

Ukraine

Status Index 5.9 (Democracy: 3.2 / Market economy: 2.7)		Management Index 5.1	
System of government	Presidential democracy	Population	49.3 mill.
Voter turnout	72.2 % (Parliamentary elections 2002)	GDP p. c. (\$, PPP)	4,350
Women in Parliament	5.3 %	Unemployment rate	3.7 %
Population growth^a	n. a.	HDI	0.766
Largest ethnic minority	17.3 % (Russians)	UN Education Index	0.93
		Gini Index	46.2 (2000)
Data for 2001 – if not indicated otherwise. ^{a)} Annual growth between 1975 and 2001. Source: UN Human Development Report 2003.			

1. Introduction

With a good 10 years as an independent nation, Ukraine is among the younger states in Europe. On 24 August 1991, Ukraine declared its independence, succeeding for the first time in its history. The initial phase of Ukraine's independence was marked primarily by national consolidation. A key factor in this consolidation was the task of maintaining national unity, despite regional and ethnic differences between eastern Ukraine, which had been shaped by Soviet Russia, the actual core of Ukraine in the west, and the Crimea, which historically belonged to Russia. Simultaneously, Ukraine's independence was threatened by the strong neighboring nation of Russia.

The influence of economic interest groups and clans was negatively linked to ethnic divisions and Russian dominance. Neither President Leonid Kravchuk (1991–1994) nor President Leonid Kuchma (during his first term) was able to constructively resolve the differences of interests between Parliament and the administration to a degree that made a lasting reform policy possible. In independent Ukraine there have been difficulties both in creating a new institutional framework and in distributing power among civil servants. The division of power between the president and Parliament was unresolved until the new constitution was adopted on 28 June 1996. As was somewhat typical for post-Soviet states, conflicts arose between the members of the administration, who styled themselves as backers of reform, and the Parliament, which was seen as an impediment to reform. The continual conflict was less about ideological interests than power politics. The participating interest groups and individual actors focused mostly on political decision-making powers and economic resources.

The power struggles led to political and economic instability. Kuchma managed to put a stop to these negative trends during his second term of office. Together with Prime Ministers Yushchenko and Kinach, the president was able to establish a reform-oriented government. The opposition within the Supreme Council (Parliament) acquiesced, taking a more constructive stance. Moderate growth and structural reform halted the economic downturn.

The political system is now more stable. Formal reform measures have repeatedly led to negative reactions from interest groups, which seriously hamper the sustainability of the changes. Furthermore, the present system promotes corruption and results in limitations on political freedoms. The future of the market economy and democracy in Ukraine will depend greatly on whether the present reform measures can be sustained successfully. For the reforms to be successful, the influence of the interest groups must be channeled into institutional structures.

2. History and characteristics of transformation

When Ukraine emerged from the rubble of the Soviet Union as an independent state in 1991, it needed to surmount numerous ethnic and national problems. The eastern part of Ukraine had a Russian character, both because of its populace and the Soviet structures of heavy industry and raw materials extraction. Western Ukraine, on the other hand, has ties to the historical traditions of Poland and Galicia. The Crimean peninsula presents a special case. After the Soviet Union collapsed, many Crimean Tatars returned to the peninsula, adding ethnic and economic problems to the existing tensions. Aside from the ethnic question, the country's consolidation was also hindered by its proximity to and dependence on Russia. The country's diverse populace was aggravated by the lack of a Ukrainian state church.

Along with Ukraine's foreign policy and foreign trade emancipation from its strong neighbor Russia, Ukraine's cohesion as a nation-state is crucial to its continued existence as an independent nation. Maintaining national unity has succeeded primarily through the establishment of a strictly centrally organized state. As a result, the governors of the 24 administrative regions are not elected by the people; rather, they are appointed by the president. Only the Crimea Autonomous Republic has been awarded greater regional autonomy. The centralized structure of the state, however, also constitutes a tool for maintaining independence. The country's relationship with Russia was worked out between Russia and the West through deft foreign-policy tactics. Both the signing of the Russian-Ukrainian agreement regarding the division of the Black Sea fleet in July 1997, as well as the friendship treaty signed by both countries were milestones in this process. At the same time, Kiev was able to draw closer to NATO and the European Union, strengthen its ties with the West by signing numerous agreements, and expand cooperation in general.

The blend of various ethnicities, languages and economic structures has coalesced after independence with a network of political and economic interest groups. The adoption of the Ukrainian constitution in 1996 was a negotiated compromise that reflects the power relations of the time and protects the country's consolidation. The gas sector in Dnipropetrovsk, the coal industry in Donetsk, and Lviv as the intellectual center of western Ukraine are all crucial to the distribution of power in the political system.

The failure of attempts at economic reform was symptomatic of the initial years of transformation in Ukraine. The main causes of stagnation and crisis were not so much the lack of ideas, but political conflicts and corruption that hampered everything. The actors' special interests were stronger than their interest in modernizing the country. Political priority initially rested on consolidating the independent Ukrainian nation-state and consequently the country's border with Russia. In 1998 industrial production amounted to only about 40 % of 1990 production levels; the level of agricultural production reached only half of its capacity during the same time period. During the Russian financial and economic crisis of August 1998, the Ukrainian economy hit rock bottom as well. Reform was overdue.

3. Examination of criteria for democracy and a market economy

3.1 Democracy

Ukraine is formally a parliamentary democracy. According to the constitution, the administration and the Parliament balance each other out so that the president cannot make decisions without the legislative branch. In practice, however, this structure has often led to blockades of reform within the government, which were only dissolved after President Kuchma temporarily secured a clear majority in Parliament. Here it is important to note that political parties exercise their influence more based on affiliation with economic interest groups than along platform lines or according to ideological positions. Thus, economic interests often intermingle with regional ones. Although the framework and level of organization in civil society has improved, individual incidents—such as the murder of opposition journalist Gyorgi Gongadze, make the limits of civic action clear.

3.1.1 Political organization

(1) *Stateness*: On the basis of the 1996 constitution, Ukraine has formally succeeded in establishing the state's monopoly on the use of force. In principle, state power has been set up throughout the country and is sufficiently centralized to prevent eastern and western Ukraine from splintering apart. At the same time, sufficient autonomy rights have been granted to deal with the Crimea issue.

Rights for national minorities are guaranteed not on a territorial level, but on an individual one. All citizens have the same civil rights. The Tatars who have returned to Crimea accept their right to Ukrainian citizenship, but organizational and financial difficulties are involved in their release from their former citizenship.

State power is noticeably impaired by the power of interest groups. The influence of special interests destabilizes the political system through corruption and reform bottlenecks, and also because key political positions are occupied by representatives of the various interest groups. None of the five major churches, neither an orthodox one (Ukrainian Orthodox Church, Moscow Patriarchy; Ukrainian Orthodox Church, Kiev Patriarchy; Ukrainian Autocephalous Orthodox Church) nor a Catholic one (Greek Catholic, Roman Catholic), functions as a state religion. The lack of a state religion and the resulting national identity questions, along with intra-church conflicts are, or rather, were the real denominational problem in Ukraine. Potential conflict over secularization is not taking place between church and state, but rather between the individual denominations.

(2) Political participation: The distribution of political offices takes place through general and free elections, which are the accepted method of filling leadership positions. National observers and international organizations, such as the Organization for Security and Cooperation in Europe (OSCE) and the Council of Europe, criticized the executive branch's handling of the media and exertion of influence on the campaign during the most recent parliamentary and presidential elections. Even though the election ran largely democratically, general conditions are anything but fair. Fundamental democratic principles are restricted by pressure from the administration on opposition media and independent journalists. Office-holders use the opportunities presented by the executive branch and its allies in the media to improve their standing in election campaigns. Elected office-holders have the power to govern in important areas, but lobbyists have succeeded again and again at exercising influence over the highest members of the executive branch and their political course of action.

In contrast to the powerful lobbyist groups, the political parties wield comparatively little influence and are rather fragmented. In the last parliamentary elections, on 31 March 2001, a total of 33 parties and political blocs qualified for the ballot, but because of the four-percent-clause only six parties and a number of independent direct candidates entered Parliament. The candidates from the "For a United Ukraine" party, associated with Kuchma, received a disproportionate number of direct mandates in relation to the total number of votes, and the "independent candidates" were often already on the side of the ruling party during the campaign. Reform parties, on the other hand, received the majority of their votes via the party lists and not from direct mandates. Viktor Yushchenko's "Our Ukraine" bloc, for example, managed to garner twice as many votes via the party lists as it did via the direct mandates. All these facts are signs of the administrative

pressure that can be placed on constituencies by local administrations, but not on the party lists.

The American organization Committee to Protect Journalists nominated Leonid Kuchma in 2001 as one of the world's ten greatest enemies of the press. State interference with individual journalists has already brought upon Ukraine criticism from the Council of Europe and the European Union. Thus far, the most prominent case is the murder of journalist Gyorgi Gongadze in September 2000; he had reported on corruption surrounding Kuchma in the Internet newspaper *Ukrainsky Pravda* on multiple occasions. Tape recordings from the president's official residence that became public give rise to the suspicion that Kuchma himself is involved in the case. Gongadze has become a figurehead for the opposition.

(3) *Rule of law*: The Ukrainian constitution provides for a division of powers and an independent judiciary branch. Constitutionally, the executive branch has significantly less power than in other countries in transition, and the role of the Parliament is strengthened with a positive effect on the principles of the division of power. However, the executive branch has repeatedly succeeded in exerting administrative pressure on the composition of the legislative branch. The division of powers between the executive branch and the legislative branch is capable of blocking the implementation of reforms, and it has done so in the past; it has also led to numerous personnel changes in top government positions.

The legislative reforms of recent years, such as reform in the criminal procedure code, have likely raised the degree of the rule of law in Ukraine. Although an independent judicial branch is anchored in the constitution, in practice, the independence of the dispensation of justice is impaired. The biggest problems here are insufficiently educated judges, their low salaries, and dependence on the executive branch in questions of discretion. As long as the budget and resource problems in the judicial branch remain unsolved, powerful lobbying groups can easily exert influence over the law.

The judicial branch's insufficient independence has its most negative effect on effectively fighting corruption. The fight against corruption is used selectively and specifically as a means of eliminating opposition to the administration, as well as by lower-level delegates. Corrupt delegates are prosecuted neither sufficiently nor according to transparent and fair criteria. Some cases have met with public criticism, as with deputy prime minister for energy, Yulia Tymoshenko. Tymoshenko, who was personally involved in the energy sector in the early 1990s, successfully took action against the black economy in the Ukrainian energy sector. Amidst allegations of forging documents, smuggling Russian natural gas, corruption, and tax evasion in connection with her economic activities, she was temporarily arrested multiple times, but then released every time by order of the Supreme Court. As head of the "Yulia Tymoshenko Bloc," she became one of the leaders of the opposition.

Serious civil rights violations have manifested themselves repeatedly through murders, attacks, and intimidation of journalists, parliamentarians, members of the political opposition and rival trade union representatives. This led to a debate in the 26 April 2001 parliamentary session of the Council of Europe regarding the exclusion of Ukraine from the body. Once again, the body granted Ukraine a transitional period to achieve substantial progress. According to the Council of Europe's normative guidelines, the abolition of the death penalty on 22 February 2000 was an essential advancement in guaranteeing human rights.

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: Democratic institutions basically function as they should; however, there is extreme friction between Parliament and the administration, as well as within the administration. Throughout Ukraine's more than ten years of independent existence, it has been rare for a prime minister to remain in office for longer than one year. The changes at the top have repeatedly been tied to major insecurity regarding the continuation and direction of reforms. In addition to fluctuations in personnel, there have also been debates about institutional reforms of the system of government. In both personnel and institutional decisions, the lobby groups attempt to assert their influence at a political level. Those who pull the strings of political and economic power accept the institutions of a democratic Ukraine only insofar as the institutions can serve as a tool for securing their own interests.

(2) *Political and social integration*: The party system in Ukraine is seriously fragmented and is split between those in the president's camp and those who oppose him. The party system is poorly developed, and in addition, with the exception of the Communist Party, there is a lack of differentiation between the party platforms. The parties and voting blocs are primarily political vehicles for individual leading politicians and at the same time, they serve as a way to drive the leader's interests. "Our Ukraine" stands for the former Prime Minister Viktor Yushchenko, "For a United Ukraine" is Kuchma's ruling party, and Yulia Tymoshenko founded the "Tymoshenko Bloc." This list continues in this way for all the parties.

The populace's faith in the country's political institutions remains low. The opposition was formed as an extra-parliamentary protest. There have been a great number of massive protests in the last couple of years. A call for Kuchma's ouster from office is being led by the Communists, the Socialists, the Tymoshenko Bloc, and the Our Ukraine party. The "Ukraine Without Kuchma" movement opposes the integration of power and assets, and the the executive branch's repressive actions against independent media. The protest movement's strength lies in demonstrations against specific issues, and its weakness lies in formulating a constructive position, which must also solve questions of personal power. Political

protests tend not only to question the system of government and its elite, but to also target both of these factors as a main argument for political protest.

The topography of social interest groups is determined by influential actors, such as the Ukrainian trade association. Important social interest groups are not constituted institutionally, but their informal alliances—which consist of regional and sector-based insider relationships—are that much stronger because of it. They wield considerable influence over the country's political and economic events. Although civil society's legal, administrative, and organizational framework is not particularly well developed, the number of NGOs has doubled since 1996, and their professionalism and social acceptance have grown steadily. For example, NGOs have taken on increasing importance in questions of health care (especially AIDS), agrarian reform, the fight against the "Natasha Trade," election monitoring, and the fight against corruption.

3.2 Market economy

3.2.1 Level of socioeconomic development

Income inequality in Ukraine shows a negative trend in development. In the period between 1998 and 2000, the Gini index ratings point to increasing inequality of income, and the baseline level of inequality of income was already relatively high compared with the neighboring countries. In the late 1990s, the country's social downturn could not be stopped. According to estimates from the United Nations, 25 % of the Ukrainian populace was living below the poverty level, and opinion polls at the time indicated that 80 % of Ukrainians considered themselves poor. This is a clear indicator that social exclusion is quite pronounced, both qualitatively and quantitatively, and is also structurally reinforced by the massive influence of interest groups.

3.2.2 Market structures and competition

Individual elements of a free market and competition have been successfully introduced in Ukraine. Some of these elements are the elimination of controls over consumer prices in 1994, and most other prices as well, with the exception of key sectors, such as energy prices and rent subsidies. Despite important reform measures in recent years, such as the introduction of new basic banking legislation, important institutions for a smoothly functioning market economy remain absent.

Legal security for private enterprise and free trade are still too poorly developed to guarantee a market-economy system. The biggest problems come from the illegal practices of corruption, money laundering and smuggling, which are insufficiently punished through legislation, actual application of legislation, and criminal

prosecution. Lobbyist groups from heavy industry and the raw materials sector continue to exercise great influence on the Ukrainian market and the country's economic system, and they are far less interested in free-market mechanisms than are the small and medium-sized enterprises that are currently establishing themselves. Despite individual advances made in the privatization of large-scale industry, such as the privatization of six regional power distributors (*Oblenergos*), privatization in general has been sluggish at best. There is a lack of both domestic and foreign investors. In addition, privatization is hampered by the closed structures formed by regional clans.

Ukraine's most important foreign trade partners are former Soviet states, in particular Russia, which, in the first half of 2002, accounted for 36.9 % of imports and 22.6 % of exports. Ukraine's second most important foreign trade partner is the European Union, which accounts for about 15 % of Ukrainian imports and exports. Foreign trade formally follows the principles of free trade, but they are seriously hampered by non-trade-related priorities, and in addition they are restricted by frequent changes in ratification and customs processes. The Ukrainian government has declared its objective of joining the World Trade Organization (WTO). In 2001, Kuchma delivered guidelines for adjusting Ukraine to the WTO's standards, under which about 500 regulations must be adjusted annually. The program is underfinanced, though, which makes its implementation appear rather unrealistic.

The banking legislation that came into force in January 2001 was an important step forward. These laws strengthened the Ukrainian national bank, and enhanced and solidified the rights of investors. The capital market's real problem is not a lack of differentiation in the banking sector, but rather its extreme differentiation, with more than 150 banks, many of which are financially weak. Money laundering and insufficient legislation, along with a lack of efficient institutions in the fight against money laundering have also proved to be fundamental problems for Ukrainian capital markets.

3.2.3 Stability of currency and prices

Following the Russian financial and economic crisis of 1998, Ukraine's macroeconomic indicators initially deteriorated, but there has been clear improvement since 2000–2001. The GDP's development since 2000 has exhibited stable increases of between 4.5 % and 9.1 %. Economic growth was accompanied by a conservative fiscal policy, stable exchange rates, and a surplus in the balance of payments. Changes in consumer goods prices and producer prices were also dominated by the crisis in Russia during the evaluation period. Prior to 1998, positive price developments were already noticeable; consequently it was possible to decrease inflation that reached more than 300 % for consumer goods prices and more than 400 % for producer prices, to a level of a little more than 10 % in 1998 (consumer goods prices in 1998: 10.5 % and producer prices: 13.2 %). The

Russian crisis delayed these positive approaches, and it is only since 2000 that a return to 1998 values can be seen for producer's prices and since 2001 for consumer goods prices. Furthermore, the expected 12.0 % rate for producer prices since 2002, and the expected 1.6 % for consumer goods prices not only show a clearly positive trend, but also a definite improvement.

Inflation control and exchange rate policy are recognized economic policy goals that were set back by the crisis. They were neither consistently nor sustainably anchored institutionally to withstand pressure from domestic interest groups and lobbyist groups during the evaluation period.

3.2.4 Private property

The Ukrainian constitution includes a right to private property and with new basic legislation effective since the beginning of 2002, the opportunity to purchase private land now exists. Through 2001 the private sector's share of the gross national product grew to 60 %, which indicates that it has not yet been possible to privatize larger, strategically important enterprises. Lagging privatization was also due to the lack of interest on the part of domestic and foreign investors. Although property rights are formally anchored, their implementation will remain problematic so long as the executive and judicial branches do not succeed in efficiently implementing property rights and property protection in practice. Organized crime, corruption, and the power of interest groups restrict property freedom and rights.

3.2.5 Welfare regime

The establishment of an independent Ukraine and the economic crisis in the early 1990s led to the collapse of the social security system, and thus to an increase in social problems. The results of the transformation include increasing segregation of rich and poor in society, the decline in life expectancy by an average of two years, and a growing percentage of the populace living below the poverty line (most recently almost 30 %, according to the European Bank for Reconstruction and Development). Adequate medical care in the state-run health sector is often only available through bribes, and qualified medical services have drifted to the private sector, rendering them unaffordable for the majority of the populace. It remains to be seen whether and to what degree the government's reform program, planned for 2006, will have a positive effect on the social sector.

The ratings given in the UNDP Human Development Reports from 2000 to 2002 for the GDI (Gender-related Development Index) in the years 1998 to 2000 remain largely stable, both in terms of their placement and the ratings themselves. Thus, with a rating of between 0.739 and 0.744, Ukraine ranges in the middle of the field from places 74 to 80. Neither a positive nor a negative trend can be

detected. Women are underrepresented in economic and political positions of leadership.

3.2.6 Strength of the economy

Since 2000, the macroeconomic data have pointed to sustainable and positive economic development in Ukraine, after the repercussions of the crisis in August 1998 were overcome. Thus GDP is growing again, although it has not yet reached the level of 1998. In addition, official unemployment figures are going down once again, following their increase in connection with the crisis in Russia, and were in the tolerable range of 3.7 % in 2001. The decline in and stabilization of the annual budget deficit to as low as 2 % of GDP must also be seen as positive. After peaking in 1999, the external debt was stabilized at about \$12 billion. A positive balance of trade, although small, was first noted in 2000. However, a slight downward trend must be noted for subsequent years.

3.2.7 Sustainability

Numerous environmental problems are a harsh legacy of Soviet industrialization. The Donetsk-Dnepr industrial region has one of the highest levels of water and air pollution in all of Europe. The main causes of these problems are antiquated iron and steel plants, as well as power plants. The Chernobyl reactor catastrophe on 26 April 1986 was the biggest accident so far in the history of civilian atomic energy. Inefficient energy use is one of the country's greatest environmental problems. Although environmental objectives are anchored both legally and institutionally, they have thus far been observed and implemented selectively. A drive for sustainability is coming from both Ukrainian civil society and the international community. The on-schedule closure of the Chernobyl reactor blocks was supported by almost \$100 million.

State and private institutions for education, training, and development exist in significant segments, but they vary greatly in quality. Access to high-quality, recognized educational institutions depends somewhat on financial opportunities, and is characterized by some corrupt practices. Thus, corruption has also become a problem in the education sector. Ukraine is suffering from brain drain, particularly in technology and the natural sciences.

4. Evolution

(1) *Political regime*: The evolution of the political system has demonstrated both positive and negative aspects. Some administrative progress can be seen within the government. Simplified access to documents, the opportunity to have public hearings, and the interparliamentary groups all increase the transparency of

government action. Some initial steps toward “e-governance” were taken under Prime Ministers Yushchenko and Kinach. The “small reform” of the judiciary branch in 2001 succeeded in introducing a new criminal procedure code. In early 2000 the death penalty was abolished. However, the reform was unable to make the relationship between the central government and the regions either more efficient or democratic. Corruption, administrative pressure, and interference by executive bodies (such as the Department of the Interior or tax authorities) severely constrict the government’s actions related to democracy and the rule of law. The most serious democratic shortcomings lie in restrictions on the freedom of the press, which go as far as murder of disagreeable journalists and administrative pressure on the opposition.

(2) *The degree of democratic consolidation* did not improve significantly. Even though Ukraine has a differentiated political system, power lies more than ever in the hands of interest groups and special-interest actors, who make decisions while skirting existing structures.

(3) *Level of socioeconomic development*: The level of socioeconomic development in Ukraine remains unchanged. The HDI rating is stable, hovering in the range of 0.745, which signifies a good medium level of development (HDI: 1998: 0.744; 1999: 0.742; 2000: 0.7448). During the evaluation period, general institutional conditions improved considerably in some key areas. These include the introduction of basic legislation, new banking legislation, as well as the reduction of state intervention in setting prices and the increase in support for small and medium-sized enterprises. However, reform measures were regularly slowed down or even halted completely by the direct and indirect resistance of interest groups. Thus, for example, the infrastructure sector was monopolized by rent-seekers, who successfully diminished reforms in the energy sector, telecommunications, the rail system, and local services. Growth rates of 6 % in 2000 and 7 % in 2001 are a clear indicator of quantitative economic growth. It remains disputed whether this is qualitative growth or simply the aftereffects of the Russian financial and economic crisis in 1998, representing a minimal upward trend after the preceding depression. However, the increase in economic activity among small and medium-sized enterprises, for example, is a clear indication of structural change.

5. Transformation management

5.1 Level of difficulty

The foundation of the Ukrainian state presented the actors with the challenge of consolidating a fragmented and ethnically heterogeneous state. A split between the Russian eastern Ukraine and the Ukrainian western part of the country could have meant dissolution of the country, an end to independence and new occupation by Russia. There was a potential for conflict because the Crimea was

striving for independence and because the peninsula had to absorb numerous returning Crimean Tatars. These problems were successfully solved in the early years.

None of Ukraine's five major churches constituted a state church. Conflicts developed among the different denominations, most of which related to claims to particular church buildings. The vast majority of the resulting disputes could be reconciled. Ukraine has liberal laws regarding religion, which also guarantee freedom of religion in practice. Ukrainian civil society traditions are rather weak. However, in recent years, popular acceptance of and willing involvement in civil society have both improved, and the number of civil society activities has also increased.

Seen formally, there has been some progress in the development of the rule of law. However, there can be no talk of a breakthrough for reforms until the legal system is well enough equipped, in terms of both finances and staffing, to resist corruption and the influence of interest groups. The system of government set out in the constitution of 1996 is a subject of debate regarding further institutional reforms. For example, these debates were expressed in a referendum changing the constitution, which was carried out in January 2000. If the referendum is ratified by Parliament, the decision provides a stronger role for the president. In early 2003, Kuchma restarted the debate about reforming the system of government. His goal is strengthening Parliament, by which means the president hopes to enfeeble the opposition's public protests, in particular.

5.2 Reliable pursuit of goals

The reform-oriented administrations under Prime Ministers Yushchenko (1999–2001) and Kinach (2001–2002) pursued in their various reform programs long-term goals in addition to political management. In doing so they achieved some key successes, such as the adoption of basic legislation and banking legislation, the introduction of a new administrative tax system (tax liability law), the privatization of some major enterprises, and the consolidation of the banking sector. Other reform projects, such as the reform of the civil code, failed due to the president's veto, and the introduction of new tax legislation was defeated by Parliament. Even when actors succeeded in formulating reforms and implementing them administratively, they met with considerable resistance from interest groups, resulting in few changes actually being made. It remains to be seen whether Premier Viktor Yanukovich (former governor of the Donetsk region) will succeed in continuing along the fragmented course of reforms, or if he will primarily represent the interests of the Donetsk clan.

While the government does impart basic confidence in the future for the lives of its citizens, this confidence in the future has been suspended in some striking instances. The murder of opposition journalist Gyorgi Gongadze and Kuchma's

suspected involvement are an example of restrictive action against a free society. A Russian passenger plane traveling from Tel Aviv to Novosibirsk on 4 October 2001 was hit by an errant missile fired during a Ukrainian military exercise, and all of the plane's occupants were killed. In view of the rampant corruption and weakness of the legal system, economic confidence in the future is not fully guaranteed. Entrepreneurial action is highly risky, considering the state's limited capacity to arrange things predictably.

5.3 Effective use of resources

The annual budget deficit has been reduced over the years, and has stabilized at well under 2 %. In comparison to that, the gross domestic product has been growing steadily, and as of 2002 annual growth had stabilized at 4.5 %. Thus the positive economic development supports the long-term goals of reducing the budget deficit and national debt, and ending 2002 with a budget surplus. The parliament's right to draft the budget is sufficiently legally secured. For this reason, the cabinet cannot circumvent Parliament's binding budgetary resolutions. However, it is not inconceivable that the multifaceted, intertwined interests along with wide-ranging corruption and money laundering could distort the relationship between budget development and the reality of state expenditures (*Budget deficit*: 1998: -2.8 %; 1999: -2.4 %; 2000: -1.3 %; 2001: -1.6 %; 2002: -1.8 %; *GDP*: 1998: -1.9 %; 1999: -0.2 %; 2000: 5.9 %; 2001: 9.1 %; 2002: 4.5 %).

Numerous factors make it clear that the government has thus far been unable to utilize personnel and institutional resources effectively. The Ukrainian state is too strongly centralized to adequately accord administrative and budgetary alternatives for efficient government action in the administrative regions. Corruption works itself into state structures so that state action is often linked more closely to special political and economic interests than with the common good. As described above, the administration can realize only a portion of its announced reform measures, because resistance from Parliament or the president has blocked or delayed the implementation of some measures, and the informal power of interest groups has blunted the effectiveness of other measures.

Although property rights and the basic mechanisms for a functioning market are enshrined in law, their implementation often fails because of the judicial branch's low level of efficiency. Some progress has been made in recent years regarding the appropriation of infrastructure and human resources. All in all, the results are mixed, and so progress toward development and transformation has been limited.

One of the biggest difficulties facing Ukraine is corruption, which has a negative effect on both the economy and politics. Ukraine placed 85th out of a total of 102 countries in the Corruption Perception Index compiled by Transparency International. Ukraine is a classic case of private interest groups colonizing important parts of the state, , state resources being constantly distributed on the

basis of patronage networks, and corruption forming an integral characteristic of the state and administrative culture. In the words of George Soros: "Ukraine gives corruption a bad name." With its intended orientation toward Europe and sustained interest in joining the European Union, Ukraine is attempting to emphasize its European heritage by distancing itself from its Russian and Soviet traditions.

5.4 Governance capability

In contrast to the early years of Ukrainian independence, the decision-makers have recently demonstrated an ability to learn in formulating reform plans. Innovation and, in particular, the ability to win the fight against informal structures have largely been absent. The administration has only limited political and social authority to introduce and carry out reforms; the more so as it, too, is part of the interest groups or in cahoots with them.

Although reformers recognize both the opportunities for development and the narrow leeway for changes, they have not yet succeeded in sustainably increasing their room for action and decreasing the influence of the interest groups. Reviewing distributive effects, this trend can also be seen in economic policy. Although these problems are recognized, no adequate measures have been undertaken to overcome them.

5.5 Consensus-building

The major political and economic actors agree on at least one of the two goals (democracy and a market economy). However, it is essential here to distinguish clearly between informal special interests and the introduction of formal regulations to create a democracy and a market economy. This mesh of interests is less about the basic rejection or acceptance of democratic and free-market values, and more about the concrete shaping of the system.

In the evaluation period, the reform programs were not represented consistently enough and could be implemented only with some compromises. In doing so, there were often disagreements and stalemates between the president, the administration, and Parliament. The frequent changes in the office of prime minister, and the power of the various interest groups linked to the respective premiers have also led to uncertainties in the continued pursuit of various reform courses, and also caused fractures in the approaches to shaping reforms. All of these developments make clear that the reformers have not been able to control all the actors with veto powers or became actors with veto powers themselves.

In the early years of Ukraine's independence, the government succeeded in averting ethnic and territorial conflicts on the Crimean Peninsula as well a split

between eastern and western Ukraine. Current social conflicts are inflamed by the question of loyalty to the president. The opposition is concentrating primarily on demanding a “Ukraine without Kuchma.” The president, in turn, is attempting to mitigate this line of conflict by reforming the system of government, which would involve strengthening Parliament. The success and credibility of these intentions remain doubtful.

Even if the government attempts to increase people’s willingness to show solidarity through social policy reform, corruption and the black economy inevitably restrict cross-group or inter-subject solidarity. To date, historical injustices in Ukraine have not been worked through comprehensively and systematically. Also, commemoration of Stalinist atrocities was used by the administration as a means of carrying out an anti-communist election campaign.

5.6 International cooperation

During the entire period of its independence, Ukraine has sought and received international help to support its reform policies. This help has included loans from international financial organizations as well as technological and humanitarian help from international organizations and individual states (USAID, the EU). However, American assistance within the framework of the Freedom Support Act in fiscal year 2003–2004 has been cut from \$155 million to \$94 million. Among other reasons, this was a reaction to the supposed sale of the Kolchuga radar system to Iraq.

Because of these types of incidents and speculation, as well as breaches of minimum democratic standards—in particular the restrictive interaction with the media, high levels of corruption, and the advancing but inconsistent reform policy—the Ukrainian government has had only limited success presenting itself as a reliable partner to the international community. Despite these difficult conditions, political actors are endeavoring actively and successfully to establish cooperative international relationships. With its strategic neighbor Poland’s admission to the European Union and NATO, Ukraine now borders those entities directly. Ukraine’s ambitious goal is to join both institutions itself. Although this major challenge is destined to fail at present, Ukraine is intensively pursuing relationships with its neighbors to the west.

6. Overall evaluation

For the previous five years, this report arrives at the following concluding evaluations regarding the starting conditions, current status and evolution achieved, as well as the actors’ political achievements (management):

(1) *Starting conditions:* One of the few positive starting conditions was the successful national consolidation along with the handling of the Crimean conflict. The economic and political situation was extremely complex, however. The economy was only half the size it was in 1990, and the crisis manifested itself largely in agriculture and industrial production. In 1993 inflation climbed to a record 9000 %. The state budget could be approved only with a deficit. An almost complete lack of structural reforms went along with the macroeconomic deficit, and attempts at reform were often blocked by Parliament. Although a new constitution was adopted in 1996, the distribution of power in the political system was dominated less by institutions and more by influential clans, such as those from the Dnipropetrovsk gas sector and the Donetsk coal industry. Ukraine is certainly one of the most corrupt countries in the world.

(2) *Current status and evolution:* When seen in relation to the challenging starting conditions, considerable success was achieved in reforms in the last five years. As of 1998, the economic downturn stopped; and both favorable conditions and structural reform measures contributed to its halt. The greatest success so far is that it was even possible to affect changes in economic efficiency and the effectiveness of the state. However, the level of both democracy and transparency must be rated lower. Media freedom is impeded by all available means; the success of political and economic reforms is extremely restricted by corruption; and formal progress always meets with resistance when it encroaches directly upon the power of interest groups. Leading political offices change occupants often.

(3) *Management:* The Ukrainian government attempted to reform key areas of the economy. In these key areas, such as agriculture and the power industry, structural reforms were begun, although they have not yet been successfully concluded, and met with resistance and unanticipated problems. Greater success was achieved in improving the conditions for small and medium-sized enterprises, which has already had a positive effect on their economic activities. Foreign debts were converted and repaid on time. The adoption of some significant reform legislation shows the political elite's constructive attitude. In some sectors, NGOs are also making an important contribution to transformation management. However, further management success is being hampered by the power of interest groups.

7. Outlook

The last five years have shown considerable progress on reform measures in Ukraine. The task for the future lies in consolidating and updating structural reforms. A much more difficult task is integrating the interest groups and clans into formal structures of governance. The success or failure of the Ukrainian transformation will depend on what prospects the West, in particular the European Union, can offer Ukraine. If this turns out unfavorably, the eastward expansion of the EU threatens to draw a new line separating Ukraine from its neighbors,

through which the country would fall even further behind its western neighbors in development.

In the economy, it is vital to continue with successfully started structural reforms and stable macroeconomic indicators. The investment climate for domestic and foreign investors would be improved by greater transparency and simplified structures in the tax system, an improved infrastructure, a less fragmented banking sector, and also by declines in corruption and the shadow economy. It is imperative to dismantle legal shortcomings and irregularities in privatization, which are, for example, blocking the privatization of key operations in the energy sector. The government must accelerate its adjustment of standards and norms with the prospect of integrating Ukraine into the European economic area and the world economy. The most challenging tasks in the reform of the Ukrainian economy remain the dismantling of corruption and the shadow economy. In the meantime, this has become more than just an internal problem—it is also causing significant damage to Ukraine's international image.

One of the political challenges is creating an efficient and democratic form of federalism. The debate recently initiated by Kuchma regarding strengthening Parliament's role would be a step toward improved democracy, were it not for the fact that this is really a pseudo-discourse by the president against extra-parliamentary opposition. To improve its resistance to the power of interest groups, the political system must become more transparent and align itself more strongly with democratic and formal processes. The consolidation of institutional decision-making processes is all the more important because the 2004 presidential elections signify a turning point in the political transformation. Because the current office-holder cannot run for a third term, a transfer of power at the top is inevitable. If the power of interest groups cannot be integrated more firmly into institutions than before, then this will lead to new shifts between the influential clans.

An essential and significant reform task is creating a stable framework for free media. Independent reporting must no longer be punished by measures ranging up to murder. The opposition should not just criticize Kuchma; it should also purposefully strengthen its constructive position. Social reform will also depend on the government's ability to make functioning and honest public systems available to the populace.