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SUPPORTING UKRAINE'S DIFFICULT PATH TOWARDS REFORMS

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EXECUTIVE SUMMARY

Ukraine's past attempts to reform and modernize have seen many failures and setbacks. The change in government triggered by the Maidan protests has raised hopes that this time will be different. Will it really and what could be done to make it happen? The present policy paper addresses this question by reviewing post-Maidan reform progress, assessing the European Union's current support and identifying what the latter could do to enhance the odds of sustainable progress.

Reform progress along the "4 Ds"

An overview of the post-Maidan reform process along the four priorities identified by President Petro Poroshenko yields a mixed picture:

- Deregulation: significant progress
- De-bureaucratization: moderate and slow progress
- Decentralization: significant, but politically controversial progress
- De-oligarchization: legislative progress, but limited implementation

Stumbling blocks and bright spots in the reform process

Key stumbling blocks include the costs and destabilisation flowing from the conflict in the Donbas; the country's imminent risk of economic collapse; the continued influence of vested interests (in particular oligarchs) and the growing domestic awareness of the cost of reforms causing political destabilisation. At the same time, there are a number of important reform enablers. Ukraine has the most reform-oriented government and parliament since independence. A network of sophisticated civil society organizations pushes for reform. And a range of national and international players support the reform process.

The EU's multifaceted support to the reform process

The Union has provided a wide range of measures including technical expertise; macro-financial assistance and loans; unilateral trade measures; development assistance and budget support as well as the mobilisation of finance for investment projects. While the EU's assistance has been substantial, important economic, political and security-related stakes attached to the success of Ukraine's democratic path call for additional and more targeted support.

Boosting and fine-tuning EU assistance

The EU could enhance and refine its assistance in four ways:

- Raise economic and political pressure on Ukrainian decision-makers
- Extend direct support to reform enablers such as reform-oriented bureaucrats, civil society organisations and independent media
- Prevent economic collapse and reassure investors through additional macrofinancial assistance and a political risk insurance scheme
- Promote EU-Ukrainian interaction through an enhanced EU presence and visibility in Ukraine and greater information exchange with Ukrainian experts in Brussels

INHALTSVERZEICHNIS

INTRODUCTION

In the last two decades, reforming Ukraine was a story with many setbacks. Since the country's independence in 1991, consecutive governments failed to build functioning state institutions. After mostly murky privatizations in the early 1990s, a select group of businesspeople seized control of parliament, government and judiciary, passing laws in their and their political allies' favour rather than creating a basis for sustainable social and economic development. The notion of 'reforms' became synonym to new ways of looting the budget, dismantling rule of law and cloaking corruption[1].

Hopes were high that the 'Orange Revolution' in 2004 would be a game-changer. After protests over a rigged election, a supposedly reform-oriented government came into power and promised to break with 'old traditions'. But a lack of competence and infighting in the 'Orange camp' led to five years of political turmoil, with four governments and two parliamentary elections, which paved the way for the rise to power of President Viktor Yanukovych in 2010.

Yanukovych's coalition programme was entitled "Stability and Reform". A Reform Committee, headed by the President himself, was created to prepare new laws, which were quickly passed by the parliament. These so-called 'reforms' resulted in an important roll-back of democratic freedoms and further corruption. According to Ukraine's former chief prosecutor, Oleh Makhnitsky, Yanukovych's rule and his "mafia-style syndicate" cost the Ukrainian state up to $100 bn[2]. The President was ousted in the course of the Euromaidan revolution in 2014. Ukraine's economic and political reform setbacks explain why the country, that began its transformation in 1991 with a GDP per capita superior to that of Poland, has now fallen far behind its neighbour.

"THE IMPACT OF THE EU'S REFORM-FOCUSED ENGAGEMENT REMAINED LIMITED"

Since Ukraine's independence, the European Union (EU) has been actively engaged in Ukraine with various reform-oriented measures, including a Partnership and Cooperation Agreement signed in 1994 and activities in the framework of the European Neighbourhood Policy (ENP) since 2005. The former High Representative for the Common Foreign and Security Policy, Javier Solana, helped negotiate the agreement which led to the peaceful end of the 'Orange revolution'. Nonetheless, the impact of the EU's reform-focused engagement remained limited.

Will this time be different? Will the new, post-Euromaidan government deliver on its promise to implement the much-needed, deep reforms? Or will this just be another disappointing stage in Ukraine's unfortunate reform history? And which role could the EU play to effectively support Ukraine's path towards sustainable reforms?

Our paper addresses these questions by focusing on the internal transformation processes in post-Maidan Ukraine. These are unfolding in a highly complex geopolitical environment. Russia's policy of hybrid destabilization could significantly derail Ukraine's reform progress, be it through energy cuts, political destabilization or military engagement. While aware of these external threats, we focus on the country's internal reform efforts and base our analysis on a scenario of steady stabilisation. The dangers related to less rosy escalation scenarios have been widely discussed elsewhere. While we might lose some comprehensiveness, we hope to gain focus.

Our analysis starts with an overview of post-Maidan reform achievements and setbacks in key priority areas. We then discuss the main stumbling blocks and drivers in the reform process. Subsequently, we provide an overview of the EU's assistance to the reform process and close by identifying future avenues of assistance.

1. Aslund, Anders, Ukraine: What Went Wrong and How to Fix It, Washington: Peterson Institute for International Economics, 2015, p. 59-100.
2. Faulconbridge, Guy, Dabrowska, Anna, Grey, Stephen. "Toppled 'mafia' president cost Ukraine up to $100 billion, prosecutor says", Reuters, 30.04.2014.

1. Reform progress along the "4 Ds"[3]

Since the Euromaidan revolution, Ukraine's government has been confronted with a myriad of reform demands, both from domestic actors and international partners. Five voluminous documents now form the basis of the reform process:

- Ukraine's Strategic Vision – 2020[4]
- Ukraine's Government Programme for 2015[5]
- the Coalition Agreement[6]
- the EU-Ukraine Association Agreement Agenda[7]
- Commitments to the International Monetary Fund[8]

To resolve contradictions between these demands, prioritize reforms and foster political consensus the reform process has been coordinated by a National Reform Council (NRC). The NRC brings together key political actors (the President, Prime Minister, Cabinet of Ministers, heads of parliamentary factions and committees) as well as representatives of civil society and business organizations. Work progress is tracked by a Reform Monitoring Framework, which evaluates to what extent reforms have been adopted, implemented and how they have affected policy impact and public perception[9]. The Framework is based on a system of performance indicators selected in consultation with international donors.

In the following we will analyze progress in four priority reform areas defined by President Petro Poroshenko: deregulation, de-bureaucratization, decentralization and de-oligarchization (the "4 D's")[10]. We focus on progress made since the current government of Prime Minister Arseniy Yatseniuk came into power in December 2014[11].

1.1. Deregulation: significant progress

> "DEREGULATION HAS MADE THE STRONGEST HEADWAY SO FAR"

Deregulation has made the strongest headway so far, particularly owing to leadership by Aivaras Abromavičius, the Lithuanian-born Minister of Economic Development and Trade. Ukraine's overregulated business environment has been a major deterrent for business activity and investment. In 2014, it took a company on average 277 days to obtain access to electricity, placing Ukraine as 185th out of 189 countries in World Bank's Ease of Doing Business rankings. Other 'pain points' include trading across borders (154th position in the ranking), resolving insolvency (142nd), protecting minority investors (109th) and paying taxes (108th)[12].

3. This section draws on expert interviews, own analysis and publications, including reform monitoring projects. The latter are prepared by Vox Ukraine, Democracy Reporting International, National Reform Council, Carnegie Endowment, Reanimation Package of Reforms, and Kyiv Post
4. Verkhovna Rada of Ukraine, On the Strategy for Sustainable Development, Ukraine – 2020, adopted 01.12.2015.
5. Verkhovna Rada of Ukraine, On the Program of the Cabinet of Ukraine, adopted 11.12.2014.
6. Verkhovna Rada of Ukraine, Agreement on coalition of parliamentary factions 'European UKRAINE', adopted 27.11.2014.
7. EU-Ukraine Association Council, EU-Ukraine Association Agenda, adopted 16.03.2015.
8. International Monetary Fund, Ukraine: Memorandum of Economic and Financial Policies, adopted 27.02.2015.
9. See the Implementing reforms website. More information here.
10. Saakashvili, Mikheil, Poroshenko's four Ds, Politico, 05.11.2015.
11. After former President Viktor Yanukovych fled to Russia in February 2014, a provisional government was formed, which was severely constrained in conducting reforms since the parliament was still dominated by deputies from the Party of Regions and Communist Party linked to Yanukovych (see Aslund 2015, p. 113-132, for details). The current government of Prime Minister Arseniy Yatseniuk came into power only after the parliamentary elections of October 2014 and has been in power since December 2014. This date will be taken as a starting point for the analysis.
12. World Bank, Doing Business 2015: Ukraine, Washington: World Bank, 2014.

To improve the business environment, Minister Abromavičius identified together with business representatives 201 obstacles for business, out of which 84 were removed and 88 are in the process of being addressed[13]. In particular, laws simplifying the registration of new businesses and strengthening the protection of investors' rights were adopted. The amount of licences required for producing and selling products and services has been cut by 50%, particularly in the food, energy and IT sectors. Moreover, 28 out of 56 business inspection agencies with bad reputations as instruments for extorting bribes from businesses rather than protecting consumers[14] were shut down. In addition, an office of business ombudsman was created, with the former EU Commissioner for Taxation and Customs Union, Audit and Anti-Fraud, Algirdas Šemeta, as its first director[15]. Finally, the total number of taxes was reduced from 22 to 11 and a currently debated major tax reform will likely set up a unified taxation level of 20% on payroll, VAT, personal and corporate income, thereby significantly simplifying the payment of taxes and minimizing the scope for conflict with tax authorities over their interpretation[16].

The next step in the deregulation programme will be a 'regulatory guillotine', that is a systematic review of business regulations and large-scale removals of obsolete regulatory acts. It will be implemented with the help of Jacobs Cordova and Associates, a leading consultancy applying this method[17].

1.2. De-bureaucratization: mixed results

In contrast, progress on de-bureaucratization has been slow, despite the fact that deep public administration reform is of systemic importance for the overall process. In the end, the government's ability to deliver on reforms will depend to a large extent on whether the bureaucracy is able to implement new policies. Over the last two decades Ukraine has failed to reform its Soviet-style civil service designed to follow top-down orders rather than develop and communicate sensible policies and deliver them to high quality. Because wages were low and rules on recruitment, promotion and dismissal intransparent, the bureaucracy failed to attract talented and incorruptible civil servants who would transform its ability to deliver results.

Much could be changed through a comprehensive law "On the State service" which has been introduced to the parliament in March 2015. If adopted, it would introduce a merit-based approach to recruitment, promotion and remuneration as well as safeguards against discretionary dismissal of civil servants[18]. It would also encompass a much-needed separation between civil service and political positions. However, the law has not been passed despite eight consecutive votes and there is no concrete date for its adoption yet[19].

"UNTIL NOW, ONLY FRAGMENTED MEASURES WERE INTRODUCED"

Until now, only fragmented measures were introduced. To enhance the attractiveness of the public service, a law removing limits on salaries of top state employees was adopted. In the area of state-owned enterprises open competitions to appoint CEOs were introduced. Moreover, there are currently discussions on setting up a special fund for increasing salaries of civil servants[20].

The delivery capacity of the bureaucracy could also have been improved by systematic, merit-based staff renewal. Here, results are mixed. The Ministry of Economic Development and Trade dismissed 400 out of 1200 civil cervants based on poor performance reviews and hired 85 new ones on merit-based grounds[21]. In addition, a highly visible personnel change was carried out in the traffic police, which was renowned for its extensive

13. Expert interview, 23.07.2015.
14. Stecklow, Steve, Piper, Elizabeth, Akymenko, Oleksandr, Special Report: How scams and shakedowns brought Ukraine to its knees, Reuters, 07.08.2014.
15. Business Ombudsman Council of Ukraine, Quartely Report April-June 2015, accessed 05.09.2015.
16. Aslund, Anders, Ukraine Needs a Radical but Sensible Tax Reform, Vox Ukraine, 04.09.2015.
17. Verkhovna Rada of Ukraine, Head of Verkhovna Rada Committee for Industrial Policy and Entrepreneurship Viktor Halasiuk meets with experts of Jacobs Cordova and Associates company, press release, 28.04.2015.
18. OECD, Anti-Corruption Reforms in Ukraine, Round 3 Monitoring of the Istanbul Anti-Corruption Action Plan, p. 86 ff, adopted 24.03.2015.
19. Reanimation Package of Reforms, Infographics: Results of the Second Session of the Verkhovna Rada of the 8th Convocation, accessed 05.09.2015.
20. The fund could be established with support of the European Union. Conditions for its establishment include adopting the law "On the State service" as well as a reform strategy for public administration. More on the President of Ukraine's official website.
21. Lichnerowicz, Agnieszka, Ukraiński minister walczy z plagą korupcji: W moim resorcie zwolniłem już 400 osób z 1200 zatrudnionych, TOK FM, 19.06.2015.

bribing practice. The new traffic police force is younger, well-paid, well-educated and equipped to Western standards. The roll-out of the first 2000 policemen and women in Kyiv was completed in July 2015 and will be followed in the coming months by Kharkiv, Lviv and Odessa. The new traffic police is welcomed by the population as one of the few visible reforms since the Yatseniuk government came into power. In addition, it is clearly associated with international support. The US provided training and other assistance worth $15 mio and Japan donated environmentally-friendly patrol cars[22].

Staff renewal in other areas of administration has been much slower. Even if the government implements its pledge to shrink civil service by 10% in 2015, employment levels will still be higher than in 2012[23]. Moreover, since transparent dismissal rules are not yet in place, it is unclear to what extent lay-offs reflect performance criteria or rather follow from arbitrary decisions or mechanistic across-the-board cuts.

Another factor which could have improved the quality of public administration relates to the lustration law. The law bans high-level bureaucrats with ties to the Yanukovitch regime or to foreign secret services from public service for up to ten years[24]. It thereby targets a group of civil servants which could be a major stumbling block on the way to carry out reforms. However, the law was badly designed and left too many loopholes, including the fact that decisions on dismissals were not made by independent bodies but by department heads under coordination of the Ministry of Justice, allowing civil servants falling under lustration to avoid dismissal by corrupting decision-makers. As a result, merely 2000, mostly mid-level, civil servants have so far left the administration on the basis of lustration charges[25]. This stands in stark contrast with Prime Minister Yatseniuk's promise to subject about one million officials to lustration[26]. The parliament is currently working on amendments to the law in order to extend the scope of affected officials and improve its governance structure[27].

1.3. Decentralization: progress amidst political controversy

Given the scale and scope of legislative work required for decentralization, progress has been substantial, but it is subject to political difficulties, particularly in relation to the conflict with Russia. Through constitutional amendments[28] and a set of accompanying laws, Ukrainian lawmakers conducted a substantial shift in policy responsibilities from higher to lower levels of government, especially from oblasts (regions) to gromadas (basic level administrative units)[29]. In line with the principle of subsidiarity, lower level units will receive more say in areas including education, healthcare, infrastructure and local development. They will also receive more revenues from local taxes and levies to carry out these tasks. The reform will be flanked by a voluntary 'amalgamation' of administrative units to avoid duplication of public services[30].

> "THE MORE CONTROVERSIAL ISSUE IS THE STATUS OF THE TERRITORIES IN EASTERN UKRAINE"

The more controversial issue is the status of the territories in Eastern Ukraine currently controlled by Russian-backed 'separatists' (i.e. the 'Donetsk People's Republic' (DNR) and 'Luhansk People's Republic' (LNR)). According to paragraph 11 of the Minsk II agreement, Ukrainian authorities are obliged to adopt "permanent legislation" on the "special status" of these territories by the end of 2015[31]. This has raised two controversies.

22. Vlasov, Dmytro, Ukraine's new police on charm offensive in Kiev, AP, 24.07.2015.
23. "At the start of 2015 there were 335,000 civil servants. In 2012 the figure was 275,000, and in 2011 it was 268,000 (...). A 10% cut would still mean there are more civil servants in the country than there were in 2012 or 2011" (Ianitskyi, Andrii, The high price of democracy in Ukraine, openDemocracy, 05.01.2015.)
24. Olszański, Tadeusz A., The Ukrainian Lustration Act, OSW Analyses, 01.10.2014.
25. UNIAN Information Agency, About 2,000 officials dismissed during lustration in Ukraine, 15.04.2015.
26. Interfax-Ukraine, Yatsenyuk: Ukraine lustration will cover 1 million officials, KyivPost, 17.09.2014.
27. Democracy Reporting International, Legislative Initiatives on Political Reforms in Ukraine's Verkhovna Rada (Updated on 21 July 2015), p. 3, accessed 05.09.2015.
28. Which were approved by the Constitutional Court on July 31st and are expected to be adopted by parliament and signed by the president before local elections in October 2015.
29. Ukraine's adminsitrative units are located at three levels: oblasts (regions), raions (regional sub-divisions) and gromadas (communities).
30. Democracy Reporting International, Constitutional Reforms in Ukraine: An update on Recent Developments and Debates, p. 2 ff, accessed 05.09.2015.
31. "Conducting constitutional reform in Ukraine, with the new constitution coming into force by the end of 2015, providing for decentralization as a key element (taking into account the characteristics of individual areas of the Donetsk and Luhansk regions, agreed with representatives of these areas), as well as the adoption of the permanent legislation on the special status of individual areas of the Donetsk and Luhansk regions in accordance with the measures specified in Note [1], until the end of 2015.", Minsk Agreement, Unian, 12 February 2015.

First, in the run-up to the vote on the constitutional amendment bill on July 16th, president Poroshenko moved – reportedly after pressure from Germany, France and the US[32] – a passage indicating that the "special status" will be specified in future legislation from general points of the bill to the actual text of the constitution[33]. This has raised fierce opposition in the parliament since some deputies argued that such a move could be the first step towards a legalisation of the so-called 'People's Republics'. On 31 August 2015 the parliament passed the decentralisation bill in the first reading after heated discussion and with a simple majority of 265 votes. The vote triggered violent protests, which the government blamed on the nationalist Svoboda ('freedom') party[34]. It is far from certain whether the bill amending the constitution will garner the necessary two-third majority in the second and final reading later this year.

Second, the passage states that the "special status" of DNR/LNR territories will be specified in further legislation. Its exact details are thus still open. For instance, it is unclear which policy areas can be decided autonomously in the 'separatist'-controlled areas and which by the central government in Kyiv. It is also open which government functions in the DNR/LNR territories will be funded by the central government[35]. In other words, it is unclear if the "special status" will mean 'decentralization' (giving the territories some autonomy as in the current reform package, but keeping control over core policy areas in Kyiv) or 'federalization' (granting DNR/LNR far-reaching autonomy bordering on a legally confirmed surrender of control over the territories)[36]. This ambiguity can be a source of conflict with Russia, which might pressurize the government to pursue 'federalization' by granting as much policy autonomy to the 'separatists' (e.g. on law enforcement, foreign policy, judiciary, public administration or use of natural resources) while forcing it to pay as much as possible for public services in those regions (e.g. pensions, healthcare, education or energy).

Moreover, some commentators fear that even if the law specifying the "special status" will limit the extent of policy autonomy of DNR/LNR, a future, more pro-Russian government in Kyiv could easily extend this autonomy as only a simple majority in parliament is required, as compared to a 2/3 majority needed for constitutional amendments.

1.4. De-oligarchization: new legislation – limited implementation

> "DE-OLIGARCHIZATION CAN BE SEEN AS A LITMUS TEST FOR THE OVERALL REFORM EFFORTS"

Progress on de-oligarchization has been significant in terms of legislation but limited regarding implementation. It can be seen as a litmus test for the overall reform efforts since it addresses the key mechanism nurturing Ukraine's public policy problems: corruption. Historically, Ukrainian oligarchs have misappropriated funds through a range of channels. They rigged public procurement, siphoned off public subsidies (most notoriously in the energy market), pursued insider privatization and large-scale tax evasion and captured undue profits from state-owned enterprises[37]. Rigged public procurement alone accounted for about €11 bn losses to the public budget per year[38].

The oligarchs' grip on the Ukrainian state also extended to the political process: they have been offering campaign financing and media coverage to candidates in return for favours, such as passing favourable legislation, placing trusted bureaucrats in ministries, regulatory agencies and state-owned enterprises as well as dismantling judicial oversight. Since much of this is public knowledge, it is no surprise that Ukraine was ranked 142nd out of 175 countries in Transparency International's 2014 Corruption Perceptions Index[39].

32. Kuczyński, Grzegorz, Nuland zatrzęsła Kijowem. Plotki o tajnej umowie Obamy z Putinem, TVN24, 31.07.2015.
33. More specifically, to paragraph 18 of the transitional arrangements of the constitution.
34. Zinets, Natalia, Balmforth, Richard, Ukraine guardsman killed in nationalist protest outside parliament, Reuters, 31.08.2015.
35. As of November 2014 Ukraine has stopped – by presidential decree – payments of wages, pensions, medical and other public services on the occupied territories and ordered its public servants to evacuate to areas controlled by the government. However, residents of occupied territories can still collect social benefits in government-controlled areas. More: Eastern Ukraine: a Dangerous Winter.
36. Olszański, Tadeusz A., Ukraine: sovereign decentralisation or federalism without sovereignty?, OSW Commentary, 18.04.2014.
37. Matuszak, Sławomir, The oligarchic democracy: The influence of business groups on Ukrainian politics, OSW Study 42/2012.
38. Mostovych, Anna, Yanukovych and co. stole over $11 billion annually, Euromaidan Press, 09.09.2014.
39. Transparency International, 2014 Corruption Perceptions Index – Results. Accessed 05.09.2015.

From a legislative perspective, there has been impressive progress, mainly due to the insistence of the IMF, the European Union and civil society actors on deep anti-corruption reforms:

- New laws on the disclosure of ownership structures of companies, real estate and cars will make it harder for public officials to hide illegal assets.
- Public procurement will now be conducted through an online platform developed together with Transparency International[40].
- Energy subsidies were cut, thereby increasing natural gas tariffs by 280% and heating tariffs by 66%, but flanked with a support program for the poorest households.
- A major gas market reform law breaks up the monopolistic state-owned company Naftogaz into separate production, transport, storage and distribution firms to create a competitive gas market in line with EU's Third Energy Package[41].
- Legislation on state-owned enterprises has increased the transparency of corporate governance structures, reporting of business results and appointment of CEOs.
- A package of laws on the banking sector has made it more difficult to use banks for money laundering or murky insider deals endangering public deposit insurance[42].
- A law on public broadcasting allows for the creation of a publically funded, but politically independent media service.
- A law on the financing of political parties could make it harder for oligarchs to exercise financial leverage over politicians.

In addition, two anti-corruption agencies were created. The National Agency for Prevention of Corruption will verify asset declarations of members of parliament, mayors, police, judges and prosecutors and monitor conflict of interest issues in the public service. And the National Anti-Corruption Bureau will conduct pre-trial investigations and file court cases against senior officials whose income profiles do not match their expenditures.

> "LEGISLATIVE PROGRESS HAS NOT BEEN MATCHED WITH SWIFT IMPLEMENTATION"

However, legislative progress has not been matched with swift implementation. Until now convictions of high-profile oligarchs, politicians or public servants based on corruption charges have been limited. This can partly be traced back to the stagnating progress in implementing reforms of the prosecution and judiciary, which is one of the major neglected areas of the government's reform agenda[43]. The 'purging' of ranks of prosecutors and judges from civil servants with links to patrons in business or politics and the creation of new, effective mechanisms of self-cleansing which would be in line with separation of powers has been pursued without political momentum[44]. A major impediment of the process also derives from the fact that the President still controls the Attorney General who has shown limited vigour in pursuing deep reforms of his institution. There is some hope that a new law on prosecution which came into force on 15 July 2015 as well as constitutional amendments to the principles of recruitment, assessment and dismissal of judges as currently discussed in the commission preparing constitutional amendments will improve the environment. However, more progress is needed much faster in this systemically important area.

40. The platform, called ProZorro, is currently a pilot project used for tenders up to 100.000 UAH. Its roll-out plan envisages to move most of public procurement to the platform starting in 2016.
41. Though not a member of the European Energy Community, Ukraine is rapidly aligning with the Third Energy Package. In addition, Ukraine expanded reverse flow capacities with Slovakia, Hungary and Poland. In the first half of 2015 already 62% of gas imports came from EU member states. Prospectively all gas imports could be procured in the EU instead of Russia, thereby eliminating intransparent Ukrainian intermediaries benefiting from gas trade with Russia. More: Konończuk, Wojciech, Reform #1. Why Ukraine has to reform its gas sector.
42. As a result, more than 50 insolvent and/or fraudulent banks have been removed from the market since the end of 2013, resulting in large outflows from the Deposit Guarantee Fund but cleaning up the country's banking system.
43. Democracy Reporting International, Ukraine's Political Reforms: One Year on from Euromaidan, accessed 05.09.2015.
44. Popova, Maria, Ukraine's Judicial Reforms, Vox Ukraine, 15.12.2015.

Table 1 ► Progress in Ukraine's reforms

REFORM AREA	PROGRESS SINCE DECEMBER 2014[1]
Deregulation	Significant progress
De-bureaucratization	Moderate and slow progress
Decentralization	Significant progress, but politically controversial
De-oligarchization	Legislative progress, but limited implementation

Source: own compilation

1. As explained previously, December 2014 has been taken as a starting point for the analysis since this date marks the start of Arseniy Yatseniuk's tenure as Prime Minister. Before this date, a provisional government was in power, which was severely constrained in conducting reforms since the parliament was still dominated by powers linked to former President Yanukovych (see Aslund 2015, p. 113-132, for details).

This brief and necessarily incomplete overview indicates just how crowded Ukraine's reform agenda is. Progress to date has been uneven (see Table 1). There have been significant advances in the fields of deregulation and decentralization as well as impressive legislative steps towards de-oligarchization. However, reforms of the large Soviet-style bureaucracy remain scattered and the sustainability of efforts towards altering a long-standing system of oligarch capitalism could be questioned. Meanwhile, progress in the field of decentralization could easily fall prey to political considerations in light of the ongoing conflict with Russia.

2. Stumbling blocks and bright spots in the reform process

Ukraine's reform process takes place in a difficult political and economic context. This adds to the challenge of improving governance after two decades of foregone reform efforts. However, the context also displays positive factors which were not present before the Euromaidan protests. This raises some hopes that reformers will succeed in modernizing the country.

2.1. Obstacles and risks

The conflict in the Donbas poses a major financial, economic and political challenge. Conducting the military operation alone costs up to $7 mio per day[45]. The ongoing fighting and the threat of escalation make it difficult to attract badly needed foreign investment. Dealing with at least 1.4 mio Internally Displaced Persons[46] poses a humanitarian and political challenge, particularly for regions bordering the Donbas, where high unemployment, accommodation shortages and overburdened public services risk becoming a destabilizing factor. The military operation also puts a strain on the decision-making capacity of key political actors who have to divide their attention between military planning and the reform programme. The conflict also dealt a blow to immediate de-oligarchization after the Euromaidan revolution, since some oligarchs were major financial supporters of pro-Ukrainian militias[47].

In addition, the looming danger of economic collapse poses a risk. According to the IMF, Ukraine's GDP dropped by 18% in the first quarter of 2015 and is expected to fall by 9% in 2015. Public debt is expected to reach 94.5% in 2015, much of it denominated in foreign currency, which could increase debt levels further due to exchange rate fluctuations. Moreover, $15.3 bn of Ukraine's $40 bn 2015-2018 public financing gap is to be covered by debt restructuring. Here, a haircut and maturity extensions were agreed with bondholders in August 2015[48], but the repayment status of a $3 bn bond bought by Russia during Yanukovych's tenure is still

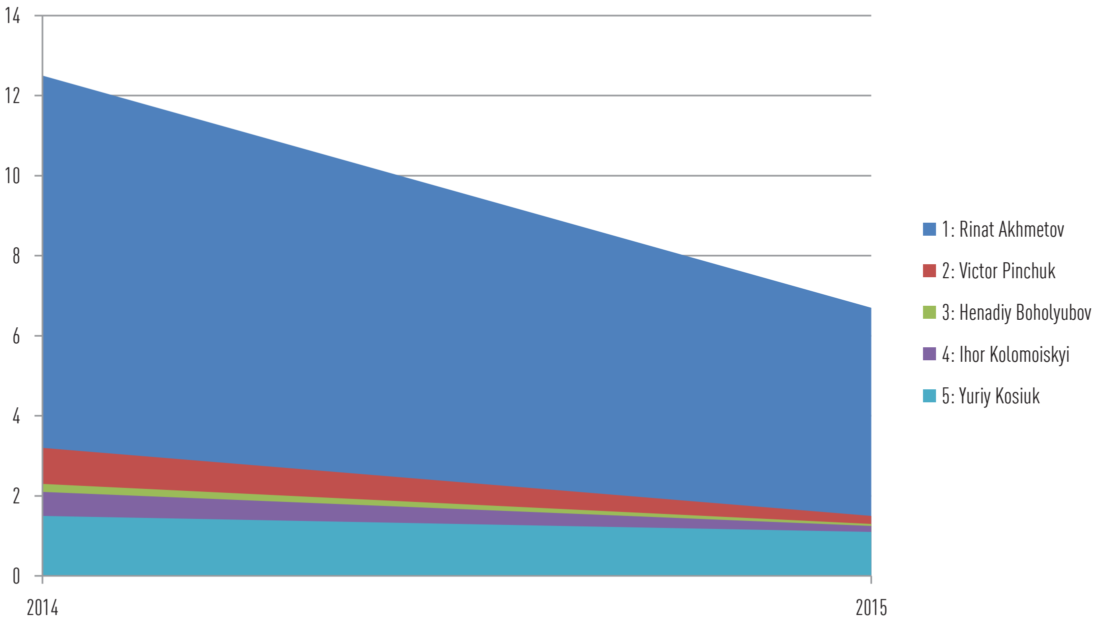
45. UNIAN Information Agency, Yatsenyuk to Steinmeier: every day of Donbas war costs Ukraine up to $7 mln, 29.05.2015.
46. Internal Displacement Monitoring Centre, IDMC estimates that there are 1.4 million IDPs in Ukraine as of August 2015, accessed 05.09.2015.
47. Chazan, Guy, Olearchyk, Roman, Ukraine: An oligarch brought to heel, Financial Times, 25.03.2015.
48. Doff, Natasha, Krasnolutska, Daryna, Ukraine Wins Debt Relief as Russia Refuses to Join Agreement, Bloomberg, 27.08.2015.

unclear[49]. The difficult economic situation puts a strain on public finances, making it harder to flank tough reforms with additional social spending and it forces the government to conduct harsh and unpopular austerity measures. Moreover, it decreases foreign investors' confidence that Ukraine is a safe country to do business in – at a time when Ukrainian firms desperately need investment to modernize and tap into EU markets.

Vested interests are a key issue which has prevented reforms in the past two decades. The role of oligarchs could be a particular risk[50]. Due to their influence in the parliament, media, administration, prosecution and judiciary, oligarchs could block legislative projects, sabotage their implementation or pressurize government to revoke or water down laws once the attention of international donors decreases. Their leverage also comes from the structural power of assets under their control[51].

There is some evidence that the oligarchs' power is eroding[52]. Between 2014 and 2015 the five wealthiest oligarchs lost about 50% of their assets (see Figure 1). This is partly because assets were based in the 'separatist'-controlled areas of Eastern Ukraine, partly because of severed trade links with Russia and partly due to new laws and regulations. Moreover, oligarchs are increasingly being stripped of publically visible displays of influence[53]. In March 2015, Ihor Kolomoyskyi lost his position as governor of the Dnipropetrovsk region. And Dmytro Fyrtasz suffered a setback when his protégé and head of Ukraine's intelligence agency SBU, Valentyn Nalyvaichenko, was dismissed in June 2015. Fyrtasz himself is meanwhile under house arrest in Austria due to US-based corruption charges.

Figure 1 ► Top five Ukrainian billionaires (total net worth in $ bn)



Source: Carnegie Endowment for International Peace

On the other hand, it is a bit early to see if this is a sustainable tendency. Decreased levels of assets do not directly translate into less control of the political process. It is public knowledge that parts of the current parliament de facto represent oligarchs who provide crucial financing for elections and media coverage[54]. The

49. Talley, Ian, What's $3 Billion Between Enemies? Ukraine and Russia Battle Over Debt Terminology, WSJ Blog, 28.03.2015.
50. Matuszak, Sławomir, The oligarchic democracy: The influence of business groups on Ukrainian politics, OSW Study 42/2012.
51. There are various estimates of the share of Ukrainian economy under the oligarchs' control, ranging from 38-85%. However, they are fraught with methodological issues (Who counts as 'oligarch'? What does 'economy' and 'control' mean? How can assets be estimated given intransparent accounting systems?). A back-of-the-envelope calculation shows that in 2014 the five richest people in Ukraine owned $21.6 bn, which corresponds to 16.4% of GDP. For comparison, the five richest people in Germany in 2014 owned 2.5% of GDP. The calculation is based on World Bank data on GDP levels in 2014 and data by Forbes and Manager Magazin.
52. Aslund, Anders, Ukraine: What Went Wrong and How to Fix It, Washington: Peterson Institute for International Economics, 2015, p. 26-32.
53. Jarábik, Balázs, Bila, Yuliya, And Then There Were Five: The Plight of Ukraine's Oligarchs, Carnegie Endowment for International Peace, 17.06.2015.
54. In fact, Ukrainian newspapers regularly publish an overview of which MP sits into which oligarch's 'pocket', see e.g. Elections will not weaken the positions of oligarchs in politics.

oligarchic dominance in the media market hasn't changed either[55]. Also the fact that President Poroshenko himself still owns assets causing potential conflicts of interest (e.g. the MIB bank and 'Channel 5' TV station) doesn't bode well for the seriousness of the current state of de-oligarchization[56].

Moreover, the window of opportunity for reforms is closing. About one and a half years have passed since the Maidan protests, but tangible positive effects of reforms have been limited. At the same time, the price of reforms can be clearly felt, for instance through drastically increased energy costs. As a consequence, popular unrest (sometimes referred to as 'third Maidan') might cause political instability and the rise to power of anti-reform parties or new parties heavily controlled by oligarchs such as 'Ukraine of the Future' and 'Ukrop'[57].

2.1. Reform enablers and reasons for hope

"REFORMS ARE MANAGED BY THE MOST PROFESSIONAL GOVERNMENT AND PARLIAMENT SINCE INDEPEDENCE"

The reform context also displays enablers of deep change. First, Ukraine's reforms are managed by the most professional, reform-minded and EU-oriented government and parliament the country has had since its independence in 1991. In the government, key posts of ministers and deputy ministers are held by foreign-born and Western-educated professionals without ties to the previous system[58]. This includes Natalie Jaresko, the US-born finance minister and Aivaras Abromavičius, a Lithuanian-born minister of economic development as well as a team of Georgian-born executives including David Sakvarelidze, deputy prosecutor general and Eka Zguladze, deputy interior minister responsible for police reform. Reform-mindedness extends also to the Verkhovna Rada, where a group of NGO professionals, activists and journalists related to the Euromaidan movement entered the parliament and now forms an interfactional group of "Eurooptimists"[59]. Despite all problems, there is more will to reform than in the past two decades.

Second, a network of new, sophisticated civil society organizations (CSOs) has been playing a key role in the reform process[60]. These CSOs provide reform expertise, act as watchdogs, conduct advocacy and serve as training ground for responsible political leaders and civil servants. CSOs also monitor the implementation of reforms and – in case of irregularities or delays – inform international donors, conduct media campaigns and organize street protests[61]. They are moreover instrumental in informing the Ukrainian public about the reform progress and securing its support.

The reform-oriented CSO ecosystem includes, first, 'reform platforms' represented in the National Reform Council. For instance, the Reanimation Package for Reforms[62] coordinates working groups in which experts develop draft laws in key reform areas, lobby for their adoption through a network of reform-oriented deputies and closely monitor the legislative process and subsequent implementation.

A second group includes think tanks, watchdogs and advocacy organizations which often 'lend' their experts to reform platforms such as the Reanimation Package, but work independently by shaping public opinion through media interviews, naming and shaming manipulation attempts or writing independent analyses on key reform issues. These CSOs also engage in direct cooperation with the government and donors. For example, Transparency International co-developed an online platform for public procurement, ProZorro.

55. Dovzhenko, Otar, Media serfdom in Ukraine, openDemocracy, 06.05.2015.
56. Bidder, Benjamin, Filz in der Ukraine: Die zweifelhaften Poroschenko-Connections, Spiegel Online, 03.08.2015.
57. Olszański, Tadeusz A., A trial of strength in Ukrainian politics after the head of the special services resigns, OSW Analyses, 24.06.2014.
58. Kościński, Piotr, Zasztowt, Konrad, Foreigners in the Ukrainian Government: A Unique Solution for Challenging Times, PISM Policy Paper No. 28 (130), September 2015.
59. Wikipedia, Interfactional Union "Eurooptimists", accessed 05.09.2015.
60. Ogryzko, Olesia, Pishchikova, Kateryna, Civic awakening: The impact of Euromaidan on Ukraine's politics and society, FRIDE Working Paper No. 124, July 2014.
61. Radio Free Europe, Ukrainian Activists Stage Toilet Protest, 17.06.2015.
62. See the reanimation Package for Reforms website

Finally, a third group flanks policy work through civic media initiatives. It includes independent TV stations (such as hromadske.tv), social media initiatives (such as Euromaidan Press), counter-propaganda projects (such as StopFake) and independent platforms for press conferences (such as Ukraine Crisis Center).

Nevertheless, the full potential of reform-oriented CSOs has not been realized yet. There is some reluctance in government, parliament and administration to regard CSOs as partners rather than enemies in the process of decision-making and monitoring of public policy. In addition, the CSOs could benefit from a stronger coordination of their efforts. Despite those challenges, they constitute a new group of actors which has not been present in Ukraine in the last two decades and now promises to change the odds for successful reforms.

International organizations, especially the EU and the IMF, but also the diplomatic services of the US and EU member states, are a third enabling factor. Their leverage on the reform process derives from control over the disbursement of financial assistance which is tied to the fulfilment of reform goals. Paradoxically, the difficult financial situation of the Ukrainian state enables deeper reforms as it increases this leverage. Besides financial assistance, international organizations and bilateral partners provide much-needed technical advice on reform content, e.g. through advisors seconded to ministries, or workshops for the exchange of best practices. International support has been coordinated through several international high-level conferences and at the level of the G7.

To be effective, international donors must have access to reliable information about the reform progress which requires monitoring efforts going beyond what is possible within their limited manpower. This points to a symbiotic relationship with Ukrainian civil society organizations which conduct broad and deep monitoring and pass on analytical results to the donors' decision-makers.

Finally, the delivery of key reforms has just started or will start shortly. Once the improvements in the quality of governance and – in the medium term – improved living standards – become visible, the public perception that the benefits of reforms are worth their costs might be reinforced. Table 2 presents an overview of some of the upcoming reform roll-outs.

Table 2 ► Expected forthcoming reform delivery (selection)

REFORM	DESCRIPTION	DATE OF DELIVERY
Roll-out of new traffic police	Introducing a young, educated, well-equipped and well-paid traffic police force.	Completed in Kyiv in July 2015, roll-out in Odessa, Kharkiv and Lviv by the end of 2015
Opening of public registers	Opening the registers of property, cars and company ownership to allow better public scrutiny of corruption schemes.	Already partially completed, full implementation by the end of 2015
Opening of the National Anti-Corruption Bureau	Will conduct pre-trial investigations and file court cases against senior officials involved in corruption.	By the end of 2015
Online platform for public procurement	The platform ProZorro will allow a transparent conduct of public purchases.	Currently used for procurement up to 100.000 UAH, starting from January 2016 without this limitation
Gas market reform	Break-up of the state-owned company Naftogaz, and gradual creation of a competitive gas market in line with EU's Third Energy Package	Gas market law in force from October 2015
Regional decentralization	Will delegate decision-making responsibility to the lowest possible regional unit according to the principle of subsidiarity, and match this with more local-level revenues.	To be implemented before October 2015

Source: own compilation

3. The EU's multifaceted support to the reform process

The EU is amongst the most prominent external drivers of Ukraine's reform process. It has been the country's most important international donor since the country's independence. The EU has supported the post-Maidan reform agenda politically and economically. Its key added value in comparison to other international players is its focus on structural and systemic reforms. The EU's assistance includes the provision of technical expertise; macro-financial assistance and loans; unilateral trade measures; development assistance and budget support as well as the mobilisation of finance for investment projects. A comprehensive overview of *all* EU and national support measures would go beyond the scope of this paper. The following thus focuses on key elements of EU-level support since 2014 and assesses strengths and weaknesses.

3.1. Technical assistance

In April 2014, the European Commission established a Support Group for Ukraine in Brussels to coordinate resources and technical expertise for the implementation of comprehensive economic and political reforms. The creation of the Support Group was a symbolic gesture. It was the first time that the EU established such a group for a third country. With 30 full-time staff it aims to provide comprehensive support to Ukraine's reform process. The basis for the Group's work is the "European agenda for reform"[63], which matches EU activities to Ukraine's various short to medium-term needs. The Group aims at mobilizing member states' expertise and ensuring coordination with other international donors. It has had positive impact on the reform process in selected areas. One example was its support to the Ministry of Agriculture in the elaboration of an agricultural reform strategy.

However, two factors seemingly limit the Group's effectiveness. The first concerns insufficient absorption capacity and bureaucratic resistance of some Ukrainian authorities. The second is the rather limited size of the Support Group when taking account of its very broad mandate. The fact that the Commission's Greece Task Force, with the much narrower task of supporting the authorities in the implementation of structural reforms, has twice as much personnel as the Ukraine Support Group is illustrative.

The mentioned limitations also apply to another instrument of technical support, namely the EU Advisory Mission (EUAM) to Ukraine. The civilian CSDP mission with headquarters in Kyiv was launched on 1 December 2014 for an initial duration of two years. It aims at promoting cohesive reform and restructuration of the country's security services delivering the rule of law, including the police. EUAM Ukraine thus faces the difficult task of "de-sovietising" Ukraine's civilian security sector in cooperation with the Ministries of Interior, Justice, Foreign Affairs, the State Border Service and Security Service.

> "THERE SEEMS TO BE QUITE A LOT OF MINISTERIAL RESISTANCE TO SYSTEMIC REFORM"

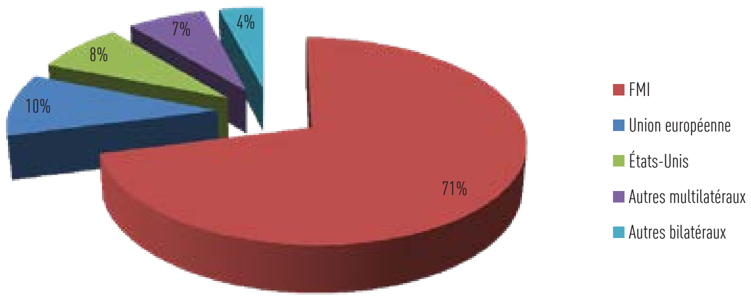
However, there seems to be quite a lot of ministerial resistance to systemic reform. The head of EUAM, Kalman Mizsei, explained this resistance by the fact that "many people in various ways benefited from the old, inefficient and largely corrupt system"[64]. In addition, EUAM is rather small when compared to other civilian CSDP operations. A useful reference point is the EU's rule of law mission EULEX Kosovo, which has an annual budget of €90 mio and an authorised maximum strength of 800 staff. Meanwhile, EUAM Ukraine disposes of €13.1 mio per year and has a maximum authorised strength of 101 staff. The difference in size and resources may be explained by EULEX Kosovo's broader mandate. However, it may seem surprising that EULEX has nine times as many resources as EUAM considering that Kosovo's population is around 20 times smaller than that of Ukraine. The size of EUAM Ukraine had divided 'dovish' and 'hawkish' member states, the latter of which were in favour of around 200 personnel. Few advocated a significantly larger number due to the constrained CFSP budget[65].

63. European Commission, EU–Ukraine – A European Agenda for Reform, 04.07.2014.
64. Emmott, Robin and Yukhananov, Anna, „Insight - West's offer to rebuild Ukraine faces reality check", Reuters, 26.02.2015.
65. Nováky, Niklas I. M., „Why so soft? The European Union in Ukraine", Contemporary Security Policy, 2 (2015): 244-266.

3.2. Macro-financial assistance

The Commission disbursed €1.61 bn in the course of 2014 and early 2015 under two macro-financial assistance packages. In April 2015, it adopted a third package of up to €1.8 bn, which constitutes the largest macro-financial assistance programme ever awarded to a non-EU country. Disbursement was made conditional on reform progress in six areas: public finance management; governance and transparency; the business environment; the energy sector; social safety nets; and the financial sector. The EU is currently the second largest contributor of macro-financial assistance (see Figure 2).

Figure 2 ► Program Financing – new official disbursements (2015-2018)



Source: IMF, March 2015

Figure 3 ► Ukraine Program Financing (US$ billion)

	2015	2016	2017	2018	Total
Financing Gap 1/	21.4	6.8	6.9	4.8	40.0
Reserve accumulation	10.8	3.9	6.3	6.7	27.7
Underlying BOP gap 1/	10.6	2.9	0.7	-1.9	12.3
Identified Financing 2/	21.4	6.8	6.9	4.8	40.0
Bilateral and multilateral	16.3	3.5	2.5	2.5	24.7
IMF	10.0	2.5	2.5	2.5	17.5
Other multilateral/bilateral	6.3	1.0	0.0	0.0	7.2
Multilateral	1.8	0.0	0.0	0.0	1.8
European Union	1.8	0.7	0.0	0.0	2.5
United States	2.0	0.0	0.0	0.0	2.0
Other bilateral	0.7	0.2	0.0	0.0	0.9
Debt operation	5.2	3.4	4.4	2.3	15.3
Memorandum items:					
Project loans 3/	2.0	2.6	2.7	2.2	9.5
Multilateral	2.0	2.2	2.4	1.8	8.4
Bilateral	0.0	0.4	0.4	0.4	1.1
Gross international reserves	**18.3**	**22.3**	**28.5**	**35.2**	
% of composite metric	66	79	96	113	

1/ Excludes the effect of spending reflected on the current account generated by project loans.
2/ Excludes project loans.
3/ Project financing to the public and private sector.

Source: IMF, 2015

Meanwhile, the International Monetary Fund (IMF) remains Ukraine's key financial anchor. In 2014, it adopted a two-year $17.01 bn Stand-By-Arrangement to address Ukraine's short-term balance of payments problems. In March 2015, the Stand-by-Arrangement was replaced by a four-year Extended Fund Facility of $17.5 bn with $5 bn for immediate disbursement . The Extended Fund Facility is part of a larger $40 billion package, which should fill Ukraine's public financing gap. It includes bilateral and multilateral financing as well as debt operations worth $15.3 bn (see Figure 3).

3.3. Trade and development measures

The implementation of the Deep and Comprehensive Free Trade Area (DCFTA), signed in 2014, was postponed to January 2016 to avoid further destabilization of the country and preserve Ukraine's access to the Ukraine-Russian preferential regime. Until then, the EU is granting unilateral tariff reductions for Ukrainian exports worth nearly €500 mio per year to revive the ailing economy.

The EU also provides development assistance in the framework of the ENP. Up to €1 bn have been earmarked for Ukraine under the European Neighbourhood Instrument (ENI) for 2014-2020[66]. It is only slightly higher than the amount earmarked for Tunisia (between €725-886 mio), whose population is more than four times smaller than Ukraine's. It is also interesting to note that the EU has not raised its reference amount for Ukraine in comparison to the previous financing period (2007-2013)[67]. The only difference could be an additional €40-50 mio per year under the umbrella programme depending on Ukraine's progress in deepening democracy and respect of human rights[68] ("more for more"). However, the application of the "more for more" principle has been criticised in the past[69]. It does not offer sufficient incentives and was applied inconsistently across neighbouring countries. The EU has also been reluctant to apply negative conditionality in the form of "less for less". Due to the relative lack of flexibility, the effects of the EU's conditionality have not been substantial.

In April 2014, the EU activated one of its flexible support instruments for transition processes and approved a Special Measure worth €365 mio in grants financed under the ENI[70]. It included a State Building Contract of €355 mio, which aimed at supporting the Ukrainian authorities throughout 2014-2015 in short-term economic stabilization as well as public finance management, anti-corruption, public administration, budget transparency, judicial and constitutional reform and electoral legislation. Disbursement was made conditional on reform progress. The Special Measure also included a €10 mio Civil Society Support Programme to strengthen the role of civil society in monitoring the stabilization and reform process.

> "THE SHARE OF EU FUNDS DEDICATED TO UKRAINE'S CIVIL SOCIETY ORGANISATIONS IS RATHER LOW"

Despite that, the share of EU funds dedicated to Ukraine's CSOs is rather low when considering their key role as drivers of Ukraine's reform process. Only one percent (i.e. €10 mio) of the earmarked ENI funds for 2014-2020 is reserved for civil society support. Another €4.5 mio are available for Ukraine under the European Instrument for Democracy and Human Rights (EIDHR) for 2013-2017. EIDHR funds are mostly dedicated to civil society projects in the field of electoral and constitutional reform. A more flexible funding source is the European Endowment for Democracy, which functions as a private non-profit organization and has focused on Ukraine's media sector[71]. However, between 2013 and 2015 only €5.3 mio have been disbursed for the whole Eastern Neighbourhood[72].

66. The total amount of ENI funds for the sixteen ENP countries is €15 bn for 2014-2020.
67. European Commission, „Ukraine", Accessed 20.08.2015.
68. European Commission, „Memo: European Commission's support to Ukraine", 05.03.2015.
69. Koenig, Nicole and Scherer Nicolas, Europäische Nachbarschaftspolitik auf dem Prüfstand: Lehren aus dem Süden, Policy Paper, Jacques Delors Institut – Berlin, 24.03.2015.
70. European Commission, Implementing Decision on a Special measure 2014 in favour of Ukraine to be financed from the general budget of the European Union, C(2014) 2907, 29.04.2014.
71. European Endowment for Democracy, „We support", accessed 20.08.2015.
72. European Parliament, Resolution on the EU's new approach to human rights and democracy – evaluating the activities of the European Endowment for Democracy (EED) since its establishment, 2014/2231(INI), 09.07.2015. ht

3.4. Investment and project funding

A last vector of EU support is longer-term investment and project funding. The European Investment Bank (EIB) is to provide financing for long-term investments in support of the local private sector and economic and social infrastructure of up to €3 billion in 2014-2016. The European Bank for Reconstruction and Development (EBRD) could add up to €5bn for structural and macroeconomic reforms.

3.5. Overall assessment: good is not good enough

Overall, the Commission estimates the EU's financial assistance to Ukraine for 2014-2020 at €11 bn (see Table 3). This would be equivalent to roughly 1 per cent of the EU budget for the same period. At first sight, this figure seems relatively high. It is equivalent to about 71% of the total ENI budget for 2014-2020. In addition, the EU's macrofinancial assistance to Ukraine (€3.4 bn in total) has been the highest provided to a third country so far.

Table 3 ► EU financial support to Ukraine (2014-2020)

TYPE OF SUPPORT	REFERENCE AMOUNT, INSTRUMENT, TIME FRAME
Macro-financial assistance	• €610 mio: First package (Decisions 2002 and 2010), disbursed 2014-2015 • €1 bn: Second package (Decision 2014), disbursed 2014 • €1.8 bn: Third package (Decision 2015), disbursed 2015- early 2016
CFSP-related actions	• €42 mio: Instrument contributing to Stability and Peace (election observation, OSCE Special Monitoring Mission, support to conflict-affected population and IDPs), 2014-2020 • €15 mio: Common Foreign and Security Policy (CFSP), 2015-2020
Trade support	• €500 mio/year: tariff reductions, 2014-2016 (estimate by the European Commission)
Technical and budgetary support	• €355 mio: State Building Contract ('Special Measure'), 2014-2015 • €70 mio: Special Measure in support of Private Sector Development and Approximation, 2015 • €1 bn (indicative): ENI, 2014-2020
Humanitarian aid	• €42 mio: European Commission, 2014-2015
Investment project financing (Dependent on bankable projects)	• Up to €3 bn: European Investment Bank, 2014-2020 • Up to €5 bn: European Bank for Reconstruction and Development, 2014-2020 • €200-250 mio: blending finance from Neighbourhood Investment Facility, 2015-2020
Civil society support	• €10 mio: Civil Society Support Programme, 'Special Measure', 2014-15 • €10 mio: civil society support, ENI, 2015-20 • €4.5 mio: EIDHR, 2013-17 • European Endowment for Democracy [1]

Source: European Commission, 2015

1. Exact financial figures for support of Ukrainian projects unknown.

However, the €11 bn figure has to be taken with a 'pinch of salt'. €8 bn thereof consist of investment project financing by the European Investment Bank and European Bank for Reconstruction and Development. In contrast to grant or loan finance, the disbursement of this part of the package depends on the availability of bankable projects. It is thus possible that parts of this sum will not be disbursed. Moreover, while project investments (e.g. in infrastructure) could be clearly advantageous in the long run, the government urgently needs more liquid funds to stabilize the budget and finance the reform process, including measures to absorb social costs of reforms.

An assessment of the EU's assistance to Ukraine also has to take into account the important stakes. First, from a geopolitical perspective, support to the democratization of Ukraine can be seen as a key instrument for the defense of the European security order, established after the Second World War and based on the principle of national and territorial sovereignty as well as peaceful conflict resolution. With the annexation of Crimea, Russia has blatantly violated this order. Allowing Moscow to obstruct the country's path towards democratization would represent an even more dramatic setback for Europe's security order[73].

Second, the collapse of the Ukrainian state and economy could pose immediate risks to EU member states. The EU would be directly affected by refugee flows, a surge in organised crime and potential risks related to Ukraine's nuclear infrastructure, including Europe's largest nuclear power plant in Zaporizhiya.

Finally, support to Ukraine can be seen as an investment yielding economic and political returns. A stable and reformed Ukraine could become an attractive investment location for European firms, offering a young and educated population, traditions of research and development, competitive wages and a large and unsaturated domestic market. Due to its unique location, Ukraine could become a bridge for economic exchange between the EU and the Eurasian Economic Union[74].

In addition, Ukraine's success would send a political signal to Eastern Partnership countries that pursuing deep reforms in line with EU standards is worth the cost: reforms will be rewarded and will result in higher standards of living. This in turn would make EU's neighbourhood safer and more prosperous, directly corresponding to goals of the ENP. In light of these undeniable political, economic and security-related stakes, the current level of EU's support to Ukraine is still relatively modest.

4. Boosting and fine-tuning EU assistance

"UKRAINE IS ON A GOOD TRACK TO MODERNIZE AND BECOME A STABLE AND WELL-GOVERNED COUNTRY"

Ukraine is on a good track to modernize and become a stable and well-governed country. In the longer term, it might have a unique chance to follow the path of countries such as Poland and become an integral part of a group of stable, peaceful and prosperous European neighbours. However, this will require serious assistance from the EU. The prerequisites for success are there. The EU is already a recognised and credible supporter of Ukraine's reform process and has a strong advantage in fostering longer-term systemic reform. In addition, Ukraine's political leadership and its people are as pro-European and committed to modernization as never before. Nevertheless, in light of the various obstacles in the reform process, the EU will not only need to maintain, but also to enhance and refocus its support to the reform process. In the following, we present four ways in which this could be done.

4.1. Raising economic and political pressure

While the legislative progress has been impressive to date, the main focus should now be on ensuring that the laws are correctly implemented and enforced. To make this happen, the EU needs to make better use of its economic and political leverage over Ukrainian decision-makers in parliament and the executive.

The **EU's economic leverage** derives from its ability to make financial assistance conditional on reform progress. With the above-described portfolio of financial assistance, the EU is already able to exert some leverage. However, the EU could boost this leverage by sharpening some of the existing ENP instruments and devising new ones. The ENP revision in autumn 2015 represents a unique opportunity in this regard[75]. In a first step

73. Fischer, Joschka, Enderlein, Henrik, Europe's War in Ukraine, 05.02.2015.
74. Beaver, William, Is Now the Time to Invest in Ukraine?, The Moscow Times, 28.07.2015.
75. European Commission and High Representative of the European Union for Foreign Affairs and Security Policy, Joint Consultation Paper: Towards a new European Neighbourhood Policy, JOIN(2015) 6, 04.032015.

the EU should sharpen the application of conditionality by providing more positive incentives ('more for more') while taking the possibility of sanctioning reform relapses ('less for less') seriously.

"A NEW 'EUROPEAN MODERNIZATION FUND' AS ADDITIONAL INCENTIVE FOR DEEP REFORMS"

Sharpened conditionality could be combined with additional incentives for ENP 'frontrunners', i.e. countries that are willing and able to engage in value approximation and deeper association[76]. Additional incentives could be channelled through a new 'European Modernization Fund' that provides substantial financial assistance in return for deep reforms in areas of strategic importance[77]. In Ukraine, the Fund could be used to foster regional and rural development in light of the upcoming decentralization reform, infrastructural projects in the area of energy efficiency, transport and environment, or adaptation of Ukrainian firms to EU standards. Progress in these strategic areas could be rewarded with additional funding while relapses in potentially problematic fields such as de-bureaucratization, corruption and de-oligarchization could be sanctioned by cuts. Such a Modernization Fund would increase EU's leverage over Ukraine's reform process while enhancing the country's ability to reform. In line with the principle of differentiation, it could bolster the ENP's impact by encouraging 'frontrunners' and sending a clear signal to others that the EU is able to reward deep reform with serious assistance.

The **EU's key political leverage** lies in the promise that the fulfilment of the Association Agreement will lead to 'deeper integration with the EU'. Some elements of deeper integration, such as visa liberalisation and closer economic integration through the Deep and Comprehensive Free Trade Agreement are clearly spelt out. However, the EU remains rather ambiguous as to whether deeper integration may entail membership in the future. The Declaration of the Eastern Partnership Summit in Riga simply "acknowledged the European aspirations and European choice of the partners"[78]. Commission President Jean-Claude Juncker remained equally vague when he stated: "They are not ready. We are not ready, but the process is under way"[79]. This lack of clarity, which has been a long-standing pattern in the EU's relations with Eastern Partnership countries, has not proved particularly effective in fostering democratization, nor has it prevented tensions with Russia.

If, for one reason or the other, the Union excludes a membership perspective for Ukraine for the time being, it could enhance its political leverage on the reform process by outlining alternative options. It could complement the Association Agreement with a more comprehensive roadmap, which ties clearly defined and timed milestones to elements of deeper integration. Such a roadmap would provide reform-oriented Ukrainians with a powerful instrument to exert pressure on reform laggards and explain painful reforms to the population. It would also be in line with the proposal by High Representative Federica Mogherini to "transform the divisive 'all-or-nothing' membership question into a more constructive 'integration' question – based on successive functional building blocks"[80].

4.2. Extending direct support to reform enablers

The EU's multi-faceted technical assistance is a good starting point. However, it should be expanded in three directions to address some of the key obstacles and directly target enablers of the reform process.

First, the EU should not limit its engagement to technical top-down advice, but extend it to reform implementation. If implementation continues to be endangered by insufficient **bureaucratic capacity**, even the best reform schemes are bound to fail. To enhance capacity, the EU should prioritize the planned programme of salary enhancements for key Ukrainian civil servants and ensure that its budget allows attracting a critical

76. Landaburu, Eneko, La politique de voisinage: stop ou encore?, Tribune, Notre Europe – Institut Jacques Delors, 27.05.2015.
77. The Fund could constitute a new instrument specifically targeting ENP countries showing the highest willingness and ability to reform. To be effective, it should involve financing capacities at a level sufficient to effectuate reform adjustment. Specification of exact details would go beyond the scope of this paper.
78. Council of the European Union, Joint Declaration of the Eastern Partnership Summit, 21-22.05.2015.
79. Jean-Claude Juncker in: Kaža, Juris and Norman, Laurence, „EU Offers Eastern Neighbors Solidarity at Summit, but Little Else", Wall Street Journal, 21.05.2015.
80. Federica Mogherini, High Representative of the Union for Foreign Affairs and Security Policy. The European Union in a changing global environment A more connected, contested and complex world. Brussels, June 2015.

mass of competent professionals to public service. This should include a focus on regional bureaucracies. The transformation of Ukraine's bureaucracy has just started and will not happen over night. However, getting the start right will be crucial to promote a sustainable transformation in the medium-term.

"CIVIL SOCIETY ORGANISATIONS SHOULD BE SUPPORTED FINANCIALLY AND INVOLVED MORE STRONGLY IN DECISION-MAKING"

Second, financial and political support to **civil society organizations** (CSOs) as a key ally in the reform process should be expanded. While established CSOs in the larger Ukrainian cities usually do not have significant financial problems, financial bottlenecks of CSOs in the start-up phase and those working in the regions should be addressed. Additional issues to be put on EU's agenda include ways of securing long-term financing for strategically important CSOs and of supporting cross-CSO coordination to foster synergies, enhance information exchange and avoid duplication. Moreover, the EU could use its political leverage to put pressure on the Ukrainian authorities to include them in the decision-making and monitoring process of reforms. According to a 2015 Special Report by the OSCE, only few CSOs participate in regional decision-making through the 'civic councils'[81]. A concrete step would be to make financial assistance to national and regional authorities conditional on CSO participation. Positive examples of CSO inclusion such as the group that prepared the bill to set up the National Anti-Corruption Bureau – including Ukrainian MPs, Western consultants as well as CSO experts should lead the way.

Third, **independent media** can act as enablers of the reform process and should receive more attention and funding. Due to the firm control of oligarchs over the media market, information about reforms might be strongly distorted or even blocked from reaching the population. Funding for independent media – especially in the regions – should be increased as it is the best chance to keep pressure on the reformers. Extending the existing funding through the European Endowment for Democracy could be a viable option.

4.3. Preventing economic collapse and reassuring investors

Ukraine's difficult economic situation fuelled by Russia's hybrid destabilization carries many risks for the reform process. It limits the government's fiscal room for manoeuvre, deters foreign direct investment and worsens credit conditions for Ukrainian firms. The EU should solidify its role as an economic stabilizer and credibly reassure the international financial community that Ukraine's failure is not an option. Economic stabilization could be provided in two ways.

A **macrofinancial arm** should send a signal that the EU is prepared to prevent Ukraine's financial collapse in the long term. It should also indicate EU's ability to assist in case of extraordinary short-term difficulties. Consequently, it could encompass a preliminary offer of a fourth EU macrofinancial assistance package for the period after support measures of international donors expire in 2018, prepared in coordination with the IMF. Moreover, it could outline in what way the EU will assist Ukraine in case of extraordinary events threatening the country's economic sustainability.

In terms of financing, short-term measures could draw on the Macro Financial Assistance[82] (MFA) programme which is currently being used for supporting Ukraine. Long-term measures could draw on MFA, but also mobilize funds from the Balance of Payments Assistance facility (which has unused funds of $47.5 billion)[83] or the European Financial Stability Mechanism (with $15.8 billion of unused funds)[84]. These instruments are currently limited to assist EU member states in financial difficulties, but could be used for Ukraine by modifying their regulations by a qualified majority upon a proposal by the European Commission. Their advantage lies in the fact that they do not require additional financial commitments by member states but instead use the borrowing capacity of EU institutions[85].

81. Organisation for Security and Co-operation in Europe, Civil society and the crisis in Ukraine, SEC.FR/125/15/Corr.1, 04.032015.
82. European Commission, Macro-Financial Assistance to non-EU countries, accessed 05.09.2015.
83. European Commission, Balance of Payments, accessed 05.09.2015.
84. European Commission, European Financial Stabilisation Mechanism (EFSM), accessed 05.09.2015.
85. Fischer, Joschka, Enderlein, Henrik, Europe's War in Ukraine, 05.02.2015.

Moreover, an **insurance arm** should convince firms and investors from EU member states that it is safe to do business in Ukraine. While the Ukrainian economy desperately needs foreign investment to stabilize, investors demand stabilization as a prerequisite to move in. This vicious circle risks destabilizing the economy before reforms can show their effects. To cut this circle, the EU could establish a political risk insurance scheme for investing in Ukraine. Such form of insurance is already provided by the World Bank[86] or the German firm Euler Hermes[87], but on prohibitively expensive terms. This calls for the involvement of the EU, which – if properly designed – could provide a 'big bang for the buck' while likely being almost costless[88].

4.4. Promoting direct EU-Ukrainian exchange

Despite a general sympathy for the EU following the Euromaidan protests, the knowledge about the EU remains limited. This is also due to the Union's relatively low visibility, especially in the regions. The knowledge gap should be addressed so that Ukrainian citizens acquire a realistic picture of the costs and benefits related to deeper EU integration, do not fall prey to disinformation and do not get the feeling of being 'left behind' by the EU. In this regard, three strands of measures could be envisaged.

The EU could enhance its presence in Ukraine by building a **network of regional representative offices** that would 'bring the EU closer to the people'. These offices would provide a link between the local population, firms and civil society organizations on the one hand and the European institutions on the other. Regional offices would enhance the EU's visibility and allow for a more targeted disbursement of its funds. In addition, the member states could re-consider the question of extending the regional outreach of EUAM Ukraine beyond the capital. The question had been postponed earlier due to member state divisions. However, a broader outreach would not only enhance visibility but could also have a stabilising and mildly deterrent effect[89].

"MORE VISIBLE REFORM AND INVESTMENT PROJECTS OF THE EU ARE NEEDED"

Meanwhile, the EU institutions could re-evaluate their portfolio of engagement in Ukraine to **identify more visible reform or investment projects**. In this regard, the US engagement in Ukraine can be seen as a good example. Its aforementioned support to the police reform was not very costly but effective and visible. Support to highly visible bottom-up reforms should not come at the cost of supporting systemic top-down reform. Nonetheless, some more tangible examples for EU engagement could boost its popularity and strengthen the hand of pro-European Ukrainian reformers that might have to confront an increasingly impatient and reform-tired population.

In parallel, **Ukraine's presence in the EU could be strengthened**. Disinformation is not restricted to the country itself, but can also affect Brussels and national capitals. Improving the access to information about developments in Ukraine could enhance the quality of public debate in Europe and, by extension, Ukraine-related policy making. To this end, a liaison office for Ukrainian experts, journalists and civil society activists could be created in Brussels. The office would host Ukrainian representatives who would conduct, discuss and publish policy relevant research, organize events and network with decision-makers. The dual benefit of such an office would consist in giving EU decision-makers more insights into current trends in Ukraine while giving Ukrainian representatives a chance to establish contacts and learn about decision-making processes in the EU.

86. See: Multilateral Investment Guarantee Agency's website.
87. See: Euler Hermes' website.
88. Soros, George, A New Policy to Rescue Ukraine, New York Review of Books, 05.02.2015.
89. Nováky, Niklas I.M., Why so soft? The European Union in Ukraine, op. cit.

CONCLUSION

Since 2014, Ukraine has taken important steps towards modernization and democratisation. It seems that that this time might indeed be different when it comes to successfully moving Ukraine's governance closer to European standards and thereby increasing the country's stability and prosperity. In this process, the EU has been a key economic and political supporter. Nonetheless, a whole range of obstacles and risks remain. These include internal factors such as bureaucratic resistance, corruption or oligarchic influence as well as costs and uncertainties linked to Russia's hybrid destabilization in Eastern Ukraine.

To prevent relapse and counter risks, the EU will have to put additional political and economic weight behind its support. In this policy paper, we outlined a number of ways in which the Union could counter-act reform spoilers and empower enablers. However, sustainable reform implementation will also require a broader and comprehensive EU approach. The latter has to address not only Ukraine's internal reform problems but also counter Russia's evident attempts to derail the process through on-going hybrid destabilisation. Here, EU's response should include at least humanitarian aid, sanctions as well as continued diplomatic efforts towards a political solution of the conflict.

"THE CONSEQUENCES OF INACTIVITY WOULD BE SERIOUS"

There is no doubt that the tasks facing the EU in Ukraine are challenging. However, the consequences of inactivity would be serious. Letting Ukraine fail entails a risk of humanitarian crisis at the EU's borders, uncontrolled migratory flows and a surge in organised crime. Most importantly, it would be a signal for Russia's current leadership that undermining the democratic aspirations of sovereign neighbours through military and hybrid warfare pays off. Allowing this logic to settle would deal a serious blow to the foundations of Europe's security order and further taint the EU's image as a civilian power in the neighbourhood.

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