

UKRAINE PARLIAMENTARY ELECTION IN: WHAT THE RESULTS MEAN FOR PLANNING GR EFFORTS?

On July 21, Ukraine held its early parliamentary elections. According to preliminary results¹, five parties will be represented in the Parliament (Verkhovna Rada):

1. "Sluha narodu" ("Servant of the People") - 43,14%
2. "Opozitsyyna platforma – Za zhyttia" ("Opposition Platform – For Life") - 13,06%.
3. "Batkivshchyna" ("Fatherland") - 8,18%.
4. "Yevropeyska solidarnist" ("European Solidarity") - 8,12%.
5. "Holos" ("Voice") - 5,84%.

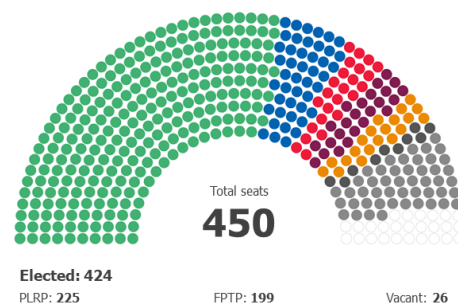
The main outcome of the election is the overwhelming victory of "Sluha Narodu" party led by the President Volodymyr Zelensky. Getting 253 as of 450 seats in the Parliament (124 by the party lists and 129 by single-member constituencies), Sluha Narodu will be able to form majority in the Parliament without inviting any other partner in the coalition.

A number of parties, represented in the previous Verkhovna Rada convocation ("Radical Party of Oleg Lyashko", the "Opposition Bloc", "Samopomich" ("Self Help"), "Volya narodu" ("People's Will"), "Vidrodzhennya" ("Revival"), including the "Narodnyy Front" ("Popular Front") Party of Arseny Yatsenyuk (ex-Prime Minister) and Arsen Avakov (the Interior Minister), which formed the basis of the parliamentary coalition of the previous Rada convocation, will not be represented in the new Parliament. Therefore, we may expect their leaders and allied forces to lose influence and political importance.

Seat distribution in new Verkhovna Rada*

| Party | Votes | Seats nation-wide | Seats single districts | Total |
|--|--------|-------------------|------------------------|-------|
| ● Servant of the People | 43,14% | 124 | 129 | 253 |
| ● Opposition Platform – For Life | 13,06% | 38 | 7 | 45 |
| ● Fatherland | 8,18% | 23 | 1 | 24 |
| ● European Solidarity | 8,12% | 23 | 1 | 24 |
| ● Voice | 5,84% | 17 | 3 | 20 |
| ● Other parties | | | 10 | 10 |
| ● Independent | | | 48 | 48 |

*According to the results of the CEC processing 93.85% of ballots



¹ Based on CEC results published after processing 93,85% of protocols on 23 July 2019



The parliamentary overhaul is of such significance as Ukraine is a parliamentary-presidential republic. The current power-sharing structure between the institutions gives the Verkhovna Rada a central role. In particular, the Verkhovna Rada shall approve Presidential nominations for the positions of Prime Minister, Ministers of Defense and Foreign Affairs, heads of the Security Service and the National Bank. The Verkhovna Rada shall also approve nominations of other ministers, heads of the Antimonopoly Committee, the State Property Fund and other departments made by the Prime Minister.

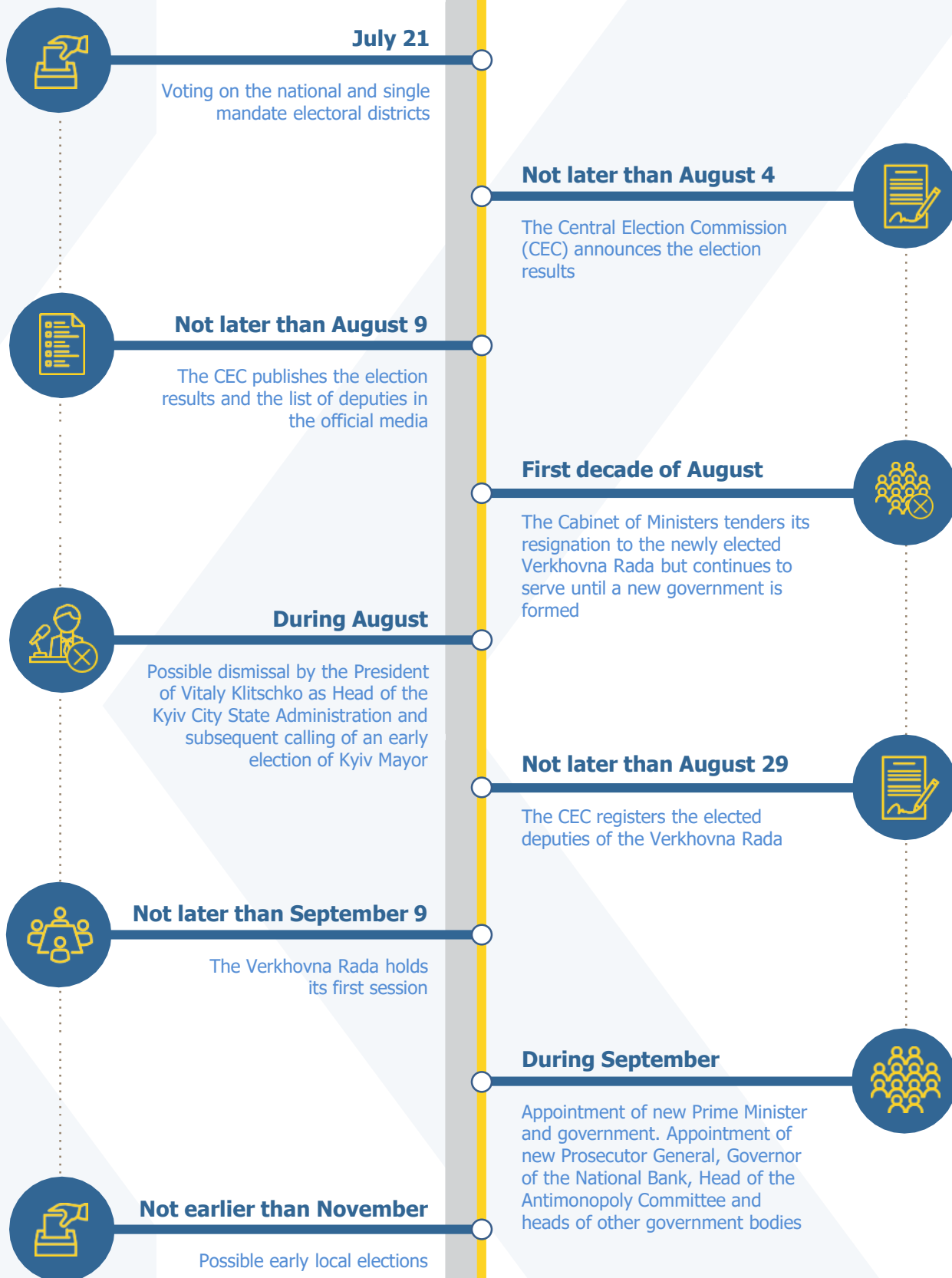
It is assumed that the new Verkhovna Rada will be able to start work not earlier than in September. Then, in September, we should expect a PM change and full government reshuffle.

It is expected that the actions of the government, the Parliament and the President in the first months after the election will incur high destabilization risks for the situation in the country as two factors will affect the power transition – possible start of the Minsk Agreements' implementation and the resolution of the issue around the Russian gas transit through Ukraine from 2020 and gas supply to the country's economy.

In addition, the results of the parliamentary election may prompt early municipal elections, including of the mayor of Kyiv, in the autumn.

Thus, by 2020, the power renewal that started with Mr. Zelensky's victory in May 2019 may be accomplished at all power levels.

Ukraine's 2019 Parliamentary Election





Forming a governmental coalition

By law, to form a majority coalition, a union of parliamentary factions with a combined membership of at least 226 MPs is required. Such a coalition may include two or more parties, regardless of whether a smaller coalition would already have the necessary number of votes.

If we consider the need to ensure political stability, an “expanded coalition” may be beneficial to President Zelensky for several reasons:

- Dividing political responsibility with a partner:
The concentration of power by one political party maximizes the risks of making it fully responsible for the situation in the country. The coalition government makes possible to divide responsibility for decisions made with a partner.
- An “expanded coalition” is also important to achieve a constitutional rather than just a simple majority in the Verkhovna Rada (*it is necessary for making important decisions related to the Minsk Agreements and amending the constitution in other important areas*).
 - The coalition uniting members of several parties has higher opportunities to be supported by independent MPs elected by single-member constituencies with support of other parties, than one-party led government. Such an ad hoc majority may be necessary to approve constitutional laws, where at least 300 votes are required.
- A drawback of the “expanded coalition” is the need to distribute administrative resources among several political projects.

The probable coalition partners for “Sluha Narodu” party (in case such expanded coalition is formed) are the “Holos” party of Svyatoslav Vakarshuk (singer, lead vocalist of Okean Elzy rock band) and “Batkivshchyna” of former Prime Minister Yulia Tymoshenko.

The majority obtained by pro-presidential party can influence the course of the legislative process:

- We can expect a simplified review / passage procedure for bills initiated by the Office of President Zelensky.
- Bills initiated by the Cabinet of Ministers will probably have to go through a more complicated approval procedure due to the compromise figure of the Prime Minister and a larger number of stakeholders involved in the work of the government (*see the “Change of Prime Minister and new government” section*).

“Yevropeyska solidarnist” of Petro Poroshenko and “Opozitsyyna platforma – Za zhyttia” of Yury Boyko and Viktor Medvedchuk (*former Energy Minister and Head of the Presidential Administration under Leonid Kuchma respectively*) will most likely be in opposition. These are parties with polar political views, which means that the opposition will be divided.

There is a high probability that the Central Election Commission (CEC; controlled by people associated with Poroshenko) will delay the opening of the new Verkhovna Rada as much as possible:



- Theoretically, the CEC may delay the registration of the elected MPs until August 29. This means that the new Parliament will meet for the first time not earlier than in early September.
- The “Peter Poroshenko Bloc” and the “Narodnyy Front” (“Popular Front”) of Arseniy Yatsenyuk and Arsen Avakov control the majority in the Rada of the current convocation. They lost control over the future Parliament in the election.
- The opening date of the new Parliament may become a subject for political bargaining between Petro Poroshenko and Volodymyr Zelensky:
 - President Zelensky is interested in gaining control over the Parliament as quickly as possible, which will allow him to initiate a change of Prime Minister and the Cabinet of Ministers.
 - Poroshenko, on the contrary, is interested in keeping the current convocation of the Rada in power for as long as possible as his party is strongly represented there.

Distribution of committees

The distribution of seats in parliamentary committees will depend on the structure of the parliamentary coalition:

- The practice of the last election suggests that most of the committees will be controlled by the majority party:
 - Important “resource” committees directly influencing the passage of “economic” legislation are likely to be shared between them. These committees include:
 - The Budget Committee;
 - The Economic Policy Committee;
 - The Committee on the Fuel and Energy Complex;
 - The Committee on Tax and Customs Policy, etc.
- Since there is no law on opposition in Ukraine that would guarantee control over certain committees (procedural, freedom of speech committee, etc.) and important parliamentary positions (vice-speakerships) to opposition forces, this issue is left for the majority parties to decide.

Change of Prime Minister and new government

As a result of the election, we can expect a major government reshuffle. The new Prime Minister and government (*the Cabinet of Ministers automatically resigns before the newly elected Parliament*) are likely to be appointed in September. There is a wide range of candidates for the post of Prime Minister. It can be either one of the current political figures or a new person selected from among public servants.

The choice of the future PM depends on three main factors:

1. The results of the political bargaining of “Sluha Narodu” party with potential coalition partners:



- a. Yulia Tymoshenko, Svyatoslav Vakarchuk, as well as people loyal to President Zelensky may want the PM position for themselves.
2. The position of foreign partners, first of all the US and EU:
 - a. The US and EU may be interested in nominating a person associated with Western institutions to be Prime Minister (*potential; candidates are Ukraine's Alternate Executive Director in the Board of IMF Vladislav Rashkovan; Secretary of the Security Council Oleksandr Danyliuk; and former Economy Minister, a Lithuanian citizen, Aivaras Abromavičius*). Oleg Ustenko, the Executive Director of The Bleyzer Foundation and Advisor to the President Zelensky.
 3. The position of the political sponsors of Mr. Zelensky, primarily the billionaire Ihor Kolomoyskyi.
 - a. Mr. Kolomoyskyi may be interested in appointing Andriy Kobolev or Yuriy Vitrenko, senior managers of the Naftogaz of Ukraine that are close to him, or other people who he can influence.

The composition of the government will most likely reflect the interests of all three above-mentioned stakeholder groups. Still, their relative "weight" in the new Cabinet of Ministers remains to be discussed.

In addition, gaining control over the Parliament will allow President Zelensky to make a number of other important appointments including of the Prosecutor General, the heads of the National Bank, the Antimonopoly Committee, the National Commission for Energy and Utilities Regulation, etc.

After the appointment of the Prime Minister, some changes may be made to the structure of the executive bodies. In particular, we can expect the Ministry of Information Policy to be abolished, and the National Council on Television and Radio Broadcasting and the State Committee for Television and Radio Broadcasting to be merged.

The agenda of the authorities after the parliamentary election

In the medium and long term, the main challenges for the authorities are low economic growth rates (3-4% per year according to the baseline forecast of the Ministry of Economy until 2022).

Combined with the apparent vulnerability of the economy (dependence on export markets, large external and domestic debt, low reserves, etc.), low growth rates can cause new financial crises and increased inflation expectations among businesses and the public.

In this context, it is becoming more important for the Ukraine government to develop and implement an accelerated economic growth program. Such a program may include a number of significant reforms including:

- A tax reform, including introduction of a Tax on Withdrawn Capital or its equivalent in place of the income tax, which is currently being discussed.



- A land reform and lifting the moratorium on the sale of agricultural land.
- A new wave of privatization, aimed primarily at attracting large foreign investors to systemically important sectors of the economy (energy, industry, communications, etc.).
- Full launch of the gas and electricity sector reforms, enabling access to these markets for foreign companies.

In turn, the implementation of the mentioned reforms also bears significant risks (*growth of tariffs, conflicts during the redistribution of the land market, budget revenue shortfalls caused by reduced fiscal burden on businesses, etc.*).

Possibility of early local elections

There is a possibility of holding early local elections (by default, the elections should be held in October 2020). This is due to the following reasons:

- Interest in early elections from the “Sluha narodu” party, whose ratings tend to decline over time (as the “virtual party” will face real issues).
- The fact that the composition of the regional councils (regional, city and village ones), in which the “Petro Poroshenko Bloc” has significant representation, and a number of non-parliamentary parties (the “Radical Party”, “Ukrop” are represented, no longer reflect the real electoral preferences:
 - This contradiction may cause a systemic conflict between governors (and local administration heads) appointed by the President and members of local councils. In turn, such a conflict may potentially hamper adoption of vital decisions at the regional level.

In addition, early local elections can become an important component of the implementation of the Minsk Agreements on the Donbas (if such a political decision is taken):

- Providing autonomous status to the uncontrolled territories of the Donbas (the unrecognized Donetsk People's Republic and Luhansk People's Republic) can provoke a chain reaction in other regions of the country that will require similar rights for themselves.
- In the current political system at the regional level, such processes can lead to high tensions and an increase in separatist sentiments. Changing the composition of regional councils, the election of city mayors and village heads *during which the representation of the ruling parties in the field will increase* will contribute to halting these destructive processes.

The early local elections, if held, will complete the “reset” of the government system in Ukraine as such. If this decision is made (constitutional grounds for holding early elections remain in question), they can be held not earlier than in November of this year.

Regardless of the decision on holding early local elections across the country, early mayoral election may be held in Kyiv. This is caused by a special status of the capital, in which the positions of mayor and head of the City State Administration have so far been held by a single person (Vitaliy Klitschko).



At the same time, most of the powers (on financial and budget matters) belong to the head of the City State Administration. It is very likely that President Zelensky will dismiss Mr. Klitschko as Chairman of the Kyiv City State Administration.

Main trends of the post-election period

There will be much uncertainty in the first months after the election, with a coalition created, the government, individual ministers and agency heads, replaced, governors dismissed and appointed, etc.

On a separate note, we should say that the current Interior Minister Arsen Avakov will be part of the new political house of cards. On the one hand, he is one of the leaders of the "Narodnyy Front", a party that lost all of its parliamentary seats in the election. On the other hand, he is said to informally control several well-organized and armed radical groups (the Azov regiment, the National Corps and other far-right groups) that pose a potential danger to the official authorities.

Two major short-term challenges coincide with these processes, that is, the need to ensure a trouble-free heating season and the possible start of the implementation of the political component of the Minsk Agreements. Both of them bear significant risks in terms of the stability of the political system.

In the medium and long term, the main task remains to ensure sustainable economic growth, which depends on a number of factors:

- Renewed cooperation with the IMF and other creditors of Ukraine.
 - The ability of the Government to make the current debt payments (in fact, to refinance previously received loans) and finance the budget deficit directly depends on this.
 - Today, the Ukrainian economy is debt-laden, and the need of the Government and state-owned companies for new loans is only increasing (in the first half of 2019, the Ministry of Finance has already exceeded the annual external borrowing threshold set by the budget).
- Implementation of complex economic reforms (tax, land, energy, etc.) and work to attract foreign investment.
- These measures will create the necessary conditions to keep inflation within 5-7% and prevent a sharp devaluation of the hryvnia in the next 2-3 years under the baseline scenario which does not include a new global financial and economic crisis.



Relationships with foreign partners

The post-election period is likely to see a steady tendency for external players to increase their influence on Ukraine's domestic politics and economy.

This influence tends to be institutionalized through the following mechanisms:

- Start of operations of the High Anti-Corruption Court of Ukraine, which is expected in September (the Court will be the key body of justice for corruption crimes of senior officials).
 - The Court's start of operations (a significant part of the judges are appointed with the participation of foreign experts) will complete the creation of the so called "anti-corruption vertical" which also includes the National Anti-Corruption Bureau of Ukraine and the Specialized Anti-Corruption Prosecutor's Office. Foreign organizations have taken part in establishing and funding these institutions.
- Appointment of people loyal to Western institutions to key government positions (from the Prime Minister to ministers and lower-ranking officials and heads of state-owned companies).
 - It is possible that the practice of appointing foreign specialists to high government offices will be revived during the new government's formation (a significant number of such specialists served in the government of Arseniy Yatsenyuk).
- The practice of filling the supervisory boards and boards of directors of state-owned companies with foreign specialists (independent directors) who exert significant impact on their work. This practice is enshrined in legislation and is already actively applied to several companies (Ukrzaliznytsya, Ukrnafta, the Naftogaz of Ukraine, etc.).
 - In addition, appointment of foreign specialists as advisers to high-ranking public servants (the Prime Minister, ministers, etc.) may become widespread, as well as their participation in various advisory bodies under the Cabinet of Ministers and ministries (this might be organized like the current strategic advisory group under Prime Minister Volodymyr Hroysman, led by the Slovak politician and economist Ivan Mikloš) is likely to continue and expand.
- More active participation of foreign business associations in the work of government agencies (the European Business Association, American Chamber of Commerce, etc.).

In addition to the institutional influence, their indirect influence on Ukraine's domestic policy agenda will continue and increase:

- Memorandums on action plans between the government and the IMF, commitments to the EBRD, the European Investment Bank and individual donor states.
- Participation in the dialogue with Ukraine's authorities through the EU Delegation to Ukraine, the US Special Representative for Ukraine, as well as the embassies of the EU and the USA in Ukraine.

At the same time, there is a redistribution of influence from the European Union towards the US, which has firmly achieved the position of a dominant influencer of Ukraine's authorities.



Key challenges for the authorities in 2019-2020.

In the months following the election, the state authorities will face the need to solve two major problems that could have a significant impact on the political and economic agenda of the country:

1. Resolving the conflict in the east of the country (implementation of the Minsk Agreements).
2. Reaching a decision on the Russian gas transit and ensuring a smooth heating season of 2019-2020.

Prospects for resolving the conflict in the Donbas

The implementation of the Minsk Agreements (provides, in particular, for an autonomous status of the uncontrolled territories of the Donbas, an amnesty for the parties of the conflict, etc.) will become more of a pressing issue immediately after the election for a number of reasons.

First of all, this is a matter of fulfilling President Zelensky's main election promise, that is, to stop the hostilities in Eastern Ukraine. The only existing mechanism for resolving this conflict today is the Minsk Agreements.

Secondly, Kyiv's search for compromise with Moscow and the unrecognized republics of the Donbas can be facilitated by international politics in relation to this issue. Settlement in the Donbas is one of the topics of the latest consultations between Russia and the US (although without any significant progress to date). The largest EU member-states (first of all, Germany and France) are also interested in breaking the deadlock for Donbas settlement.

At the same time, the implementation of the political part of the Minsk Agreements ([providing autonomy status to the Donetsk and Luhansk regions) might trigger internal political instability in Ukraine. This topic can be used by opposition forces (ex-President Petro Poroshenko and right-wing radical groups) to destabilize the authorities up to raising the issue of impeaching President Zelensky and, as a result, scheduling an early presidential election.

Intensifying street confrontation involving radical groups is also possible.

Solution of the "transit" problem and the heating season

A problematic heating season of 2019-2020 is highly probable as the ten-year transit gas contract with Russia shall expire by the end of 2019.

The conclusion of a new agreement is complicated by the crisis of relations between Kyiv and Moscow. In addition, if the second line of the "Nord Stream 2" project is launched in 2020, the need for gas transit through the territory of Ukraine will objectively decrease.

A termination of the gas transit through the territory of Ukraine, in turn, will cause problems with the supply of gas to a number of regions of the country, first of all in the south and east.



The termination of the contract falls on the winter period, so it elevates the problem to a national security issue. It would also be problematic to compensate for funds now received as payments for the gas transit (\$1.5-2 billion per year) by increasing the foreign debt.