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UKRAINE ECONOMIC REFORM PROGRAM 2016-2018

A Background Note: Lessons from a Quarter Century of Independence.

“Those who don’t know history

are destined to repeat it”

{Edmund Burke **}**

“Khto ne znaye istoriyu

pryrecheney yii povtoryate”

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I.OVERVIEW

The poor state of the Ukrainian economy in the last two years is largely a legacy of the misguided economic policies and lagging market reforms of a quarter century.[Figure 1]. The consequence of past policies is most dramatically reflected in the fact that while at the end of the Socialist period, per capita income of Ukraine and Poland were approximately the same, by 2013 Ukraine fell so far behind reforming countries in Central Europe (including Baltics) that its per capita income was only one-third of Poland’s. [Figure 2]. [1] However it is wrong to infer from this as many foreign observers - particularly journalists - do, that Ukraine is on the brink of collapse, that it approaches a failed state. This is far from the case and any historical review must recognize the achievements. One can point to four of the most important positives.

First, the enduring historical quest of Ukrainians to be recognized as distinct from Russia has not only been formalized by the Independence Declaration, but also has been solidly established in a multiplicity of international institutions and is recognized worldwide. Politicians - and even more so populations - around the world “know” and accept that Ukraine is a real nation with Olympic athletes, EuroCup teams, football stars entertainers, and a territory with sovereign borders. Outside of a few unsympathetic political circles there is absolutely no need to convince the populations of the world

[1] The values shown in Figure 2 are in constant 2012 $US at market exchange rates. The common alternative od using Purchasing Power Parity (PPP) data does not change the picture very much : the gap that opened up is only a little smaller. The advanteage of using market exchange rate $US is that it reflects another important dimension of more successful transition in Poland : the appreciation of the Zloty due to the large improvement in productivity .

that seizing Crimea and intervening in the Donbas was nothing less than a military aggression against a sovereign country.

Second, democratic standards, personal liberties and human rights are incomparable to those of the Soviet period, with freedom of expression, religion, minority rights and perhaps most dramatic the right to travel to other parts of the world. All this has begun to move Ukraine towards being the "civilized country" its people so ardently desire. International ratings of the level of democracy rank Ukraine in the middle range, far better than most of its former USSR neighbors which have seen a strong reversal to authoritarianism in the last decade. The latest Freedom House score of 3.0 [Figure 3] may be short of the values in Central Europe, but is as good or better than in the Balkans, and far superior to most countries to the East.[2]

The **third** positive is that living standards of the population are generally far better than 25 years ago, contrary to the incorrect comparisons of official GDP statistics sometimes cited to show that per capita GDP today in Ukraine is still lower than in the last years of the Soviet period.[3] Corrected GDP estimates as well as many direct measures of consumption-high-quality food intake, living space, car ownership, foreign travel- are all considerably higher than in the Soviet period.[4] Even these comparisons underestimate the improvements, as they do not measure the enormous value of not standing in line early in the morning because of goods shortages or the importance of consumers having a wide variety of goods to choose from.

Fourth, Ukraine has become a very open and globalised economy. This must be considered as one of the most outstanding success stories of economic policy efforts at liberalization. Ukraine's Trade Ratio ([Exports +Imports /GDP]) of approximately 100% of GDP is above the norm for its size and level of development, and higher than that of Poland or Russia. The oft-repeated concerns about economic dependence on Russia were until 2015 correct in reference to energy imports. But on the export side, dependence on Russia as an export market was reduced sharply as early as about 2000, reaching levels of 25-30% which is in fact more or less what econometric studies of geographic destination estimate as normal. By 2015 politically motivated import restrictions by Russia have reduced this share to an abnormally low 15% or so.

Thus there should be no question that economic conditions for Ukrainians are in general better than in Soviet times. However, notwithstanding these positives, it must still be emphasized that the dominant outcome since Independence is the tremendous underachievement of the economy in the sense of falling far behind its neighbors to the West. This shortcoming presents to the new

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[2] In this scoring 1.0 is fully democratic and 7.0 fully authoritarian. Bosnia-Herzegovina and Macedonia are worse at 3.5, and apart from Georgia countries to the East are at the high authoritarian values of 6.0 to 7.0.

[3] Such comparisons by some international organisations are statistically doubtful as Soviet statistics of Net Material Product overstate considerably the real value of output, while the later estimates of GDP understate value especially where informal activities are important. Even the prestigious *Economist* makes this mistake.

[4] Shleifer and Tresiman (2014 make such a correction for GDP and also show that in Ukraine housing space has increased by 31%, consumption of fruits by 47%, of vegetables by 58%. Other data show that auto ownership has risen five-fold. These values are generally in the middle range for transition countries.

Government of April 2016 its **main task: not losing any more time in accelerating the economic reforms begun after the victory of the EuroMaidan in February 2014**. As will be shown later, reform progress while far from complete, has been made since, and significantly so in some areas like macro stabilization, banking reforms, a start on improved business climate. But that progress so far falls short of the intentions of the Maidan and the leadership. The purpose of this note is to provide an underlying philosophy and a strategic roadmap for the detailed Program of Reforms that will address this task. Let us start with a statement of what should be the main goals of such a program given the legacy inherited from the previous Governments.

- In the broadest historical sense the Program should be considered as the agenda of actions that will finally, after 25 years, allow Ukraine to catch up to the leading post-communist reformers in the region
- The Program must be so constructed as to promote a return of economic growth that is sustained and rapid enough to make up for the gap in living standards created since Independence as the economy fell behind its more dynamic neighbors in Central Europe .
- However, this growth promotion must not be pursued through the obviously unsuccessful policies of the past based on budgetary support from the State, which succeeded only in giving rise to an oligarchic system and solidifying the culture of corruption. Encouraging growth must instead be market-based, establishing the most favorable conditions for innovative and entrepreneurial private activity, in particular for small and medium enterprises (SME's)
- While it will be useful to highlight elimination of corruption as the "Number One Problem", in real-time sequence it will be impossible to achieve this before considerable progress is made on eliminating the incentives for corruption, *i.e.* excessive state intervention (including a still very high state ownership in the economy), regulation, and poor Rule of Law.
- While improvements in living standards of the population in the medium term will come largely from the higher economic growth, the Program must at the outset also include substantial elements of targeted social assistance for those with incomes below and just above the poverty line. Ukraine's social expenditures are still well over 15% of GDP, which is far above the international norm for its level of development . But this is because they are badly structured and wasteful, with the MOF estimating that as much as 8% are illegally paid out. Targeted assistance would help reducing such wastage and related corruption while still addressing the real needs of the low-income population. The recent success in compensating gas-price increases should be seen as a model for other forms of targeted assistance("**adresna dopomoha" should become a key slogan).**
- An important aspect of the Program has to involve resolute progress towards EU integration and fulfillment of the Association and Deep and Comprehensive Free Trade Agreements. The proper way to perceive this goal is through its symbiotic relationship with the five goals mentioned above: pursuing these five goals will be very much assisted by the process of implementing the Agreements, and achieving them will make a major contribution to the

pace of integration and speed of the progress towards the final stage of the Membership Accession.

- This Note focuses on the economic components of the Program; but an equally important responsibility of the Government must be to ensure continued maintenance of democratic standards and further progress in its enhancement, for example decentralization of governance. It must not be forgotten that the experience of a quarter century of transition shows that countries which have attained the greatest success in market reforms have also been the countries with the highest degree of democratization.

The rest of this Note is structured as follows. Section II reviews THE MAIN FACTORS BEHIND UKRAINE'S POOR ECONOMIC PERFORMANCE, starting with a clarification of what transition to market and capitalism really means, then reviewing in a comparative perspective with other transition countries the history of lagging reforms, showing how this lag resulted in Ukraine's economy falling behind so far, and finally discussing how this legacy, worsened by the shock of the Russian aggression, contributed to the sharp recession of 2014-2015 . Section III then proposes a list of ECONOMIC REFORM PRIORITIES FOR 2016-2018 by deepening and making more concrete the strategy for attaining seven broad goals above. Given the legacy of misguided and erroneous policies of the past, it is important in looking forward to not repeat similar mistakes, therefore the discussion will include both what needs to be done and what should be avoided.

II.MAIN FACTORS BEHIND ECONOMIC DETERIORATION OF 2014-2015.

As is common in most countries, the population of Ukraine tends to attribute bad economic conditions to the policies of the Government in place. But just as in other countries this is at best only partly correct, and at worst wrong or misleading because governmental policy actions impact real economic activity with a – sometimes considerable – time-lag. The reality is that most of the deterioration of 2014-15 is due to the legacy of misguided policies of past regimes, plus the losses due to the shocks of Russia' military and trade war against Ukraine .This must not however be seen as an apologia for any shortfalls in reforms by the post-Maidan Governments because deeper reforms may have reduced the economic decline, and, more importantly, the extent of reforms achieved in 2014-2015 will now matter a great deal for future economic performance. The Note addresses this period below in the sub-section *Post-Maidan Efforts*, but to truly understand how Ukraine came to the poor economic situation of 2014 it is necessary to look farther back at the process of transition since Independence, providing a brief sketch of reform history over 25 years. Together all this background will then allow for a more focused response to the question of what caused the very deep recession of 2014-2015.

Clarifying the meaning of transition, capitalism, markets, and reforms.

Before this, it is useful to clarify and define some relevant concepts to correct the many misunderstandings and confusion about economic reforms that exist in the public mind. Most public discussions are not anchored in any objective measures of how far policies have gone towards creating a true market economy, perceptions of how much or how little reform has in fact been achieved are rather formed in vague and often erroneous ways. As a resultto this day prevails a deeply-rooted myth that the pain suffered by the population since Independence is attributable to too much reforms, when in fact it is easily shown that the truth is exactly the opposite: **the greater economic pain of Ukrainians is due to too little reforms.** Until this myth is exploded, it stands as a major roadblock to any reform efforts. One of the key tasks of the new Government is to undertake a public outreach to make this clear.

One must begin by defining in simple ways what transition to the market means and explain how it is possible to measure the extent of reforms, or lack thereof. Successful transition requires two major changes. **First** private ownership of productive resources must be allowed, that is "capitalism" must be put in place and property rights assured . But **second**, the system of central planning which determined how much would be produced, by whom, and for whom, has to be replaced by a properly functioning market open to all and subject to a transparent, even-handed Rule-of-Law. A properly functioning, competitive market open easily to all – large and small – is crucial but not yet achieved in Ukraine. The regulatory and legal institutions needed for this are far behind as Figure 1 starkly shows. Because of this imperfect market, the legal system and government policy favors the large capitalists, *i.e.* oligarchs, and imposes difficulties for small entrepreneurs.

A misunderstanding of the need for both these changes in transition has created another myth in the public mind that since Ukraine has a lot of capitalists, some of them rich enough to merit the label '"oligarch", reforms have taken place and that therefore the poor economic situation of the majority of the population is caused by reforms. In reality Ukraine developed partial-capitalism for the chosen few and not true capitalism easily open to all, precisely because it has not yet completed the institutional reforms to create an open market in which all can compete fairly protected equally by a transparent Rule-of-Law. This myth should be one of the points that the New Government's public outreach must address.

Another clarification is needed on measuring reform progress. How can one know objectively how much or how little reform there has been? In fact the extent of progress to such a complete market system has been quantitatively measured since 1990 by the Transition Progress Index (TPI) compiled annually by the European Bank for Reconstruction and Development (EBRD). The comparative achievements of Ukraine and other transition countries are illustrated in Figure 1. The Index is shown in two parts. In the left panel one sees the progress in reforms LIBERALIZING market operations (free prices, free market operations, relatively open international trade including foreign exchange operations, unimpeded private ownership). The right part shows the quality ofthe market INSTITUTIONS (measuring ease of doing business for all, transparent taxation procedures without arbitrary inspection applied to those without political power, , even-handed, and transparent Rule-of

Law, efficient and corruption-free judicial procedures). The bold blue lines representing Ukraine shows that after a very late start it has finally moved relatively far on liberalising markets, but is still well below the levels attained in Poland and Central Europe . Much worse however, the lag on improving the quality of institutions is far greater. Indeed until about 2000, the progress in reforms in both areas was so limited that Ukraine remained on the bottom of such charts - that is among the least progressive reformers.

With these background clarifications we proceed to give a brief history ofthe economic policies and market reforms overt the different regimes since Independence .

Reforms 1991-2013: Very late start, then too little progress to catch-up

There is wide agreement among analysts of Ukraine that economic reforms were **too long delayed** after Independence with virtually no progress through the Kravchuk Presidency. In the EBRD's measure of reform progress, TPI, by 1994 Ukraine was near the bottom, with only two other transition countries lower, Azerbaijan and Turkmenistan. A significant increase of this index came only under President Kuchma in the period 1994-1998. In retrospect, it is evident that this start came **too late** to prevent negative effects of the delay and since this reform surge was stopped by 1998, it was **too little** to catch up to the leading CEB transition countries. While there was no reversal as in Russia after 1998, further progress was **too slow** to make much difference or to undo the malignancy of a self-serving, rent-seeking oligarchy that had by then become entrenched and politically powerful.

The virtual lack of an economic policy and reforms in the first Governments, the absence of a sensible energy policy, and the disinterest in any serious European integration, had four major negative consequences. ***First*** was the disastrous economic performance with a sharp output decline and a costly hyperinflationary episode. Ukrainians suffered a decade-long recession that was nearly the worst in the region; Figure 2 shows the continued decline of income while Central Europe saw a strong recovery from about 1993-94,opening up a huge gap. Underground activity plus a visible growth surge after 2000 eventually brought the economy to a standard higher than in the Soviet period, but it was from too low a base and too short-lived to catch-up to Central Europe. Consequently, the standard of living of Ukrainians as measured more broadly in the Human Development Index of the United nations, Figure 4, declined sharply until 2000, and recovered much more slowly than in Central Europe.

The ***second*** consequence was the embryonic start of a rent-seeking capitalist class later called the oligarchy. With private enterprise allowed since the 1987-88 Gorbachev Laws on Cooperatives, but unreformed state controls continuing, rent-seeking became the best way to become successful new capitalists. The term “rent-seeking” in economic theory refers to the efforts of private sector companies or individuals to increase profits by obtaining special privileges from governments which others do not have. It was first introduced in economics by Anne Krueger in a 1974 study of how Latin American and Asian capitalists achieved profits by lobbying governments for protection against import competition, but it soon widened to any actions to get privileges[5]. In transition economies this covered many different insider-deals including rights to export grain in early years, right to import gas from Russia, special privatization rights, unique tax-exemptions. In this “game” insiders clearly had a great advantage over new entrepreneurs in obtaining the economic privileges granted by the government. The enormous rents[6] generated in the early years created large wealth for a few new capitalists and, importantly, the future means to resist any change in the system.

Third was the parallel development of a corruption-based environment. Understandably the privileges noted above generally involved a bribe in some form to the government official granting this privilege, or a politician facilitating it. But this form of high-stakes corruption, while it was the least transparent and caused enormous damage to the Ukrainian economy, was not the only form of corruption that evolved. Equally damaging to Ukraine’s economic potential were the bribery and corruption possibilities for bureaucrats created by the lack of reformsfreeing up the economic activity for new and small entrepreneurs. The myriad regulations, licenses, permits, taxes, penalties embedded in complex laws and regulations and the lack of a fair Rule-of-law impeded the boom of new SME entrepreneurship seen in Poland and elsewhere, drove them underground and kept them too small to present any threat to the insider-capitalists. For the latter, the complex bureaucracy was not a problem as they could use the “Rule-of –Telephone” instead of the Rule-of-Law . As Figure 5 shows by the late –nineties the World Bank Index of Corruption Control places Ukraine below the 10th percentile in a sample of about 180 countries; that is **90% ofcountries had less corruption than Ukraine.** The die was cast and with the exception of short-lived reforms in 2005-2006 corruption has persisted and Ukraine has throughout remained no better than the 20th percentile.

The ***fourth*** consequence was the long delay in meaningful efforts towards European integration thus missing out on the powerful anchoring effect of a membership accession process, which was so beneficial to Central Europe and recently has been showing similar effects in South-East Europe[7]. There is no certainty that an early approach to the EU at the time of Independence would have met a positive response, but the lack of reforms was certainly a signal to Europe that Ukraine was not ready for boarding the accession train. The puzzling and misguided stance of Ukraine’s politicians that **“the EU did not invite us“** resulted in an opportunity missed at a time when the euphoria of the Berlin Wall and the “liberation“ of the captive nations of the USSR was still in the air. As a result, even serious entreaties by later Ukrainian governments faced increasing difficulties since by that time the EU began to suffer “enlargement fatigue”.

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[5] This work is of such importance it merits a precise reference: Anne Krueger, “The Political Economy of a Rent-Seeking Society “, *The American Economic Review,*vol. 64, no.3, January 1974, pp. 291-303

[6] A little known early example was the licences to export beer to Poland in 1992-94, when Ukrainian price controls meant its cost was multiples lower than in Poland, allowing the exporter a large profit-margin on the difference . The total amounts of profit were not large, but over time the magnitude of rents possible through other schemes grew by multiples.

[7] A recent study by Havrylyshyn (2016; reference in Figure 1) points out that several countries in that region –sometimes labelled the Balkans – have leaped beyond Ukraine in achieving much better corruption control and high rankings in the Ease Of Doing Business Reports; in 2015 Macedonia was at 12th rank the highest of transition countries and better than Australia, Canada, Germany . This was part of an effort to progress on EU membership .

Each of these four consequences has been continuously seen as a threat through all the subsequent Presidential regimes. Starting in the fall of 1994, Kuchma, the new President supported by a team of a few committed and knowledgeable reformers (Pynzenyk, Shpek, Yushchenko and others) undertook a meaningful start to real reforms and macro-stabilisation. However by this time, the vested interest "oligarch" embryos had matured and were strong enough to effectively oppose these reforms. Perhaps as early as 1997 they appear to have "captured" economic policy-making, reformers in government were replaced, and reform momentum was halted. Though in Kuchma's second term from 1998 to 2004 reforms were not reversed as was the case in Russia in these years, further progress was very slow, hesitant and mostly only in the market liberalization areas with very little improvement of the institutional quality (see Figure 1). This can be explained by the fact that for the new oligarchy more freedom to operate in markets was acceptable, but increasing opportunities for new entrepreneurs through the better Rule-of-Law and transparency was not in the interests of the oligarchy. By the end of Kuchma's term, Ukraine's economy had achieved at least a rudimentarily functioning market economy, but the surge of reforms in 1994-96 was too little and what came in 1998-2004 was too slow to catch up. Since reforms in Central Europe continued strongly, especially on institutional improvements, Ukraine remained near the bottom of the TPI rankings.

The economic recovery in 2000 was substantial, but not sustained because of the continuation of a highly regulated business environment and persistent corruption[8]. The poor business and corruption climate not only kept growth too low to catch up to Central Europe, but had other negative effects of great importance. **First,** much-needed foreign investment which had fuelled the export boom and the high economic growth in Central Europe, was discouraged from coming to Ukraine by the poor business climate. Figure 6 dramatically shows how little investment came to Ukraine in comparison to countries with more advanced reform achievements – though undoubtedly this was also thanks to their being in an EU Accession status since the mid-nineties. Over the twenty years 1992-2012, the total cumulated amount per capita is estimated by the EBRD at $ 1.469, compared to the much higher values in Central Europe and the very high values of top countries like Estonia with more than $11,000. Note that even Georgia, much farther from Europe, under military threat from Russia, with much more limited export potential, had a value of $2,224, well above Ukraine's. This is an excellent example of how improved business climate and reduced corruption level makes a difference to foreign investors. After the Rose Revolution of 2003, Georgia's reforms proceeded at a blitzkrieg pace so that its placement on the Ease of Doing Business rankings leaped from around 140th place in 2003-2004 (about the same as Ukraine then) to the 37th place in 2007, and as Figure 5 showed, the Corruption Control percentile jumped to levels of 50-60%, in the same range as Poland.

[8] In Figure 1 it is clear that improvement of institutions was very limited with the gap between the leading reformers and Ukraine widening; in Figure 2, one sees the same widening gap between per capita GDP of Poland, Central Europe on the one hand and Ukraine on the other hand; Figure 5 shows corruption control improvements were marginal and Ukraine remained among the worst 15-20% of countries.

Second, the social costs of non-reforms meant that even if Ukraine managedto recover the standards of the late-Soviet period, these wouldnot increase at anything like the speed seen in Central Europe. In Figure 4, the broad measure of well-being compiled by the United Nations Development Program, the so-called Human Development Index (HDI), shows that the leaders with early and rapid reforms had not suffered significant social pain in the first decade, and by 2005 achieved levels far beyond those of the Soviet period. This is perhaps the best single indicator of the goal of transition that the population at large hoped for. In sad contrast, Ukraine, whose leaders at the outset explained their strategy of delaying reforms by arguing that this would avoid the social pain of “shock therapy “, in fact suffered far greater worsening in the first decade and despite some improvements after 2000, by 2005 were far behind Central Europe.

This deserves further elaboration. The myth perpetrated by the early political leadership that the social pain was due to reforms is easily exploded by looking at facts instead of unsubstantiated assertions . Unfortunately this myth persists to the present day and is part of the reason why reforms were slower than they might have been in 2014-2015- resulting in a lack of faith in governments that speak of reforms, and increased counter-productive populism. This points to an essential task for the new Government:

- **there must be a public outreach to explain the real history of reforms and performance since Independence and thereby to justify the new strategy of a rapid correction of past policy errors as the only possible path to high and sustained economic growth .**

An analogous myth needing correction concerns low gas prices and the “pain” that raising them would cause. In fact the real costs of the“cheap gas” turned out to be enormous for Ukrainians, though hidden below the surface. These costs comprised several elements[9]:

- uncertainty of supplies, with cut-offs by Russia meaning unheated homes in many periods,
- government loan guarantees for private intermediaries to purchase from Gazprom inevitably meant eventual large payments by the State budget, diverting tax revenues that might otherwise have provided social services in education, health, infrastructure,
- the guarantee system was in effect a transfer of wealth to energy-oligarchs who as noted above worked against progress towards real market reforms,
- no incentive for improvements in energy-efficiency which are essential to attain global competitiveness for Ukrainian industry,
- together all of the above contributed to Ukrainians per capita income falling far behind those of leading reformers,

[9] That the myth persists to the present day is exemplified by many articles in the Ukrainian press, one of the latest being in the May 4, 2016 Ekonomichna Pravda “ Palevna Revolyutsyia : { *The Heating Fuels Revolution },,*Halyna Kalachova. As most such articles it makes no reference to the hidden costs of “cheap-gas” but instead repeats the concerns of the short-term impact on people’s budget.Thus instead of considering why raising gas prices must be part of the solution it continues to feed the fears of the population by discussing it only as a “problem”.

- on the matter of sovereignty, low gas prices gave Russia strong leverage over Ukrainian political and economic directions and this economic dependence undermined political Independence throughout this period.

We go on to the next regime, under president Yuschenko and the Orange Revolutionaries. New rays of hope appeared in late December 2004 when the fraudulent Presidential election victory by Yanukovich was reversed in a clean and supervised election forced by the people's demonstrations in the First Maidan, the now world-famous Orange Revolution. Under President Yushchenko and Prime Minister Tymoshenko, it seemed that the new team of committed reformers would correct all these negative consequences. But it was not to be; a wide raft of liberalizing reforms and institutional improvements were in fact proposed, some put in place, but bitter dissension within the ranks of the Orange Regime among like-minded reformist democrats took center stage. By 2009, liberalizing reforms had not gone much further, and most disappointing, institutional cleansing to eliminate corruption and create a transparent and fair rule-of-law environment largely failed. World Bank rankings showed corruption as bad in 2010 as it had been in 2004. While popular interpretations of this failure put blame primarily on the power struggles among Orange leaders, the quiet influences of an undiminished oligarchy successfully blocking reforms were at least as important.

Economic growth slowed during the Yushchenko years, though some of this can be attributed to the global recession which began in 2007 and affected adversely expanding exports to Europe; nearly all Central European countries (except Poland) experienced a recession as well. Insufficient reform policies also contributed to the slowdown, the gas trade continued in the usual manner despite the major energy-sector reform efforts put in place in 2005. Most analysts of Ukraine agree that while internecine struggles in the Orange ranks diverted political energies from the reforms expected by Maidan 2004, another quiet force was equally important: the oligarchs regrouped and used the splits within the Orange forces to impede or reverse any significant reforms. Beyond that, the dissension in the Orange ranks and the bitter open fight between the top two people also discouraged at-first-eager foreign investors, and confirmed the skepticism within the EU about Ukraine's candidacy for integration and membership,-though in the end the EU began to graduallyshift to a more positive attitude on Ukraine relations. By about 2008 there was an informal start fn negotiations on free-trade and preparations for discussions on an Association Agreement.

The souring of the Orange resulted in Yanukovich's victory in the presidential elections and undertaking what might be best characterized as a juggling act of some minimal reforms to satisfy the EU and start formal negotiations; a strong pivot to authoritarian control of politics which helped the process of enriching his "family " through enormous corrupt procurement deals; and at the same time assurance to Moscow of close relations dramatized by the extension of the Sevastopol base lease to 2040. Any liberalizing tendencies were limited or reversed, procurement favoritism bled the budget and by the last years economic instability threatened to erupt. The sum of these actions resulted in a worsening of democratic standards with Ukraine losing its Freedom House status of "Free", dropping to “Partly Free” again (Figure 3), and corruption worsening to a percentile ranking about 12%, not seen since the late nineties (Figure 5).

Perhaps surprisingly, EU negotiations went well despite all these negatives and both the Association Agreement and the Deep and Comprehensive Free Trade Agreement were initiated by the two sides. In the end, this was a Pyrrhic victory for Yanukovich since at the very last moment he made a decision of not signing the documents. This is of course what sparked the fire of the second people’s revolution in Ukraine, the EuroMaidan Revolution of Dignity. Unlike the bloodless Orange Revolution, this one led to over a hundred casualties, the quick fall of Yanukovich and the appearance of a new government renewing hope for democracy, economic reforms and eventual EU Membership.

The new leadership, with President Poroshenko elected in May 2014, did indeed finalize the signing of the EU documents and began the long but steady journey towards Europe and a correction of past erroneous economic policies. Before assessing the achievements and any shortfalls of the two Governments of this period, it may be useful to summarize briefly the state of the Ukrainian economy at the beginning of 2014, that is the legacy of the previous Governments since Independence.

The Legacy in 2014: Capitalism for the Few, Low Incomes for the Many

A wide gap in income relative to Central Europe by 2014 was the most visible legacy of misguided economic policies since Independence. The first decade of the disastrous economic decline had already resulted in Ukraine’s income moving from parity with Poland to as low as one fourth in 2000 (Figure 2). After this, growth did recover, but as Central Europe was also growing, this gap narrowed only marginally – to about one-third in 2013 when the Post-Maidan Governments took over. Apart from the variable degree of commitment to reforms across the spectrum of politicians, the task was made more difficult by the persistent myth amongst many in the population that the income gap was due to too much reforms – though most Maidan participants intuitively understood this and wanted more reforms. The quantitative evidence in this Note that it was too little reforms that caused the problem was not widely understood. Consequently the public receptivity to quick steps to catch up on reforms was weak and dulled any boldness on the part of the new leadership.

The role of billionaire class oligarchs and less-wealthy capitalists – let us call them mini-garchs[10] – in determining the pace of economic reforms in Ukraine is best understood as a vicious circle of causation. The sequence in time is clear: the lack of reforms in the early years conceived their embryos, and hesitant reforms after 1998 helped nurture the oligarchy to maturity. But once matured and very wealthy, they in turn blocked completion of reforms, particularly on institutional quality,

[10] One must not make the mistake of thinking that only the dozen or so oligarchs appearing on the Forbes lists of billionaires comprise the cabal of a fifth column opposing full transition to a real market economy. Those who have become entrenched smaller capitalists with a few hundred or even only tens of millions of wealth, and have done so through the insider privilege mechanism, are also likely to work against easing entry of new entrepreneurs who may threaten their status. Thus the reference to the lesser “mini-garchs”.

because completely open, transparent and competitive markets with a level playing field before the law, was not in their interest. And thus in Ukraine, similarly to Russia, Kazakhstan and elsewhere in the former USSR, they became active in politics, using their wealth to ensure reformers were not allowed to implement a complete transition to a market economy. They supported financial stability, but opposed full market liberalization and transparent institutions. When reformers went too far, they lobbied to push them out. This happened repeatedly since the nineties and even in the post-Maidan period.

The power of the “oliharkat” is partly behind the slow economic growth. Continued blockade of complete reforms and institutional development enriches the oligarchs and assures their continuation as the dominant political force in the country. But the cost is that the new competition and innovation by start-ups, which results in such phenomena as Silicon Valley, is stymied by the anti-competitive environment in which oligarchs thrive. The hope for a hi-tech boom is prevented by the unfriendly business climate and not by the lack of strong human capital endowments. Economic growth lags, is not sustained, and the major victims are the Ukrainian people, who continue to suffer low income levels.

Pervasive corruption became an additional brake on economic performance and further reforms. Some of this was connected to the rent-seeking process with the vested interests paying bribes in many different forms to politicians and officials, for benefits from insider privileges in a still highly regulated economy. Thus it is correct to say as some analysts that high-level corruption was the hand-maiden of the oligarch development .

However, there developed a separate stream of corruption as incomplete reforms left to the present day a plethora of regulations not only for business, but also for personal activities, thus providing officials the arbitrary mandate to sign or not sign, to fine or not to fine. While the size of the individual bribes at the small business and personal levels pale in comparison to the oligarch-politician corruption, the aggregate for 45 million people is not a paltry sum[11]. Its pervasiveness and persistence to the present day ensures it has been and continues to be pernicious in suppressing a vibrant, open and sustained economic growth.

Misguided and self-serving policies of the past political elites created the opportunity for Russia’s unfriendly actions towards Ukraine. Of course the trade war that started in 2013 and the military aggression of 2014 also have roots in Russia’s own policy of reviving imperialism. But Ukraine’s own energy dependence policies, the very late efforts at EU orientation and the overall economic weakening have fed Moscow’s strategy by making it vulnerable to its threats and inimical tactics. Before 2013, blaming Russia for the inadequate economic performance is not compelling and was rather a political ploy by Ukrainian leaders to divert attention away from their policy mistakes.

[11] Transparency Intentional estimates that annually 23% of the population faces bribe requests; if the average were about $100, the total is already over Billion $. More likely this average could be about 2000, hence $ 2 billion.

The lack of a solid EU anchor before 2014 must also be considered a legacy of past regimes. Had earlier governments worked seriously towards EU integration, it is very likely this could have had the same beneficial effect both on the Ukrainian reform progress and the economic performance, as it did in the CEB countries. Why hasn't it been done?At the beginning, when the euphoria in Europe about the end of the communism was at its peak, the fault was entirely on the first government,which did not have an EU policy. It was sometimes claimed that this was because the EU did not "invite" Ukraine as it had Poland and others, a claim that verges on the absurd given that no country was ever "invited", that the legal mechanism for integration starts at the initiative of a candidate country, not the EU side. By the time Ukrainian leaders made declarations ofa desire fora membership backed by a serious policy, enlargement fatigue had set in on the EU side. Thus, when negotiations finally began about 2008-2010, two decades of possible anchoring benefits had been lost.

Finally, one must consider the 2014-2015 as the most immediate legacy of previous regimes. The preceding background analyses of developments since Independence makes it more clear what were the main factors behind this sharp economic downturn.

First place in the list of factors must go to the legacy of poor economic policies since Independence, which left the Ukrainian economy weak, inflexible, subject to theinterest of a powerful oligarchate, ridden with regulations and corruption, which inhibit new innovative business activity, and finally vulnerable to the political-imperial designs of Russia. The discussion in preceding sections has made clear how the misguided polices of the past caused such a state of affairs. While this legacy and the state of war with Russia should not simply excuse new Governments from doing too little to repair past errors, there is no question that the situation faced was in some ways far more complex than that at the beginning of the transition. Powerful oligarchic vested-interests and a corruption-fed entrenched bureaucracy was not something facingthe leaders of Ukraine in 1991 or Poland and other countries in 1990. The key point is that while this legacy was not the immediate cause of the recession, it reinforced the recessionary trends and made it more difficult to fight the recession.

Secondly and more directly, the recession had a start in the last year of the Yanukovich period, with GDP growth in 2013 barely positive at a very low 0.3%. This was due to deteriorating financial situation since 2012, with declining exports, artificial maintenance of a highly overvalued exchange rate, increasing budget deficits and a surge of money creation to cover these growing gaps. The negative growth of GDP in 2014 was partly an inertial continuation of this trend, while the burst of inflation to 16% per annum was partly a result of the high monetary expansion in 2013 and partly due to the unavoidable exchange rate correction.

But not all of the economic decline can be attributed to the worsening macro policies of the last Yanukovich years; the external shock of the Russian military aggression and the trade war added to this with an almost arithmetic effect lasting through 2015. The annexation of Crimea and the incursion into the economically much larger Eastern Donbas simply subtracted – immediately – a significant portion of GDP. The loss in Crimea is easy to know as GDP data are calculated by Oblast- its entire value of 3.8% of GDP was lost in 2014 . For the Donbass a calculation is more complicated as only parts of the Oblast were occupied-and even there some production continues and enterprises still pay taxes to Kyiv. An estimate has been made for SAGSUR combining GDP and industrial production data, showing that perhaps as much as 75% of the Ukrainian GDP decline in 2014 was this arithmetic subtraction; for 2015 it was less at about 40%, but still high. [12] In effect this means that for the unoccupied territory, the recession was much less severe than the overall statistics show: instead of declining at 6.5% in 2014 and 10.0% in 2015, the rates were closer to 2.0% and 6.0% .

However apart from the direct loss the war also created instability and uncertainty, which also resulted in a slowdown of – already low – foreign and domestic investment. To this, one must add the necessary diversion of budgetary resources to military expenditures as Ukraine was forced to enhance the capability to defend its territorial sovereignty and aim at the restoration of occupied areas. Finally, the restrictions by Russia on imports from Ukraine-undoubtedly violating WTO principles- led to considerable reductions of exports, with production falling particularly sharply in the south-eastern regions of Ukraine which are unsurprisingly and entirely sensibly highly dependent on Russian markets. For 2016, the one-time loss to Russian occupation of these Ukrainian territories is no longer technically measured in growth rates of GDP, as this rate is now calculated on the base of economic activity in the controlled territory. However, the uncertainty effect may still be negative – as investors, especially foreigners, worry about the risk of the conflict exploding to a higher level of military actions.

The above arguments must not be understood as suggesting that the economic policies of post-Maidan governments are irrelevant; they are very relevant. Many expert observers have commented that the best weapon against Russian aggression available to Ukraine is rapid reforms of the economic and judicial shortcomings inherited from past governments. While military defensive activities go on, there is every reason to proceed as quickly and as far as possible with this reform agenda. As already emphasized there is no question that things have moved forward, but that they have gone more slowly than possible seems to be widely accepted. It was the recognition of this by the political leadership that led to the change of government in April and the opportunity thus created for a renewed surge of reforms to complete the economic transition in the next few years. Could more reforms have brought the economic crisis to an end sooner than January 2016 ? Maybe, but not very much likely. However, following the same logic used above to show that the 2014-2015 recession was the lagged result of preceding poor economic policies, it is equally true now, that economic performance in 2016 onwards depends on the policies pursued in these last two years. So YES, more reform progress in these two years would have been good for future growth, and even more important, making up for lost time in the New Economic Reform Program is crucial to ensure that growth in the future is sustained for many years and is high enough to begin the catch-up to the standards of living achieved in the rapid reformers of the region.

[12] I AM GRATEFUL TO Pavlo Kuhta for providing these estimates and the detailed statistics behind them.

Post Maidan Efforts to Correct Past Shortcomings

There has been a considerable debate in recent months among local and foreign experts as to whether the two Post-Maidan Governments could have done much more reforming in two years. If there is a rough consensus amongst experts, it seems to say that forward progress was significant, especially in some areas, but that it was less than should or could have been done. The views of official external institutions and the diplomatic community are similar. At the same time it is generally agreed that the main barriers to faster movement were in the Parliament. Until the fall 2014 elections and formation of a new government in December, the existing Parliament included very large numbers of anti-reform Deputies left over from the Party of Regions Yanukovich regime. In the new Parliament a broad consensus on reforms clearly existed, especially within the Coalition, but with substantial differences on the technicalities, speed, strategy and tactics. This resulted in a slower pace than initially planned. Looking forward the debate on whether reforms could have been more rapid loses much of its relevance; with a new Government in place the important questions are what to do next, and how quickly. But the achievements and shortfalls of the past two years do have large implications since, at the minimum, they inform of the future agenda by recapping what was already achieved, and what is left undone. It is in this spirit that the Note reviews below the positive achievements of the last two years, as well as the shortfalls in reform.

On the positive side, the major economic policy achievements since Spring 2014 are in the areas of fiscal and monetary stability, a big step forward in gas-price adjustment to market levels and a serious beginning on improvement of the business climate. Eight specific actions merit noting:

1. The budget stabilization goals as agreed under two IMF programs have been largely met or even somewhat exceeded by the end of 2015, though of course the consolidated deficit of 5.8% of GDP is still high and more adjustment will be needed to reach the target of 3.9% for 2016.
2. A major element in this adjustment has been the increase of gas prices to households of about 50%, which allowed the subsidy to Naftohaz to decline from about 5.5% in 2014 to 3.5 % in 2015. The new government has already by early May 2016 undertaken the steps needed to finish the process of moving gas prices to world levels for all users.
3. The targeted assistance program to compensate low-income households for these increases is in place, and perhaps as many as six million individuals have been receiving such compensation, though the system is still being refined.

4. Some beginning on tax and pension reforms has been made contributing to this adjustment, but much of the plans on this have been stretched out to coming years.
5. A major success in renegotiating sovereign debt was achieved, reducing it by about 20-25% and rescheduling payments. In parallel disputed debt claims by Russia's Gazprom are under negotiation.
6. The National Bank took radical action very early, even before a new IMF program, to stop intervention and allow the overvalued Hryvnia (about 8 hrv/$)to float to an equilibrium level, and at the same time sharply cut monetary emissions. Given the high emissions in 2013, inflation jumped to nearly 25% in 2014; this plus the common effects of exchange rate overshooting led to a temporary speculative devaluation reaching nearly 40 hrv/$, but this was successfully stabilized down to the range of 20-25.
7. The National Bank has also gone far on a rationalization of the banking system, retracting licenses for about one third of Ukrainian banks, which considered to be unviable.
8. The World Bank raised Ukraine`s rank on the Ease Of Doing Business from 112th place in 2013 to 83rd in 2015. Though some of this improvement is attributable to a change in the Bank's methodology, nevertheless a beginning was made in the direction of an improved business climate by simplification and/or elimination of many regulations, licensing and inspection procedures.

As a result of these achievements –even if they are judged by some as too little- several beneficial outcomes are identifiable. Ukraine is in a better position to return to financial markets; inflation by end 2015, early 2016 was clearly well down in the single digits, and a turnaround in GDP growth had begun in the first months of 2016. Gas imports from Russia declined very sharply due to consumption savings and the arrangement for return-flow imports from Central Europe. The share of exports going to Russian markets fell dramatically from about 25 % to half that in 2015, but it is debatable whether this is a good thing or not. The driving force was not yet a boom of exports to the EU, but rather the restrictions Russia placed on the imports from Ukraine. As stated earlier, this is a level far below normal, and its immediate effect was to add to the decline in GDP. But as long as Russia continues these restrictions and the military actions, the government of Ukraine can only wait for a future of stable, friendlier relations.

On the side of shortcomings in reform the principal area of limited achievement concerns corruption control, as shown above the improvement on international rankings is marginal at best. Indeed experts at Transparency International consider that what has been done is at most that the necessary legislation and regulations on paper have been put in place but not really implemented.

There is a widespread view that the power of the oligarchate is undiminished, hence reforms must be more radical to deal with this. In fact, there is no better reform to reduce the monopolistic power and political influence of oligarchs than the market institution reforms which increase the competitive power of SME's, of new entrepreneurs. Furthermore one should recognize that some changes in the old power equation appear to have taken place thanks to the positive policy changes noted above. Raising the price of gas to near world-price levels has largely eliminated one of the largest areas of rent and political power. It has also opened up prospects of a less-monopolistic domestic gas production environment. The gradual shift to trade with the EU under free-trade also reduces such power, though it is too early to expect much of an effect .

One area where rent-seeking and oligarch influence opportunities remain is in government procurement and operations of the many still-state-owned enterprises. Indeed the so far limited progress on privatizing them means a continued drain on budget resources. Other areas of lagging reforms meriting early attention are the very limited real reduction of the regulatory environment, government staffing reductions, and the virtual standstill on land privatization. To deal with the unfinished agenda one can list at least seven major areas where urgent progress is needed:

1. The single most important shortfall in the reform efforts since 2013 has been the lack of any meaningful actions to prosecute past corruption transgressions. While several legislative and administrative changes have been made including new agencies with large staff to investigate corruption, the long delay in changing personnel at the Prosecutor's office and limited cases brought to court is reflected not only in the volley of criticism voiced domestically and abroad, but by the very limited improvement in the international rankings. Though it may be argued that it takes a long time to prepare concrete court cases, the lesson for the new Government is surely clear: it must move as quickly as possible in this area.
2. Improvements in the Rule-of-Law are largely on paper, and the implementation of better, more open, even-handed and corruption free court proceedings still awaits the planned replacement of judges from earlier regimes. Whether the pace in the past was too slow can be debated, but the objective for the future is again that more rapid progress is essential.
3. The Ministry of Economy's plans to privatize about three thousand enterprises still in state hands is far from being fulfilled. They continue to be a drain on budget resources, and to provide too many opportunities for crony appointments, procurement, hence corruption.

4. The upgrading of Ukraine by 29 places in the Ease of Doing Business rankings is still far short of what should be attainable. There are only three transition countries worse than Ukraine while about 25 are far better. Recently Macedonia was able to leap to an almost unbelievable 12th position, the best for any transition country, better than Australia, Canada, Germany, and a bigger improvement than even Georgia had attained. This recent case demonstrates clearly that it can be done even with deeply entrenched opposition.
5. Agricultural sector reform has been very modest and leaves that sector still largely in a Soviet model .While private farming is in principle allowed, this is only under the leasing system in which the land is not owned by the individual and cannot be used for collateral to borrow funds that are essential to any new venture from the banks. Put simply, the incentive to improve efficiency is absent. Small private farmers are further constrained by a reliance on big oligarchic conglomerates which largely monopolize related services such as supplying agricultural machinery, fuel and other inputs, and dominate in first-level processing, export channels, transport and distribution. Ukraine's historical reputation as breadbasket of Europe based on an overwhelming comparative advantage of fertile soil, cannot possibly be realized without moving to full privatization of land. The EU agreements will begin to increase demand from those markets, but the supply response from the Ukrainian side must be based on completing land privatization.
6. In the area of the state budget, two important reforms have not moved far enough: revision of the tax code is incomplete, and pension reforms have been pushed back in time, jeopardizing the deficit reduction targets for the next two years.
7. Last but not least is the establishment of a public outreach program to explain regularly and transparently the reasons for and nature of economic reforms. If populism has increased since early 2014, it is not only because gas prices have been raised and some pension rationalization has occurred, but also because there has been too little effort by the government to explain and justify publicly the steps being taken. It is not enough to have top leaders give occasional speeches or Television interviews—far from everybody is there to hear this. There must be a more systematic initiative for government representatives and other experts to find ways to reach a much larger audience and explain, debate, discuss openly why reforms are needed for the benefits of the entire population and not merely because the IMF and others "require " certain prior actions to release tranches of finance. The beginning of such outreach is exemplified by the speech of President Poroshenko, Feb 15, 2016 : It set the tone by telling the public *"We have launched a number of important and very difficult reforms. However, the public wants more".* It needs to be followed up by various officials with more details and regular updates.

III.ECONOMIC REFORM PRIORITIES FOR 2016-2018

Lessons of Transition History in Ukraine and its Neighbors.

One of the main arguments given in earlier years for the delayed and hesitant reforms was that Ukraine is “”unique “, therefore what other countries did is not applicable. As most myths this one contains a half truth, namely that there are indeed features of the economy and society unique to Ukraine- but this in fact can be said about every country. It was wrong to derive from this the overarching conclusion that Ukraine should delay reforms. The correct inference should have been – and must now be – that Ukraine must follow a strong reform strategy like every successful reformer,, but may need to apply somewhat different tactics. Two areas of uniqueness will be noted where this flexible principle should have been applied differently . Among socialist countries, Ukraine had one of the highest shares of GDP in heavy industry including military production with its world-renowned high levels of scientific knowledge. The sensible thing that should have been done would be to give the highest priority to privatization and regulatory simplification to this sector allowing it to move rapidly to conversion from military to hi-tech consumer and industrial goods. In fact exactly the opposite was done, allowing it to continue to be a drag on the budget and economy. Similarly, Ukraine’s rich endowment of fertile chornozem and temperate climate was also unique, and indeed had for centuries before collectivization been a key exporter of agricultural products earning it the label “breadbasket of Europe”. It too should have been the first focus of privatization and simplified business procedures. Instead a mythology that land belongs to everybody and must be protected from foreign ownership was constructed to permit agricultural oligarchs to garner huge rents from privileged rights to buy, sell, transport, export and distribute the output of the land. Instead of agriculture becoming a leading export and growth driver, a major contributor of budget revenues it became one of the biggest sink-holes of subsidies which fed the few rent-seeking oligarchs of the sector.

It is important to recognize that, as time passed, not all of the early history and experience of other transition countries is relevant today –but much of it still is with some modification. The first and most important lesson is clear in the comparisons of Figures 1, 2 and 4: the evidence after 25 years is overwhelming that regardless of the technical details of polices applied, the countries that performed best in overall economic growth of GDP, and best in terms of improving living standards of the population, were the countries that began reforms early and progressed resolutely. That this has continued to be the right recipe is shown by at least two examples. When in 1998 a reform (and democratically) oriented government of Slovakia ousted the hesitant reformer, Prime Minister Meciar, the new Prime Minister, Dzurinda and his team pursued a rapid and comprehensive catch-up reform package that led to Slovakia's having the fastest GDP growth in Central Europe and attaining one of the highest GDP per capita levels. Similarly, the victory of Georgia's Rose revolutionaries, allowed the reformist President Saakashvili with a team of ardent reformers to move extremely rapidly and lift Georgia from the lowest positions on various international rankings to the highest.

The third important lesson is that a popular perception linking reforms to deteriorating standards of living, was a myth created for the convenience of leaders who preferred to go slow in order to permit friends and associates to become the first new capitalists. The facts of twenty five years laid out in this Note demythify this: social pain has been greatest where there were least reforms. Ukraine has suffered considerably from this myth as even the most devoted reform leaders continue to face strong public opposition. It is essential that this lesson is understood and the public convinced to destroy that myth.

Priority policy steps

The Introduction laid out seven broad aims of a new Economic Reform Program for the near and medium term period, including: catching-up to the leading and successful Central European reformers, achieving strong GDP growth, controlling corruption, developing an efficient system of targeted social support, and progressing rapidly on EU integration. But these are not policy actions, but rather a list of the end-goals of the Program. It is necessary to make concrete the means by which these goals are reached, that is the specific policy steps and their timing. This Note is not the place for a full technical presentation of proposed legislation, decrees, decisions of policy ; it will instead emphasize what are the most critical areas of reform.

1. *Fiscal and Financial Stability* is the first and most essential task of any Government wishing to promote good economic performance. It is notable that while amongst economists there has been some difference of opinion on the speed of liberalization, there was always a consensus that macro-stability is the foundation and *sine-qua-non* condition of good policy. In fact stabilization has been largely achieved by the end of 2015, with a Total Budget deficit reduced to 5.8 %, below the IMF program target, monetary targets also more than met, with consequence that the hryvnia has been successfully stabilized and inflation by early 2016 fell well below double digits. This plus an agreed debt reduction has returned a degree of confidence in the Government and allows a return to financial markets. The policy for the

future must be to sustain this fiscal and monetary stability, and go on to further budget reforms in three areas. First, proceed with the planned pension reforms, raising retirement age and reducing remaining privileged pensions. Second, apply the successful targeted assistance for gas-price compensation to other areas of social support by eliminating universal subsidies and replacing them with assistance to low-income individuals. Third, complete the planned tax reforms. Caution is merited on taxes: proposals to promote growth in sectors with export potential *(e.g.* hi-tech, processed foods) through tax-exemptions, must be firmly resisted. The global experience with such an approach is at best mixed and suggests that it is particularly risky in a situation of embedded corruption .

2. *Deregulation and improved business climate* has been another area of significant progress in 2014-2015, albeit still quite limited in comparison to most other transition countries. Accelerating the actions in this area must be immediate, deep and comprehensive, using the momentum of the good start. Part of this business climate reform package must be an early program of privatizing the thousands of remaining state enterprises, small as some of them may be. A monitoring benchmark for this would be useful: reaching a ranking in the Ease of Doing Business report of 50^{th} position by the end of 2017. As evidenced by experience of many transition countries- Georgia, Macedonia and others- this is not an unreasonable goal and can be done quickly. The value of such an improvement in the investment climate for promoting growth would be enormous, and of course such simplification and transparency in doing business would be the essential first step in fighting corruption.
3. *Effective and Transparent Rule-of-Law* must be pursued in parallel with business climate enhancement, though relevant changes in the judicial process are likely to require more time. Thus, any goals measured by using international rankings on quality of justice [13] could be more modest and more medium-term than for business climate. Policy actions in this area go beyond reforming courts, establishing expertise on commercial disputes, replacing current judges suspected of corruption as was done for city-police forces. Undertaking widespread prosecutorial actions against past corruption activities as well as judges and officials of the system involved in this must be an important part of the phalanx of policies aimed at controlling corruption. It is good to be reminded of experience in other countries. It is impossible to catch in this prosecutorial net-sweep all perpetrators. In fact however, it is less necessary than a simple demonstration of seriousness of punishment for corruption, which will have to go a long way to gain credibility and to reduce the motivation for future corruption. Deregulation will reduce opportunities for corruption thus lowering its benefits, while prosecutorial punishment will raise its cost. Together these two scissor-blades will become the most powerful tool for cutting corruption. Indeed the value of these two combined actions extends to the concept of Dignity so central to the Maidan; concrete actions of these two sorts will show the population that the Government is serious about establishing dignity and fairness for all – especially so if

[13] The World Bank's World Governance Indicators includes a component on Rule-of-Law Quality, but there are others that could be used for monitoring .

the corruption cases reach high enough[14]. By this the Government can begin to regain credibility and trust of the population, which in turn will ease the introduction of some fiscal measures that may be unpopular.

4. *Completing energy sector reforms* including the final steps of raising gas price to real world cost levels and allowing the exploitation of available domestic sources. The basic principles and legislation for this seem to be already in place by early May 2016 .
5. *Facilitating export growth and diversification* is a widely popular notion that unfortunately yields some questionable policy proposals; here it is as important to note what needs to be done as to indicate what needs to be avoided. The most important actions are two: accelerate the process of deregulating and easing the procedures for new business; move as quickly as possible on implementing the terms of the EU agreements, specifically on aspects having to do with access and certification. There may be a shortcut available on sanitary products – technical certification in the form of a law that grants automatic domestic certification for a new product if the enterprise is able to obtain an EU certification. Avoiding double certification testing procedures would speed up the process. The actions to be avoided here are any special government procedures or tax exemptions aimed at high-potential sectors, or establishing Tax-Free-Zones. The global experience with these focused stimuli is not very good; though some such efforts to have Government officials "pick winners" may succeed, most do not . And even those that do are, just like Tax-Free-Zones, at a great risk of enhancing corruption. Given the deeply rooted corruption problem of Ukraine, creating yet another set of opportunities is surely to be avoided.
6. Land privatization and related agricultural sector reform may be very difficult politically given the misperceptions built up in the population by the vested-industry conglomerates that profit from the present situation. But this is a critical area for future growth and exports. It is a mistake to look down on agricultural exports as somehow unsophisticated compared to IT or complex manufactured goods. There are innumerable very rich farmers in advanced countries with similar chornozem advantages –Canada, Australia, New Zealand, even the US. There is nothing wrong in having both a sophisticated industrial or IT sector and a large agricultural sector. Not taking advantage of the vast new markets in food products that will gradually open up in the EU would be wrong. But to achieve success in this area, land privatization and elimination of non-transparent agro-oligarchic activities is necessary .

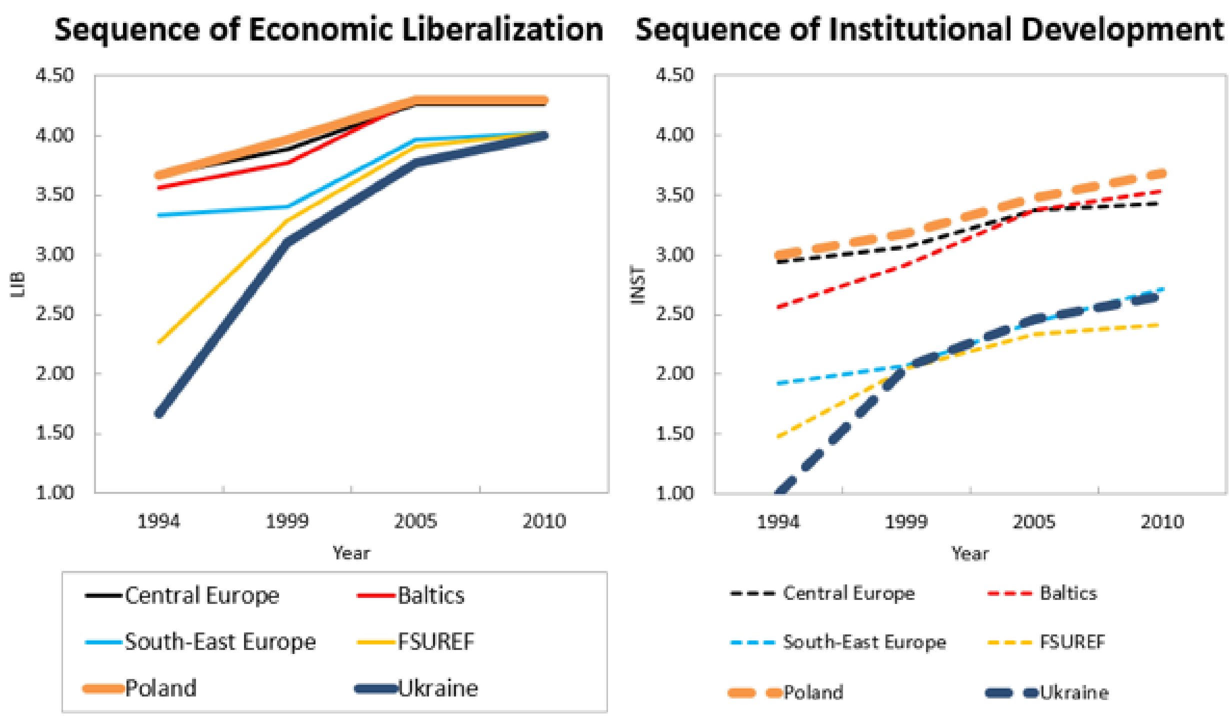
   Public Outreach to Ensure Ownership of Reform Program, while not an economic policy action as such is uniquely important to Ukraine where so much negative mythology about markets has been built up. Even the most convinced and committed reform-oriented Government must take account of public views and undertake a public campaign of explaining, convincing. Some of the relevant myths and misperceptions have been discussed earlier. The list is long but must include at least the following: explaining real costs of low gas prices, focusing heavily on "adresna dopomoha"; explaining with comparative international analysis the need to reform

[14] The example of recent and current proceedings in Romania against high-level officials like city-Mayors demonstrates such seriousness.

pensions, raising retirement ages reflecting demographic trends, etc, ; explaining why social costs of gradual reforms in Ukraine were far greater than those in Poland and Central Europe with rapid reforms; explaining the lag between policies and results and, where possible, identifying new export areas to EU; explaining illegality of Russia trade restrictions, and pursuing a wide campaign of complaints at WTO; combating the perception that private land ownership harms small farmers, making clear that the biggest losers are the rent-seeking vested interests that profit from the present controlled environment in agriculture, in much the same way as in manufacturing sectors.

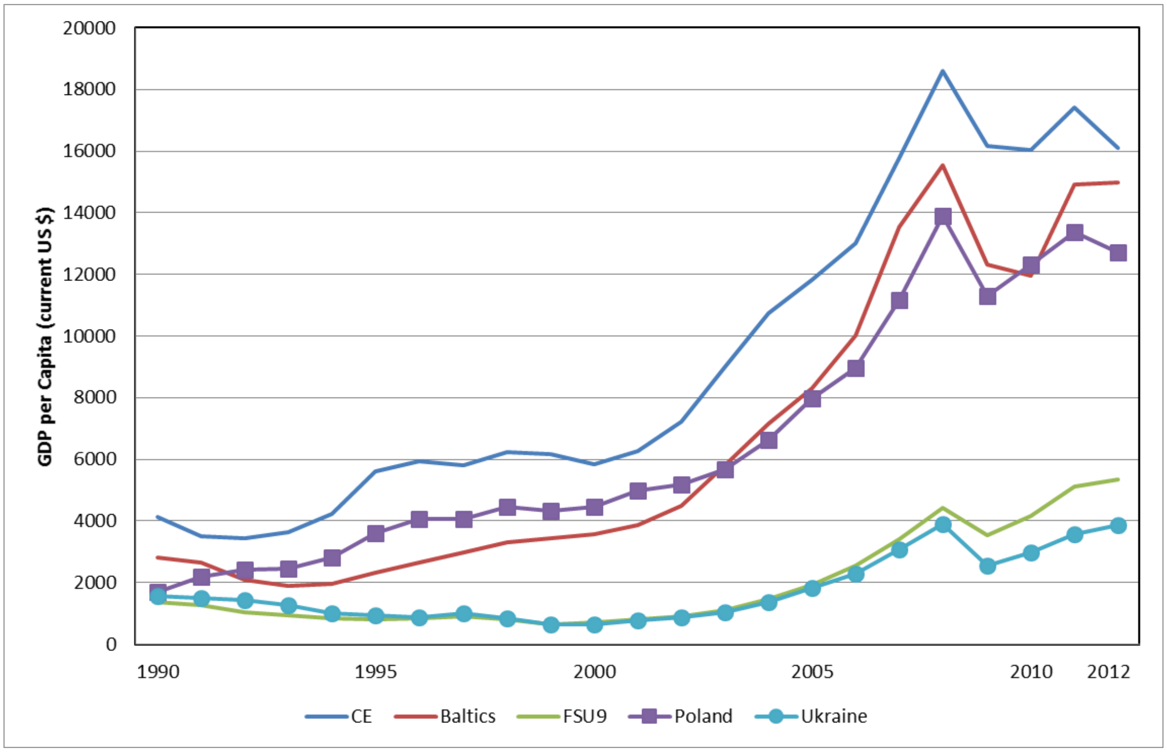
FIGURES AND TABLES

FIGURE 1. EBRD INDEX OF PROGRESS TO MARKET



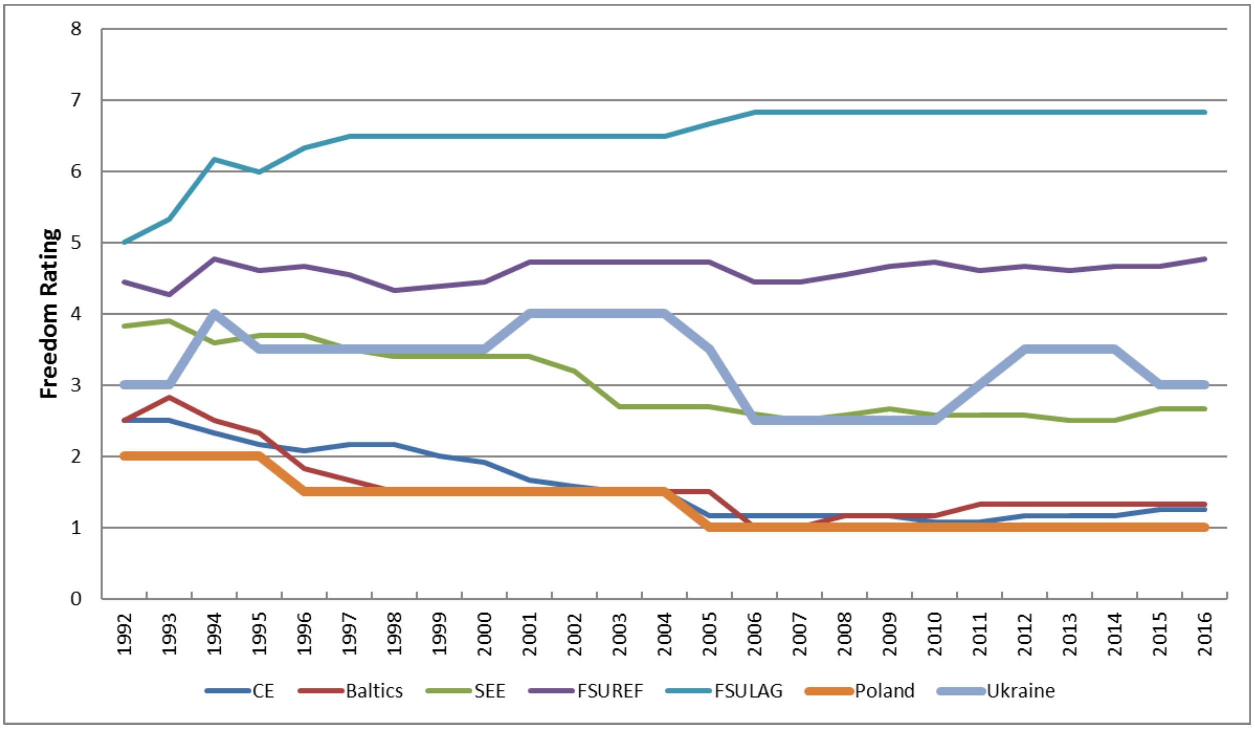
Notes: Source: European Bank for Reconstruction and Development, website on Transition Progress Index. The country groupings are taken from Oleh Havrylyshyn (2016 forthcoming) T*he Political Economy of Independent Ukraine.* London : Palgrave MacMiIllan Publishers. FSUREF comprises countries from Former Soviet Union group which have undertaken at least some significant reforms : Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Ukraine, Moldova. Tajikistan . Belarus, Uzbekistan, Turkmenistan with TPI values still about 2.0 or less, are labeled in later graphs as FSULAG, that is lagging reformers.

FIGURE 2. EVOLUTION OF GDP PER CAPITA BY TRANSITION COUNTRY GROUPS plus POLAND AND UKRAINE



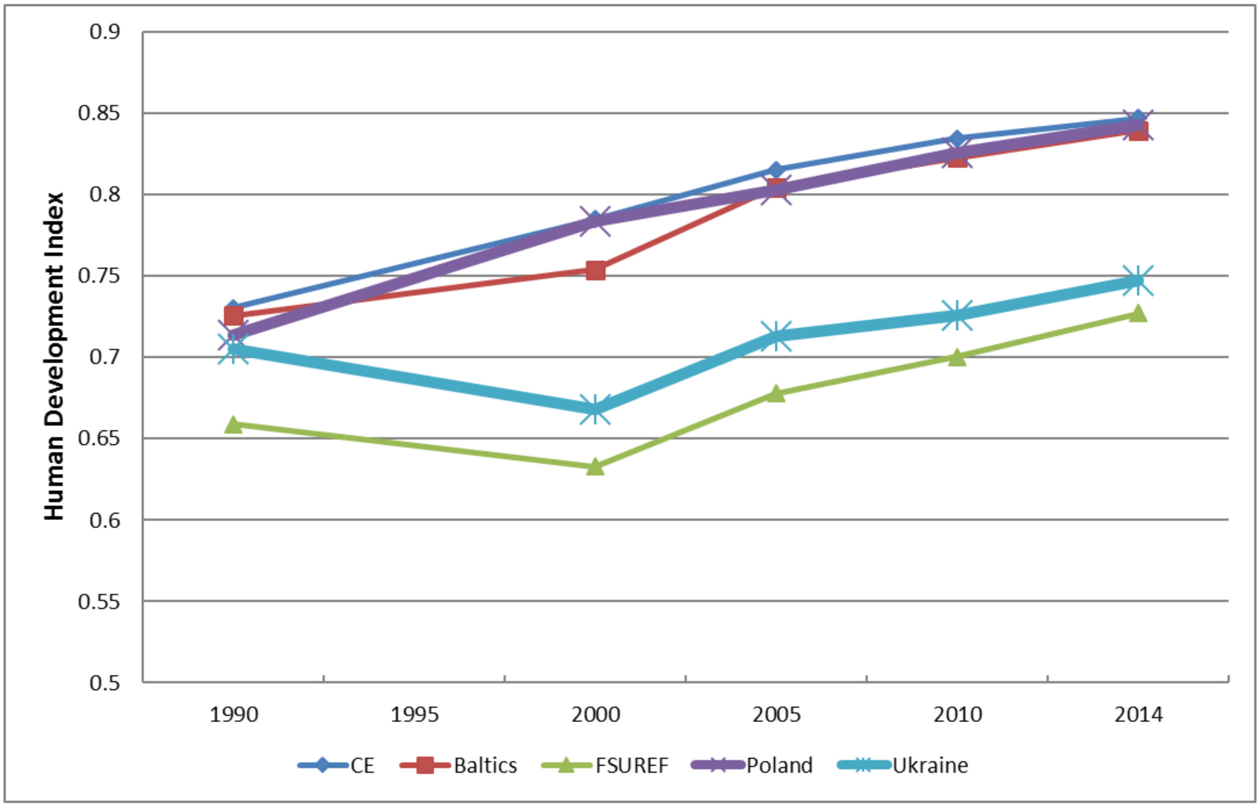
Source: World Bank, World Development Indicators. Country Groups: CE (Croatia, Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia); Baltics (Estonia, Latvia, and Lithuania); FSU9 (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia Federation, Tajikistan, and Ukraine). **Note:** Many comparative assessments use growth rate data in local currency. This understates performance as it misses the effect of productivity gains (Balassa-Samuelson effects). For this reason, this comparison uses current US$. Groupings are as in Figure 1.

FIGURE 3. DEMOCRACY RATINGS BY COUNTRY GROUP plus POLAND and UKRAINE . 1992-2013



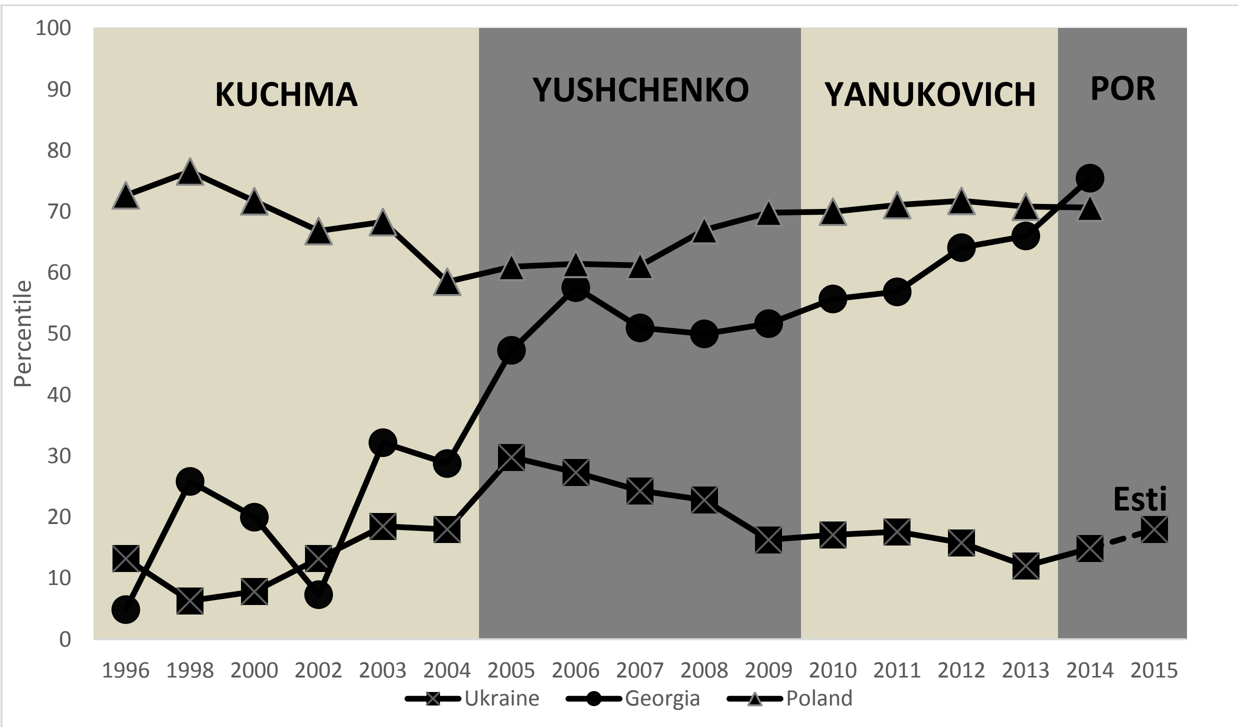
Source: Freedom House, Washington D.C., website for Democracy in the World. Footnote 1 explains the scoring scheme.

FIGURE 4. HUMAN DEVELOPMENT INDEX FOR SELECTED COUNTRY GROUPS PLUS POLAND AND UKRAINE



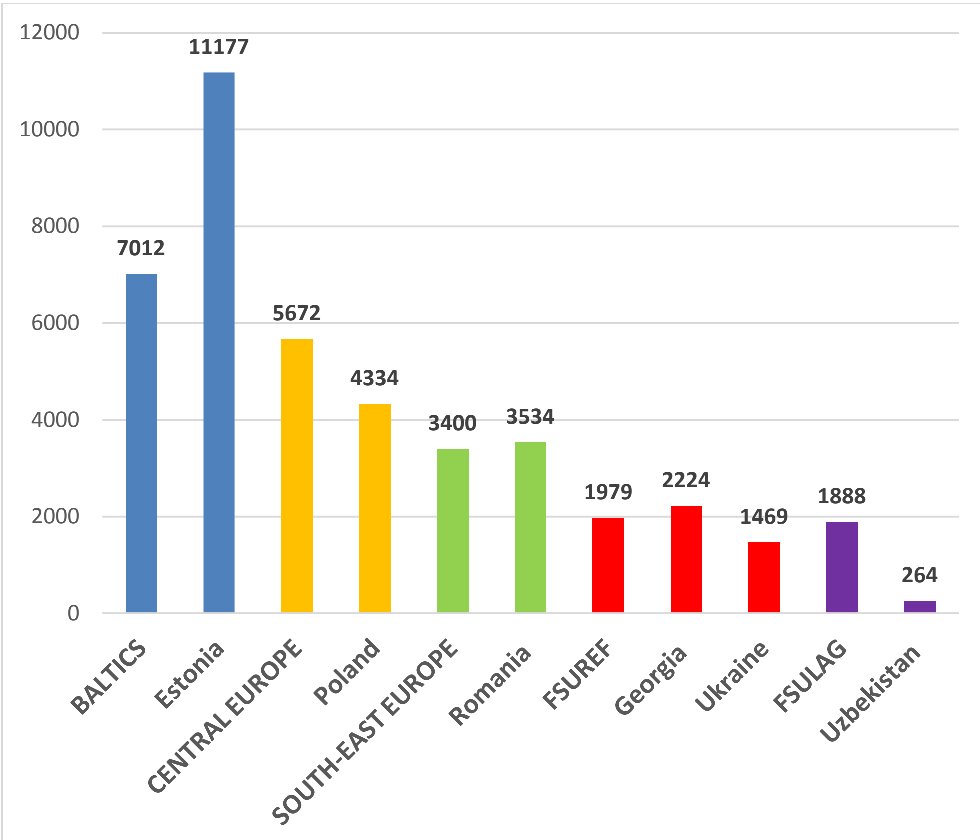
Source: United Nations Human Development Reports, online database. Country groups as in Figure 1. For Central Europe –CE- and Baltics- the graph does not show some small declines in the HDI, as these took place only between 1990 and 1995 after which the values began to increase.

FIGURE 5 . TIME TREND OF CORRUPTION CONTROL PERCENTILE POSITION UKRAINE, POLAND, GEORGIA.



Source: World Bank, World Governance Indicators website latest year. The latest available survey covers only 2014. The 'estimate' shown for Ukraine 2015 is based on the different survey done by Transparency International, taking the ratio of its 2015 to 2014 value and applying to the World Bank's values. Higher values mean less corruption. The percentile measure is then to be interpreted as follows: for example, the historical peak value for Ukraine in 2005 was the 29.4th percentile, meaning that of the an out 180 countries in the sample, 29.4 % had worse corruption than Ukraine, and 70.6 % had less .

FIGURE 6. TOTAL CUMULATIVE FDI FROM 1992 to 2012. SELECTED COUNTRY GROUPS AND COUNTRIES: $US per capita



Source: EBRD Transition Report 2013. Not all countries are shown here.