

What Hinders Reform in Ukraine?

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Twenty years after gaining independence, Ukraine has a poor record in adopting and implementing political and economic reform. Ukraine has changed its political institutions several times but has yet to achieve a stable system capable of securing democratic freedoms and providing a foundation for implementing comprehensive economic reform.

Following the Orange Revolution, Freedom House ranked Ukraine as a free country in terms of political liberties and civil rights from 2005 through 2009. It lost this status after President Viktor Yanukovich began implementing a host of anti-democratic policies that undid many of the previous political reforms. The constitutional court's 2010 decision to overturn the 2004 amendments to the constitution, taken under obvious political pressure and in questionable legal conditions, returned considerable power to the president's office. After a string of four presidential and parliamentary elections in which the opposition was able to win, Ukraine held local elections in October 2010 that were widely criticized as not meeting international standards, suggesting that future elections will not be free and fair. While traditional media, the main source of news for 69 percent of Ukrainians, remain more lively than their Russian counterparts, they have never been reformed in a way to guarantee freedom of speech and are now coming under pressure from the Yanukovich administration. The judicial system also remains subject to political pressure, with the use of subjective prosecutions against opposition leaders, including most prominently Yulia Tymoshenko. Similarly, the Security Service of Ukraine (SBU) has been much more active since the beginning of 2010 in exerting pressure on a variety of civil society actors. Moreover, since December 2010, critics claim that Ukraine has been holding political prisoners.

While Ukraine has made some economic reform advances, such as joining the World Trade Organization, the general consensus is that the country needs to implement comprehensive and wide-ranging fiscal and infrastructure reforms. Ukraine has yet to restore the income levels that it enjoyed during Soviet times. While Ukraine's

economy grew about 7 percent a year from 2001 to 2008, it did so mainly as a result of external and temporary conditions without implementing key reforms in governance and improving the investment climate. Among key areas that need to be addressed are energy sector reform and the elimination of price subsidies, which are a major driver for the country's high levels of corruption. Businesses that lack political connections consider the tax code to be unfair, with small business owners turning out for large street protests in November 2010.

The following analysis looks at the primary drivers of reform in Ukraine and the main obstacles that hinder advances.

Reform Drivers

Concentrated Executive Power

The Yanukovich administration has consistently argued that “political consensus” among the executive branch and parliament is necessary to carry out reform. The president moved quickly to strengthen his political power during the first part of his term. Annuling the 2004 amendments to the constitution ended the split in power between the president and prime minister that held from 2004 to 2010 and returned considerable authority to the president. Similarly, Yanukovich now has a parliamentary majority, achieved by rewriting the rules in a questionable way.

While, in theory, a strong executive with wide-ranging powers can quickly implement a comprehensive reform program, Ukrainian and other post-Soviet experience has demonstrated that such empowered leaders do not necessarily use their power to launch reform. President Leonid Kuchma implemented some necessary economic reforms at the beginning of his first term, but once he won the adoption of a new constitution, ostensibly for the purpose of implementing further economic reforms, he lost interest in doing so and reform progress ground to a halt. Likewise, concentrating power has not helped promote reform in Russia; there Vladimir Putin has held supreme authority for more than a decade but has not pushed forward any substantial reform effort since the end of his first term in 2004. Although after his election in February 2010, Yanukovich was able to consolidate much greater power than Kuchma had held, he has not announced any substantive reform agenda beyond entrenching himself in power and blocking the opposition. In short, the concentration of power in the hands of the president is a key problem in Ukrainian politics.

While decentralizing power may seem a counterintuitive way to carry out reforms, since it disperses the authority to adopt and implement policies aimed at making major changes that are politically unpopular in the short term, such an approach is imperative in Ukraine. Concentrating power also concentrates the resistance to reform, while disbursing it opens up greater opportunities for change while also increasing the number of points where resistance would need to be applied to effectively block reform. Studies of Middle Eastern states like Saudi Arabia have shown that full control over society results in the complete immobility of the state. The only solution, however imperfect, is decentralization.

External Pressure

Outside pressure, particularly in the form of opportunities to join the European Union or another organization that requires well-defined standards of its members, has proven successful in encouraging reform in many countries in central and east Europe. Such external requirements make it easier for domestic politicians to blame necessary change on external forces beyond their control. Several outside actors have the ability to influence reform in Ukraine.

- *International Monetary Fund (IMF)* – The most powerful outside stimulant for reform has been the IMF. The IMF began offering support for Ukrainian reform in September 2004, though its aid came at a time when Kuchma realized that Ukraine had no choice but to reform. Although privatization went through, many of the other key reforms discussed did not happen. The IMF has also been the greatest driver of reform for the Yanukovych administration. The Fund offered Ukraine a \$15.6 billion loan in July 2010. The conditions attached to the agreement made it possible for the government to tighten spending and raise domestic natural gas prices 50 percent in August 2010, leading to the release of the first \$3.4 billion from the loan. However, when reform progress ground to a halt, the IMF refused to release additional tranches. A key sticking point was that Ukraine needed to reduce its spending on pensions. With outlays now at 18 percent of GDP, Ukraine’s pension commitments are among the highest in the world. Before releasing additional money, the IMF has demanded pension reforms and further cuts in domestic gas subsidies. In July, Ukraine’s parliament agreed to increase the pension age for women from 55 to 60, but the ultimate fate of the measure is uncertain and the government has resisted implementing higher gas prices.
- *European Union (EU)* – Ukraine currently has no chance of joining the EU as a member, so the EU cannot exert pressure over Ukraine the way that it did in the states of central Europe. However, the EU does have some leverage. Part of its power derives from Ukraine’s need to balance pressure from Russia; another part consists of the attraction it offers in terms of markets and economic opportunities. Yanukovych has pursued a Deep and Comprehensive Free Trade Area agreement with the EU, making clear that he is interested in strong ties with the West.

Obstacles to Reform

Imperial and Soviet Legacies

Path-dependency analysis explains why Ukraine will have a difficult time overcoming the policy decisions made during the Soviet era, even twenty years after the Soviet Union ceased to exist. This legacy includes extensive state control over the economy, frequent electoral manipulation, a poorly functioning judiciary, insecure property rights, and markets distorted by monopolies. It also is apparent in the industrialization patterns of eastern Ukraine. Of course, some legacies date back from before the Soviet

period, such as the regional, cultural, linguistic, and religious cleavage lines in the country. Overcoming these legacies will be slow and expensive.

Unreformed Bureaucracy

Related to the problems of the Soviet legacy are the strength of an unreformed bureaucracy. Ukrainian observers note that the bureaucracy has changed little since the Leonid Brezhnev era: it cannot convert political decisions into administrative procedures, does not actively generate new ideas, and does not inform the public about what it is doing or encourage outside input into decisions and implementation. Even Yanukovich complained in an April 2011 speech to the parliament about powerful bureaucratic stakeholders who try to hang on to pursue their own corrupt interests while remaining accountable to no one. Such recalcitrant bureaucratic players are a problem in many states.

Like many other bureaucracies, the Ukrainian one does not encourage innovative risk taking. Most bureaucrats feel they are judged on the number of mistakes they make. Therefore, it is best to avoid taking action because doing as little as possible minimizes the number of potential mistakes. Similarly, entrenched rentier elites in Ukraine's bureaucracy often subvert efforts to design and implement reform.

Lack of Transformational Leadership

Ukraine suffers from a lack of transformational leadership, in the sense that James MacGregor Burns defines it. Burns stresses the need for a leader who advances collective purposes by being attuned to the aspirations of followers. While such transformational leaders are initially motivated by personal goals, they ultimately achieve higher purposes. Yushchenko had considerable opportunity to implement reform after the Orange Revolution, but he did not do so. Ukraine has instead been saddled with "power wielders," who are intent on realizing their own purposes regardless of the common good.

Another key problem for Ukraine's leaders is that, regardless of the amount of power they wield, they simply do not have a strong set of ideas for what to do. Local observers, for example, have accused Prime Minister Mykola Azarov's government of having no plan for comprehensive reform beyond securing the interests of a narrow elite. The ongoing drama of relations between Yanukovich and Tymoshenko, and the system's apparent inability to produce new leaders, make the introduction of any kind of reform unlikely. The presidential elections of 2010 did not bring fresh faces to the fore: Serhiy Tihipko and Arseniy Yatseniuk combined won less than 20 percent of the vote in the first round and have not played a decisive role since then.

Bifurcation of Society and National Identity

The split in Ukraine's national identity and cultural background makes it difficult to consolidate either a democratic or an authoritarian society or to implement reform since it is impossible to achieve the kind of national consensus necessary to drive progress or to assemble a sense of shared sacrifice for a higher purpose.

Patrimonial Clan Politics

The merger of economic and political power in Ukraine is best symbolized by the rise of the Donetsk clan, of which Yanukovych is the most prominent representative. According to this line of analysis, reform is hindered by the rise of oligarchs and business conglomerates that combine the use of state property and public-sector subsidies with the active support of public officials. These quasi-monopolies control large parts of the economy in key industrial areas and effectively use their economic power to capture the state. Through their regional power base and ability to grab considerable power at the national level, the members of the Donetsk clan have the ability to sabotage a wide variety of political and economic reforms. In addition, key business interests control the television watched by the vast majority of the population and can use their position to exert considerable influence over the public opinion.

Lack of Trust in Public Institutions

Analyses of Ukrainian taxpayer willingness to pay their taxes indicate that they have much less trust in their country's political institutions, and therefore much less desire to act as actual citizens, than do residents of Poland or Russia. Ukrainians who do not trust their state logically see little sense in engaging with it. Therefore, they have few incentives to set up civil society groups or to seek ways to hold state officials accountable. Similarly, the general weakness and disorganization of the state means that Ukrainians have little fear that the state will enforce its policies. The result is that little pressure for reform comes from society.

Failure to Combat Corruption

The various Ukrainian governments have failed to reduce the amount of corruption in the country, one of the key consequences of concentrating power, thereby provoking cynicism and distrust among the population. The result has been a withering of the civic activism that seemed to demand significant change at the end of 2004.

Electoral Cycle

Politicians naturally want to avoid adopting painful reforms that will cause them to lose their popularity. They believe that providing money to the population rather than reform will win the support that they need. Relatively poor voters have short time horizons and are not interested in reforms with long-term payoffs. Accordingly, many observers believe that few substantive reforms will take place in Ukraine before the October 2012 parliamentary elections, which will be a crucial assessment of the first half of Yanukovych's five-year term. From this point of view, the need to maintain popularity will prevent effective change that would require personal sacrifice from voters. Since coming to office, Yanukovych's popularity has fallen below 30 percent so he will be particularly interested in populist measures.

Policy Implications

Ukraine has made little progress toward reform under Yanukovich. He has not taken advantage of short-term drivers that can stimulate reform, such as concentrating power in the executive and blaming external forces. Instead, his administration has concentrated power in the presidency to ensure long-term rule while resisting outside pressure from the IMF to implement strategic energy reforms. The failure to take advantage of the short-term efforts to advance reform make it all the more difficult to address the long-term obstacles.

However, given that Russia's main interest in Ukraine is extracting maximal profits from its energy sales, gaining control of the most lucrative economic assets, and aligning Ukraine with Moscow's foreign policy goals vis-à-vis the West, the Yanukovich administration has demonstrated a strong interest in developing ties with the EU and the United States, even as it continues to erode democratic institutions at home. This Russian pressure opens the possibility for the EU and United States to exert a positive influence on Ukraine if Western leaders define a clear set of goals and methods for attaining them. Such goals should include a democratic Ukraine that is committed to reform, starting with its energy sector.

The fact that the Yanukovich administration claims to be working on implementing necessary reforms in its presentations to foreign audiences opens the door for engagement. The administration argues that it is adopting reforms in 21 key areas. The process started with tax reform; the government now claims that collections have increased. An administrative reform is claimed to have sliced the size of the bureaucracy at the federal level, and downsizing is set to improve efficiency at the regional and local levels in the future. The government has also moved ahead with unpopular pension reform.

The West can "stay engaged" with Ukraine by pushing reforms while making it clear that continued deterioration of democratic institutions in Ukraine would make the country an unsuitable partner. The IMF has rightly blocked the further distribution of funds until Ukraine makes progress on ending energy subsidies. U.S. and EU leaders, particularly U.S. President Barack Obama, should speak out forcefully in denouncing democratic backtracking while providing incentives to carry out reforms. These external incentives and pressure are the only way that Ukraine will overcome its numerous domestic obstacles to reform. Whereas Russia often seems impervious to such external pressure, Ukraine is much more open to it.