock production and processing are more labour intensive than field production, and it could also elevate the quality of food products in Ukraine. Ukraine stands a good chance of not only providing high quality food to its own citizens in place of frozen meat imports but also of becoming an exporter to global markets in this sector.

To achieve the set goals, one should consider establishing a state agency with local divisions that is responsible for implementing agrarian policies (ie 'Agency for the Modernisation and Development of Agriculture'), in cooperation with the two institutions Ministry of Agrarian Policy and Food of Ukraine. While the government and the ministries should focus on management at policy level, the agency would be responsible for implementation and day-to-day action in the agricultural sector.

This agency's activities should focus on the following issues: governance of state-owned land and management of its gradual privatisation as well as leasing with priority given to farmers living in the close vicinity of the plots being sold or leased; support of farmers in the form of monetary, educational and professional help; promotion of Ukrainian agriculture product and incorporation of the sector into value added chains.

10 Modernisation and development of Ukrainian agriculture

Even though Ukraine is a world leader in crop exports, its agricultural sector still has vast potential for growth. Currently, internal consumption of agriculture products amounts to 40% of production and exports to 60% with only 35% of production capacities being used. This means there is potential for easily tripling the production volume and decreasing internal consumption to less than 20%. Meanwhile, state support of agriculture is at a low level (by comparison, the Common Agriculture Policy of the EU was 46.7% of its budget).

Ukrainian agriculture suffers from low productivity as a consequence of land ownership policy, insufficient investment (which, in turn, translates into both relatively low production mechanisation and use of fertilizers) and the inadequate level of qualifications of most farmers. Apart from huge agro holdings that use state-of-the-art management systems and look globally competitive, the potential for the export of food products by Ukrainian farmers is still underutilised and lies in small- and medium-sized farms.

An inadequate framework of land ownership rights hinders any farming concentration process. There are hardly any support programmes for agriculture and most small farms (up to 1,000 ha) have trouble accessing financing. Focusing on extensive big-area farming leads to production that adds little value. Food processing facilities need to be developed to create an entire value chain for the Ukrainian agricultural sector. On the other hand the Ukrainian Ministry of Agriculture directly supervises 600 business entities (state companies), only 42 of which are profitable. Initiatives for the rapid privatisation of state-owned land are gaining popularity among the ruling powers in Ukraine.

Recommendations

The aim is to enhance the productivity of the agricultural sector, create value adding production chains and increase exports and income from this sector. A precondition to meeting these objectives is land reform that ensures the sustainable introduction of a free market for farmland. The general idea behind this

3 New jobs – basis of economic growth

One characteristic feature of the Ukrainian labour market is the relatively low level of the official unemployment rate. According to the World Bank, it fluctuates around 10%, a level comparable to that of Poland. However, the difference between the two countries is the size of the shadow economy. Bloomberg estimates it at nearly 60% of GDP in Ukraine, whereas in Poland the size of the informal economy is one-third that size. This fact clearly shows that the recent economic and political turmoil has been absorbed by the shadow economy. This problem is further exacerbated by the recent military unrest in the eastern Ukraine, which has resulted in massive redundancies and a reallocation of people out of the military conflict areas. Official statistics on these matters cannot be considered reliable. Therefore, this situation calls for immediate action.

Recommendation

Job creation should be treated as a precondition for the successful transformation of the Ukrainian economy and for further growth prospects. This is essential for several reasons. Firstly, greater numbers of jobs mean a smaller informal economy and less pressure on young people in the labour force to emigrate. Secondly, only people satisfied with their career perspectives (or the development of their own enterprises) will contribute to the successful implementation of economic recovery and support further institutional reforms. These people constitute the middle class, which favours both economic and political stability. This dual stability, in turn, translates into greater support for reforms. It is worth mentioning that consumer spending by the middle class is what typically fuels economic growth (or sustains it during economic downturns). Thirdly, as mentioned earlier, Ukraine's economy is suffering from large employment in the shadow economy, where jobs are typically characterised by low productivity.

The question of how to create new jobs must be supplemented by the question of how to encourage a transfer of jobs from the shadow economy to the formal economy, as this process should be treated as one of the main drivers of economic growth.

Firstly, Ukraine should consider lowering the level of pension contributions, which currently exceeds 30% and is paid mainly by employers, who are actually creating jobs. Lowering the tax wedge is therefore crucial in fighting the shadow economy in Ukraine. If pension contributions in Ukraine were decreased by 10 % (ie by one-third), the number of people working in the formal economy (ie new officially registered jobs) would increase by about 18 %. If this growth were combined with active promotion and successful nationwide implementation of the concept of micro-financing, about 2 million additional jobs could be created. This job growth would also mean a 10 % increase in personal income tax revenues and in the stream of social contributions.

Secondly, it is essential to create a more business-friendly environment. The vast majority of micro-, small- and medium-sized firms, which create the most jobs, is struggling with the hostile institutional environment. Therefore, the reforms for strengthening the position of these firms in their dealings with state institutions (as proposed in this report, eg the section on 'SME support and protection') are crucial to fostering job creation in Ukraine. Public administration agencies should encourage, not hinder, the conduct of business. The interests of employers should be put first. This role could well be played by a national office representing the Ukrainian business community (parallel to an ombudsman office for the business community), provided it were equipped with tools to protect the firms effectively from any unjustified actions by state institutions (eg suspending the execution of the collection of tax liabilities). It is necessary that the voice of the business community in general and of small- and medium-sized entrepreneurs in particular be heard by Ukrainian lawmakers as they prepare new bills. It should be stressed that when a favourable environment for SME sector development is provided about two million jobs should emerge in the formal economy.

Thirdly, it should be noted that not only the quantity but also the quality of jobs matter. Supporting the development of clusters, prosperity zones and green jobs is an optimal way of creating 300,000–350,000 innovative and highly productive jobs. Furthermore, many people outside of the formal economy and labour market (eg older people, the unemployed) could be suited for the jobs mentioned. This would not only provide a solution for several essential problems of the Ukrainian economy (low productivity, low level of innovation, high energy inefficiency) but also discourage people from taking advantage of early retirement and social benefits.

Finally, it is crucial to promote a dialogue between employers, unions and government in order to create a stable and flexible business-institutional envi-

ment. One means to support this could be to create a state-owned institution aimed at fostering merger and acquisition activities in the sector, ie a 'Banking Sector Consolidation Fund'. Due to formidable troubles in the banking system and limited opportunities for raising capital (as well as the eroded capital base of Ukrainian banks), the government should consider two possible options on how to manage the fund:

1) encourage foreign investors - ie international financial institutions (IFIs) - to increase their engagement in foreign-owned banks. Their know-how and well-established reputation on financial markets would be beneficial, translating into lower funding costs for them and/or;

2) consolidate state-owned banks through governmental capital assistance. This participation should be the result of a preceding profound analysis by the government, with the ultimate target being increased fair market competition, bank management based on economic principles and a cap on the size of these institutions. The final result would be future relief for the government budget.

As the government would have a stake in the merged banks, the risk of political interference in managing the banking sector could arise. In order to mitigate that risk, the government would receive preferred stocks and would become a non-voting shareholder. After the banking sector is stabilized and brought under control, banks would be merged and cost synergies achieved; the government would have to sell the shares for a pre-determined price.

9 Consolidation of the banking sector

Ukraine has a relatively fragmented banking sector. The top five banks in the banking sector accounted for about 43% of total assets in 2015 whereas the average ratio for Central and Eastern Europe was about 69%. The number of banking institutions, even after a series of recent bankruptcies, is high and the level of equity at small banks is relatively low. As a consequence, these banks have low resilience to market turmoil and currency risks. The trust of the citizens in the banking sector is unsatisfactory, and the whole sector cannot play its desired role in the modernisation and development of the national economy.

It is essential to note that the banking sector enjoys high economies of scale. In the case of Ukrainian banks, this is difficult to achieve due to the high fragmentation of the sector. Ukrainian banks therefore have limited capacity for substantially improving their profitability and stability. This further exacerbates problems with access to and less effective risk management. Moreover, the short open currency positions of many banks make them vulnerable to destabilisation as a result of further UAH depreciation, which in turn is, to a large extent, a consequence of speculation on the currency. Banks, especially smaller banks, do not have access to sufficient UAH resources apart from clients' deposits. Moreover, empirical evidence shows that growing numbers of people are trying to transfer their savings out of the Ukrainian system. Whereas these transfers used to be undertaken for amounts exceeding one million US dollars, now it is getting popular to seek safe havens for deposits of USD 100,000-200,000. It is important to boost the sector's resilience to all the afore-mentioned risks. In accordance with the IMF programme, the NBU has taken actions such as forcing banks to report their ownership structure but most importantly closing insolvent banks, thereby fostering the re-dimensioning of the banking sector. Like all Ukrainian enterprises, the banks are also subject to frequent (almost constant) controls from authorities; the moment they finish evaluating one issue they begin with the next.

Recommendations

In order to make Ukraine bankable again a strong and consolidated banking sector with strong and stable entities implementing international best practices

ronment. Only then can business thrive and will companies be more inclined to create new jobs. Such an environment was created in Poland, and when the dialogue between the three parties was established no strikes and social unrest took place. However, when a lack of goodwill disturbed this collaboration, the country was shattered by massive strikes which brought no benefit.

Such an approach could lower the administrative cost of running a business and therefore increase employment. Examples of the many possible changes that are in line with this philosophy would include increasing the flexibility of the labour market (ie by introducing flexible working hours, reducing redundancy benefits), reducing bankruptcy costs, introducing procedures to enhance systemic and customer bankruptcy. All these proposals encourage employers to expand their business by reducing the risk and costs of failure. In a favourable and stable environment, employers reinvest their profits and create new jobs; in a hostile one, they transfer the profits abroad. Therefore the importance of social dialogue and strong participation in law making is not to be underestimated.

Moreover, a business-oriented institutional environment is a precondition for attracting foreign investors. As noted elsewhere in this report, more business in the Ukrainian prosperity zones and in the cluster-based economy could provide a sound basis for improving the attractiveness of Ukraine for investors. Ukraine is suffering from outdated technology because of the low level of innovation of the Ukrainian economy (innovative products account for only 3 % of the total in Ukraine whereas that figure is 40 % in the EU). Therefore, the inflow of FDI would spur innovation and create high-value-adding jobs, which is essential to fostering economic growth and discouraging people from leaving the labour market before the official retirement age. Moreover, with Ukraine's highly skilled and abundant labour force, the country still has untapped potential for becoming a production and outsourcing hub for foreign companies. Poland was in quite a similar situation in the 1990s. Today, business outsourcing centres there employ twice as many people as the mining industry (which was one of Poland's key industries until recently).

In conclusion, the reforms just described worked in Poland, enabling it to catch up successfully with Western Europe. After 25 years of transformation, Poland's labour productivity has more than doubled and now amounts to 71 % of Germany's. Ukraine has an immense chance to follow the Polish example and repeat its economic success. However, it should be noted that the creation of over four million new jobs will require a holistic approach to the solutions proposed in this report and an effective dialogue between the government, employers and employees.

4 Ukraine – a key European production hub

Ukraine has been plagued by a series of political upheavals and economic woes in recent years. As a result of unfavourable economic conditions, foreign capital has abandoned the country. With mass redundancies looming, the Ukrainian authorities should focus on export-oriented and labour-intensive industries and offer an attractive business environment for foreign investors. By doing so, they could challenge those countries viewed as major destinations for outsourcing and subcontracting businesses (mainly India and China). However, in order to successfully confront its many challenges, pursue prosperity and take full advantage of its great economic potential Ukraine must implement an overarching development strategy that would set the country's future course. The ultimate success of an economic recovery lies with the state's ability to pursue this strategy.

Potential for growth

Ukraine has a significant supply of unused labour as a result of relatively high unemployment. According to the World Bank database, this unused pool accounted for 9.3 % of the total labour force in Ukraine whereas in China and India it was 4.6 % and 3.6 %, respectively. Additionally, Ukraine has a low rate of participation in the labour force, which in 2013 amounted to 59.4 % (calculated as a share of the total population above age 15) (in China this figure was 71.3 %). Therefore, there would be considerable room for improvement in labour productivity if Ukraine managed to transfer the workforce from its shadow economy (where labour productivity is lower) to the formal economy (with its relatively capital-intensive modes of production).

Furthermore, capital intensity in Ukraine is scarce (gross fixed capital formation in 2013 was 17.5% according to the World Bank database) compared to China and India (46% and 30%, respectively). Its marginal productivity will therefore be much greater than in capital-abundant countries when capital flows into Ukraine. This constitutes a great opportunity for foreign investors on the lookout for large profits and for Ukraine itself. Another notable aspect is that labour costs, which were already relatively low, will decrease even further due to the significant depreciation of the hryvnia.

Therefore, in order to make such an institution as efficient and flexible as possible it is essential to concentrate all FDI matters under one roof. The aim is to create one centralised institution (but with local offices in created 'prosperity zones') that will:

- promote Ukraine as an attractive place to invest capital;
- offer information and advice on potential investment opportunities in Ukraine (regular research reports about industries);
- cooperate with the government officials on behalf of foreign investors on the land ownership issues, infrastructure provisions etc. Also while acting as an intermediary preventing corruptive demands;
- coordinate collaboration of foreign firms with Ukrainian universities and other enterprises to facilitate spill-over effects (achievable by setting up new business parks together with departments of Ukrainian universities focusing on local business parks as the main specialisation while providing assistance in areas such as innovation, R&D, mechanics, ceramics etc);
- offer advice on tackling legal issues (consulting activities);
- protect foreign investors from institutional problems in Ukraine, as this institution will be equipped with special rights, eg suspending the collection of contested tax liabilities.

The important change in the role of this institution compared to the ones previously operating is that its equally important goal is to attract investment and provide support and active protection to investors of all sizes (especially smaller ones) in their day-to-day problems following the establishment of their facilities on Ukrainian territory.

8 Attracting FDI inflows and preventing FDI outflows

The quality and volume of FDI inflows to Ukraine leave a lot to be desired, eg according to the World Bank data FDI net inflow in 2014 was equal to 0.64% of GDP (in Hungary it was 6.2%; in Slovenia, 3%; in Czech Republic, 2.4%; in the Slovak Republic, 0.9%). The country that invests the most in Ukraine is Cyprus. This is the case because Ukrainian investors often set up their headquarters in tax havens (eg in the Cherkasy region about 60% of FDI comes from Belize) while still operating in Ukraine. In fact it is this round-tripping of domestic capital (UA -> tax haven -> UA) which inflates official FDI numbers and does not bring new technology, expertise and innovation. When considering investment opportunities, foreign investors are discouraged by institutional problems in Ukraine (eg the large shadow economy, corruption, the quality of the institutional framework, the poor implementation and enforcement of often well designed rules and regulations), not to mention problems with advanced payment of taxes and corruption in VAT reimbursement. Ukraine needs the 'prosperity zones' (industrial parks) to increase its export potential. Ukrainian exports are falling and even after the reduction of trade barriers the effects are not enough to reverse the negative trend. This shows that there is an urgent need to increase the quality and competitiveness of export goods.

Recommendations

In order to make Ukraine more attractive for investment and to attract FDI inflows an office for foreign investors should be established in Ukraine ('Plenipotentiary Office for Foreign Investors in Ukraine', hereafter 'POFIU'). This institution would act on behalf of foreign investors in their dealings with tax authorities and other state institutions and would have some special privileges (eg suspension of the collection of the imposed taxes in connection with contentious issues or any other adverse actions of state officials). It would also take over the duties of the Invest in Ukraine Agency, thereby combining two institutions with a similar agenda, so as to avoid confusion for foreign investors.

Since the Ukrainian economy is mostly based on labour-intensive industries, labour compensation as a percentage of GDP is relatively high, at 66.3 % in 2014, whereas for China and India it was 40.2 % and 50.1 %, respectively. This implies that there is significant potential for productivity growth as a result of augmented capital investment (hence, capital per employee will rise). Considering that the workforce is highly skilled (according to the World Bank, tertiary school enrolment in 2013 stood at 79% in Ukraine, 30% in China and 25% in India) it is insufficient fixed capital investment that is causing human capital underutilisation.

Another competitive advantage over the two countries mentioned is Ukraine's attractive location. Since it is situated at a relatively short distance from other European countries it has a cost advantage over India and China in the form of much lower transportation costs. Additionally, Ukraine's geographical location creates an opportunity to benefit from major trade routes intersecting on its territory. Moreover, Ukrainian territory, particularly the richness of its soil and natural resources, still present great opportunities for economic growth and for the creation of new jobs, not only in rural areas but also in urban processing facilities all over the country .

Recommendations

Ukraine stands a good chance of successfully challenging leading countries in becoming a subcontracting hub. In support of this goal we recommend a set of Lighthouse Projects aimed at improving the overall attractiveness of Ukraine as an investment location and making its economy more competitive. These efforts include tackling rampant inflation and the much depreciated currency. These two issues are the biggest maladies in the Ukrainian economy currently impeding its recuperation. Mechanisms to reinforce incentives for foreign investors should be introduced. Providing professional advice and support for foreign investors who are considering setting up business in Ukraine is important but even more important is support for their further uninterrupted operation. Moreover, the promotion of prosperity zones aimed at providing an extraordinarily favourable environment for business development should be treated as one of the top priorities for the Ukrainian government. Further strengthening a business-friendly environment will undoubtedly depend on successfully combating endemic corruption, as well as offering greater support to the SME sector (small and medium-sized enterprises).

It is essential to take actions aimed at increasing the regional and international role of Ukraine as a centre of production and business process outsourcing. These efforts would enable Ukraine to compete successfully with the world's top emerging economies (China, India) and also create quality jobs in more advanced sectors of production and services. In support of this goal, the above actions should be complemented by an intensive political campaign from the EU countries to present Ukraine as a promising major European economy with stellar perspectives, especially considering its geographical location (between Europe and the Middle East). The strong and clear message to foreign investors must be that the 'Ukrainian tide' is just beginning to turn and it is the best possible moment to join in. One of the elements of this strategy might be the upcoming massive privatisation process in strategic economic sectors. A good example of a high-potential sector is agriculture, as its production capacity could increase at least three-fold within a relatively short period of time, with a perspective of increasing exports of food products to the EU and the entire world. Agroholdings and small- and medium-sized farms have an equally important role to play in this process.

However, the role of the state in promoting microfinance should not be omitted. Therefore, it is highly recommended that the state provide strong support in developing banking structures in rural areas (through cooperative banking). Ukrainian policymakers should also build a clear and flexible regulatory framework. These efforts would include streamlining procedures, creating easy-to-follow laws (Ukraine could greatly benefit from Romanian experience in developing fine legislative initiatives in this field) and supporting complimentary services (ie infrastructure, health etc). It is essential to remember the basic idea of micro-finance – this instrument has to be very simple yet effective. Another good example to follow for Ukraine is Bosnia and Herzegovina, where over 200,000 people (5% of the entire population) benefited from micro-credit loans. A similar commitment in Ukraine (proportional to population size) would result in about two million additional jobs. Assuming the value of the credit amounted to about USD 1,500, the total investment in the micro-credit scheme would be USD 3 billion. To show the potential of microfinance development in Ukraine it suffices to say that currently only about 160,000 people are receiving it. Ukraine's current macroeconomic situation is very favourable for the development of this type of financing for two reasons. Firstly, due to exchange rate depreciation, microfinance institutions could potentially lend out more financial resources and therefore service a broader range of financial needs (if the loans are denominated in eg USD or EUR), which is of vital importance in the wake of economic recession. Secondly, the high inflation rate would facilitate repayment of these loans. The state should also provide basic trainings for aspiring entrepreneurs to provide them with financial knowledge. These efforts would have an even broader impact on alleviating poverty and would gradually strengthen the middle class, which in turn would further stimulate economic recovery in the long term.

7 Microfinance – still untapped opportunity for job creation in Ukraine

Since Ukraine is a former Soviet Republic, Ukrainians (specifically those above 40 years old) often do not have adequate experience with the idea of taking out a credit or loan or running their own business. Factors such as limited access to capital, the high costs of credit, an unstable institutional environment, the underperforming banking industry, a high share of the population being excluded from traditional financial services (especially those living in the rural areas) significantly affect the development of business opportunities for small entrepreneurs. Political unrest and mass unemployment exacerbate the situation even further. Therefore, small entrepreneurs have to rely on their relatives or informal networks to borrow the necessary funds; also excessively high interest rates prevent them from becoming financial self-sufficient and from pursuing most attractive investments.

Recommendations

In order to reduce the above maladies Ukraine should encourage the development of microfinance services to offer small business loans to cover budget expenses, inventory, etc. Since these services are offered to mostly low-income families and small-time entrepreneurs, microfinance would become a useful tool for fighting the shadow economy, which is one of the major economic problems Ukraine is facing at the moment. Furthermore, it is very unlikely that many of the older people who lost their jobs as a result of the recent crisis and military unrest will find another one in the formal economy. For these individuals, micro-loans may be the only chance to avoid entering the shadow economy. Furthermore, the idea of microfinance strengthens social bonds. People with no collateral, virtually no financial knowledge, receive money and they do their best to repay the loan. They were trusted, so they, in turn, trust other people. Besides improving social bonds, microfinance facilitates the development of civil society and creates a sound basis for further economic reforms. It is also worth adding that this instrument is a very secure one for investors (the repayment rate of micro-credits in India varies between 95% and 98%) while offering a high average rate of return (about 30%).

5 Drivers of economic growth and innovation – the defence, space and aerospace industries

Due to political turmoil Ukraine had to terminate long-time cooperation agreements with Russia, thereby putting its own manufacturers in the extremely unfavourable position of losing their main customer. Moreover, key component parts cannot be imported, which brought many of these companies to the verge of collapse. This applies not only to arms manufacturers but also to the space and aerospace industries. At the same time, many parts and components are produced and used in both countries.

The Ukrainian defence industry plays a crucial role in the economic well-being of the biggest cities in the south-east of the country. These are also the regions where pro-Russian feelings are found in a significant share of the population, thus making them even more vulnerable to political unrest (apart from that, such a political mishap would cause mass unemployment, exert fiscal pressures on the state budget etc). Equally, the advantage of having a technologically independent aviation and space industry should not to be forfeited.

Recommendations

Given Ukraine's relatively low production costs and the fact that it already has an adequately skilled workforce, an industrial base and operational capacity; Ukraine stands a good chance of becoming a subcontracting hub for the global defence industry. Such a hub likewise has immense potential for becoming the main source of innovation and cutting-edge technologies penetrating other sectors of the economy (and also bolstering Ukraine's defence capabilities) and a key driver of economic recovery. Even though the numbers of employees may be lower compared to more traditional industries, the impact of technology and innovation transfer to high value added industries must not be underestimated. In order to realise its full potential, these industries must undergo a major transformation but first and foremost, Ukrainian authorities should focus on preventing their collapse by developing commercial ties with Western countries (as a substitute for the ties with Russian industry). The current situation is leading to a loss of qualified workers who cannot endure lasting salary cuts and are leaving Ukrainian industry for good.

In order to remedy these maladies Ukraine should:

- pursue the rapid expansion of its range in the field of life extension and overhaul of the legacy military equipment inventories as well as its up-grade services for countries using armaments and equipment produced in the USSR;
- intensify efforts to find new customers for indigenous suppliers to keep production and employment up;
- increase production of new component parts and subassemblies, otherwise try to import them from the EU countries (specifically EU member states from Eastern European since they share the same Soviet technical legacy) or boost initial efforts to pursue import-substitution (initially, these measures are being carried out by Ukroboronprom companies);
- intensify efforts aimed at parallel production based on military research and production (wherever it could be carried out relatively soon without incurring excessive cost) to civilian applications.

The industrial companies require a major modernisation process to enable them to compete on the global arms market. To achieve this, huge funds and changes in the institutional framework are required. Therefore in the longer-term Ukraine should:

- establish joint ventures and industrial partnerships and create attractive investment opportunities in the field of high-tech and science-intensive technologies. Such undertakings are already taking place (mostly in cooperation with Poland but also with Sweden, France etc). It is advised to earmark additional funds for R&D institutes (most preferably working in close cooperation with arms and aviation producers) to lay solid foundations for modern and competitive industry focusing on the most advanced cutting-edge technologies;
- continue the modernisation and retooling of their production lines in order to make Ukrainian planes and military equipment as compatible as possible with Western standards;
- consolidate industry and put emphasis on raising cost-effectiveness through the privatisation of Ukrainian defence companies. Moreover, increase the proposed scale of the privatisation process (last year's government plan to privatise 15% of the defence industry is far too low - eg Russia aims at increasing the role of private capital in its defence industry up to 30%, whereas in the US private investors own 60% of this industry);

tion with the election procedure and financing sources elevates the dialogue to the level of international institutions (foreign financing of ombudsman activity) and of the Ukrainian government, which seems to somehow leave Ukrainian business representative organisations somewhere off on the side. Social economic dialogue in Ukraine is not effective, and any measure that would remedy this situation could be considered. Ukrainian social dialogue should again be under the auspices and responsibility of the president of Ukraine. Taking into account the positive impact of the creation of the ombudsman office relative to the amount spent, Ukraine should easily be able to introduce wider and more far-reaching steps to business, especially SMEs, for support and protection by taking the above described actions.

business interests is worth supporting. Unfortunately this council has only an advisory role. It seems that its prerogatives should be strengthened and the election procedure amended to give more influence to the representatives of Ukrainian business. The external origin and financing of this council also seems to be an obstacle to full incorporation of this institution into Ukrainian reality. One should consider either incorporating the office into the Ukrainian system altogether or creating a parallel institution on the Ukrainian side that would closely cooperate with the Business Ombudsmen Council and have real prerogatives to act on behalf of businesspeople in Ukraine.

Currently the council can consider individual claims of entrepreneurs and make recommendations to the authorities. It or its parallel office should also be equipped with tools to protect the firms from any kind of unjustified adverse actions on the part of state institutions. The right to act as an auxiliary legal advisor/representative in and out of the courtroom in disputes between businesses and state institutions or to suspend the collection of tax liabilities, which could otherwise jeopardise a company's liquidity and potentially lead to its bankruptcy, should also fall within its remit. Such prerogatives were given to a similar institution in neighbouring countries.

The second strengthened field of activity should entail representing the interests of the business sector in its relations with the government and law-makers and include the right to recommend to the president that he veto controversial bills, failing which, that their *vacatio legis* be extended if the decision to do so is backed by joint statements from the trade unions and the employers' federations.

The last issue to consider when discussing the idea of the ombudsman or preferably the newly created parallel office head is their method of election and the criteria that the person appointed to the post must meet. As the rules now stand, the appointee should be a well-known and respected authority with deep legal knowledge unquestionable reputation. While giving all due credit to the current ombudsman's excellent job, a Ukrainian citizen should follow in his footsteps or better yet, be named as head of a newly established Ukrainian counterpart office and cooperate as such with the ombudsman. Secondly, the candidate should be elected solely by the representatives of the employers' federations and trade unions, as he acts on their behalf. Such a candidate would just need to be approved by the prime minister, so that his ability to cooperate effectively with the government would not be questioned at the very beginning of his term. This would be one of the foundations of effective social dialogue. The current situa-

- intensify cooperation with arms industries from Eastern Europe (this is becoming an increasingly important part of Ukraine's defence strategy considering the compatible industrial base and shared Soviet heritage) in the field of new weapon types designed and produced by companies located there for the purposes of their own armed forces. This should be a relatively cheap way of replacing inherited arms and furnishing the NATO eastern flank with new and modern weapons and also facilitate technology transfer.

6 SME support and protection

An obstacle to entrepreneurial development in Ukraine is the lack of actual business traditions. This is one of the vestiges from communist times. For the nearly 50 years of the centrally planned economy there were virtually no opportunities for launching private enterprises whereas for the last 20 years, the unfavourable economic conditions and the unstable political environment precluded business activity equally effectively. At the beginning of the transformation process, business awareness was scant and entrepreneurial expertise was scarce. Empirical evidence suggests that in the early 1990s fewer than 40,000 people in Ukraine possessed an adequate understanding of the workings of the market economy. In recent years there have been positive actions towards SMEs, such as the introduction of a simplified tax system. However, until now both the state and state institutions have not created a sufficiently business-friendly environment. Unclear regulations and vast numbers of permits and licences make entrepreneurs vulnerable to arbitrary interpretations of the law by state officials, which, given the ubiquitous corruption and impartiality of the Ukrainian judicial system, effectively thwarts the rise of robust entrepreneurship. What is more, Ukrainian companies suffer from a shortage of professional management (Ukraine was ranked 115th out of 144 countries classified in this category by the World Economic Forum in the Global Competitiveness Report in 2014; Poland took 71st place). Therefore, starting a business in Ukraine seems to be a rather daunting task.

What further cripples SME sector development in Ukraine is an unjustified expansion of state agencies that are entitled to control and supervise business activity. That is why the contribution of the SME sector to GDP in 2014 in Ukraine was disappointingly low and ranged between 20% and 25%, whereas for Poland it was ca 50%. A much wider discrepancy was observed in the micro business segment, where that figure in 2014 was merely 2% - 3%, whereas for Poland it was 14%. This implies that the smaller the firm's size the more obstacles it has to overcome to operate successfully.

New approach to development

There is no denying that Ukraine has already made much progress towards creating a more business-friendly environment. The procedures associated

with starting a firm have been substantially reduced. Small enterprises as well as private entrepreneurs enjoy a simplified taxation system, which has won wide acceptance over the last two years (the number of SMEs and citizens taking advantage of the system has grown two-and-half-fold and one-and-half-fold, respectively). Moreover, a suitable regulatory framework facilitating a quick start of a business already exists. However, the current system of simple division into 'small' and 'others' does not take into account the specific situation of medium-sized enterprises, which can be drivers of development. The state runs electronic state registries which, although not free of charge, provide computer printouts that are recognised as official documents. The problem lies in the propensity of state officials to engage in corrupt or otherwise arbitrary practices and in the weakness of entrepreneurs to protect themselves against those shortcomings. According to the Doing Business 2015 report it takes just 21 days to register a business activity (interestingly, it is less than for some of the EU states; eg in Poland it takes 30 days). All these efforts have been widely acknowledged – indeed, Ukraine went up 16 places between 2014 and 2015. Nonetheless, it occupies the 96th position (out of 189), which indicates that there is still plenty of work to do.

Recommendations

There is a need to introduce a more detailed approach to enterprises of different sizes. The sector requires the separate administrative recognition of the specifics of micro-, small- and medium-sized companies and an adjustment of regulations respectively. The current regulations apply well to micro companies and private entrepreneurs. Small- and medium-sized enterprises should be clearly separated from large companies (and even further subdivided among themselves) and specific regulations on taxation, accounting and licensing must apply respectively. Such a detailed approach to supporting and protecting SMEs requires strong backing within official structures that could lead the process of implementation-related dialogue between government and representatives of the sector. A good base for this endeavour is the recent creation of the Business Ombudsman Council in Ukraine, although it is recommended that Ukraine develop an office of its own that is not directly related to any international institutions.

It is essential to reinforce Ukraine's business resilience to the arbitrariness of state bureaucracy. The ombudsman's focus on simplifying regulation, improving the business environment, and preventing corruption and the abuse of private

Further increases in taxes or social security contributions would further undermine public sentiment and trigger a further increase in the share of the shadow economy/salaries. In the short term the public sector could contribute to stabilising inflation by refraining from increases in public charges and fees. This implies that significant and permanent cuts in general government expenditures must be undertaken immediately.

Privatisation needs proper strategic planning

As a medium- or long-term measure, budget revenues can be increased by a well-prepared privatisation process. There is an ongoing discussion in Ukraine whether further companies are to be privatised or not. On the one hand the sales revenues are urgently needed and further restructuring of the companies may need additional investments. On the other hand lessons learned from prior privatisations clearly show that proper preparation is crucial to a successful privatisation process.

The first step is to determine which companies are to be privatised and up to what percent or which companies and percentage stakes should remain in the ownership of the public sector. For this purpose, a set of criteria that responds to current and future (foreseeable) developments has to be drawn up. Based on this set of criteria, the existing investment portfolio of the public sector is to be evaluated. Since not all companies are to be privatised at once, a procedural model, which takes into account current market trends, has to be determined. This is an urgent task in policy prioritisation. Implementation should then be assigned to a privatisation agency.

To avoid any accusations of corruption the privatisation process should be as transparent as possible and follow best practices⁵ from abroad. As seen in other privatisation processes clustering makes sense (eg infrastructure clusters, research and development clusters). Nowadays it appears that a holistic privatisation of infrastructure companies cannot be recommended, because there is no functioning market for infrastructure in general. It is uneconomical to simultaneously establish entities that compete with each other (eg road systems). It is much more advisable to have the government build infrastructure but then leave its business operation, in particular, to private sector know-how.

⁵ The German Treuhandanstalt (Trust Agency) was founded in 1990. Entrusted with the role of privatising the East German economy after reunification, the agency supported the process of changing the economic system from the formerly planned economy to a democratic market economy.

good examples from the zones to the entire economy, as the positive effects and gains would be more visible in comparison with the needed costs. In this approach, tax incentives are not of key importance. The most important thing is to show that investments can flourish once favourable conditions are created, a positive attitude towards investors is achieved and corruptive behaviour is eradicated. Tax incentives within the zone could be limited to their being relieved of customs duties and indirect taxes (VAT and excises). Tax breaks should be avoided (except VAT tax breaks). Goods produced by indigenous manufacturers that enter the zone should be treated as exports (from the domestic economy), and hence can be zero-rated for VAT and entitled to customs duty drawback when appropriate. Goods could be exported from the zone to other countries without prompting tax liabilities. Consequently, when goods enter the domestic economy from the zone, they should be treated as imports, and therefore be subject to the suitable customs duties, VAT and excises. As special zones are regarded as extra-territorial, the perimeters should be under protection and effective customs control. Prosperity zones may offer advantages over duty drawbacks or suspension mechanisms for exporters, including simplified administration procedures, exemption from customs duty on equipment used in the zone, and infrastructure provision. Foreign companies may be attracted by an opportunity to store imported goods under beneficial customs arrangements. Deferral of tax payments until the goods are actually used or re-exported can benefit companies' cash flows. Non-tax incentives such as public grants for developing human capital and R&D are of vital importance for companies, as is the potential promotion of land and building facilities at below-market rates by the authorities. In the end it is necessary to achieve a point at which accumulated investment and job creation incentives are at a better level in Ukraine than in neighbouring countries. In global competition only smart approaches can guarantee success.

Advanced infrastructure is often in place, in particular in these zones that can be conveniently located in or close to ports or airports; otherwise, it should be the duty of the state to provide the necessary infrastructure for the zones without any burdens on investors or any investment tax. Privileges of prosperity zones are to be granted to less-developed regions for financial equalisation rather than to well-developed ones. The exception should be the zones focusing on business process outsourcing. They can be located near strong academic centres to provide jobs for higher education graduates.

The main goal of prosperity zone formation is to spur regional development through the establishment of business-friendly enclaves that allow FDI inflows and support export-oriented production.

The provision of direct-tax incentives is very much a second-best option, and should be executed in a manner that reduces the risk of economic distortions and at the same time is in line with the WTO agreements. In order to minimise these distortions, the number of direct tax incentives might be limited to those directly related to the amount of investment, with accelerated depreciation or tax credits included as part of the standard tax code and not taking the form of tax holidays.

Ukraine's budget is jeopardised by the large shadow economy and the high level of tax evasion. Different sources say up to 60% of GDP is produced by the shadow economy, others say about 50%. What is certain is that the shadow economy undermines the revenue side of the budget. Other factors to be mentioned are an inefficient, costly social security system and an inefficient system of state procurement.

Tax revenues provide for around 80% of the total revenues of the consolidated budget of Ukraine. However, the portion of taxes decreased over 2012-2015 from 80.9% to 72.6% (the latter figure is based on the actual execution of the budget for 1Q 2015, so the annual figure may be larger). The decrease in tax revenues may be seen also in absolute figures: while in 2012 taxes provided for UAH 360.6 bn, in 2014 this figure amounted only to UAH 343.6 bn, ie 4.7% less.

1.2 Priority recommendation: emergency package for Ukraine

The situation described above clearly shows the urgent need for a turnaround. The vicious circle of budget deficit, high inflation, lack of stability of the currency and economic decline has to be stopped and reversed. Budget reorganisation provides the basis for the whole reform process. It is to be seen as a first step for a coherent overall approach. People need to know how the turnaround of the country will be achieved and what their contribution should be. The necessary transformation process will take time and resources. While restructuring is unavoidable, appropriate steps must be taken to counteract social hardship.

Strict discipline in fiscal policy

Budget consolidation is the key factor necessary to achieve macroeconomic stability in Ukraine. The share of public spending as a percent of GDP is very high, mirroring an inefficient public sector. It is quite unclear what public funds are really used for in Ukraine. While the proposed budget is announced in public, there are no state of the art controls to determine how effectively tax revenues are used. A comptroller's office does report to the Rada, but the level of transparency on the use of public funds needs urgent improvement, especially in the form of audit units with an effective toolset to counter corruption and embezzlement.

This devaluation triggered a rise of inflation, and in 2014 the inflation rate skyrocketed to 24.9%. However, up to July 2015, inflation reached 39.3% as compared to 2014. Therefore, figures in UAH that relate to 2014 and 2015 are not comparable to those of previous years due to distortions caused by inflation. Compared to the inflation rate in 2014 of 24.9%, the dynamics of GDP and revenues in the consolidated state budget in real terms should be decreasing, which shows the critical situation in the Ukrainian economy and public finance. The dynamic deficit in the state budget is worth mentioning. It has steadily increased, from 3.6% in 2012 to almost 5.5% today. Exploding inflation is detrimental to prospects for the economic development of Ukraine. It erodes consumer and investor confidence, leads to a further expansion of the already large shadow economy in Ukraine and puts a heavy burden on public finances. The current inflation trend in Ukraine is caused by the sharp rise in consumer prices for energy and the sharp devaluation of Ukrainian currency.

Taxes collected in Ukraine are spent to finance government functions, as is shown in Table 2. The Ministry of Finance of Ukraine, the State Treasury of Ukraine and the State Committee on Statistics issue annual and intermediate reports to show how the budget revenues are spent.

Table 2: Expenses of the state budget of Ukraine in 2013-2014⁴

Expenses	2013	2014		
	UAH m	%	UAH m	%
Public administration	50 101	12.42	65 826	15.3
Army and defence	14 843	3.679	27 363	6.36
Public order, security and judiciary	39 191	9.71	44 619	10.37
Economic activity	41 299	10.24	34 411	7.8
Protection of the environment	4 595	1.139	2 597	0.6
Housing and municipal services	97	0.024	112	0.26
Healthcare	12 880	3.192	10 581	2.46
Intellectual and physical development	5 112	1.267	4 872	1.13
Education	30 943	7.67	28 678	6.66
Social protection and security	88 547	21.95	80 558	18.72
Funds transferred to the budgets at other levels	115 848	28.71	130 601	30.36
Total	403 456	100%	430 218	100%

⁴ Conclusions on execution of the State Budget of Ukraine for 2014, (Accounting Chamber of Ukraine), accessed at <http://www.ac-rada.gov.ua/control/main/uk/publish/category/412>

13 A cluster-based economy

The Ukrainian economy has many promising opportunities to pursue. Even though it has a backlog of work to do that has been mounting up for the past 25 years; a well-educated labour force and established independent industries constitute a solid foundation for future development. Currently, Ukraine lacks effective collaboration between the state, academic institutions and business, yet it could greatly benefit from promoting the transfer of foreign innovation and technology.

The first step towards enhancing cluster formation in Ukraine should be to establish technological parks and incubators for entrepreneurs, offering various forms of tax relief, free accounting services, access to IT technologies as well as favourable conditions for mutual cooperation that would facilitate technology and idea transfer between small- and medium-sized innovative enterprises. Well-developed industrial areas of the country would serve as a good basis for this purpose.

It would be easy to situate cohesive clusters in Ukraine geographically given the relatively small number of cities separated by extensive agricultural areas. Existing organisations, especially R&D institutes, could provide initial support on early stages of cluster meetings and introduce companies to the cluster.

The formation of branch clusters may be considered a priority in the implementation of cluster initiatives. The cluster provides a framework for cooperation and collaboration among branch leaders across the country. It should produce competitive advantages for attracting and retaining business ideas, for hiring and growing a skilled labour force, for increasing productivity, for developing innovations and for improving conditions in manufacturing.

Recommendations

Technological parks should be located in proximity to regions offering the most attractive conditions for entrepreneurs. However, the key criterion for selecting a location for such parks should be the willingness of the innovative business to compete (ie it does not necessarily have to be the biggest of agglomerations).

The main sectors to consider for the creation of clusters include:

- Energy and ecology
- IT, software and programming
- Agriculture
- Textile and chemicals
- Steel/heavy industry

Since Ukraine has a highly skilled and educated workforce it could serve other European countries as an outsourcing hub for the IT and innovation sectors. Ukraine has a well-developed software sector and therefore should take advantage of it and cooperate in this field with larger economies to benefit from its technological advantage.

The purpose of clusters is to increase the competitiveness of enterprises situated within them. The success of clusters is based on competition, focus on leaders and support from state authorities. The implementation of cluster initiatives will hinge on government support as a determining factor in the formation of a national cluster policy.

The ultimate success of implementing a cluster-based economy depends on an ability to develop high quality management structure. Competent and skilful managers are crucial for cluster organisations since they provide professional services to cluster firms, support companies entering global markets, boost their innovation capacity and sharpen their competitiveness.

1 Part I Tax

1.1 Introduction

The catastrophic state of Ukraine's economic situation is sufficiently known: a 7.5%¹ drop in economic growth in the current year, a loss of value for the local currency (-34.3%² to the US dollar since the beginning of 2015), a decrease in fiscal revenue, a budget deficit amounting to 5.5% of GDP, public and private debt amounting to 115%³ of GDP, melted monetary reserves and a significant decrease in FDI.

Table 1: Selected macroeconomic figures for Ukraine for 2012-2015

	2012	2013	2014	2015
GDP of Ukraine (nominal value, UAH m) ¹	1 404 669	1 465 198	1 566 728	367 577*
GDP of Ukraine (nominal value, USD m) ²	176 308	182 026	130 908	17 409.6*
GDP of Ukraine per capita (UAH) ³	30 928.6	32 028.5	36 495.9	n/a
Consolidated budget revenues ⁴	445 525	442 789	456 067	198 409**
Budget revenues in GDP, in % ⁵	30.5	29.4	29.1	n/a
Deficit of consolidated state budget, in % ⁶	-3.5	-4.2	-4.6	-5.5 (forecast)
Price index of consumer goods and services, % ⁷	99.8	100.5	124.9	139.9***

* In 1Q 2015

** Based on actual data as at 1 April 2015

*** January – July 2015

As may be seen from Table 1 above, Ukraine GDP in UAH displays a positive growth dynamic: in 2014 GDP in current prices rose 7.7% against 2013. However, this is not the case if these figures are indicated in US dollars: in 2014 the GDP in US dollars was 28.1% less than in 2013. This is a result of the huge devaluation of the Ukrainian hryvnia against major foreign currencies such as the US dollar and the euro.

1 Ukraine Data, (The World Bank, 2015), accessed at <http://data.worldbank.org/country/ukraine>

2 Національний банк України, accessed at <http://bank.gov.ua>

3 How to stabilise Ukraine, (The Vienna Institute for international economic studies, 2015)

The tax administration is one of the most corrupt bodies in Ukraine. Hence, suggestions for restructuring it, also aligned with WS Anti-Corruption and WS Rule of Law, are made. Furthermore, a web-based IT system will increase the effectiveness and efficiency of tax collection and moreover suppress corruption in tax administration. Fiscal decentralisation will in the long run improve the tax culture. Disclosing money flows of both the state and businesses will discourage tax evasion and reduce corrupt state expenditures.

Although, Ukraine needs some immediate changes in regulations, all short-term measures have to be followed and accompanied by long-term educational measures. This must be done, on the one hand, for tax officials so that they perform their responsibilities correctly both in a formal sense and a moral sense. On the other hand, this must be done for the individual tax payer to make people aware of the benefits of public services to the society (eg infrastructure, health system, education). In a fiscally healthy country, these services are provided by the state and not by a parallel system, also called corruption.

The second part of the chapter comprises recommendations for the financial market in general, with special emphasis on the banking sector in order to stabilise the financial system and hence to increase the urgently needed credibility.

Credibility is the basis for all banking transactions. Without it, sustainable long-term business relations are not feasible. In order to establish this credibility for the financial markets, the National Bank of Ukraine (NBU) has to ensure – in a first step – stable conditions for banks by providing regulations for adequate capitalisation, as well as overall consolidation of the banking sector. Concurrently, other important measures for cleaning up the corrupt and oligarchic system are to eliminate money laundering and related lending practices and ensure the transparency of bank ownership structures.

Because financial markets are not working properly, Ukrainian companies, especially small and medium enterprises (SMEs), can hardly finance their business activities. As the SME sector is undeveloped in Ukraine, special emphasis should be placed on SME financing. This sector could be the backbone of the Ukrainian economy in the future. Furthermore, spurring growth in the cooperative sector will foster SME development.

The final result of current and also future measures should be a well-functioning financial market with a healthy and transparent banking sector at its centrepiece. This also implies that bank dominance over non-bank financial institutions has to be reduced. The latter must be fostered by the government in the short and medium term until the Ukrainian economy is stabilised. The increase of importance of non-bank financial institutions will in the long run contribute to a sound structure of the financial market.

14 Human capital development

There are two major areas of human capital development in which Ukraine underperforms and which therefore require close attention. Firstly, due to the paucity of economic development and a lack of prospects, Ukraine is affected by a brain drain. Secondly, Ukrainian students do not have sufficient exposure to the practical side of their fields of study. As a consequence, there is an inadequate level of practical knowledge among graduating students. This is also caused by the lack of incentives available for graduates from potential employers. Employers dismiss work experience students acquired during their studies as irrelevant in job recruitment due to ubiquitous corruption.

Deep economic recession coupled with political unrest will most likely aggravate the outflow of the most talented and skilled members of workforce. Due to financial constraints, many gifted students do not get into the top international universities despite having the requisite intellectual capabilities. Their spirits are very low. Even among the generation raised in an independent Ukraine, the current 30-year-olds, it is common practice to start at a child's birth to save money for his or her foreign education and life abroad without a prospect of return. This is further driven by the worsening situation on the job market, which is likely to continue until the results of the restructuring actions become visible.

Recommendations

The first part of the solution to the problems discussed above is based on three pillars:

- 1) the establishment of a Ukrainian presidential scholarship (ie 'President of Ukraine Scholarship') to cover university fees and accommodation costs for Ukrainian students who are offered a place at the top 20 universities in the world. The President of Ukraine Scholarships will be granted by an independent committee based on the offers received by students from the top 20 world universities. This type of application procedure has several advantages (eg short assessment process and simplicity), but first and foremost – it would be a very transparent one, where decisions are based solely on academic credentials as proved by an admission offer from a top university. Successful applicants would be obliged to return to Ukraine and work there for at least five years after completing their studies. If they fail to do so, they would have to pay back the equivalent value of the scholarship along with a significant penalty;

2) special employment programme for the scholarship winners (and those who did not participate in the scheme, but who graduated from foreign universities and intend to continue their professional career in Ukraine);

3) an obligation for Ukrainian public university students to sign an agreement under which they receive scholarships and in return have to work in Ukraine for at least five years after their graduation. This requirement would not apply to students willing to complete short-term internships outside of Ukraine or working in government administration in foreign countries (eg in Ukrainian embassies or foreign divisions of UA registered companies).

The second part of the solution envisages an introduction of flexible university curriculum enabling students to combine studying with gaining practical knowledge in the field of their interest. Additionally, in order to increase their exposure to the practical side of their future profession, one should consider the possibility of creating a long-term internship programme for students (most preferably five to six months long) related to their field of studies. This would be an optional way for students to complete their studies instead of preparing a master's thesis or doing the equivalent of a full semester of studying. Another way to remedy this problem could be to oblige foreign investors who intend to set up their businesses in business parks or prosperity zones (which at the same time cooperate with university research institutes) to offer internships or collaborative research programmes for local students as a prerequisite for their investment (students at technical secondary schools should be included in the programme as well).

It is very important to pay attention to the situation of people whose jobs fall victim to the restructuring process in the Ukrainian economy. In order for them to fully participate in the benefits of this process, they need to be taken care of by being given requalification courses and support for increased mobility. Another important matter pertains to people relocating from the conflict zones.

Management summary

The fiscal circumstances of the Ukrainian state have brought the country to the edge of bankruptcy. The budget deficit is impacted by a conflict in the east, the tremendous share of shadow salaries and destructive corruption. In order to break the vicious fiscal circle a comprehensive emergency package is needed.

This emergency package is aiming at the triangle budget deficit, inflation and currency, in order to create stable conditions for entrepreneurial activities and future domestic and foreign investments. While international institutions have already made contributions, further activities from domestic and foreign stakeholders are urgently needed. Budget consolidation will be achieved by debt relief and a fight against corruption and the shadow economy. Supplementary financial means will be obtained from well-prepared privatisation activities. The ongoing non-transparent privatisation process has to be stopped immediately to break further oligarchic asset distribution.

If budget consolidation is achieved, inflation can be decreased and currency rates stabilised, thereby ameliorating the overall business environment. The transformation process also requires increased productivity, which will have an impact on the labour market. In order to avoid social hardships, investments, inter alia in infrastructure, should be made and new jobs created. These investments need bridge financing from international institutions. Also, oligarchs' contributions to the transformation process are indispensable and should take the form of their depositing a significant amount of money into a fund to be used for investments in Ukraine.

The overall tax system, in general, is already conformable to existing tax systems in EU countries. Therefore, it is recommended neither to discard the overall tax system nor to introduce new taxes, but instead to ensure proper implementation and effective administration operated on a legal basis.

The core recommendation for the Ukrainian tax system is a tax moratorium to stop the numerous, chaotic and unjustified amendments to tax legislation and policy. It has to be clarified whether changes to improve the social function of taxation will be enforced before or after the moratorium. The creation of new legal jobs paying regular salaries will be supported by tax relief and social security charges for employers.



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IX Tax and Finance

Results and proposals of the workstream

15 Innovative technologies as a means for modernising the agricultural sector

Ukraine has enormous potential for productivity improvements in the agricultural sector. This is largely due to adequate natural environmental conditions, ie fertile soil combined with a favourable climate. However, the potential of the agricultural sector is still underutilised. Although large agro holdings benefit from modern management practices and play an important role in global competition, the real potential for significant productivity improvements still lies in the segment of small- and medium-sized farms.

With financing being a key factor in the development of small- and medium-sized farms, there are other maladies that can be solved without huge amounts of investment. Very often the distances between rural areas and even local district seats are remarkable. This additionally impairs the access of small farms to professional training aimed at promoting modern management techniques in agricultural production, and other efficiency-enhancing technologies. It is also important to note the limited access that small farms have to financing opportunities and risk-management tools that would make production profitable and enhance group purchase/sales opportunities.

Recommendations

The development of Ukraine's agricultural sector will spur economic growth by improving business practices, increasing competitiveness and productivity, creating jobs and raising farmers' incomes. Moreover, this development of the farm sector is also expected to result in higher yields, a greater volume of trade in food products, as well as a reduction in the adverse impact of agricultural production on the natural environment.

All the afore-mentioned benefits could be achieved by introducing more efficient technologies. Specifically, the sector can be modernised by means of IT systems that a farmer can customise to his needs. Most sophisticated techniques have been developed in Europe and the US. Although advanced mapping and satellite guidance systems can be found in large Ukrainian agro-holdings as

well, small farmers cannot afford to buy such tools. Therefore, relatively cheap tools that do not entail big investments for fixed assets (ie machines, equipment) should be offered. Small Ukrainian farms would have great potential for productivity enhancement if they would apply these techniques, which could be delivered to them in the form of electronic advisory software. Ukraine should also introduce an electronic system for collecting data from the agricultural sector. The system would automatically fill out and digitalise documentation for farms and optimise production processes (this would allow a farm, for instance, to determine nutritional doses for livestock, to track crops and field records, and to control revenues and expenditures). The software should be divided into separate modules addressed to different agricultural sectors, ie be easily adaptable to different types of production (eg breeding, crops). The system should also serve as an advisory tool providing knowledge about, for instance, optimal feeding doses, proper agricultural techniques according to a detailed record of the fields, choosing and implementing plant protection products, information about what pests can harm crops or the optimal dosage of fertilizer in relation to an increase in crop growth. An additional benefit of the tool would be that it would give farmers the opportunity to network and share knowledge, as well as to benefit from collective economies of scale

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16 Establishment of a national fund for environmental protection

Ecological issues are not high on the political agenda in Ukraine. This attitude, which puts immediate results and gains before a sustainable development strategy, still prevails in many countries. This is one of the major pitfalls into which many countries have fallen, because later their budgets come under great pressure to alleviate environmental harms. In Ukraine the regulatory authorities are not independent entities with sufficient resources and powers to provide environmental protection, promote energy efficiency and carry out the modernisation of infrastructure. Moreover, agencies do not act as funds that collect and distribute financial resources; instead they govern subordinate entities. Furthermore, Ukraine struggles with a lack of a transparent process for eco-project selection. What is more, entrepreneurs and NGOs have limited access to funding opportunities that aim at improving efficiency, reducing greenhouse gases, or promoting renewable energy sources.

Ukrainian administrative reforms for the environmental governance system are not yielding the desired results. The structure of the system is inefficient and highly bureaucratic. Ukraine should pay close attention to local conditions when preparing and implementing environmental law and regulations that affect local geographical and demographic factors. There is no system of public consultations with local communities or advocacy groups. Policies implemented without prior consultations might instigate severe disruptions in the performance of environmental protection, especially at the local level. Moreover, on its road to European integration, Ukraine will benefit from EU programmes aimed at tackling ecological issues. In such cases, the creation of a fund governing EU programme expenditures seems to be a precondition. The importance of having prior experience in this field as well as a well-functioning institutional framework cannot be underestimated.

Recommendations

Ukraine has a significant problem with the inefficient distribution of financial resources in the field of environmental protection. Moreover, the country needs to have an institution that raises public awareness on environmental issues and

spends funds in a transparent manner on projects proposed by NGOs, local activists and business representatives who intend to invest in eco-friendly green projects. These efforts should go hand in hand with an efficient financial incentive scheme supported by national and local budgets to address excessive adverse impact on the environment and CO2 emissions. However, the introduction of new taxes is not the most effective way to achieve this goal. Ukraine should focus on better use of already existing fiscal mechanisms. Nevertheless, introducing new solutions according to the 'polluter pays' principle, like CO2 allowances, could enhance environmental protection and provide financial resources for new pro-environmental initiatives. The fund should also act as a national green investment scheme (GIS) operator. This should embrace numerous tasks and duties, inter alia, management and review of applications for the co-financing of eco-friendly initiatives; preparation of a list of programmes and projects suitable for co-financing; submission of cost lists suitable for the government refund; supervision of the implementation of programmes and projects as well as an assessment of their performance and the environmental effects they have produced; preparation of reports required under the contracts on the sales of greenhouse gas allowances; arrangement of technical assistance to potential beneficiaries; promotion and information activities related to the GIS; monitoring of greenhouse gas emission reduction as well as monitoring of the beneficiaries' progress in the implementation of programmes or projects co-financed by the fund.

By contrast, Poland has a long tradition in environment protection of using a project financing system run by state agencies. Established in 1989, the National Fund for Environmental Protection and Water Management manages public resources for environmental project financing and acts as the Polish green investment scheme (GIS) operator. The GIS is an element of a reliable and effective structure of financial resources available within a system to manage the greenhouse gas emissions and other substances.

In order to implement this project in Ukraine the enactment of a new law amendment, namely the act on the National Fund, is required. This act should provide the fund's independence from the government (eg control exercised by the environmental minister or the prime minister through appointment of the fund's supervisory board members). The fund should closely cooperate with the State Agency of Forest Resources (Derzhil'sagenstvo), the State Agency of Land Resources, and the State Agency of Water Resources as well as NGOs, local governments and entrepreneurs. Additionally, the fund should also develop its local structure (regional offices).

21 Sustainable public transport

Pollution deriving from transport is becoming an increasingly serious threat to both humans and the environment in Ukraine. Typically, Ukrainian vehicles are old and do not meet environmental requirements. On the other hand, the Ukrainian transport sector meets the general transportation needs of the national economy. However, its quality and energy performance adversely affects the environment. This does not comply with contemporary requirements. When purchasing means of public transport, local governments do not take into account the need to protect the environment. The railways in Ukraine are not fully electrified with the use of overhead catenary systems.

Enacted in 2010, the Transport Strategy of Ukraine for the Period up to 2020 covers many areas, one of which is improvement of sustainability and energy efficiency. The burning environmental issues in Ukraine call for decisive actions. Transportation could become one of the drivers of sustainability, because of its role in the Ukrainian economy. Ukraine is an important transit country that could benefit from the development of this sector. Nevertheless, Ukraine has to put more emphasis on environmental issues in transport.

Recommendations

Sustainable transport is a multifaceted concept encompassing a wide array of issues. Making Ukrainian transport more sustainable means that more energy-efficient forms of transportation will be introduced, eg public transit, low emission vehicles, transportation demand management, and 'active transportation'.

Efficient public transport can contribute to the improvement of air quality and the overall condition of the environment. Railway electrification results in less carbon dioxide emissions from the diesel trains that are used on non-electrified routes in Ukraine. Electric buses are emission-free means of transport, thus environmentally friendly. Ukraine has a long tradition of trolleybuses and trams in its major cities. Unfortunately, public transport is being 'privatised' with the use of small busses often adopted from cargo minivans called 'marshrutka'.

Actions aimed at introducing transport sustainability should cover various projects including public procurement focused on modernising public transport (eg electric or biogas buses). Beforehand, transport activity plans must be drawn up on environmental protection and on a rational use of natural resources. Nevertheless, solutions to sustainability problems need an integrated approach.

By pursuing 'green development', Ukraine can join the global trend of emphasising modern, innovative and environmentally friendly technologies. In one of the country's regions Ukraine could establish a 'Green Valley' where green industry would be given priority. This strategy could include tax holidays along with investments that result in establishing new green jobs. The 'Green Valley' could be viewed as a flagship project promoting Ukraine at the European level. Of course, indicating one specific region is just a minimum option. This action could also be favourable to Ukraine's exports. This green jobs initiative should be complemented by goals (percentage or quantitative) for jobs created in selected sectors of the economy (energy, agriculture, construction, transport or chemicals). Entrepreneurs and local governments participating in the project should receive dedicated support from the central budget. The source of funding could be funds earned through the sales of Kyoto Protocol emissions rights (money earned through selling Kyoto carbon credits Assigned Amount Units – AAUs). Furthermore, Ukraine should consider the establishment of a new research-executive unit which could coordinate the process of verifying, reporting and identifying projects for implementation (the Climate Institute, the Green Growth Institute etc), and supporting other institutions responsible for ecology and environment issues (eg the new 'National Fund for Environmental Protection').

Ultimately, green jobs are to be created throughout Ukraine. Consequently, the project requires more time. However, actions such as the selection and creation of a 'Green Valley' (which should be fixed at the beginning of the project schedule) could be taken faster. Nevertheless, it will require more time to create large numbers of jobs, particularly due to the need to involve external entities, entrepreneurs.

As mentioned, the establishment of the fund requires enacting an appropriate law (Act on the National Fund) and providing resources to it (allocation of environmental fees). These activities could be carried out within just a few months (formal phase). After this period the fund should become fully operational and start the distribution of financial resources based on submitted applications. It then establishes the first strategic operational programmes. The fund supports environmental protection and water management projects in Ukraine (EUR 0.5-0.7 billion per year from its own funds and those entrusted by international entities, eg the EU). In the next phase, the fund should extend its support for environmental protection and water management projects in Ukraine (for the aforementioned projects) (EUR 1 billion per year from its own funds and those entrusted by international entities, eg the EU).

17 Improvement of energy efficiency and better use of local energy sources

Ukraine is among the world's top ten most energy-intensive economies, while simultaneously being one of the most energy-inefficient countries in the region. Energy efficiency is the invisible powerhouse working behind the scenes to improve the energy security, lower energy bills and help the country satisfy its climate goals. If this issue is further neglected, the country will be unable to benefit from its competitive advantages. Apart from reducing energy expenditures and energy reliance; energy efficiency is an important driver of improving environmental quality. Ukraine was ranked 94th among 129 countries in the 2013 Energy Sustainability Rating. The country obtained B C D scores with energy security ranked 59th (B), energy equity 73rd (C), and environmental sustainability 114th (D). These rankings mirror the equally disappointing energy efficiency of the Ukrainian economy and affect each of three elements (ie energy security, energy equity, and environmental sustainability). Ukraine's energy efficiency problems derive from excessive energy intensity (triple the EU average), rudimentary infrastructure and obsolete technology. The ageing infrastructure coupled with transmission and distribution losses is crippling Ukrainian energy-intensive industries.

New situation – new necessities

For many years energy efficiency was not a priority for Ukraine. The possibility of purchasing cheap energy from Russia allowed Ukraine to neglect the necessity of saving energy. Moreover, even if energy efficiency measures were implemented, an introduction of energy-saving and energy-efficiency tools was blocked by the lobbies, mainly representing national energy-intensive industries. The situation in the heating sector perfectly reflects this issue. Many blocks of flats in Ukraine are linked to district heating networks. In theory, this is a highly efficient system, but due to serious mismanagement (dilapidated boilers, poor insulation, leaky pipes, etc) it is quite the opposite. The best proof of how airily society approaches this issue is borne out by the fact that only in the wake of the latest increase in energy prices did the installation of consumption meters become popular.

20 Green jobs initiative

Ukraine is one of the most energy-intensive countries in Europe and is far from realising its full potential in terms of developing green technologies. Public support for green growth is still inadequate. The investment climate is not favourable, as the lobby for traditional energy-intensive industry remains strong and influential. Green initiatives lack funding and are undermined by endemic corruption. Moreover, Ukraine has no efficient direct measures supporting environmental protection, and initiatives promoting eco-friendly attitudes are scarce.

The growing number of green jobs is improving society's environmental awareness. Employees become pro-ecology stakeholders engaged in environmental protection. Green growth fosters the high-tech industry and gives rise to new professions (an installer of micro installations, a certifier of renewable energy sources etc). Creating new jobs within green technology is a global trend. Around 2.2 million people worked in the EU-27 eco-industry in 2000. In 2008, this figure rose to about 2.7 million, whereas in 2012 the total number of people working in eco-industries stood at around 3.4 million. The average annual growth (2000 – 2008) for eco-industry jobs was approximately 2.72%, corrected for inflation. Therefore, the number of 'green jobs' is growing. The most significant change is observed in the 'renewables' and 'recycling' sectors with growth rates of 78% and 38% respectively. The global market for eco-industries is estimated at roughly EUR 1.15 trillion a year. There is also a broad consensus that the global market could almost double in size, with the average estimate for 2020 being around EUR 2 trillion a year.

Recommendations

Ukraine should launch an initiative encouraging growth of new workplaces in modern green sectors. This would cover the energy industry, agriculture, construction, transport, or the chemical industry. The initiative will be composed of various forms of tax relief, government subsidies and other tools aimed at nurturing the development of new jobs. Ukraine should establish a goal (percentage or quantitative) aimed at producing new workplaces in clusters and prosperity zones. It is reasonable to designate leading regions, combining this with their potential (eg in organic farming, renewable energy, opportunities to improve energy efficiency) as well as indicating pilot projects (eg specific city or industrial zone) where the green jobs initiative will be initially implemented.

processing/refining). It identifies a number of specific measures for immediate implementation (eg the Environmental Data Centre on Natural Resources (EDCNR)) and develops indicators to gauge progress towards achieving the strategy's goals, as well as providing platforms for dialogue between experts and stakeholders.

As a result of the actions carried out, Ukraine will make more efficient use of natural resources and establish high standards in this regard. Additionally, Ukraine will significantly reduce the unlawful use of the environment and the problem of illegal mines and garbage disposal. With the development of policy covering many fields (mining, forests, wastes, etc) during the evaluation phase, it may be necessary to separate out certain parts of the policy, giving them priority and treating them as separate policies, with individual action plans and funding.

Recommendations

Ukraine should set more challenging energy efficiency goals, with more reasonable action plans covering a complete assessment of its energy potential. Additionally, the public sector must promote energy efficiency, and public programmes on energy efficiency might be the right solution for this. The programmes must include activities at both national and local levels. From this perspective, the public sector should play a leading role in promoting energy efficiency. Ukraine needs to prioritise and foster modern and efficient technologies, as well as reduce high energy losses. After the modernisation process is complete and investments are made Ukraine should become independent in terms of energy imports. One tool that enhances the development of energy efficiency is the energy tariff. It should include solutions for fostering energy efficiency and investment in renewable energy. Moreover, the establishment of an energy efficiency fund could be a method of integrating efforts to improve energy efficiency in industry and in construction sectors. Ukraine needs major investment in the energy and environmental sectors in order to facilitate their modernisation, which, in turn, could produce marked improvements in energy efficiency and sustainability. Furthermore, the infrastructure has to meet smart city standards and come about by means of public-private consultations on joint energy efficiency projects. In 2010 prices, the scale of required investment reaches UAH 1,700 billion by 2030, with annual investment of UAH 90 billion. The investment will require foreign institutional funding support (the EIB, World Bank support programmes) and private investment as well as a strategic reallocation of budget support measures. A key challenge is to attract investment to modernise infrastructure and to improve the energy efficiency of the Ukrainian economy. Therefore, energy efficiency management in the energy-intensive industries must be implemented with the highest standards applied.

Greater emphasis should be put on the importance of energy efficiency in modernising the district heating sector and on renewable energy. Investment in thermal refurbishment appears to be an optimal way of enhancing energy efficiency. These efforts should be followed by plans to shut down unprofitable energy facilities. At the same time, it is essential to create a detailed plan for energy infrastructure modernisation – ie all new power plants should be fitted with the most efficient technology available. Moreover, entities investing in thermal refurbishment should be supported with instruments such as tax reliefs, or subsidies. The high standard of energy efficiency in new buildings should be implemented.

Furthermore, Ukraine needs to ensure efficient use of its resources. In this regard, the country should improve the mining law and environmental regulations to stem a further degradation of national resources. The country also needs to

prevent more vigorously the illicit extraction of minerals. Ukraine should shift its focus from natural gas to the development of and investment in domestic energy sources (shale gas – if its extraction is cost-efficient – or biogas). A new policy has to be established to support and foster Ukraine's untapped biomass potential. The forest monitoring programme must be applied. Ukraine has to step up its efforts to protect national resources by eliminating illegal mines.

In this context Ukraine should establish new legislation in the field of energy and resource efficiency. This legal act should emphasise the leading role of the public administration (both central and local) in raising energy efficiency (eg with a use of public procurement, where improved energy efficiency should be included in procurement criteria), as well as the participation of NGOs, entrepreneurs, and individuals. The act has to indicate energy efficiency targets (in %) and introduce a new energy tariff covering pro-efficiency solutions. The act should establish an energy efficiency fund to encourage investors to improve energy efficiency (eg by means of thermal refurbishment) and provide transparent distribution of financial resources (the existing State Agency for Energy Efficiency could serve as an important starting point).

Additionally, it is recommended that the new legislation introduce forms of tax relief for energy efficiency investment and set high standards of energy efficiency in new buildings. Moreover, the act on energy and resource efficiency should lay the groundwork for developing an energy efficiency strategy (as an action plan for implementing energy efficiency targets). The strategy of improving energy efficiency must cover realistic forecasts and a review of energy efficiency potential.

Nevertheless, improving energy efficiency at the described rate is a rather long-term goal. Apart from elaboration, the above strategies require proper execution, which, in turn, calls for a combination of verification and selection procedures, so the most attractive investments can be carried out. Since this field of action covers resource policy (eg illegal logging or mining), it entails a more active commitment to raising public awareness on environmental issues as well as increased expenditures on appropriate public education programmes. It is a rather lengthy process and therefore requires a lot of time.

As a result of the proposed initiatives, Ukraine should see its overall energy efficiency numbers gradually improving and approaching the European average figures. This requires that Ukraine increase its annual funding to improve energy efficiency (eg by 1.5%). Additionally, Ukraine needs to establish regional centres for energy efficiency (two or three) to monitor and stimulate growth in energy efficiency.

efforts include properly dealing with waste in kindergartens, schools, universities, and workplaces. Ukraine has to increase citizens' awareness of environmental protection.

It is essential for Ukraine to introduce a new policy on resources that is aimed at maximising the efficient use of the country's natural resources. The strategy should be based on central and local actions proposed to eliminate environmental hazards and misconduct. It has to reduce the environmental impacts associated with the use of natural resources. Ukraine must address environmental concerns (raw materials and land) by tracking and monitoring the use of natural resources and their lifecycles. These actions could reduce the size of the problem or in the long term, eliminate it completely.

The strategy has to include an educational campaign on waste management and recycling. Public administration must play a leading role in it. Moreover, Ukraine must resolve the problem of illegal mining and logging. Herein, monitoring programmes carried out with the help of modern technologies and devices may be useful. It is also essential to prevent the illegal excavation of amber. This natural asset of Ukraine should be excavated under close state supervision, with high-environmental standards applied. The strategy must tackle issues relating to sewage and polluted water and should include a clean water programme. The strategy has to indicate goals and actions in the field of sustainable development in Ukraine. They must be measurable and achievable within the next few years.

Ukraine must strengthen law enforcement. It is not just a question of increasing the level of punishment (this, however, should also be considered, especially in terms of increasing fines and administrative penalties). However, the priority must be to ensure the inevitability of punishment for actions that harm the environment. The policy should lay out a framework for the necessary legislative steps. It must also build a platform for the national fund's executive education programmes and initiatives (eg forest monitoring).

The policy should cover a number of areas related to the efficient use of natural resources, so that they do not adversely affect the environment. The comprehensive nature of the policy prolongs its implementation. Similar solutions exist in the European Union. The thematic strategies adopted by the EU under the 6th Environmental Action Programme (6 EAP) are good examples of such measures. The action programme addressed the issue of resources and called for the development of a thematic strategy on the sustainable use of natural resources. The strategy applies a lifecycle approach (examining environmental impacts at each stage in the lifecycle of a resource during extraction/harvesting, transport,

19 New sustainable natural resource policy

Ukraine does not realise the potential of its resources in an appropriate and efficient manner, thus squandering its resources and insufficiently caring about the environment. Industrial-scale mining inflicts serious damage on the environment, devastating swathes of forest. Unauthorised amber mines not only diminish the state's financial resources but also harm the environment.

Illegal waste dumping poses a threat to the health and life of both humans and animals. Only a very small amount of waste is recycled and used as secondary resources. Ukraine releases sewage, polluted water, heavy metals, and oil-related pollutants into the Black Sea. The water supply in some areas of Ukraine contains toxic industrial chemicals that exceed the limits several times over.

For many years, Ukraine has not only wasted its natural resources but also allowed for their destruction and for illegal mining. Insufficient protection, corruption, smuggling of illegally acquired raw materials have resulted in a depleted resource base.

Ukraine has not enforced environmental law efficiently. Chronic proceedings, bureaucracy, the lack of a clearly defined public interest and local administration in environmental protection created opportunities for those willing to exploit natural resources boundlessly.

The lack of adequate environmental education is to blame along with the lack of government programmes designed to prevent these types of situations. This is due to the lack of real interest in environmental issues on the part of public authorities. For many years, Ukraine has had no effective coordination and management of environmental matters. Therefore, Ukraine has not developed appropriate problem-solving schemes to use waste as a resource (eg waste to energy).

Recommendations

Ukraine needs to implement sustainable models of urban management as well as ensure proper waste management policy. The country should also increase the use of recycled materials and promote pro-environmental attitudes. These

18 A system of support for renewable energy micro-installations

A large share of Ukraine's energy supply comes from uranium and coal. With its unconstrained emission volume, the Ukrainian energy industry is based on obsolete energy installations (Ukraine has a vast overcapacity of old coal-fired power plants). In terms of the structure of the Ukrainian energy sector, there have been no major changes over the past 25 years. Not enough emphasis has been placed on sector modernisation. At the same time, the country's central regions suffer from electric energy shortfalls of more than 800 MW. Obsolete transmission grids do not allow proper distribution and cause high transmission losses.

Ukraine has already established a system of support for renewable energy sources (RES), which is based on the feed-in tariff scheme. Nevertheless, Ukrainian energy sources are treated as 'a political issue' rather than as 'a policy issue'. Thus, in the political debate, renewable energy is often used to stir discord. As a result, in June 2015 the Ukrainian parliament significantly reduced its financial support for renewable energy. Although there is no denying that the effectiveness of the previous support system was questionable (eg an allegation of an excess tariff), Ukraine should step up its efforts to accentuate the importance of renewable energy sources in its energy mix. Changing the direction of this policy would be a most regrettable mistake. Through renewable energy Ukraine could improve its energy security by reducing its reliance on external supplies. Apart from these general advantages of green energy, RES can be developed at a local level, hence reducing transmission costs and losses. Local energy sources provide a chance to build up the citizens' civil energy sector free of corruption and external influence. They would also yield great environmental value by reducing greenhouse gas emissions and improving the effectiveness of local energy resources and their consumption (eg biomass).

Recommendations

Ukraine has to increase public involvement in the financing of renewable energy sources. RES must be placed at the top of the agenda. More purposeful development of the renewable energy sector could unlock the country's economic

potential and address energy sector problems. Moreover, RES must be better promoted among local governments and communities. Access to technology must be facilitated as well. Ukraine has to improve environmental education in the field of renewable energy installations and also provide quick access to the grid in terms of the connection of renewably generated energy. Moreover, Ukraine should support local initiatives (eg energy co-operatives) that aim to install renewable energy sources. Ukraine should consider returning to the idea of incentives for energy facilities producing power from alternative sources.

Thanks to RES Ukraine could develop an eco-friendly energy sector that produces inexhaustible clean power. RES provide substantial benefits for both climate and health since they reduce greenhouse gas emissions and are based on non-depletable energy supplies (water, wind, and sun, biomass). Furthermore, they enable the country to rely (at least in the long term) on domestic energy supplies (eg biomass) and they enhance energy security at the local level. An energy sector that is based on small and micro-installations means the democratisation of the energy system. This approach allows citizens to take an active part in building up the energy supply system and to assume responsibility for it, as small-scale projects are usually involved (cheaper investment, citizens can afford it). RES projects are also rather short-term investments. The short completion schedule for such investments would be of great benefit, given the energy shortfalls in central Ukraine and the need for greater independence from foreign energy supplies. They would restore the much desired balance in the regions through a de-monopolisation of the energy sector.

However, the successful implementation of this measure calls for the establishment of solutions enabling fast installation of small and micro-scale renewable energy sources. It is essential to create fast-track procedures for small/micro RES connection, eg with the use of declarations (information that small/micro RES installations will be connected to the grid). These actions should be combined with introducing training courses for RES installers (a new profession, which could develop in Ukraine). Green jobs are not only better quality jobs than those in conventional energy and mining sectors but they also create opportunities for groups at higher risk of unemployment (ie older people, inhabitants of rural areas) with no need for any privileges (eg early retirement schemes).

Similar solutions supporting micro installations already exist in many European Union countries. For instance, in Poland individual owners of micro and small installations are exempt from the requirement to hold a license for generating and selling electricity. Moreover, from 2016 onwards, they will be selling their elec-

tricity surpluses to the grid at prices that are guaranteed for the long term (the tariff period is 15 years, although prices will differ with the technology applied and the installed power of the renewable energy source).

The establishment of a more favourable regulatory framework for micro installations requires legislative measures. This involves enacting an appropriate legal basis and developing an executive education programme (operational), which could be implemented by a national fund for environmental protection.

As a result of the new policy, the number of micro installations in Ukraine could reach 100,000/200,000/300,000 micro/small energy installations in 5/10/15 years' time. Ukraine should analyse the ultimate number of micro/small-scale installations that actually does emerge in the energy system. Reaching each interim goal will help the government keep track of the entire process and supervise the pace of the investment programme. After the 15-year goal is accomplished, Ukraine should consider the next phase of the program, which should also allow for quantitative targets and technological improvements.

Further, the banking market is highly fragmented. Although the market share of foreign-owned banks (as a % of total assets) in Ukraine was on an uptrend in 2014, increasing from 27% to around 31%, this increase should not be overrated. It is by and large a reflection of an increasing number of failed and restructured locally-owned banks. The market share of state-owned banks (as a % of total assets) increased from 18% to 22% in the same period. The NBU started in May²⁶, under the Comprehensive Program for the Development of Ukraine's Financial Sector, to force banks to report their ownership structure²⁷ and to disclose the bank's ultimate beneficial owners ('key participants'). This is a major step towards re-establishing the credibility of the banking sector.

The goal is to have:

- a transparent ownership structure;
- to identify all key stakeholders of the bank; and
- to identify all key stakeholders of all entities in the chain of ownership of equity rights in the bank, as well as the nature of relationships between them.

The NBU can further declare the ownership structure of a bank non-transparent if the bank's shares are directly or indirectly held by so-called discretionary trusts²⁸. This is also true of the spreading of a bank's property between different individuals if neither of them is the owner of a qualifying holding. The NBU has the right to require that each of the ten largest key stakeholders of the bank confirm his/her financial standing. The ownership structure is declared non-transparent if two out of the ten stakeholders (holding a stake of not less than 5% of the bank) have an unsatisfactory financial standing.

26 NBU Board Resolution No. 328, (entered into force on 23 May 2015)

27 Qualifying holding not only means formal ownership of a share in a bank, but also the ability to exercise a significant influence on the management or activities of the legal entity irrespective of formal ownership.

28 The legal ownership structure of so-called discretionary trusts provides for splitting ownership into legal and beneficial ownership, which makes it impossible to identify an ultimate qualifying shareholder in a bank.

Monetary policy should aim at price stability

While in the past the central bank of Ukraine tried to stabilise the exchange rate of the hryvnia via an exchange rate peg to the US dollar, nowadays it has already shifted from that exchange rate policy to internal price stability. This implies a restrictive monetary policy under current circumstances. When following an anti-inflation policy, Ukraine must take into account the prominent role of energy prices. Volatility in energy prices will remain high in the future. Therefore the inflation target of the central bank should be credible and realistic. The inflation target should be announced and cover a target range rather than a target value. It may also be formulated with respect to core inflation (without energy prices) rather than in terms of consumer price inflation. The shift to internal price stability implies that the exchange rate of the hryvnia is allowed to float.

The currently extraordinarily high inflation rate in Ukraine consists of a transitory and a permanent component. The transitory factors are the consequences of the devaluation of the currency and the hike in consumer prices for energy. Both factors will fade out at the end of the year and should lead to a slowdown of consumer price inflation. The high-level prices, however, will remain. The permanent component stems from the lack of stability in monetary and fiscal policy and the urgent need for structural economic policy reforms. It is the permanent component of inflation that needs to be addressed in order to achieve price stability in the medium to long term.

Increase productivity

The measures undertaken in recent years to increase the competitiveness of the national economy did not succeed. The financing of public debt through an expansive monetary policy did not work from a medium- or long-term view either nor did currency devaluation foster economic development. These policy measures must be discontinued. Therefore, the competitiveness of Ukraine's economy must be increased by improving productivity, which is low in most sectors compared with neighbouring countries. It is obvious that to increase productivity, jobs in unprofitable businesses will have to be eliminated as a side effect. The envisaged transformation of Ukraine's economy is neither easy nor short; therefore, financial means have to be allocated by international institutions (EU, EIB, EBRD, IMF and others). Debt relief and interim financing measures are required. These support measures will facilitate infrastructure investments, which are urgently needed and most notably will mitigate unemployment rates

and social hardships. Moreover, this effect is supported by the recommendations for creation of jobs in the chapter of WS Economy.

Measures against tax evasion and the shadow economy

The economy of Ukraine and the government sector suffer from the large shadow economy. The current macroeconomic instability and especially high inflation may contribute to a further expansion of the informal sector and thereby undermine the basis for economic recovery and macroeconomic stability. While Ukraine's shadow economy as a whole is highly complex, measures to combat shadow salaries and tax evasion are key. Consistent actions against fraud and tax avoidance, which will be further described in section 1.5. of this chapter, as well as a comprehensive reform of tax administration are recommended. In addition, it is essential to introduce powerful incentives for people to pay contributions into the social security system. This can be achieved by introducing strict links between contributions to and benefits from the social security system. In terms of de-shadowing, special attention has to be paid to the wide-spread practice of paying unofficial salaries that leads inter alia to huge losses in revenues to social security system, currently financed from the budget.

Recommendations

The transformation of the Ukrainian economy and society requires substantial support in the form of bridge financing from European and global institutions over a period of at least one and a half to two years. Furthermore, significant debt relief is crucial to establishing the competitiveness of the Ukrainian economy.

While the European Union and others have already made substantial contributions, Ukrainian business elites need to take urgent steps to support transformation, including by making arm's length investments in their country's future and by avoiding behaviour that is anti-democratic, anti-competitive or that in other ways undermines good governance and the rule of law. If these types of contributions are not made, privatisation processes undertaken in the past must be evaluated and as a final consequence, (re)nationalisation of central economic sectors must be considered.

In any case, existing monopolies must give way to market economy competition, and corresponding basic conditions must be created to prevent a repeat of monopolisation from the outset.

One very important measure that the NBU has at its disposal is that it can declare the ownership structure of a bank non-transparent if the bank's shares are directly or indirectly held by so-called discretionary trusts²⁵. This is also true of the spreading of a bank's property between different individuals if neither of them is the owner of a qualifying holding. The NBU has the right to require that each of the ten largest key stakeholders of the bank confirm his/her financial standing. The ownership structure is declared non-transparent if two out of the ten stakeholders (holding a stake of not less than 5% of the bank) have an unsatisfactory financial standing. In this case the NBU can impose substantial administrative and economic restrictions – declaring these institutions to be problem banks, so they are no longer able to:

- obtain a refinancing loan
- have a general licence for foreign exchange operations
- participate in a liquidity-providing tender
- increase authorised capital, as the regulator refuses to approve the revised by-laws.

2.3 Banks

Conglomeration of problems in the banking sector

The Ukrainian banking system is under immense pressure due to:

- extremely difficult operating conditions;
- further estimated asset quality erosion (NPLs: corporate, retail);
- a depletion of capital buffers; and
- highly volatile funding conditions.

²⁵ The legal ownership structure of so-called discretionary trusts provides for splitting ownership into legal and beneficial ownership, which makes it impossible to identify an ultimate qualifying shareholder in a bank.

Recommendations

To raise the credibility of the Ukrainian banking system²³, it is necessary to create a transparent and healthier banking sector. To achieve this desired outcome, it is quintessential to execute the following IMF measures, as they should be strongly supportive to the Ukrainian economy and monetary system:

The strengthening of banking supervision:

Strengthening of the overall governance structure and banking sector monitoring capabilities at the NBU, which includes the disclosure of bank ownership structures²⁴.

A special unit of the (NBU) to focus on mapping the largest industrial and financial groups in the country.

Legislative changes have already been adopted and increased bank owners' responsibility in case their banks violate prudential requirements.

Envisaged changes in banking regulation also include the establishment of a credit registry within the NBU, a transition to IFRS by mid-2015 as well as a strategy to monitor the largest banks in detail until September 2015.

Detailed regular reporting to the IMF in the future regarding banking sector issues (may help to avoid worst case scenarios).

A further point of the current IMF program concerns the restructuring of the banking sector, with a focus on detailed monitoring of insider lending to related parties and support from international accounting firms to guarantee credibility. Given the large corporate loan books in the Ukrainian banking sector (around 70% to 80% of total loans), the looming restructuring of corporate exposures and related-party lending will affect large parts of the local banking sector.

Further the Ukrainian banking sector should be adjusted in terms of private, public savings and credit banks. European banking associations can play an advisory role to establish this structure.

23 Some of the Ukrainian banks have been and are still used (by oligarchs) for money laundering, thereby undermining the credibility of the Ukrainian banking system further.

24 Goals: a transparent ownership structure, identification of all key stakeholders of the bank, identification of all key stakeholders of all entities in the chain of ownership of equity rights in the bank, as well as the nature of relationships between them. The first disclosure was released on 20 July; future disclosures will be published on a semi-annual basis.

To ensure that the Ukrainian economy remains competitive against the backdrop of low inflation and a stable national currency, the productivity of the economy must be increased significantly. This will not occur without corresponding rationalization. Social hardships (higher unemployment) are to be cushioned and offset with strategic bundles of measures (eg infrastructure investment, R&D investments etc).

A strict policy of government budget consolidation is the basis for the transformation process, with the short-term goal being a budget deficit of less than 3%.

All government spending must be transparently reported and explained in detail to the court of auditors and to parliament. The court of auditors must have the appropriate tools to enable efficient auditing of government expenditures.

Privatisation processes need proper preparation to prevent national property from being dumped and corruption from being sown. Therefore a holistic and strategic plan is to be developed first and is to involve international expertise as well as national and international individuals of the highest repute. The ongoing privatisation processes should therefore be stopped until the plan is worked out in detail.

The companies owned by the Ukraine people should be clustered and streamlined and handed over to a holding company comparable to Deutsche Treuhandgesellschaft or Austrian ÖIAG. On that level, technical details for the privatisation processes are to be worked out.

The sales revenues from privatisation should not get lost in the national budget deficit, but be used for further investments (eg infrastructure investments). For all entities where a market exists and works well, a complete privatisation is to be considered. For all entities where a proper market does not exist (eg infrastructure) a maximum amount of 49% of the shares should be privatised. Private investors would help to rationalise and optimise the currently suboptimal development of infrastructure (because of particular interests).

1.3 Characteristics of the Ukrainian taxation system

Tax systems may be characterised according to three major components. These components are tax legislation, tax policy and tax administration. Tax legislation forms the legal basis that defines the rights and obligations of taxpayers and the tax administration. Tax policy decides the overall amount of taxes levied, the number of taxes, assessment bases for taxes and tax rates. Finally, tax administration describes the overall framework, institutional structures, technologies used and organisation of responsible bodies for the collection of taxes.

The current design of the tax system of Ukraine is comparable to the tax systems of other European countries. The main taxes are corporation profit tax, personal income tax, property tax and a value-added tax. The tax system is a two-tiered one, comprising national and local taxes.

Nevertheless, the tax system of Ukraine is identified by the Ukrainian business community and foreign investors as one of the major obstacles to the economic and social development of Ukraine. The survey 'Paying Taxes 2015' conducted by the World Bank Group and PwC shows that Ukraine is ranked 108th out of 189 countries.⁶ However, this is a significant improvement, as in 'Paying Taxes 2014' Ukraine was in 164th place out of 189 countries.⁷

This widespread view is based on the following assumptions:

The tax system of Ukraine is highly discretionary, meaning that those with power can misuse tax authorities and the tax system as a tool for collecting funds not only for the state budget, but also for funding political campaigns and for personal enrichment. Even in cases where funds are collected for the state, the use of power quite often has little (if any) legal basis.

In spite of tax rates being comparable to those in many EU countries, the way tax laws are applied in Ukraine results in an excessive tax burden⁸.

6 Paying Taxes 2015, (PwC)

7 Paying Taxes 2015, (PwC)

8 Under the notion of tax burden we consider a ratio of all the expenses incurred by taxpayers to duly fulfill their tax liabilities to profits taxpayers would receive in a tax-free economy. Thus, in the expenses incurred by taxpayers we include not only taxes actually paid (ie direct expenses), but also expenses on salaries paid to tax accountants, fees paid to tax consultants, court and legal expenses borne as a result of litigation over tax cases etc (ie indirect expenses).

De-jure independence has been strengthened by the adoption of amendments to NBU law as a part of the IMF programme. The amendments enhance the financial and institutional independence of the central bank. De-facto independence has also improved this year with the influx of independent, non-partisan professionals to the central bank.

The NBU openly declared that it abandoned the fixed exchange rate regime and is moving gradually towards a monetary regime focused on price stability²². In the transition period the priorities of the NBU are to bring down inflation, restore financial stability and support economic growth, followed at some point in the future by the introduction of an inflation targeting regime.

The harsh administrative measures introduced by the NBU in Q1 2015 helped to stabilise the market and calm down panic. As a result, since then the exchange rate has fluctuated in a rather wide corridor of 10%. So, market stability is maintained by administrative restrictions. In the long-run the FX market situation critically depends on economic recovery, export promotion and import substitution. So far this process has gone rather slowly and should therefore be speeded up, given the still high security risk, slow progress in business climate improvement and sharp reduction in trade flows with Russia.

In general, the measures taken by the NBU were appropriate, in certain areas even too restrictive. This is especially true of the FX supply provided by the NBU. To give an example, because of the restrictiveness just mentioned, Privatbank may be forced to restructure its foreign debt, whereas under looser restrictions it would have been able to pay its liabilities. Therefore, the NBU should test the 'true' supply and demand restrictions, so that not too much revaluation pressure builds up. The NBU opposes clearly any populist measures (FX exposure conversion of banks) and acts as an honest issues-based mediator. Furthermore the NBU is forcing banks to increase their capital and buffers, but shows enough consideration as regards restrictions, such as the allowance for debt to equity swaps.

22 Monetary policy formulation is vested in the Department of Monetary Policy and Economic Analysis and is based on comprehensive economic analysis and forecasts. Monetary policy decisions are discussed in the Monetary Policy Committee (which consists of representatives of monetary policy, financial stability and market operations units) and then staff recommendation are delivered to the executive board. Consequently, the executive board makes the decisions. The implementation of monetary policy is the function of the Market Operations Block.

- establishing transparent bank ownership structures;
- adjusting the structure of the Ukrainian banking sector – private banks, public savings and credit banks;
- removing restrictions embodied in national law that hamper the necessary diversification of the Ukrainian financial market.

2.2 The National Bank of Ukraine

There is hardly any other institution in the country confronted with a higher degree of diverging judgements than the National Bank of Ukraine (NBU). A large part of industrialists/business people are critical of its new administration – only in office for one year so far – and blame it for most of the malfunctioning of the economy, whereas banking experts and IMF officials have a different opinion.

Businesses criticize the NBU for not supplying the market with sufficient foreign currency (FX) and consequently view the present (stabilised) FX-rate as artificial and 'practically' invalid as no/little FX can be purchased from the banks or the NBU. On the one hand they are critical of the NBU for not having a floating currency regime, and on the other hand for not refinancing certain banks, being fully aware that this capital would be used for further related party refinancing, or would not be paid back at all.

The banking experts, as mentioned before, categorise the NBU – besides the Ministry of Finance – as the institution with not only the most reforms, but also the most essential reforms.

The NBU underwent substantial internal transformation over the last twelve months. The executive board of six people is completely new; more than 50 people came to the central bank to different positions. The aim of the NBU is to cut staff size from 12,000 at the end of 2014 to 5,300 at end of this year, while removing non-core functions, downsizing support functions and enhancing core functions²¹. Also the decision-making process is undergoing substantial change amidst the establishment of internal committees (monetary policy committee, financial stability committee, credit committee etc).

²¹ The NBU reduced its maintenance expenditures for 2016 to UAH 5 bn from UAH 11 bn.

Constant changes in tax legislation make efficient financial planning impossible, increase business risks and thus the cost of capital rises. These changes also lead to corruption.

The agricultural sector in Ukraine enjoys a preferential tax regime⁹ (ie special VAT regime and special regime of direct taxation that does not envisage taxation of profits of the taxpayer), thus the tax burden is shifted to other sectors of economy.

Weak anti-avoidance rules combined with an excessive tax burden promote the use of aggressive tax planning and corruption in the tax sphere.

The social function of the tax system does not receive proper attention and tax rules inadequately address social aspects of individual taxpayers.

The social security system is separate from the tax system in Ukraine. Nonetheless, the aforementioned excessive shadow salaries create a gap in the social security system of around 30-33%, and therefore severely affect the Ukrainian tax system. The burden for employers of the SSC (single social charge), which totals up to almost 50% of salaries, discourages enterprises from regularly employing people and fosters shadow salaries. Special enterprises provide companies with cash in order to pay their staff. The costs of cash are estimated to be as much as 10%, which is still a major cost advantage in competition with honestly operating companies.

Fiscal blueprints of the European Commission

The European Commission, DG Taxation and Customs Union, has developed a comprehensive set of 'Fiscal blueprints' (FB) in the field of tax legislation (and administration) in order to provide a benchmark for the optimal design of tax systems. The set of FB was drafted in order to give guidance to EU candidate countries to 'enhance their administrative capacity in adopting, applying and enforcing the *acquis communautaire* in preparation of membership.' The FB describe the best practices available in member states that have been identified to support the effective and efficient functioning of taxation systems. A first set of FB was published in 1999 and in 2007 a further amendment was undertaken.

⁹ It should be taken into consideration that subsidies for agricultural goods do not exist in Ukraine of a kind comparable to EU member states. Therefore, the tax system has to be seen from a broader view.

Tax legislation is essential in developing and maintaining a law framework that allows a proper application and enforcement of national and supra-national tax policies and clearly defines taxpayers' rights and obligations. Tax legislation has to have a clear statutory basis. Tax law has to be stable over time and clearly stated in order to be applied by the tax administration and to be known by the taxpayers. The law has to provide for adequate rights for the representation and protection of taxpayers. Tax law should prevent double taxation and respect international agreements and treaties. Tax law needs to be fully and appropriately published.

Tax legislation needs to be approved by parliament. An appropriate period of time should pass between the approval of a tax law and its entry into force. The structure of the legislation should be coherent, consistent and clear. The tax administration should publish and disseminate its interpretation of tax laws. The application of the law should be without distinction and discrimination. Court decisions have to be respected by the tax administration. The tax administration has to operate in a transparent manner to ensure sufficient legal security to the taxpayers. The private and family rights of taxpayers under international law must be strictly respected. Fair and balanced appeal and complaint procedures are offered to taxpayers disagreeing with decisions made by the tax administration. Tax compliance is supported by an obligation of registration. Tax compliance has to be supported by an obligation on the part of taxpayers to keep records of key elements of their activity. It is supported by a robust but sensible regime of sanctions. The autonomy of the tax administration should be provided for by law. There should also be a statutory basis for the reporting done by the head of the tax administration.

Tax auditing needs have a clear and consistent legal basis. The legal basis should balance the rights and responsibilities of taxpayers. Taxpayers have to be required to provide suitable access to data. In order to avoid tax evasion, tax avoidance or double taxation, treaties with other tax administrations in strategically important countries have to be in place. The treaties have to be in accordance with international models, should cover all relevant taxes and include provisions for the recovery of tax debts. Fiscal law should clearly define illegal behaviour, responsibilities and sanctions to combat tax fraud and tax avoidance.

The gap between the current Ukrainian tax system, especially the tax administration, and the afore-mentioned European best practises, need not be described in detail. To close that gap, a strategic approach is recommended.

The most pressing problems of banks are:

- large currency depreciation (led to huge NPL figure (non-performing loans) and wiped out the banks' capital, nearly 40% of loan books were in foreign currency (FX));
- economic slump (6.8% GDP contraction in 2014, further 7.5% decline expected this year);
- loss of Donbass (which accounted for nearly 15-20% of banks' assets).

As other areas of the financial market are interrelated to bank business – like leasing or insurance –, these activities have been hit by the crisis as well. This is also true of private equity and venture capital transactions, where activities were subdued before and are currently almost non-existent.

The following factors adversely affect the financial sector and must be changed to guarantee a more diversified and well-balanced system:

- imbalances within the banking sector exist – foreign banks vs state-owned banks (unfair competition) vs local private banks;
- imbalances between the total assets of the Ukrainian financial system exist (banks 86% vs. non-bank financial institutions 14%);
- restrictive regulations, but also Ukraine's dire economic situation prevented and still prevent the flourishing of non-bank financial institutions;
- overcrowded segments (banks and insurance companies) are negatively impacting competition and profitability.

To transform the status quo, a truly independent National Bank of Ukraine (NBU) is vital for tackling the problems that have plagued the banking sector for a long time. Another very important task is to implement new laws and reforms. The ECB should provide technical support, especially for stress tests, but also best practices.

Consequently, the policy measures have to focus on:

- ensuring adequate capitalisation and the elimination of non-profitable and undercapitalised banks;
- eliminating money laundering and other illegal activities;
- eradicating related lending practices;

2 Part II Finance

2.1 Introduction and hypotheses

Since the collapse of the Soviet Union, Ukraine has not been able to bring about a full change in its financial sector. Even before the crisis, this reform bottleneck created an imbalance between banks and the other parts of the financial system.

The ongoing economic, social and political crisis put additional stress on the financial system, the banking sector in particular. Industrial output decline, capital outflows, job cuts, and the vast volatility of monetary fundamentals and the exchange rate created an extremely challenging environment for local banks, which represent, with 86% of total financial assets, the largest part of the Ukrainian financial sector²⁰.

Based on these dire prospects the following hypotheses have been made:

HYPOTHESIS 1: The current banking system in Ukraine, as we know it, will cease to exist, as it has to be re-capitalised, de-criminalised, and re-dimensioned.

HYPOTHESIS 2: Currently, in this volatile and insecure environment, it will be hard to attract investors other than international financial institutions (IFIs), considering the government's very limited capacity to provide financial support.

HYPOTHESIS 3: A conflict in Donbass, populist legislative initiatives, local elections in October and the battle with an oligarchic system to curtail its power pose the biggest threats to any successful reshaping of financial markets from today's point of view.

HYPOTHESIS 4: The European Central Bank (ECB – for the implementation of adequate stress test) and European institutions can tremendously speed up the reform process in certain parts of the financial sector.

²⁰ The bank dominance is comparable to countries like Albania, Belarus, as well as Bosnia and Herzegovina, but definitely not comparable to Poland, Russia or Romania. But more important in terms of Ukraine is the fact, that no other country in the region (with the exception of Russia) has such excessive links to off-shore locations, which is not conducive to the health of the country's financial market.

Constant changes in the tax system

From 1991 to the present, the tax system of Ukraine has undergone constant change: in 2011 the tax laws were combined into a tax code along with substantive changes in the tax rules. Starting in 2011, the tax code was amended by 106 laws, with a number of amending provisions being of a significant nature. Unclear and ambiguous regulations lead to conflicts between fiscal authorities and open the door to random decisions and corruption by fiscal officials.

These changes mainly fulfilled the fiscal purpose of increasing public revenues, disregarding the steering purpose of taxes such as to establish a business-friendly environment. The tax rates are comparable to other (EU) countries. IMF, EU and other international organisations are giving recommendations to the government; nevertheless the main issue is the proper implementation of this internationally proven system.

Although the 2015 reform is very recent, the Ministry of Finance of Ukraine says a new tax reform is already on the way. Based on current practices, it is expected that the new reform package will be passed by parliament and will be enforced from 1 January 2016.

It should be noted that the tax code provides that any changes to it must be enacted at least six months prior to the beginning of the new budget period. However, in spite of this rule, laws amending the tax code are often passed after this deadline. For instance, the 2015 tax reform passed parliament in December 2014 and took effect on 1 January 2015. Non-compliance with a stability principle would not be too painful for business if the amendments were less frequent but in a situation where rules change constantly, this is a real problem.

Another thing to be mentioned is a lack of transparency. Development of legislation amending the tax code is mostly conducted behind closed doors. Suggestions for amendments and their analysis are often not available to the business community and the general public.

Also, changes to tax legislation are being developed without obtaining proper business expertise. This often renders the rules inadequate for meeting economic reality and leads to poorly formulated tax legislation. This situation results in a further bundle of issues, such as the ambiguity of provisions passed and the need for further amendments to rectify these shortcomings.

Recommendations

It is recommended that tax rates not be increased to 'stuff budget holes' but instead that the tax code be implemented and executed properly. If this task is carried out, taxes might even be able to be lowered in the long term.

There is an urgent need for stability in Ukrainian tax legislation and policy. A legal moratorium for tax amendments for certain provisions in the tax code should therefore be instituted. It has to be clarified and justified whether sectoral and social amendments in tax legislation, provided afterwards in detail, have to be introduced before or after the moratorium.

The provisions not amended for a period of three years shall represent main parameters of the tax system, namely:

- list of taxes and charges
- tax periods
- tax rates
- rules for the determination of the bases for taxes and charges
- deadlines for filing tax returns and payment of taxes and charges etc.

This shall be implemented by inclusion of respective provisions in the tax code of Ukraine.

It is essential to ensure that the Ukrainian Ministry of Finance fulfils the legal requirements to conduct open discussions of proposals for amendments to tax legislation and regarding feedback received from the business community and other stakeholders. It is vital to ensure that all interested parties have a real possibility to participate in the discussion and that results of the discussions receive proper attention from the legislature. Such discussions must be made available to the general public through Internet media.

The goal of the above steps is to decrease business risks that stem from uncertainty about the legal environment.

Recommendation

Undertake public campaigns to educate the general public about the role of taxes in a society.

Since the state does not fully fulfil its duties in respect of law enforcement and does not provide for effective control over spending of the budget funds, civil society has to be encouraged to take an active part in monitoring the application of the tax system and the use of the collected revenues to increase accountability of those with power. As mentioned, it is mostly relevant for local communities.

Table 3: Selected data on budget deficit and losses from shadow salaries payment, UAH bn

	2012	2013	2014	2015
Deficit of consolidated budget of Ukraine	-50.88	-63.69	-72.010	-76.011
Financing of the state pension fund from the state budget ¹²	64.2	83.2	75.8	80.9
Losses of the state pension fund due to unofficial salary payments	Approx. UAH 97 bn per annum 13			

Recommendation

Employers – national and international – should be liberated from all burdens be it employers’ taxes or social security charges for a full year in order to create a considerable incentive for new official jobs.

Intensify the campaign against shadow salaries and fictitious businesses that make possible the conversion of funds in bank accounts into cash in amounts sufficient to fuel the shadow economy. Achieving this goal will be supported by the recommendations of WS Anti-Corruption and WS Rule of Law.

Promote a campaign encouraging employees to report to the tax authorities and police on employers paying shadow salaries.

Gradually decrease the SSC rates paid by employers to align this with the possibilities of the economy to bear this burden. This must be accompanied by a pension reform and reform of health care system.

1.10 Outlook

As the history of taxation in Ukraine is quite short, people in Ukraine often do not understand the roles that taxes should normally play in the nation’s economic and social life. This is combined with the lack of information on taxes collected and on how the tax money is spent. This creates more possibilities for misuse of the collected funds. This factor is especially important for the local budgets, where it is easier to exercise control over amounts collected and financed.

1.4 Recommended changes within the tax system

As mentioned above, some changes to Ukraine’s tax system are recommended. It has to be considered whether those changes should be done before the moratorium takes place, during the moratorium or afterwards. Nevertheless, proper preparation is key.

The requirements for alignment of the Ukrainian tax legislation with the regulations of the EU Association Agreement primarily refer to value-added tax and excise tax. Currently, the government of Ukraine is taking steps to fulfil its obligation under the agreement and is making significant progress in this regard.

VAT legislation

In the area of harmonisation of VAT legislation, significant work is yet to be done. Though Ukraine implemented a VAT in 1992 and the main provisions of the current legislation are similar to the EU rules, there are still a number of differences that are to be eliminated during five-year period provided for in the agreement.

One of the issues is the special VAT regime for agriculture, which does not correspond with EU VAT legislation. Also, provisions of the tax code of Ukraine related to VAT are to be harmonised with EU legislation in respect of definition of taxable persons, place of supply and some others factors.

Inadequately developed social function of the current tax system

The inadequately developed social function of taxes is insufficient and needs to be improved. The significant drawback of the current system of taxation of income of individuals is that this system does not properly account for the specific circumstances of each individual taxpayer. It is suggested that the amount equal to the subsistence level not be taxed so as to prevent the earnings of the individual from falling below this subsistence level.

However, the current system of Ukraine does not meet this requirement. The currently established social tax allowance does not correspond with the real economic situation and does not fulfil its function (the established monthly minimum wage is UAH 1,218, which is around EUR 50). Also, the tax rules do not

take into account the number of dependents in the family. This omission leads taxes being charged on low salaries and pushes low-income earners below the poverty line.

Furthermore, the current VAT rates do not allow for a decrease in rates on goods important in social terms (goods and services for sport and healthcare, goods for children, education and cultural purposes).

Inequality of taxation through different sectors of economy

One of the fundamental principles of modern tax systems is that they are supposed to provide for equal taxation throughout the various sectors of the economy to ensure the efficient distribution of resources.

The Ukrainian tax system envisages special tax rules applicable for certain business sectors. For example, the Ukrainian tax system provides for beneficial taxation for agricultural businesses of all sizes. The special regime provides for exemption from CPT; taxation is based on the land used and the normative monetary assessment of the land used. This beneficial taxation is due to the IMF, which does not allow agricultural businesses to be subsidised. The preferential taxation rules therefore offset this disadvantage compared to EU countries.

Besides the above, the agricultural entities enjoy a special VAT regime, where VAT due is not paid to the state but is left in the hands of the taxpayer in order to be used for business purposes.

This leads to losses in tax revenues and distorts the distribution of market resources. Also, it has a negative social effect since such a system deprives local tax budgets of financial resources to fulfil their functions.

Recommendations

Decreased VAT rates should be introduced for social and cultural types of goods and services.

Taxation of income of a household (family) instead of individual taxation. This approach is widely used globally by economically developed countries. All the material aspects of families must be considered (eg number of children, housing expenses, expenses for education, healthcare etc).

several times less than the tax burden on official salaries. Although the companies converting bank money into cash (conversion centres) operate outside the law, they exist and are widely used. The high level of corruption makes this phenomenon possible.

From the cost of cash and cost of paying taxes, it follows that businesses that pay 'white' salaries find themselves in a much worse situation in terms of the cost of their goods and services as compared to their rivals paying salaries in cash. That means there are economic advantages for business to pay shadow salaries. This has a major effect on foreign investors and large Ukrainian companies that usually pay official salaries and, consequently, restrains foreign investors from working in Ukraine.

Employees are forced by hard economic conditions and the situation on the labour market to accept shadow payments. Though receiving official salaries is more attractive for employees, very few can afford demanding them from employers or quitting their jobs at companies paying shadow salaries. Recently, there was a campaign in Ukraine encouraging employees to report to the authorities on shadow payments, but it did not reach its goals due to the above factors.

The high burden on salaries restrains a rise in salaries even at companies working fully in compliance with legislation, which has a negative effect on the volume of business in the internal market.

The use of the decreasing ratio, as mentioned before, does not apply to new companies that started their activities in 2015. Also, the system does not allow a ratio to be used for companies that paid official salaries in 2014 and that do not increase salaries by at least 20% in 2015. As already mentioned, the companies working in compliance with the laws are put at a disadvantage compared to their competitors paying shadow salaries. Also, use of the decreasing ratio may not be applied on a constant basis since companies cannot raise salaries by 20% each year, so a more sustainable approach should be found.

The data provided in Table 3 below shows that if salaries are paid officially, there would be no need to finance the state pension fund from the state budget. In this case the latter would be in surplus.

paid by employers varies from 36.76% to 49.7%; the rate paid by employee is 3.6%. The SSC base is capped by 17 minimum subsistence levels (currently UAH 20,706, approx. EUR 830).

It is a widespread practice that salaries are paid in cash without any taxes being charged, or salaries are split: the smaller portion that slightly exceeds the minimum wage is paid officially, while the main part is paid in cash. The scale of the problem may be illustrated by data provided by the Institute of Strategic Research: in 2012 the shadow economy had cash salaries payments amounting to UAH 170 bn¹⁸.

In 2015 the government introduced a possibility to use a decreasing ratio to the SSC rate payable by employers. The ratio is computed by dividing the average monthly SSC base of 2014 by the monthly SSC base of 2015. The minimal value of the ratio that could be used is limited to 0.4. There are a number of criteria established for companies to be eligible to use the decreasing ratio. The system is designed in such a way that after application of the ratio, the average amount of monthly SSC charges due in 2015 are not less than those paid in 2014. The purpose of the system is to encourage employers to shift from shadow to white payments of salaries. However, the system of criteria that are to be met is designed in such a way that it is actually impossible for taxpayers to use it.

Shadow salary payments stress the budgetary situation

The level of SSC along with the personal income tax creates a total tax burden on salaries of around 50%, which is considered to be too high for Ukrainian businesses. This pushes employers to pay salaries in cash. There were a number of campaigns in recent years to combat the issue, but they were not successful. The reason for this is that in reality the authorities do not want to eliminate the problem, as this is a constant source of enrichment for many of those with power.

In order to pay unofficial salaries the businesses need considerable amounts of cash, and there is a system in Ukraine that enables them to obtain it. According to Ukrainian media, the cost of getting cash can be as high as 10%¹⁹ which is

18 Національний інститут стратегічних досліджень, «Тіньова економіка в Україні: масштаби та напрями подолання», 2011 <http://www.niss.gov.ua/content/articles/files/TEN.indd-532d7.pdf>

19 Ринок оготівкування: післясімейне роздолля, 2014, ZN,UA http://gazeta.dt.ua/finances/rinok-ogotivkuvannya-pislyasimejne-rozdollya-_.html

Make the subsistence level untaxable for each taxpayer; when taxing families, make the subsistence level for each family member tax-exempt.

Review the current system of tax allowances for healthcare, education expenses and expenses for acquiring housing to align the amounts and possibilities to get tax benefits with a real economic environment.

The implementation of the above measures will decrease causes of social instability by easing the tax burden for low income earners and will improve the situation on the internal market by increasing the spending of households.

Based on the above, it is suggested that these regulations be abolished for large and medium-sized agricultural companies and that the current tax regimes be left for the use of small farmers.

However, since the agricultural sector in Ukraine does not receive state aid comparable to that received by agricultural business in EU countries, it is important that one find and apply ways to compensate losses from the abolishment of the special tax regime. Otherwise the agricultural sector would become less able to compete.

1.5 Tax avoidance and evasion, wide-spread abuse of tax provisions

Tax evasion is a major threat to the tax system of Ukraine due to the vast extent of this phenomenon. It has to be seen as a dominant factor between tax legislation and tax administration. According to the most recent study by the Ministry of Economic Development and Trade of Ukraine, the shadow economy in Ukraine accounted for 47% of the total economy in 1Q 2015¹⁰. In this same period, according to the method of 'households expenses – retail', the level of the shadow economy skyrocketed to 56%.

The weak anti-avoidance rules in the Tax Code create a number of issues that prevent Ukraine from effectively fighting the shadow economy. This results in businesses employing aggressive tax planning techniques and shifting profits out of Ukraine into low-tax jurisdictions. The lack of exchange of information

10 Tendencies of a shadow economy in Ukraine, (1st quarter 2015 by Ministry of Economic Development and Trade of Ukraine)

between countries and the absence of initiatives in Ukraine to actively engage in a global exchange of information initiative promoted by the OECD leaves wide room for tax avoidance and evasion and deprives the state budget of a large portion of revenues.

On the administrative level, tax evasion is developed on the ground of corruption within SFS and other controlling bodies of the state. Therefore combatting corruption is seen as a key for improving the situation with tax evasion. However, the absence of the rule of law and the high tax burden, especially on salaries, also add to the motives to do business in the shadow economy.

Recommendations

Introduction of controlled foreign corporations (CFC) rules to capture individual shareholders as well as corporate ones in respect of income received by the companies in the possession of such shareholders that are registered in offshore and low-tax jurisdictions.

Active participation in the Global Forum on Transparency and Exchange of Information for Tax Purposes (<http://www.oecd.org/tax/transparency>) and ensure participation in the automatic exchange of information. Participation in the exchange of information on financial accounts as envisaged by the program of the mentioned forum should be made compulsory by law; a strict procedure should be developed to analyse and take appropriate measures based on the information received from foreign financial institutions.

Further development of anti-abuse provisions when applying for double tax treaty benefits, re-negotiation of double tax treaties in order to introduce provisions limiting provision of tax benefits in situations which are not intended to be covered by the treaties.

Introduction of control over expenses of individual taxpayers in combination with one-off tax amnesty. Introduction of this measure for state officers first (for a period of three years to gain proper experience by the SFS) and for all individual tax residents afterwards.

Introduction of a mandatory annual declaration of income and wealth for each individual taxpayer.

Significant decrease of limits for cash transactions with individual customers. Currently the threshold is set at UAH 150,000.

Recommendation

The system in Ukraine is rather centralised, with both revenues and expenditures going through the central treasury in Kyiv. This over-centralisation makes it impossible for state agencies to obey formal rules and breeds corruption.¹⁴ Fiscal decentralisation could be a way to increase incentives at all level of the government and enhance transparency of public finance.

All state authorities are compelled to deliver nearly all revenue to the central treasury, which discourages their incentive to collect revenues. Often, local authorities can retain funds collected through penalties and fines, implying inefficient and corrupt forms of taxation.¹⁵ Political decentralisation, discussed widely in Ukraine, should be accompanied by fiscal decentralisation. The constitution should state that regional and local authorities should be entitled to their own independent budgets.¹⁶ It is known that there are still obstacles to be removed, eg insufficient know-how of tax officials in rural areas.

Furthermore, in the long run, fiscal decentralisation and as a consequence thereof disclosure of money flows from taxpayers will improve the tax culture as well as benefits for the respective regions. Please see also the 'Modern Government' chapter in this report.

1.9 Social security charge

Portion of own revenues in the pension fund is around 67-70% of total revenues, which results in a deficit of the state pension fund in 2012 – 2015 of around 30-33%. This shortfall is covered by transfers from the state budget¹⁷. In 2011 four social security charges were combined into one payment called 'Single Social Charge' (SSC). This made tax reporting much simpler.

The payment of the SSC is split between employer and employee, and the rates vary depending on the category of occupational risk involved. The standard rate

¹⁴ Aslund (2015), p. 173.

¹⁵ Aslund (2015), p. 173f.

¹⁶ Aslund (2015), p. 173f.

¹⁷ «Динаміка надходжень коштів з основних джерел доходів Пенсійного фонду України», <http://www.pfu.gov.ua/pfu/doccatalog/document?id=227439>

1.8 Fiscal decentralisation

There is a widespread trend across advanced economies, including also many EU member states, to shift responsibilities from the central government towards subnational sectors of government. This shift arises not only in countries with federal forms of government but also increasingly involves centralised ones. Decentralisation concerns public expenditures as well as public revenues. Subnational governments are assigned a number of revenue sources, with grants and taxes being the most important ones.

The most decentralised functions are environmental protection and housing for which 60% to 80% of total expenditures are rendered by subnational governments. Recreation, culture and religion, and education with decentralised portions of expenditure of more than 40% on average in the EU are also very important subnational expenditure categories. The least centralised functions are general public services¹³, public order and safety, health and social protection, where subnational levels spend less than 40% of total expenditures in the country.

On the revenue side subnational governments rely on two main sources for the financing of public expenditures, namely taxes and transfers from the central government. Fees and property income are much less important. On average subnational governments rely slightly more on transfers; however, taxes play an important role. The tax structure of autonomous taxes at the regional and local level can be deduced from information about OECD countries. For the calculation, only countries with considerably tax autonomy are taken into account. At the regional level, taxes on income, consumption and wealth are the most important sources of tax revenues. With the exception of Spain, only information from non EU member states was used for the calculation. For this reason we find a high share of consumption taxes, as the US, Canada and Australia rely heavily on consumption taxes at the regional level.

¹³ One has to be cautious with the interpretation, as expenditures at the central level also include transfers to subnational governments in the context of revenue sharing.

Introduction of a mandatory requirement for use of cash registers by private entrepreneurs and legal entities at any point of sales. Use of electronic cash registers was recently made mandatory for entrepreneurs with annual revenues exceeding UAH 1 m. However, in order to close loopholes for revenue hiding, this requirement should be extended to each private entrepreneur transacting in cash without any thresholds.

Introduction of the above steps would help to decrease losses in tax collection that arise due to tax avoidance and to minimise motives for use of aggressive tax planning schemes involving moving funds out of Ukraine.

1.6 Ensuring an efficient tax administration

The Ministry of Finance of Ukraine must ensure the proper functioning of the tax system. The statute of the Ministry of Finance provides that the ministry is a main body of executive power of the state that ensures, inter alia, formation of the tax policy and customs policy, state policy on the administration of a single social charge, state policy for counterfeiting, for breaches of tax and customs legislation and that the ministry implements the aforementioned policies.

In order to fulfil the task on formation and implementation of the state tax policy, the Ministry of Finance has under its management the State Fiscal Service (SFS) of Ukraine. It was not always the case that the tax function within the state was designed this way. The state bodies administering tax functions underwent a number of reforms in recent years. Until 2013, there were two bodies, namely the State Tax Service and the State Customs Service, that were responsible for the implementation of the tax policy of Ukraine and customs policy respectively. In 2013, these bodies were combined into the Ministry of Revenues and Charges. However, this latter ministry did not last long. In May 2014, it was re-organized into the State Fiscal Service, which now is under the Ministry of Finance of Ukraine.

The SFS has offices throughout the country and practically implements the tax policy by exercising control over compliance of the taxpayers with the tax laws, control over collection of taxes etc. In addition to regional subdivisions, the SFS has in its structure a number of specialised tax inspections for work with large taxpayers.

As of 1 January 2015, the SFS includes 25 main branches (one in each oblast), 311 territorial branches, one inter-regional and seven specialised tax inspections for servicing large taxpayers. According to the official website of the SFS the SFS employed 58,826 people. This number is slightly lower than in recent years: as of 1 January 2011, the SFS employed 62,233 people, which is 5.5% more than at the beginning of 2015¹¹.

The number of personnel working at the SFS might be seen as high. The table below compares these personnel levels with those in EU countries; nevertheless the use of state-of-the-art systems like e-taxation will contribute to lowering the number of SFS employees:

Table 4: Ratio of the number of tax officers to the number of legal entities in Ukraine and some EU countries*¹²

Country	Number of legal entities registered in the country	Number of tax officers	Ratio of the number of tax officers to the number of legal entities, %
Ukraine	1'503'435	58'826	3.91
France	1'800'000	69'700	3.87
Poland	394'324	42'800	10.9
Hungary	536'900	22'500	4.19

Recommendations

For the functioning of the tax system the autonomy of the tax administration is regarded as essential. Autonomy has to be reflected in its organisational structure and operational responsibilities. The responsibilities have to be clearly defined at all levels of the tax administration. Policies of the tax administration should be chosen with a high degree of freedom. The tax administration needs a clear, transparent and published mission and vision. The strategies of the tax administration must be guided by objectives and benchmarks.

11 Державна фіскальна служба України, «Кількість працівників ДФС України відповідає загальним європейським практикам», 2015 <http://sfs.gov.ua/pro-sfs-ukraini/struktura-/aparatt/13-organi-zaciyno-rosporyad-dep/povidomlennya/180869.html>

12 Державна фіскальна служба України, «Кількість працівників ДФС України відповідає загальним європейським практикам», 2015 <http://sfs.gov.ua/pro-sfs-ukraini/struktura-/aparatt/13-organi-zaciyno-rosporyad-dep/povidomlennya/180869.html>

Personal responsibility has to be implemented for tax officers who impose additional tax charges and penalties that prove to be groundless. The responsibility measures must include disciplinary and administrative measures.

Legal prohibition has to be introduced for use of ratios of a normative tax burden as a basis for additional tax charges. This will be realised by inclusion of a respective provision into the tax code of Ukraine.

It has to be legally prohibited for the SFS to preclude taxpayers from exercising their rights on grounds not directly provided for in the tax code by inclusion of respective provision in the tax code.

Possibilities for tax officials to obtain qualifications have to be created and improved. This could be achieved by use of the currently available educational centres. Whereas lecturers should not only be those working in the National University of the SFS, but mainly those working in business in order to provide a shift from the purely fiscal approach of the attitude of tax officials.

New personnel must possess sufficient technical expertise along with high ethics to confront unlawful orders from the top and suggestions for bribes. The new staff shall receive proper training before entering into office to ensure that it has an adequate technical background.

The current staff shall be re-assessed based not only on technical skills, but also based on psychological and ethical criteria, and allowed to join the reformed state tax service only upon successfully passing tests. Assessment and education of employees at tax authorities have been successfully conducted in several EU twinning projects.

The personnel of modernised tax offices shall be paid salaries sufficient to exclude low pay as a motive for corruption, a practice recommended for all public service staff.

The modernised tax office(s) shall be under the operational control of a specially appointed person. The head of the SFS shall not have any right to intervene into the operating activities of the modernised office(s).

The work performance of the modernised office(s) shall be assessed based on compliance with the laws, but not tax collections, although the latter shall be included in the performance assessment as well.

by denying the right to recognition of input VAT for companies that purchased goods and services from suppliers that were assessed in a certain way, which is against the law. However, a taxpayer marked in a system as a 'wrong' one does not have a practical possibility to sue the tax office, as the tax office, formally, does not harm the taxpayer. But in reality applying this method may ruin the business of the victim, since his customers would not have a right for input VAT on their purchases as well as deductible expenses so they would normally opt for a safer supplier. In order to mend the situation for a specific taxpayer, the tax authorities may require bribes and/or additional payments to the budget above the level required by law.

Fiscal treatment of the quite often ambiguous provisions of the Tax Code of Ukraine by SFS. While it is understandable that tax authorities apply a fiscal approach, even in case of clear provisions of tax legislation that provide for a decrease of tax liabilities for a taxpayer, the SFS tends to treat such provisions fiscally and introduce barriers that make use of such provisions actually impossible.

Recommendations

While it would be relatively easy and logical to suggest introducing further amendments into legislation aimed at preventing the situations described above from happening, the problem is that existing laws are not executed properly. Therefore, new laws may fail in achieving their goal. Hence, the main measure to take is to ensure that tax law is enforced as intended, to stop corruption and to increase efficiency in tax administration.

Introduction of more rigorous penalties for corruption offenses. This must be aligned with a reform of prosecution and the judiciary system to ensure the inevitability of prosecution (see also WS Rule of Law).

A simple replacement of all employees in the tax administration would lead to a chaotic situation, as know-how is needed for the performance of tax administration tasks. Therefore, well-trained European experts should support the transformation process within the scope of twinning projects. Another positive effect of the twinning regime would be financing from the EU.

Furthermore, ethical and content related education for tax officers shall be emphasised.

At the same time, an e-taxation solution would enhance transparency, efficiency and anti-corruption efforts in the comprehensive tax administration and would therefore allow several birds to be hit with one stone.

The autonomy of the tax administration implies the importance of effective internal and external auditing. External auditing has to be done by an independent institution, which should also assess the performance of the tax administration office. The tax administration should be managed and assessed based on effective performance management systems. The audit strategy of the tax administration needs to be risk based considering the size, complexity and compliance records of taxpayers. The audit should use state of the art tools and techniques. Available information from the tax audit needs to be regularly monitored and evaluated.

The tax administration must perform a solid and active headquarters function. This will be accompanied by clear rules defining the relationship between headquarters and regional and local offices of the tax administration. Performance indicators have to be used to evaluate workload and risks at all levels of tax administration. The allocation of resources will be guided by the regular evaluation of workload.

Regulations have to be developed in order to prevent or give early warning of fraud and irregularities amongst employees. These regulations have to be combined with clear, fair and proportionate sanctions for employees involved in irregularities or misconduct.

Successful and effective revenue collection has to be based on a comprehensive and integral revenue collection strategy. This strategy needs to include management controls, detailed records and audit trails to facilitate internal audits. Independent comprehensive audits have to be carried out periodically. Recommendations of external independent auditors have to be seriously considered by the tax administration. Automated revenue receipt and accounting systems ensure that revenue collection can be processed quickly.

In comparable countries, an e-taxation system was implemented in order to ensure effective, comprehensive tax revenue collection. The state-of-the-art system includes the following modules: registration of taxpayers, management of tax returns, taxpayer and revenue accounting including automatic calculation of interest and penalties, case management, document management, risk assessment, enforcement, reporting, MIS – Management Information System.

The positive impact that resulted from the e-taxation tool was, inter alia, equal treatment of all taxpayers, transparency in taxation matters, minimisation of possibilities for corruption, guaranteed sustainable revenue collection, support of international organisations (IMF, EU), increased voluntary compliance, decreasing

operational costs through the introduction of a web-based IT system, increased qualifications of tax officials, increased trust of the taxpayers in the system and its authority on the whole. A guideline for implementation of an e-taxation solution can be found in the Lighthouse Projects section.

1.7 Abusive practices of tax authorities

The tax authorities employ a variety of methods that go beyond those established by law in order to collect money in excess of what is envisaged by tax legislation and without a legal basis. As a result, the tax authorities charge the required amount of additional tax and the taxpayer has three options:

- go to court
- pay to the budget what SFS requires or
- pay bribes to the SFS representatives to resolve the issue (widely used in practice).

In addition to that, the financial police open criminal proceedings against the officials of the 'victimised' taxpayer, which pushes the taxpayer to resolve the issue as quickly and as painlessly as possible.

The situation for the 'victimised' taxpayer is complicated by tax authorities challenging deduction of expenses and denying a right for recognition of input VAT for counterparties of the 'victim'. The customers of the 'victim' are sent letters from SFS informing them that a 'victim' is an entity under high risk and this means that input VAT and expenses on purchases made from such a taxpayer will be challenged. In a majority of the cases the customers stop buying from such a taxpayer. As a consequence, the taxpayer who wishes to file the case with the court may find his business ruined by the time the court rules in his favour, if and when it does so.

It should be mentioned that courts quite often rule in favour of taxpayers, but in many cases it does not help due to the practices described above. On the other hand, however, the tax officials that apply these practices do not bear any responsibilities even if the court rules in favour of a taxpayer in a given case. Hence, there is a clear inequality in the balance of rights and responsibilities.

Understanding this situation makes taxpayers reluctant to enter into disputes with tax authorities, so the fiscal mechanism was widely used to collect funds

to cover budget deficits in cases of need, but also for the financing of political campaigns to win elections, for personal enrichment of those with power, for suppressing competitiveness in the national economy (only those related to ruling politicians would win the market) etc.

Hence, instead of the rule of law based on enacted laws, there is a rule of a shadow law. This is a major problem that caused many reforms in taxation to fail. Improvements in the provisions of the tax code, the civil code or the criminal code have little effect, as in many cases these provisions do not work as intended. Therefore, improvement is first needed in a system to ensure that the law really applies.

For a better understanding of this situation, examples of practices used by tax authorities are listed below:

While conducting tax audits, the tax authorities use ratios of target tax burden to be borne by the entity and in case the actual tax burden is less than what the tax officials want to see, they impose additional tax charges and penalties to get the desired level of tax burden. When imposing additional tax charges, the tax authorities do not take into account the specific economic situation of the taxpayer. The desired levels of tax burden are not at the personal initiative of given tax officials, but are established by interior orders of SFS. Therefore the tax officials in the territorial branches are forced to do as required, and are praised for successfully performed tasks instead of being penalised for abuse of power. In order not to be involved in disputes with tax authorities, taxpayers falsify their tax returns in order to pay more taxes as indicated by the target tax burden requested by SFS, while the tax liabilities of the company computed based on actual financial results is less than that amount.

Recognition of business transactions as false ones. The tax authorities may decide that certain transactions of the taxpayer are fictitious and, based on this, deny deductibility of related expenses and a right for input VAT. The practice is that the tax authorities recognise the transactions as false ones on no legal grounds. This could be done, for instance, if the counterparty of the taxpayer allegedly evades taxes (no court decisions are required for this allegation; it is just a decision made by a tax official).

Method used by SFS to apply certain statuses to VAT payers that are purported to categorise entities with respect to their situations as VAT payers. While this is a reasonable method of categorising taxpayers for the internal purposes of SFS (eg risk assessment, control planning etc) the SFS extended its use of this method

Insurance linked to the College of Physicians of Ukraine

A nation-wide privately owned insurance company with a separate governing board should be established and linked to the College of Physicians of Ukraine. Reimbursement for all existing and future medical procedures and products will be negotiated between the governing board of the insurance company and the governing board of the College of Physicians of Ukraine and respectively its subspecialties. The insurance company will offer three different types of insurance, as in most countries: basic insurance, semi-private insurance and private insurance. A detailed description of this company and the decision between income-related or per-capita monthly fee are two tasks that will be left open for the time being. If the Ukrainian government accepts this approach to modernisation, these tasks will be given to our Workstream Healthcare subcontractor Professor Szucs, who has broad international experience in healthcare financing.

The healthcare system will, of course, not remain free of charge and should not cover all the costs of diagnosis and treatment. When medical care is provided free to 'consumers', demand inevitably escalates and spending increases as products provided at a price of zero are treated as if they have zero resource costs. Hence, resource allocation decisions would become inefficient over time and insurance companies would be forced either to raise more revenue or curb services. When care requires major diagnostic or surgical procedures, the system proposed will define another mechanism to allocate scarce resources and this will be outlined elsewhere. Overall, there are only specified subgroups, eg certain pensioners and children, for which hospital care will either be free or incur minimal costs, as they usually receive governmental support. Dentist examination and procedures as well as non-traditional medicine such as homeopathic measures and life style medicine, will not be covered by this insurance company.

The negotiation of reimbursement for medical procedures and products between the College of Physicians of Ukraine and the privately owned CPU-linked insurance company will lead to a step-wise elimination of the traditional Semashko model where reimbursement was linked to the number of hospital beds instead of the number and quality of medical procedures performed.

The construction of a nationwide privately owned insurance company is open to international investments and cooperation.

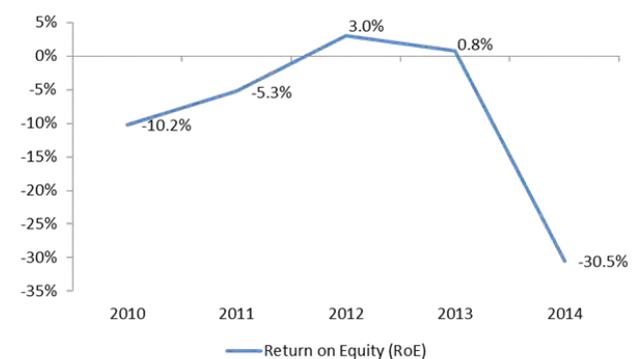
In this case the NBU can impose substantial administrative and economic restrictions – declaring them to be problem banks, so they are no longer able to:

- obtain a refinancing loan;
- have a general license for foreign exchange operations;
- participate in a liquidity-providing tender; and
- increase authorised capital, as the regulator refuses to approve the revised by-laws.

Ukrainian banking is unprofitable for the following reasons:

A weak operating environment as well as a decline in profitability: Banks are confronted with a revenue shortfall due to escalated credit and market risks and the vastly depreciated domestic currency, resulting in a severe contraction of margins. Banks need to adjust operating expenses in line with accelerating inflation. As a result, the total banking sector loss reached UAH 53 bn in 2014. Additionally, banks are forced to create extra provisioning for bad loans and foreign-currency-denominated loans. The main risks are a prolonged economic slump, causing further currency depreciation.

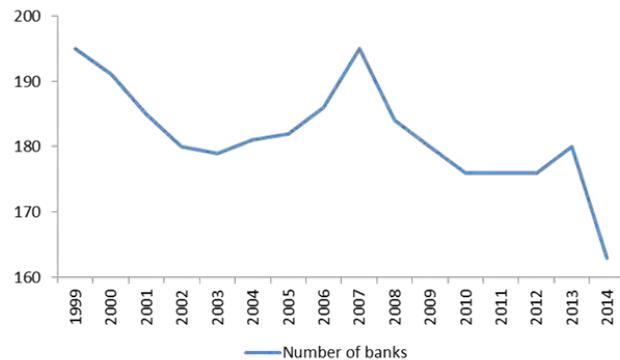
Graph 2: RoE (Return on Equity):



Source: NBU, Raiffeisen Research

Liquidity shortage and funding problems: One of the key problems currently faced by Ukrainian banks is the liquidity shortage, exacerbated by vast deposit outflows²⁹. The result is a liquidity crunch, leaving many banks with no other option than to close and leave the market³⁰. The volatility of deposits prevented Ukrainian banks from reducing their reliance on international wholesale funding (25% of total non-equity liabilities as of April 2015). Given the lack of access to FX and pressure on Ukrainian government finances, banks will have difficulty repaying their international facilities coming due in 2015.

Graph 3: Consolidation dynamics:



Source: NBU, Raiffeisen Research

Rising NPL ratio: A rapidly and sharply worsening economic environment caused a spike in the NPL ratio, with NPL levels reaching 37.5% in 2012 and 2013 and then further increasing to 45% in 2014. The looming structural clean-up of the banking sector (being part of the IMF support package³¹) may also add to NPL

29 During 2014, the Ukrainian banking sector lost UAH 200 bn in deposits, which is about 15% of the banking sector's total assets.

30 From the beginning of 2014 until July 2015, the NBU classified 54 banks as insolvent (of these 45 have already been liquidated).

31 In March 2015, the IMF Executive Board approved a new four-year Extended Fund Facility program for Ukraine totaling USD 17.5 bn. The first tranche of USD 5 bn was already released, USD 2.7 bn thereof aimed at supporting the budget. The remaining amount was used for replenishing National Bank FX-reserves. The new IMF programme is based on a UAH/USD rate of 22 as at year-end 2015, an average UAH/USD rate of 21.7 in 2015 as well as an update expectation for a GDP drop of -9% (as of May 2015, previously -5%).
The key requirement of the new IMF programme was the de-escalation of the conflict in the eastern regions of the country. It is based on the expectation that the Ukrainian economy will eventually cease to feel the impact of the conflict and start performing again in 2016 (after a deep recession in 2015).

4 Recommendations

Lighthouse project: College of Physicians of Ukraine (CPU)

Basic structure of the College of Physicians of Ukraine

The modernisation of the Ukrainian healthcare system is a political, economic and medical issue. Swift and cost-effective changes to save lives and build trust could be implemented most rapidly at the level of the medical profession itself. It is therefore imperative that the medical profession undergoes reorganisation aimed at defining cost-effective and life-saving measures at the doctor-patient level. All Ukrainian doctors should be represented by a new 'College of Physicians of Ukraine' ('CPU'), setting and monitoring the standards of medicine in all specialties and licensing doctors and hospitals, eg similar to the Royal College of Physicians in United Kingdom¹³ or other national organisations of countries within the European Union. The College of Physicians of Ukraine should be a non-profit organisation and should be affirmed by an act of the cabinet of ministers of Ukraine or by an act of parliament. The members of the governing boards of the College of Physicians of Ukraine as well as the members of the governing boards of the sub-specialities will work on a rational base with a limited term of board membership. The College of Physicians of Ukraine defines the rights and obligations of local communities and medical teams with regard to economic and medical activity of healthcare facilities for provision of accessible healthcare to people. In addition, the College of Physicians of Ukraine assures the mechanisms of professional responsibility of medical professionals through the system of self-government of the medical professions.

13 Royal College of Physicians: <https://www.rcplondon.ac.uk>

3 Complications

Obstacles to swift change

The largest obstacle to swift changes in the healthcare system is its inherent complexity as well as the participation of different players with widely different objectives. The same can be said of healthcare systems in most countries.

Reforming the Ukrainian healthcare system poses particular difficulties due to the structural inefficiency of the system at all levels; its fragmentation into several independent providers of healthcare with budget sovereignty; its inefficient financing and the lack of an insurance-based system of health financing. In addition, the global economic crisis and the political unrest and conflict in Ukraine make it impossible to mobilise adequate resources to guarantee equity in access to core health services; moreover, these factors exert upward pressure on prices within the healthcare system, which is particularly true with regard to pharmaceuticals.

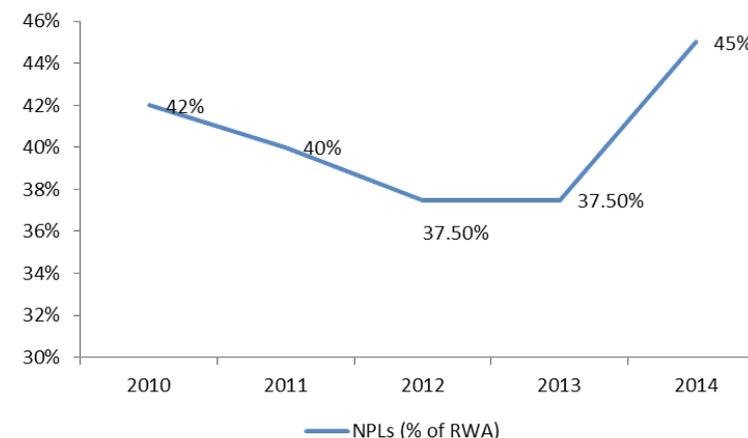
Low wages of state employees including healthcare workers go hand in hand with high out-of-pocket expenses, so the majority of healthcare workers want to maintain the existing infrastructure. In addition, it will take time to improve the weak postgraduate level and the uneven distribution of human resources.

Due to high popular mistrust, the efforts to encourage the population to embrace healthier lifestyles have a limited impact, and treatment compliance rates for people living with chronic conditions are very low, with less than half of all patients saying that they follow their doctor's recommendations. Besides, the modernisation of healthcare systems is known to cause a catastrophic rise in healthcare costs, which is unacceptable in current times.

Nevertheless, improving the quality of care would save lives. Even though the modernisation of the Ukrainian healthcare system should go forward at all levels, the most important objectives with regard to swift changes are to save lives and rebuild trust.

formation in 2015³², but may finally pave the way for a more sustained NPL resolution in 2016 and beyond.

Graph 4: Historical NPL development:



Source: NBU, Raiffeisen Research, Moody's

Decreasing capital adequacy: In the first three months of 2015 capital adequacy fell further, from 15.6% at the end of 2014 to 7.4 % in the first quarter of 2015. In 2014 fourteen banks failed to meet the Tier 1 CAR (Capital Adequacy Ratio) requirements (2013: eight banks), and 34 banks failed to meet prudential regulation requirements (2013: 26). As CARs are rapidly decreasing, the main risk from a capital perspective is the failure of systemic banks. The IMF estimates that the total amount of funds needed to recapitalise the banking system in Ukraine will amount to some 9.25% of GDP (based on 2014/15 figures).

Populistic legislative initiatives: There is a growing populist mood in the parliament. In July a narrow majority in the parliament passed a law on the restructuring of retail (PI) loans in foreign currency into local currency in the third and final reading. This trend might increase risks to the IMF programme and the continuation of the path of stringent structural reforms. The law mandates the conversion of the principal of a loan at the exchange rate prevailing on the day the loan

³² Moody's even estimates in its Banking System Outlook for Ukraine that the NPL ratio will increase to 60%.

was granted. Given the severe devaluations in 2008 and 2014/2015, the law, if enforced, would pose a direct threat to the existence of the country's financial and banking system. Outstanding retail FX loans in the amount of USD 4.7 bn would substantially shrink on the balance sheets of banks, falling from around UAH 100 bn to just UAH 25 bn. This decline would trigger large-scale recapitalisation needs among banks in addition to already existing ones.

However, the president criticised the law soon afterwards, so it is highly unlikely that it will be implemented. According to the IMF agreement, the president is even obligated to use his veto power if a law on compulsory FX conversion is adopted.

Legislation plays a crucial role in the current situation of banks

Regulatory/tax-problems with NPL treatment: The main problem of NPL write-offs is tax accounting, as it is currently more beneficial for banks to continue forming risk provisions for NPLs and keeping them on the balance sheet³³ without jeopardising their results. Consequently balance sheets of banks are burdened with NPLs with a maturity of five years or more.

Regulatory and legislative barriers for debt sale: Debt recovery is very problematic in Ukraine. The following areas are concerned:

Currency legislation: A FX debt can only be sold to other banks (the NPL volume does not decrease but is just reallocated among banks). A FX debt sold to non-banking financial institutions requires both parties to have an NBU licence, general as well as individual.

Debt sold to foreign institutions: The sale of a problem debt requires registration of loan agreements with the NBU based only on the request of the borrower, who is usually not an interested party for such a transaction.

³³ According to the tax code, loan loss provisions are generally accepted as taxable expenses. At the same time an NPL write-off is treated as a separate event with special tax recognition rules. This means that for any NPL write-off, banks should use the risk provisions that have been created. The problem is that there are only a few cases in which banks can use existing provisions without negative tax consequences. In most of cases, write-offs immediately increase taxable profits.

Healthcare costs do not automatically increase because of the demographic factor of age – one of the major and internationally widespread misconceptions in the current debate about the costs of healthcare systems. It is the other way around: people live longer, because countries are investing more in their healthcare systems. This fact offers the opportunity to influence healthcare costs by appropriate and knowledgeable investments.

A patient who can pay, who knows the right people and who is able to get the appropriate information can get timely and appropriate treatment in the current Ukrainian healthcare system. If money is not the point, many patients go abroad.

Some groups of the population have a better chance of obtaining treatment more quickly: children are treated for free until the age of 18; pensioners have to add a minimal amount to the costs of treatment, for which they obtain government support. Some other groups of people can afford private insurance; some belong to business companies providing financial support for their members or employees; military personnel have their own facilities and so on. Hence, social status, income, profession and position within the society may facilitate the chance to quickly obtain the appropriate medical treatment for an individual health problem.

Once a patient is hospitalised, the quality of the care that he receives is still influenced by his financial resources, as a specific therapeutic measure might eventually not be used because the patient can only pay part of the diagnostics or the treatment.

Overall, for the average patients, medical care in the Ukrainian healthcare system does not correspond entirely with the current administrative descriptions of how the system should work.

Giving attention to some kind of healthcare reform merely on administrative and organisational levels only – although necessary – will not solve the problems described above. Improvement must also take place at the patient-doctor level with regard to the whole complex relating to the financing of medical care.

If the patient's complaints persist and the local feldsher centre was unable to help, most patients start to consult friends, relatives and neighbours about the best way to proceed and whom they should consult¹². A patient with a heart attack or with persistent pain due to ischemic heart disease finally may be admitted to a regional hospital where he can obtain more advanced care. In case of medical treatment, the patient usually has to pay himself. Whether or not he can afford medical treatment is another question. The medical treatment partly depends on whether or not the patient can afford the medications or not. There are three possible scenarios: 1) the patient can afford medical treatment even for the long term; or 2) he cannot afford it, therefore any kind of medical prescription is ineffective and the patient's health deteriorates; or, 3) he can afford some of the drugs, meaning that he will omit those drugs which are expensive and only take those he will be able to afford, particularly when he has to deal with long-term medication. Hence, a large number of patients are not able to follow the recommendations of their physicians, which renders many prescribed therapies completely useless.

If the patient has clinically symptomatic coronary artery disease that does not respond to medical treatment alone, he may afford cardiac catheterisation. If he needs a stent, he gets his stent immediately, provided he can pay for it. Otherwise, he (his family or his relatives) has to search for solutions to be able to afford the necessary treatment.

Aside from financial problems, the patient must be able to find the appropriate doctor and must obtain appropriate consultation in time, which depends on personal involvement and sometimes on informal out-of-pocket payments. Hence, whether or not a person receives the best medical treatment in time or not is a financial problem or a problem of knowing the right people, having the right connections, a situation that is the same as in other European countries.

The consequence of this Soviet Semashko model might lead to deteriorating health for the average patient who has problems obtaining appropriate advice and who sometimes is scarcely informed about potential preventive, diagnostic and therapeutic measures. On a broad scale, this system fails to increase life expectancy as well the quality of life once someone falls ill.

12 Stepurko T et al. (2013). Prevalence and factors associated with the use of alternative (folk) medicine practitioners in 8 countries of the former Soviet Union. *BMC Complementary and Alternative Medicine*, 13:83.

Tax risks: Debt sale and debt settlement result in high tax risks for banks.

Legislation on protection of personal information: Without the consent of the borrower, the bank is not allowed to disclose personal information of private individuals and as a result is unable to sell a specific debt.

Legislation on bank secrecy: Without the borrower's consent, the bank is not allowed to provide a potential buyer with information on claim rights before signing the assignment agreement of such claim rights³⁴.

Recommendations

To solve the problematic debt recovery situation, the following improvements need to be implemented:

- a transparent and fair court process and an efficient enforcement procedure;
- favourable tax treatment for debt sale and debt settlement for both the bank and the borrower;
- currency regulation on debt sale operations improvement. A clear regulation on FX debt sale procedures and sales to foreign institutions;
- legislation on bank secrecy and protection of personal information needs to be improved to facilitate a debt sale;
- improvement in NPL write-offs as well as changes to the tax code;
- cancellation of moratorium on acceleration of mortgage loans;
- strengthening of legal protection of creditor rights. This is one of the main obstacles to the sustainable recovery of the banking system.

34 This is especially true of 'old' loan documentation signed before passage of the Ukrainian law on the protection of personal information, which went into force on 1 January 2011.

Recommendations on recapitalisation

Infusion of bank owners' funds and own capital as the best option for recapitalisation and therefore also as the best measure to restructure the banking sector³⁵. Under the IMF plan, banks are obliged to increase capital to 5% in 2016, to 7% at the end of 2016 and to 10% by the end of 2018.

The recapitalisation of foreign-owned banks should be done either solely by their owners as expected, or/and by partnering with the EBRD or other IFIs (such as EBRD in Aval) given the very high-risk environment in Ukraine. Their importance will grow in the future, as they guarantee quality of banking services, transparency, higher technological standards, but most importantly business culture and compliance.

The size of state-owned banks should be also capped, as they concentrate a huge number of clients, often prevent fair market competition, are lacking a clear strategy and are plagued by direct lending practices and by political influence, but do not provide value added to the economy. To relieve the state budget, Ukgazbank should be privatised, Oschadbank should be turned into a real savings bank and Ukreximbank should focus on the corporate sector. 'Corporatizing' the latter two might be an option; participation by global development banks and agencies might be helpful. One option for recapitalisation is state participation via non-voting shares for a certain time period (five years).

Capital injections by the Ukrainian state would be a potential solution for the recapitalisation of private Ukrainian banks, as they have limited access to capital markets. Dependent on the solvency of Ukraine, the injections could be replaced – to a certain extent – by state guarantees, which should be partly structured as guarantees in legal form.

³⁵ However, the IMF reserves 4% of GDP in public funds as a buffer that could be used to restructure and recapitalise local banks.

unacceptable work environment for physicians and nurses, and is a heavy financial burden for the state. Consequently, popular mistrust of doctors is strikingly high, as emphasised by the fact that 90 % of the patients would prefer to choose another option for their health problem, and many in fact do. According to some informal data, every year Ukrainian patients spend more the 700 million euros abroad, an amount representing nearly 15 % of the healthcare budget (unofficial information).

Ukrainian healthcare system: the patient's view

The following factors are all related to notions of how a healthcare system should be organised, at least on paper: organisation, regulations, decentralisation, reforms, regional and local health authorities, financing, capacity planning, cost control, approved state quality standards, clinical protocols, licencing, delivery of medical services, regulatory processes, patient empowerment, recent package reforms, provision of universal access to unlimited care, postgraduate medical education programmes, medical research system and more.

The modernisation of the healthcare system must place the patient in the centre of all reform steps. Hence, the major questions are these: How do the great majority of patients experience the healthcare system? How and when do the great majority of patients get appropriate medical care when needed? The quality of the healthcare system becomes evident if a patient without any special connections and knowledge needs to consult with a medical professional regarding his health problem. The following section describes the pathway of a patient to obtain appropriate medical care for his health problem. In addition, the financial pathway for the average patient is described.

Let us say, for example, that a patient in a rural area contracts abdominal pain, which continues to hurt him and to reduce his quality of life, eventually rendering him unable to work. His first step in seeking help will be to consult a local health office, where he will find nurses and so called feldshers. A feldsher is a health care professional providing various medical services mainly in rural areas.

The health care for the patient can obviously become dependent on the quality and experience of the feldsher, whose basic and continuing education is not standardised.

In case of an emergency, the patient is transferred to a local or eventually a regional hospital. Transfer by ambulance is free.

item budgeting for health facilities and seniority-based salaries for doctors and nurses). Therefore the majority of public resources go towards maintaining the existing infrastructure. Also as a result, the health infrastructure is oversized, with more than 300,000 beds and 2,400 hospitals¹¹ (almost twice the number of Spain, a country with a similar population, and much above EU averages per population). Yet this infrastructure is extremely fragmented and unable to provide an adequate response to the current health crisis.

Organisation

The health system is officially state controlled and nationally administered by the Ukrainian Ministry of Health and several independent administrative organisations such as the National Academy of Medical Sciences, the Kiev Municipality Healthcare Department, the Security Service of Ukraine, the Ministry of Internal Affairs and other entities having their own budget sovereignty. Most medical services are provided to the population in local self-governing facilities at the regional, district, municipal or village level. Apart from the development of a formal private sector consisting mostly of pharmacies, medico-prophylactic facilities and privately practicing physicians; the basic organisational structure has essentially remained unaltered since the Soviet period. In the Semashko model, citizens have been obliged to access healthcare according to the location of their permanent residence for primary as well as secondary medical care with special referrals to third and fourth tier treatment by local doctors. Today, Ukrainian citizens are 'free' to choose doctors and healthcare facilities, but this, again, depends on unofficial direct payment to medical experts.

While the quality of university medical studies is comparable to Western standards, there is an almost complete lack of standardised high-level postgraduate education. Therefore, there are only a small number of high-level experts. They reached this level mainly through self-initiative and the implicit will to achieve the highest professional level according to international standards.

As a result the Ukrainian healthcare system provides neither prevention nor satisfactory treatment of diseases. This system is customer-unfriendly, creates an

11 WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe.

Recommendations on the Deposit Guarantee Fund

The Deposit Guarantee Fund (DGF) is in charge of dealing with insolvent banks (managing receivership and recovering assets of liquidated banks). To be used effectively, the DGF needs to undergo a capacity increase and to have qualified personnel and expertise.

Consequently, asset recovery levels are extremely low. The legislative framework has been amended recently, but day-to-day operations should be improved substantially.

2.4 Credit unions and cooperative banks

For centuries credit unions and cooperative banks have played an important role in many western economies³⁶. They are important institutions to mitigate financial exclusion, especially in rural areas. While credit unions enable their members to improve their economic basis ('help for self-help'), cooperative banks contribute substantially to investment³⁷ and are very robust due to their capital reserves and composite structure compared to joint stock banks. In many western countries both organisations work in tandem. Credit unions are mostly the provider of liquidity in case of the need of financing. Cooperative banks collect liquidity and redistribute it via loans where it is needed. They also assume other important functions (accounting, regulatory reporting, risk management etc).

Although in credit unions are widespread in Ukraine (617 as of the end of 2012) and penetrate rural communities not reached by banks³⁸, they play only a subordinated role. A cooperative banking system does not exist in Ukraine.

36 Every second bank in Europe is a cooperative bank

37 The cooperative banking system plays a crucial role in accumulating and transferring capital in rural areas. This is particularly important in countries where a relatively large share of the population is employed in the agricultural sector. This is the case in Ukraine, where 17.2% of the total employment worked in the agricultural sector in 2012; for the EU the average amounted to 5.1%.

38 1.2 m members at the end of 2012

On the one hand the term 'cooperative' was associated with commercial banks in the early 1990s; on the other hand Ukrainians are not familiar with the cooperative banking concept³⁹ and its core values⁴⁰.

Credit unions are hampered in their ability to issue longer-term loans, as their sources of funding are limited to customer deposits and member investments. Additionally, regulatory hurdles complicate their access to deposit licences - only 30% of credit unions are allowed to accept deposits.

Poland can serve as a good example for Ukraine for the implementation of cooperative banks. It is also a post-communist country and struggles with similar economic and social problems (although of a much lower magnitude). The cooperative banking system has 10 m clients (about 1/3 of the working age population in Poland), a 9.5% share of total banks assets, and over 3,000 local branches. These statistics demonstrate that Ukraine has great potential for developing a similar banking scheme, from which it could benefit substantially.

The most pressing issue concern setup requirements, which are too stringent, as the initial capital required for setting up a cooperative bank in Ukraine is very high (UAH 120 m), five times the Polish requirement of PLN 4 m. This is also true of the required minimum number of cooperative members to establish a cooperative bank (minimum of 50 members in Ukraine vs. minimum of 10 members in Poland).

The consequence is an underfinanced agricultural sector. Ukrainian farmland represents ~30% of the total available farmland in the EU. One quarter of the globally available chernozem earth (black soil) is located in Ukraine⁴¹. This is an asset of strategic importance, as global food demand will continue to rise in the future. This rise would translate into a conservative tax revenue stream for the Ukrainian government, provided credit unions are financially strengthened and a cooperative banking system is put in place first.

39 One obstacle is the name 'cooperative' itself. This word is considered, especially by the younger generation, to be old-fashioned, useless and overly bureaucratic. There is a need to create a new term and name for this sector.

40 The idea of cooperative banking is based on virtues that are essential to establish civil society, such as solidarity, mutual responsibility, and the superiority of individual and social aims to pure financial profit.

41 Ukraine is globally the third largest producer of corn and the seventh largest producer of wheat.

Even though infant mortality has decreased substantially since 2005, the infant death rate in Ukraine is still at least twice as high as in Western European countries⁶.

Financial coverage

Total health expenditure in Ukraine amounted to 7.72 % of GDP in 2012⁷ (with an EU average of 9.8 %) or approximately US\$299.3 per capita at the average exchange rate in 2012 (EU range: US\$901 to US\$6,867 per capita)⁸. Government health expenditure accounted for 12.7 % of total consolidated budget expenditures, or approximately 4.44 % of GDP, while the rest (over 3.26 % of GDP) was mainly patients' out-of-pocket expenditures covering up to 44% of the total expenses in the healthcare system, which mainly include unofficial remuneration of medical experts.⁹ Now these high levels of out-of-pocket medical costs create severe financial barriers for the poor and potentially catastrophic expenses for those who seek care and/or need to purchase medicines for chronic diseases. Hence, up to 22.6 % of those who need care are not able to receive it or buy medicines, primarily due to affordability. Moreover, a substantial amount of out-of-pocket money is used for direct payment of doctors¹⁰, representing a substantial part of their limited salary. This increases the reluctance of medical experts to participate in reforming the financing of the healthcare system.

Most state health financing comes from general taxation, while other sources of revenue, such as insurance, are almost non-existent. Government money is allocated according to inputs (linked mainly to beds and bed-days, with line-

6 WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe

7 State Statistics Service of Ukraine, 2014c; WHO 2015.

8 WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe.

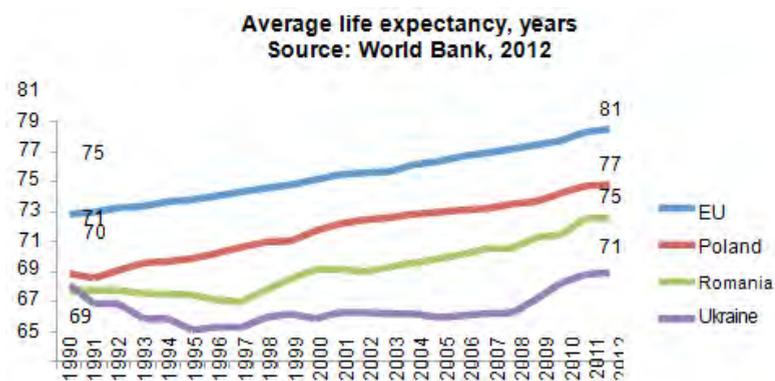
9 Stepurko T (2013) Informal payments in Central and Eastern European countries. Doctoral dissertation, University of Maastricht.

Stepurko T et al. (2013). Prevalence and factors associated with the use of alternative (folk) medicine practitioners in 8 countries of the former Soviet Union. BMC Complementary and Alternative Medicine, 13:83

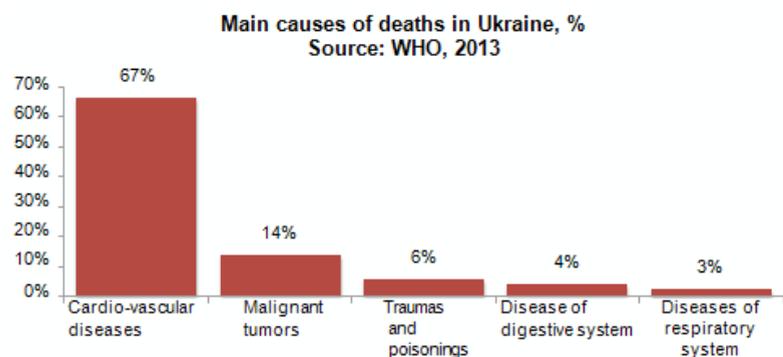
10 Stepurko T (2013) Informal payments in Central and Eastern European countries. Doctoral dissertation, University of Maastricht.

Health status

Between 1985 and 2012, total life expectancy at birth increased from 69.9 to 71.3 years, but then stagnated and recently even fell⁴.



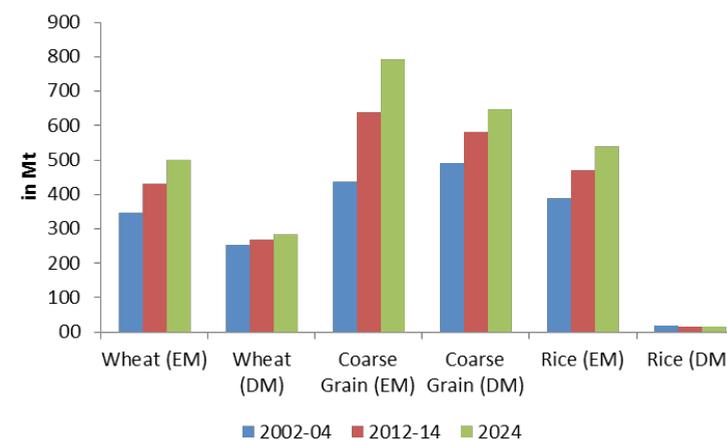
Uncommunicable diseases and injuries are the main culprits in the mortality crisis in Ukraine, with cardiovascular diseases being responsible for approximately 70 % of all deaths⁵ followed by cancer and external causes including accidents and poisonings. All these factors together account for 87 % of all deaths in



⁴ WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe

⁵ WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe

Graph 5: Estimated cereal consumption until 2024 – emerging and developed markets:



Source: OECD, FAO

Recommendations

In order to settle the problem of the scarcity of cooperative banking, it is essential to take the following measures:

- the NBU should take over the regulation of credit unions above a certain size in terms of capital;
- on the other hand the setup requirements for cooperative banks regarding required initial capital should be relaxed⁴² as must the requirements on the number of the cooperative members needed to establish a cooperative bank (from currently a minimum of 50 members to a minimum of ten members);

⁴² The minimum level of initial capital needed to establish a cooperative bank is five times greater in Ukraine (about PLN 20 m) than in Poland (about PLN 4 m). Moreover, this gap is even greater when Poland's and Ukraine' GDP per capita (PPP) levels is compared (about USD 25 k vs. about USD 8.5 k). Therefore, the new level of the initial capital required in Ukraine should be fifteen times less than its current value (UAH 120 m), ie about UAH 8 m, taking into consideration that the discrepancy of that requirement between Poland and Ukraine is five-fold and that the difference between Polish and Ukrainian GDP per capita levels is three-fold.

- in order to effectively spur the growth of the cooperative banking sector, an association of cooperative banks could be established. This association would act as a representative of the cooperative banking sector, but would also assume other important functions (accounting, regulatory reporting, risk management etc);
- further it is necessary to increase knowledge about the cooperative banking idea, especially among the inhabitants of rural areas;
- additionally, as one third of total land available is owned by the government, a land reform should be implemented.

2.5 The microfinance sector

Microfinance as a financing solution for SMEs

Ukraine has vast potential for SME growth given its abundance of rich agricultural soil, its large supply of high calibre technical talent and an environment conducive to improvements in energy efficiency. The major obstacles are ways of financing needs, which are extremely high. Any support measures have to consider the current critical condition of the Ukrainian state and its population:

- Over 1 m displaced persons
- Tens of thousands of war veterans
- High unemployment based on the economic crisis.

In this environment, the creation of new jobs/fostering of start-ups is an indispensable prerequisite. Considering these facts it should be emphasised that SMEs have displayed much greater strength in the face of a crisis. This is clearly evidenced by the percentage of non-performing loans held by Ukrainian banks. The highest losses occurred with large enterprises whereas SMEs are the only business segment still showing profitability – though modest – in banks' profit and loss accounts.

Contrary to the above situation, the creation of the CPU as a non-profit but state organisation will become a uniting force in creating a 'single medical area' with possibilities of new multisource legal financing.

1 Aim

The health system in Ukraine has not yet undergone reform even though the health sector is one of the vital factors for a successful, prosperous future for the Ukraine.

Between 1970 and 2010, Ukraine 'gained' only one year of life expectancy and dropped 92 positions in ranking with regard to adult and child mortality¹. Workstream 'Healthcare' describes the current situation and provides suggestions for the modernisation of the Ukrainian healthcare system.

2 Situation

The evidence shows that Ukraine is facing a health crisis and that its healthcare sector is not delivering results either in terms of a) health outcomes, b) financial coverage, or c) organisation. The reason for these shortcomings is that the Ukrainian health system has preserved the fundamental features of the Soviet Semashko model ('state run, highly centralised and chronically underfunded in real terms')^{2 3} against a background of changes that have developed along the line of market economic principles. Some changes in the healthcare sector have been initiated and realised since independence; however, attempts for fundamental reform have failed.

1 WHO Regional Office for Europe (2014). Health for All Database (HFA-DB), offline version, April 2014 edition. Copenhagen, WHO Regional Office for Europe.

2 Lekhan VN, Rudyi VM, Nolte E (2004). Ukraine: Health system review. Health Systems in Transition, 6(7):1-128.

3 Lekhan VN, Rudyi VM, Richardson E (2010). Ukraine: Health system review. Health Systems in Transition, 12(8):1-183.

Management summary

Healthcare for the population of Ukraine is one of the key functions of the state and is set out in the Ukrainian Constitution. Health reform must be a major priority. The creation of a 'College of Physicians of Ukraine' will be the mechanism for setting and monitoring standards of medicines in all specialities and for licensing doctors and hospitals. That body could also act in a leadership capacity to bring about a restructuring of health and medical care as part of a comprehensive endeavour. The indignity and trauma of having to secure basic medical care through bribes, or the risk of being denied it, must be judged by the many zero tolerance target areas of anti-corruption.

This draft describes the initial steps for reforming the healthcare system of Ukraine in conjunction with other Workstream Groups of the Agency for Modernisation of the Ukraine.

These first reform steps are aimed at introducing mechanisms of professional responsibility for medical professionals in the form of a self-government system for the medical profession. The major targets are as follows:

- immediate improvement of the quality of medical care with regard to mortality and morbidity
- cost-effectiveness

During these difficult times Ukraine needs to get and keep the people's trust in healthcare and primary care services. One of the primary aspects of strengthening this trust will be the legal agreement between the government and the College of Physicians of Ukraine (CPU). Existing medical care in Ukraine is divided among a vast number of governmental institutions under the previous Semashko model, thus creating such problems as these:

- Incapability of the system to make rational use of the state budget for medical care, especially highly-specialised healthcare;
- Lack of proper planning for bed-days at the second and third tier of medical care services, as well as absence of prioritisation in preventive care and rehabilitation;
- Failure to implement a healthcare insurance system;
- Disorganising, uncontrollable actions of the public medical system; and other negative effects.

Recommendations

Financing is a major obstacle for the further development of SMEs in Ukraine due to:

- A chronic shortage of capital
- Extraordinarily high financing costs.

Under the president's leadership, state authorities should develop a roadmap for a 'New mass SME invest/support programme' which foresees the following:

- easier access to finance and business development opportunities;
- access to market;
- easier access to financing based on lower interest rates. Maximum loan rate up to 20% with 5% compensation from budget (this practice is well known in Ukraine, having been implemented earlier for farmers);
- risk-sharing programs for start-ups covering 50% by a newly established state agency in combination with supranational funding from EBRD, EIB, EIF, IFC and KFW (Germany) and leveraging of this low-interest funding with domestic funds;
- individually tailored loan for individuals who are self-employed, small enterprises that were established only recently, SMEs that have been active in the market for a longer time;
- the introduction of guarantee schemes: from special financing vehicles (like Ukrsofsbank and/ or others) to grant guarantees for investment loans, which are then granted by normal commercial banks (scheme to be developed similar to the 'Export Promotion Scheme' in Austria and many other countries)⁴³.

⁴³ The programme should be well equipped with tools in order to prevent 'misuse' (ie artificial SPVs getting privileges). The above mentioned state agency should cooperate with the state register of final beneficiaries/ financial monitoring bodies for purpose of insuring that the right recipient receives the financial support.

Access to the market would be based on a governmental purchase and price preference policy for SMEs:

- to set the national minimum of purchases to be routed via SMEs at 25%,
- to provide equal opportunities to large businesses and SMEs on tenders.
- Private equity, venture capital and start-ups ecosystem

2.6 Crisis hampered the prosperous development of the private equity sector

The private equity sector in Ukraine is small and relatively inactive due to the poor investment climate. Just one private equity (PE) fund has been set up since the crisis. Other firms have had trouble raising additional funds due to poor performance of pre-crisis funds – lacking successful exits. Venture capital (VC) and the start-up ecosystem are only beginning to develop. Especially the VC scene comprises only a few players and sparse investments.

Bank financing as the main financing source for SMEs

SME financing is largely supplied in the form of short-term bank financing, with limited offerings from leasing companies, credit unions, PE funds, and VC firms. Trade finance for SMEs in the form of letters of credit and guarantees is limited overall and this activity is highly concentrated among a small number of banks. In terms of products, guarantees are most commonly used. Overall, a significant SME financing gap exists in Ukraine, particularly notable for loans, creating an impediment to SME development.

Recommendations

As PE firms leverage companies it is necessary for them to operate under stable economic conditions; otherwise the probability of default will be very high. The Ukrainian economy, with its high inflation, immense currency depreciation and its industrial output decline, does not offer the needed framework for buyout activities at the moment. If these economic difficulties can be overcome, it will be necessary to provide financing through other channels than banks, for

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X Healthcare

Results and proposals of the workstream

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instance through international financial institutions (IFIs). People with sufficient own funds, market knowledge and consequently risk judgment capabilities could be an ideal source for VC investments companies⁴⁴. But as outlined for PE firms, before VC can flourish, it is necessary to have stable economic conditions (traditionally VC firms have an IRR requirement of up to 45% as the probability of failure for start-ups is even higher than for leverage buyouts).

2.7 Leasing companies

Leasing has a special status among hard currency debts.

Based on unofficial data, about 200 leasing companies exist in Ukraine but only ten to twelve companies are offering leasing service openly on the market. They can be categorised as either:

- bank subsidiaries/ universal leasing companies⁴⁵: From 2010-2012 majority ownership of leasing companies by banks or financial institutions increased significantly⁴⁶ due to the fact that leasing was and is considered a less risky instrument (ownership title on collateral)⁴⁷; or
- passenger car leasing companies and captives⁴⁸:

44 These companies typically operate as a member of a financial group and provide long-term leasing financing to the group's clients and via partners/vendors: RLUA, OTP Leasing, VTB Leasing, Ukrainian Leasing Fond (VieshEkonomBank), UniCreditLeasing, ALD Avtomotiv (SG Group).

45 These companies typically operate as a member of a financial group and provide long-term leasing financing to the group's clients and via partners/vendors: RLUA, OTP Leasing, VTB Leasing, Ukrainian Leasing Fond (VieshEkonomBank), UniCreditLeasing, ALD Avtomotiv (SG Group).

46 Only 3 of top 10 leasing companies in 2010 were majority owned by banks or financial institutions.

47 Average time between decision of repossession and execution is about 100 days which is significantly better compared to collateral of loans.

48 This category includes leasing companies established as specialized companies providing car leasing only, including car fleet management services. Several companies are owned by local dealers of leading Original Equipment Manufacturers (OEM): Porsche Leasing, AVIS, ILTA Leasing (Peugeot dealer).

- As leasing companies operate under looser regulations⁴⁹, leasing contracts are used by these companies to provide access to hard currency (for leasing payments/monthly instalments), but the customer has to pay his or her obligation in the local currency, as the calculation of these payments is linked to foreign currency. This is a typical market practice on the Ukrainian leasing market (in 2014 only 2% of leasing transactions were in local currency). The reason for this situation is a lack of long-term hryvnia refinancing (three to five years).
- In May 2015 the NBU changed the rule for legal lending, limiting the level for subsidiaries / 'bank insiders' from 5% to 25% of the bank's regulatory capital. This will have a positive impact on the future development of leasing, as the business model of leasing companies based on FX funding from 'inside the banking group' is impossible to maintain and causes a high level of risk and losses in case of local currency devaluation.

Recommendations

The acute shortage of medium- and long-term funding for the industrial sector plagues the Ukrainian economy. As a considerable part of these companies has outdated industrial as well as agricultural equipment - inefficiently or badly serviced – a dire need for equipment modernisation exists. The leasing product for standard assets with a liquid secondary market (eg tractors, cars etc.) would be ideal to meet this demand, being less complicated for customers (ie fewer formalities concerning collateral compared to a bank loan).

One solution to this supply-demand mismatch is to implement taxation advantages for lessees comparable to those in existing legislation in several EU countries. This special taxation regime⁵⁰ would stimulate investment in fixed assets while simultaneously having no negative impact on the state budget in the medium term.

49 Under the leasing company act in Ukraine, leasing companies are registered as standard legal entities, hence as non-financial institutions, without special regulations from State Commission for Regulation of Financial Services (SFR) or any requirements for the level of equity, capital ratios, management systems or reporting rules.

50 A taxation of the depreciation of leased objects within the leasing term.

Looking at the Visegrad⁵⁹ countries, which have the most developed financial markets and legal systems in CEE at their disposal, crowdfunding is still at an early stage (second stage)⁶⁰ and not an immediate priority. What does that mean for Ukraine? Considering the fact that industrial output is estimated to shrink by 15% (from -10.7% in 2014) and unemployment to increase to 11%⁶¹ in 2015 (from 9.3% in 2014), providing SMEs with financing as well as bank recapitalisations are more important in the short to medium term.

59 Czech Republic, Hungary, Poland and Slovakia

60 First stage: crowdfunding starts to be perceived as a solution to individual cases and is conducted through single-purpose web sites only. Second stage: intermediary platforms appear. Third stage: the market creation stage happens when experts, advisors, and media promote and develop the tool. Final stage: the 'asset class' stage follows, in which the necessary legal regulations and good practices are worked out to protect the interests of both CFP owners and their users.

61 How to stabilise Ukraine (Vienna Institute for international economic studies, 2015)

- reduce commission levels to achieve long-term convergence with CEE standards;
- apply normal taxation rules for insurers instead of the current combination of 3% on premiums and 18% general profit tax;
- the social contribution for employees remains high at up to 40% of the salary and is payable by the employer. All the agent's commissions are subject to social contribution (effectively increasing commissions by 40%), forcing some insurance companies to optimise taxes and create an unequal competitive environment;
- strong motor bureau controlled by insurers (not government officials/parliamentarians).

If these key issues are resolved a profitable insurance sector is likely, as the insurance density (per capita expenditures for insurance products) in Central Eastern Europe (CEE) is rather low compared to Western European markets. While the average Austrian, for example, invests about EUR 1,954 per year in his security, this figure is just EUR 53 for Ukraine.

2.10 Further financing opportunities – crowdfunding

The global crowdfunding market grew excessively in the last couple of years. Crowdfunding platforms (CFPs) raised USD 16.2 bn⁵⁶ in 2014, compared to USD 6.1 bn in 2013. North America still accounts for the largest market with a market volume of USD 9.46 bn, followed by Asia with USD 3.4 bn and Europe with USD 3.26 bn. Although these figures are impressive, the amounts raised in Europe by crowdfunding are negligible by comparison. In the United Kingdom, at USD 2.4 bn⁵⁷ the largest CF market in Europe, lending facilities granted to UK businesses (large corporates and SME) amounted to USD 190 bn⁵⁸ in 2014.

⁵⁶ Massolution, 31 March 2015, most active categories: business and entrepreneurship at 41.3% / USD 6.7 bn; social causes 18.9% / USD 3.06 bn; films and performing arts 12.13% / USD 1.97 bn; real estate 6.25% / USD 1.01 bn; music and recording arts 4.54% / USD 736 m.

⁵⁷ It's not just crowdfunding, (Tech.eu, 23 February 2015)

⁵⁸ Trends in lending, (Bank of England, January 2015)

2.8 Stock exchange

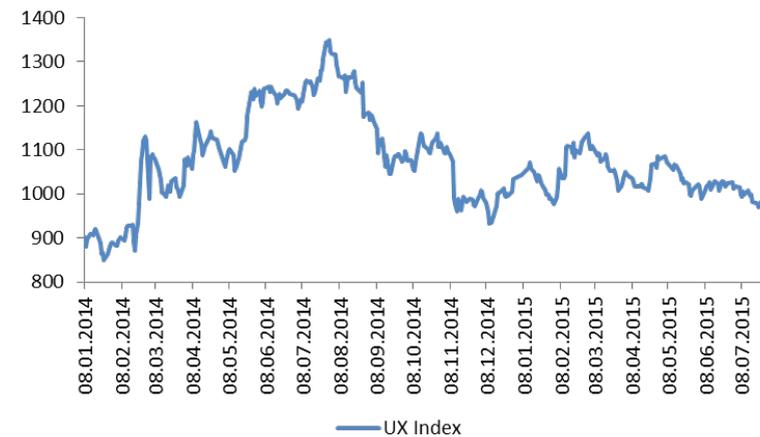
Volumes and values decreased massively on Ukrainian stock exchanges

98% of all traded contracts are concentrated at two stock exchanges in Ukraine:

- Ukrainian Exchange (UX)
- PFTS.

UX is the largest stock exchange. Trading volumes have decreased dramatically (more than 90% in the last three years). Only local players (eg Dragon Capital) are left as important liquidity providers. Russian banks and brokers have stopped trading. The UX lost 67% of its value over the last three years as a result of the overall economic downturn and the conflict in eastern Ukraine.

Graph 7: UX index value



Source: NBU, Raiffeisen Research

The Moscow Exchange (MICEX) is the largest shareholder of both Ukrainian exchanges. Through a merger⁵¹ MICEX would become the controlling shareholder. Although this is more a political than an economic issue, a Russian entity as majority owner of the merged Ukrainian exchange might be hard to sell to the public. MICEX is not a fully government-controlled entity and the status quo (low volumes and low profitability) does not help either Ukraine or MICEX⁵².

Recommendations

The merger of the two exchanges (put on hold since 2014) should be pushed through to create a single stock market in Ukraine with the advantages of reduced costs and inefficiencies, higher trading volumes and increased business activity through an expansion of derivatives listings and a broadening into commodities, to compensate for the lost trading volumes of Russian investors.

2.9 The insurance sector

The economic downturn, rising inflation and depreciation of the hryvnia (UAH) are leading to a real income decline, which in turn is negatively impacting the decision of the Ukrainian people to buy insurance products. Thus the insurance market as a whole is declining (in EUR equivalent). To give an example, as new car sales are declining (~-70%), so too are gross written premiums (GWP)⁵³.

51 In the Extraordinary General Meeting held on 21 January 2014 the shareholders of the Ukrainian Exchange (UX) approved plans to merge UX into PFTS Stock Exchange (PFTS).

52 Central Bank of the Russian Federation, UniCredit Bank, State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank), VTB Bank, Joint Stock Commercial Savings Bank of the Russian Federation, EUROFINANCE MOSNARBANK, Eurofinace Capital, ROSBANK, Commercial Bank, CentroCredit, International Bank for Economic Cooperation, St. Petersburg Bank, Gazprombank, Bank of Moscow, Association of Russian Banks, Sotsinvest-bank, ING Bank Eurasia, Deutsche Bank, JP Morgan Bank International

53 The total premium (direct and assumed) written by an insurer before deductions for reinsurance and ceding commissions.

Insurance sector faces incalculable risks

Although the number of insurance companies has fallen significantly, from originally 700 in 1994 to 440 in 2015 (385 life insurance companies and 55 non-life-insurance companies), this number of insurance companies is still excessive and so too are the commissions charged. The UAH devaluation increases loss ratios (especially for CASCO and health products). The conflict in eastern Ukraine and the annexation of Crimea affect both premiums and benefits/claims. The dire condition of the banking market – no new lending and high NPLs – has a direct impact on the insurance market. In terms of legislation, a lack of reforms is the result of a weak regulator (the regulator will be subject to the authority of the NBU in 2015/16). A good example is the weak motor bureau, which is not able to clean up the market in motor third party liability insurance (MTPL)⁵⁴. Also the bottleneck concerning the implementation of new laws is problematic (the new law on insurance has still not been adopted – it is planned for the second half of 2015).

Recommendations

A profitable insurance market is only possible if the following key issues are resolved along with economic stabilization⁵⁵:

- improve the old legislative basis – outdated requirements (electronic policy not allowed; all policies require signatures etc);
- take action to battle corruption;
- passing laws and regulations (on insurance, MTPL etc);
- further clean up the insurance market;
- exert regulatory control over insurance reserves and provide coverage with quality assets, as well as review reserves calculation, coverage and solvency requirements;

54 A motor third party liability (MTPL) insurance is mandatory liability insurance. All motor vehicles participating in road traffic and subject to registration in traffic register must have valid MTPL insurance.

55 Stabilisation of UAH devaluation, end of the conflict in eastern Ukraine, continuation of reforms (including privatisation, financial sector, court system, public health, pension system)

5 Lighthouse Projects WS Economy

5.1 A Partnership with the Pan-European Commodities Exchange

A Partnership with the Pan-European Commodities Exchange

Project phases and timing (approximately 3 years):

Step 1 Set up a partnership between the Warsaw Commodities Exchange and the Ukrainian Universal Commodity Exchange or other commodity exchanges (up to 12 months)

Step 2 Further integrate European commodities exchanges into a Pan-European Commodities Exchange (above 12 months)

Funding amount: High

Project benefits

Development of the agricultural sector in Ukraine and laying the foundation for stronger political and economic ties with the EU countries

Description of the project

Step 1

as a short-term measure (within a year) the Ukrainian Universal Commodity Exchange (UCEX) (or other commodity exchanges created for this purpose) should establish a partnership with the Warsaw Commodities Exchange (WCE). The institutions may exchange licences, programmes, know-how and other expertise in running the commodity trading business.

The College of Physicians of Ukraine as well as a nationwide insurance company could be established within two years. Certainly, there are many organisational issues that have to be addressed by the on-going and time-consuming reformation of the Ukrainian healthcare system. The foundation of the College of Physicians of Ukraine and the establishment of an associated insurance company, however, are the initial measures that can be undertaken without increasing healthcare costs unacceptably. In addition, taking action to directly influence medical care at the patient level is deemed to bring about a swift reduction in the mortality and morbidity rate, which will in turn lead to a prompt improvement of the patients' trust in the Ukrainian healthcare system.

Structure and responsibilities of individual sub-specialties

To start with, two medical specialties should be chosen to implement changes that allow a swift reduction in the mortality and the morbidity rates for a large patient population and that achieve immediate results with an inherent long-term effect on Ukrainian society. These two specialties could be cardiovascular medicine and mother-and-child care.

General remarks

Cardiovascular medicine was chosen as the primary example because up to 70 % of all deaths in Ukraine are caused by cardiovascular diseases. Actions taken to improve cardiovascular medicine save lives immediately, eg successful emergency coronary stenting for acute myocardial infarction. On the other hand, appropriate mother-and-child care – the second example – has a great impact on early survival as well as on wellbeing later and much later in life. That is because poverty and illness during early childhood are the most important predictors for dramatically increased sickness in adulthood. Therefore, swift implementation of organisational steps has a direct impact on survival and life expectancy. Once serious illness strikes, both survival and life expectancy are of central interest to the majority of the Ukrainian population, as the Ukrainian health care system still hovers around the 'safety level' of the Maslow's hierarchy of needs¹⁴.

14 Understanding and motivating healthcare employees: integrating Maslow's hierarchy of needs, training and technology. Benson SG1, Dundis SP. J Nurs Manag. 2003 Sep;11(5):315-20

The more detailed description below of cardiology and cardiovascular surgery presents some general organisational and quality assessment steps that can easily be introduced by all medical subspecialties performing any interventions or operations. Once approved and found to be highly effective, the basic principles can subsequently be overtaken by one subspecialty after another until all medical subspecialties are unified within the College of Physicians of Ukraine. This, of course, should and will include the areas of emergency medicine and primary care, which will need more time to become integrated parts because consistent quality measures are more difficult to implement.

Cardiology and cardiac surgery

The future society of cardiology and society of cardiovascular surgery in the College of Physicians of Ukraine are the key players in swiftly improving the quality of care in cardiovascular medicine and must define and implement the actions necessary to achieve these goals:

Swift reduction of mortality and morbidity rates in association with interventional and invasive procedures. Interventions and operations do not have to be re-invented in a bureaucratic way:

- there is vast experience in developed countries in achieving excellent results in the treatment of cardiovascular diseases; highly-effective protocols can either be taken over one-to-one or modified according to specific needs. The same is true of organisational protocols, eg the transfer of patients with acute coronary syndrome to reduce the pain-to-treatment time determines early mortality, late outcome and return to work;
- on-site education brings about the most rapid and impressive improvement in interventional cardiology and cardiovascular surgery. Hence, the society of cardiology and society of cardiovascular surgery should choose partnership(s) with experienced societies and promote joint on-site education in Ukraine. Example: within 15 years, the Swiss Society of Cardiology reduced the hospital mortality rate for acute myocardial infarction from 30 % to 3 % in patients without and to 6 % in patients with cardiogenic shock by applying a nationwide rescue system to reduce the door-to-balloon time in patients with acute coronary syndrome.¹⁵

This style of rescue system should be analysed and adapted to the needs of Ukrainian patients, starting with urban areas and then extending this program to

15 Outcome of patients admitted with acute coronary syndrome on palliative treatment: insights from the nationwide AMIS Plus Registry 1997-2014: <http://bmjopen.bmj.com/content/5/3/e006218.full>

Funding amount: Low

Project benefit

Higher quality constitutional discussions; international input on current issues

General context of the project and expected impact

The written constitution is the foundation for political and constitutional discussions. Those discussions require a profound understanding of the complex dependencies and interconnections of the constitutional provisions. An international forum can bring insight into the current or future constitution as well as stimuli from the outside.

The experts meet on an annual basis and discuss one or two current issues from a national and an international point of view.

Description of the project

Composition: A solid group of experts is formed. It is open to others on invitation. Both academicians and practitioners are gathered. The group should consist of not more than 10 to 16 people. A 1 to 1 ratio of national to international experts is advised.

Project management is needed to organise the invitations and the annual meeting. An optional publishing of the results has to be supervised.

Meetings are held on an annual basis first in Ukraine, then in Germany. Depending on the actual impact of the first meeting the next one could be postponed to be held only six months later. At the two-day long meeting an introductory speech is held by both a national and an international expert on the same topic. Afterwards everyone is invited to discuss the topic further.

The outcomes of the discussions are most likely to be taken home by each expert and will hopefully be integrated in their daily work. To reach other interested experts the results of the meeting could be published as well.

Implementation effort

Transportation of the group of experts and their accommodation accounts for most of the costs. At the meeting, and maybe in the previous process, translation will be needed. The publishing of the results both in German and Ukrainian would also require translation and would incur some costs but they would be manageable.

Expected impact

Civic education on a regular basis can raise awareness of political and constitutional matters, which is fundamental to civil society and civil engagement. Without political and constitutional awareness of at least basic principles, citizens are reduced to a compliant mass that cannot decide on its own.

The setup of an independent foundation ensures that the published material can be perceived and will not be rejected instantly as ordinary political promotional material.

Implementation effort

Personnel costs account for approximately one third of the costs. The staff of the foundation is composed of a few media experts and some office personnel. These costs are clear and manageable. To recognise the experts' work on articles, etc., they will be reimbursed.

Two-thirds of the costs are for the media work to publish the articles in an appropriate manner. Lay-outing, printing, publishing has to be considered.

4.2 German-Ukrainian Forum on Constitutional Law

German-Ukrainian Forum on Constitutional Law

Project phases and timing (6 months for start-up, then annual meetings):

- Step 1** Inviting 10 to 16 experts (practitioners, scientists, ...) to participate in the forum (2 months)
- Step 2** Selecting one or two (up-to-date) topics to discuss (1 months)
- Step 3** Organising the meeting, first in Ukraine, next year in Germany (2 months)
- Step 4** Introductory speech at the meeting by two experts from each country, afterwards intense discussion (2 days)
- Step 5** Optional: publishing the results (1 month)

rural areas. All interventions and operations having a high mortality and morbidity should be addressed first, as they offer the largest potential for immediate improvement.

On-site education: there are several potential partners for widely distributed on-site education in Ukrainian cardiovascular departments, eg societies from different countries or the European Association for Cardio-Thoracic Surgery per se. On-site education is feasible and highly effective for many reasons. On the one hand, there are only a very limited number of cardiovascular departments in Ukraine to be served and the number of patients getting interventional or surgical procedures is limited as well. On the other, cardiac interventional and surgical procedures produce a rather binary result: either good, or not, which will facilitate quality control as well as estimation of educational progress. On-site education has been found to be extremely cost-effective and can immediately reduce interventional and surgical morbidity and mortality. This has been proven in several cardiovascular centres throughout 'Eurasia'.

Technology transfer: transfer of knowledge and skills is inevitably linked to simultaneous transfer of medical devices and products as well as the implementation of new medications. For the transfer of well-known, clinically widely used and acknowledged technologies and medications from EU countries; administrative work-up in the government has to be reduced and should only be addressed by the College of Physicians of Ukraine and/or its subspecialties at the lowest possible administrative level (principle of subsidiarity). This approach will speed up technology transfer and avoid unnecessary, costly and time-consuming bureaucracy. In addition, this transfer of knowledge and technology will ensure swift access to vital medications for a wider range of patients, with the government financially supporting certain categories of pensioners and poor people.

Quality control and assessment of educational progress: each medical society will be responsible for some kind of well-defined quality control of the clinical results achieved. The data set collected and analysed should be very limited and only address the few most important points and outcome measures: indication, procedural mortality and morbidity (primary interest of patients) as well as the incidence of the most costly side-effects and complications. The latter include neurological outcome, infection and early redo at the site of primary surgery (interest of insurance companies and third-party payer). Initially, broad-based collection of myriad data creating huge IT-based data sets is unnecessary. These efforts would not bring immediate benefit to either patients or doctors but,

instead, would delay the necessary steps to decrease mortality and morbidity rates and would be extremely expensive. Results must be collected and analysed by the society of the medical specialty involved. Low-quality performers will be interviewed, leading to an immediate improvement in their results (informal knowledge about quality control system in cardiovascular surgery of the Netherlands). In addition, high-quality interventional medical experts and surgeons significantly outperforming average national results will also be interviewed to analyse and further distribute their superior knowledge. This style of quality assessment is aimed at introducing mechanisms of professional responsibility for medical professionals through a system of self-government within the College of Physicians of Ukraine and respectively within each sub-specialty.

The sub-specialties of the College of Physicians of Ukraine will be responsible for the distribution of relevant information, which is important for general health. In addition, the sub-specialties are obliged to engage in continued, nationwide health campaigns such as anti-smoking or healthy food campaigns. Anti-smoking campaigns in conjunction with an appropriate legal framework are found to be highly effective and lead to a swift improvement in the general health of the population. In Switzerland an anti-smoking campaign associated with nation-wide law-based restriction of smoking led within six months to a significant decrease in the incidence of acute myocardial infarction and the number of costly emergency cardiology interventions.

The sub-specialties of the College of Physicians of Ukraine will be responsible for promoting cost-effective medical treatment. The details of cost-effective medical treatment are out of the scope of this current document and will be outlined at a later time.

Public versus private hospitals: initially, private hospitals are not of major concern when reorganising Ukrainian healthcare system. Nevertheless, private hospitals could boost competition with regard to the quality of medical care, and therefore, must be established. However, private hospitals often care for more healthy patients rather than competing with public hospitals in purely medical terms. This would increase the overall costs of medical and non-medical services. In addition, they are often more committed to specialties like plastic surgery and all kind of wellness treatments, which are not the main issues when starting to reform the Ukrainian healthcare system.

General context of the project

An educational project is recommended to raise people's awareness of fundamental matters of the state. A brief reference to the past – not on the European but on the American continent – can explain this idea thoroughly. The American constitution of 1787/1788 could only come into effect after being adopted and ratified by at least nine states. A newspaper was established to advertise for this 'more perfect Union' and to explain the effects of an accepting vote. The so-called 'Federalist' covered only constitutional matters. It explained this proposed 'more perfect Union' and editors argued for it.

As a lighthouse project a series of newspaper supplements, for example, could be published to explain fundamental ideas of the current constitution and other political matters to the broad public. Those ideas might be the separation of powers, fundamental rights, powers of state bodies and more.

This forum can also be used to explain, publish and discuss constitutional amendments and of course a future new constitution. People's participation will most certainly not only raise awareness about constitutional matters, but also foster acceptance for the current and future constitutions.

Description of the project

A foundation is set up, which independently and without political influence takes care of this project. It asks experts to contribute articles on constitutional and political matters, which are then published in several forms by the foundation.

Composition: The foundation is staffed by Ukrainian office personnel and by Ukrainian media experts. A small number is sufficient, because media output should occur only every second month. The article writers should be experts from Ukraine and from other countries. A proportional mix ensures both Ukrainian insight and international observation.

Project management is needed to organise the setup of the foundation and assistance for the experts.

The monthly outcome of the foundation's work will be edited educational articles covering a wide range of constitutional, political and sociological matters.

To ensure that the foundation is not trapped in political matters itself or appears politically influenced, the initial founding of the foundation should come from various sources. If there is one major writer, his writing has to comply with the independence of the foundation.

4 Lighthouse Projects WS Constitution

4.1 Establishing a 'Foundation for Civic Education'

Establishing a 'Foundation for Civic Education'

Project phases and timing (8 – 12 months in total):

- Step 1** Establishing a foundation, based probably in Ukraine or Austria (2 months)
- Step 2** Organisational set-up, including an office in Ukraine (1 month – parallel to step 1)
- Step 3** Selecting a small staff of mostly media experts in Ukraine (1 – 2 months)
- Step 4** Inviting political, sociological and constitutional experts to contribute to a media product to be decided later (2 months – parallel to step 4)
- Step 5** Experts contribute articles on political, sociological and constitutional matters (3 – 4 months)
- Step 6** Articles are promoted as for example newspaper supplements, internet blogs, Facebook posts (2 months)
- Step 7** Preparing next issue

Funding amount: Medium

Project benefit

Greater awareness for civic engagement and political processes, especially for constitutional basics; preparation for social participation in connection with a fresh start on the constitution

The licensing of hospitals and medical experts: the individual sub-specialties will be responsible for licensing hospitals and medical experts to guarantee the nationwide provision of medical care and to prevent the costly distribution of high-tech medical care to rural areas. In addition, the sub-specialties of the College of Physicians of Ukraine will have the power to limit the distribution of medical care within Ukraine and to define the type and number of medical services offered in any area. The College of Physicians of Ukraine will also have the power to define the number of experts necessary in each sub-specialty to prevent unnecessary high number of specialists per area, which usually is a key cause for exceedingly high costs in the healthcare system. The licensing of hospitals and medical experts by the College of Physicians of Ukraine will be based on calculated needs of medical care per area, as well as on the quality of the medical services offered.

Medical care for elderly people and mother-and-child care

According to the scheme used to describe reforms within the subspecialty of cardiovascular medicine, the same measures can be applied to organise and improve care for elderly people and prenatal mother-and-child care, around birth as well as after birth.

The quality of medical care is mainly measured by how the system works for elderly and disadvantaged people as well as in the sub-specialty of mother-and-child care, as childhood mortality usually serves as an international measure to determine the quality of a specific healthcare system.

For this largely unprotected population of patients additional financial resources should be funded with a persistent commitment of the national budget.

Administration, organisation and financial issues

Actions mentioned above are directed at reorganising the healthcare system primarily with regard to direct medical care.

The healthcare system does not allow reorganisation from the bottom up unlike the police department, for instance, which can recruit a new staff and start from 'day zero', so to speak. During a reform, patients continue to be sick and the ongoing services of the healthcare system cannot be restricted while the reform is under way.

Therefore, administrative, organisational and financial issues of the current healthcare system can only be changed step-by-step. Appendix 1 will outline how modernisation of the healthcare system can be introduced without the costs skyrocketing, as has been observed in other countries.

The foundation and implementation of the basic structure of the College of Physicians of Ukraine, however, would not be costly and should be financed from the outside, eg by the AMU fund. Step-by-step, financial resources from the Ukrainian Ministry of Health and several independent administrative organisations such as the National Academy of Medical Sciences, the Kiev Municipality Healthcare Department, the Security Service of Ukraine, the Ministry of Internal Affairs and others will be transferred to the College of Physicians of Ukraine. The latter will then be primarily responsible for implementing the changes in the individual sub-specialties. In addition, financial resources of the College of Physicians of Ukraine will come from certification of hospitals and doctors, membership fees as well as the insurance company linked to the College of Physicians of Ukraine, as already mentioned above.

In the third phase mediators from the core team accompany judges to hear cases, discuss them together in regard to suitability for mediation, connecting factors, ways to present mediation case-related and give feedback in general. Per judge joining the project 4-5 cases are attended and discussed. Usually trust in the professionalism of the material, mediators and process and a common understanding is built up in this phase.

In the fourth phase, judges refer cases to mediators. Cases are completed within mediations. In parallel the core team of mediators work on an organisation/association to open the cooperation with the court to other mediators (formulate statutes, ethical principles, define prerequisites to become a member, develop special training program, prepare qualifications checks, search for candidates, information events, etc). After 10 – 20 cases in mediation the project is officially completed.

The outcome of the project is evaluated and presented in the fifth phase. Further steps can then be determined.

Expected impact

Parties save time and money. Judges are unburdened and have more time for other cases and other reform steps. Several intertwined cases can be dealt with at the same time in mediation. New cases can be avoided. Image-boost for the court and the initiators. Mediation is recognized as a successful alternative dispute resolution method in Ukraine. Interest of other courts to implement similar projects. Viable alternative for those who have reservations about the current court system – parties are not dependent on the judge, fewer possibilities for corruption. Steep learning curves for all stakeholders and participants in the project. Positive financial effect on the overall system.

Implementation effort

An internationally renowned expert with experience in similar projects has to be commissioned as the project leader/manager. An administrative worker has to be employed part-time for organisational issues like coordinating the various trainings, court hearings to be attended by mediators, writing of minutes, information sheets, setting up the future organisation for court near mediators, etc. Interested judges attend one seminar and one to two meetings per month to align with the mediation team – no expense allowance is needed as the seminar is free of charge. Core team mediators attend two half-day trainings per month free of charge. The whole process would benefit from media coverage on a local and national level, as well as reporting to the key stakeholders in the justice system across the country.

Funding amount: Low

Project benefits

Immediate circumvention of the current problems that the civil justice system faces; sustainable effect through implementation of court-related mediation

Description of the project

A pilot project designed to deal with the lack of adequate training in mediation in Ukraine by introducing the skill to a local network of legal services providers.

As outlined in Section 5.3. of the WS Rule of Law chapter, mediation offers the opportunity for immediate circumvention of the problems that face the civil justice system, because the mediator enables the parties to reach a judgment as to how to resolve their dispute, without litigating the issue.

Expected impact

Knowledge of what mediation is and what it can offer can be trained, piloted and positively publicised on a local level, with a view to copying nationally.

International experience shows that court-initiated mediation is most likely to encourage the use of mediation as the broader framework is known and the benefits are made visible to all stakeholders (judges, parties, justice system) relatively quickly. The pilot scheme would focus on enrolling those core constituent groups.

In the first phase the general interest for a mediation project will be developed with the head of the court and selected judges, together with the local law faculty and selected lawyers and other potential partners. There should be a core team of a few selected and renowned mediators from acknowledged national mediation institutions (Ukrainian Mediation Centre, Ukrainian National Association of Mediators and the like).

The project is officially kicked-off in the second phase, with training for both judges (shorter) and mediators (longer) taking place to prepare them for identifying suitable cases for mediation / and for referring the parties to mediation professionally respectively to present mediation at court adequately, cater to the special needs of court-related mediation and enhance qualification where need was previously identified. Working materials and processes are developed mutually by judges and mediators – possibly together with representatives of the bar association and the notary.

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XI Lighthouse Projects

Expected impact

The so-called 'contemporaries of independence' are leaving university: too young to have played a role in the Orange Revolution and therefore too young to be disappointed by its failure, their talents, aspirations and idealism need to be forged into a fast-track graduate generation capable of leadership in bringing about modernisation.

Previous projects in Ukraine and Eastern Europe have normally provided scholarships to go abroad and/or imposed a western model on a transition country. This project should locate in Ukraine and combine external and domestic talent and ideas. It must also be in partnership with the state, because there should be a coordinated fast-track system of promotion covering core fields of graduate studies.

Implementation effort

Doing this well takes planning and consultation. It might be best to convene a foundation committee to develop the idea and raise the funds. The AMU Summer School project (see Lighthouse Project 3.2. above) would also help to develop an implementation plan.

3.4 The Mediation Project

The Mediation Project

Project phases and timing (20 – 25 months):

Step 1 Set-up phase (2-4 months)

Step 2 Project start: training and developing working material (3 – 4 month)

Step 3 Mediators attend court sessions (4 – 6 month)

Step 4 Test phase: judges refer cases (10 – 12 month)

Step 5 Evaluation and further proceeding (1 month)

3.3 The National School of Law, Economics and Administration

The National School of Law, Economics and Administration

Project phases and timing (5 years):

Step 1 Research and proposal development (12 months)

Step 2 Funding (6-9 months)

Step 3 Establishment, recruitment of faculty and building development (36 months)

Step 4 Recruitment of student body and curriculum development (12 months)

Funding amount: High

Project benefits

Develop a fast-track graduate generation capable of leadership in bringing about modernisation. The project is not for profit, but will need to generate income in due course to sustain the quality of what it teaches and the international reputation that it aspires to.

Description of the project

Create a new graduate school in Ukraine that combines law, public administration and economics. It will bring academics and outstanding practitioners from Ukraine and from abroad to create a new generation of fast-track public servants. All graduates will contract to do five years of public sector employment and be the beneficiaries of domestic and international mentoring. The management of the scheme should be predominantly international, at least in its initial era.

Explanation of the 'funding amount' categories used in the Lighthouse Project templates below:

Low means up to EUR 500,000

Medium means up to EUR 3,000,000

High means up to EUR 10,000,000

1 Lighthouse Project WS EU Integration

1.1 EU Association Observatory

EU Association Observatory

Project phases and timing

- Step 1** Decision on establishing an EU Association observatory, including which institution(s) want(s) to run it (NGOs, social partners)
- Step 2** Start with a number of workshops in Kyiv
- Step 3** Follow up with events at regional level
- Step 4** Organise a first wrap-up conference and review the results in terms of the quality of new EU-based legislation in Ukraine, enhanced stakeholder participation and public opinion on EU association

Expected funding amount: Low

Project benefits

A broader cross section of society is involved in the implementation of the Association Agreement, and the quality of legislation and implementation is improved.

Description of the project

The observatory will allow NGOs/ social partners to judge progress in implementing the commitments in the Association Agreement (AA) but also to approach the government actively on the upcoming work agenda in order to present proposals and launch a public debate on difficult issues. It aims at civil society empowerment and improved ownership of the EU association process.

This project could be conducted by a dedicated pro-European NGO in Ukraine

Expected impact

Reform in the country is dependent upon the opportunity for fast-track leadership, but there is no guarantee that the best people will rise to the top. AMU has to find them and channel them into public and private modernisation initiatives. This is a key opportunity to further develop the modernisation program in partnership with talented partners in Ukraine. It also enables the different centres of excellence in Lviv, Odessa, Kharkiv and Kyiv to be more dynamically integrated, which is an important feature of the modernisation in its own right. It further provides the opportunity to bring together the law and business groups that have been encountered around the country that are presently determined to work outside of the system of corruption and to introduce modern practices into law, business and administration. The scheme would (1) refine the AMU Programme proposals and specific action plan and (2) develop the graduate school project.

Implementation effort

The location for the summer school should be outside of Kyiv – either Lviv or Kharkiv (or potentially split between both). It is necessary to find Ukrainian partners to act as joint convenors. The Rule of Law workstream has already identified delivery partners in each of the key cities. They could convene Rule of Law specialists, so it would be feasible to convene small groups of like-minded young academics and practitioners to work within each of the AMU workstreams.

The AMU workstream managers could design the course with the Ukrainian convenors. WS leaders plus some other foreign experts could be brought to Ukraine to give seminars, as could some key Ukrainian figures.

As this is a summer scheme and not a graduate school, an easily implementable system of transparent recruitment for the school will have to be devised, based upon previous involvement with the AMU programme and recommendations based on CVs and references.

3.2 AMU Summer School

AMU Summer School

Project phases and timing (12 months):

Step 1 Recruit external and domestic partners based upon the AMU faculty and their connections (1 – 2 months)

Step 2 Planning (9 months)

Step 3 Summer School in Lviv or Kharkiv [or both] in July 2016 (7/10 days)

Funding amount: Low

Project benefits

Refine / update AMU proposals; develop the graduate school project to fast-track new excellent leadership; network non-corrupt law and business groups

Description of the project

A 7/10 day summer school with two functions:

- To teach and develop core aspects of the AMU Modernisation programme
- To use the student and teaching faculty to help conceive the detail of a Graduate School of Law, Economics and Public Administration (that is described below in Lighthouse Project 3.3).

The Summer School links and sustains the AMU networks. The summer school will provide a platform for developing other education/organisational initiatives (eg mediation and arbitration training, seed funding for small and medium business) and it acts as a pilot scheme for setting up a graduate school that will cover the key subject matter of AMU's expertise. This pilot scheme should be a combined AMU faculty initiative, benefiting from the expertise of the other Workstreams.

(or by the social partners), thus initiating a process of broader public information and subsequently also triggering discussion about needed reform steps. Unlike the approach in the Association Agreement, which presents sector challenges with time lines in the annexes, the project would build on the agreed yearly implementation schedule in the Association Agreement and thus cover all sectors in a given year. The advantage of this approach is that one could discuss the workload for a foreseeable span of time and could also more holistically discuss the likely reform impact on other sectors of the economy. Major reform steps in Ukraine will no longer be just a matter for the government or a sector, but a subject for public discussion and scrutiny.

The political rationale for an observatory

The EU will monitor the implementation of the AA regularly, at least once a year. The result will be made public, both in the EU and in Ukraine. Implementation largely in line with the Association Agreement will be presented as a success story, thus strengthening the relations and also the standing of Ukraine. In contrast, major slippages will be portrayed as a lack of commitment and reform spirit on the Ukrainian side.

Furthermore, Ukraine needs to involve the public. This is part of the implementation of the Association Agreement. But the public needs also to be prepared to become involved. The monitoring of the reforms and the progress achieved would stimulate discussion, but also help the broader public better understand why reforms are needed and what their likely result would be, thus fostering acceptance of this orientation towards EU integration.

Expected impact

The association with the EU as THE road to EU membership could serve as a positive narrative that increasingly unites the country. Involving civil society and social partners in designing and implementing reforms strengthens ownership and responsibility and ensures that the approximation towards the EU is done according to best wisdom and the real conditions on the ground in Ukraine. More importantly even, broad societal engagement is crucial to carrying the burdens associated with the reforms and to bridge the time gaps between carrying the burdens and experiencing the fruits of the reforms.

The observatory improves the capabilities of the NGOs/social partners to play a more active role in the association process. It allows these players to judge governmental plans on a more informed basis and gives them the opportunity

to work early on upcoming issues, presenting their own proposals to the government and the public and launching a public debate on difficult issues.

This could lead to a new approach to designing reforms in Ukraine, with full stakeholder involvement, as it becomes clear that stakeholder involvement is not only a desire but indeed a legitimate right stemming directly from the Association Agreement and that stakeholders are serious about living up to their rights and obligations.

Consequently EU matters will no longer be reserved for 'activist' engagement but understood as internal matters of Ukraine politics that affect each and every person and therefore need to be not only watched from a distance but also actively carried out. A better design of EU-related reforms could also translate into business growth and thus preserve existing jobs or even create new ones.

Implementation effort

The work tools for the observatory (monitoring tables) have to be established. Once elaborated their use needs a small dedicated team to kick-start the process. This could be done in regular workshops to discuss the agenda 2015/2016 with the involvement of government, parliament, media, industry and trade unions and also EU specialists. The discussion should cover legal progress, implementation problems and also the identification of upcoming challenges. The government should be invited to explain its strategy, but also to react to observations and requests. In the end, all participants should understand that cooperating in the largest possible sense is the sensible way to implement the Association Agreement commitments.

As a follow-up to the meeting format in Kyiv, workshops should be organised in regions, ideally together with local business chambers. Information about the needed/envisaged reforms would be combined with discussions among the participants. These events should by no means be seen as an academic exercise.

The EU delegation in Ukraine should be involved from the outset.

The day of the provisional entry into force of the Association Agreement, 1 November, could be a good day to kick off the process; alternatively, the day of ratification or the day of signature.

After about a year (or in connection with Europe Day in May) a civil society conference should wrap up the main results up to that point. Cooperation partners in the regions could be inspired to carry out similar events.

Expected impact

Key features would include the UK trainers coming to Kyiv rather than the other way round. It would be an opportunity for AMU to partner with key British organisations in developing rule of law focussed training.

Bringing UK judges as part of the delegation would serve to improve the organisational esteem and internal morale of the beleaguered Ukrainian judiciary on a wider basis. The value of such a project was specifically encouraged by the eminent Slyn European Law Foundation in its 2008 study of the Ukrainian judiciary, but sufficient funds and organisational commitment will be needed to enable the project to achieve the desired impact.

Implementation effort

Initial positive feasibility contact has been made on the British and Ukrainian operational sides. There is a need to have follow-up meetings and then recruit judges (ideally two or three eminent retired judges and one sitting judge) to travel with the UK trainers. Other UK partners dedicated to the assistance of rule of law education should be approached in order to participate in the seminar. A briefing paper would have to be drafted in order to stimulate interest and direct the trainers in what subject matter training is required. Then the trainers can develop their own seminars. The Ukrainian partners should also deliver their seminars about the challenges faced.

The logistics of the trip would have to be co-ordinated (AMU Offices in Vienna/ Kyiv in close consultation with the UK Judicial Studies Board and the National School of Judges).

3 Lighthouse Projects WS Rule of Law

3.1 Judicial Studies Seminar

Judicial Studies Seminar

Project phases and timing (9 months):

Step 1 Set-up meetings in London and Kyiv (1-3 months)

Step 2 Recruitment and further planning (2 months)

Step 3 Seminar in Kyiv around Easter 2016 (3-5 days)

Funding amount (based on five days and 14 people travelling): Low

Project benefits

Further reform of legal education; higher-quality court decisions

Description of the project

A delegation of UK judges and judicial trainers to come to Ukraine and share ideas with their counterparts with regard to lessons learned in redesigning the judicial curriculum in the UK.

These efforts are linked to Section 2 of the Rule of Law WS Chapter to this report that seeks to develop the Rule of Law as a transformative idea and Section 3 of the chapter that focuses on the content of judicial reform, including the enhancement of initial entry training and continuing professional development.

Ukraine's Judiciary Development Strategy 2015-2220 envisages a redefined role for the National School of Judges in terms of initial training and continuing assessment. This is further required by the Fair Trials Act 2015. The curriculum is currently being redesigned.

1.2 EU Education and University Cooperation

EU Education and University Cooperation

Project phases and timing:

Step 1 Identification of the cooperation partners in EU and Ukraine;

Step 2 Agreement between the partners on scope of cooperation in consultation with the responsible ministry (to ensure the recognition of the certificates)

Step 3 Lectures on EU matters (Law, politics) either via new media or regularly at a university in Ukraine by teachers from an EU university

Funding amount: Medium

Project benefits

Increase in the number of Ukrainians students with specialised EU studies; improved networking between EU and Ukrainian university

Description of the project

This project involves close cooperation between two higher education institutions to kick off specialised EU studies in Ukraine. Teachers from an EU university would lecture and hold seminars in English on specialised EU subjects. The EU university would also conduct the examinations of the students to exclude any corruption. Ukraine needs to see that the courses/studies are officially recognised.

The political rationale

Currently Ukraine lacks dedicated EU studies, but must upgrade the knowledge and skills on EU matters and prepare a young generation for the fact that a large part of Ukrainian legislation will be driven by EU rules. Moreover the preparation for EU membership needs an informed public and more knowledge about EU integration.

Expected impact

A number of Ukrainian students will receive first-hand education about the EU at home. If the project runs well, it could have a multiplying effect and other universities (both in the EU and in Ukraine) could team up with each other.

The teaming up of universities and high schools would also facilitate the future participation of both partners in EU research projects within Horizon 2020. Ukraine is allowed to participate in this programme, which makes networking of universities and high schools across several countries a precondition for successful application.

Implementation effort

Implementation requires the dedication of the universities and the support of the governments to get the project running.

initial period of operation, the court would be managed by lawyers invited from abroad who have appropriate knowledge and experience and who would also take part in the proceedings.

Expected impact

Companies would have a reliable instrument and procedure available to them for the fair and rapid resolution of disputes between companies as well as between companies and public institutions. This is an indispensable element for achieving a favourable business environment.

Also the Ukrainian judiciary as a whole could benefit, within several years, from young Ukrainian lawyers from the arbitration court transferring to regular courts. After several years, they will have acquired experience and high ethics from serving in an institution based on impartiality and professionalism, free of corruption and led by international jurists of unquestionable repute.

Implementation effort

Phase 1 is a preparatory phase that will be devoted to introducing necessary acts to the legal system in order to lay a sound legal foundation for the functioning of the arbitration court. To draft these regulations, a group of international experts, who can refer to the best international practice, will be convened. The issue requiring special attention will be that of enabling the settlement of disputes between companies and public institutions. The support of the Verkhovna Rada for the drafted regulations will be sought by an international figure of high esteem.

At the same time an agreement on the modalities of the court will be negotiated with the FEU and hopefully signed.

In phase 2 practical preparations will be carried out: the court's statute, rules of procedure and code of conduct will be elaborated; its premises in Kyiv will be rented; lists of 'super-arbiters' (international practitioners) and 'arbiters' (young qualified Ukrainian lawyers), who agree to work for the court, will be brought together; contractual obligations will be defined. The president and the presidium of the court will be appointed. Information on the setting up of the court will be disseminated among members of the FEU and other Ukrainian and foreign companies.

Phase 3 of the project will encompass the court's initial two years of operation.

1.3 Translating the EU acquis

Translating EU acquis

Project phases and timing:

Step 1 Submit a request to the European Commission/ the EU to assist the translation of EU legislation as covered by the Association Agreement into Ukrainian – at least with translators, ideally also with substantial financial support

Step 2 Decide on the language basis for the translation (English or any other official EU language, for which sufficient translators are available) and select high quality translators because EU legislative language is quite specialised

Funding amount: Low to high, depending on the speed of implementation and on potential EU involvement

Project benefits

Creates a basis for the proper functioning of the rule of EU law

This modus operandi will be repeated with regard to phases 2 and 3. Experience from earlier workshops will be used in the elaboration of the content of the subsequent ones. Some NGOs may be encouraged to take part in the workshops for a second or even third time to build up their knowledge and networking capabilities. However, new participants will always be invited to add new experience and to provide an opportunity for the further dissemination of best practices identified at earlier stages of the project.

2.3 Setting Up an Arbitration Court

Setting Up an Arbitration Court

Project phases and timing (27 months):

Step 1 Introducing necessary legal acts and modalities (3 months)

Step 2 Organisational and practical preparations
(3 months – in parallel with step 1)

Step 3 Operating the arbitration court in its initial phase (24 months)

Funding amount: Medium

Project benefits

A reliable institution for the fair and rapid resolution of disputes

Description of the project

Depending on the necessary legislation being adopted by the Verkhovna Rada; an arbitration court, possibly attached to the Federation of Employers of Ukraine, could become operational in the near future. It would be a common instrument and procedure for dispute resolution, which would be easily accessible to all companies and also competent in cases between companies and public institutions. Mirroring the structure of the FEU, the court would have branches throughout the country, so recourse to it would be simple and inexpensive. In its

Description of the project

Ukraine is obliged to transpose a substantial part of the EU acquis into Ukrainian legislation, both regulations and directives. While regulations need to be implemented as such (and therefore will be automatically translated), EU directives, which are the predominant legal instruments, leave a margin of discretion for national implementation. The proper implementation in Ukraine can only be judged against the EU legal acts. In the EU each and every citizen and undertaking have the right to access EU legislation in the national language. Ukrainian businesses and citizens should also be guaranteed this right. This is particularly important in case of doubts and disputes as to whether Ukrainian legislation really does comply with EU law.

The translator(s) should closely work with the European Commission and with specialists, because EU legislation is complicated to translate and every word matters.

The translation should be done into Ukrainian first; but there should also be a Russian translation.

Whoever carries out this project will do an invaluable service to the entire Ukrainian society.

Expected impact

Ukraine needs the translation of the EU acquis and the sooner it is done the better for the proper functioning of the rule of law. In particular, legal disputes about the proper implementation of EU rules will be facilitated.

Implementation effort

It must be clear who is running the project. Presently Ukraine is left alone with this task. Internally the Ministry of Justice is responsible for the translation until 2017 (which seems too ambitious). Therefore the project, including its financing should be discussed with the European Commission again to achieve massive EU support. The reference language (one of the official languages of the EU) as well as the individual translators will have to be chosen very carefully to ensure high quality results. The translation efforts could be scheduled step by step, based on the annual implementation agenda. The translation should start with all legislation on product markets as agreed in the Association Agreement to have an immediate effect for the industry of Ukraine. The translated acquis should be made public on a web site.

2 Lighthouse Projects WS Anti-Corruption

2.1 'The Rise of Whistle-Blowers and Watchdogs. Reinforcing and Helping to Network Anti-Corruption NGOs.'

'The Rise of Whistle-Blowers and Watchdogs. Reinforcing and Helping to Network Anti-Corruption NGOs.'

Project phases and timing (6 months):

Step 1 preparation and staging of the first workshop; dissemination of the results (2 months)

Step 2 preparation and staging of the second workshop; dissemination of the results (2 months)

Step 3 preparation and staging of the third workshop; dissemination of the results (2 months)

Funding amount: Low

Project benefits

Anti-corruption NGOs are networked and have more capabilities to act successfully.

Description of the project

The project will consist of a series of workshops dedicated to Ukrainian NGOs active in tracking corruption and recommending structural solutions to counter-act it. The workshops will create a platform for the transfer of expertise and good practices from foreign NGOs to Ukrainian ones, as well as for the exchange of knowledge and experience between the Ukrainian NGOs.

Expected impact

Approximately 60 participants from Ukrainian NGOs will take part in three different 3-day workshops and will be trained and networked. A number of grassroots activities will be elaborated, structured and implemented in the local communities as a result. An organisational structure of cooperation and exchange will be created for the NGOs involved.

As a follow-up to the workshops, content will be developed in the form of guidelines and plans of actions together with NGO activists participating in the project. It is assumed that several concepts for anti-corruption activities will be presented and shared or worked out during the workshop – a 'watchdog', a support group, an intervention organisation, a legal help organisation, investigative journalism through social media and others.

Networking and dissemination tools (social media) should be used to share the results of the workshops with other Ukrainian NGOs. They will help the NGOs involved to conduct, develop and integrate their grassroots anticorruption activity and campaigning.

A possible result of the workshop might be to raise the idea of organising a national anti-corruption congress, which would help to integrate dispersed activities of grassroots groups and movements.

Implementation effort

In phase 1 a number of NGOs interested in launching and conducting anti-corruption activities will be identified. Out of this group, 20 organisations will be selected and invited to participate in the first workshop.

The workshop will include a series of analytical and strategic sessions aimed at analysing the acquired knowledge and translating it into plans of action. The sociological (research-based) knowledge will be transferred to and used by grassroots activists in order to help them to develop their activity and possibly to raise it to the level of a social movement. The AMU Sociological Study results will be analysed by social activists, who will try to answer the following basic questions: How can this knowledge be used to mobilise grassroots activities of citizens, patients, prime movers, schoolchildren, parents and others? Who are the victims of and participants in corruptive practices? How can good practices be dispersed? How can civil society organisations be motivated to act as parts of an anticorruption social movement?

Workstream EU Integration

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Appendix WS EU Integration

Workstream Anti-Corruption

A1 - AMU_Research_SociologicalStudy

A2 - AMU_Research_Survey_Business

A3 - Anti-CorruptionGuidelinesForPublicOfficials&CivilServants

A4 - Anti-CorruptionHandbookForCivilServantsInPublicProcurement

A5 - Anti-CorruptionHandbookForEntrepreneurs

Workstream Tax & Finance

Information on the status of the Consolidated and State Budget of Ukraine for 2014

Shadow economy in Ukraine_methods of elimination

The shadow economy in Ukraine_reasons and cures

WIIW_2015_How to stabilise the economy of Ukraine

World Bank_PwC_Paying Taxes 2015

Workstream Health

Appendix WS Health

Step 2

in the medium term (more than one year) WCE should merge with its Bucharest counterpart with an eye to creating the Pan-European Commodities Exchange (PCE) as the final goal. Therefore, the partnership with WCE would create an ideal opportunity for UCEX to merge with PCE.

Expected impact

There are several ways that UCEX and Ukraine could benefit from this idea:

1. The project is a great opportunity for a deeper integration of UCEX in the Central and Eastern European commodity exchanges and markets. This will increase its regional role and boost revenue and profit for UCEX (eg by facilitating improved trading liquidity and broadening the scope of financial instruments; as a result, more investors will be attracted to UCEX). If successfully integrated in PCE, the involvement of foreign investors is likely to grow in the Ukrainian financial market, which is a highly desired scenario.
2. It strengthens Ukraine economic ties with the EU countries, as the agriculture sectors are very important to the economic policy of the leading EU countries.
3. It creates an additional incentive for the development of the Ukrainian agricultural sector. It addresses the problem of limited risk management opportunities for small farmers, which is a substantial obstacle to their further development. It improves access to tools offsetting the risk of commodities price volatility for the profitability of farm output, thus encouraging farms to increase their production scale and promoting further investment, which is of crucial importance to this segment. Moreover, this will also create a strong stimulus to modernise the small farm segment (eg to use computers and other electronic devices in the production process on a mass scale).

Implementation effort

There is a wide circle of stakeholders (politicians, regulators, commodity exchange owners and employees, farmers, investors) who need to be involved, taking the following into account:

- consistent political support for the idea (both Ukrainian and European);
- it is essential to promote this idea both at the level of Ukrainian farmers (so that they are more actively involved in taking advantage of the instruments

offered by UCX) and foreign investors (so that they invest on the commodity exchange);

- need to adjust the regulations and technology of both commodity exchanges; and
- need to find experts with experience in this field.

5.2 Management Staff Exchange Programme for Family-Owned Enterprises

Management Staff Exchange Programme for Family-Owned Enterprises

Project phases and timing (1 to 2 years):

Step 1 Establishment of a cooperation between organisations, recruitment of exchange personnel (up to 3 months)

Step 2 Realisation of the exchange program (up to 12 months)

Funding amount: Low

Project benefits

Strengthening of ties between UA and EU companies, CSR benefits

Description of the project

Family-owned enterprises constitute an important part of the economy. Often in turbulent times they are more resilient to turmoil because their management has a more long-term perspective of building up a business than corporations struggling to achieve quarterly targets. Exchange between management staff of such companies is a simple but potentially very beneficial project. The project can be run in cooperation with Polish Family-owned Enterprises Association (which would ensure that companies operating on a global scale are included) and also involve other EU countries.

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Illya Yemets

Workstream Leader Healthcare

Since 2011	Director of Ukrainian Children's Cardiac Centre, Kyiv Professor of Pediatric Cardiac Surgery, P. L. Shupik National Medical Academy of Post-graduate Education, Kyiv
2010-2011	Minister of Health of Ukraine
2003-2010	Chief cardiac surgeon of the Ministry of Health of Ukraine
2003-2010	Director, Ukrainian Children's Cardiac Centre, Kyiv
1997-2003	Chief of neonatal cardiac surgery department, Amosov National institute of cardiovascular surgery
1992	Charter member of the first Rotary club in Ukraine
1992	Performed first open heart surgery in the newborn in Ukraine
Nationality	Ukraine
Born	Arkhangelsk, USSR (present Russian Federation)

Expected impact

- Strengthening of ties between UA and EU companies
- Promotion of knowledge on best practices and diversity in running a business
- Promotion of cooperation, joint ventures and technology transfer between UA and EU
- Creation of an influential group of opinion leaders in Ukraine to push economic development, European values, and open up the country in general
- Creation of an influential group of opinion leaders in Europe who understand Ukraine and support it in EU business circles

Implementation effort

Minimal. AMU should sign an LOI with respective associations and become the leader of the programme, managing the contacts and bringing partners together. AMU could also run preparation programs for the exchange candidates.

5.3 Young Entrepreneurs Venture Capital Fund

Young Entrepreneurs Venture Capital Fund

Project phases and timing (1.5 years):

- Step 1** Establishment of the fund and its promotion; financing first start-ups (up to 6 months)
- Step 2** Evaluation of the start-ups' initial performance; second tranche of funding; first profits are being earned (up to 18 months)

Funding amount: Medium

Project benefits

A return of about 25% p.a. (average for the venture capital industry) in general should be aimed at

Description of the project

The fund will support the most promising and innovative business ideas by providing funding for them. In return, the fund will participate in future profits of start-ups it decides to finance. The estimated budget for this project is EUR 10 million, with EUR 50 thousand being given in support of every idea as an initial investment. If a particular idea succeeds (proof of concept), its projected profits are adequate and further growth prospects are promising, it would be granted a further tranche of capital worth EUR 100,000; however, this will depend on the individual case. The fund should also provide support for the management of the start-up companies, eg accounting, tax advice, legal advice and support.

Step 1: Establishment of the fund and its promotion; financing of first start-ups

Step 2: Evaluation of the start-ups initial performance; second tranche of funding; first profits are being earned

Expected impact

The aim is to spur the growth of innovative start-ups, create spill-over effects for other industries and release the business potential of young people. Also it is a perfect tool for promoting AMU as an organiser of real support for UA companies.

Implementation effort

Although the project will not require substantial initial investment costs, it needs to be headed by a committee made up of experienced professionals of high integrity who have knowledge of the Ukrainian economy and international business experience. Day-to-day management must also comply with the above criteria.

In order to establish a process that will lead to an effective selection of business ideas, which will obtain funding, it should consist of two rounds. The first round would be the evaluation of business plans, which are submitted to the fund by means of an online application form. Those who pass the first round screening would then be invited to the second stage of the process, consisting of a 10-15 minute presentation given in front of the committee. It would be a chance for aspiring businessmen to convince the committee of their business ideas. Then, the committee would select the most attractive and promising start-ups to finance.

Paul Robert Vogt Workstream Leader Healthcare

Since 2011	Honorary Doctorate, Pavlov Medical University, St. Petersburg, Russia
2000-2007	Vice-President, European Homograft Bank, Brussels, Belgium
Since 2006	Consultant Surgeon, Hirslanden-Klinik, Zurich, Switzerland
2000-2006	Chairman, Department of Cardiovascular Surgery, Gießen, Germany
Since 2000	Honorary Professor, Tongji Medical University, Wuhan, China Honorary Professor, Nanjing First University, Nanjing, China
Since 2000	Founder and President, EurAsia Heart – A Swiss Medical Foundation
Nationality	Switzerland, Principality of Liechtenstein
Born	Lachen (Schwyz), Switzerland

Michal Ludwikowski Workstream Manager Economy

Since 2013	General Director of Polish Economic Congress Foundation
Since 2012	Polish Peoples Party Supreme Council Member
2011-2013	Chairman of the Board of the Development Foundation
2010-2011	Adviser to Deputy Prime Minister and Minister of Economy Waldemar Pawlak
Nationality	Poland
Born	1985, Bydgoszcz, Poland

Michael Spindelegger President of AMU and Workstream Leader Tax & Finance

2013-2014	Minister of Finance of Austria
2011-2014	Vice-Chancellor of Austria
2011-2014	Chairman of the Austrian People's Party (ÖVP)
2008-2013	Minister of Foreign Affairs of Austria
2006-2008	Second speaker of the Austrian Parliament
2000-2006	Vice-chairman of the Austrian People's Party (ÖVP)
1996-2006	Member of the National Council of Austria, head of the Parliamentary Committee on Foreign Affairs
Nationality	Austria
Born	1959, Mödling, Austria

5.4 Electric Vehicles Factory

Electric Vehicles Factory

Project phases and timing (min. 24 months):

Step 1 Negotiations (6 months)

Step 2 Formal arrangements (6 months)

Step 3 Realisation (12 months)

Funding amount: High

Project benefits

The factory will become a competitor on the European and global market by creating cheap and efficient compact class and premium cars.

Description of the project

Electric cars are the future of world transportation. Environmentally friendly, quiet, with the appropriate technical parameters; electric car will be able to compete on normal market terms with an ordinary car in the near future. Low labour costs, skilled staff of engineers and mechanics plus vast experience and long traditions in the automotive industry prove that Ukraine will be a suitable place to establish this type of factory. Another interesting opportunity would be to cooperate and use Tesla patents that were recently opened to public use and supply Tesla batteries to a new UA car brand.

Expected impact

The new factory for electric vehicles in Ukraine will optimise production costs. The factory will become a competitor on the European and global market by creating cheap and efficient compact class and premium cars. One should also consider the possibility of producing electric buses. Annually, the factory will produce anywhere from a few hundred initially to a few thousand and several thousand cars after the start-up phase.

Implementation effort

It is necessary to place the factory in the most optimal region of Ukraine (quality road network and railway, proximity to airports). Obtaining investment tax relief and other forms of investments incentives should also be discussed during negotiations. An important element of the project should be to find a partner who could be a supplier of technology. For this purpose it is necessary to consider cooperation with the traditional automotive corporations that want to enter the market of electric vehicles or to work with companies already active in this field.

5.5 Introducing Farm Management Software to UA Agricultural Sector

Introducing Farm Management Software to UA agriculture sector

Project phases and timing (1 year):

Step 1 Adaptation of existing software (1 - 3 months)

Step 2 Tests (3 - 5 months)

Step 3 Implementation and marketing (> 6 months)

Funding amount: Low

Project benefits

Reduced costs of inventory replenishment, decreased costs of livestock feeding, increase in production efficiency for Ukrainian farmers

Description of the project

Introduction to the Ukrainian market of a web-based comprehensive ERP system for agriculture entrepreneurs that is provided in a SaaS (Software as a Service) model. This system helps to keep track of operations, improve business organisation and manage field history, herds, finances, stock, and machinery. Clear layout and intuitive solutions must enable any user to work with the system easily, even without prior training.

Maik Bäumerich Workstream Manager Constitution

Since 2011	Research Assistant at University of Cologne
2014	Doctor of Laws
2012	Master of Business Law, University of Cologne
2011	First State Examination
Nationality	Germany
Born	1986, Leverkusen, Germany

Waldemar Pawlak Workstream Leader Economy

Since 2013	President, Polish Economic Congress Foundation
2007-2010	Deputy Prime Minister and Minister of Economy of Poland
2001-2005	President of the Board of the Warsaw Commodity Exchange
1995-2010	Candidate for President of Poland
1992-1995	Prime Minister of Poland (was appointed two times)
Since 1991	Leader of the Polish People's Party
Since 1989	Member of the Sejm
1985-1989	Member of United People's Party
Nationality	Poland
Born	1959, Model, Masovian Voivodeship, Poland

Otto Depenheuer

Workstream Leader Constitution

Since 1999	Professor at University of Cologne, Chair for Public Law and Philosophy of Law, ipso facto Director of the "Seminar für Staatsphilosophie und Rechtspolitik"
1993-1999	Professor at University of Mannheim; Chair for Public Law and Philosophy of Law
2004-2014	Vice President of Görres-Gesellschaft zur Pflege der Wissenschaft ("Goerres Society for the Support of Science and Scholarship")
Since 2008	Chairman of Scientific Advisory Board of the "Deutsche Stiftung Eigentum" ("German Foundation for Property")
Since 2009	Member of scientific advisory board of the Foundation "Haus der Geschichte der Bundesrepublik Deutschland" ("House of the History of the Federal Republic of Germany")
Since 2005	Member of Board of the "Institut für historische Anthropologie e.V.", Salzburg ("Institute for Historical Anthropology")
Publications	http://staatsphilosophie.uni-koeln.de/schriften/schriftenverzeichnis/
Nationality	Germany
Born	1953, Cologne, Germany

Expected impact

For many years farms in Europe were not treated like regular businesses. During this period, multiple computer tools were developed to help entrepreneurs from other industries in their everyday work. Unfortunately these tools are not suitable for managing farms due to the specific needs involved. A Polish company developed a solution designed for the farming industry that is ranked among the top three in the world. Polish experience shows that tangible and significant effects are visible after just one year of using this software:

- reduction of costs of inventory replenishment by 8%
- decrease in costs of livestock feeding by 18%
- increase in production efficiency by 14%.

Implementation effort

The introduction of this software to the Ukrainian market requires mainly translation and adaptation to the needs of Ukrainian agricultural entrepreneurs followed by standard sales and marketing campaigns.

The next part of the development of this software should be a gradual implementation of EU requirements in the documentation and management related to farming. Ukraine aspires to join the EU and therefore some processes known to entrepreneurs in the EU can be also be implemented at this stage of the project. The use of the software can guarantee that Ukrainian farmers will be brought closer to European standards, particularly in terms of management and sanitary requirements.

5.6 Leasing of Renewable Energy Sources (RES) Installations

Leasing of Renewable Energy Sources (RES) Installations

Project phases and timing (min. 36 months):

Step 1 Establish a body to prepare a leasing offer, purchase the installation and implement it later (6 months)

Step 2 Promotion of the service (6 months)

Step 3 Realisation on the largest possible scale (24 months)

Funding amount: Medium

Project benefits

Protection of the environment, strengthening of local energy security, creation of new 'green jobs' and enhanced competition

Description of the project

Renewable energy sources are clearly an opportunity for Ukraine. Not only can they contribute to protecting the environment, improving air quality or fulfilling obligations to reduce emissions, but they also strengthen local energy security, create new 'green jobs', and enhance competition. However, the development of renewable energy sources (RES) in Ukraine requires a commitment of private investors with adequate capital. This applies in particular to micro and small generation of RES. In many cases, a lack of financing prevents Ukraine from reaching its full energy potential. In others, investors willing to install RES run into obstacles preventing them from entering the market. The RES leasing initiative fits the needs and opportunities of the Ukrainian market very well. Appropriately fixed lease instalments would enable energy production to generate earnings and cover payments to the lessor.

Danny Friedman QC Workstream Manager Rule of Law

2013	Appointed Queen's Counsel
2000	Founding member of Matrix Chambers, United Kingdom
1996	Called to the Bar of England and Wales: practice in England and internationally has focussed on the rule of law challenges faced by societies in transition: cases, studies and public inquiries concern Iraq, Afghanistan, Israel/Palestine. Libya, Algeria, Jordan and Northern Ireland
1999-1996	LLM – London School of Economics, University of London
1989-1991	BA (Hons) Modern History – Wadham College, Oxford University

Publications

Since 2003	Contributing human rights editor, Archbold Criminal Pleadings and Practice (published annually)
2014	Inquest: Practitioners' Guide (Third Edition) (Second edition 2008, First edition 2002)
Nationality	Great Britain
Born	1970, London, Great Britain

Lord Macdonald QC Workstream Leader Rule of Law

Since 2012	Warden of Wadham College, Oxford
Since 2011	Chair of Reprieve, in succession to the late Lord Bingham of Cornhill, member of the Council of the Institute of Contemporary Arts, Honorary Fellow of St Edmund Hall, Oxford
Since 2010	Deputy High Court Judge and a member of the Advisory Board of the Centre for Criminology at the University of Oxford
Since 2009	Visiting Professor of Law at the London School of Economics
Since 2008	Private practice at Matrix Chambers, regular contributor to The Times
2003-2008	Director of Public Prosecutions (DPP) of England and Wales
Nationality	Great Britain
Born	1953, Windsor, Great Britain

Expected impact

Ukraine will significantly develop the sector of micro and small renewable energy sources. The project will lead to the leasing of 50,000-200,000 small-scale renewable energy installations. An additional capacity will be created for those who currently cannot afford RES. Greater prevalence of RES will increase the social acceptance of these sources.

Implementation effort

Realisation of the project requires the establishment of a body responsible for its implementation. The body will be responsible for preparing a leasing offer, purchasing the installation and handling the leasing. It will be necessary to start negotiations with the relevant technology providers, as well as create a head-quarters and hire the best available energy and finance experts. The project also entails building a network of distributors and hiring agents. These efforts should also be adequately promoted and advertised so as to reach the widest possible audience.

5.7 Science-Business Supercluster by 'Index Copernicus'

Science-Business Supercluster by 'Index Copernicus'

Project phases and timing (4 years):

Step 1 Preparation phase: research and development of regulations for the projects and start of evaluation process of academia units (6 – 12 month)

Step 2 Initial data gathering and development of the virtual supercluster (12 months)

Step 3 Acquiring companies to enter the virtual cluster (12-24 months)

Funding amount: Medium

Project benefits

Accelerating innovation transfer and economic growth

Description of the project

The scope of the 'Copernicus Supercluster' project is to establish a country-wide, virtual cluster in Ukraine that allows cooperation between scientific units (academia) and business in a continuous process, thereby accelerating innovation transfer and economic growth. It will involve all academia units and the majority of business associations. 'Index Copernicus Supercluster' is a globally unique package solution (successfully introduced in Poland) that combines:

- a well-developed and described business process package linked with public regulations regarding state, performance-based financing of scientific units ready to be quickly introduced and adopted by national government;
- state-of-the art ICT system to continuously collect well-structured information from every scientific unit about completed, on-going and/or planned scientific projects. The projects are described in business-specific language and evaluated to be presented to the wide business for potential partnerships;
- state of the art ICT system to evaluate scientific units in order to distribute state financing based on performance;
- well-developed and described package of business processes to enable cooperation between scientific units and business to develop common projects financed both by public authorities and private businesses.

Expected impact

Improved efficiency of public spending for science and the higher education sector. Public spending will be linked to the quality of academic achievements (measured by using a globally approved evaluation tool). The most active and effective scientific unit will get the majority of public support while less efficient ones will be encouraged to start a restructuring process. The process of creating innovations and their transfer to the economy will help Ukrainian companies to become more competitive faster, first in local and then in global markets.

Private companies will become more competitive. They will be encouraged to invest in cooperation with academia by granting public support for common projects financed partially by the public and partially by the private sector. More innovation will be created based on the needs of private companies. Local Ukrainian companies – especially SMEs – will be better prepared for competing with incoming foreign investors.

Robert Smolen Workstream Manager Anti-Corruption

Since 2010	independent consultant; Chairman of Board, Andrzej Frycz-Modrzewski Scientific Foundation - Centre for Strategic Analyses; Deputy Chairman, Stronnictwo Demokratyczne (Democratic Party)
Since 2006	President, Polish Pro-Integration Association 'Europa'
2001-2005	Member of Parliament (Sejm), Chairman of the EU Affairs Committee, Spokesman of SLD Parliamentary Faction
1996-2001	Under-Secretary of State in the Chancellery of President of Poland; Deputy Head of National Security Bureau
1988-1995	diplomat, Ministry of Foreign Affairs of Poland
Nationality	Poland
Born	1964, Zagan, Poland

Włodzimierz Cimoszewicz Workstream Leader Anti-Corruption

Since 2007	Senator (Independent) in the Senate of Poland
1989-2005	Member of the Sejm
2001-2005	Minister of Foreign Affairs of Poland
1996-1997	Prime Minister of Poland
1995-1996	Chairman of the Constitutional Committee of the National Assembly
1995-1996	Deputy Speaker of the House (Sejm)
1993-1995	Vice-Prime Minister and Minister of Justice of Poland
1990-1991	Chairman of the largest political parliamentary Caucus of the Democratic Left Alliance
Nationality	Poland
Born	1950, Warsaw, Poland

Academia will be prepared to participate in future grant competitions, especially those run by the European Union. Those grants are awarded on the basis of evaluation procedures.

Students will be better prepared to find jobs and start a career after graduating. Students involved in joint projects in the business world and at universities will obtain a more practical education and will be able to find future employers during their studies.

The market for investment funds will grow. A virtual supercluster providing complex information on current and planned projects of academia will attract funds to invest in the most promising projects.

Implementation effort

Finding a local partner who is well experienced in legislative procedures and has knowledge of legal regulations governing science and the higher education sector will be one of the most important efforts. The expected partner should be capable of preparing all the regulatory changes required and be ready to assist with the process of information dissemination and enactment by parliament.

The translation of all aspects of the supercluster project into Ukrainian could be done in cooperation with a Ukrainian university specialised in public administration and business management.

As the Polish experience has shown, initial data gathering and the evaluation of the output of academia is a difficult process. It requires a well-trained customer support centre, which should be run by experienced public change managers.

6 Lighthouse Projects WS Tax & Finance

6.1 E-Government: Project e-Taxation

E-Government: Project e-Taxation

Project phases and timing approx. 1.5 year (18 months):

Step 1 Inception phase

Step 2 System installation

Step 3 Personal income tax (small business) and income tax on individuals

Step 5 Basic functionality audit management

Step 6 Payments of national taxes and value added tax

Step 7 Corporate income tax

Step 8 Personal income tax on wages and social & health insurance contributions

Step 9 Payments of tariffs and profit tax for small business

Step 10 New e-filing

Step 11 Final acceptance

Funding amount: High

Project return

Revenue increase in first month, project amortisation within one year, replacement of 50% of the manual processes with automated, transparent tax system

Petra Erler Workstream Manager EU Integration

Since 2010	Managing director of the European Experience Company GmbH, Potsdam
2006-2010	European Commission, Brussels, Head of cabinet of Vice President Verheugen (Enterprise and Industry)
1999-2006	European Commission, Brussels, member of cabinet of Commissioner/Vicepresident Verheugen (Enlargement; Enterprise and Industry)
1991-1999	Representation of the State of Brandenburg at the Federal government, Bonn, Head of department (European Affairs)
1991	Assistant to a member of Bundestag, Dr. N. Wiczorek
1990	Office of the Prime Minister of the GDR, Secretary of State (European Affairs) and before Ministry of Foreign Affairs of the GDR, Berlin, Adviser to the Minister and member of the strategic planning task force
1984-1990	Institute for International relations, Potsdam-Babelsberg, Assistant (Department for world economy)
1981-1984	TextilCommerz, Berlin, Team leader
Nationality	Germany
Born	1958, Werdau (Saxony), Germany

Günter Verheugen

Workstream Leader EU Integration

Since 2010	Professor at the European University Viadrina
2004-2010	Vice-President of the European Commission and EU Commissioner for Enterprise and Industry
1999-2004	EU Commissioner for Enlargement
1998-1999	Minister of State in the Department of Foreign Affairs
1994-1997	Deputy chairman of the parliamentary group of the SPD
1983-1999	Member of the German Federal Parliament
1978-1982	Secretary general of the FDP (liberals)
Nationality	Germany
Born	1944, Bad Kreuznach, Germany

Description of the project

The Ukrainian tax system is considered to be one of the most complicated in the world. In order to make the system more transparent and the payments traceable, to regain taxpayers' trust and fight corruption within the tax administration system the implementation of a holistic e-taxation solution for the national finance and tax administration including a web-portal for tax payers is suggested. The system includes the following modules: registration of taxpayers, management of tax returns, taxpayer and revenue accounting including the automatic calculation of interest and penalties, case management, document management, risk assessment, enforcement, reporting, and an MIS – Management Information System.

Acceptance of the system must be promoted at the highest possible levels. Financing must be guaranteed for a maintenance period covering minimum 24 months after implementation.

Goals

- Replacement of the existing IT system with a web based solution based on the latest technology
- Introduction of functionality and workflows based on best international practice
- Migration of all data from existing systems
- Go-live at the beginning of a year
- Training, for the taxpayer and for the administration staff handling the system
- In the course of the project, specifications and requirements of the International Monetary Fund and the European Commission have to be followed and implemented
- Consideration of all Ukrainian types of taxes, direct as well as indirect taxes, including collection of value added tax (VAT) and social and health insurance contributions
- All documents produced, resulting from various workflows, have to be generated by the system without manual intervention.

Expected impact

- Equal treatment of all taxpayers
- Transparency in taxation matters
- Minimisation of possibilities for corruption
- Guaranteed sustainable revenue collection
- Support of international organisations (IMF, EU)
- Increase in voluntary compliance
- Decrease in operational costs thanks to the introduction of a modern, web based IT system
- Increase in tax officers' qualifications
- Increased trust of the taxpayers in the system and in authority on the whole

Implementation effort

The estimated implementation effort involves 11,000 men days.

The estimated financial efforts amount to around EUR 10 million.

6.2 Improving the Quality of Operation of Tax Administration Units

Improving the Quality of Operation of Tax Administration Units

Project phases (approx. 3 years):

Step 1 Analysis of the present situation as regards the present legal basis for the operation of tax offices and tax chambers

Step 2 Training for the staff of the units involved in the project

XII Curricula Vitae

The proposed measures are also of economic importance due to the fact that there is a greater chance that more people will be kept in the labour process.

Implementation effort

- The CPU tool for monitoring and observation has already been established.
- Its use needs a dedicated small team to start the discussion. This could be done in regular workshops, so the agenda could be discussed with the full involvement of government, health organisations, parliament, media, industry and trade unions as well as EU specialists or experts.
- The discussion should cover legal progress/process, implementation problems, the identification of upcoming challenges, insurance problems.
- As a follow-up of the meeting format in Kyiv, workshops should be organised in regions, perhaps jointly with the local health organisations, combining information about the needed/envisaged reforms with discussions involving the participants. These events should by no means be seen as an academic exercise.
- The CPU delegation should be involved from the beginning and asked (after a successful start of some workshops) for financial support.
- Amounts between EUR 20,000 and EUR 50,000 can be agreed by the delegation. There is a lean procedure/process for gaining access to financial resources.

After around six months a CPU conference should wrap up the main results achieved up to that point (if necessary with a strong call towards the government for CPU to be heard and the government to become more involved). Contacts in regions could be encouraged to stage similar events.

- Step 3** Development of the training programme on quality management in public administration
- Step 4** Training in internal audit management for selected internal auditors from the selected units of the tax administration
- Step 5** Training of a group of trainers from selected units of the tax administration in quality management
- Step 6** Training on the principles of documenting according to quality standards and process management in organisations as an instrument of system implementation for the team dealing with documentation
- Step 7** Training for the quality officer with regard to the leading auditor
- Step 8** Development of the quality management system, including standards, procedures and documentation for the tax administration at the regional level
- Step 9** Execution of the pre-certification audit in the scope of receiving the ISO certificate and provision of assistance to prepare on how to apply for certification

Funding amount: High

Project benefit

Increase in efficiency in the tax administration, decrease in level of corruption in tax administration, improved expertise for tax administration officials

Description of the project

Overall objective is to improve the quality of operation of the units in the Ukrainian Tax Administration

The public administration is divided into segments, which means that individual institutions vary in the approaches they take to strategic-planning and policy-development capacity. It is known, however, that the functioning of the quality management system as a whole undoubtedly has a greater effect than the functioning of individual elements by themselves. For this reason, selective and uncoordinated activities at the local level that do not constitute a cohesive entity (a system) will not achieve the envisaged effects. They are insufficient for assessment, and complex changes should be introduced in order to improve the effectiveness and efficiency of the tax administration.

Due to the different solutions used, the quality of the individual tax offices' systems and resulting operating standards in practice is difficult to control and evaluate at the central level.

Standardised operational procedures for units of the tax administration set down in manuals

Therefore, as a result of this project, all units undergoing the procedure of implementing quality standards should be more efficient in their operation and should be comparable in terms of structure, procedures and operation. This change, in turn, will make it easier to exchange knowledge and transfer best practices.

Need to improve efficiency of the tax administration and provide good-quality services to compliant taxpayers and decrease corruption through documentation of the procedures

Trainings and organisational changes are stimulated by the central level of the administration. Implementation will undoubtedly contribute to increased control of the administration's activities and prevention from corruption, which will be achieved by mechanisms such as documenting the operational procedures. The project goals are to improve efficiency and harmonise activities, which have been clearly defined. Implemented standards will also support anti-corruption actions undertaken in the tax administration. Activities foreseen in the project should result in the improvement of the services offered to the taxpayers, especially in the clear division of responsibilities among employees and then clear flow of documents within the tax administration units. According to the system requirements, access to the knowledge database will also be available to all employees, which will support them in everyday tasks. In the process detailed by ISO, for example, taxpayers' services are described in the standardised instructions, information cards and process management book.

Implementation of the system should also result in the preparation and use of standard layout for internal documents used within the unit eg internal instructions or letters to the taxpayers. Such a solution has many advantages. Changes made to the widely-used documents will be announced to all employees. In pre-prepared documents, it is easy to identify the subject and the author of the document (very important for internal and external communication). The solution also ensures that the procedures followed by employees of the tax administration are always up-to-date.

Furthermore, Ukraine needs to win popular trust for healthcare and primary care services. This is part of the implementation of the government-CPU agreement.

Expected impact

- CPU as a monitoring and observatory board would help to improve the quality of care and this would save lives. Furthermore CPU supports a coordinated approach with the government to modernise the Ukrainian healthcare system. This approach should be implemented at all levels.
- Swift and cost-effective changes saving lives and building trust are implemented most rapidly at the medical professional level.
- Reorganisation of the structures for medical professionals, with the defining of cost-effective and live-saving measures at doctor-patient level being mandatory. All Ukrainian doctors should be represented by this new 'College of Physicians of Ukraine' ('CPU'), setting and monitoring the standards of medicine in all specialties and licensing doctors and hospitals, similar e.g. to the Royal College of Physicians in United Kingdom or the other national organisations of countries within the European Union.
- This measure entails the creation of a nationwide standardised health procedure of high quality for the good of humanity and for the good of the government. Quality can only be improved if all subspecialties receive continued education, organised at the level of each subspecialty and supervised by CPU.

This could lead to a new approach to the design of reforms in Ukraine, with full stakeholder involvement, as it becomes transparent that stakeholder involvement is not a desire but a legitimate right.

Consequently health matters will no longer be an area for activists' engagement (of a few people, participating also in healthcare-Ukraine platforms). Instead, it will be understood as an integral part of Ukraine's politics, which affects each and every person and therefore needs to be not only watched from a distance but also actively carried out.

Better designed health-related reforms could also boost the satisfaction of the population and reduce health budget costs. Together with our targeted savings, we could focus the realised surplus of financial resources on other needful areas.

Most medical services are provided to the population in facilities at the regional, district, municipal or village level. Apart from the development of a formal private sector consisting mostly of pharmacies, medico-prophylactic facilities and privately practicing physicians; the basic organisational structure has essentially remained unaltered since the Soviet period.

The implementation of a College of Physicians of Ukraine (CPU) is aimed at setting and monitoring the standards of medicine in all specialties and licensing doctors and hospitals. This practice will be similar to the Royal College of Physicians in United Kingdom or other national organisations in countries within the European Union.

CPU will be a monitoring as well as an observatory board and will allow all doctors, social partners and the population not only to inform and judge the level of implementation but also to actively launch a public debate on difficult health issues. It will also serve as a platform for public feedback.

It aims at civil society empowerment and enhanced ownership for the health process.

The project should be run by the College of Physicians of Ukraine (CPU) as a dedicated pro-European NGO initiating a process to improve the quality of medical care and patients' trust in the national healthcare system.

CPU would effectively become a competence centre (CC) or information centre (IC) for (all) health matters.

It could start by preparing series of workshops dedicated to healthcare providers (such as doctors, nurses, hospitals, and so on) as well as to the civil society. It will also act as medium to inform the public about the 'new health platform' and to win support for its activities.

The political rationale of a 'College of Physicians of Ukraine' (CPU)

The government monitors the implementation of CPU. Every year, CPU provides the government with a consistent report about the progress achieved. Results will be made public, in Ukraine and to other international organisations.

Implementation largely in line with the government-CPU agreement will be presented as a success story, thus strengthening relations and also the standing of Ukraine.

The implementation process calls for planned alignments and checks; CPU will be adapted at short notice to circumstances where needed and introduced gradually.

Expected impact

- Tasks and responsibilities are described and divided among employees
- Shorter and thus faster decision-making process
- Elaboration of training programmes for the tax administration
- Training for tax administration employees in quality management and internal audit management
- Elaboration of standard and up-to-date layout of documents

Implementation effort

In the Ukrainian Ministry of Finance there will be special units responsible for implementation and coordination of the project. Besides, each unit involved in project implementation will have appointed a representative responsible for carrying out the project.

Project implementation will not interfere with day-to-day activities of the involved units.

Actions taken in scope of project implementation require hiring of **resident implementation advisors (RIA)**. They should:

- work in the framework of the project for 15 months;
- be fluent in English, be open-minded and have social skills enabling them to work efficiently in a team with Ukrainian partners;
- have a university degree;
- have at least ten years of experience in tax administration of an EU member state;
- also have ideally four years of experience in implementing quality management systems; alternatively, the team would have to include a separate long-term expert in QMS with several years of experience in implementing QMS in the context of large administrative entities, preferably in the tax and fiscal sector; and
- have at least general understanding of Ukrainian tax administration.

The following is true of the experts provided by the RIA:

- at least half of them must have at least two years of experience in implementing ISO quality management standards in public administration;
- short-term experts should be able to advise and provide necessary training on the preparation of necessary documentation and on implementing requirements set by ISO standards; and
- short-term experts should provide expertise in implementing specific ISO requirements in the units of the tax administration.

6.3 Resolving the Problematic Debt Recovery Situation (NPL)

Resolving the Problematic Debt Recovery Situation (NPL)

Project phases and timing (7 – 12 months):

Step 1 1 to 3 months – strengthening legal protection of creditor rights

Step 2 6 to 9 months – implementation of legislation for fair court process, write-off improvement etc.

Funding amount: Low

Project benefits

Improvement of financing opportunities for the economy; enforcement of stability and efficiency of the banking sector;

Description of the project

Banks are sitting on a large NPL stock, which spiked in the recent months due to the deteriorating economic environment. Based on the current legal framework,

7 Lighthouse Projects WS Health

'College of Physicians of Ukraine' ('CPU')

College of Physicians of Ukraine (CPU)

Project phases and timing: (This schedule initially depends on the project start; total timeframe including national insurance would be minimum seven years.)

Step 1 CPU represents medical experts from specialties in Ukraine led by a board.

Step 2 CPU will be established according to a decision of the National Parliament or the government (next 6 month till one year).

Step 3 CPU organises development of medical subspecialties, starting with cardiovascular medicine and mother-and-child care (next 6 month).

Step 4 CPU licenses hospitals and doctors according to specific quality criteria (within one year).

Step 5 All medical subspecialties join CPU (within 2 – 3 years).

Step 6 CPU establishes national insurance for all Ukrainian citizens (within 3 – 7 years).

Funding amount: High

Project benefits

Substantial; increase in general health in cost-effective way

Description of the project

The health system in Ukraine is state controlled, and nationally administered by the Ukrainian Ministry of Health and several independent administrative bodies. These bodies include the National Academy of Medical Sciences, the Kiev Municipality Healthcare Department, the Security Service of Ukraine, the Ministry of Internal Affairs, as well as others having their own budget sovereignty.

Expected impact

- Stabilisation of the economy, future GDP growth
- Strengthening of the Ukrainian SME sector, basis for future innovation
- Creation of jobs
- Contribution to social stability
- Stabilisation of the NPL stock of Ukrainian banks

Implementation effort

- Change in tax legislation, introduction of new legislation - government purchase and price preference policy for SMEs, SME-protection authority as well as export promotion framework
- Determination of which ministry (finance or economy) is responsible for the allocation of low interest rate loans to banks and for communication with supranational agencies

banks cannot reduce their NPL stock, which in turn negatively affects the granting of new loans. To solve the problematic debt recovery situation, the following improvements have to be implemented:

- a transparent and fair court procedure and an efficient enforcement procedure;
- favourable tax treatment for debt sale and debt settlement for both sides – the bank and the borrower;
- there is a need for currency regulations on debt sale operations improvement; clear regulations on FX debt sale procedures and sales to foreign institutions;
- legislation on bank secrecy and protection of personal information needs to be improved to facilitate a debt sale;
- NPL write-offs must be improved and the tax code changed;
- cancellation of moratorium on acceleration of mortgage loans; and
- stronger legal protection of creditor rights – this is one of the main obstacles to the sustainable recovery of the banking system amidst the lack of progress with judiciary reform.

Expected impact

- More efficient and stable banking sector
- Positive impact on the economy through new loan financing

Implementation effort

Legislative changes at NBU, Ministry of Justice and Ministry of Finance level

6.4 SME Financing

SME Financing

Project phases and timing:

Step 1 Implementation access to market, as well as communication strategy (3 to 4 months)

Step 2 Implementation of guarantee schemes, tax privileges, protection authority etc. (4 to 8 months)

Step 3 Provisioning of loan at lower interest rates (15 months)

Funding amount: Medium to high

Project benefit

Improvement of SME sector, creation of jobs, contribution to social stability

Description of the project

Financing is a major problem for further development of SMEs in Ukraine due to the following reasons:

- A chronic shortage of capital;
- Extraordinarily high financing costs.

This makes financing the most difficult obstacle to SMEs for further development. Therefore, the creation of new jobs/the fostering of start-ups are indispensable prerequisites. Under presidential leadership, state authorities should develop the roadmap: 'New mass SME invest/support program' covering the aspects below.

1. Access to finance

Easier access to financing would be based on

- Lower interest rates: max. loan rate up to 20% with 5% compensation from budget

- Risk-sharing programs for start-ups: covering 50% by newly setup state agency in combination with supranational funding from EBRD, EIB, EIF, IFC and KFW (Germany) and leveraging of this low-interest funding with domestic funds

In terms of promoting credit to SMEs the risk sharing program should be individually tailored for:

- individuals who are self-employed
- small enterprises that were established only recently
- SMEs that have been active in the market for a longer time.

The steps listed below have to be undertaken:

- **introduction of guarantee schemes:** from special financing vehicles to grant guarantees for investment loans, which are then granted by normal commercial banks. The program should be well equipped with tools in order to prevent 'misuse' (ie artificial special purpose vehicles (SPVs) getting privileges);
- **tax privileges:** tax privilege for start-ups with own equity investment > 30% and 100% Ukrainian registration. This tax relief could be based on the creation of new employment;
- **combine SME financing with export promotion:** offer privileged interest rates for export activities in the field of manufacturing (not agriculture);
- **SME-protection authority:** appointment of an ombudsman, to whom SMEs can complain in case they are fraudulently treated by official organizations; and
- **comprehensive communication strategy:** with a focus on increasing the awareness of SMEs about support programs (local and international media).

2. Access to market – 'Government Purchase and Price Preference Policy for SMEs':

- to establish at national level that at least 25% of purchases should be routed via SMEs;
- to provide equal opportunities to large and SME business on tenders.