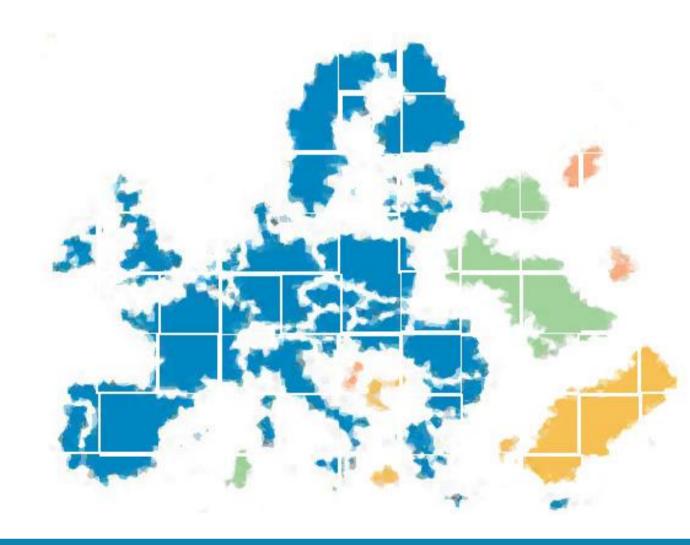


# Corruption Challenge and Countering Corruption in Ukraine

# Oleksandr Sushko



# Center for European Neighborhood Studies

The Center for European Neighborhood Studies (CENS) is an independent research center of the Central European University (CEU) located in Budapest, Hungary. Its main goal is to contribute to an informed international dialogue about the future of the European Union in the world, while capitalizing on its Central European perspective and regional embeddedness.

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# Frontiers of Democracy Embedding Democratic Values in Moldova and Ukraine

Moldova and Ukraine, countries of the European Union's Eastern Partnership program, are undergoing complex processes of democratic transformation, but with weak embeddedness of democratic values and principles drawbacks can occur. It is embeddedness that helps to overcome the challenges of transformation and pushes countries beyond mere frontiers of democracy towards becoming strongly committed democratic communities. The goal of the <u>"Frontiers of Democracy: Embedding Democratic Values in Moldova and Ukraine"</u> project of the CEU Center for European Neighborhood Studies is to facilitate embedding democratic values in the societal ethos in Moldova and Ukraine by providing a forum for discussion of the difficulties of such a complex process and by drawing on the transition experience of the Visegrad countries (the Czech Republic, Hungary, Poland and Slovakia).

• Visegrad Fund

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# About the author

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# Corruption Challenge and Countering Corruption in Ukraine

Corruption remains the main challenge preventing Ukraine from the essential success in reforms after the Revolution of Dignity (2013-2014). Within the last two years, Ukraine made some important steps ahead in the right direction in countering corruption; however, a lot is still to be done in order to ensure sustainable success.

According to Transparency International, Ukraine remains one of the most corrupt countries in Europe: its rank for 2015 is 130 out of 168 countries evaluated, with only minor improvements compared to the previous year (score: 27 out of 100).<sup>1</sup> According to the Freedom House Nations in Transit 2016 Annual report, Ukraine's score for corruption just slightly improved as compared to 2014 (from 6.25 to 6.00).<sup>2</sup>

One can hardly find something that would be very specific in Ukrainian corruption when compared to other countries, however, the overall problem proved to be so deep and complex that it is widely recognized as the major challenge to national security. In particular, the entire Ukrainian public procurement system has been deeply penetrated by corrupt practices: the official cost of a usual procurement contract includes hidden extra payments known as *otkat* – the part of the amount which goes back to the contracting agency. The average share of the so-called *otkat* may vary from at least 15-20 percent to over 50 percent of the contract's total cost. Because of this practice, annually over 10 billion EUR has been stolen from public funds. Due to the existing merge of politics and business in Ukraine, governmental top-officials and MPs have been extensively using their positions to ensure the various preferences of their businesses. Conflict of interest at top level dominated national politics.

Corruption has been deeply integrated into the lives of ordinary people: for instance, when visiting doctors, hospitals, which are formally free of charge, people usually bring money to pay informal extras. These payments constituted an income ten times higher than the official – ridiculous – salaries of doctors (about 150-250 EUR per month). This kind of practice remains to be widely tolerated, and makes any sustainable anti-corruption policy difficult in the public health area.

Some things have started to change in the recent years and months, however, even more has to be done to tackle the problem in a relatively appropriate way. Evidently, in terms of legislative changes and institutional development

<sup>&</sup>lt;sup>1</sup> Corruption Perception Index 2015. Transparency International. <u>http://www.transparency.org/cpi2015</u> <sup>2</sup> Nations in Transit 2015. Freedom House <u>https://freedomhouse.org/report/nations-</u> transit/2016/ukraine

The chapter on Ukraine was written by the author of this analysis together with Olena Prystayko.

Ukraine has made significant progress, which was widely recognized by the experts domestically and abroad.<sup>3</sup> In particular, Ukraine adopted new anticorruption legislation, created new institutions to implement anti-corruption policies, and took steps toward transparency in political party financing and public procurement. At the same time, these changes are not sufficient if they are not supported by changing governance practices (e.g. the elimination of corruption from day-to-day administrative culture) and efficient actions of the prosecution and the judiciary system against high-ranking conventioneers.

# Legal and institutional developments in 2015-16

A new law creating the National Anti-corruption Bureau of Ukraine (NABU) came into force in January 2015, and the institution was formally established in April 2015. The head of NABU and an anti-corruption prosecutor were appointed in a transparent and accountable manner, and the bureau has launched its first investigations in the end of 2015. As of July 2016, NABU has launched a number of significant investigations against people close to the former and current governments. However, the efficiency of the Agency's work will be tested by the judiciary system, which has not been reformed yet.

A new law on corruption prevention entered into force on April 26, 2105, providing for the creation of the National Agency for Corruption Prevention (NACP). The NACP's functions include approving the rules of ethical behavior for public officials and monitoring and verifying officials' declarations of assets and income. The NACP started its operation in the summer of 2106, after 4 out of its 5 members were appointed by an independent commission. Additionally, the practical operation of the e-declaration system for public officials had to be launched in August 2016 to provide the essential scope of publicly available data to check if the style of living of public officials, their assets and properties correspond to their official incomes.

In April 2015, the government approved a national program for the implementation of its 2015–17 anti-corruption strategy. The plan calls for additional legislation on various subjects including lobbying, whistle-blowers, and the release of the registration information of some state-owned enterprises. To eliminate the basis for corruption among elected officials, the strategy also requires a review of the electoral law and the creation of effective mechanisms to eliminate conflicts of interest. The strategy further envisioned the creation of an open register of enterprises with over 50 percent state ownership, and the release of data on state procurement by June 2016.

The parliament also adopted a law on political party financing in October 2015, allowing the financing of parties from the state budget and introducing

<sup>&</sup>lt;sup>3</sup> Марія Стрельцова. "Посол США: Україна досягла значних успіхів у зменшенні корупції в енергетичному секторі". Українські національні новини, June 30, 2016. <u>http://www.unn.com.ua/uk/news/1582932-posol-ssha-ukrayina-dosyagla-znachnikh-uspikhiv-u-zmenshenni-koruptsiyi-v-energetichnomu-sektori</u>

mandatory reporting on all parties' incomes and expenditures. Legislation amending the law on access to information was also introduced to make this information accessible for the public.

## Developments in public procurement

Progress on public procurement reforms also continued. A new law on public procurement adopted in September 2015 requires the disclosure of information on public tenders, including bids, the final beneficiaries of participating companies and the evaluation protocol. A pilot online system for public procurement called ProZorro has started to operate, introducing accountable and transparent standards for procurement policy. Experts gave the launch of this pilot project a positive assessment, and in May 2016, it received international recognition at the Public Procurement Awards competition as the best start-up in public procurement technologies in the world.<sup>4</sup> The measurement of the system's effectiveness is based in part on the average number of participants in each public tender, the share of tenders with participants from different parts of Ukraine, the number of participants from other countries, and the share of tenders that are competitive. According to expert assessment, the total amount of savings in the online system as of April 1, 2016, before its full-scale introduction, already reached 1.4 billion UAH (550 million USD).<sup>5</sup>

Since April 1, 2016, the web-platforms *Public procurement*<sup>6</sup> and *ProZorro*<sup>7</sup> became the only available instruments for regular procurement for all central authorities and big national state-owned companies. Since August 1, 2016, all public procurements in Ukraine (including local ones) have to be processed via the *ProZorro* system. Therefore, the public procurement reform that has been accomplished is becoming a key cornerstone of anti-corruption policy in Ukraine.

## Reform of the civil service

The ongoing civil service reform is supposed to become a powerful anticorruption instrument, as well, with high potential to change the entire governance system currently based on clientelism and nepotism. The law on civil service was adopted on December 10, 2015. It affects the entire public administration sphere, eliminating the post-soviet legal framework and

<sup>&</sup>lt;sup>4</sup> World Public Procurement Awards 2016. <u>http://www.procurementleaders.com/world-procurement-awards/winners</u>

<sup>&</sup>lt;sup>5</sup> В Україні з 1 квітня всі держзакупівлі переведуть в електронний формат. Дзеркало тижня. April 1, 2016

http://dt.ua/ECONOMICS/v-ukrayini-z-1-kvitnya-vsi-derzhzakupivli-perevedut-v-elektronniy-format-204365\_.html

<sup>&</sup>lt;sup>6</sup> Public Procurement <u>https://www.dzo.com.ua/</u>

<sup>&</sup>lt;sup>7</sup> ProZorro Online Procurement System <u>https://prozorro.gov.ua/</u>

introducing a model based on the best international standards. The law was elaborated by civil society experts, which demonstrates the ever-growing role of civil society in policy making in post-Maidan Ukraine.

According to the law:

- Differentiation between political and administrative positions in the government has been introduced.
- The position of state secretary is to be introduced in each ministry as a top administrative official responsible for management and human resources. The state secretary will be a civil servant chosen through a contest. If s/he performs his/her functions well, s/he will retain his/her position when the cabinet of ministers is reappointed, thus contributing to institutional continuity.
- Public officials should be appointed through open competition on the basis of transparent Terms of References.
- Officials are appointed to positions for a five-year term and can serve no more than two terms in a row.
- Managers will not be able to manipulate their subordinates with salaries. Previously, a bureaucrat's salary consisted mostly of bonuses (70-80 percent). Now, bonuses will only make up 30 percent of the salary.
- The government may legally engage additional funds (including international donors' contribution) to raise salaries to the appropriate level. (Currently the level of the average salary in the government is about 200 EUR, which is considered to be an "invitation for corruption".)

The law is formally in force since May 1, 2016, however, its full operation requires additional institutional setups, such as the operation of the Commission of the High Corps of the Civil Service authorized to select high-ranking public officials, which was finally established in July 2016. As of July 2016, powerful forces, including the President's Administration, are trying to return some powers to the president when it comes to the selection process of the heads of the local administrations. This is at least one-fifth of those officials who are affected by the reform. The law stipulating such a change has been voted in the first reading by the Rada in July, and was strongly criticized by reform-minded civil society activists.<sup>8</sup>

The open data policy, which is part of the anti-corruption package, has resulted in opening registers of property (including registers of real estate and vehicles), and the mandatory declaration of ultimate beneficiaries of

<sup>&</sup>lt;sup>8</sup> Statement of the Reanimation Package of Reforms civil initiative, the Center for Political and Legal Reforms, and the civic platform "Nova Kraina" regarding the draft law "On civil service" (Reg. No. 2490) <u>http://rpr.org.ua/en/news/statement-regarding-the-draft-law-on-civil-service-reg-no-2490/</u>

business entities. All registers are available via the internet as e-registers, which also facilitate the work of investigatory journalists via the disclosure of sensitive information of politically exposed persons. The Ministry of Interior has opened, in December 2105, the register of vehicles, including private cars. This is the next step (after the opening of the real estate register in October) implemented in accordance to the new legislation introducing transparency of assets.

## Sectoral reforms

Corporate governance reform is an essential part of countering corruption in Ukraine, especially when it comes to state-owned enterprises. In a number of the largest state-owned enterprises (previously, the largest source of corruption), the reform has brought its first visible fruits. Instead of declaring losses, as usually they did before, many of them reported profits in their 2016 annual reporting.<sup>9</sup> Apart from finances, governance practices are also changing. For example, a reputable and professional CEO with extensive working experience in Poland was selected for *Ukrzaliznytsya*, the national railway company, by an independent nomination committee and was appointed by the company's new cabinet in late April 2106.

Reforms also impact the energy sector, which has been identified as one of the most corrupt segments of Ukraine's economy for many years. The largest shadow incomes were generated in this sector since the 1990s. The situation now is changing for the better thanks to the gradual implementation of European legislation (the  $2^{nd}$  and  $3^{rd}$  Energy Packages), Ukraine's membership in the European Energy Community Treaty and the gradual decrease of energy dependence on Russia. Additionally, the new Cabinet of Ministers decided in April 2016 to unify natural gas prices in Ukraine introducing a single market price for both retail and industrial users. The new regulation effectively restricts grounds for corruption, which prevailed for decades. According to experts of the Atlantic Council, this decision is "a major triumph of economic realism over populism and the agents of corruption".<sup>10</sup>

Corporate governance reform has reached *Naftogaz*, the largest energy company of Ukraine, as well: its independent board has been appointed including 3 international experts with trustful career records among its 5 members. Furthermore, two alternative approaches on splitting *Naftogaz* into separate extracting, delivery and storage components have also been presented in April 2016 – one by the Ministry of Energy and one by *Naftogaz* itself. Discussions on these developments are still ongoing.

 <sup>&</sup>lt;sup>9</sup> "TOP 100 state-owned companies of Ukraine in 2015, paid to the state budget amount to UAH 8.5 bln in dividends". News from Ukraine, July 20, 2016 <u>http://en.reporter-ua.ru/top-100-state-owned-companies-of-ukraine-in-2015-paid-to-the-state-budget-amount-to-uah-8-5-bln-in-dividends.html</u>
<sup>10</sup> Basil A. Kalymon. "Ukraine's New Government Scores Big Reform Win." Atlantic Council. May 3, 2016. <u>http://www.atlanticcouncil.org/blogs/new-atlanticist/ukraine-s-new-government-scores-big-reform-win-land-reform-should-be-next</u>

In December 2015, Ukraine officially published its first Extractive Industries Transparency Initiative (EITI) report.<sup>11</sup>The document was presented at the Forum for Sustainable Management of Deposits in Kyiv, and was posted on the website of the Ministry of Energy and Coal Industry of Ukraine. Thanks to this, everyone has a chance to learn about the key oil and gas deposits in Ukraine, the holders of licenses, production volumes, and payments by companies to the budgets of all levels.

## Conclusions

Ukraine made its first evident steps toward a genuine anti-corruption policy, and significant achievements were made, especially in terms of the legal framework and the institutional setup. In particular, the revolutionary reform of public procurement procedures, which was recently accomplished (including the introduction of the *ProZorro* e-system, which is a huge step toward the elimination of corruption in one of the most corrupt spheres) generates hope for the overall success of countering corruption in Ukraine. Furthermore, civil society remains to be a strong and determined ally of the reformist forces in the government.

At the same time, the major challenges of anti-corruption policies in Ukraine are the lack of success concerning the reforms of the judiciary and the prosecutor's office, and the pervasive conflicts of interest in politics. The government was also unsuccessful in reforming the customs service, perceived as one of the most corrupt governmental agencies. For example, the idea to delegate some functions to foreign companies (including Crown Agents) has not been implemented. These particular failures are influenced by various interest groups with connections to the government benefitting from the status quo, which use any available instruments to delay relevant political decisions. At this point, further success is critically dependent on the political will of the leadership to eliminate corruption as a tolerated practice of governance in Ukraine.

<sup>&</sup>lt;sup>11</sup> Extracting Industries Transparency Initiative. Ukraine <u>https://eiti.org/ukraine</u>

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