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UKRAINE'S ECONOMIC REFORMS: WHAT HAS BEEN DONE AND WILL IT SUCCEED?

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This article attempts to offer a picture of the state of the economic reform in Ukraine in the summer of 2015, assessing what has been done. It offers a periodisation of Ukraine's economic policy since its independence in 1991, suggesting that Ukraine has seen three periods of significant reform and this is by far the most important. The main cause of Ukraine's current economic decline is Russian warfare. The present situation differs greatly from that after the Orange Revolution in late 2004. These reform efforts are more far-reaching than earlier attempts, especially in the energy and banking sectors. Finally, four risks to the present reform wave are discussed. The four big risks to this reform wave lie in Russian warfare, insufficient international funding, lagging reforms in the judicial sector, and the wearing out of the coalition because of economic hardship.

Keywords: Ukraine, economic reform, macroeconomic stabilisation, energy reform, judicial reform, international assistance

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In the summer of 2015, Kyiv is vibrant with intellectual and political discussions. As after any revolution, the debate is about what is wrong and what should be done.[1] Policy people acknowledge that reforms are proceeding, but too slowly, while a typical business verdict is that corruption is as bad as before, but it has become more disorganised since the old Yanukovych hierarchy has broken down.

The economic situation is frightful, with GDP falling by 17.2% in annualised terms in the first quarter of 2015 and annual inflation peaking at 61% in April. But much has gone right, more than Ukrainians usually notice. What everyone recognises is that Ukraine has a strong civil society. People are active both in discussions and in deeds. The state functions poorly, but volunteers help everywhere, from the battlefields to hospital beds and schools. Civil activists expose corruption and its culprits every day, often forcing top officials to leave office after prolonged struggles. Street protests are commonplace.

This article attempts to offer a picture of the state of the economic reform. What has been done and what has failed so far? The first section offers a periodisation of Ukraine's economic policy since its independence in 1991. It suggests that Ukraine has seen three periods of significant reform and this is by far the most important. The second section argues that the main cause of Ukraine's current economic decline is Russian warfare. The third section clarifies the differences between the current situation and that after the Orange Revolution in late 2004. The fourth section explains how the current reform efforts are more far-reaching than earlier attempts, especially in the energy and banking sectors. Finally, four risks to the present reform wave are discussed.

1. A PERIODISATION OF UKRAINE'S ECONOMIC POLICY SINCE 1991

Ukraine's economy has persistently underperformed. It has done far worse than any of its big neighbours, Poland, Russia, and Turkey. In 1990, Ukraine, Poland, and Turkey were at similar levels in terms of GDP per capita in purchasing power parities. Since then, Poland and Turkey have approximately doubled their GDP per capita at fixed prices, while Ukraine has declined by one-fifth according to the World Bank (2014). Moldova is the other post-Soviet country in Europe that has performed as poorly as Ukraine.

If we instead compare GDP per capita at current prices and exchange rates in 1989 and in 2013, we find that Ukraine was slightly ahead of Russia and at the level of Poland and Turkey in 1989, while the three other countries were at a level approximately three times higher than Ukraine's in 2013 (IMF 2014). With the

[1] A general background to this article can be found in my new book: Åslund (2015a).

large depreciation of the Ukrainian hryvnia in 2014, Ukraine's GDP per capita at current prices has fallen to one-sixth of the Polish level.

How could this happen? The explanation is that Ukraine has suffered from pervasive corruption. Ukraine's independence was driven by two interest groups. One was Rukh, the primarily West-Ukrainian nationalist movement that wanted independence and a strong Ukrainian state without any clear economic views, but it was never supported by more than one-quarter of the population. The other interest group of importance was the old Soviet Ukrainian nomenklatura of the east that wanted two things, power and money.

The Ukrainian state was formed by a coalition of these two interest groups. In a somewhat simplified form, one may say that the nationalists handed political and economic power to the old nomenklatura as long as they accepted the Ukrainian nation and the promotion of Ukrainian national symbols and language. The problem with this alliance was that nobody cared about economic policy.

Ukraine's economic policy and its results are well illustrated by its real economic growth rates from 1989 until 2014.

We can distinguish between five different periods. *First,* in the early transition, in 1991–1994, Ukraine had no economic policy, which led to hyperinflation and massive output fall. Ukraine did far worse than Russia, which attempted serious reform, even if it did not quite succeed.

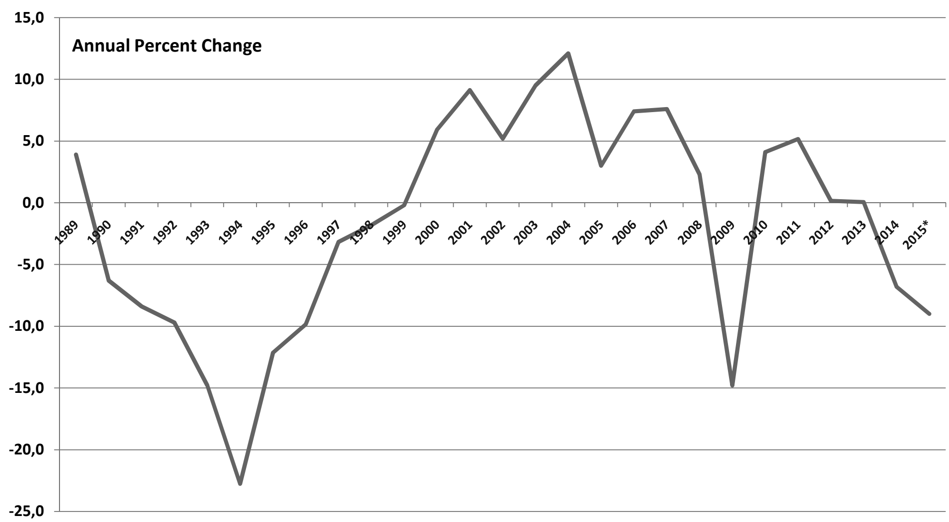

Figure 1. Ukrainian GDP growth, 1989–2015

Source: IMF World Economic Outlook, April 2015.

Second, in 1994–1995, President Leonid Kuchma carried out elementary market reforms and fiscal stabilisation as Kyiv concluded its first IMF program in October 1994. However, the economy was not sufficiently liberated in order for it to start growing. In 1995–1999, GDP continued to shrink. In the decade of 1989–1999, it fell by a total of 61% compared with 52% for Russia, whereas Poland's GDP rose by 22% (UN ECE 2000: 225). Evidently, Poland had surged ahead thanks to its early, radical, and comprehensive market reforms (Sachs 1993).

Third, in the first quarter of 2000, Ukraine enjoyed its second great reform spurt after President Kuchma was re-elected and Viktor Yushchenko became Prime Minister. Finally, Ukraine started growing fast, at an average of 7.5% a year, from 2000 to 2007. This was Ukraine's only successful period. To the disappointment of many, the Orange Revolution of November-December 2004 did not result in any new reform wave, but in chaos.

Fourth, the global financial crisis of 2008–2009 exposed the overheating of Ukraine's finances. The country had thrived on a big financial bubble, which burst in September 2008. Its GDP plunged by 15% in 2009 (IMF 2014). The aftermath of the crisis brought little relief to Ukraine. Although it had suffered such a severe crisis, its recovery has been slow and partial. In 2012 and 2013, it recorded no growth at all because of Yanukovych's miserable, predatory economic policies.

The *fifth* period started with a new big decline in output in 2014, largely caused by Russian warfare as discussed below. The question is whether this crisis will be utilised. As it appears at present, Ukraine is in its third reform wave. Will this go deeper and be more successful than those in 1994 and 2000?

To sum up, only in the 8 years between 2000 and 2007 did Ukraine perform well economically. Other countries that had similarly poor economic performance in the 1990s were Russia, Moldova, and Kazakhstan. These four countries had ended up in an under-reform trap of rent seeking and oligarchy (Åslund et al. 2001). Around 2000, they all broke out of it and started growing fast, but Ukraine has got stuck once again.

More than any other post-communist country, Ukraine has been ruled by a score of big businessmen that have captured the state (EBRD 1999). They dominate large sectors of the Ukrainian economy, notably energy, metallurgy, mining, and the chemical industry, letting neither foreigners nor smaller Ukrainian businessmen into these sectors. They made their fortunes through rent seeking, primarily the gas trade, in the early 1990s, and by capturing the state, they have managed to maintain their rents. The oligarchs have controlled the state through large representation of their own in parliament and in the government, but they have also bought all kinds of services from senior officials (Åslund 2009).

Improved governance is crucial for higher economic growth and greater economic welfare, and governance becomes more important for growth as an economy advances (Acemoglu 2008). Among post-communist countries, Ukraine has a curious position with regard to freedom and corruption. It is as corrupt as the standard post-Soviet country, but it enjoys much greater political freedom. Hardly any country that is so corrupt has such great transparency and freedom. This is no equilibrium. Either corruption and authoritarianism, or freedom and good governance are likely to win.

All the Central and Eastern European countries that have become members of the European Union have advanced to full democracy and succeeded in limiting their corruption. They have entered a stable equilibrium, with democratic forces checking that the government cannot become too corrupt.[2] Most of the post-Soviet countries, by contrast, have ended up in a suboptimal equilibrium with great corruption that is being maintained by predatory authoritarian regimes, which benefit from the corruption. The question is in which direction Ukraine will move, towards less corruption or towards more authoritarianism.

This uncommon situation can be explained by the prominent role of oligarchs in Ukrainian society. Competition between the big business groups has kept Ukraine quite an open society, but they have also rendered society corrupt and unequal to their benefit, which led to the Orange Revolution in 2004 (Åslund – McFaul 2006).[3]

President Viktor Yanukovych, by contrast, tried to consolidate power in the hands of his family as in most other post-Soviet countries. In doing so, he turned against both the people and the oligarchs. An important reason for his demise was that powerful big businessmen owned most of the television channels, which exposed Yanukovych's wrongdoings.

2. UKRAINE'S MAIN ECONOMIC PROBLEM: RUSSIAN WARFARE

After two years of stagnation in 2012–13, Ukraine's economy has deteriorated sharply.[4] Its GDP contracted by 6.8% in 2014, and it is forecast to shrink by another 9% in 2015 – a total loss of roughly 16% over two years. In mid-2015,

[2] It is possible that Hungary will slip away from this favourable equilibrium, but that has not been recorded as yet.

[3] The best book on post-Soviet oligarchs is Freeland's (2000) discussion of the Russian oligarchs in the 1990s. Frishberg (2006) has written extensively about the Ukrainian oligarchs without mentioning their real names, while Puglisi (2003) and Åslund (2009) have named them and their companies.

[4] This section draws on Åslund (2015b).

things seem to be stabilising. The depreciation of the hryvnia has eliminated the country's current-account deficit, and a massive fiscal adjustment brought Ukraine's budget into cash balance in the second quarter of 2015, but the situation remains precarious.

Although corruption is a severe and long-standing problem, Ukraine's primary economic challenges are no longer homegrown; they are the result of Russian aggression. The country's belligerent eastern neighbour has annexed Crimea, sponsored rebels in eastern Ukraine, pursued a trade war, intermittently cut off its supply of natural gas, and is threatening financial attack. So far, Ukraine has miraculously managed to withstand these assaults with little international support, but it is in desperate need of assistance.

Russia's annexation of Crimea in March 2014 seized 4% of Ukraine's GDP. Since then, Russian-supported armed forces have occupied territories in eastern Ukraine that accounted for 10% of the country's GDP in 2013. With the Donbas region's production having plummeted by 70% in the months since, this has cost Ukraine some 7% of its 2013 GDP (Dragon Capital 2014).

Less noticed is that Russia is also pursuing a trade war against Ukraine. Last year alone, Ukraine lost half of its exports to Russia, amounting to 12% of Ukraine's total exports in 2013, and this decline has been aggravated this year. Since 2013, Russian trade sanctions have slashed Ukraine's exports to the country by 70% – accounting for a drop of 18% in Ukraine's total exports. Russia pursues all kinds of illicit trade sanctions against Ukraine.

Ukraine's previously substantial agricultural exports to Russia have been restricted through phytosanitary regulations amounting to unfounded prohibitions. Steel exports have been blocked through personalised antidumping actions. In addition, Russian state enterprises have stopped purchases from Ukraine as a matter of policy. That Russia became a member of the World Trade Organization in 2012 has had no positive impact. Naturally, the Ukrainian exports of armaments to Russia have declined. Logistical issues, the lack of alternative commercial links, and the specialisation of some products meant that the goods could not be redirected in the short term. This loss is likely to correspond to a 6% decline in Ukraine's GDP.

All businessmen are aware of Russia's assault on Ukraine, and few want to invest in a war zone. As a consequence, Ukraine's net foreign direct investment, which was steadily slightly over 3% of GDP a year before the start of hostilities, has evaporated. This implies a reduction of 3% of GDP. Furthermore, Ukraine has faced an intermittent gas war. A financial assault may be yet to come.

Leaving Crimea aside, we may conservatively assess Ukraine's economic losses from Russia's aggression, amounting to roughly 7% from lost production in occupied eastern Ukraine, 6% losses from trade sanctions, plus 3% from lost foreign direct investment amounts to 16% of GDP. That is, the total amount Ukraine is estimated to have lost from the beginning of 2014 to the end of 2015.

Russia's apparent but undeclared aim is to make sure that democratic Ukraine fails, without looking entirely guilty of having caused that failure. This leads to an important conclusion: Ukraine is not the culprit but the victim, and it should be treated accordingly.

On July 1, Russia re-opened an old front in its economic war on Ukraine when the energy giant Gazprom, which is majority-owned by the Russian state and pursues Russian foreign-policy objectives, decided to cut off the country's gas supply. Given the global gas surplus, Europe is in a position to tell Russia in no uncertain terms that its corrupt practices are no longer acceptable.

3. HOW THE CURRENT SITUATION DIFFERS FROM THE ORANGE REVOLUTION

Overtly, the Euromaidan or revolution of dignity of 2013–14 appears quite similar to the Orange Revolution of 2004. Will the new democratic government be able to avoid the mistakes and disorder in the aftermath of the Orange Revolution? The present situation is quite different, but the policy lessons from the mistakes of the Orange Revolution remain poignant.

The mood after Euromaidan could not be more different from the atmosphere after the Orange Revolution. Then, the victors and the population were caught in euphoria after a peaceful and swift democratic breakthrough. After the Maidan was tainted with blood and Ukraine subject to severe Russian military aggression, the Ukrainian mood is sombre. The challenge of the democratic government is to save the nation.

This time, the public mood is characterised by justified suspicions. Everybody understands how deeply ingrained corruption is also among the democratic opposition. Civic society has grown much stronger. It is not prepared to give any authorities the benefit of the doubt. In 2004, the economy had grown by 12%, limiting economic concerns, while it was declining in 2014. Ukraine had large twin deficits in 2013, which had to be cured.

A decade ago, the European Union was a distant perspective. Now Ukraine has signed the substantial Association Agreement, which amounts to a civilisational choice. It contains a blueprint for a reform of the Ukrainian state along European lines, and the EU has committed substantial technical assistance to achieving this goal.

Two big lessons stand out from the Orange Revolution. The first policy must be to make a clear break with the prior corrupt political and judicial system.

Given that the existing parliament was pervasively corrupt, early parliamentary elections were essential. A corrupt person is not likely to turn honest, but needs to be replaced by a person who has not been corrupted as yet. The greater the turnover in the elite, the better it is. Many institutions, such as the government, can be cleansed by a decent parliament, but that is not true of the courts and law enforcement.

The second broad policy must be to eliminate the main political and economic mechanisms of corruption fast, so that the new rulers are not corrupted by the old system. The incentives must be set right. This cannot be done gradually because then the new rulers will be corrupted by the old system, and the reform will never be completed. Classical corruption traps, such as various fixed prices for gas between which rent seekers can arbitrate, must be eliminated as soon as possible and not in steps over several years. Similarly, corrupt enterprise subsidies must be abolished. State procurement cannot be made competitive gradually. It should be done in one single step. Where negative social effects arise, they should be dealt with through direct cash compensation. Ukraine has a developed system of 745 social welfare bureaus across the country that can and should be used.

4. MORE FAR-REACHING REFORM EFFORTS THAN PREVIOUSLY

The key thing was to achieve a clear break with the old system politically, legally, and economically.[5] Soon after the democratic breakthrough in February 2014, Ukraine carried out early presidential and parliamentary elections. Pro-European reformers won both elections, laying a political base for serious democratic and market economic reforms. However, until the parliamentary elections on October 26, the old vested interests dominated parliament, blocking most reform legislation. These elections gave reform a political mandate.

On December 2, a new government was appointed. It is younger and more qualified than any previous Ukrainian government. In the last Yanukovych government, only two ministers spoke English, while in the current government, only two out of 20 ministers do not speak English. The typical new minister is a 38-year-old investment banker with a Western MBA. Many ministers are not corrupt and they are strongly committed to sensible reforms. Radical anti-corruption reforms are usually carried out by young, well-educated outsiders, who are free from the old system. Of Ukraine's twenty ministers, only five had been ministers before December 2014. Ukraine has got a credible reform team.

[5] This section draws on Åslund (2015c).

On December 9, the new government presented its reform program, which was the kind of program Ukraine needed: brief and focused on key reforms. It was criticised within the coalition because it did not contain all the measures of the 66-page-long coalition agreement, but that was its strength: it offered a clear focus.

The new government started with a Sisyphean task, to adopt a new budget for 2015 and to conclude a new loan agreement with the International Monetary Fund. A budget was hastily adopted on New Year's Eve, but it had to be redone. In January, the IMF arrived with an unprecedentedly large mission of 25 professionals that worked for one month with the new government. The result was an unexpectedly strong financial stabilisation program, a four-year Extended Fund Facility. It was agreed on February 12 (IMF 2015).

In April 2014, Ukraine and the IMF had concluded a standby program, but it was never more than a stopgap measure to keep Ukraine afloat until new elections were held. It contained too little reform, fiscal adjustment, and international financing. The new IMF program is stronger in all these key regards. One of the critical concerns is that Ukraine's economic situation is truly terrible. Last year, the IMF had anticipated a GDP fall of 5%, but it became 6.8%.

A key aspect of Ukraine's economic crisis is that its international currency reserves have run low. From February 23 to 25, the country experienced a real financial meltdown. Temporarily, the exchange rate of the hryvnia collapsed from 20 hryvnia per dollar to 40 hryvnia. Panic erupted. People rushed to the shops to buy whatever they could. The National Bank of Ukraine (NBU) has sensibly adopted a floating exchange rate as recommended by the IMF and minimised interventions. But Ukraine's international reserves had declined to $5 billion, just over one month of imports, which was far too little.

The reason for the dwindling reserves has been a lack of international financial support. Last year, Ukraine's international debt obligations were far larger than the international credits it received. Even the IMF disbursed only $4.6 billion, while it received $3.6 billion in repayments, so its net credits to Ukraine were merely $1 billion. Incredibly, on October 30, the European Commission forced Ukraine to pay Gazprom $3.1 billion of disputed arrears without offering any additional support to Ukraine. This large payment brought Ukraine's reserves below the critical level. The EU purpose was entirely self-centred – to make sure that Gazprom continued to deliver gas to EU countries during the winter.

The new IMF program made all the difference. On its own, it was not sufficient to impress the market, but on March 2, the Ukrainian Parliament adopted eight important laws as prior actions. Then people knew the IMF funding would arrive, which turned the market around. These laws involved energy prices, the budget, and taxation. On March 11, the IMF Executive Board adopted its program for Ukraine, and the next day a disbursement of $5 billion was made, doubling the

Ukrainian currency reserves. The exchange rate has stabilised at 21–22 hryvnia per dollar as the IMF predicted, but currency regulations remain severe, impeding foreign trade. On July 31, the IMF Executive Board decided to make a second disbursement under this program of $1.7 billion since Ukraine had complied with the demands of the program and adopted all the prior actions for the second disbursement that the IMF required.

The IMF program foresees $40 billion of international financing for Ukraine during four years, of which $10 billion shall be disbursed in the first year. The problem is that other financing is minimal. The EU is offering credits of about $2 billion, the United States $2 billion, Japan $1.6 billion, the World Bank $2 billion, China $2.4 billion, and Germany $800 million. Optimistically, this financing might amount to $12 billion, but virtually all of this is credits, some not very soon and some short-term. Therefore, the IMF has called for a restructuring of Ukraine's foreign Eurobonds of a total of $23 billion. The IMF hopes that Ukraine can save $15.3 billion by a combination of longer bond maturities, lower yields, and reduced face value of the bonds. This is a complicated negotiation and the outcome is by no means given, but on July 31, media announced that the bondholders had offered a haircut of 5%, while the Ukrainian government calls for 40%. The IMF wanted to see some progress in these negotiations before its second disbursement.

Ukraine's debt situation is further complicated by Russia owning a Eurobond of $3 billion that it insists on getting back in full. The key issue is whether the Russian debt is to be considered private or sovereign. In fact, it is both and gives Russia both advantages. Thus, Russia is adding a financial battlefield in its war against Ukraine. The international financing for Ukraine remains desperately short.

The large and unsuccessful bailout program for Greece had an indirect impact on the fate of Ukraine. The Greek Program that started in 2010 has consumed most of the EU policymaking capacity and the EU has no appetite for any more bailouts. As a result, the EU has only committed some €5 billion to Ukraine in 2014–15, while the total bailout to Greece has risen to some €300 billion, although Ukraine is in an existential crisis and the country's collapse under Russian aggression and financial strains would also put Europe in jeopardy.

The implementation of Ukraine's reforms has been impressive. Until July 2015, Ukrainian parliament adopted close to 400 laws. For the first time, Ukraine saw far-reaching structural reforms. The most impressive reforms have taken place in the energy and banking sectors. These reforms have also led to a substantial fiscal adjustment.

From the beginning of 2015, the coal subsidies were abolished, which had cost 1% of GDP previously. On April 1, Ukraine raised all energy prices to half the cost recovery level. Gas tariffs for households quadrupled. Wasteful energy subsidies that amounted to 10% of GDP in 2014 are set to fall to 2% of GDP in 2015. Of this amount, 6% of GDP comes from the abolition of subsidies, and 2% of GDP because of lower international energy prices. At the same time, Ukraine has redirected its imports of gas to Europe, which now accounts for most of Ukraine's gas imports, with Gaz de France and Statoil being the main suppliers. Gazprom has been forced to cut its prices, but Ukraine prefers to purchase from Europe given that Gazprom has proven utterly unreliable in its deliveries and tends to change prices all of a sudden.

At the same time, special pensions to privileged groups have been cut down and pensions are not supposed to be indexed until December, reducing the costs of pensions by probably 6% of GDP from 16% of GDP in 2014 to a more normal 10% of GDP in 2015. Thus, Ukraine is carrying out a fiscal adjustment of some 14% in 2015, though military expenditures are supposed to increase from 1.6% of GDP to 6% of GDP, but that still amounts to a fiscal adjustment in the order of 10% of GDP, which is very substantial.

Much of Ukraine's banking was outright corrupt with extensive related lending, often of 80% of all assets or even more. Since the fall of Yanukovych, the NBU has taken over no less than 53 collapsing banks out of 182 and put them into administration. The NBU is likely to take over a similar number of banks from among the rest. This leads to a valuable purgatory of the banking system, but in the short term, it means that the banks in restructuring are not offering much credit, which depresses the economy.

In parallel, Ukraine has carried out substantial deregulation, abolished a dozen inspection agencies, prolonged and simplified agricultural leaseholds, and many more things. Real reform is underway.

5. RISKS TO THE REFORMS

The risks to the Ukrainian reform program are many and great. Four threats stand out: Russian aggression, insufficient international funding, lagging reforms of law enforcement, and domestic political challenges arising from the miserable economic performance.

(1) The prime Kremlin aim appears to be to destabilise Ukraine so that the current democratic regime fails. As discussed above, Russian aggression is massive and manifold. Direct warfare causes the greatest damage, but the second biggest impact comes from the trade war that attracts little international attention. Russia also pursues an intermittent gas war against Ukraine, and financial warfare is to be expected. To this comes subversion with dozens of bomb attempts in otherwise

peaceful parts of Ukraine and a massive infiltration of secret police agents. All these factors harm business and deter foreign investors.

(2) Ukraine's financial critical need is to raise its international currency reserves to some $20 billion, while they were just $10.3 billion at the end of June 2015. The best way of reinforcing Ukraine's reserves would be if the European central banks offered a swap credit of some $10 billion to the NBU. These credits would function like the stabilisation fund Poland received from the West in 1990 (Sachs 1993). That funding should exist but never be touched because if Ukraine's other reserves fell below a certain level, the creditors would be entitled to impose new policies that would strengthen the reserve situation. The money would stay in European capitals and never be used, but this backstop would calm the currency market so that Ukraine could ease its draconian currency regulations.

(3) The power of the old vested interests has not been broken, especially in law enforcement. Ukraine has 19,000 prosecutors and 10,000 judges. Since virtually all Ukrainian prosecutors and judges are considered corrupt, they should all be sacked through lustration as was so wisely done in eastern Germany after reunification. There, roughly one-third of the replaced prosecutors were young East Germans, one-third West Germans, and one-third retrained East German prosecutors (Staats 2011: 98). Law enforcement requires a similar purification. The number of Ukrainian judges and prosecutors should probably be halved. Ukraine adopted a law on lustration last fall, but only about 2,000 senior officials have been sacked. One obstacle is the resistance of the old elite that appeals to the still corrupt courts and usually wins. Another problem is the Council of Europe, which opposes and delays the vital lustration with all kinds of more or less irrelevant legal arguments. Without cleaning out the top rung of the judiciary, Ukraine's reforms cannot succeed.

(4) The economic situation may just be too terrible so that people give up on reforms that appear to be too slow and opt for populism. Typically, this happens about two years after a democratic breakthrough, and Ukraine is planning local and regional elections on October 25, 2015. These elections are likely to occur at a time when the economy is at its nadir. Last February, the IMF predicted Ukraine's GDP would fall by 5.5% in 2015. By April, it had cut its forecast to 9%. Rising populism is evident in the political debate, parliamentary votes, and opinion polls.

Officially, the coalition consists of 296 deputies out of a total of 450 seats, and 226 votes are needed to adopt legislation. Most reform laws pass with about 270 votes. Out of 582 draft laws that the government had put to parliament until the end of May, only 44 percent were adopted. Many important laws do go through, but often laws are sidelined by procedural means because the coalition lacks cohesion and the reform process is slowed down. An underlying problem is that public understanding of market principles is surprisingly weak in Ukraine. The debate usually deteriorates to what the government can do to help people, while the real question is how the burden of the state can be eased so that Ukraine can finally start developing. Ukraine's public expenditures were 53% of GDP, while most countries in the region have a level of 35% of GDP, which would make sense also for a relatively poor country such as Ukraine. Opposition is building against increases in energy tariffs and the awful economic situation.

There is an obvious risk that the ruling coalition will fracture. The Fatherland Party of Yulia Tymoshenko with 19 deputies votes persistently against the government and it belongs to the coalition in name only. The Radical Party of Oleh Lyashko with 21 mandates produces similar populist arguments, but tends to vote with the government. Self-Reliance with 32 deputies is undisciplined and unpredictable, but often tells the truth. These three parties all thrive on populist advocacy, and they are currently gaining popular support.

Prime Minister Arseniy Yatsenyuk's People's Front with 81 deputies votes for government proposals as could be expected with good discipline, while President Petro Poroshenko's bloc of 144 parliamentarians is a diverse and undisciplined herd. All too often, it hinders votes on government proposals. Both these parties have lost popular support, partly because they are accused of corruption, and partly because they do pursue reforms. The main reason that the prime minister and the president hang together is that otherwise they would hang separately, as Prime Minister Yatsenyuk quoted Benjamin Franklin while in Washington on July 13–14.

The risk that the window of opportunity will close is all too evident. Far more reforms have been accomplished in Ukraine than is generally understood both in Ukraine and the West, but the situation remains desperate. Russia plays with the country as a cat with a mouse. Ukraine needs more Western support, especially financial assistance, but it does not appear to be forthcoming. The economic situation is terrible. A GDP fall of 11% for the 2015 whole year appears probable and the standard of living is likely to fall much more. The economic hardship bears on the brave population, and the danger of a serious backlash is imminent.

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