

White Book of Reforms

Five Years of Reforms

joint KSE and VoxUkraine project

NGO «Vox Ukraine»

Kyiv, 2019

Authors

Anna Bilous, Blavatnik School of Government, University of Oxford; Artur Kovalchuk, KSE; Bohdan Prokhorov, CES; Daryna Marchak, KSE; Denys Nizalov, Global Land Alliance, De Montfort University, VoxUkraine; Dmytro Yablonovskyi, CES, VoxUkraine; Elena Besedina, KSE; Ilona Sologoub, KSE, VoxUkraine; Maryna Khorunzha, KSE; Oleksandra Betliy, IER, VoxUkraine; Oleksiy Gribanovskyi, KSE; Olena Bilan, Dragon Capital, VoxUkraine; Olga Kupets, KSE; Olga Nikolaeva, KSE; Ostap Kuchma, KSE; Tetyana Tyshchuk, KSE, VoxUkraine; Tymofii Brik, KSE; Veronika Movchan, IER, VoxUkraine; Yaroslav Kudlatskyi, KSE; Yuriy Gorodnichenko, University of California, Berkeley, KSE, VoxUkraine.

Acknowledgements

The authors are grateful to VoxUkraine Editorial Board and especially Oleksandr Zholud for proofreading the text. The authors are grateful to Ksenia Alekankina, Anastasia Chernukha, Liena Shulika, Julie Danylenko for their valuable help during the work on this project.

Contents

INTRODUCTION	4
Chapter I. GOVERNANCE	6
<i>Political System</i>	6
<i>Public Administration Reform</i>	10
<i>Deregulation</i>	18
<i>Judicial Reform</i>	22
Chapter II. MACROECONOMIC ENVIRONMENT	27
<i>Monetary Policy And The Banking Sector</i>	27
<i>Fiscal Policy And Public Finance.....</i>	33
<i>Pension Reform</i>	40
<i>Trade Policy Reforms</i>	43
Chapter III. SECTORAL REFORMS	47
<i>Energy Markets</i>	47
<i>Strategy For Land Reform In Ukraine: 2019-2024.....</i>	51
<i>Privatisation</i>	59
<i>Public Procurement</i>	64
<i>Reforms In Education And Healthcare</i>	70
Chapter IV. FOCUS ON PEOPLE.....	77
<i>Demographic Prospects Of Ukraine.....</i>	77
<i>People's Beliefs And Political Response</i>	84

INTRODUCTION

Ukraine is often described as a 'crossroad' or a 'borderland' between East and West. As such, it is believed to combine some features of both. But we would rather describe Ukraine as a blend of 'North' and 'South' in the meaning of economic models where 'North' denotes more technologically advanced states and 'South' — less developed ones.

Indeed, Ukraine combines the features — good and bad — of developed and developing countries. For example, its low birth rate, ageing population and shrinking labour force resemble the demography of developed countries. At the same time, its average life expectancy is ten years lower than in the EU, which makes reforming Ukraine's pension system an enormous challenge.

Its growth rate of 2-3% also resembles that of developed countries — despite Ukraine's income per capita being at levels of developing countries. Like many developed countries, Ukraine has rather generous social obligations. However, it struggles to collect taxes to finance those obligations: the level of tax evasion and capital flight is at par with [developing](#) world. Corruption and quality of governance, specifically law enforcement, resemble the 'South' too. Somewhat counterintuitively, high levels of corruption induce the desire for a large government and significant state interference.¹ This desire is intensified by paternalism inherited from the Soviet Union.

Voting for populists, previously characteristic of developing countries, now is spreading to the developed world. Ukraine has not been left out of this trend. Similar to developing countries, Ukraine lacks strong institutions present in developed countries that help their economies to withstand populists in the highest political offices.

Under these conditions, where can Ukraine find strength and resources for growth? One answer is to create a market for agricultural land. According to the World Bank estimates, it can provide about additional 1.5 percentage points to GDP growth annually. Moreover, this effect will be felt almost immediately.

Another 'low hanging fruit' is the free trade agreement with the EU. Ukraine's exports of goods to the EU in 2018 were 19.6% higher than in 2013, and with further implementation of the

¹ Vitaliy Protsenko [explains](#) how corruption provides fertile ground for the desire of a 'strong hand', and VoxUkraine&KSE [research](#) shows that 73% of Ukrainians support some kind of state interference with the economy and people's rights.

agreement this trend will continue. At the same time, Ukraine should pursue signing bilateral trade agreements with other countries.² Exports of products in which Ukraine has comparative advantage as well as inclusion of Ukrainian companies into global value chains will add to sustainable growth.

However, the most important factor is fostering investment. The level of gross capital formation in Ukraine recently has been about [20%](#) of GDP. This is close to the EU level, while in developing countries this indicator is significantly higher — about 30%, and in some instances above 40% of GDP. Investment is required in all the sectors, both into physical objects such as equipment or infrastructure and into intangible assets such as knowledge and skills of both youth and adults.

To attract investment, one does not have to invent a wheel: the necessary conditions are secure property rights and a functioning law enforcement. When these are in place, development of various instruments of financial intermediation (if they are allowed by legislation) is just a matter of time. Certainly, it is advisable for governments to reduce the regulatory burden on business and lower uncertainty by being more transparent about policy formulation and building it on rules and evidence rather than short-term political gains. Then the best possible signal to foreign investors would be trust of Ukrainian businesses to their own state.

In developed countries, before making a final decision, an investor studies the law. In developing states, she looks for ‘facilitators’, ‘guarantors’ and workarounds. In Ukraine, investors probably do both. Hence, reduced need for the second type of inquiries would be a clear sign of progress.

The path from ‘South’ to ‘North’ is not an easy one. Ukraine will continue to embed the features of both developed and developing countries for quite some time. However, we would like those to be the best features — the ‘Northern’ level of law compliance and the ‘Southern’ investment rate. Then it would be possible to grow at the rate of developing countries and approach the quality of life of developed ones.

In this paper we overview the progress on the path of structural reforms that lay the foundations for sustainable growth and highlight necessary next steps.

² Trade+ centre at KSE [advises](#) that the countries first in turn should be US, Ireland, Japan, Germany, Switzerland, Sweden, the UK, Qatar, China and Mexico.

/1 GOVERNANCE

Political system

Before 2014, Ukraine had the «winner-takes-all» highly centralized political system with dualism of executive branch and unclear division of responsibilities at the local level. The decentralization reform ongoing since 2014 is aimed at reducing the significance of the national government and shifting responsibility for everyday issues to locally elected officials. This should induce more responsible behaviour not only of local officials but also of citizens and thus foster democratic development in Ukraine. However, without solving the problems embedded into the Constitution, the political system reform will be incomplete.

During the 23 years of its existence, Ukrainian Constitution has seen three major changes of distribution of powers between the President and the Parliament. Initially adopted in 1996 with almost unrestricted power of the president, in 2004 the Constitution was amended to shift most of the powers to the parliament. These changes were cancelled by the Constitutional Court in 2010 upon request of the then-president Yanukovich, and revived again in 2014, after the Revolution of Dignity.³

Currently the parliament is the main source of power in the country: it appoints the Prime Minister and almost all members of the Cabinet and approves candidates for positions of ministers of foreign affairs and defense submitted by the President; it provides its consent for a number of other appointments (prosecutor general, head of the security service, head of the

³ For a comprehensive discussion of Ukraine's constitutional design see the [article](#) of Myerson, Roland and Mylovanov) and an explainer [article](#) by Rostyslav Averchuk.

National Bank and others). However, to exercise this power, the parliament needs to have at least 226 votes. Before 2019, no single party had this number of votes, so they had to form coalitions. Parliamentary negotiations slowed down adoption of legislation — both progressive and harmful one.

Electoral system

Broad powers of the parliament raise the importance of [electoral system design](#). For most of the time, Ukraine has had a mixed system whereby half of the parliament is elected by party lists and another half — in single-mandate districts (although Ukraine experimented with both completely proportional and completely majoritarian systems).

With parties centered on their leaders rather than a set of ideas, both components of the current electoral system have serious flaws:

- 1) Party leaders can trade places on party lists — either for money or for loyalty.
- 2) In single-mandate districts candidates with the most money have the highest chances to win (although the last elections showed that there can be exceptions to this rule).
- 3) In single-mandate districts many votes are lost, so the winners can actually be minority candidates.

The «open list» system [adopted](#) in July 2019 should deal with these flaws — increase representativeness, create incentives for formation of ideological parties and allow local leaders to enter national politics under the brands of some political parties. However, the new Electoral Code has not been signed by the president yet. And if signed, the system will be enacted only at the end of 2024, so the next parliamentary elections will be held by the current system.

Dualism of executive power

The president appoints heads of local administrations, candidates for which are submitted by the Cabinet of Ministers. Heads of local administrations are responsible to both the President and the Cabinet. This dualism embedded in the Constitution is a prerequisite for a conflict between the President and the Prime Minister. It deprives the Cabinet of full control over the executive branch and thus undermines its ability to pursue its policies. The 2015 draft changes to the Constitution which were a part of the decentralization reform [would not](#) have resolved this problem. However they were not voted by the parliament due to the clause on special status of the Donbas included into them.

Decentralization

The decentralization reform implemented since 2014 is perhaps the most important one. It is also quite [popular](#) among voters. Prior to the reform there were four administrative levels in Ukraine — village/town/city district — raion or city — oblast — state. Villages often were too small to provide their people with quality public services. The decentralization reform aims at formation of Amalhalated Territorial Communities (ATCs) which will have sufficient budget for this. ATC target population minimum is 10 000. As of August 2019, ATCs [covered](#) 40% of Ukrainian territory with almost 30% of population. 4330 smaller communities merged into ATCs and 6331 communities remain outside of reform yet.

To encourage voluntary merger of communities, the newly formed ATCs are provided with fiscal incentives — 60% of personal income tax and 10% of profit tax remaining in a community, as well as provision of subsidies and subventions from central budget for infrastructure development. ATCs are allowed to establish property and land tax rates within defined limits. Simultaneously local governments were empowered with more responsibilities for the everyday lives of their communities — i.e. they can decide on the distribution of medical and educational subventions, infrastructure financing etc. An important element to this was Ministry of Justice delegating a number of registration services to local authorities and private notaries. Thus currently ATCs can compete on the quality of services provided to their people and on the investment climate they create.

Although generally decentralization has been a success with ATCs and cities as primary winners,⁴ the progress was bumpy. Some oblast and especially raion officials sabotaged the formation of communities. Some newly formed communities are still too small to provide a decent level of public services. Thus, although average ATC population is 10.7 thousand people, 37% of communities are smaller than 5 thousand people. These communities would have to merge with other communities.

An important incentive for decentralization has been the government [decision](#) to allow ATCs to get state-owned land around them into their communal property. This land can become an important source of revenues. Sometimes ATCs have to sue the state land management agency to get this land. Nevertheless, as of August 2019 646 ATCs have received 1.5 million ha of agricultural land.

The final steps of the decentralization reform should be to:

- 1) Mandatory merge ATCs that did not voluntarily merge before the deadline which has to be defined.

⁴ For an intermediate detailed evaluation of decentralization reform (2014-2016) see [Levitas&Djukic](#) (2017), see [Dudley \(2019\)](#) for evaluation of the most recent results.

2) Resolve the issue of raions — one needs to [decide](#) whether raion level of the government remains. If yes, then its powers and responsibilities have to be redefined, if not — then raions should be liquidated by law.⁵

3) To clearly distribute the responsibilities on the local level — i.e. between local branches of the central government and local elected officials.

According to the logic of the reform, at some point the Constitution should be amended to reflect the new reality and to notch up the new distribution of powers between the centre and the regions. If the parliament starts working on such Constitutional amendments, it should also use this opportunity to eliminate the powers of the president to interfere with government policies. As Roger Myerson [notes](#), the president who would agree to reduce his powers would serve his people best.

Decentralization has two important political implications. First, it [allows](#) growth of 'grassroot' political leaders. In Ukraine, a traditional way into politics has been either through joining a party list and thus being 'pulled' by a party leader or through 'bribing' voters of a certain district — either directly or indirectly, i.e. with provision of some public goods. With the decentralization reform, local politicians have incentives to provide good services to people of respective communities in order to be elected to the higher level.

Second, with increased responsibilities of local governments for most aspects of everyday life voters have no one to blame for poor public services than their local government and ultimately themselves for making a bad choice. This should encourage responsible voting.

Certainly, these changes would not happen overnight. However, the incentives have been set right, and the reform should continue.

⁵ The former minister of regional development [suggested](#) to reduce the number of raions from 465 to 102 leaving them with functions of coordination of local offices of central government bodies.

Public Administration Reform

Prior to 2014...

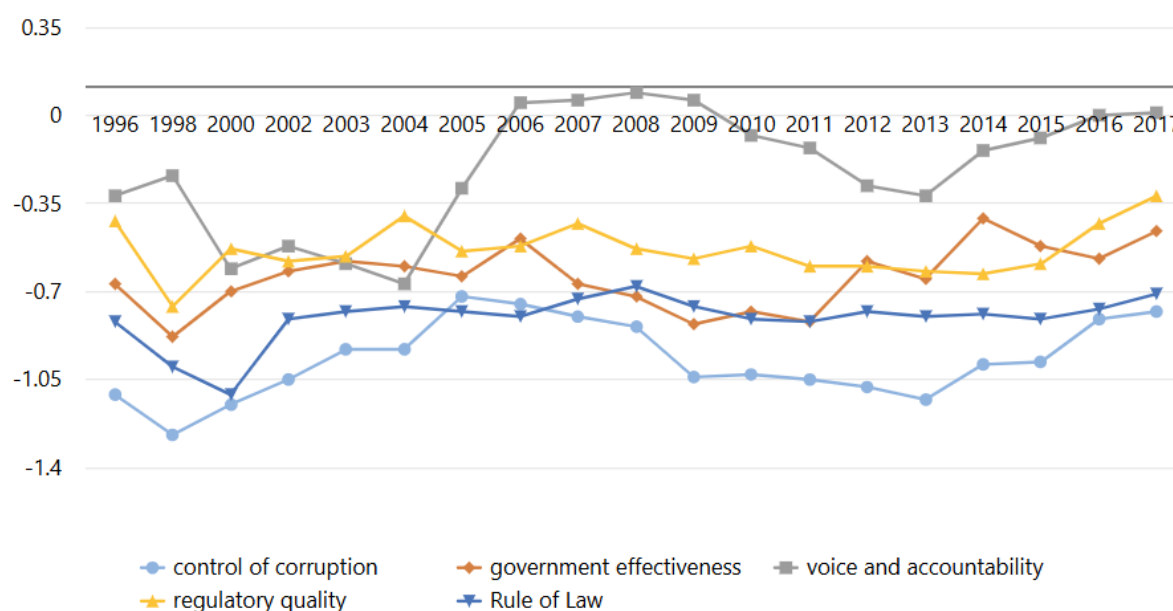
Ukrainian civil service has been characterised as one of the most unstable in the region (Verheijen & Rabrenovic 2015: 16)⁶. While the body of the civil service was formed during the Soviet period, the public administration was constantly going through changes both before and after independence. The most recent reform agenda was formulated in 2014/15. Previously, the government declared the start of a large-scale public administration reform in 1993, 2000 and 2011.

Prior to the recent reform strategy, the reforms were mainly focused on the institutional reorganisation. The Law on Civil Service (1993) introduced the concept of civil service and defined some of its functions. However, the core responsibilities, recruitment process, reward system, and accountability were not clarified. The 1993 understanding of civil service is limited: the civil service is supposed to enable the government to «fulfil the functions of the state». In practice, this was reminiscent of the Soviet practice whereby civil service did coordinate everything the government was supposed to be in charge of, including all the firm activity. In the period post 1991, such a definition did not give enough clarity on the issue apart from saying that civil service has to do everything that the state does. This was also suggesting that the civil service is in itself an embodiment of the state. The 2000 Strategy introduced a number of changes, most notably in the process of policy formulation, performance and appraisal systems. Finally, the 2011 changes to the Law on Civil Service have never entered into force. The issues raised in the 2011 draft law contributed to pursuing the reform agenda (for instance, on performance assessment of civil servants).

In the eyes of the general public civil service was a Pandora's box, and a potential threat to democracy. This tendency, though popular across developed countries, was reinforced by the fact that the civil service, its composition and incentive system and practices of interactions with politicians, were formed during the Soviet period. Supporting this negative outlook was the government effectiveness data produced by the World Bank: the Bank could not record any major change in the performance of Ukraine's government so far (Figure 1).

⁶ Verheijen, T.J. and Rabrenovic, A., 2015. Civil service development in Central and Eastern Europe and the CIS: a perfect storm?. In *Comparative Civil Service Systems in the 21st Century* (pp. 15-37). Palgrave Macmillan, London.

Figure 1. Ukraine's Governance Indicators



Source: [World Bank's Worldwide Governance Indicators](#)

... and recently

The current wave of public administration reforms starts with the adoption of the new edition of the Law on Civil Service in 2015. In the following years, the government prioritised public administration reform. As part of this effort, the government developed the Strategy of Public Administration Reform for 2016-2020. The Strategy was broadly based on the SIGMA framework for public administration reform developed by the EU and OECD for the European Neighbourhood Partnership and EU Accession Candidate countries. This was warmly welcomed by the international partners. The European Commission estimated its total funding for a programme to support the execution of the strategy at EUR 104 million.⁷ To reflect on the initial years of the Strategy implementation, the government has conducted an [assessment](#) of the public administration in 2018. Based on the results, the Strategy was amended and extended till 2021.

External players such as the European Union, World Bank Group, and European Bank for Reconstruction and Development have all played a significant role in supporting positive change in Ukrainian public administration. Perhaps most importantly, the European Union supported the reform aimed at improving policy-making capacity within the Ministries. The reform introduced new policy-making and strategic planning divisions (called Directorates) within the government. The Directorates were sponsored from the budget, with considerable

⁷ Financial and Economic Analysis Office in the VRU, 2018. Financing the Reform of Public Administration in 2017: Plans and Facts

support from the EU. In 2017, the estimated assistance amounted to EUR 10 million.⁸ This effort was conceptualised as a way to renew Ukrainian civil service by attracting talent to well-paid government positions. 10 Ministries, 2 agencies and the Secretariat of the Cabinet of Ministers took part in the pilot project that started in 2016. Since 2016, 58 Directorates [were formed](#) as a part of the pilot with more than 500 reform experts joining the government.

Moreover, the EU and the World Bank are assisting the Government in developing human resource management, analysing public accounting, tax administration and other core areas for an efficient government operation. The [programme](#) is fully financed by the European Union. The EU [provided](#) a EUR 3.03 million grant for the development of the integrated HR system. Another EUR 2 million were provided by the EU for the World Bank's advisory services in support of the reforms aimed at improving efficiency in HR services. The Cabinet of Ministers adopted a high-level Concept for Human Resources Management Information System (HRMIS) implementation in public administrative institutions.

Success stories

There were multiple instances where civil service reform has succeeded so far. We have identified the following developments to illustrate the positive change:

1. Transparent and competition-driven recruitment practices

The Government has made considerable progress on multiple stages of the reform. The recruitment procedures were modified, necessary changes in the regulations were adopted and amended (in particular, the procedure for conducting competition for civil service positions). The Government has launched the human resources recruitment [portal](#) to advertise positions and recruit new civil servants. 28,100 civil servants were recruited through the competitive process in 2018 alone (Cabinet of Ministers, 2019: 32),⁹ while total number of civil servants in Ukraine is about 200 thousand.

The Government is now working to create the Human Resource Management Information System (HRMIS). The World Bank has already conducted a background [study](#), and the contractor developing the HR portal has been [selected](#) on an open tender. The National Civil Service Agency will be responsible for the implementation of the HRMIS. Initial stage of the project includes a limited number of central executive bodies, and active phase will ensure a [country-wide coverage](#).

2. Competitive recruitment for Senior Civil Servants

⁸ Secretariat of the Cabinet of Ministers of Ukraine, Response No 6511/0/2-17 from 21/07/2017 to the Request of MP A.Shkrum No 417/213-17 from 3/07/2017.

⁹ Cabinet of Ministers, 2018. Reform Implementation of Ukraine's 2016-2020 Strategy of Public Administration Reform in 2018

Introduction of transparent recruitment of senior civil servants (grade A) was a truly revolutionary change. The Government passed new regulations on Commission for Senior Civil Service. The Commission started working already in 2016.

During 2016-2018, the Commission for Senior Civil Service held 229 competitions for Category A positions in civil service, including state secretaries of ministries, heads of oblast and district state administrations, heads and deputy heads of central executive bodies.¹⁰ Based on the competition results, 150 officials were appointed, and 94 positions remain vacant (table 1).

Table 1. Recruitment Dynamics for Category A Positions, 2016-2018

	2016	2017	2018
Competitions announced	109	99	21
Competitions conducted	109	97	19
Winners appointed	36	100	14
Vacant positions		44	50

Source: [Report On Implementation Of Ukraine's 2016-2020 Strategy For Public Administration Reform In 2018](#), p.33

3. Reinforcing policy-making capacity within Ministries

Introduction of Directorates within the ministerial hierarchy has achieved its projected results: young people and those from «outside of the system» went into the heart of the government to strive for success of the reforms. While details of the long-term reform are still in need of further consideration, the reforms have to be congratulated on many intermediary achievements. Among them — introducing competitive pay, eliminating corruption in the recruitment process, improving training for civil servants, setting a clear system of performance indicators and reforming the image of civil servant in Ukrainian society (Bilous & Tyshchuk 2019).¹¹

4. Striving to improve countries' representation in international governance-related rankings

International rankings are used to evaluate the reform. While international rankings can be questioned in terms of methodology and gaming effects they create, they are definitely unbiased and incorruptible by individual governments. The choice of indicators provides a useful overview of the public administration system and stimulates the government to pay

¹⁰ Reform Delivery Office, Cabinet of Ministers of Ukraine, 2018. [Public Administration Reform Report for 2016-2017](#), p. 40

¹¹ Bilous, A., Tyshchuk, T., 2019. Civil Service Reform in Ukraine: Patterns of Success in Reforming Institutions. Vox Ukraine, forthcoming

attention to the way it is accessed by international organisations and generate more and better quality information about its operations.

An overview of the progress against different rankings and indices is demonstrated in the Public Administration [Report](#) (Directorate of Public Administration at the Secretariat of the Cabinet of Ministers 2018:14) — figure 2.

Figure 2. Performance against the selected international rankings and indices of governance



Source: [Directorate](#) of Public Administration at the Secretariat of the Cabinet of Ministers 2018, p. 14

5. Digitalization

Ukraine made a major breakthrough in the sphere of digitalization. The digitalization agenda has affected service delivery and internal workings of the state apparatus. In 2014, the Government successfully passed the legislation on the administrative services, allowing to simplify administrative service delivery for the end users. At the end of March 2019, 121 types of administrative services were [available](#) to citizens and businesses online. Further

improvements in other services including implementation of the one-stop-shop approach were also observed. With the «transparent offices» entering into force in 2014,¹² 778 Centres of Administrative Service Delivery were operating in Ukraine by 2019. Moreover, the government has improved its record in terms of publicly available information online, both at the level of central and local authorities ([Open Data Barometer](#), 2019).

Secondly, the government has improved its internal processes and organisation. Open and competitive procurement process and the launch (and gradual improvement) of Prozorro system is just one example. Prozorro system made many corruption schemes related to government procurement impossible. The human resources recruitment portal www.career.gov.ua was a step forward in improving the transparency of the state apparatus and attracting higher calibre of professionals to civil service. Continuous development of the HRMIS, e-health, portal for educators, and TREMBITA portal for interaction of government institutions have all signified a move towards a rapid modernisation of Ukraine's public administration.

What are the key risks ahead?

- Lack of political support
- Changing the strategy of reform
- Reversal of the reform progress
- Ineffective communication of the reform

Civil service reform is not implemented for the sake of civil service. In fact, all the changes are supposed to contribute to:

- Generating better value for money
- Improving access to public services and their quality
- Making the way the government is running more efficient
- Increasing the chances that policy interventions are effective

Each of those end goals of civil service reform should be considered seriously. In a nutshell, these are the main challenges governments are typically facing on their way to a more efficient civil service.

Generating value for money implies that the civil service is aimed at cost cutting. To this end, the civil service has to be capable of producing up-to-date management data series. Most governments find this challenging, so a lot of extra efforts have to be put in to ensure that the

¹² The reform was introduced in some of the city council beforehand, however it had a limited spread (Dobryanska, N., 2014. [Centres of Administrative Service Delivery — a Way to Fight Bureaucratisation and Corruption](#). Dzerkalo Tyzhnia, 29/04/2014).

current posts are assigned the responsibility and hold accountable for executing the necessary steps.

Access and quality of services: the Government should focus on making reforms count for the public. In other words, access and quality of services should be prioritised in order to improve quality of governance. Moreover, this can also help generate public buy-in (broaden the support base for the public administration reform).

Making governments more efficient: The positive change is hard to sustain. Once the government has changed, there is a likelihood that reforms will be reversed or altered. The inconsistency in reforming such a complex mechanism as civil service often reduces chances for the reform effort to succeed. This is because the rewards and bargains system (RBS) within the civil service is hard to control for — and more prolonged period is needed to understand the ways in which reform has changed this system. This means that every reform changes the underlying reasons for why people join and stay in the civil service, what skills and experience are valued etc. This generates a balance of rewards and bargains. Building on the need for some change in the RBS, policymakers can make further interventions. However, if there is a gap in understanding the changing RBS, effective policy interventions are unlikely.

Making more effective policy interventions: Policy analysis, including projected outputs and outcomes of interventions, and impact assessments have to be further improved. More trainings are needed to ensure that the civil servants are prepared to take on the policy analysis to satisfy the evidence-based policy requirements.

What is the plan?

1. Advance the strategy of reform

Strategy is very important. While SIGMA lays out some directions, it is not designed to address the issues of the actual balance of power and responsibilities across government institutions. This is something to be considered on a national level.

One thing is to make sure reforms cover all the ministries — or at least have a pre-approved plan of doing so. Another outstanding issue here is to make sure that civil service reform is ongoing not only within the ministries, but within other structures, such as parliamentary committees and president's administration.

2. Consult with civil servants and other stakeholders to ensure that the reform is supported

The drivers of the reform should be seated within the Parliament, in the Cabinet of Ministers and/or within the highest political leadership of the country. Moreover, the strategy and tactics of the reform should make sense to those outside the civil service — and outside the government.

3. Focus on value for money

This priority has to be incorporated into the civil service agenda. This can be done, for example, by delegation of responsibilities for scrutinising government programmes and ensuring that adequate progress was made with respect to public spending on a particular programme or project. Those responsibilities can be assigned to senior civil servants within the government or concentrated in the so-called «delivery units».

4. Generate a broader support for reform

This step is crucial. The government needs to show that there is political and technical support for the reform. It has to emphasise that the reform goes in line with the international commitments that Ukraine has signalled, in particular to the EU. On top of those measures, more effort should be put into:

- Demonstrating tangible change
- Linking reform outputs to outcomes
- Being transparent about funding the Strategy of Public Administration Reform
- Openly discussing the cost-cutting measures adopted as a part of the reform

Some reform elements might generate more visibility than others. For example, e-governance and one-stop-shop system for e-services are much more visible to citizens compared to other, more intricate institutional reforms. There should be a reasonable trade-off between visible reforms that improve access and quality of public service — and the concealed but costly institutional reforms aimed at creating a stronger and more capable government in the long-term.

Deregulation

Having a history of enormous government involvement in the economy during the Soviet past, since gaining independence in 1991, Ukraine has been gradually reducing both government ownership and government intervention in the economy. However, in 2014, despite the efforts, Ukraine remained a rather regulated economy.

In general, role and scope of government intervention is a highly debatable issue across the world. Many countries experienced both tightening of regulations (e.g. in the aftermath of the 2008 crisis) and reduction in the government regulations. The latter is more often and takes the form of deregulation which may be of two types: radical, i.e. regulatory guillotine used, for example, in Croatia, Macedonia and Armenia, and selective deregulation chosen by Ukraine.

Large-scale deregulation reform in Ukraine started in early 2015 when the Cabinet of Ministers of Ukraine [adopted](#) Resolution 42, 'On Some Issues of Business Deregulation'. The reform actions were aimed to deregulate business activities, to bring Ukrainian legislation in line with the EU legislation and achieve the TOP 30 ranking in Doing Business by 2020 with the [ultimate goal](#) to attract more foreign and domestic investments into the economy. Even though this objective is unlikely to be achieved, Ukraine's ranking in Doing Business have been improving since 2014 when Ukraine ranked 112th. Currently (in Doing Business-2019) Ukraine ranks 71st, up from 76th in 2018, 80th in 2017. Improvement in the ranking has been mainly accomplished due to the progress in the areas of starting a business, protecting the rights of minority investors and enforcing contracts (Figure 3). Despite the right direction, Ukrainian regulatory environment remains complicated, sometimes contradictory and preserves a lot of «relic» clauses that have no economic or common sense.¹³

Other important deregulation measures were outsourcing of registration services from the Ministry of Justice to local governments and private sector, and launching of Ministry of Justice online service (together with opening registries) which greatly simplified registering property rights for firms and real estate. Other deregulatory measures included halving the number of licenses, considerable reduction of the number of certificates, simplification of tax administration, simplification of imports and exports of services etc.

The first [Action Plan](#) for Deregulation was adopted in March 2015 for 2015-2016 and included 131 measures. By the end of 2015, more than 60 percent of the measures were implemented. In August 2016, the Cabinet of Ministers of Ukraine approved the updated Action Plan for

¹³ As a prominent example, regulation of prices on certain products in Ukraine was finally cancelled only in mid-2017, while in other transition countries price liberalization was a key element of the package of initial market reforms. Other examples — a number of Soviet-time sanitary norms and standards (not used anymore) were cancelled in 2015-2016.

Deregulation of Economic Activities in Ukraine for 2016-2017 (the «Plan») which is still in force. The Plan set a number of objectives to improve and simplify the regulatory environment in such strategic areas as agriculture, construction, oil and gas and mineral resources, power, information technology and telecommunications, food industry. Overall, 112 measures in 11 sections were foreseen in the Plan. These measures were expected to reduce the regulatory burden in these specific areas and to generally improve the business environment in Ukraine.

Figure 3. Doing business rank of Ukraine by pillars



Source: Doing business reports

The State Regulatory Service of Ukraine (DRSU) is responsible for coordination of the implementation of the Action Plan. In particular, each month all government bodies mentioned in the plan have to submit reports to the DRSU on implementation of the measures in the Plan for which they are responsible.

As of July 20 2019,¹⁴ out of 112 measures foreseen in the Plan, 32 measures (or almost 30 percent) had not been implemented yet and one measure was withdrawn from the Plan. The most problematic area with the highest share of the failed deregulation measures of the Plan is simplification of administrative procedures for regulation of economic activity. Clearly, the new government will have to review the Plan and speed up the deregulation measures.

¹⁴ Source: 2016-2017 Action plan implementation [page](#) on the DRSU website, visited on August 14 2019

The deregulation reform was not limited to the implementation of the Action Plan. The Cabinet of Ministers continues to hold 'deregulation Cabmin' days from time to time when regulations hampering business activity are reviewed and outdated and irrelevant regulations of Soviet origin are abolished all together.

Moreover, to prevent the new ineffective regulations from entering into force, the mandatory regulatory impact assessment (RIA) and small business test (M-Test) for all new regulatory acts produced by the central executive government branches were introduced in late 2015. The M-test is similar in spirit to SME test used in the EU to evaluate the regulatory cost of new legal initiatives imposed on the small and medium business which is often disproportionately affected by the government regulations relative to large business.

In Ukraine, deregulation and entrepreneurship became one of the priorities for the National Reforms Council created in 2014. The Council was supposed to act as a consensus platform for main stakeholders in developing the road maps of the reforms and included the main stakeholders (executive and legislative branch representatives as well as civil society representatives). Unfortunately, ambitious goals of the creators of the Council remained on paper: by late 2017 the Council became a powerless institution with negligible impact on the reforms in Ukraine.¹⁵

Despite of the undertaken efforts, the Ukrainian economy remains heavily and often inefficiently regulated. To change this, several steps are needed.

First, the new government needs to revise and speed up the implementation of the deregulation plan.

Second, Ukraine has to adopt legal provision for regulations revisions or period of their validity, which are a common practice in the EU countries. Many regulations in the EU have «expiration» date, and the effectiveness of those which do not have this date has to be evaluated after a specified period (usually 3-5 years). Based on this evaluation, regulation can be revised, amended or abolished.

Third, improve application of the regulatory impact analysis (RIA) to make it a real instrument for stopping «bad» regulations and not just «red tape» documents. A similar instrument should be implemented for the regulatory acts initiated in the Parliament to stop the legislative 'flood' observed in the previous convocation.

Forth, improve communication with the business community to encourage more self-regulation of industries. This principle has been already included in the [Concept note](#) of

¹⁵ According the different ways of surveys (in 2016-early 2018), only around 15% of the respondents knew about what the Council was doing, and almost half of these respondents believed that the Council was ineffective (Source: reforms.in.ua)

deregulation reform developed by the MoEDT in 2015 but did not seem to receive enough attention.

Judicial reform

Poor protection of property rights by Ukrainian judiciary has been a major obstacle to [foreign investment](#) for a long time. Inside the country, it has had one of the lowest levels of trust (according to the survey of the Institute of Sociology, in 2018 only 0.8% of people completely trusted and 6.3% somewhat trusted the courts, and this level has been more or less stable — see Figure 4). The latest polls suggest that judicial reform is [among top-5](#) priorities of Ukrainian citizens. Indeed, any progressive legislation loses sense if there is no mechanism to enforce it. And it is hard to expect economic growth if basic rights of agents, including property rights, are unprotected.

Judicial reform has been on the agenda of many Ukrainian governments. In fact, some of Ukrainian presidents tried to reform the system before¹⁶ but these reforms were not aimed at making the system a truly law-protecting rather than a repressive tool. The results of such 'reforms' have been fully felt during the Euromaidan, when courts sentenced people on the basis of fake police protocols or without any evidence.

An early attempt to 'reload' the courts was implemented in 2014 — heads of all primary-level courts were dismissed. However, [85 per cent](#) of them were re-elected by the staff of the respective courts.¹⁷ Thus it was clear that judicial system needs much more than that. At the same time, reforming courts is one of the hardest tasks because the government has to find a balance between integrity of the judiciary and its independence.

The [Strategy](#) for reforming the judicial system was adopted in 2015. Already in the early 2015, the law «[On the right to justice](#)» was adopted. It strengthened the role of the Supreme Court and streamlined some of the court procedures. Voluntary 'cleaning' of the judicial branch started in 2015 with introduction of e-declarations — about 2000 of 9000 judges left their positions unwilling to declare their assets. Mandatory cleaning of the judiciary, i.e. re-attestation of judges has been underway since 2016. As of end-2018, [over 20%](#) of judges that underwent the re-attestation procedure did not pass it. Today, the system has over 4000 vacancies (table 2). Naturally, lack of judges causes overload on the remaining judges and prolonged consideration of cases. This is the price one has to pay for higher quality of the judiciary.

¹⁶ See the [article of Irena Budz](#) for a comprehensive discussion of evolution of Ukrainian judicial system.

¹⁷ At that time, heads of courts distributed the cases among judges (now this is done automatically) and thus could arrange hearing of certain cases by the «right» judges.

Table 2. Number of positions and vacancies in Ukrainian courts

	Total number of positions	Vacant positions
Local Courts	5045	4412
Appellate Courts	1439	70
Higer Anti-corruption Court	39	1
Higher Intellectual Property Court	30	0
Supreme Court	196	2

Source: [Higher Qualification Commission of Judges](#)

The major reform of the system started with amendments to the [Constitution](#) in summer 2016, complemented by the new [law](#) on Judicial system, on the [Higher Council of Justice](#) (which is the self-governing body responsible among other for prudential oversight of judges and disciplinary actions towards them) and [amendments](#) to the court procedure.

All in all, the judicial reform has brought up the following changes:¹⁸

- the court system was changed from four-level to three-level one. The intermediate level between appellate courts and the Supreme Court introduced by former president Yanukovich was eliminated. The role of the Supreme Court was strengthened. An open competition for 196 positions in the Supreme Court started in 2017. In May 2019, 193 vacancies were filled. However, the Civic Integrity Council that had an advisory role in the selection procedure reports that [44](#) appointees have dubious reputation.
- the Higher Court on Intellectual Property and the Higher Anti-Corruption Court (HAC) were established in mid-2018. Establishment of the HAC was uneasy because this court completes the vertical of anti-corruption bodies — National Anti-Corruption Bureau (investigation), Anti-Corruption Prosecution and Anti-Corruption Court (conviction). In September 2019 the HAC started its operations. International experts played a major role in selection of the HAC judges. In fact, the willingness of the former president Poroshenko to undermine their role was one of the major obstacles to the adoption of the law on the HAC.
- the independence of the judiciary was strengthened along several lines. Firstly, selection and disciplinary actions towards judges are performed mostly by the professional community. Thus, if previously the Higher Council of Justice (HCJ) consisted of 10 representatives of judges and other lawyers and 10 representatives

¹⁸ More details on the judicial reform can be found on a special portal: <http://sudovareforma.org/>

of executive and legislative power, today the ratio is 15 to 6. The Higher Qualification Commission of Judges (HQCJ — the body responsible for selection of judges) previously did not include representatives of attorneys and included a person from the Ministry of Justice. Now it includes two representatives of attorneys and no Ministry representatives. Secondly, judges now do not have a five-year 'probation' period. They are appointed once and for life (they can be dismissed by the HCJ if they commit a crime or ruin their reputation). However, the minimum age and experience needed to become a judge were raised. Thirdly, judges are appointed not by the parliament but by the Higher Council of Justice (the president formally signs the decree with appointment of judges recommended by the HCJ). At the same time, members of the HCJ and the HQCJ cannot work elsewhere while previously they were allowed to hold elected or executive offices. Finally, salaries of judges were increased multiple times. Simultaneously, judges are obliged to submit the declaration of their assets and revenues and the declaration of integrity, and their immunity was limited — now a judge can be detained if captured at the crime scene.

- the institution of attorneys was considerably strengthened — they received a lot of opportunities to protect their clients which were not available to them before. At the same time, only attorneys are allowed to represent a person in court, while previously anyone could do that (although the law which still has to be adopted can limit this clause only to criminal or otherwise significant cases).
- court procedures were streamlined — in particular, many have been transferred into electronic form (e-court), and an automatic distribution of cases among judges was introduced.
- to improve the enforcement of court decisions, private enforcement agents were allowed, and remuneration of public enforcement agents was linked to the results of their work.

Thus, the institutional carcass for the judicial reform is sound. However, its actual implementation is not flawless. For example, there were questions to the procedure of re-evaluation of judges. The Civic Integrity Council even issued a statement on its withdrawal from the process since too little time provided for the procedure did not allow to thoroughly evaluate candidates. After this statement the process slowed down and even was broadcasted via web-cams.

The process of reorganization of courts is not complete either. In fact, appellate courts were renamed rather than renewed. The consequences of half-reformed judicial system are quite obvious — for example, there is a number of dubious decisions on reversing the resolution of insolvent banks by the NBU, renewal on the job of many policemen dismissed upon attestation or of heads of state-owned enterprises fired within the SOE corporate governance reform. Thus, some courts are trying to reverse the reform progress, including that of judicial reform. A recent scandal revealed [participation](#) of Kyiv District Court in [\[sometimes successful\]](#) attempts to replace the HQCJ members to take this body under control of the

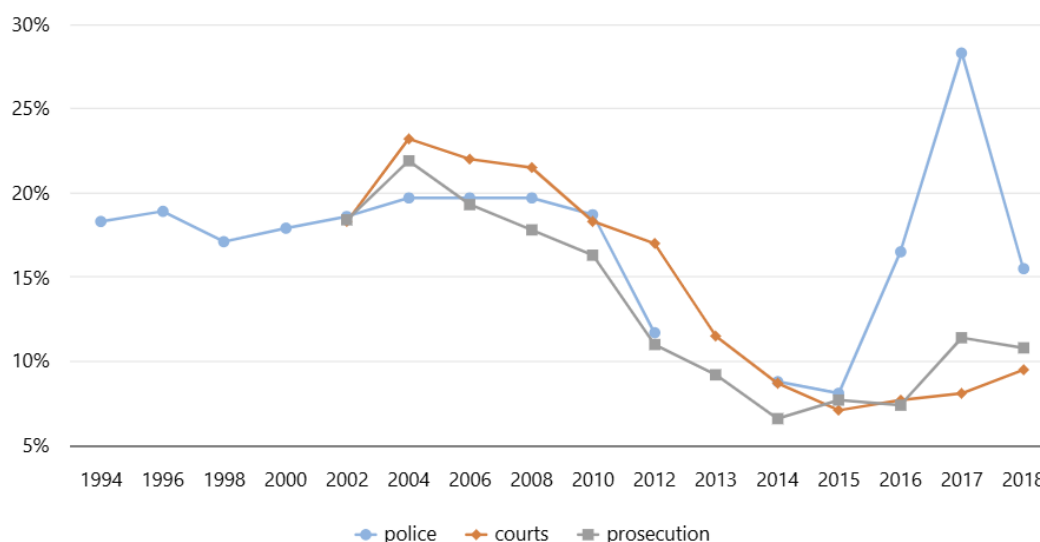
executive branch. The respective recordings were released by the NABU but have not yielded any tangible results yet.

Both newly elected president, parliament and civic activists argue for the 'reload' of [Higher Council of Justice](#) and Higher Qualification Commission of Judges since these bodies [did not properly implement](#) their functions. NGOs [argue](#) for selection of members of these two bodies with the help of international experts and with increased role of the Civic Integrity Council using the same criteria that apply to judges. Whether the new government accelerates the judicial reform or reverses it remains to be seen.

Prosecution reform and police reform have been one of the biggest disappointments of the last five years since only the first steps were made in them. The prosecution was deprived of the general oversight function (a Soviet remnant) while its other operations are unchanged. Within the police reform, the brand new patrol police was created, and other policemen underwent the re-attestation procedure. However, only about 5-6% of policemen were fired as a result, and many renewed in their positions with the help of the courts. Since the rest of the police remains unreformed, the new people leave the new patrol police. And the trust of citizens to police as a whole is deteriorating.

Figure 4. Trust to judiciary, prosecution, police

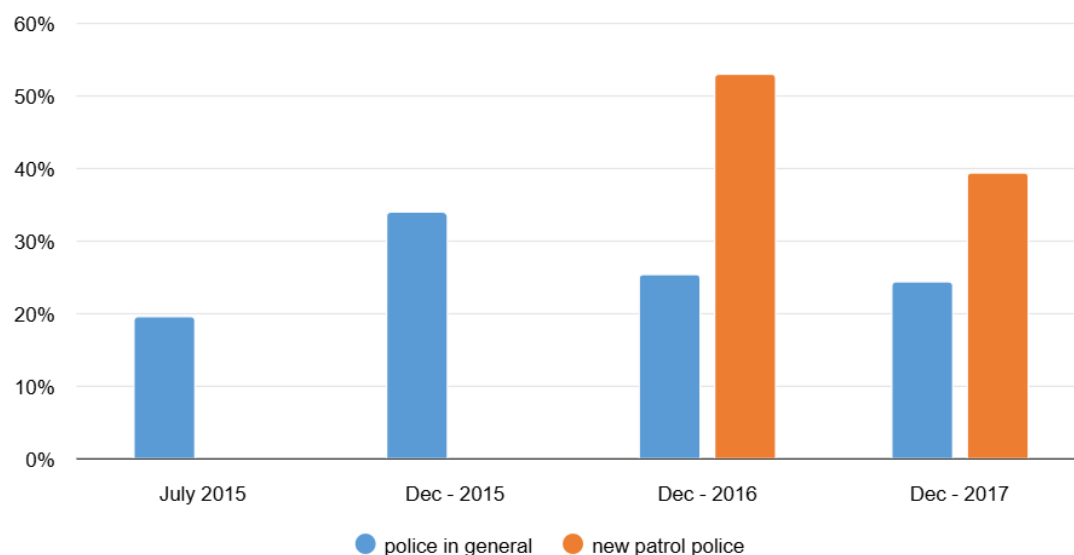
Panel A.



Note: the graph shows the share of people who said they trust or mostly trust in those who had a definite answer.

Source: Institute of Sociology NASU surveys

Panel B.



Source: Democratic Initiatives Surveys

Table 3. Trust to judiciary by different types of respondents

Respondents	Do you trust...	2015	2016	2017	2018	2019
		Share of those who fully trust and mostly trust				
General public	judiciary/courts	5%	10%	12%	16%	
Court users	trust and confidence in the judiciary	16%	13%	28%	34%	
Attorneys and prosecutors	trust in individual courts where you are a party in a case			43%	47%	56%
	judiciary in general			38%	41%	44%
Jurors	a specific court where you are on jury duty					82%
	judiciary in general					62%
Court staff	trust in courts where you work			60%		87%
	judiciary in general			59%		72%

Source: USAID «New Justice Program» surveys

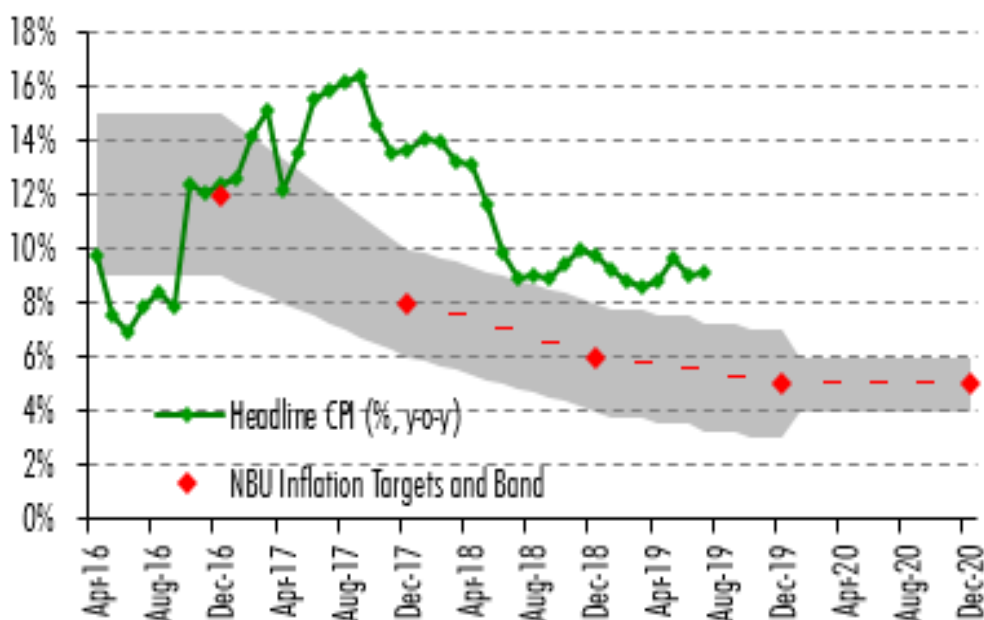
/2 MACROECONOMIC ENVIRONMENT

Monetary Policy And The Banking Sector

Recap of progress

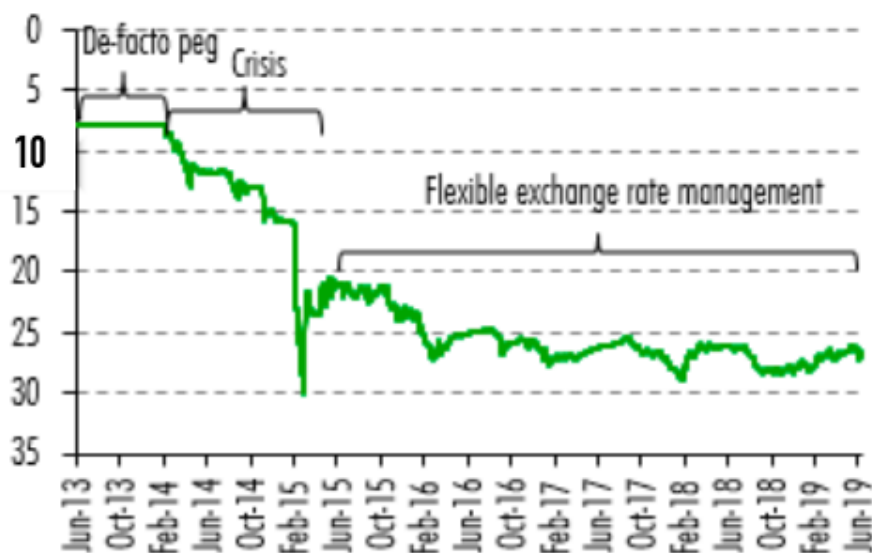
The National Bank of Ukraine (NBU) has been a leader of reforms in Ukraine since 2014. Specifically, the central bank introduced a number of policies that lay foundation for economic prosperity of Ukraine. First, the NBU adopted a new policy framework: inflation targeting with a flexible exchange rate. This policy introduces a nominal anchor (low and stable inflation) and provides a powerful absorber of domestic and external shocks (flexible exchange rate). This is a significant step forward because the previous policy framework based on a fixed exchange rate made the economy prone to banking and currency crises (indeed, Ukraine experienced three severe crisis between mid-1990s and 2014).

Figure 5. Headline Inflation and NBU Targets



Sources: NBU, SSS

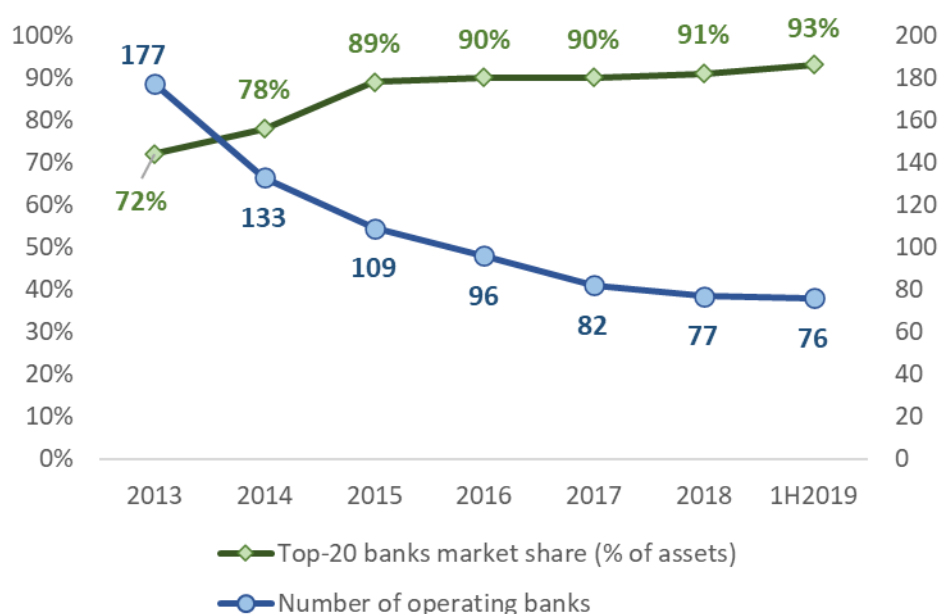
Figure 6. A shift to flexible exchange rate management



Source: NBU

Second, the central bank made a strong effort to clean up the banking sector and make it more transparent and resilient. While consolidation of banks, a wave of bankruptcies, and the nationalization of PrivatBank (the largest private bank in the country) were costly, accounting for 12% of GDP, a sound banking sector improves allocation of resources in the economy, a critical ingredient for economic growth. Furthermore, the central bank introduced new systems of risk management and other macroprudential tools to ensure that the taxpayer will be less likely to carry the burden of bailouts.

Figure 7. Number of Banks and Banking Sector Concentration



Source: NBU

Finally, the central bank underwent a series of structural reforms aimed to ensure sound policymaking. For example, decisions on monetary policy are now made by a committee rather than a single person. The new law adopted in 2015 enshrines the independence of the central bank, which is highly important for a country with weak institutions and strong political influences.

The central bank received not only significant powers but also was assigned a new degree of accountability. In contrast to pre-2014 policies, the NBU now publishes a wide range of documents to provide the public with policy decisions and analyses. The NBU was recently [recognized](#) as the top central bank in terms of transparency.

Current and future challenges

Nationalization of PrivatBank

The government was forced to nationalize PrivatBank in 2016. It was a classic too-big-to-fail case: because PrivatBank accounted for a third of retail deposits and a half of payment transactions, its bankruptcy would have led to a financial crisis and a deep downturn in an already weakened economy. The cost of the bailout amounted to approximately 5% of GDP. Pre- and post-nationalization audits revealed massive fraud. Despite this strong evidence, there is a significant risk that previous owners can take control over the bank and/or receive a sizable compensation from the government for the takeover. If this scenario is realized, the NBU (and more generally the country) will face unprecedented challenges. Indeed, the scale of possible cost in this scenario is colossal not only in terms of possible payments (which can undermine the fiscal position of the government and foreign reserves of the central bank) but

also more fundamentally undermine the ability of the government and the central bank to govern the country. For example, a reversal of the nationalization will greatly weaken the de facto ability of the NBU to regulate banks and may reignite related-party lending and other abuse that led to the massive crisis of 2014-2015.

If the Ukrainian judicial system turns out to be unable to reach a just verdict, the NBU and the government should actively seek justice in foreign jurisdictions where the rule of law is stronger.

Political risks

For the first time in Ukraine's history since 1991, legislative and executive branches of the government are controlled by one party (Servant of the People). As a result, the ruling party has significant leverage over the central bank and other government bodies. It would be most unfortunate if the ruling party used its powers to undermine the NBU as an institution. Attempts to influence policy or leadership will be dire. Recent examples of Argentina and [Turkey](#) where the executive branch meddled with central banks illustrate that such interferences lead to a macroeconomic crisis, which Ukraine can hardly afford given its geopolitical and economic situation. The central bank will be well advised to build defenses to political interference. International partners such the IMF and donor countries should be informed about political pressure. The central bank should also increase its outreach to the general public to ensure that the NBU has public support as an institution tasked to provide low and stable inflation, a major public good.

Global trends

Recent developments in global markets suggest a significant risk of a global recession in the near future. Like many other emerging economies, Ukraine may be hit hard by the global slowdown. The major risk stems from commodity prices, which typically decline in global recessions. Since the main exports of Ukraine are commodities, Ukraine may lose a sizable share of its export revenues. Sharp deterioration in terms of trade may also trigger capital flight, amplifying depreciation pressure on the currency and potentially destabilizing the financial system. The central bank should be ready to promptly respond to these risks with a pre-designed policy package. In case of terms of trade shock, the hryvnia should be allowed to depreciate to absorb the shock. Attempts to defend the hryvnia would be a waste of foreign reserves and would undermine the credibility of the central bank's commitment to the flexible exchange rate regime and thus the inflation targeting framework. Hryvnia depreciation should be accompanied by monetary policy tightening to curb inflation expectations. In case of capital outflows endangering financial system and causing currency overshooting, the NBU should be ready to reintroduce capital controls.

Another risk stems from the volatile global investor mood towards emerging markets. Global investors may change their positive attitude towards emerging markets even if there is no

immediate problem in Ukraine. In other words, Ukraine may be considered as being in one group with e.g. Argentina. As Ukraine's integration into the global financial system has been limited so far, negative impact of global risk-off was limited only to government borrowings. However, as Ukraine's financial markets get better developed and closer integrated into global system (e.g. foreigners invested more than \$3 bn in Ukraine local currency government bonds in January-July 2019, 15% of central bank reserves), swings in foreign investor attitude will have a more profound effect on the currency, financial markets and the overall economy requiring proper policy responses.

Fiscal dominance

For a variety of reasons, the government has been running a fiscal deficit. So far, the government used domestic and international borrowing to cover its fiscal deficit. The balance of risks is such that the government is more likely to face larger rather than smaller fiscal deficits in the short run. For example, a sharp output drop as a result of a global recession can seriously reduce the tax revenue of the Ukrainian government. In addition, the government faces large debt amortization in the coming years, while global financial markets may deteriorate to an extent that borrowings will become prohibitively expensive or unavailable. As a result of negative shocks, the government may be limited in its ability to borrow and hence may turn to the central bank to fund its operations. Given the current political arrangement in Ukraine, the central bank may have few tools to resist the pressure from the government. Indeed, apart from appeals to the general public and the international community, the central bank can do very little to dissuade the government from using the printing press (seigniorage) to pay for its expenditures. Because Ukraine has a history of chronically high inflation, dominance of fiscal policy over monetary policy will likely spur inflation expectations, a run on banks and the currency, and ultimately lead to a massive macroeconomic crisis.

Major capital inflows

If the new government chooses a path of radical reforms (e.g. introduces a market for land), it is possible that Ukraine will attract major inflows of foreign borrowings and direct investment. This may amplify the positive effects of the reforms and may resemble the economic boom of the 2000s before the 2008-2009 Global Financial Crisis. Major inflows of capital can result in a strong appreciation of the hryvnia which can make Ukrainian exporters less competitive. Furthermore, while this appreciation can help with lowering inflation expectations and inflation, large inflows of capital can lead to a credit boom which can make the country vulnerable to a sudden stop in capital flows and hence a credit bust (think about the crisis in Ukraine during the Great Recession and the Global Financial Crisis). In this scenario, the central bank should be vigilant and use its macroprudential tools to ensure that Ukraine avoids a damaging credit cycle.

Summary

Given the internal and external economic challenges for Ukraine, it is vital that the National Bank of Ukraine preserves its independence from political pressures, actively monitors the macroeconomic conditions, and is ready to deploy a broad spectrum of tools to deliver its main policy objective — low and stable inflation.

Fiscal Policy and Public Finance

During its independence, Ukraine faced deep financial and economic crises several times — in the early 1990s, in 1998, in 2008-2009 and in 2014-2015. One of the factors that exacerbated the crises was its imprudent fiscal policy.

Economic theory suggests that fiscal policy should be countercyclical, i.e. during economic downturns public expenditures should rise to soften the contraction, while during booms the government should try to reduce the deficit and repay some of its debts. However, governments' short-sightedness is also a phenomenon with which economists are very familiar. Governments try to raise expenditures to stimulate the economy and please their voters. This is exactly the Ukrainian situation — governments of our country run a budget deficit even in times of a very strong growth (2002-2008).

To finance it, they borrowed primarily on external markets. Thus, in downturn times, when expenditures have to be increased, the following happened:

- UAH value of government debt jumped upwards since the crises were accompanied by sharp currency devaluations.
- External markets closed and the government struggled to finance the really needed budget deficit.
- The government turned to the IMF as a lender of last resort.
- IMF provided the bail-out but also recommended fiscal austerity and structural reforms. Fiscal austerity was usually implemented to receive the first tranche of a program but as soon as the situation stabilized structural reforms were forgotten.

The 2014-2015 period was different for several reasons. First, the crisis was too deep and accompanied by a loss of territory because of Russia's aggression. Second, the newly appointed government was determined to implement structural reforms. Indeed, at the beginning of 2015 the Index for Monitoring of Reforms was at historically high levels. However, in a year or so the pace of reforms considerably slowed down, and implementation of programs with the IMF was delayed.

Prior to 2014, the Ukrainian fiscal system was characterized by several systemic flaws:

- Absence of fiscal rules. In generally weak institutional environment government short-sightedness becomes unavoidable. Fiscal rules can help mitigate this problem — that is why in Poland, for example, they are embedded into the Constitution. By fiscal rules

we mean not only the most widely known public debt cap but also restrictions on frequency and size of state budget amendments¹⁹.

- Persistent budget deficit and thus rising public debt. At the same time, the government tried to 'conceal' the true level of debt by issuing state guarantees for borrowing of state-owned companies rather than direct government debt. For instance, although the state budget deficit in 2013 accounted for 4.3% of GDP, the total public finance deficit stood at 6.7% of GDP (the respective figures surged to 4.6% and astonishing 11.6% of GDP respectively in 2014).
- Inefficient use of funds. Although the program budgeting was introduced already in 2002, its implementation was rather formal than genuine. Purposes of government budgetary programs and indicators of their achievement were (and still are) vaguely defined and/or irrelevant. Another prominent example of inefficiency is keeping household gas tariffs 2-3 times below the market level. Equivalent to provision of a universal subsidy, this situation created plentiful opportunities for arbitrage — gas could be purchased from Naftogaz at 'household' price and sold to the industry at the market price. In 2014, this resulted in Naftogaz deficit higher than the State budget deficit (see the Energy Market section for details).
- Diversion of public funds to private pockets close to the government. This was implemented using various schemes. One of the most popular — 'manual' VAT refund to exporters. In order to get the refund, companies had to 'give back' up to 30% of the refund sum. Otherwise they could wait for years. Another vast source of rent was public procurement — government agencies used to buy things from their 'preferred' suppliers at higher than market prices.
- Overly regressive tax system. The government used to provide extensive tax exemptions to the largest companies which had a strong lobby in the Ukrainian parliament. In the early 2000s, these privileges were provided via the 'special economic zones' and 'territories of priority development' that covered 10% of Ukrainian territory and were extensively used to minimize tax payments by large businesses. Even after these tax loopholes were closed in 2005, numerous tax privileges for business remained. In 2011 tax privileges provided to 15 sectors of the economy amounted to 4.5% of GDP. In 2012-2013, estimated total revenue that business retained due to various tax privileges was about UAH 70 billion or 20% of potential tax revenue²⁰. This created adverse incentives since honest taxpayers were 'punished' for their honesty and were at a competitive disadvantage compared to those who managed to evade taxes or get privileges. To compensate for the lost

¹⁹ As an example, consider the budget-2012. The government led by Mykola Azarov (March 2010 - January 2014) tried to steeply raise social spending before the parliamentary elections held that year. Thus, the budget was amended 39 times, and at the end its revenues grew by 7.5%, expenditures by 10.5% and the deficit by 54%(!)

²⁰ Theoretical and practical aspects of the application of tax benefits in Ukraine, Serebryanska Y. V, Volochay A. S.

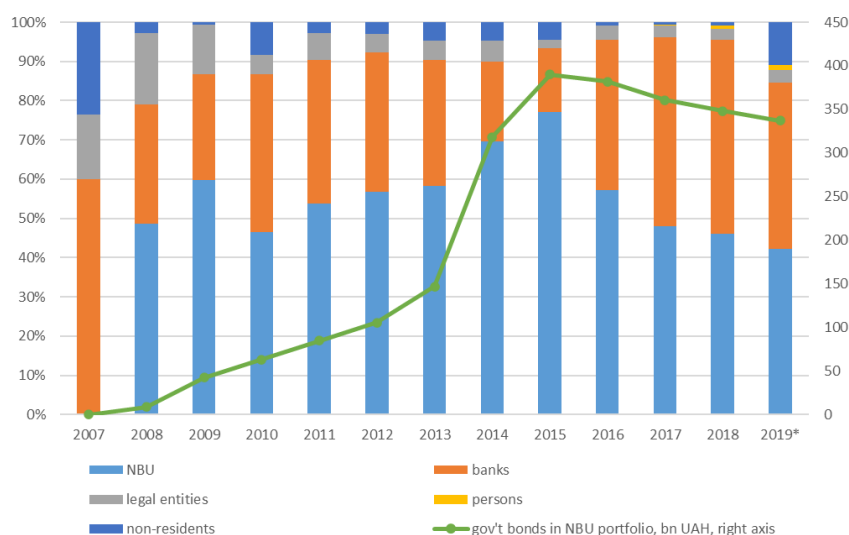
budget revenues, the government disproportionately taxed other economic agents, i.e. households.

In 2010, the government negotiated a program with the IMF to overcome the consequences of the world financial crisis. However, after receiving the first tranche, it stopped fulfilling program conditions. Thus, borrowing abroad became much harder for it. Before June 2012, while the conditions on foreign markets were more or less favorable, the Ministry of Finance managed to make several placements of Ukrainian debt securities. But soon the sentiment in foreign markets changed, the lenders' appetite for high-risk countries plummeted, and the window of opportunity for placements closed.

After that, the government started using various more or less legal methods to finance the budget deficit:

- collection of additional funds from business, i.e. advance profit tax payment (as of January 1st 2015 these advance payments amounted to UAH 25.2 billion).
- implicit emission²¹: the Ministry of Finance would issue domestic government bonds and the National Bank of Ukraine would immediately buy them out. During 2011-2013, the NBU became the largest holder of domestic debt securities (figure 8).
- usage of funds of local governments stored at the Treasury account to finance expenditures of the central government.

Figure 8: Distribution of government bonds by holder types, year-end



Source: National Bank of Ukraine. *as of end-July

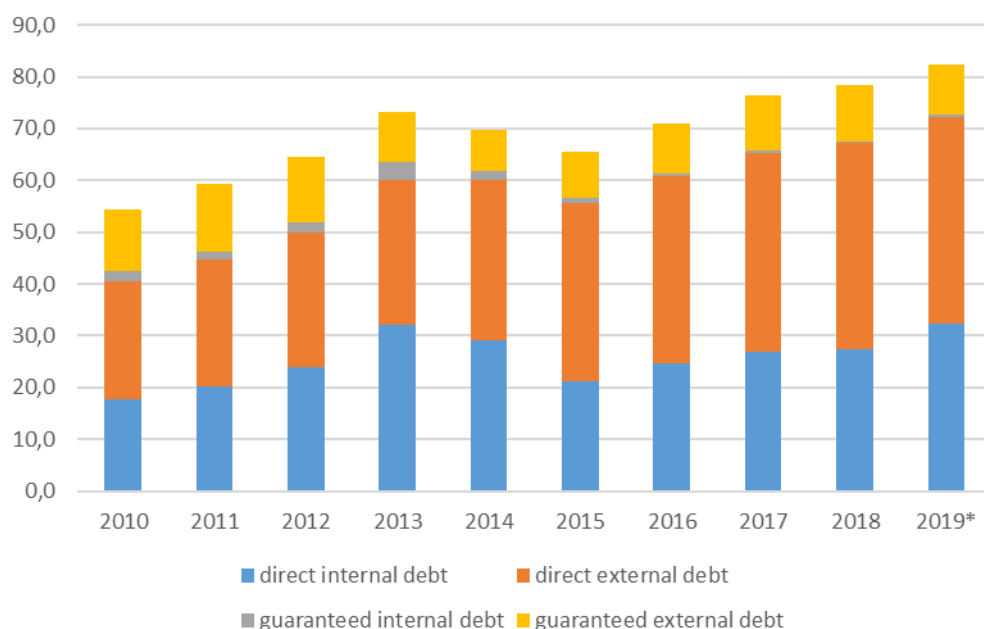
Besides, the government extensively issued state guarantees — for example to the state road construction company Ukravtodor or the State Agency for Investment and National Project

²¹ This is directly forbidden by the law, and formally a secondary market was used, e.g. government increased Naftogaz capital with bonds and the latter sold bonds to the NBU

Management (figure 9). In this way, the government did not formally assume additional debt obligations but in fact agreed to finance the debts of a large number of economic entities that did not have the resources to repay the debts themselves. Thus, even today the government is repaying the guarantees on the Ukravtodor debt accumulated in 2011-2012.

At the end of 2013 such policies have put the economy on the brink of the crisis, and Russian aggression only pushed it in the back.

Figure 9: Distribution of Ukrainian government debt, \$ billion, as of year-end



Source: Ministry of Finance. *as of end-July

Progress of reforms

After the Revolution of Dignity, the situation in public finance management began to change rapidly — in particular, due to the lack of opportunities to continue financing the budget under the schemes practiced by the previous governments. The government negotiated a stand-by program with the IMF in 2014, replaced by a four-year Extended Financing Program (EFF) in 2015 and adhered to fiscal discipline implied by the program. For the first time in the history of Ukraine's cooperation with the International Monetary Fund, Kyiv was able to receive three tranches under one program.

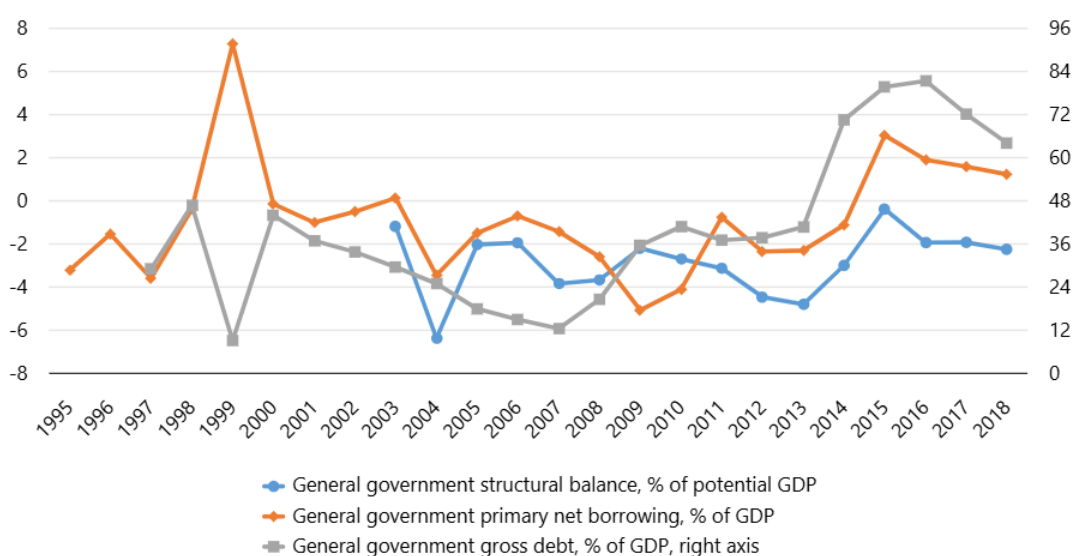
During 2014-2015, hidden budget deficits were eliminated. One of the most important steps in this was reduction of Naftogaz deficit from UAH 115 billion in 2014 to zero in 2016. Instead, the government introduced a more transparent scheme of providing citizens with utility subsidies.

During the last four years, both the state budget deficit and general government deficit have been kept within the limits defined by the IMF program. In 2015, the Parliament approved changes to the Budget Code introducing fiscal rules which significantly narrowed the list of cases when changes to the state budget can be made. This is an important safeguard for over-inflating budget expenditures. Using funds of local budgets to finance central budget expenditures is also prohibited.

Besides, now VAT refund is automatic, and VAT registry is open — so anyone can check which companies received VAT refund and when.

To control fiscal risks imposed by state-owned enterprises on public finances, the Ministry of Finance created a special unit within the Ministry.

Figure 10. Public finance deficit and government debt



Source: IMF data

The central bank independence was considerably strengthened. Thus, after 2016 the government does not issue bonds if there is no demand for them.

Government debt restructuring in 2015 allowed to reduce the debt burden on the state budget, and «distribute» public debt payments over time.

As a result, the government debt fell from 79% in 2015 to 61% in 2018.

The Ministry of Finance has also significantly expanded its ability to receive financing in the internal market from foreign investors. To this end, in early 2019 Ukraine joined the Clearstream system, the international securities depository.

The taxation system has also seen important changes.

Since 2015, the Ministry of Finance started to address the problem of regressive taxation. Gradually, the majority of tax exemptions for business were cancelled. The greatest resistance was on the side of the agrarian sector for which the special VAT regime was cancelled at the end of 2016 (previously, agro firms transferred the VAT payable to special accounts and could use this money for investment). Direct subsidies to agro sector were introduced instead.

At the same time, at the end of 2015 the rate of the single social contribution was cut from 44.6 to 22 percent. It was a significant step towards correcting inequalities in the taxation system and towards a fairer distribution of the tax burden among taxpayers.

Key priorities for the future

Over the five years following the Revolution of Dignity, key structural imbalances in the public finance sphere have been largely corrected.

However, the job is far from completed. At the moment the Ministry of Finance works on modernization of public finance management system to raise the efficiency of management of budget resources and government debt.

This implies:

1) effective budget planning process. The main task here is ensuring that every taxpayer hryvnia is used to the maximum benefit of the state (value for money).

To achieve this, the government needs to practically implement the medium-term budget planning already foreseen by legislation and to adopt a different approach to drafting budget programs, the quality of which determines the quality of the expenditure part of the budget. The programs should contain clear and measurable policy goals achievement of which requires public money.

An important step in this direction has already been made: since 2019 the Ministry of Finance started the spending review process. This approach is used by many countries to analyze whether certain budget expenditures help achieve public policy objectives to which they are tied.

At the moment the process is quite difficult due to (1) high level of conservatism of government bodies, (2) lack of clearly defined policy goals and (3) no quality statistics required to measure the progress towards the goals in many areas.

2) effective liquidity management. The Ministry of Finance needs tools to effectively manage funds of the state budget accumulated in the Treasury and FX accounts of the government. For example, depositing these funds for short periods of time can bring additional interest revenues to the budget and reduce liquidity risk.

3) effective public debt management aimed at minimizing the risks of financing the budget deficit and reducing the cost of borrowing for the Ministry of Finance.

4) reform of the State Fiscal Service, which in 2019 was divided into the State Customs Service and the State Tax Service. Declared aim of the reform is reduction of administrative burden during both paying taxes and crossing the border.

5) further promotion of the fairness of taxation system and switching to more progressive taxation when those with higher incomes also pay higher taxes (although tax rates may be flat). This among other requires solving the problem of the so-called internal offshores, among other — schemes used by large businesses to minimize taxation via registering their employees as individual entrepreneurs. The BEPS rules should be introduced and implemented to effectively deal with tax optimization by business.

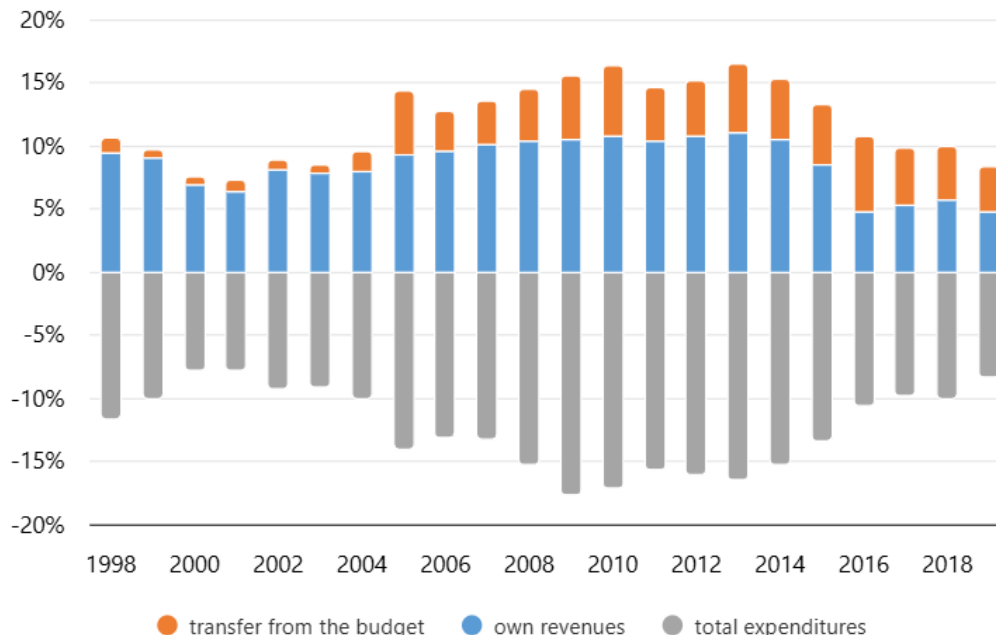
In order to implement these reforms, the Ministry of Finance has already approved the Public Financial Management Strategy (2017), the Government Debt Management Strategy (2019), and the [framework](#) for the fiscal authorities reform. The Ministry must now ensure that these strategies are successfully implemented.

Pension reform

As many other countries in the world, Ukraine is facing an ageing population. The share of population aged 60+ was around 23% at the beginning of 2019 and is estimated to reach 33% by the year 2050. This is a challenge for the traditional pay-as-you-go (PAYG) system that brings the necessity for additional pension provision to make the pension system sustainable over the long run. The first attempt to change the pension system was made in 2004 when in addition to traditional pay-as-you-go system the voluntary accumulative pillar was introduced.

However, measures taken in 2004 were not sufficient to make the pension system sustainable. PAYG first pillar had suffered from high deficit covered by the state budget. Effective pension age was markedly lower compared to OECD countries (58.5 years for men and 55.9 for women). This is lower than the official pension age at that time (60/55) due to early pension opportunities for a number of professions.²² There are also «special» (privileged) pensions which are paid from the state budget.²³ Overall transfers from state budget to pension fund amounted to UAH 142.6 bn in 2016 (20% of total state budget expenditures — see Figure 11).

Figure 11. Pension Fund balance, per cent of GDP



Source: Pension Fund Budget, State Statistics Service

²² These professions were military, coal miners, teachers and some other. After 2017 reform, only military professions keep the right for early retirement.

²³ Again, in 2017 their scope was considerably reduced.

Population ageing is just one of the pension system problems. State Pension Fund revenues are undermined by the widespread practice of unofficial salary payments. This way employers pay lower taxes and employees receive slightly higher salaries. Among the reasons for this are overall low levels of trust to the government, high political and economic volatility. On the other hand, sometimes people are forced to accept informal employment arrangements if they want to get a job. This is a consequence of outdated labour legislation which makes it very costly to formally employ a person. As a result, Pension Fund does not have the money to pay pensions.

As for the voluntary pension savings, despite being introduced 15 years ago, this sector remains small, with total assets of UAH 2.8 billion (~USD 104 million), compared to the annual State Pension Fund expenditures of UAH 438.6 bn, and has low coverage. It was hit hard by the economic recessions of 2008-2009 and 2014-2015.

Introduction of Compulsory accumulative pillar was constantly postponed. The discussion of the second pillar recommenced since 2017.

To stabilize the pension system, in October 2017 the parliament passed important legislative changes to pay-as-you go system. First, the link between tenure during which a person made contributions to the Pension Fund and his/her old age pension was strengthened. The minimum tenure to be eligible for old-age pension increased from 15 to 25 years in 2018 and will gradually rise to 35 years by 2028. Although formally the retirement age remains at 60 for both sexes, those with lower tenure will retire later — at 63 or 65 depending on the duration of their employment.

The law also eliminated the majority of «special» (privileged) pensions, including those for public employees, MPs, prosecutors, journalists, scientists etc. Previously granted special pensions remained but they are not adjusted for inflation anymore. Therefore, the burden of these higher pensions will fade out gradually.

The reform also reduced the coefficient for tenure in pension calculation from 1.35% to 1% for each year in employment, so new pensions will become smaller. On the other hand, the law implied revision of current pensions based on the average wage over 2014-2016 and eliminated discrimination²⁴ of people who retired earlier. Further revision of pensions should be performed automatically every year by 50% of three-year average wage growth plus 50% of the annual CPI. The first revision was done in 2019. As a result, the law omitted significant

²⁴ The formula for calculation of a pension includes coefficient based on person's duration of employment, ratio of her salary to average wage in the economy during the respective time, and average wage in the country. But average wage used for calculation of pensions was not adjusted automatically — for example, before its increase in 2017, 2007 average wage was used. Thus people who retired earlier, other things being equal, had lower pensions.

increase in average wages in the beginning of 2017 when doubling of minimum wage drove an increase of average wages.²⁵

These measures helped to reduce the pension fund deficit, while overall disbursements from State Budget to the Pension Fund were reduced to UAH 150,0 bn in 2018 (15% of total budget expenditures), though the full effect of the reform will be evident only in the long run.

Apart from PAYG system changes, the law also foresees introduction of the second pillar of the pension system based on compulsory personalized contributions. As for now, the introduction has been postponed as important prerequisites for it are still missing. There are two alternative views toward realization of the idea.

The first idea is the decentralization model described in the [draft law](#) recently recalled. This model foresees compulsory contributions to private pension funds starting from 2% of the salary and gradually rising to 7%.²⁶ At the point of retirement funds thus accumulated are used to buy the annuity life insurance. An alternative [idea](#) was offered by the National Securities and Stock Market Commission. They suggest to pool all compulsory contributions into a single Savings Fund which will be managed by a competitively selected asset management company or several companies. Contributions will be paid independently of single social contribution to PAYG system, starting from 2% of labour income and gradually increasing to 10%. The Savings Fund will have supervisory board and administrative office. The head of administrative office will be appointed by the Supervisory Board. Unlike the other draft law, this model allows investment into foreign stocks and bonds.

However, the most important prerequisite for introduction of compulsory contribution pension provision lies not with pension laws but with other issues. This is the financial markets reform that would introduce much tighter and sophisticated oversight of asset managers (including private pension funds) and insurance companies. And certainly we cannot leave out the broader context of reforms such as property rights protection, judicial reform and others. Absence of these has been the main reason to postpone the introduction of the second pillar of the pension system (compulsory contribution scheme) as without it them the risks of money losses by pension funds are quite high. And if the government has to cover these losses, the burden on the budget will be even more substantial than today.

²⁵ In 2017, average wage was 37% higher than in 2016 in nominal terms and by 19.1% in real terms, which is the highest rate since 2005.

²⁶ Some market players [argue](#) for development of the decentralized model.

Trade Policy Reforms

Foreign trade is a driver of Ukraine's economic growth. A small open economy, the country is highly reliant on the international markets with the trade over GDP ratio being around 100%. The military and economic aggression of the Russian Federation created new challenges which called for trade growth and diversification to compensate for the loss of territories and external markets. We analyse key achievements and failures of the previous five years and define priorities for the trade policy making for the new government.

Key steps forward

Regional trade agreements: The launch of the deep and comprehensive free trade area (DCFTA) with the EU is the most ambitious trade liberalisation project Ukraine has ever implemented. For a vast majority of products, the country got duty-free access to the second-largest market in the world, while committing to gradually open its market for EU products and harmonise its trade-related legislation with that of the union as to reduce trade costs associated with non-tariff barriers to trade.

Export of goods to the EU has already intensified, reaching USD 20.2 bn in 2018, the absolute maximum since independence. Moreover, while total real exports remained depressed, real exports to the EU increased by more than 50% in 2013-2018. According to the IER [survey](#), 28% exporters and importers have already gained from the DCFTA, and 41% expect to gain within five years. Only 4% of respondents reported any DCFTA-related losses.

Ukraine also signed new free trade agreements (FTA) with Canada and Israel. Although the two countries currently account for a small share of Ukraine's total trade, they provide important sectoral opportunities. Moreover, Ukraine joined the Pan-Euro-Mediterranean Rules of Origin Convention (PEM) allowing for more liberal rules for the confirmation of the product origination status (so-called diagonal cumulation) in the framework of preferential agreements (PTA) signed by 50 member-countries of the PEM, including the EU, the EFTA, Israel and Turkey. Currently, Ukraine employs PEM rules of origin with the EU, and soon should start using them in trade with the EFTA, Israel, Georgia, and Moldova, but further FTAs with other PEM member-states should allow capturing more of the diagonal cumulation benefits.

Reforms in TBT/SPS regulations: Reforms of the industrial product safety, the so-called technical barriers to trade (TBTs), and food and related products safety, the so-called sanitary and phytosanitary measures (SPS), are in the heart of the EU-Ukraine DCFTA. They are also important for trade with other partners and for the development of the internal market, providing better safety protection and predictability.

According to a focus group interview conducted by the [3dcftas.eu project](https://3dcftas.eu), Ukraine has already demonstrated satisfactory progress in the implementation of its TBT-related commitments. All key horizontal (cross-sectional) legislation was passed, although its complete identity with the EU norms is yet to be achieved. About a half of the to-be-aligned technical regulations setting mandatory requirements of product safety have been already aligned with the EU directives. The same is true for about 60% of voluntary standards, including a large part of the so-called harmonised standards providing a presumption of conforming with the technical regulations. The country has also progressed in the development of the institutions for standardisation, accreditation, metrology and market surveillance. Still, the conclusion of the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), the «industrial visa-free regime», remains the major short- to medium-term policy goal requiring both legal and institution-building efforts.

The implementation of the SPS-related reforms has also moved forward. New laws regarding food safety, feed safety and state control were adopted, and the newly established State Service on Food and Consumer Protection has become an important player in the institutional architecture aimed at food safety enforcement. At the same time, Ukrainian producers of animal-origin products, the most demanding segment in terms of food safety, improved their access to the EU market: their number increased from about 150 in 2013 to about 400 in 2019.

Public procurement and foreign trade: Break-through reforms in Ukraine's public procurement not only affected fiscal parameters but also allowed the country to enter the international procurement market. In May 2016, Ukraine joined the WTO Government Procurement Agreement (GPA) and got access to public tenders of the member-states, including the EU, the USA, Japan, South Korea etc. Importantly, positive cases of the GPA tenders wins are already being [reported](#). While the GPA provides access to the EU public procurements at the level corresponding to the initial stages defined by the DCFTA, the latter allows for much deeper integration subject to completion of the harmonisation process. It requires further legal efforts, but also active cooperation with the EU partners on institutional structures under the Association Agreement (AA).

Trade in services: The new [law](#) on liberalisation of services exports (2016) removed major administrative barriers related to financial and accounting reporting and foreign currency operations for exporters, thereby reducing unproductive trade costs in the sector. The decision created new export stimulus especially for the ICT and professional services, growth of which accelerated to 28-29% per annum in 2017-2018.

Foreign currency liberalisation: The liberalisation of the foreign currency market launched in February 2019 gave another boost to Ukraine's foreign trade. Revision of economic sanctions for currency regime violations enabled a long-needed relief for the business.

Policy/institutional framework: The Government strengthened policy and institutional frameworks for trade policy development and implementation in Ukraine. In late 2017, after

several years of extensive discussions and consultations with stakeholders, the Export Strategy for 2017-2021 and the associated action plan were [adopted](#) setting clear-cut policy priorities and targets and defining means for their achievement. Moreover, six sectoral export strategies are currently in the pipeline as to pinpoint the priorities and challenges of the industry-specific export promotion.

Another positive step was the establishment of the Export Promotion Office as the public body responsible for export promotion and facilitation. While exporters are largely [positive](#) about the EPO activities, it still lacks capacity and wider awareness about its activities.

Main policy challenges and further plans

Customs reform: Although introduction of the one-stop-shop approach at customs and establishment of the State Customs Service as a separate state entity are important steps forward, many more vital aspects of the customs reform persist. Launch of the authorised economic operators institute, adoption of transit-related conventions and establishment of the common transit monitoring system, implementation of the commitments adopted under the recently launched [WTO TFA](#), and the major overhaul of the customs administration are among the things on the to-do list.

Establishment of the ECA: While setting up the export credit agency (ECA) has been a much desired institutional development, the current design of the ECA is quite dubious. Some of the main concerns are that the respective law stipulates that ECA's support can be extended only to certain industries, the list of which seems to have been compiled arbitrarily and thus bears a risk of corruption and rent-seeking. The support liability requirements are rather fuzzy and are not in accord with the norms of the law on the provision of state aid to economic entities. Moreover, there is a risk that in certain cases the mechanism of partial compensation of interest rate on export credits could be interpreted as a prohibited export subsidy practice under the WTO rules. On top of such issues, the agency's budget is rather limited, and it remains to be seen just how effective the institution can be under the constraints.

Protectionist measures: Probably the most debatable case of Ukrainian protectionism is the ten-year ban on export of all unprocessed wood (wood logs) imposed in 2015 in addition to the permanent ban on exports of sawn wood effective since 2005. Initiated in the parliament, the law aimed to support domestic producers, such as the furniture industry. However, it had a dubious effect due to remaining legislation loopholes and increased smuggling practices. At the same time, the moratorium countered Ukraine's international obligations: stalled EUR 600 mn of the macro-financial aid from the EU and landed the country in the formal dispute settlement [procedure](#) under the EU-Ukraine AA.

Another protectionist step is the increase in export duties on metal scrap. The decision contradicts Ukraine's WTO commitments and is potentially actionable through the WTO trade

dispute settlement mechanism. However, its impact has been truncated as it does not affect Ukraine's FTA partners.

Conclusions and recommendations

The DCFTA gave a boost to the EU-Ukraine trade, however, it is far from reaching its potential level. One of the reasons for this is the non-tariff barriers. Therefore, the government should persist with the ongoing legislation, standards and processes harmonisation efforts in TBT/SPS spheres, including the conclusion of the ACAA. It is hard to catch up with the EU regulations that undergo further changes, therefore no time should be lost.

As for the FTAs Ukraine has concluded to date, it is advisable to make an impact assessment of their potential extension to trade in services, and launch respective talks if found plausible. The effect of the Export Strategy should also be evaluated and possibly adjusted given the changing international trends.

Concluding new FTAs and PTAs should be employed as to further promote Ukraine's international trade. It is advisable to prioritise the most promising markets. The Foreign Trade Research Center Trade+ at the KSE updated and narrowed down the list of «markets in focus» set forth in the Export Strategy. Out of the identified top-twenty most promising markets, Ukraine does not have FTAs with nine: the USA, Qatar, Japan, China, Mexico, South Korea, Vietnam, Hong Kong and Singapore. Prior to engaging in any negotiations with either of the identified markets, however, more detailed analysis of individual markets should be performed.

The government launched FTA negotiations with Turkey, a member of the PEM and Ukraine's large trade partner. Ukraine is interested in the Turkish agricultural market, which is highly protected, and should aim to access it in addition to the preferential access it got to the manufacturing products market thanks to the EU-Ukraine DCFTA and Turkey-EU customs union on manufacturing products. The scope of the future agreement should thus be carefully drafted considering the importance of the duty-free access to Turkey's agricultural market.

Continuing and strengthening the efforts in reforming customs, as well as transforming ECA into a fair and actionable mechanism are crucial steps in supporting and boosting the country's foreign trade. It is also necessary to eliminate the protectionist measures adopted in violation of the country's international commitments, as to signal that Ukraine is a reliable and predictable international trade partner and thus stipulate investment.

/3 SECTORAL REFORMS

Energy Markets

Until 2014, Ukraine suffered from chronic non-market distortions in the energy market which have largely caused public finance crisis in 2014-2015 on the background of the armed conflict in Eastern Ukraine and the annexation of Crimea.

Among the main problems at the time were:

- cross-subsidization (low tariffs for households, high tariffs for industrial enterprises),
- monopolization of the sector with a weak regulator,
- lack of measuring devices (except for electricity) in the majority of households,
- negligible investments into infrastructure (significant energy losses on the way from producer to consumer),
- subsidies to the chronically loss-making coal industry, and others.

Problems on the gas market contributed the most to the rise of government debt. The state basically subsidized the whole population through Naftogaz by keeping tariffs low. Losses from buying gas at a high price and selling it at a low price were a burden on the state-owned company. As a result, by the end of 2014 Naftogaz deficit reached the level of 5,3% of GDP — higher than the state budget deficit.

Ukraine approached the problem in two dimensions. First, the corporate management reform at Naftogaz and creation of an independent supervisory board, which made a successful standoff against the Gazprom in the Stockholm arbitration court possible.

Second, the new Law On the Natural Gas Market liberalized this market, aligning it with the demands of the European Energy Community. It actually destroyed the monopoly of the oblgases (regional gas distribution companies): network management business was separated from trading, allowing new players to enter the market. As an illustration, consider that competition on the natural gas procurement market in Prozorro is one of the highest among all the markets — 2.9 participants per tender against the average of 2.3.

The reform continues. For example, just in 2019 monthly balancing of natural gas market was replaced by the daily one. This enhances transparency and competitiveness of the gas market. Monthly balancing caused numerous manipulations and abuses, related among other to the difference in the price of gas for domestic and industrial consumers. Now, demand and supply of natural gas are cleared every day and the price is adjusted accordingly.

Another important development of 2019 is synchronizing the work of the Ukrainian gas transit system (GTS) operator with European operators.

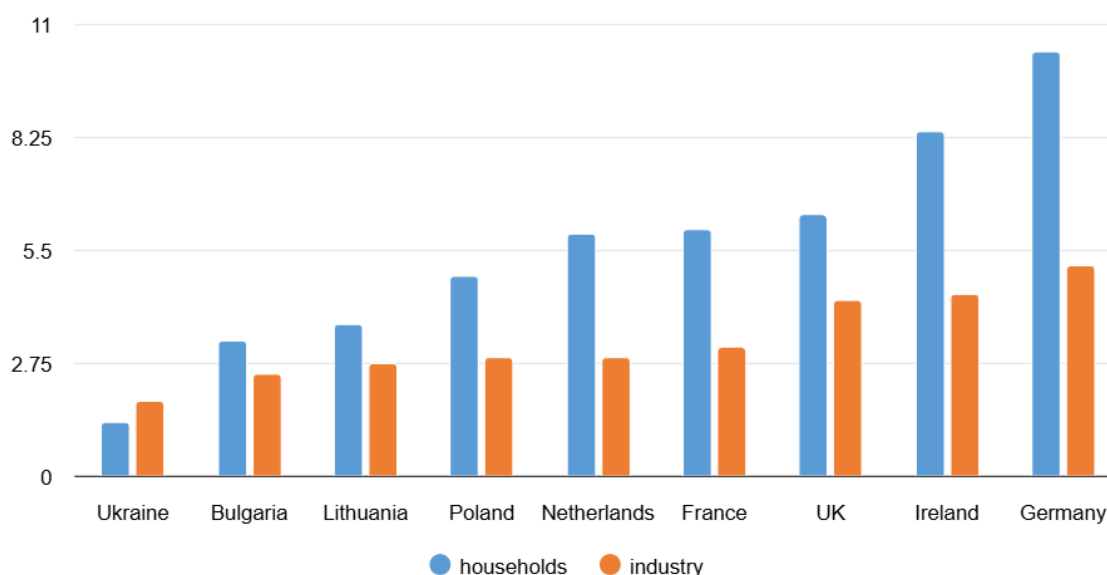
However, gas market reform is still incomplete. From the very start there was no competition in district heating provider segment and, accordingly, in the segment of gas consumption by the population. Full market liberalization would imply rising gas prices for the population if world gas prices rise. Therefore, development of an effective subsidy system would become more urgent. Yet, monetization of subsidies that would create incentives for energy savings started only in 2019, five years after the reform was launched and subsidies were introduced to protect the poor population from tariff increases. In 2018 — first half of 2019, market price of gas was almost 1.5 times higher than the tariff for district heating companies and population. Naftogaz still has to supply gas at a lower than market price according to the Cabinet of Ministers Resolution on the Provider of Last Hope (Public Service Obligations, PSO).

The upcoming 2019/2020 heating season makes the completion of the four-year reform possible. Since the summer of 2019 market prices for gas have fallen to levels even lower than those stated in the Cabinet of Minister Resolution on PSO. Natural gas prices in Europe have fallen to a ten-year minimum and continue to decline, as suppliers do not intend to reduce supply, [Bloomberg](#) reports, citing energy traders. This opens a window of opportunity for the government: population won't even notice the price liberalization.

The same goes for the electricity market, which has just started its transition to deregulated one in summer 2019, according to the Law on Electricity Market adopted in 2017. It has the same potential risks of rising household tariffs. In Ukraine electricity tariffs both for households and industrial consumers are [the lowest](#) in Europe. However, the major

difference is that in Ukraine household tariffs are 30% lower than tariffs for other consumers, while in Europe household tariffs are 25% to 250% higher (Figure 12).

Figure 12. Household and non-household electricity tariffs in selected European countries in the first half of 2018, UAH/kW-hour



Source: National Commission for Regulation of Energy and Communal Services

*household tariffs include taxes; industrial tariffs exclude VAT and other refundable taxes

** We used the exchange rate of the National Bank for the first half of 2018: 1 EUR = 32,42 UAH

At the moment the household consumption segment is not included into the newly created market: households receive electricity at fixed tariffs established in 2017. While on the gas market special obligations (PSO) are imposed on Naftogaz, in the electricity market the losses are assumed by state-owned Energoatom and Ukrhydroenergo.

The half-hearted approach observed in gas and electricity market reforms is found in other areas of the energy market too. For example, in 2019, green tariff auctions were [introduced](#) but their actual launch is delayed for 3-4 years.²⁷ Subsidies for energy consumption monetization are only partially implemented and depend on the quality of registers and consumption accounting. Auctions for the sale of rights for the development of natural

²⁷ In Ukraine, 'green' tariffs are the highest in Europe which attracted much investment into the green energy facilities and provided investors with rather high profits. However, cost of green power generating facilities (e.g. solar panels) is falling dramatically. Hence, the government introduced 'green' auctions - an investor who wins the auction by promising the lowest green tariff is granted the right to construct a generation facility, while the government fixes this tariff for this investor for the next 20 years.

resources (including oil and gas) began in late 2018 after the most interesting sites were distributed without any competition.

Some reforms didn't even start. RAB regulation projects on the electricity distribution market have not yet been implemented, which does not allow to solve the problem of depreciated power grids; there still cross-subsidization of households at the expense of the industry which distorts the markets; payment for the use of gas networks is yet to be introduced, subsidized coal industry remains unreformed, and the unbundling of Naftogaz (separation of gas transmission network) is not completed.

While these issues remain unresolved, new challenges arise. The main case of concern is termination of Russian gas transit through Ukraine since 2020 and a potential loss of about \$3 billion (or about 3% of GDP) a year — unless we sign a new transit agreement with Gazprom, which Naftogaz officials consider highly unlikely. This threat requires mobilization of efforts far beyond the energy sector. One of the solutions can be quick implementation of the [Trilateral agreement](#) signed at the end of August 2019 during President Vladimir Zelensky's trip to Warsaw. The agreement envisages supplies of liquefied natural gas from the US to Poland and Ukraine, the use of Ukrainian underground gas storage facilities (UGS) and the enhancement of gas infrastructure. This is largely political rather than economic issue and it depends on the improvement of Ukrainian-Polish relations.

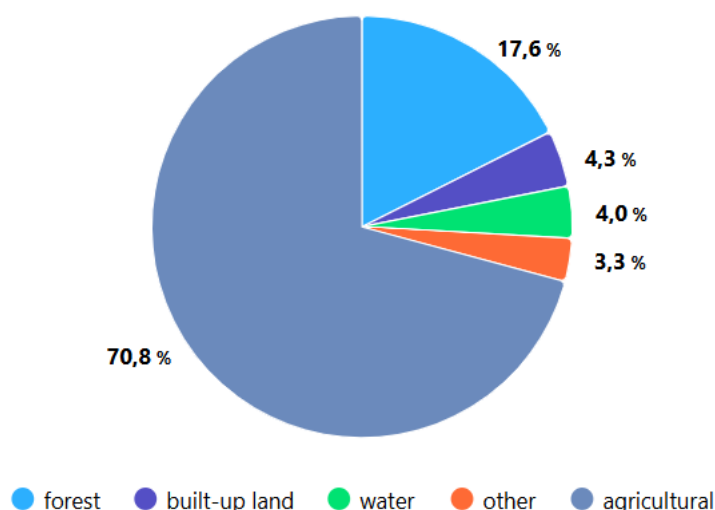
Strategy For Land Reform In Ukraine: 2019-2024

Since 1991, Ukraine is implementing one of the longest land reforms in the modern history. It has transferred to private ownership about 31.5 mn ha of land, established about 7 mn new land parcels and an infrastructure for land market. However, the reform remains unfinished as sales transactions for about 41 mn ha are restricted, which violates the constitutional rights of about 7 mn private land owners, limits access to finance, productivity growth and tax revenue in rural area. This and some other distortions are a source of corruption, which prevents sustainable development in Ukraine and are the target for the next stage of land reform.

Background and earlier reforms in the land sector (before 2014)

Ukraine has some of the best endowments of land resources in Europe. Out of the total territory of 60 mn ha, 42.7 mn ha (70.8%) are agricultural land (see Figure 13) with some of the most fertile soils. Another 17.6% of territory are forests and 4.2% are built-up areas. Land is one of the key resources for rural and urban development. If used effectively and sustainably, it could boost economic development and well-being of population, stimulate investments and productivity growth in agriculture and several other sectors. However, this growth is held back by multiple sources of inefficiency which are the targets of land reform.

Figure 13. Land use types, million ha



The land reform started in 1991 with transfer of property rights and management of land from the state to collective farms (in case of agricultural land) or to local governments (in case of urban land) and then to private individuals. The goal was to establish lease and sales markets for land and a relevant market infrastructure. As a result, 6.9 mn rural residents (about 16% of total population) have received about 27 mn ha of agricultural land (about 45% of the total territory) in private ownership by parceling out the land of former collective farms. About 4.5

mn ha of land of other designated use types were privatized by decisions of local governments. By 2017, about 52.2% of land were transferred to private ownership while about 28.8 mn ha (47.8% of total) remain in state or communal ownership (of them, about 10.5 mn ha of agricultural land). However, starting 2001, the rights of individual owners to dispose of private land were constrained by the [moratorium](#) on sales of agricultural land. In 2018 the European Court for Human Rights has [recognized](#) the moratorium as a violation of property rights. The moratorium has also affected state and communal land.

A big step in the development of land market infrastructure was establishment in 2013 of a unified electronic State Land Cadaster linked to the Registry of Rights. By 2017, the State Registry of Rights recorded about 2 mn transactions per year with agricultural land, and more than 0.2 mn transactions with non-agricultural land. About 76% of transactions with agricultural land are leases, followed by bequests (18%) and sales²⁸ (3.1%). For non-agricultural land, 36.8% of transactions are sales, followed by bequests (26.8%) and leases (19.2%). Mortgage transactions are almost non-existent.²⁹

As the moratorium distorts the sales market for agricultural land, most of the private agricultural land is leased out. Currently, about 4.7 mn private owners (70% of the total number) lease their land to agricultural producers — total size of the formal lease market is about 17 mn ha. However, the lease market for agricultural land is distorted as well by imposition of 7-year minimum length of lease, which causes the short term leases to stay informal. These distortions result in the allocation inefficiency for agricultural sector, limit access to finance as land cannot be used as a collateral, reduce incentives for investments and sustainable use of land and reduce the lease and tax revenue and value of assets for the land owners. Moreover, a non-transparent use of state and communal land and multiple conflicts of interests in management of public land (28.8 mn ha including 10.5 mn ha of agricultural land are affected) result in corruption, lost budget revenue, inefficient and non-sustainable use of land resources. These issues should be the primary focus of land reform in 2019-2024.

Steps in land reform that were implemented during 2014-2019

The progress with land reform in Ukraine was [assessed](#) by the World Bank in 2012-2013 using inputs from leading Ukrainian and international experts. This analysis was followed by development of a «Single and Comprehensive Strategy and Action Plan for Agriculture and Rural Development in Ukraine for 2015-2020» ([Strategy 2015-2020](#)) by the Ministry of Agrarian Policy and Food. This strategy has identified land reform as one of the key priorities

²⁸ About 3 mn ha of private agricultural land are not affected by the moratorium (e.g. land for individual subsistence farming, gardening).

²⁹ For more information on structure of land market see Land Governance Monitoring [reports](#) and media [publications](#).

for strategic development of Ukrainian agricultural sector and rural areas. Despite the fact that the strategy was not formally adopted by the Government, six out of 15 proposed reforms were implemented partially or completely and progress was made along several other dimensions. Besides, on April 3rd 2017, the Cabinet of Ministers adopted a mid-term [Priority Action Plan](#)-2020, which has a significant overlap with the Strategy 2015-2020 and was used by Government as a formal reference point for development and adoption of annual plans.

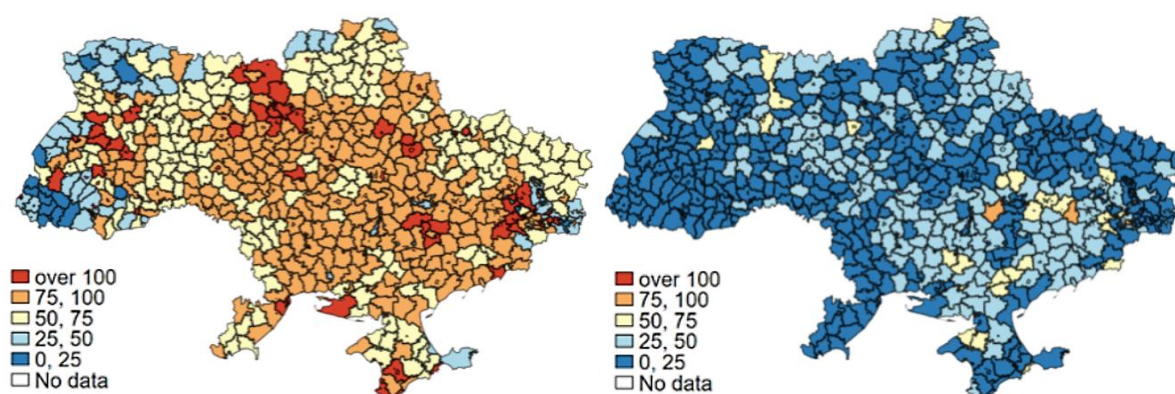
As a result, the following steps were implemented by the Government and other stakeholders during 2014-2019:

- In 2018, the Government has registered and transferred to the ownership of amalgamated territorial communities close to 1.5 mn ha of state agricultural land. This process continues in 2019;
- Numerous e-services were introduced by the State Geocadastre and the Registry of Rights, which reduced time for service provision, improved transparency and lowered corruption;
- Data exchange between the Cadaster and Registry of Rights was established; and procedures for mandatory check of background information before the land transactions were introduced by the end of 2018;
- Starting March 2015, notaries and several other categories of legal service providers have received an authority to register the rights for land and real estate in the State Registry of Rights. Prior to that, the registration was performed only by the state registrars causing significant delays and being a source of corruption. This step was augmented by establishment of Anti-raider Commission and further improvements of registration infrastructure.
- In 2018, State Geocadaster has undertaken an effort to correct errors in the Land Cadaster which do not require re-surveying or court decisions. The information on several types of remaining errors is now publicly available in the online cadastral map. However, this process remains unfinished.
- Starting 2013, auctions for selling rental and ownership rights for state and communal land were introduced. In 2015, the auction became mandatory which led to a significant increase in the land prices and budget revenues. Since fall 2018, State Geocadastre experiments with introduction of e-auctions based on Setam and Prozorro.Sales platforms.
- The legal status of unclaimed inheritance and of land of former collective enterprises was recognized by law in 2017 and 2018 respectively.
- Transparency and access to information on land and related rights were improved by adopting the relevant normative base and infrastructure (including establishing public cadastral map). Regular monitoring of land governance based on administrative data of 6 central government authorities was established by the Cabinet of Ministers resolution #639. State Geocadastre started regular publication some of the key statistics on its activity (www.land.gov.ua).

- Public awareness campaigns on property rights protection and land market operation were implemented with the support of international donors. A coalition of stakeholders of land reform was established in 2018 to assure that land reform remains on the political agenda and to keep the Government accountable for progress.
- A concept and several versions of law proposals for opening the land market were developed by the Members of Parliament and Government and were discussed at various committees, workshops and round tables.
- A gradual process of land registration continued through 2014-2019. As of the end of 2017, State Land Cadastre had registered 86% of private and 22.3% of state land. For regional distribution see Figure 14.³⁰

Despite the above listed moves in the right direction, several steps that slowed down the land reform were made by the Parliament under the influence of populist and lobby groups. Among them were several extensions of the moratorium and introduction of 7-year minimum term for the lease agreements for agricultural land.

Figure 14. The percentage of land area registered in the SLC for private land (left) and state-owned (right) as of December 2017



Source: Land Governance Monitoring Report, 2016-2017

The ultimate goal of land reform

As it was mentioned earlier, the land reform remains unfinished. However, the set of next steps and priorities among them depend on the reform goals in general and at its current stage. Given the key issues mentioned above, the land reform 2019-2024 would target:

³⁰ This Figure also demonstrates the effect of errors in Cadastral data, where more than 100% of territory is registered

- Increasing productivity of land use, providing equal protection of rights and equal access to land market and necessary financial resources to all land owners and land users;
- Improving sustainability of land use and resilience to climate change;
- Increasing transparency of land use, access to information, and preventing corruption.

An alternative set of goals is also feasible, e.g. supporting the decentralization process and building capacity of local government; reducing poverty. However, the alternative goals would lead to different priorities among the reform activities.

Strategic priorities for 2019-24 and expected results

To target the above goals, the priority actions for land reform in Ukraine for 2020-2025 would include:

1. Opening market for agricultural land: Lifting the moratorium would restore the property rights of land owners, reduce risk to investments in agriculture and would provide for allocation efficiency, investment and productivity growth. Secure land market would also stimulate investment in climate change mitigation technologies such as irrigation. It will replace the current informal market and reduce corruption. However, in order to achieve these goals the design of land market should take into account the following issues: (i) potentially excess supply as for 18 years owners could not dispose of their property; (ii) inequality in access to finance and a risk of land ownership monopolization. Alternative models and market parameters are actively [discussed](#) by experts and Government.
2. Restructuring the State Geocadastre: Currently, the Law on Land Cadastre and the Resolution on State Geocadastre include multiple conflicts of interests which are a source of corruption (no matter what people would manage this organization) and reduce incentives to implement land reform. Some of the key problems are listed below along with their suggested solutions.
 - 2.1. Problem: Monopoly in access and asymmetric information on the status and properties of registered land parcels and territories. Geocadastre provides paid access in a very restrictive format to a selected group of users. This limited access to information allows Geocadastre and affiliated businesses to collect rent on information and increases cost to the land owners. It also controls the market for land survey services and limits the competition, slows down development of cadastral system (e.g. error correction, registration). Restricted access to information allows to cover up potential illegal activities by land surveyors, registrars and other authorities regarding land allocation, tax collection, execution of court decisions, etc.

Solution: Provide an open access to cadastral information (including coordinates) in machine readable format for multiple parcels and territories subject to protection of personal and sensitive information for all categories of users. This step can be complemented with establishment of infrastructure for geo-spatial data accumulation, access and processing.

- 2.2. Problem: Geocadastre develops policies and procedures for land survey and valuation services, orders implementation of such work using budget funds, assesses quality of such work, but also implements land survey (inventory), valuation and related project using about 50 state land survey institutes and enterprises. Most of the work performed by such state enterprises can be performed by the private sector. This combination of functions restricts competition and crowds out private sector in the areas of land survey, cadastral work and valuation, leads to corruption and collecting rent, limits the use of competitive procurement procedures and abuse of budget funds.

Solution: Privatize state land survey institutes and state enterprises

- 2.3. Problem: The authority over management, registration and control over the use of state agricultural land (about 8 mn ha out of 10.5 mn.ha) belongs to the same authority — Geocadastre. This creates incentives for corruption in providing access to land, implementation of inventory of this land, in providing information about it. As a result, budget revenues from the use of state land falls and funds for inventory of such land could be abused. Corruption over management of state land can not be effectively eliminated.

Solution: Accelerate the process of transfer of the state agricultural land, which is not under state-owned enterprises, to the ownership of local communities (amalgamated communities). Auction out agricultural land in areas where the amalgamated communities are not established.

- 2.4. Problem: training, accreditation (licensing) of land surveyors, auctioneers and valuers (including approving the membership of professional qualification committees), distribution of work orders for state land, providing access to information and assessment of work is done by the same institution — Geocadastre. It creates incentives for gaining rent on accreditation process and limits competition in the sector.

Solution: Transfer the accreditation function to professional associations. Establish professional quality insurance.

- 2.5. Problem: The right to initiate inventory of land belongs to the owner of land (including owners and designated managers of state agricultural and non-agricultural land). This creates incentives to avoid inventory and registration with the purpose of tax evasion and non-transparent management of state land. The results are reduced budget revenues, informal use of state land and corruption.

Solution: Provide the right to initiate land inventory to local governments, which would increase tax revenue. Establish in the Land Cadastre a special

status for land parcels which were registered by local governments in a process of inventory with a clear authority and procedures for local governments to become custodians for such land before the legitimate owners are identified and registered their rights.

- 2.6. Problem: Currently, only the state cadastral registrars can enter information into the Land Cadastre, which creates a bottle-neck in cadastral registration and error correction process.

Solution: Provide to certified land survey engineers rights to enter information to the Land Cadastre (which would be followed by the quality check by the Land Cadastre).

The proposed restructuring would leave Geocadastre with technical functions for maintenance of the Land Cadastre system and maintaining the unified standards for cadastral work.

3. Stop the practice of free land privatization: The Land Code-2001 (articles 116, 118, 121) and the Law on Private Farming (2003) provide the right for free privatization of land to all citizens of Ukraine. Such provision is not sustainable since land resources are limited and, jointly with restricted access to information, leads to corruption. This norm should be revised.
4. Restructure the Land tax and provide an open access to information on tax revenue for each registered parcel: the current system does not provide incentives for productive use of land as the normative value is not based on market prices, tax rates are too low and there are multiple ways to evade tax, which makes enforcement of tax collection not effective and distorts the market.

The following actions can augment the above strategic changes:

- Establishing a partial credit guarantee agency for small producers to facilitate the use of land as a collateral and to improve access to finance.
- Establishing a Land Ombudsman to coordinate efforts for protecting land related rights and respective legislative changes, which can be coordinated with the results of the Ant-Raider Committee activities.
- Upgrading capacity of State Free Legal Aid system to protect rights of land owners, land users and local governments.
- Establishing legal base and procedures for selling ownership and rental rights for land via e-auctions.
- Providing for mandatory recording in the Registry of Rights and publication of information on contract prices for land and real estate;
- Completing inventory and registration of rights for state and communal land;
- Improving procedures for systematic error correction and inventory of land and completing registration of land parcels with cadastral numbers but no technical documentation;

- Establishing legal base and responsibility for land governance monitoring (regular publication of key administrative data);
- Transferring state land which is in the permanent use of farmers since 1990s into their private ownership.

Implementation of the above activities should be complemented with an active communication campaign, which would increase public awareness and support of the land reform. The communication should be accompanied by regular public opinion surveys on the level of protection of land related rights. An example of such survey is Property Right Index ([Prindex](#)), conducted in Ukraine in 2019 (results will become publicly available by the end of 2019), which can be used to monitor the progress with further implementation of land reform.

Privatisation

History and background

Ukrainian history of privatisation looks like a never-ending story of losses with only a few remarkable successes.

The major wave of mass privatisation in the 1990s was executed by preferred share allocation and voucher privatisation mechanisms. It helped create a class of oligarchs rather than entrepreneurs and responsible owners and left a perception of unfairness among the population.

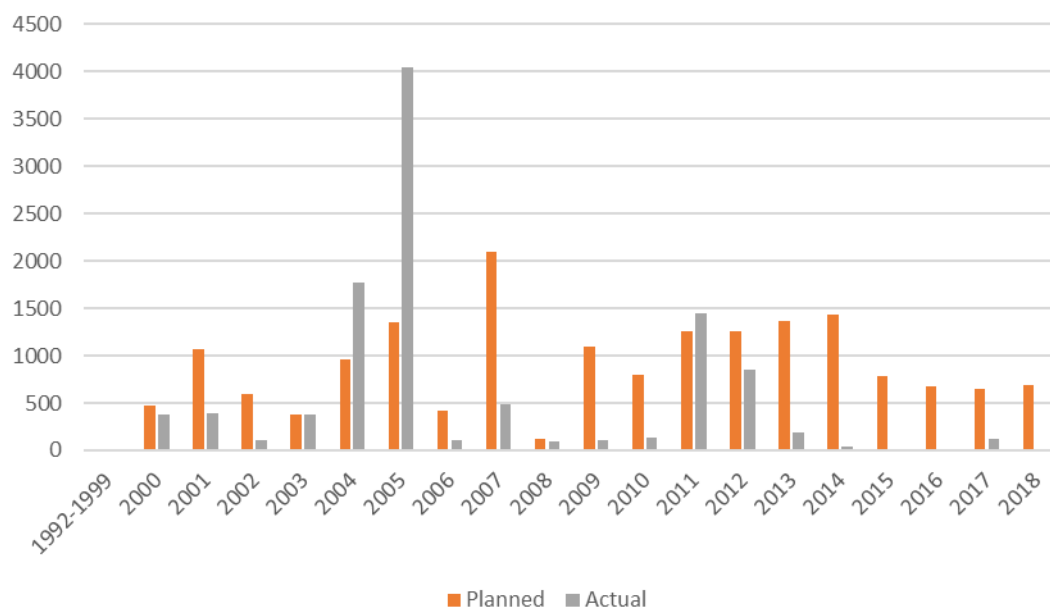
In October 2005, the largest Ukrainian steel mill Kryvorizhstal was [re-privatised](#) for a record amount of \$4.8 billion at a starting price of \$2 billion. However, it has been the most successful case yet. Although privatisation was taking place in the years to follow, it was mostly opaque and with limited competition.

Ukrtelecom, the largest state-owned enterprise (SOE) privatised in recent years, [was sold](#) for \$1.3 billion in March 2011. The litigation is ongoing as the state is trying to take the company back due to the violation of investment obligations taken by the new owner.

Hope to change the situation came about after the Revolution of Dignity. The new government has called for accelerated reforms, including privatisation. However, despite the plans to attract UAH 17 billion to the budget from privatisation in 2014, that were then carried over year after year until 2018, the implementation of the budget revenue plan was a [failure](#) and ranged between 1 and 3% (Figure 15).

2017 was an outlier with privatisation revenues reaching UAH 3.4 billion. These revenues were almost wholly [obtained](#) from the sale of minority stakes in the five power distribution companies to the [richest](#) person in Ukraine Rinat Akhmetov who already [owned](#) the majority stakes in them.

Figure 15. Privatisation in Ukraine: planned and actual revenue (USD mln)



Source: State Property Fund, State budgets

Recent developments

The Revolution of Dignity of 2014 raised the expectations that more enterprises would be privatised as transparently as the Kryvorizhstal back in 2005. However, the major companies' privatisation attempts have been [blocked](#) either by vested interests of the incumbent management or by the oligarchic lobby.

In 2016, the Ministry of Economic Development and Trade (MEDT) included 3445 enterprises in the triage list. Today the number of enterprises in triage has decreased to 3243 (due to small-scale privatisation and liquidation), and its structure has [changed](#).

In 2018, the «[Basic Principles](#) of Implementing Ownership Policies for Public Sector Entities» were adopted. According to these principles, SOEs with majority state ownership should develop 'ownership policies' defining the rationale for state ownership over these enterprises and their operational goals.

In March 2018, the new privatisation [law](#) came into force. It simplified the classification of assets to privatise (instead of 6 groups dividing them into just two — «large-scale» and «small-scale» privatisation with clear sets of procedures).

Small-scale privatisation proceeds via the state-owned Prozorro.Sale electronic bidding platform since August 2018. It can be considered a success with 1 142 auctions that brought UAH 570 mln to the state budget and 910 mln to local budgets over the first year of activity. As of now the share of successful auctions constitutes 40,9% of all auctions (due to the [low](#)

[number](#) of bidders), and the majority (61%) of auctions were [organized](#) by local councils rather than by the State Property Fund.

For the large-scale privatisation, the law enabled application of the English law to privatisation agreements and also allowed State Property Fund to attract professional investment advisors. Large-scale privatisation had been blocked in courts at different stages until recent positive developments (e.g. the claim for termination of the contract with the investment adviser for President-hotel was [dismissed](#) and bankruptcy proceedings for Centrenergy were [closed](#)). It might be connected with the recent political shift.

Two state-owned banks (SOBs) — Ukrgasbank and Privatbank — should be privatised by 2020 and 2022 respectively according to the government SOB [Strategy](#). The government also plans to sell 45% of Oshchadbank, of them 25% via an IPO. SOBs — both intended for privatisation and those remaining in the state ownership — have been introducing proper governance structures. The process is to be completed during the next year or so. Corporate governance reform is an important milestone in preparation of SOBs for the privatisation and private capital injection. Despite government plans, we [argue](#) for complete rather than partial privatisation of state-owned banks.

Policy problem and reform goals

Ukraine's economy is held back by more than three thousand of state-owned enterprises. The majority are inactive or loss-making. They are on average [less profitable](#) than private firms. They are also the major recipients of state aid in the form of recapitalisation and loans from the state-owned banks.

Furthermore, the SOEs are a source of corruption. In our view, [the most effective way](#) to deal with corruption is 100% privatisation of state-owned enterprises.

Privatisation is one way of attracting strategic [foreign](#) investments that can bring new production and management technologies to enterprises and raise their efficiency.

To facilitate privatisation, the following policies should be enacted:

- Active involvement of foreign investors into privatisation.
- Reducing the level of information asymmetry by involving independent investment advisers.
- Linking the system of financial and non-financial incentives (KPIs) of SOE top management to preparation of SOEs for privatisation — to prevent them from sabotaging privatization efforts.
- Priority privatisation of enterprises operating in competitive markets.
- Zero state share in privatised enterprises.

Potential future policies

The triage list from 2016 should be updated according to the newly created ownership policy legislative framework. It is necessary to repeal the [Law](#) «On the List of Objects of State Property that are not subject to privatisation» and at the same time dismiss the criteria for exclusion from privatisation described in the [Law](#) «On Privatisation of State and Communal Property».

Instead, an expert commission of members of different parliamentary factions, the public, and international financial organizations should be set up to review draft ownership policies of all state-owned enterprises and define which ones should inevitably remain in the state ownership. The rest of enterprises should be privatised. SOE ownership policies should be subject to regular reviews which can reconsider the rationale for remaining in the state ownership.

Ownership policies can include plans for reorganization, partial or complete privatisation of the SOEs.

Enterprises ownership policy of which is approved must be transferred to the centralized institution for public property management.³¹ This institution should implement state ownership policy and at the same time isolate state assets from the political influence and manage them for the benefit of the society.

According to the [principles](#) of ownership policy which should be implemented:

1. The following should remain in state ownership:

- natural monopolies for which no special privatisation conditions have been developed;
- entities that are vital for the national security or carry out other socially important activities that cannot be fully provided by private firms.
- OECD [Principles of Corporate Governance](#) and OECD Guidelines on [Corporate Governance of State-Owned Enterprises](#) should be applied in the management of the

³¹ There are three layers of corporate governance - owner, supervisory boards, executive management. Currently the reform covers mainly the second layer - creation of independent supervisory boards. We also suggest considering changing the first layer - transfer ownership function from ministries or the government to centralized ownership entity. Ministries now often have a conflict of interest - they may perform ownership, regulatory and policy functions at the same time. In our view ministries should focus on policy function. Regulatory functions (topical for monopolies) should be given to independent regulators. Ownership function can be delegated to centralized ownership entity.

state-owned enterprises; in particular, supervisory boards should be established with a majority of independent members.

2. Remaining enterprises should be privatised, transferred to a public-private partnership (e.g. concessions) or liquidated.

Equal rules of the game for private and public companies must be established. The state should neither create preferable conditions for SOEs nor complicate their business. Preferable conditions may include tax rebates, subsidies, special conditions on loans etc. Complications may result from additional unjustified bureaucratic and controlling procedures, limitations on asset management.

Public Procurement

Progress during 2014-2019

Public procurement reform is an example of transformation of a volunteer project into one of the most prominent [reforms](#) conducted in recent years in Ukraine. Introduction of the Prozorro system brought transparency to public procurement sphere which previously was intensively used for rent-seeking and significantly increased its efficiency. This fact [is recognized](#) both by Ukrainian procurement entities and Ukrainian companies. The reform was acknowledged by the global community as well: Prozorro received many international awards, including the [World Procurement Award](#) in 2016.

The reform started in 2015 when the Parliament approved the law «[On public procurement](#)». The law radically changed the public procurement procedures. The most significant change brought by the law was the launch of the electronic procurement system Prozorro. No less important were introduction of public procurement professionals — people responsible for conducting procurements (in fact, since that time a procurement officer was recognized as a distinct profession) and the notion of a centralized procurement entity (such an entity can accumulate demand from several public entities and conduct the tender for them).

The Prozorro improved public procurement system via two main channels:

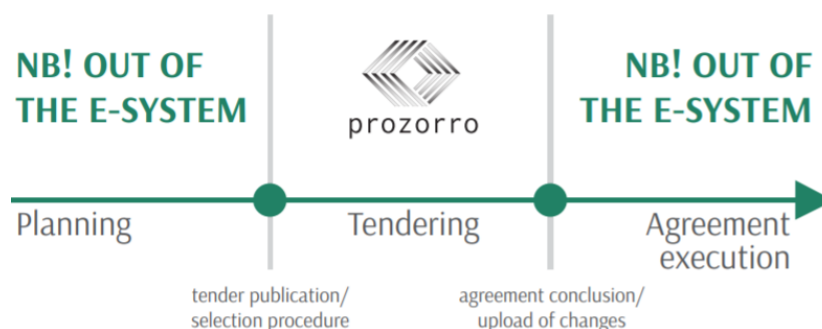
- digitalization of the process (this considerably simplified the tender process and reduced the room for 'human factor' prone to corruption);
- data availability (anyone can analyze the Prozorro data and find out whether there was a fraud).

Although the Prozorro system doesn't cover the whole procurement process (figure 16), it still accumulates the information from other stages and affects them.

The benefits of using electronic tools in public procurements are well known, and the Ukrainian case is no exception:

- additional saving for both procuring entities and tender participants;
- simplified participation in tenders for all companies, including small ones;
- simplification of the procurement process as well as a reduction in its duration;
- increased transparency;
- greater innovation and developing new tools.

Figure 16. Procurement process and Prozorro place in it



Source: Prozorro

Since the launch of the new system in 2015, 36.5 thousand public entities conducted about 3 million procurements with total initial value of about UAH 1.7 trillion. These entities were able to save almost UAH 87 billion (where savings are defined as the difference between initial/expected price and final contract price). One study [shows](#) that introduction of Prozorro resulted in additional 3.5-5.8% of savings for above-the-threshold³² tenders compared to the previous system.

As for now, more than 200 thousand companies participated in public procurements. Of them, 87 thousand participated in competitive tenders — on average 2.3 participants per auction. Introduction of Prozorro significantly increased diversification of suppliers. Average number of suppliers per procuring entity increased from 3.4 in 2012-2015 to 5.9 in 2017-2018. All the markets analyzed by the Centre for Excellence in Procurement at KSE (e.g. fuel and medicines) became more diversified.

Electronic system changed the way of communication between procuring entities and potential tender participants. It is now much easier to submit a question on a particular tender and receive a response to it. Even though the response is mandatory only for above-the-threshold tenders, by answering questions a buyer [increases her chances](#) to successfully complete the tender.

The official motto of Prozorro team is «Everyone sees everything». It highlights the huge amount of information that became available for anybody who is interested in it. Companies can easily analyse their markets and identify new opportunities. Procuring entities can use the data to raise their efficiency. NGOs use the data to monitor public procurers and identify potential cases of inefficiency or even corruption.

³² The threshold is UAH 200 thousand for goods and UAH 1.5 million for works. For procurement above the threshold, a Prozorro auction is mandatory, for smaller purchases desirable.

Machine readability of Prozorro data fostered creation of new electronic tools based on these data. Some of the tools help monitor public procurements, others support public entities in their procurement activity. Some of the tools available at <https://dozorro.org/tools>.

The Prozorro system already has shown significant results in public procurements. Nevertheless, it is constantly improved. The Government cooperates with experts and think tanks in developing new instruments for the system.

The second procurement revolution

In August 2019 MPs registered the draft law [No. 1076](#), which sums up practical lessons learned during the last four years and builds on existing progress in the areas of procurement centralization, professionalization, and transparency.

Developed by the experts of the Ministry of Economic Development and Trade, the amendments aim at improvement of existing legislation by legally incorporating the procurement tools that are already functional or were recently piloted. The draft law provides several fixes for existing problems and closes some minor loopholes, while laying the ground for future advancements of the procurement system.

One of the major changes concerns below-the-threshold procurement market. The bill introduces a new option for purchasing general merchandize goods (e.g. stationery) directly via e-catalogs thus avoiding the cumbersome procurement process. At the same time, the simplified tendering procedure becomes mandatory for all purchases above UAH 50 000. Procuring entities will be able to choose between using catalogs or a tendering procedure. The intended result is both more transparent and more efficient system of below-the-threshold procurement.

E-catalogs will be administered by the new agent of the procurement process — the Centralized purchasing body (CPB). While *State Agency «Professional Procurements»* is functioning since 2017, the draft law formalizes its status and allows to create regional CPBs adjusted to the needs of local procuring entities. CPBs will be responsible for administering e-catalogs and framework agreements on behalf of their clients as well as for providing professional assistance and education to procuring entities.

The process of transferring procurement duties from tendering committees of public entities to authorized persons (APs) becomes irreversible. The new law makes tendering committees illegal after the since January 1, 2022. KSE analysis (forthcoming) shows that APs on average are working faster and more professionally while using fewer human resources. Besides that, unlike tendering committees, APs do not suffer from the problem of dispersed responsibility.³³

³³ A tendering committee is a few people (usually 5-8) who gather to perform a procurement. An authorized person will be one (or a few) people within an entity who will be specifically responsible for

Procurement practice exposed a number of flaws in the existing legislature. First, currently it is impossible to make corrections of tender documentation after the tender (thus, if mistakes in documents are found, sometimes the tender has to be re-run, although minor mistakes are ignored). The draft law allows potential suppliers to correct the documentation in 24 hours after the procuring entity informed them about mistakes. Secondly, procuring entity gets an opportunity to punish unscrupulous suppliers by banning them from participating in its tenders for three years if a supplier failed to fulfill the previous contract. Moreover, if a supplier fails, the procurer can purchase up to 20% of the needed item without tender. This will help procurers to continue their activity which depends on the input in question while they run a new tender. In addition, the bill amends the Code of Administrative Offences to differentiate the fines into three groups according to the seriousness of violation (currently there is just one size of fine for all the cases).

The draft law addresses another important issue — that purchasing price of a product often does not provide adequate assessment of its initial value, as the costs of exploitation and technical service are not taken into account. This issue is addressed by introducing the concept of the product life cycle cost as an alternative to the price. It means that a procuring entity will be able to include associated costs such as service and utilization, energy consumption and environmental externalities into technical specifications of a contract.

The new draft law consolidates recent advancements in procurement centralization, professionalization, and transparency. If it is adopted, it will help make procurement process simpler, more efficient, competitive and secure for both suppliers and contracting authorities. However, there are still certain areas for considerable improvements. Thus, existing legal framework purposefully distinguishes price as the single most important criterion for supplier selection. This was done in order to eliminate deeply rooted corruption in public procurement (prior to the reform, 'qualification conditions' for suppliers were extensively used to exclude 'outsiders' from government tenders). Today, when procurers, suppliers and watchdogs are more professional, know the procedures and how to monitor procurement, one can start introducing non-price criteria into tender procedures. Usage of non-price criteria is a widely spread practice to best fit the needs of a procuring entity.

Besides, more efforts are needed to make existing technical solutions interoperable with the EU procurement networks, which would stimulate international participation in the Ukrainian procurement market and new procurement options for Ukrainian suppliers.

Medical procurement

procurement. This will allow to raise skills of such a person and also make her responsible for proper implementation of procurement procedures, whereas tender committees are often unprofessional and responsibility of their members is blurred.

In Ukraine, two types of entities can procure drugs for public money — hospitals procure what they locally need, and the Ministry of Health buys drugs for centralized government programs, such as programs on containing HIV or reducing incidence of tuberculosis or hepatitis. While hospitals use the Prozorro system since 2016, for centralized procurement other solutions had to be found. As a temporary measure, procurement has been performed by international organizations. At the end of 2018, a centralized procurement agency was created which will gradually overtake this function.

Prior to 2014...

Heavy corruption within government procurement of medicines was a well-known fact. For example, the Anti-Corruption Centre reports that in 2014 government procurement of medicines failed due to:

- (a) economic factors (such as rising prices for imported drugs because of Hryvnia devaluation),
- (b) continuation of old corruption schemes and the emergence of new ones with involvement of the Ministry of Health (MoH) and local distributors (companies that often procure drugs for public money).³⁴

In particular, the report states that *«the result of such failure was the lack [in 2014] of the most necessary vital drugs in many regions of Ukraine»*. Thus, in 2014 there was a significant shortage and even complete absence of medicines for patients with tuberculosis, HIV/AIDS, hepatitis and cancer. At about the same time, Ukraine started to feel lack of pediatric vaccines. This is still a topical issue.

In March 2015 Parliament adopted the law allowing transfer of centralized medical procurement to international organizations. However, MoH signed agreements with international organizations six months later because of resistance of many stakeholders and lengthy political discussions. Agreements unblocked the procurement of medicines for 12 state-level MoH programs. However, in the procurement and supply of medicines Ukraine started to lag by one year: at the end of 2016, the programs of 2015 were almost completely fulfilled, and tenders for procurement of medicines planned for 2016 were just starting.

Ukraine still buys medicines with a considerable delay, although this year the Ministry of Health expects the situation to improve. The procurement for 2017 started in August 2018. In 2018, the Ministry of Health finally managed to balance the timeframe for the procurement process.

³⁴ MoH issued a ToR that included dozens items, and there were just a few firms that could supply all of them. To the contrast, international organizations allow suppliers to select which items of a list they are willing to supply and then select suppliers based on total cost.

Procurement of medicines through international organizations saved up to 40% of the respective budget, which allowed to earmark the saved funds for additional procurement of medicines. However, the procurement process of international organizations is not flawless — e.g. the Accounting Chamber points at the poor accounting of drug stocks and imperfect needs calculation in the regions.

At the end of 2018, MOH created the State Enterprise «Medical Procurement of Ukraine». This agency should become the main procurement organization and ensure transparent, high quality and timely supply of drugs to Ukrainian patients. The Agency is currently undertaking preparatory work to fulfill its functions.

In March 2019, the first successful auctions — procurement of anti-TB drugs for the Global Fund money — were run by the Agency. The Agency procures drugs through Prozorro and manages to do that at significantly lower prices than an average ProZorro prices of comparable goods. For example, the final price of Ganciclovir at the Agency tender was UAH 500 per 500 mg vial, which is 34% lower than the minimum in ProZorro for 2018 — UAH 757.56.

In 2019, the Agency together with KSE introduced verification of the list of medicines needed for 16 state-level health programs. As a result, unjustified expenditures of UAH 102 million were avoided.

Eventually, «Medical Procurement of Ukraine» will centrally procure all medicines and medical equipment for implementation of strategic state-level programs. Also, it will work with both local and international markets to reduce prices, merge local purchases (i.e. collect orders from a number of hospitals and buy the needed drugs in bulk), carry out framework purchases, create and maintain electronic catalogs for subordinate purchases of medical supplies, and raise the level of professionalism in the procurement field.

Reforms in Education and Healthcare

Decentralization is tightly linked to education and healthcare reforms through financing of these spheres. Besides, education and healthcare are the most obvious criteria for voter evaluation of the job a local government has done. The foundation of reform was laid in 2015, when predefined financing of each school or hospital was replaced by educational and medical subventions. The subventions are distributed between local governments by formula which includes population size and a few other parameters.

Local governments decide how to distribute the subvention between facilities located on their territory. Local governments can also provide additional funds to facilities — for example, to buy equipment, provide higher salaries or training for teachers, doctors or facility managers. They also can launch joint projects with public or private funds, business or international organizations to attract additional resources.

This change in financing scheme launched the process of optimisation of educational and hospital networks.

Thus, Amalgamated Territorial Communities (ATCs) can make decisions about the quantity and location of schools within them. For example, they can decide to merge several small schools into one and provide transportation to this school from the other villages, or organize a school hub with branches instead of several small schools.³⁵ A recent government [decision](#) allowed organization of such school hubs not only within an ATC but also for several ATCs or rayons within one educational district if they think that it would benefit children living in those communities.

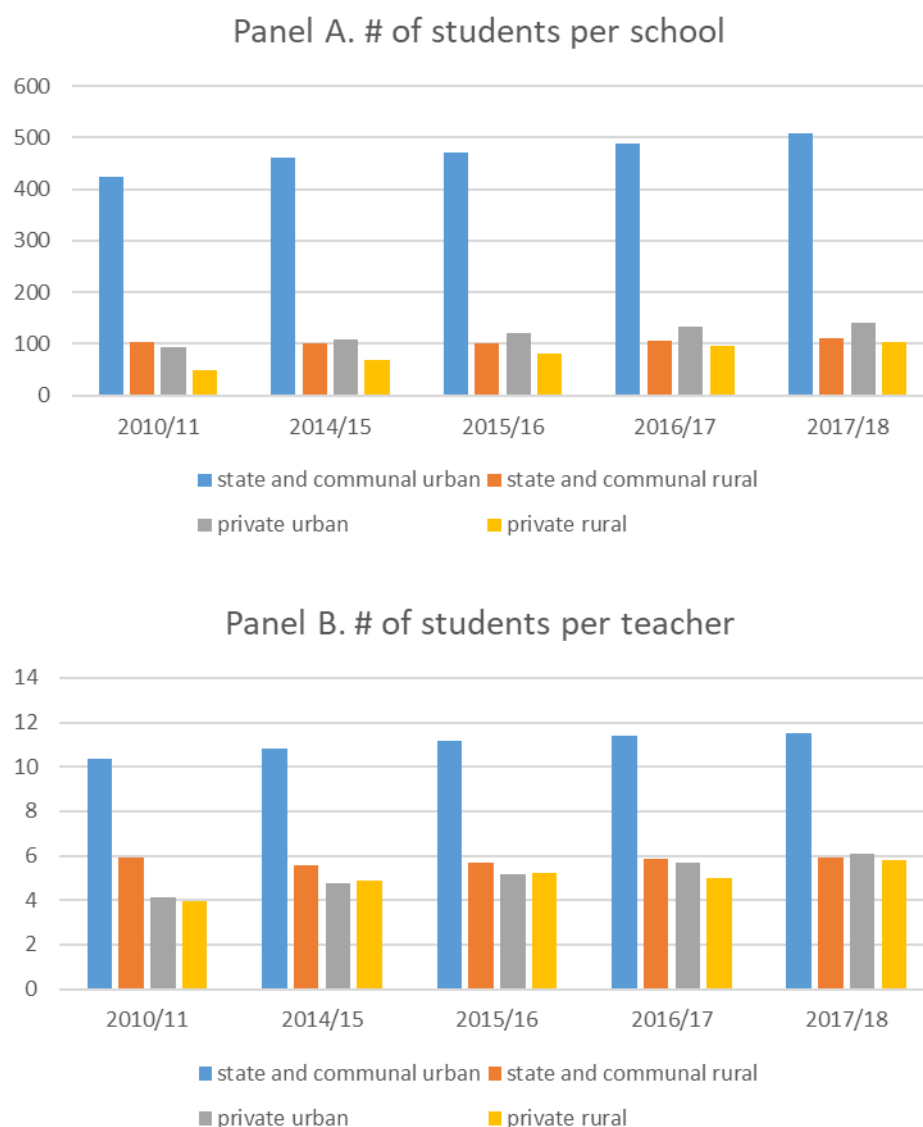
Ukraine currently has a room for school network optimization, especially in villages (figures 17, 18). Larger schools are both more cost efficient³⁶ and able to provide better education to children because they don't have to assign one teacher to teach several subjects. Besides, large schools allow children to better develop soft skills and provide them with the study environment that is both cooperative and competitive.

³⁵ The school hub with branches compared to several small schools provides savings on administrative cost (thus, school hub needs just one principal), and also allows to optimize teacher workload (thus, a teacher may be teaching one day at one branch, another day at another branch etc. while traveling between schools is usually not possible).

³⁶ Thus, in 2018 the cost per student in a small school was estimated at UAH 58 thousand, while Ukraine average is UAH 15 thousand.

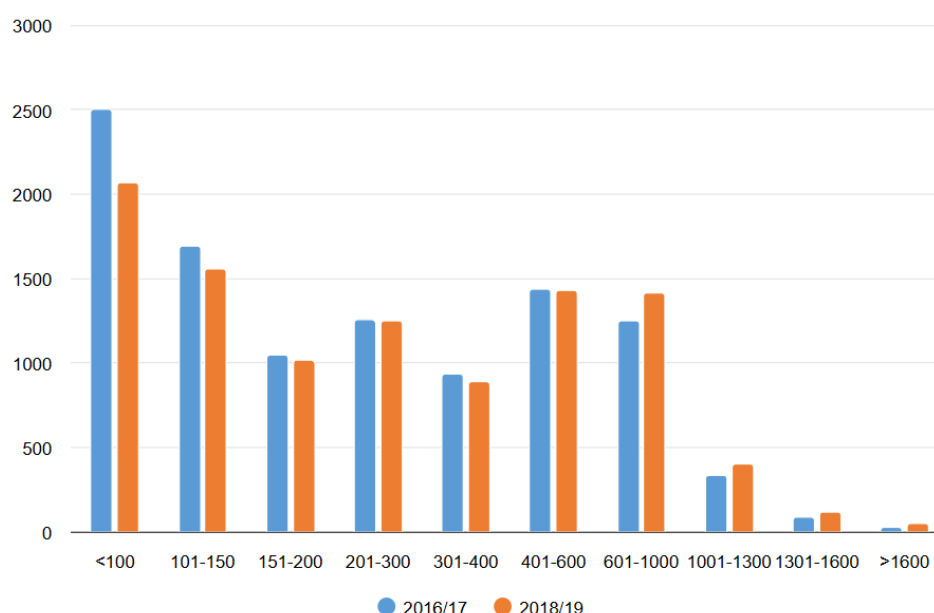
Although general cost may not be much lower because the children need to be transported to the school hub, the benefits for quality of education are clear. Certainly, this reform has to be actively communicated to local dwellers who sometimes are opposed to closing a school in their village.

Figure 17. Number of students per school and students per teacher



Source: State Statistics Service of Ukraine

Figure 18. Distribution of schools by the number of students



Source: [Institute of Educational Analytics](#)

A similar financing scheme was implemented for healthcare facilities — local governments were given the right to decide how much money to provide to each polyclinics or hospital on their territory. However, since 2017 the healthcare financing reform has taken a step further.³⁷ The «money follows the patient» principle is being gradually implemented in healthcare to replace the infrastructure financing.³⁸ For this, a few steps are necessary:

- 1) Medical facilities have to become not budgetary institutions but communal or state-owned non-profit enterprises. This shift provides them with much more autonomy and control over their budgets. Thus, they can establish the list of fee-paid services (while previously the price-list for them had to be approved by local governments), set the salaries (while for budgetary institutions the salaries are defined by the Unified Tariff Scale set by the central government), and to officially fundraise (while budgetary institutions can get additional funding only through semi-official charitable funds). Currently all of the primary level facilities and [about 50%](#) of secondary and tertiary level facilities became non-profit enterprises (the share differs by oblasts). Certainly, this transition provides much more room for decision-making of facility managers. At the same time, it increases their responsibility and skill requirements (among other, they need to develop managerial skills).

³⁷ The healthcare reform [Strategy](#) was developed in 2015. Current reform mainly proceeds along the lines of the Strategy. The details of healthcare reform and next steps can be found in the Ministry of Health [Transition book](#).

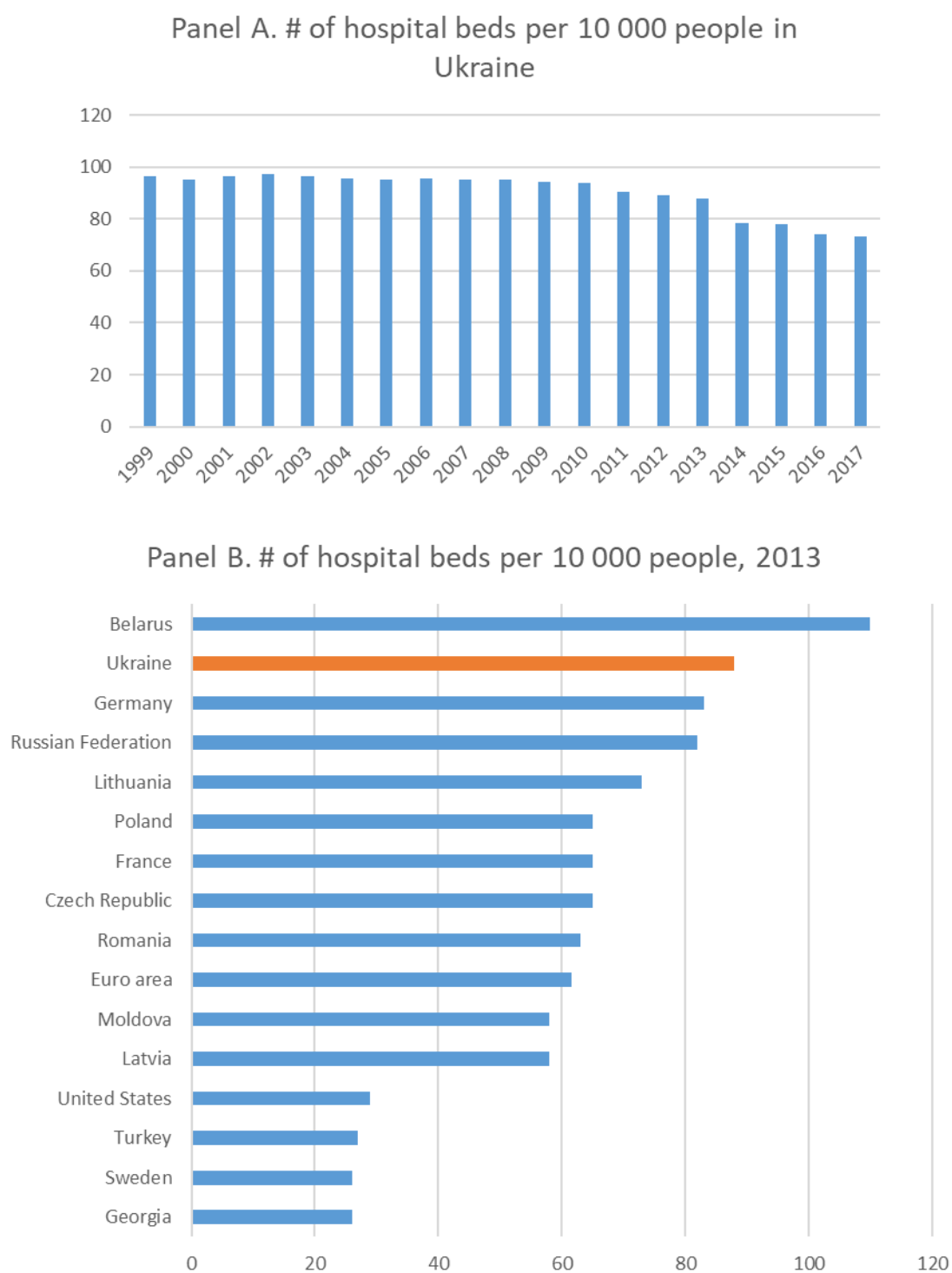
³⁸ Financing according to the number of beds, number of doctors or square meters of the facility.

2) A 'pay-per-service' scheme has to be introduced. Ukraine chose to have a centralized model — thus, a single government agency ([National Healthcare Service](#)) established in March 2018 makes payments to all the facilities or doctors for the services they provide. Furthermore, 'pay-per-service' financing requires defining the list of services financed completely by the government, co-financed by patients and completely financed by patients, as well as the calculation of prices for services. At the primary level (family doctors) Ukraine has a fixed payment per patient who signed the declaration with her family doctor (payments for children and elderly patients are higher than for middle-age adults). At the secondary and tertiary level, the [DRG](#) system will be gradually introduced.

3) For 'pay-per-service' to become operational, the e-Health system has to be established — so that the National Healthcare Service sees which services were provided to a patient by a certain facility or a family doctor. Thus, payment to this facility or doctor is delivered automatically within the contract with NHS. Ukrainian e-Health is a two-tier system whereby the government controls the central database and private companies can provide interface, i.e. the systems through which doctors can access this central database. There is already a dozen of interface systems on the market.

4) Then, the local governments have to make decisions on the hospital network. In Ukraine, the network is abundant (Figure 19), and many hospitals cannot provide a decent level of services. With payment-per-service scheme 'good' hospitals (i.e. those with many patients) will receive more money than those to which patients do not apply. Thus, local governments will have to decide on hospital concentration within hospital districts — in a similar way they decide on school concentration within educational districts. They will also be able to provide additional support to local medical facilities. Some local governments already do this at the primary level. For example, they provide cars to family doctors so that they could visit patients or renovate premises where they work. By doing this, local officials are earning 'electoral points' in the eyes of their voters.

Figure 19. Number of hospital beds per 100k people in Ukraine and in other countries, 2013



Source: State Statistics Service, the World Bank

As of today, the primary care has completely switched to the new financing scheme, and the next levels of the system will be reformed starting 2020.³⁹ Since the reform is still incomplete, it has mixed perceptions in the society — both by [doctors](#) and [patients](#). As with any reform, there are winners and losers. The reform introduced competition between facilities and doctors along the quality line — so some of them will be closed or will have to find another job. Moreover, private facilities can compete with communal and state owned ones for the public money since if they sign a contract with NHS they can receive payment per service on equal terms. But the society as a whole will win from increased quality of service and more efficient use of funds.

In the higher education the «money follows the student» scheme was introduced only partially — thus, the volume of state financing of education on certain specialties is centrally defined (i.e. the government decides for studies of how many engineers or lawyers it will pay). The distribution of these state-funded places across universities is based on demand — if more higher-grade students apply to a certain university to a certain specialty, this university can get more budget funding. The distribution of students is performed automatically taking into account students' grades for after-school tests and their preferences for universities and specialties. Introduction of external after-school testing in 2008 has greatly reduced opportunities for corruption at the entrance to universities and thus allowed students without money or connections to enter 'prestigious' universities previously closed for them.

Today, the external testing is being gradually introduced at the 'exit' of universities too. Thus, in 2018 external testing in law was introduced for those willing to enter MA programs in the field, and an external testing in foreign languages for students with BA degree was introduced in 2019.

In medical education, the external exams for graduates have been in place since the late 1990s. However, the quality of medical education remained questionable. Thus, Tetyana Tyshchuk and Inna Sovsun [found](#) some unusual patterns in results of national medical exams. These patterns raise questions to grading algorithm. Besides, sometimes these exams include questions from previous years, and since the databases of questions are publicly available, students can memorize questions rather than understand the material. To circumvent this, international exams (IFOM) are being introduced for Ukrainian medical students since 2019 as a part of external assessment of the quality of their education. This creates incentives for medical schools to improve the quality of education which they provide.⁴⁰

³⁹ Currently, the pilot project with secondary care facilities [is implemented](#) in Poltava oblast. The results show reduction of the length of stay of patients in hospitals and increase of the share of complicated cases (which implies reduction of unnecessary hospitalizations).

⁴⁰ Ministry of Health developed the [Strategy](#) of development of medical education in Ukraine.

Starting [2020](#) the graduates of medical schools will be distributed to hospital internships automatically according to the results of external assessment. Moreover, funding for internships will be distributed not to universities but to hospitals thus creating incentives for them to teach young doctors thoroughly. To further raise the quality of medical education, the minimal threshold of 150 points for after-school internal testing was introduced for entering medical universities (in 2019, 36% of graduates got this score for external testing in Math, for example). This allows to select future doctors among the most motivated students and will raise the average quality of doctors in Ukraine in the long term. Meanwhile, 'money follows the patient' scheme will reward better doctors already in the short term.

Certainly there are crucial elements other than financing both in healthcare and education reform. For educational reform these are new educational standards (currently adopted for the primary school), new competences and subjects and new ways of teaching. For healthcare reform these are licensing requirements and analogues of standards — medical protocols. In 2017 the government allowed hospitals to adopt international treatment protocols without adjusting them to Ukrainian conditions. At the same time, they can continue using Ukrainian protocols adopted earlier. Hospitals which adopted international protocols can file requests to the Ministry of Health for procurement of respective equipment or medicines. Thus, gradually the true health needs of the population are being revealed.

An essential part of the primary healthcare reform is the «Accessible Medicines» program. Within the program, patients can get drugs for a few chronic conditions (diabetes, asthma, cardiovascular diseases) free of charge or for a small co-payment if they receive an electronic prescription from their family doctor. Use of electronic prescriptions allowed to reveal [31 thousand](#) 'fake' patients with diabetes. This program helps shift the focus from hospital care to primary care and prevention or control of chronic diseases since the latter is much less expensive.

Substantial savings to the healthcare budget were induced by transferring of government procurement of drugs to international organizations. This was a temporary measure to break up the salient corruption schemes. Today, the centralized medical procurement agency is being created, and it will take care of the procurement for «Accessible Medicines» programs as well as procurement of expensive drugs (such as drugs for cancer treatment or orphan diseases). For more details on medical procurement please refer to the procurement chapter of this book.

It is very important that healthcare and educational reforms continue because half-reforms or reversed reforms are worse than no reforms at all.

/4 FOCUS ON PEOPLE

Demographic Prospects Of Ukraine

Demographic prospects

Continuing decline of total population and especially of the labor force, along with its aging, is one of the major challenges to be addressed by the Ukrainian government. If gender- and age-specific labor force participation rates remain constant at the 2016 levels, the labor force in Ukraine is projected to shrink by about 2.9 million people aged 15 years and above by 2030. Even though a larger percentage of seniors aged 65+ years is expected to join the labor force in the future, it will not be enough to make up for decreasing numbers of youth entering the labor force and of working-age population as a whole.

As a consequence, the burden on people of working age who supply their labor will gradually increase. According to the ILO estimates, there will be 155 non-working dependents for every hundred workers in 2024, compared to 137 dependents in 2015 (see Labor Dependency ratio, Table 4). These dependency ratios would be even larger if only formally employed persons, i.e. those who are taxed under the existing tax guidelines, were counted as employed, and informally employed persons were classified as dependents.

Table 4: Dependency ratios in Ukraine, 2000-2030

Dependency ratio	Definition	2010	2015	2020	2025*	2030
Demographic dependency ratio	Children aged 0-14 and Seniors aged 65+ per 100 persons aged 15-64 years	43	45	50	53	55
Economic dependency ratio 1	Persons aged 15+ years that are outside the labour force per 100 persons in the labor force	82	83	87	94	99
Economic dependency ratio 2	Children aged 0-14 and Persons aged 15+ years that are outside the labour force per 100 persons in the labor force	112	116	123	130	134
Labor dependency ratio	Children aged 0-14 and Persons aged 15+ years that are either outside the labour force or unemployed per 100 employed persons	130	137	146	155	n.a.

Source: Demographic dependency ratio — UN World Population Prospects 2017 (<https://population.un.org/wpp/Download/Standard/Population>), Labor dependency ratio — ILO modelled estimates November 2018 (<https://www.ilo.org/ilostat>), Economic dependency ratios — author's calculations based on population from UN World Population Prospects 2017 and labor force participation rates from ILO (<https://www.ilo.org/ilostat>) by sex and 5-year age groups. Data in 2020-2030 are based on UN population projections (medium variant), with gender- and age-specific labor force participation rates assumed to be constant at the 2016 level.

Note: * 2024 is the latest year for Labor dependency ratio provided by the ILO (as of September 2019).

There are three key policy areas for rebalancing demographics and mitigating possible negative economic effects of shrinking and aging population in Ukraine and other countries in the region.⁴¹ These are:

- raising fertility rates and motivating higher female labor force participation rate, with policies that help women combine motherhood with work (maternal and parental leaves, child care services and workplace practices) rather than financial transfers to encourage childbirth;
- improving health of (older) individuals and enabling longer and more productive work lives, with important policies aimed at skills development of an aging workforce, removing incentives of older workers to retire early, and supporting employers who show favorable attitudes toward older workers;
- promoting immigration and discouraging emigration, with effective policies that would make the Ukrainian economy more attractive to potential migrants by improving the business climate and reducing the barriers of the foreign born to formal employment, education and social protection.

Migration

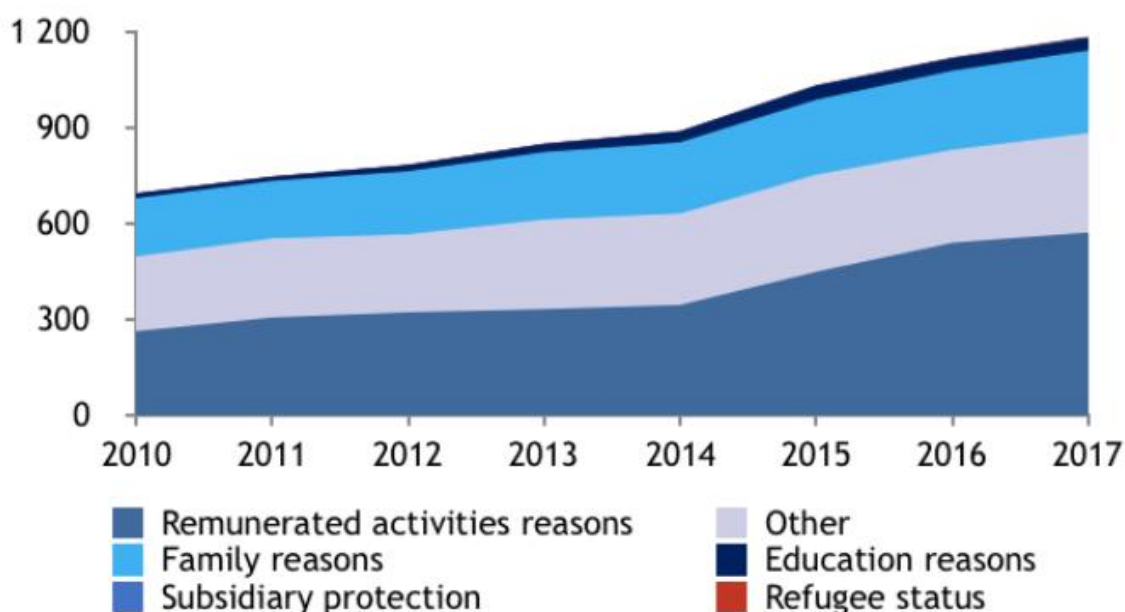
According to the UN data, the total number of migrants from Ukraine has not significantly changed since 1990 and comprised 5.9 million individuals in mid-2017. In all years, Russia is the major country of destination for individuals born in Ukraine, accounting for about 60 percent of the total migrant stock. However, the overwhelming majority of migrants in Russia reported by the UN are in fact Russian nationals born in Ukraine before the USSR dissolution rather than genuine emigrants moving from Ukraine to Russia in the 2000s. The total share of all EU/EFTA, the US and Canada countries is 28 percent of the total stock of migrants from Ukraine in 2017 defined according to the UN approach. Thus, using the Eurostat statistics on permits issued to Ukrainian citizens by EU/EFTA countries, and supplementing it by comparable data from Russia, the US and Canada whenever possible, we embrace the lion's share of Ukrainian citizens residing and working abroad.

Analysis of the data from Eurostat reveals that the stock of Ukrainian citizens residing in EU/EFTA countries with valid permits at the end of 2017 was 1 188 088 and it is 1.7 times higher than at the end of 2010. The upward trend was driven predominantly by an increase in the number of permits issued for remunerated activities, followed by other reasons and family reasons (Figure 20). Poland is the major EU host country for Ukrainian citizens, accounting for 38 percent of the number of Ukrainians with valid permits of all types at the end of 2017.

⁴¹ See more in Bussolo M., J Koeetle, and E. Sinnott (2015) *Golden Aging : Prospects for Healthy, Active, and Prosperous Aging in Europe and Central Asia*, Washington DC: World Bank

Other important countries are Italy, Germany, Czech Republic, Spain, and Portugal, which issued about half of all permits held by Ukrainians in the EU/EFTA area at the end of 2017.

Figure 20: All valid permits held by Ukrainian citizens in EU/EFTA countries on 31 December of each year by reason, 2010-2017



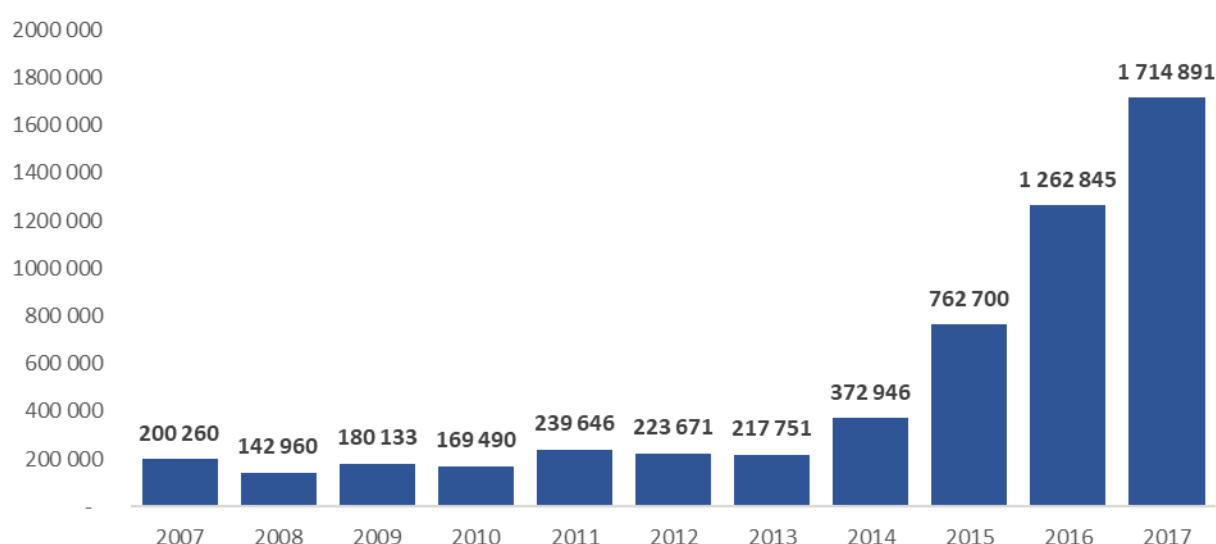
Source: Eurostat (retrieved in July 2019)

It should be noted that permanent migrants from Ukraine who have acquired citizenship in host countries are not captured by statistics on permits used above. According to Eurostat, the total number of Ukrainian citizens who acquired citizenship of some EU/EFTA Member State in 2010-2017 amounts to 144 153 people, with the largest numbers registered in Germany (32,672), Portugal (22 377), and Italy (15 258). Besides, 64 845 Ukrainians were naturalized in the US over the same period (according to the US Department of Homeland Security data). According to Immigration, Refugees and Citizenship Canada, the number of new Canadian citizens among former Ukrainian nationals in 2012-2017 is 12 324 people. But all these numbers are substantially smaller than 268 896 Ukrainians who acquired citizenship of the Russian Federation during the last three years (2016-2018).

The end-of-year stock of valid permits for remunerated activities issued to Ukrainian citizens in EU/EFTA countries more than doubled since 2010: from 265 344 in 2010 to 574 498 in 2017 (Figure 21). However, the true number of Ukrainians working in EU/EFTA is expected to be much larger than 574 498. This is because at least three categories of migrants are not captured by statistics on permits for remunerated activities: (i) holders of residence permits issued for family or other reasons who can work legally in the host country with no additional permits required; (ii) irregular migrants without the legal right to live and work in the host country; (iii) short-term migrants working abroad up to 3 months, especially after a visa-free travel regime with the Schengen Area countries came into force in June 2017.

According to the data of the Ministry of Family, Labour and Social Policy of Poland, the number of declarations to entrust work to a foreigner issued in Poland to Ukrainian nationals increased from 20 260 in 2007, when the system of declarations was introduced, to 1 714 891 in 2017 (Figure 21). Declarations allow Ukrainians and nationals of some other post-Soviet countries to work in Poland for six months in a year without a work permit or the necessity to conduct a labour market test. Despite the fact that the number of employers' declarations is much larger than the actual number of seasonal workers for several reasons mentioned in the Polish literature (Kalisz and Chrapek, 2019; Jóźwiak and Piechowska, 2017), there is a clear tendency towards an increasing number of Ukrainian seasonal workers in Poland.

Figure 21: Number of declarations to entrust work to a foreigner issued in Poland to Ukrainian nationals, 2007-2017



Source: Ministry of Family, Labour and Social Policy of Poland

In addition to the overall increase in migration flows from Ukraine, there is also evidence for an increasing number of highly skilled migrants to the EU Member States (Table 5) and to the US (Figure 22).

Table 5: Number of EU Blue Cards issued to Ukrainian nationals by top countries, 2012-2017

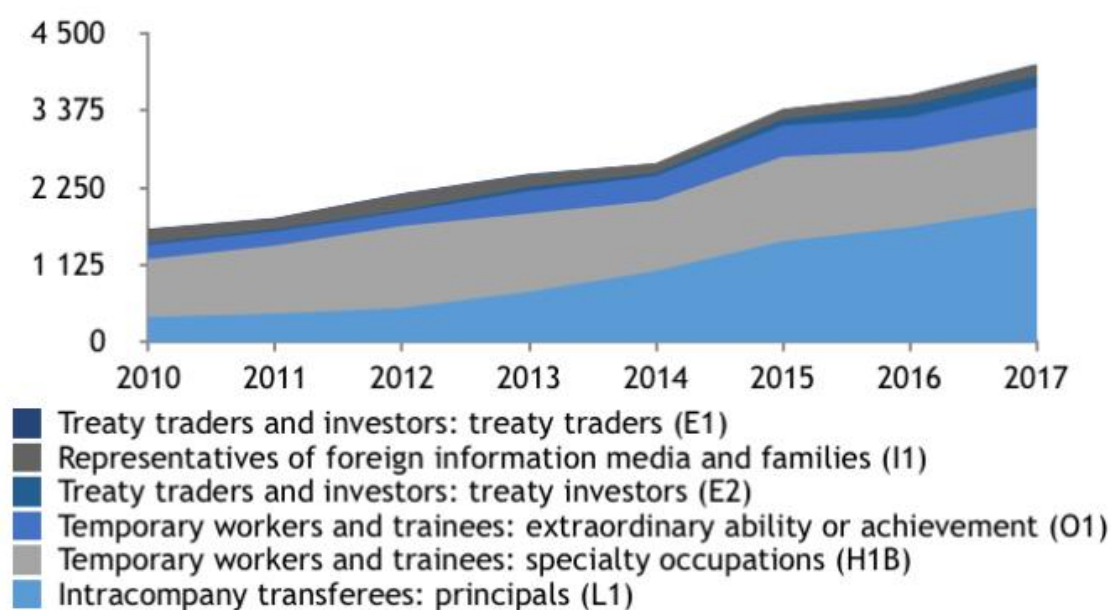
	2012	2013	2014	2015	2016	2017
EU-28	149	536	782	1,427	1,541	1,253
Germany	109	468	608	848	863	849
Poland	0	6	21	272	431	167

	2012	2013	2014	2015	2016	2017
Czech Republic	11	16	25	57	62	53
Latvia	6	6	20	49	40	48
Lithuania	:	4	31	54	33	41
Bulgaria	0	0	7	36	25	22
Luxembourg	0	3	4	12	19	16
France	2	4	6	22	12	15
Italy	0	0	6	9	14	8
Austria	15	14	20	13	10	8

Source: Eurostat (retrieved in July 2019).

Note: Countries are shown in descending order of the number of Blue Cards issued in 2017.

Figure 22: Number of non-immigrant admissions of Ukrainian nationals to the US with selected types of visas during a given fiscal year, 2010-2017



Source: DHS (retrieved in July 2019)

Key steps that have been taken to promote gender equality

- The position of the Government Commissioner for Gender Equality Policy was introduced on June 7, 2017.⁴² K. Levchenko was appointed as the first Commissioner in February 2018. This helps implement gender mainstreaming in all central and local executive bodies.
- In 2017 the Ministry of Education and Science launched the antidiscrimination expertise of textbooks used in primary and secondary schools. This will help address the issues of possible discrimination and gender stereotypes among schoolchildren.
- In 2017 the list of professions banned for women⁴³ was revoked by the order of the Ministry of Health. But references to the list of banned professions are still contained in the Article 154 of the Labour Code. This complicates the effective implementation of the policy.
- In 2017 criminal liability for domestic violence was introduced and protection of victims of physical, psychological or economic violence in families has been envisaged at the state level.
- Gender-responsive budgeting is being implemented in Ukraine by the Ministry of Finance with the support of international organizations. Gender-responsive budgeting is a legal requirement since January 2019.
- In January 2019 the new state social program «Municipal nanny» came into force after being approved by the Government in May 2018 within the National Action Plan for the implementation of the UN Convention on the Rights of the Child up to 2021. Its idea is to provide financial support to parents to fund care services for children up to three years. The policy can potentially increase the employment rate of mothers, but due to a fairly small amount of support it is likely to be effective only in small towns or villages where the salary is low.

⁴² The main tasks of the Commissioner include coordination of the work of ministries, other central and local executive bodies to ensure equal rights and opportunities for women and men, conducting the monitoring of the accounting by the Cabinet of Ministers of Ukraine the principle of gender equality, assistance in developing state programs on gender equality and cooperation with international organizations and civil society.

⁴³ The [List](#) of 458 hard, dangerous and harmful jobs in Ukraine was adopted by the Order of the Ministry of Health # 256 of 29.12.1993. It banned women's employment at certain jobs, including driving vehicles with more than 14 passenger seats, tractors and other agricultural vehicles, sea and river boats, or be employed at a number of industrial and agricultural positions

People's Beliefs And Political Response

Why is this important?

«Where are the reforms?» is the catchy phrase that became popular in Ukrainian social media as well as ironic political discussions. As the story goes, Ukrainians were not happy with the slow pace of reforms in 2019 which pushed them to vote against the incumbent president. This example shows a crucial connection between people's beliefs, their political involvement, and development of the country. What did Ukrainians think about reforms and market institutions during 2015-2019? This question is investigated further.

This chapter refers to the survey data of the Institute of Sociology NAS of Ukraine (1992-2018) and our own survey conducted in March 2019. Attitudes towards privatization, reforms, and market institutions are analyzed and discussed. These data are employed to address two questions:

- How did attitudes to privatisation change in Ukraine since early 1990s and especially in the five recent years of 2015-2019?
- Is there any correlation between support of reforms and support of political leaders?

Context

Economists have long figured out that attitudes of people affect economic performance of a country (Guriev, 2018). On the one hand, all sorts of social groups share beliefs and ideas about what is good or bad for the economy. These ideas influence people's behavior, engagement and success in economic production and redistribution. On the other hand, the very survival of economic policies in democratic countries often depend on the support of people. The second point is especially relevant for the transition societies. Economic reforms may fail when people do not support their (perceived) outcomes.

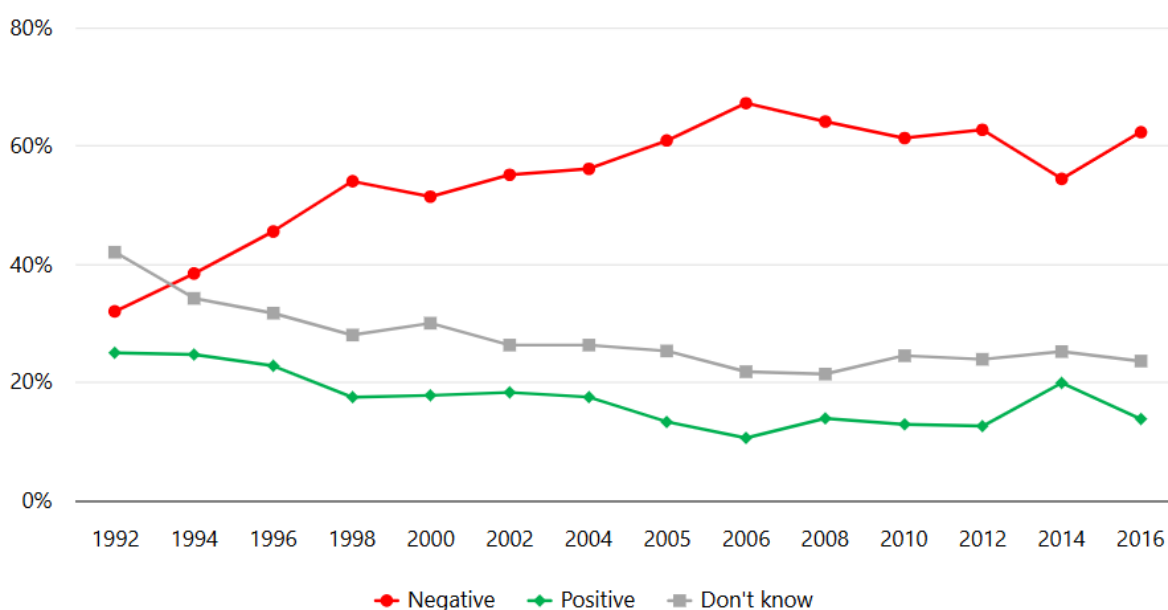
While economists and social scientists agree that economic policies are more likely to be successful when population supports them (Denisova et al., 2012; Pop-Eleches and Tucker, 2017), they often disagree on exactly why people vary in their support. Attitudes towards privatisation is perhaps the most salient example that speaks to this debate (Denisova 2016). Some scholars argue that attitudes about privatisation are negative when people experience market failures or economic hardships. Others maintain that anti-privatization (if not anti-market) attitudes are manifestation of values that were internalized during socialization in communist societies (for more details about this debate see Pop-Eleches and Tucker, 2017).

Given that a vast array of scholarly research is focused on attitudes towards privatization and market institutions, this chapter will focus on the same area. Attitudes towards privatization are indicative of how people in transition societies think about market economy in general.

The case of Ukraine

The Institute of Sociology NAS of Ukraine conducted representative surveys from 1992 till 2018 asking Ukrainians about privatisation. The data are available in a hard copy format and can be purchased from this institution directly (Ukrainske suspilstvo, 2018). As Figure 23 shows, most of Ukrainians have negative views about the privatisation of large enterprises. In the early 1990s Ukrainian society was divided in equal parts. About a third of them were positive about this idea, while another third was negative. With time, however, polarization increased. The overwhelming majority of Ukrainians do not support this idea (58% were negative, and 25% were positive in 2018).

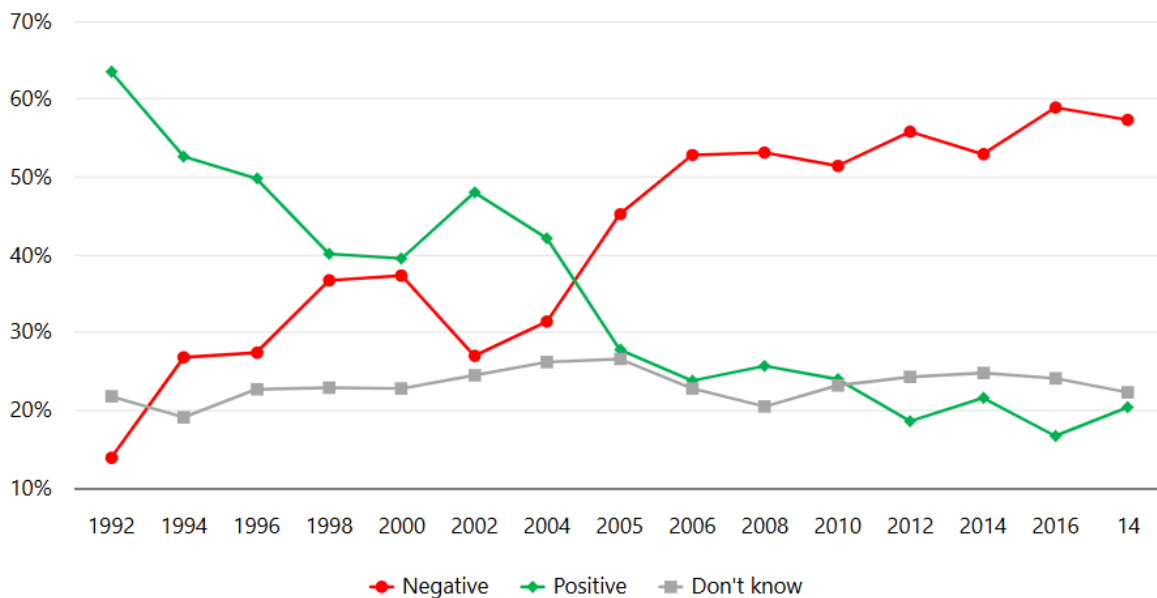
Figure 23. Attitudes towards the privatization of large enterprises



Source: Ukrainian Society survey

Another peculiar change happened with the attitudes towards land privatisation. As Figure 24 shows, most of Ukrainians were positive about privatisation of land in the early 1990s. This has changed dramatically with time (57% were negative, and 20% were positive in 2018 versus 14% and 22% respectively in 1992).

Figure 24. Attitudes towards the privatization of land



Source: Ukrainian Society survey

Considering the years 2015-2018 which is the period of recent reforms, a small increase in the support of privatisation occurred. However, when placing this shift in the broader historical perspective, one could see that this change was rather marginal and is not irreversible.

Our previous studies confirm that the variation in anti-privatization attitudes among Ukrainians can be explained by generational replacement and economic hardships. In our forthcoming paper we argue that socialization before the collapse of the USSR has a long-term effect. In times of economic difficulties skeptical worldviews towards privatisation become more salient among older generations (Brik and Shestakovskiy, 2019).

All in all, this long trend of negative attitudes towards privatisation provides a useful context to understand support of liberal reforms in Ukraine. Success or failure of reforms in 2015-2019 depends on the previous shadow of history. One should not expect incredibly positive views about liberal reforms in a society with a trend displayed in Figure 24.

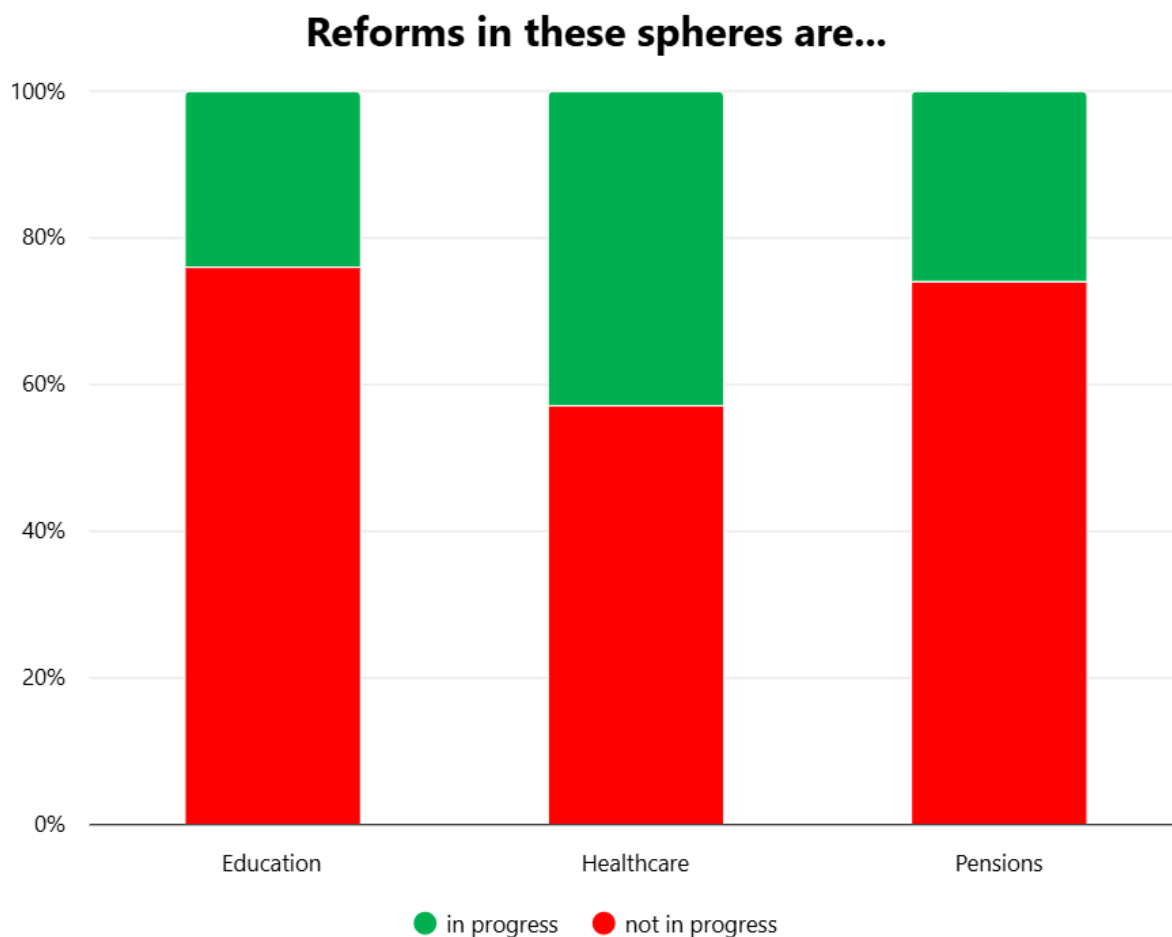
Next, our own survey conducted in March 2019 (N=1,200) includes the data about three areas of reforms: in education, in healthcare, and in pensions (Table 1).

A national representative survey was conducted from March 7th to March 17th, 2019 by VoxUkraine. The survey was supported by the International Renaissance Foundation within the framework of the project «Ukrainians on the Political Compass». Fieldwork was executed by Vox Populi agency.

Sample size of the survey was 1,200. Sampling error does not exceed 3% with a confidence level of 95%.

As Figure 25 shows, most of the respondents think that reforms are not in progress. What does it mean «to be in progress»? The questionnaire contained a question on the spheres in which reforms are actually happening (in Ukrainian «у яких із цих сфер реформи реально відбуваються?»). It is not equivalent to a positive or negative evaluation. Some respondents might believe that reforms in healthcare are happening, yet they might not like them at the same time.

Figure 25. Evaluation of the progress of reforms in three spheres



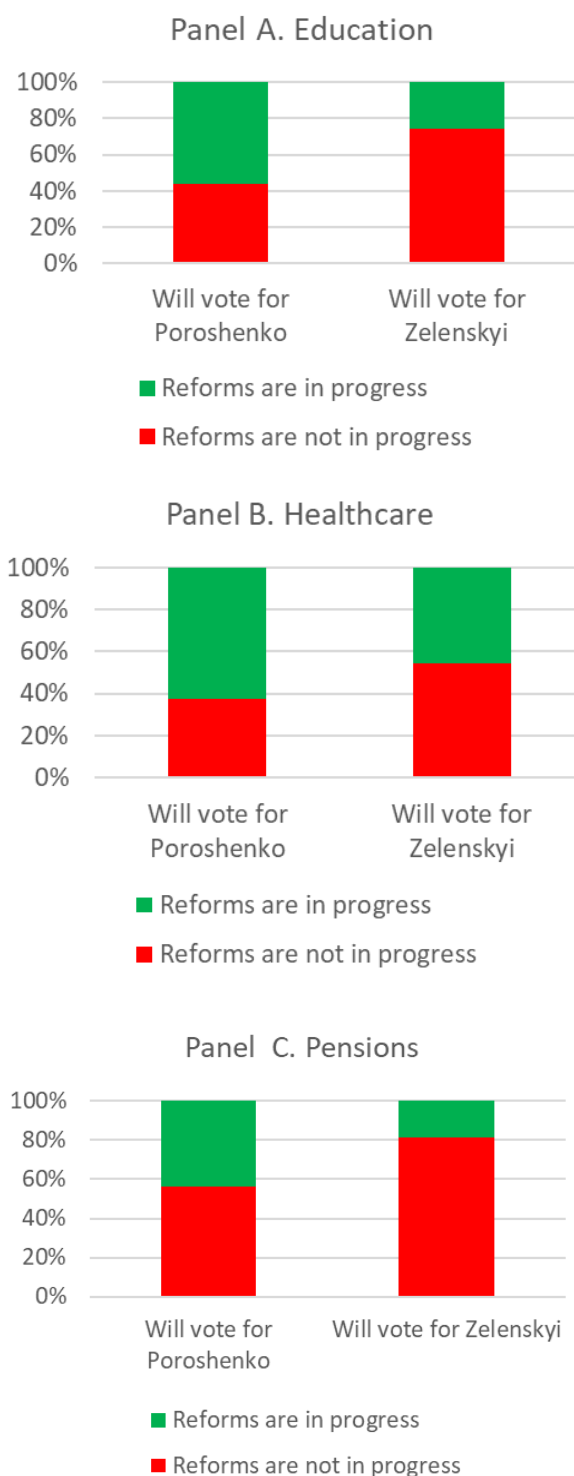
Source: own survey

What are the political consequences of the distribution shown in Figure 25? Tentatively, the data show a correlation between support of reforms that are in progress and voting outcomes. Figure 26 shows the attitudes towards three areas of reforms (education, healthcare, and pensions) for those who said they would vote for Zelenskiy or Poroshenko.

In case of Zelenskiy supporters there was no statistical difference between people who believed that reforms in education or healthcare «were in progress» or «were not in progress». Yet, those people who believed that pension reform was not in progress supported Zelenskiy more often than those who believed that this reform was in progress.

In case of Poroshenko, the data show consistent significant difference by all three reforms. Those people who believed that a given reform was in progress also supported Poroshenko more often than those people who believed that reforms were not in progress.

Figure 26. Evaluation of reform progress and electoral preferences



Source: own survey

All in all, the data show that people who thought reforms were in progress also supported the incumbent, while those who thought the opposite supported Zelenskiy.

Conclusions

Comparative literature shows that people's attitudes influence economic performance of societies. In the context of transition societies, this link is often mediated by attitudes towards reforms. When people support reforms they can wait long enough to see the benefits of (difficult) economic changes. Thus, understanding attitudes towards privatisation and relevant liberal reforms are pivotal.

Survey data from Ukraine suggest that

- Most of Ukrainians do not support the idea of land privatisation. Shares of Ukrainians who disapprove land privatisation increased dramatically from 1992 to 2018. Thus, one should not expect support of land liberalisation soon. Any land reform will face inevitably a strong resistance from people.
- Our previous studies show that people tend to have more negative views about free markets when they face economic hardships and also interpret these hardships as a consequence of market transformations.
- At the same time, there is a political cost of such attitudes. People who do not think that reforms are on the way are less likely to support the incumbents. This also means that when people do see at least some reform progress, they remain supportive of the incumbent politicians. These findings contradict the popular belief that reformists are always unpopular. Reformists can get support in transition societies when people agree that reforms are in progress.

References

- Brik, T. and Shestakovskiy, O. (2019). Market orientation in the shadow of communism: 25 years of changes in attitudes about the economy. In *Ukraine in Transition*. Palgrave Macmillan. Forthcoming.
- Denisova, I. (2016). Institutions and the support for market reforms. IZA World of Labor.
- Denisova, I., Eller, M., Frye, T., & Zhuravskaya, E. (2012). Everyone hates privatization, but why? Survey evidence from 28 post-communist countries. *Journal of Comparative Economics*, 40(1), 44-61.
- Guriev, S. (2018). Fairness and Support for the Reforms: Lessons from the Transition Economies (No. 24). SUERF Policy Note.
- Ukrainske suspilstvo (2018). *Monitorynh sotsyalnyh zmin*. ISNASU. Kyiv.