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Political Risks and Political Stability in Ukraine

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 Regime after the 2010 Presidential Elections**

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RESUME

After the 2010 presidential elections, Ukraine's policy and economy are characterized by two main processes as major results of the elections: a change in the balance of forces among groups of key political actors and the creation of the basis for the redistribution of their access to resources.

According to the UCIPR's assessment based on the data of monitoring of political processes and on the consideration of the opinion of political experts, **the risks linked to the formation of a new political regime and to a new pact of elites are the most serious** in the structure of political risks in the post-election period (March-May 2010).

The balance of forces changes as a result of a new hierarchy of power. The historical and political phenomenon of **the strengthening of features of a new political regime (a system of government) on the basis of the "old", previous constitutional model of governance** takes place.

Unlike the period of Yushchenko's presidency (2005-2010), when the application of the competitive political basis coincided with conflicts in the system of power and none of power institutions and political forces enjoyed the sufficient support for political decision-making, the period of Yanukovych's presidency is marked with **the maximization of political benefits at the expense of centralization of the political role of the institution of presidency and the control of key political and governmental positions by representatives of the same political group. Goals are attained (over three months after the elections, in particular, in the area of foreign policy) due to a higher, compared with the previous regime, level of consolidation of power groups and their recognition of the presidential right to assume executive and controlling functions** (instructions to the government and law-enforcement agencies).

The elite pact concluded under Yushchenko's presidency (focused on the development of a competitive basis in politics and efforts to bring state values into politics), is now mostly based on the use of the government's potential to promote economic interests of the main groups. Such a kind of "economic pragmatics" concerns not only the generation of profit on domestic orders, administration of budget funds and acquisition of state-owned property in the course of privatization, exactly as it happened in the previous period, but also the acceleration of processes of expanding access to raw materials of other countries (in particular, Kazakhstan and Turkmenistan) and making such resources cheaper. These goals urge the government to favor respective interests before owners and controllers of these resources. Consequently, power activities provide for the creation of respective political conditions to lobby these interests. State representatives more successfully (compared with the previous period) pursue the government policy as a tool to meet economic goals of some groups. Hence, the political agenda includes **the revision of the role and content of foreign political positions of the previous period and a clearer perspective of formulating a joint political platform along the CIS-Russian Federation axis** because the latter is a major owner of these resources. Recent changes in Ukraine's political agenda stir up discussions around the problem of choice between the promotion of the nation's political cohesion and its division into individual subjects of the international law.

Consolidation of pro-power political actors is attended with **the need to reappraise forms and strategies of activity by some economic and political groups distanced from immediate decision-making (that partially represent the political opposition).** This

process is complicated by conditions, under which one should decide in favor of either the retention and expansion of access to resources or its closure, which determines the defragmentation and weakening of each of these groups. Difficulties to be faced by the political opposition after the elections coincide with the so-called **conflict of political generations** in every group dominated by the experience of the “older” generation, whose weakness is sometimes represented in individuals and business burdens. To avoid marginalization and non-competition, political forces of this kind need, at least, to reformat their representations through the “younger” generation that **has to develop an adequate understanding of processes and new means of social support**. The building of party structures on the networks of political blocs is acute for the society.

The denial of consensus and competitiveness of the political basis has the risk of undivided political responsibility, as challenges of really effective reforms focused on the strengthening of civil rights, social leveling and a competitive economy need the political and social support and call in question the compliance of such practice with republicanism propagated as the integral national idea.

Major economic risks incorporate the traditional absence of transparent decision-making (the 2010 national budget was approved without a brief discussion); continuing paternalistic practice as regards social expenses (the share of social expenditures in the budget remained at the level of 93%) that creates a kind of an “order” for foreign loans and privatization; and the government’s stake on immediate guarantees of the stability of the power vertical, which makes it maintain a corrupt relationship with interest groups in the large business. Investment risks and challenges linked to protection of domestic market are retained for the state.

There is an expectation that the next step after the distribution of government offices, which actually means the enhancement of the institution of presidency, will be the regulation of the decision-making process. Earlier on, a political conflict between the President and the Prime Minister entailed the sharpening of an institutional conflict and created a situation of an uncertainty center of decision-making. However, “one window” cannot solve the problem alone, since a corruption element of the decision-making process is retained. Furthermore, the clash of interests of different pro-power groups in one or another industry/business might call consolidation of power groups in question.

In the medium-term period, the risks linked to bringing power groups closer to economic resources will be high due to the increased level of conflicts among interest groups caused by the fight for their access to the budget distribution and their role in the process of property acquisition and redistribution.

Western companies are not in a hurry to invest in the non-transparent economy given the absence of single market rules and the dependence of courts and judges on outside influences. Hence, **the investment risks in Ukraine will remain high** without the legal reform guaranteeing independence of the legal system, anti-corruption reform, reduction of taxation, and bringing capitals out of the shadow and off-shores.

The UCIPR predicts **the retention of the structure and degree of political risks in the medium- (6-8 months) and long-term period**.

FORMATION OF A NEW POLITICAL REGIME

Results of elections

As a result of the **2010** presidential elections in Ukraine, leader of the Party of Regions MP Victor Yanukovych was elected President of Ukraine on 25 February.

On the day of the repeat voting (7 February), he received 12,481,266 votes (48.95% of valid votes of the voters); on the day of voting – 8,686,751 votes (35.32%).

His major rival, PM Yulia Tymoshenko, got 11,593,357 votes (45.47% of valid votes of the voters) in the second round and 6,159,829 votes (25.05%) – in the first.

Both candidates proved to be unacceptable for 4.36% of the voters, as they did not support any of them (in general, on the day of voting, 2.20% of the voters did not support any candidate).

Table Difference in the support for the two main presidential candidates

Year of elections	Candidates on the day of repeat voting (second round)	Difference in votes on the day of voting (first round)	Difference in votes on the day of repeat voting (second round)
1991	L. Kravchuk V. Chornovil	12,222,754	-
1994	L. Kuchma L. Kravchuk	1,870,140 In favor of L. Kravchuk	1,905,247 in favor of L. Kuchma
1999	L. Kuchma P. Symonenko	3,749,595	5,205,302
2004	V. Yushchenko V. Yanukovych	179,944	2,267,184
2010	V. Yanukovych Y. Tymoshenko	2,526,922	887,909

Attention of observers has been drawn to the fact that **for the first time over the whole history of presidential elections¹, the winner failed to gain the support of the simple majority of the voters and for the first time, a difference in votes in the support for the candidates was so minor** (see Table “*Difference in the support for the two main presidential candidates*”).

From the viewpoint of the political risk assessment, it has to be mentioned that **if any of presidential decisions has insufficient public approval, this factor might urge the Head of State to look for a set of actions to strengthen his positions in the system of power.**

Formation of a new political regime: V. Yanukovych’s inauguration as Ukrainian President took place on 25 February, 2010, which marked the beginning of changes in the system of power.

The same day, a new pro-government Coalition for Stability and Reforms of 235 MPs was registered in parliament. It consisted of 219 MPs from factions of the PR, the CPU and Lytvyn Bloc and 16 MPs from the faction of the former majority, BYuT and OU-PSD. The coalition has 248 members as of 14 May, 2010. The Lytvyn Bloc’s faction retained its position in power and V. Lytvyn remained Speaker of the Verkhovna Rada.

The procedure and grounds for the formation of the majority coalition exposed some “new old” problems. First of all, this is the problem of relationship between political responsibility of the Cabinet and the parliamentary coalition. As is known, the only constitutional task of the majority coalition in Ukraine’s parliament is to form the government. Though the Constitution has no rule, under which the

¹ See the CEC data by the results of the 1991, 1994, 1999, 2004 and 2010 presidential elections [electronic resource]: <http://www.cvk.gov.ua/>
UCIPR Politics Division

split of the coalition in power that formed the government means the resignation of the former Cabinet before the formation of a new coalition. Actually, the Constitution provides for the situation of retaining powers of the Cabinet that lost the majority's support and its influence on the formation of a new coalition in its support. This ensures the stability of the government on the one hand and provokes interpersonal and political conflicts in the course of the formation of a new coalition and a government on the other.

The situation, when the Cabinet lost the support of political forces in parliament but retained its powers, occurred in fall 2008. On 3 September, the coalition of BYuT and OUPSD split but powers of the Cabinet were not terminated.

If a new majority coalition is not formed in due course (30 days under the Constitution), there are legal grounds for early parliamentary elections and the resignation of the government.

An option, when the split of the coalition in power and a failure to form a new majority coalition in support of the "old" government would mean its resignation, could be a way out of the situation concerning grounds for early parliamentary elections.

Such the approach would offer yet another option to overcome parliamentary crises without early elections.

In 2010, despite the fact that parliamentary responsibility of the government is provided for in Ukraine (the term of powers of the government coincides, at best, with that of parliament and the latter has the right to pass a vote of no confidence in the government²), the resignation of Tymoshenko's Cabinet was actually caused by the assumption of office by the new Head of State and the concentration of power by his team, including representatives of other political forces.

In March 2010, 243 MPs voted for the resignation of Tymoshenko's Cabinet. 172 MPs from the Party of Regions, 27 – from the CPU and 3 independent MPs passed the resolution of no confidence. What is interesting is that the initiative was supported by representatives of the factions within the former majority: 15 MPs – from OU-PSD, 19 MPs – from Lytvyn Bloc and 7 MPs – from BYuT.

The BYuT leader saw the retention of her office of Prime Minister as the only opportunity to expand the coalition and to reshuffle the government.

This satisfied neither the winners in the presidential race nor faction representatives, who looked for different means to get out of the constitutional and parliamentary crisis so that to avoid early parliamentary elections.

The former coalition of BYuT-OUPSD and Lytvyn Bloc could not hold Tymoshenko's Cabinet. Political reasons for this were, among other things, the loss of support in parliament by the government and the inability to effectively manage social resources. (It has to be mentioned that the budget for 2010 was not

² Under Article 87 of the Constitution of Ukraine of 8 December, 2004, "The Verkhovna Rada of Ukraine, on the proposal by the President of Ukraine or by National Deputies of Ukraine making up no less than one-third of the constitutional membership of the Verkhovna Rada of Ukraine, may consider an issue of responsibility of the Cabinet of Ministers of Ukraine and pass - by a majority of votes of its constitutional membership - a resolution of no confidence in the Cabinet of Ministers of Ukraine." In other words, the Constitution legitimates parliamentary-presidential responsibility of the government though in fact, the Head of State can exercise this right only if his, not government, activity enjoys the support of the parliamentary majority. In such situation (depending on the alignment of political forces), the government would never had the parliamentary support and parliament would not demanded such initiative from the President. So, this power of the President seems a symbolic political function, especially provided that the Verkhovna Rada has the right to dismiss even the Foreign and Defense Ministers appointed by his quota. And if the head of State does not enjoy political confidence in the majority, he will be under the parliament pressure as it happened in 2009, when the VR dismissed Defense Minister Yuriy Yekhanurov and Foreign Minister Volodymyr Ohryzko but could not appoint new ministers because of the political conflict in the power triangle of the semi-presidential republic.

approved by the former President and Cabinet. It was approved by the new coalition and the government only on 27 April, almost 4 months since the beginning of the budget year.)

Nevertheless, neither the former coalition nor the new one that wanted to be formed to support the President's positions had enough force to shape a new government for the stable support of its activities.

As it has been expected, a political way-out was found and declared constitutional though it was not the Constitution that dominated the coalition's formation.

The majority coalition was formed not on the basis of factions and agreed political positions (in compliance with Article 83 of the Constitution of Ukraine) but on the basis of the inclusion of independent MPs. Such the procedure was provided for by the amended Regulations of the Verkhovna Rada of 10 February approved on 9 March after the promulgation of the presidential election results.

As is known, the Constitution governs, "According to election results and on the basis of a common ground achieved between various political positions, a coalition of parliamentary factions shall be formed in the Verkhovna Rada of Ukraine to include a majority of National Deputies of Ukraine within the constitutional membership of the Verkhovna Rada of Ukraine." Under the decision by the Constitutional Court of Ukraine of 17 September, 2008, "A coalition of deputy factions is formed based on the results of elections and on the reconciliation of political positions and consists of the majority of People's Deputies of Ukraine, who make up the constitutional composition of the Verkhovna Rada of Ukraine."

And the amended VR Regulations approved on 9 March allowed some MPs to become members of the coalition.

On 6 April, 2010 (after the formation of the Coalition of Stability and Reform), the Constitutional Court of Ukraine handed down a judgment ruling, "Individual People's Deputies of Ukraine, including those, who are not members of the deputy factions that initiated the formation of a coalition of deputy factions in the Verkhovna Rada, have the right to take part in the formation of a coalition of deputy factions in the Verkhovna Rada."

The coalition's expansion at the expense of MPs, who withdrew from the factions of the parties from which they had been elected, evidenced **the ineffectiveness the personnel work of parties and approaches to the composition of electoral lists** (most of which are grounded on the material resource of candidates). **The weakness of parliamentary coalitions can be partially explained by the instable nature of pre-election blocks**, which differently presents their subjectness in different competitive environment after the elections.

Events linked to the change in the format of the pro-government majority in parliament proved **the same groups differently exercise their political participation in different political situations**. As a result, all this together **erodes fundamentals of political responsibility and complicates political forecasts**.

The government formation: the presidential elections served as a means not only to change positions of economic groups on their access to resources but also to change the political role of different political groups. They gave an impetus to the settlement of the political conflict lasting from 2005 till 2010 and resulted in the formation of a new parliamentary majority and government (which, in the political context, includes the Cabinet of Ministers, the national executive authorities and the vertical of regional state administrations).

The speed of the government formation after the 2010 elections **was high enough**: the new government was composed within less than a month. Azarov's Cabinet³ was appointed on 11 March, 2010 by 240 votes (242 votes – for the appointment of M. Azarov as Prime Minister)⁴.

The coalition managed to agree the Cabinet's composition quickly as compared to the previous period. It has to be reminded that it took the SPU-BYuT-Our Ukraine over 4 months to negotiate the government formation after the parliamentary elections of 26 March, 2006. After the split of the coalition by the conflict of interests, the Cabinet was formed by the Anti-Crisis Coalition composed of the PR, the CPU and the SPU on 4 August, 2006. After the 2007 early parliamentary elections (30 September), the BYuT-OUPSD coalition, which had already mastered the lessons of the past, convened and appointed the Cabinet led by Y. Tymoshenko in 2.5 months, on 18 December (226 out of the necessary 226 votes – for the appointment of Y. Tymoshenko as Prime Minister).

Azarov's Cabinet consists of 29 ministers (four more than the previous government): the PM, the First Vice PM, six Vice Prime Ministers and 21 ministers (including a minister without portfolio).

The one-party composition of the government also indicates the high level of power consolidation. Despite that the coalition is composed by three political forces, the overwhelming **majority of governmental officials are members of the Party of Regions or its parliamentary faction.**

Yet, the question remains as to whether the high level of power consolidation will produce an effect in the course of economic reforms, since the government understands the need for them.

Notwithstanding the high level of power consolidation, reforms could be half-hearted or reduced at a certain stage. This conclusion is made on the factors of consolidation of power elites.

³ On 23 April, 2010, M. Azarov was elected leader of the Party of Regions; V. Yanukovych remained its honorary leader

⁴ Transcript of the VR session of 11 March, 2010, the site of the Verkhovna Rada of Ukraine [electronic document]: http://www.rada.gov.ua/zakon/new/STENOGR/11031006_22.htm

FACTORS OF CONSOLIDATION OF POWER ELITES

The main aspects in the political regime assessment are factors of consolidation of elites, on the basis of which it is possible to predict the stability of political consolidation. The UCIPR's survey carried out by political experts on 20-29 May, 2010 with the participation of 21 respondents helps understand the essence of these factors (see data of the expert survey on *"The Format and Dynamics of Ukraine's Political Regime after the 2010 Presidential Elections"* presented in this Document).

The respondents concluded on values that unite power groups. The overwhelming majority (19 out of 21 experts or 90.4%) are certain that **power groups unite around the idea to use power for the capitalization of various types of the power resource.**

Pollsters deem this is confirmed by the principles of the coalition formation; the nature of the distribution of government offices, especially, in the regions (following the principle of personal loyalty, not professionalism, the appointment of persons with tarnished reputation and even the formerly imprisoned persons); the presence of representatives of the large business in most capital-intensive directions of the government policy; the fact of the postponement of the local elections to be held on 30 May, 2010 (representatives of different factions, both the majority and minority ones, participated in this process); the absence of reform programs that would allow to break off the direct dependence of the "capitalization of the power resource" on power; the content of the Kharkiv accords between the RF and Ukraine; Russia's actions in the security and humanitarian areas to strengthen its own security positions in Ukraine, including the development of new Russian-Ukrainian initiatives; and the agreements to remove the moratorium on the sale of agricultural lands for their capitalization.

Though, some experts believe the Kharkiv accords should be assessed not only from the viewpoint of conditions beneficial for some business groups but also from the standpoint of the economic progress, which will give an impetus to the restoration of Ukraine's economy in the near future.

28.5% (6 experts) think that the goal of shaping a common economic space with the RF unites elites and that a number of intergovernmental (Kharkiv) accords signed with Russia in 2010 shall be interpreted in this very context. 19% (4 experts) are sure the matter concerns the goal of shaping a common humanitarian space of Ukraine and Russia.

Efforts to develop a common security platform with the RF and to reach a consensus on the maintenance of competitive principles in the distribution of the power resource are viewed as the basis for consolidation of elites just by 1 respondent (4.7%).

None of the experts (0%) believe consolidation of elites is motivated by such reasons as: the idea to build Ukraine as a democratic, constitutional and social state, the intention to ensure Ukraine's institutional development on European values and the Eurasian idea.

2 respondents (9.4%) are convinced elites unite around the intention to work out and to implement a reform program for the social leveling.

As a matter of fact, this very goal has been declared as the main direction of the government activities. On 4 June, President V. Yanukovich presented the Program of Economic Reforms for

2010-2014 “Prosperous Society, Competitive Economy, Effective State”⁵ to overcome the crisis and to enhance the social welfare of the population.

The President said reforms in the socio-economic area will be launched since 2011.

The pollsters assessed the level of readiness of different groups for a package of reforms to be implemented (in the framework of the survey, by the content of reforms the UCIPR meant their democratic, social and legal dimensions, not reforms in the interests of power groups).

The experts are most skeptical of Ukraine’s readiness to carry out reforms to shape an anti-corruption policy and a policy for the transparent administration of public finance (71%), since results of these reforms will contradict the position of power groups.

Fewer respondents guess that for the above reason, it will be difficult to carry out the judicial and legal reform (52%) and to drive the economy out of the shadow (57%). The same stands true about the medical care reform.

In the opinion of the pollsters, the absence of the unity of views of the main power groups is explained by “failings” in the development of the local self-government (47.6%), administrative and territorial (52%), electoral (62%), political, constitutional and higher education reforms.

The experts say their uncertainty about the reforms ensuring and securing the political and civil rights is determined, to a large extent, by a type of power elite and by rapid changes in government policy.

The UCIPR compared assessments given by the respondents to the characteristics of a “new elite” desirable for the society and presented in the UCIPR’s survey in May 2009 (see data of the expert survey on “Modeling the Future: from “New Faces in Politics” to “A New Face of Politics”) with identical questions put in May 2010.

The year ago, the experts linked the main features of “new” elites to the need to be shaped out of the practice of the Soviet period (65%); to be ready to carry out reforms (85%); to hold offices in the government (90%); to be educated and to have flexible thinking (90%); to have specific achievements in the past (60%) and to have a support in the system of public administration (75%).

The respondents said a special requirement to new elites is not to be bound by the commitments and the representation of interests of the oligarchic capital and, at the same time, not to be corrupt (90%). As regards the age of “new” elites, opinions of the experts divided: some were ready to yield the palm to the young, whereas others – to the middle-aged generation. Meanwhile, only one pollster (5%) saw innovators of the socio-political discourse among persons older than 55 years, which does not refute the common statement that “Soviet-minded” officials cannot bring new values in politics.

The expert assessment of power groups in May 2010 mirrors a type of power elite represented in a desirable “portrait” of “new elites” by the following indicators: the readiness to carry out reforms (assessed as “minor” for power by 51% of experts), the holding of government offices

⁵ The “Prosperous Society, Competitive Economy, Effective State” Program of Economic Reforms for 2010-2014, the site of President of Ukraine V. Yanukovich [electronic document]: <http://www.president.gov.ua/content/ker-program.html>.

(assessed as “minor” for power by 51% of experts), the age composition (the average age of an official is 51 years) and the adherence to the practice of the Soviet epoch (57%).

The pollsters are almost unanimous (95%) in the high level of corruption of power groups, their bounds to the commitments and the representation of interests of the oligarchic capital (81%). The respondents also underscore the loyalty of power elites to “political pragmatism” (50%), the availability of specific achievements of representatives of power in the past (52%) and their support on the system of public administration.

The assessments given to a type of power elites entail, at least, two questions, which will be in the focus of analysis in the next issues of the Document on Political Risk Assessment: whether the program of economic reforms will remain just a declaration of intention and whether the economic progress justifies the narrowing of the competition of political groups and the rule of human rights.

Attention has also to be paid to the fact that the number of experts, who view the absence of money as the main factor impeding reforms, has grown over the year. In May 2009, only a few experts mentioned the above reason as the obstacle to only two reforms, the local self-government (4%) and the administrative-territorial (15%), whereas in May 2010, this list has been supplemented with the social policy reform, the need to monetize privileges and the pension reform.

The number of respondents, who believe the time for reforms is already lost, has also increased over the year (10-25% of the pollsters in May 2010 compared to 10% in May 2009). The same stands true of the list of the “lost” reforms. In May 2009, it incorporated only the anti-corruption policy and a transparent land market, whereas this year, the list has been expanded to the following ten directions of reforms: local self-government, Constitution, elections, social policy, transparent administration of public finance, national economy (moving it out of the shadow), anti-corruption policy, transparent land market, high education and medical care.

INTERESTS IN THE PRIVATIZATION PROCESS

The 2010 national budget calls for privatization revenues of UAH 10.263 billion. The most lucrative units in 2010 are Luhanskteplovoy and Ukrtelecom. The level of revenues from their privatization has to indicate the level of Ukraine's investment attractiveness.

A tender for the sale of a 76.001% stake in Luhanskteplovoy is scheduled on 15 June. The starting price is set at UAH 400 million, about 1.5 times more than that paid in 2007.

Experts estimate the market value of Luhanskteplovoy at UAH 1.2 billion. This means the company could be sold at a twice higher price of some UAH 800 million. The State Property Fund of Ukraine (SPFU) fixed the starting price, which is 50-70% lower than the real value. Despite that a buyer will have to pay the budget arrears and arrears of wages worth UAH 34 million, the volume of investment in Luhanskteplovoy is estimated at \$20 million at least.

The main bidders are Bryansk Machine Building Plant (controlled by Russia's Transmashholding) and Marganets Ore Dressing and Processing Plant (part of the business empire of Ihor Kolomoisky).

The sale of the company may cause certain difficulties. Specifically, Russian Railways holds a 25% stake in Transmashholding, whereas under the law of Ukraine "On Privatization of Property of State-Owned Enterprises", "Purchasing entities may not be more than 25% state-owned nor can they be governmental agencies." However, the law does not specify whether the matter concerns the Ukrainian or foreign state-owned property. Such ambiguity may create grounds for a lawsuit.

The previous tender, which had been held on 23 March, 2007 and in which the company had been sold to Bryansk Machine Building Plant at the price of UAH 292.505 million for 76% of shares, ended in a scandal.

The buyer has in fact "defeated" its affiliate, Demikhov Machine Building Plant (the Moscow region). Both participants in the tender were members of Transmashholding. The winner paid just UAH 505,000 (less than 0.2%) over the initial price

In May 2007, the contract for the sale of Luhanskteplovoy to the Russian company was cancelled under the lawsuit of Dniprovahonmash. Though only in November 2009, the shares of the Luhansk-based enterprise were transferred to the account of the SPFU.

In early 2010, the Russian company filed a lawsuit with the Kyiv Economic Court to return the money. Instead of UAH 292.505 million, it demanded \$58 million, which constituted UAH 459 million on the date of the lawsuit (the devaluation of the hryvnia made a difference of UAH 167 million).

It is safe to assume Luhanskteplovoy will be bought by Russians again. If so, the question is how much they are going to pay: UAH 459 million, which the SPFU owes them, or more, as Chairman of the Fund O. Ryabchenko said the bidders in the 2009 tender for the sale of Frunze-Flora and Nortima (linked to I. Kolomoisky by the media) may get back UAH 800 million after the sale of Luhanskteplovoy.

The SPFU is to announce a tender for the sale of a 92.79% stake in Ukrtelecom this August. According to Oleksandr Ryabchenko, he has already signed a respective order because he considers August to be the optimal time to get money from the sale of this telecommunications operator for the national budget by the end of the year.

The stake is estimated at UAH 9 billion though the SPFU expects to raise UAH 10 billion from the Ukrtelecom's sale.

R. Akhmetov's companies, Russian AFK System (owns MTS) and Alfa-Group (co-owns Kyivstar and Ukrainian Radio Systems) are on the bidders list.

Experts say the best time to sell Ukrtelecom was some five years ago. As for the expediency of its sale, their opinions vary. Some experts deem it should be sold as soon as possible since its price will continue to fall, whereas others think this should not be done during the crisis.

Conclusions: there is a risk that the government policy in the area of privatization will remain ineffective in the medium-term period.

It is necessary to underline the absence of a strategy for reforming property relations, disinterest to counteract the use of shadow schemes in privatization of large units and non-transparent decision-making on privatization issues.

As a result, Ukraine still does not have an effective institutional system, which could ensure the optimal use of the national economic potential and which could serve as the basis for social consensus on strategic goals of the socio-economic development. This strongly affects the intention of western investors to keep on waiting. Today, big Russian companies ready to invest in Ukraine's economy are in one way or another linked to the government. Their behavior is politically motivated and may have dangerous consequences for the national economy.

Receipts from privatization in 2010 may be lower than the planned. The global crisis that caused the fall of the world and Ukrainian stock markets resulted in the reduction of investment attractiveness of Ukrainian businesses. Besides, the investors' behavior is influenced by external market factors, first of all, political risks, which remain too high in Ukraine.

IMPACT OF NON-PUBLIC EXPECTATIONS OF INTEREST GROUPS

Energy: RosUkrEnergo (RUE) made public the amount of its claim against NJSC Naftogaz Ukrainy. RUE demands the return of \$5.4 billion, or \$490 per 1,000 m³, for 11 billion cubic meters of gas. Meanwhile, RUE's co-owner Dmytro Firtash said his company is not interested in the return of gas and cash is the best way for Naftogaz to settle for 11.7 billion cubic meters of gas.

The gas was seized by Naftogaz from RUE as a kind of compensation after Naftogaz and Gazprom had signed the contract and eliminated RUE from the scheme of supply of natural gas to Ukraine. This was done with the consent of Gazprom that has a 50% stake in RUE. In early April, the Arbitration Institute of the Stockholm Chamber of Commerce passed the interim ruling in favor of RUE against Naftogaz for \$197 million in compensation for contractual violations.

It is possible to assume that the Group DF will anyway claim to support through getting other attractive assets, in particular, in titanium industry, in which it is interested.

At the first stage, a joint venture between Gazprom and Naftogaz could be set up on a parity basis, as summed up by Gazprom's Chairman of the Board of Directors Aleksey Miller and Minister of Fuel and Energy of Ukraine Yuriy Boyko at a working meeting in Moscow.

Experts estimate Naftogaz at \$17 billion and Gazprom at \$170 billion and say the Russian energy giant could contribute production assets worth \$15-\$17 billion to the joint venture.

In the opinion of experts, it will be difficult to set up the joint venture. Inequality of the partners is obvious. Naftogaz is unlikely to get promising deposits, whereas Gazprom will get a share on one of the attractive markets.

The world practice evidences companies jointly set up a legal entity in order to execute certain functions, which are difficult to execute autonomously. In case of Naftogaz and Gazprom, the joint venture may mark the first step to the alienation of the Ukrainian property and the merger of the companies. Anyway, it is Gazprom and Naftogaz, which on 30 April, Russian PM V. Putin suggested to merge.

According to First Vice PM Andriy Klyuev, Ukraine is going **to resume cooperation with American company Vanco**. "The raids by the former Cabinet are not justified. We undermined Ukraine's image in the eyes of all international investors," he said.

Earlier on, on 13 May, PM M. Azarov reported the government is working out proposals to settle the conflict with Vanco out of court.

In 2006, Vanco International Ltd won the first public tender and in October 2007, signed a product sharing agreement (PSA) with the government of Ukraine to explore the Prykerchenska area of the Black Sea shelf. Vanco International delegated all its rights and commitments under the agreement to Vanco Prykerchenska. On 25 April, 2008, the Ministry of Environment and Natural Resources of Ukraine cancelled Vanco Prykerchenska's license. On 21 May, 2008, the Cabinet of Ministers of Ukraine decided to unilaterally withdrew from the PSA with Vanco.

On 17 July, 2008, Vanco Prykerchenska lodged an appeal on the PSA with the Arbitration Institute of the Stockholm Chamber of Commerce.

Metallurgy: Zaporizhstal Integrated Iron and Steel Works was another company that changed its owner. The media reported the sale is over and the agreement with new owners is concluded **with the participation of the Russian Vneshekonombank** (Chairman of the Advisory Board – V. Putin). 96.7% of shares of Zaporizhstal are estimated at \$1.7 billion.

Simultaneously with the sale of Zaporizhstal, a scandal occurred at **Illich Steel and Iron Works in Mariupol**, in which Russian investors are seen behind offshore companies in Cyprus.

Earlier on, on 31 December, 2009, the deal **on the purchase of 50% plus 2 shares of ISD by a group of unknown Russian investors with the Vneshekonombank's participation** was closed. The media reported a controlling stake in ISD is bought in favor of majority shareholder of Metalloinvest Alisher Usmanov (owns 50% of companies) and main beneficiary of Evraz Roman Abramovich (41%).

The events of the past six months have demonstrated **Russian companies (in particular, metallurgical ones) are actively entering the Ukrainian market with the support of Russia's Vneshekonombank**. In this situation, there is a possibility that Ukrainian businessmen will lose their impact on the alignment of forces on the metallurgical market. A possible purchase of assets of Ukrainian metallurgical companies by the Russian capital can be explained by the consent of Moscow, under the Kharkiv accords of April 2010, to make a discount in the price of Russian gas for Ukraine as it is most needed for metallurgical companies.

Ukraine is not the only post-Soviet state, whose metallurgy needs investment. Yet, other countries approached the issue of the choice of investor very cautiously. It is enough to recall the difficulties faced by Evraz Group in the purchase of a Czech company, Vitkovice Steel, in July 2005.

Yet another example is the purchase of Huta Czestochowa by the Industrial Union of Donbas. A special law offering an opportunity to restructure debt was developed for the sale of Huta Czestochowa. And right after the inauguration, V. Yushchenko had to declare his support for IUD's aspiration to enter the Polish market and to promise "this project will enjoy the support of the Ukrainian government."

This is the difference in privatization and M&A between European countries and Ukraine. Since our government encourages domestic metallurgical companies in the form of preferential customs duties, reduced prices for gas, transportation tariffs and others, such support does not encourage their capacity to exist independently on the open competitive market.

Conclusions: among interest groups that supported V. Yanukovich at the elections, there are those linked to Ukrainian capitals and Russian companies directly or indirectly subordinate to the Kremlin.

With regard to the fact that their interests sometimes compete, conflicts between interests groups are expected to increase in the medium-term period, which could reduce the level of power consolidation.

D. Medvedev's outright denial to meet the wishes of the Ukrainian business to get Central Asian gas bypassing Gazprom has become indicative in the context of competition between Ukrainian and Russian interest groups. It revealed the limits of protection, by the Ukrainian government, of the large Ukrainian capital on the foreign market, if this protection is associated with personal agreements and political trickery.

FORECAST OF THE DEVELOPMENT OF THE POLITICAL SITUATION

The medium-term forecast (for 6-8 months) includes proposals of power groups to legitimate main features of the political regime, which provides for the following:

- A model of the system of state power adequate to the real state of affairs (i.e. the enhancement of the political role of the institution of presidency represented as a means to stabilize a political multi-party system) will be developed and strengthened on the basis of “optimizing” the respective constitutional framework;
- Principles of the law on elections to authorities at a variety of levels, the legal and local self-government reform will be discussed;
- Power groups will be moved closer to the state property, in particular on the basis of state-owned holdings and at the expense of faster privatization processes;
- Conflicts among groups of interests, including power interests, caused by access to resources and the redistribution of property (in particular, on the basis of illegal takeover) will intensify.

DEGREE AND STRUCTURE OF POLITICAL RISKS

Assessment of decision-making procedures and analysis of positions of active economic agents in the system of political representation (the political decision-making process) allows assessing the degree of political risks in Ukraine at the current stage (May 2010) at the level of 6-7 points.

7 – Unpredictability is high.

Regional instability,
Inclusion of the country into the zone of conflict of interests,
Polarized politics,
High level of the “human factor” in decision-making,
Instable political ties,
Voluntarism in decision-making,
Closed decision-making in the interests of decision-making parties,
Disregard of procedures and the need for their recognition,
Unpredictable decisions,
Interference of the government with corporations,
High level of corruption

6 – Unpredictability is higher than average.

Polarized politics,
High level of the “human factor” in decision-making,
Voluntarism in decision-making,
Closed decision-making in the interests of decision-making parties,
Disregard of procedures and the need for their recognition,
Unpredictable decisions, interference of the government with corporations,
High level of corruption

The structure of political risks in Ukraine tends to be retained in the medium- (6-8 months) and long-term periods.

INFORMATION ABOUT THE UCIPR PROJECT ON POLITICAL RISK ASSESSMENT

In 2008, having many-year experience of analysis of political processes and activity of political system institutions, the Ukrainian Center for Independent Political Research (UCIPR) launched a new project linked to the identification of factors of political risks in Ukraine.

In the context of goals of this project, *a political risk* means tendencies that provoke uncertainty in the process of political and governmental decision-making and impede planning of actions on the country's markets. Political risks grow from political relations, i.e. relation concerning power and property, lie in the area of political decision-making and influence positions of agents in other areas. The term "political risk" does not coincide, by its volume, with the term "political stability" and concerns action/inaction of the government that rapidly changes conditions of work of economic agents on markets and adversely affects positions of different social groups. Political instability is viewed as an element of the structure of political risks.

The project *objective*: to forecast, on a basis of political risk assessment in Ukraine, a probability of the retention of their impact in the short- and medium-term period.

The *subject*: to evaluate the placing and correlation of groups of political influence both inside and outside the country and to analyze proposals of these groups.

The methodology: expert survey (questionnaire poll) concerning assessment of impact of the determined factors, monitoring of decisions and draft decisions of national authorities in Ukraine and abroad (that relate to Ukraine), monitoring of decision-making procedures and assessment of positions of groups of political influence.

Assessments are regularly revised.

The project is implemented by the UCIPR Politics Division.

Division Head – Svitlana Kononchuk; Project Expert – Ihor Nemchynov, Candidate of Philosophy.

Expert survey – Svitlana Gorobchyshyna

The previous issues of the Document on Political Risk Assessment are available on the UCIPR's site.