



**INEKO**

Institute for Economic and Social Reforms

## Conference summary and outcomes

### How to increase Ukraine's integration chances?

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**Goal:** The conference goal is to discuss the current reform process in Ukraine. What reforms have been adopted, what reforms are still missing and what are the biggest barriers for their implementation? How can Visegrad countries help Ukraine in identification and implementation of further reforms and in turn gain a stable and prosperous neighboring country.

**Date:** 3<sup>rd</sup> June 2016

**Place:** Representation of the EC in Slovak Republic, Palisády 29, Bratislava

More info about the conference: <http://www.ineko.sk/clanky/final-workshop-in-bratislava>

The conference was organized under the project "Hidden Triggers of Economic Growth in V4 plus Ukraine" supported by the International Visegrad Fund. See also: <http://www.ineko.sk/projekty/visegrad-fund>.

## Introduction

Ukraine represents a country of strategic importance for the countries of V4 as well as for the rest of Europe in terms of politics, economy as well as security.

The aim of this conference was to evaluate the transition process in Ukraine since the "Revolution of Dignity" in 2014 and identify how can the V4 countries help Ukraine to stabilize and prosper. It should be in the V4 interest to have a stable and prosperous neighbor as it may enhance economic growth in the neighboring countries as well.

After the collapse of the USSR Ukraine and Poland were approximately on the same level. Both countries' GDP per capita was below 2,000 USD. Yet after 25 years Poland's GDP per capita in purchasing power parities is 3.3 times higher than that of Ukraine (based on The World Bank data for 2015). Other CEECs showed similar GDP per capita and of course political standpoint although Ukraine was much tightly linked to the collapsed Soviet Union through both economy and politics. Now V4 countries are part of NATO, EU and SK and CZ are part of Schengen. More importantly though V4 countries successfully liberalized their markets, attained rule of law at acceptable level, living standards and life expectancy increased, democratic institutions are well embedded in the system. Although still in transition V4 countries have demonstrated significant progress since the collapse of communism while taking different routes to attain the same goal. These success stories could and perhaps should be examples for Ukraine on how to transform into a modern liberal country.

There is no universal manual on how to execute the transition and indeed V4 countries each took different path however there are commonalities that serve to achieve the same goal that is liberal democracy. De-monopolization, transparent privatization of state monopolies and strategic companies, market liberalization, banking reform, exposure to foreign markets and of course foreign direct investments (FDIs) that are conditioned by favorable factors (rule of law, protection of private property and rights, reasonable taxation system, etc. All are necessary steps if a country wants to prosper. Of course not all were executed without problems but Ukraine has the opportunity to learn from other countries' mistakes and attempt not to replicate them.

## Reforms

Although the current reform process is far from finished it has to be said that Ukraine has initiated and implemented more reforms since Maidan than ever before, partially thanks to conditionality pressure from the West. Also it has to be acknowledged that the current state of affairs when the government is engaged in a hybrid conflict with Russia, difficulty to remain solvent and ever-present rent-seeking tendencies is less than favorable for any reform initiative. President Poroshenko and his allies in the current government have been similarly unconvincing in embracing the reform process in some sectors.

The hybrid war and polarization not only within the society but also within the government has caused the proposed and much needed **decentralization** efforts to be put on hold. Provisions of special status for self-proclaimed occupied republics have rendered the reform without a chance to be implemented in its current version. Nevertheless, some efforts have been made towards decentralization. New communities rose from last year's elections with more revenue raising powers and heavy subsidies for capacity building.

Western pressure put huge emphasis on fight against **corruption** across all levels. Despite the public perception of worsening corruption important measures have been adopted to combat corruption. Agencies were set up to investigate and uncover high-level corruption as well as to monitor senior officials' asset declarations that have the power to recover and manage illegally acquired assets even abroad. Unsurprisingly, formation of the agencies was faced with pressure from rent-seekers and encountered problems at start but with the support of expert from civil society and western partners they have a potential to be successful. Daily updated public expenditure has been made available online. Electronic tendering platform has been created which will be mandatory for all public tenders. Still it seems that Mr. Poroshenko's administration needs incentives in form of conditionality to proceed with the battle against corruption.

**Privatization** of some 3,000 state companies is still only in beginnings although legislation has been passed that should make the process more transparent. Crucially, Ukraine has opened to the international market and reformed its banking sector allowing for fairer conditions. Floating exchange rate has seen a drastic dip in UAH value but will cause positive effects in medium-term. More effective tax collection has helped the treasury in meeting its responsibilities. However, grey economy still represents almost half of total GDP of Ukraine.

Perhaps the most important reform with immediate effects has been the **energy reform**. Gas business generated huge profits for public officials, politicians and oligarchs at the expense of state budget creating debt that was equal to percentages(!) of GDP. Prices of gas for households increased almost tenfold and reached real market prices. At the same time Ukraine has not imported any gas from Russia in the first 3 months of 2016 (consumption covered by other European suppliers and reverse flows). Energy monopoly Naftogaz has seen changes in management but is yet to undergo at least some level privatization.

Measures have been adopted that should make the **judiciary** system more credible (certification of judges) and independent (independent appointing body for judges). Prosecutor general's position too was strengthened.

The main obstacles in the reform process seem to be the oligarch and interest groups clinging to their power and business, lack of domestic experts that would drive the often unpopular reforms, insufficient institutional capacity especially on local levels and general resistance from the administrative system. Moreover, post-Maidan administrations still face allegations of corruption which creates negative sentiments among the general population.

## Recommendations

There is no universal manual to successful transformation of a country; however there are certain conditions that aid the process. Successful and less likely to be reversed reforms require broad and strong coalition not only in the government but also in the form of inclusive institutions that ensure political and economic power cannot be monopolized by a narrow elite. Among others, the inclusive institutions that facilitate a reform process include:

- Functional democratic political system (e.g. fair competition of political parties)
- Strong property and ownership rights protection
- Strong independent regulatory authorities
- Market competition, effective anti-monopoly policy

- Rule of law, independent justice
- Independent and free media

Below are some of the more specific recommendations:

Political economy:

- Mobilize pro-reform forces; create a strong informal pro-reform coalition with following key members:
  - Businesses independent from the government and monopolies
  - Independent and free media that together with NGOs and think-tanks act as watchdogs over the reform process
  - Reform minded politicians and policy makers who are willing to implement even unpopular reforms
  - Independent experts and analysts engaged in public discourse
- Reforms need be driven by motivated politicians who are willing and ready to fight vested interests and wider reform resistance (leadership), who understand why reforms are good for society (ownership), and who keep on explaining the details and the sense of reform process to the public (communication)

Taxation:

- Simplify the tax code (remove exceptions and exemptions, unify tax rates, etc.)
- Reduce direct taxes (on labor, profit) and compensate the budget by higher indirect taxes (on consumption)
- Decrease personal income tax and social and health contributions for people with low income to keep them motivated to work in the legal economy
- Introduce electronic system for monitoring value added tax (VAT) refunds

Labor market and education:

- Introduce flexible labor rules (e.g. weaker power of labor unions, more flexible hiring and firing procedures, more flexible part-time jobs, working hours, etc.)
- Increase risk of employing people illegally (tighter controls and sanctions)
- Introduce per-pupil financing at schools and partial rewards (tertiary and vocational secondary schools) based on the success of graduates in the labor market

Public finance and pensions:

- Strengthen independent analytical capacities at the Ministry of Finance
- Introduce public debt brakes
- Link pension contributions to benefits to keep people motivated to pay contributions
- Insure long-term financial stability of the pension system by parametric reforms

Privatization:

- Transparent partial or full privatization of strategic state companies to strategic investors by means of international tenders with price as the single winning criteria
  - Full privatization and clean-up of banking and insurance sector

- [at least] Partial privatization of energy companies and telecom industry – the state can keep 51% majority and sell managerial rights to the investor
- Establishing strong and independent regulatory authorities
- Price liberalization (gas, electricity)

#### Anti-corruption:

- Empower people by a strong law on free access to information (on-demand transparency)
- Put information on-line (automatic transparency):
  - Obligatory publishing of public contracts (for scrutiny), court rulings, etc.
  - On-line business registry, land registry, legislation portal, subsidies, etc.
  - Open public data (crime, health, transport, budgets of public bodies, etc.)
- Introduce transparent banking accounts for campaigns of political parties and candidates
- Establish specialized courts, prosecutors, offices, agencies for high end corruption and organized crime
- Ensure independent control/disciplinary of police, courts and prosecutors

#### Efficient administration:

- Professional, well-paid and independent administration
- Central civil service office in charge of recruitment procedures, certification, training, code of conduct, etc.
- Decentralization

#### Others:

- Attract foreign direct investment (favorable business environment, rule of law)
- Reduce economic and energy (largely successful already) dependency from Russia
- Follow own comparative economic advantages
- Eliminate subsidies that drain the budget
- Protect small and medium enterprises (SMEs) from oligarchic intervention
- Liberalization of economy first and gradual regulation afterwards
- Take advantage of international support and cooperation opportunities (international cooperation as a tool rather than a goal)
- Focus on reforms with broad support to ensure continuity

#### What can V4 countries (and others) offer?

We need to give Ukraine incentives to transform and embed crucial reforms within the system in order to prevent reform reversal (phenomenon not alien to V4 countries). Ukraine has not hesitated calling in experts and politicians from abroad that have reformist reputation. Several former Georgian officials from Mikheil Saakashvili's administration and Saakashvili himself came to Ukraine to replicate their successes. With the new government, several of foreign experts have left their positions or were replaced. It is crucial that V4 provides experts with the necessary know how to help restarting the reform process. Here are key areas where V4 can be of support to Ukraine:

- Implementing the Free trade agreement
- Promoting the EU Candidate country status given to Ukraine

- Massive vocational training help
- Visa-free travel with strong security safeguards
- University scholarships for Ukrainian students
- Macro-Financial Assistance from the EU (complementary to IMF)
- Promoting public debt reduction/restructuralization
- Promoting to tighten sanctions against Russia
- Advocating for NATO to secure territorial integrity
- Military cooperation

Still challenges in V4:

- Local oligarchs
- Shell firms
- Data accessibility and their quality
- Long term unemployment high (especially in Slovakia)
- Employment rate not increasing as fast as unemployment is decreasing
- Illiberal tendencies, power concentration, censorship, protectionism, pro-Russian movements

Transformation process in the V4 countries is far from finished, however inclusive democratic institutions are well embedded in the system in spite of periods of uncertainty (Meciar administration in Slovakia in 1990s). Ukraine has the potential to be an important economic and political partner but also can bring stability to the region. Without independent and stable Ukraine, V4 countries would lose the opportunity to boost their economies where growth dangles in uncertainty because of [but not limited to] the recent decision by the UK to leave the EU.