

## UKRAINE RISKS MAP 2017

Report presented at the OSAC Ukraine Country Council Q1 2017 Meeting “Integrating Resilience into Business and National Strategies”, by Dr. Maksym Khylyko and Dr. Oleksandr Tytarchuk, Co-founders and Members of the Board at the East European Security Research Initiative Foundation.

The purpose of the Risk Report is to provide the U.S. business with a general vision of the risks environment it may face in Ukraine. An emphasis is placed on the fact that country risks do not necessarily mean direct threats to the business, especially when local Government is interested in maintaining good relations with the U.S. Administration and business. Moreover, risks can provide additional options and opportunities to the most prepared competitors, who have a clear vision of what to deal with, as well as develop effective risk mitigation and emergency plans and integrate resilience into their business strategies.

### Major Risks Business Faces in Ukraine

The risks to be faced in Ukraine are closely interrelated, but still could be defined into two groups due to *the nature of factors triggering and influencing* them. The major risks predominantly caused and influenced by the *external* factors are the following: military conflict in the East of Ukraine; attempts of hybrid destabilization all over Ukraine; terrorist attack risks; and cyber attack risks. There are major risks mainly caused and influenced by the *internal* factors, namely: political and social instability risks; high rate of violent and non-violent crime; and corruption related risks.

By *the level of likelihood in the short- and mid-term perspective*, the risks could be classified into three groups: highly probable risks, risks of medium probability, and risks of low probability.

**Highly Probable Short and Mid-Term Risks** are the following: military hostilities in Donbas of low/average intensity; weakening Ukraine’s international stance and decreasing Western attention to Ukraine; increasing Western pressure to implement Minsk agreements on Russia’s terms; reducing external financial assistance; slow and inconsistent reforms; poor living standards; growing populism in domestic and foreign policy; high crime and corruption rates; and cyber attacks.

**Medium Probability Risks:** possible aggravation of military confrontation with Russia; authoritarian trends; social instability and mass protests; risk of early Parliamentary elections; and potential environmental risks (floods, chemical pollution). **Low Probability Risks:** large-scale conflict with Russia; terrorist attacks; intensification of separatist trends; governance failure; and the risks of revolution or military coup.

It should be noted that the critically challenging risks are mostly those of low probability (such as the risks of large-scale military conflict with Russia or another revolution in Ukraine).

In the short and mid-term perspective, immediate threats to the foreign business will be mainly posed by three highly probable risks: **Cyber attacks**, **Corruption**, and **Crime**. To cope successfully with the related problems, it is advisable to consider: effective risk mitigation strategy and emergency planning including the data protection; keeping in touch with the diplomatic missions; good publicity and contacts with the media; as well as following the rules of personal safety.

### Military Conflict in the East of Ukraine

#### War costs

Military hostilities in Donbas region, triggered and maintained by Russia through supplying of arms and militants as well as political and financial support to local separatists, exert strong negative impact on economic and social situation in Ukraine.

About one fifth of Ukrainian economic potential was located in the areas of Donbas region, which currently are out of the Governmental control; many large enterprises are either destroyed or under control of the Russian-backed separatists. Ukraine-Russia trade decreased at more than three times since 2013, without proper compensation on the other external markets. Ukraine’s nominal GDP decreased at almost two times since 2013. Ukraine’s shoestring state budget spends billions of dollars annually at war expenditures, often without clear public control.

#### War impact on labor market

Shortage of qualitative employment opportunities, uncertain prospects and constant risk of being mobilized drives brain-draining – well-educated and self-motivated people tend to emigrate. Business entities in Ukraine are at risk that their employees who are Ukrainian citizens can be mobilized at any time.

#### Risks of chemical pollution

Military activities close to the chemical plants and toxic waste storages in Donbas may cause the ecological catastrophe and pollution of the nearby regions in the East of Ukraine. The OSCE and the UN experts several times called attention to these risks, but hostilities close to the chemical industrial sites go on.

## Personal risks

In the areas of Donbas controlled by the Russian-backed separatists, the risks of being kidnapped or killed are very high, especially for the U.S. citizens due to the strong anti-American propaganda in Russian media. In the areas of Donbas close to the contact line, there is a high risk of being killed or injured due to often shellfire, sniper small-arms fire, and unexploded mines on the ground.

## Prospect for peaceful settlement

The probability of peaceful settlement of the military conflict in the East of Ukraine in the short and mid-term perspective is low – only 3.3% of the surveyed Ukrainian experts believe in such development, while 44.6% consider that the conflict will go on the same way as it is now.<sup>1</sup>

Currently, the probability of large-scale military escalation is five times lower than it was in 2014 (only 5.4% of the experts surveyed in late 2016 believed in such development compared to 27.7% in 2014). With that, in the short and mid-term perspective, the low intensity hostilities and local military operations in the East of Ukraine will most probably go on, as well as Russia's building up of its troops and military bases along the Ukrainian borders.

## Attempts of Hybrid Destabilization in Ukraine

In the short and mid-term perspective, Russia will continue its attempts of hybrid destabilizing Ukraine aiming at failure of reforms and change of government (for a more favorable to Russia).

The most probable focal points of hybrid destabilization: **encouraging separatism** (Kharkiv, Odesa and Zakarpattia regions are the most vulnerable); **information influence** and propaganda through the Russia-controlled media (including direct and indirect control); attempts to cause **economic deterioration** through limiting Ukraine's goods transit and trade with the countries of the Eurasian Economic Union; provoking **political tensions** through Russian-backed parties and/or far-right movements (with or without their awareness); and **cyber attacks** including those against the objects of critical infrastructure, public authorities and business, as well as data fraud.

## Cyber attack risks

Ukraine still lacks the whole-of-government approach to cyber defense and security. Cyber Security Strategy (adopted in early 2016) is being implemented slowly, and responsible state bodies lack highly skilled specialists due to uncompetitive salaries. On ad hoc basis, private IT companies and enthusiasts perform tasks related to cyber defense, but they cannot fully compensate for the insufficient state capabilities.

Successful Russian attacks in 2015-2016 against energy companies and websites of public authorities, including the State Treasury, Finance and Defense Ministries, Kyiv International Airport, and Railways indicated the vulnerability of Ukrainian information networks.

In the short term, the large-scale cyber attacks will be highly possible within Russian campaign of hybrid destabilization. So, the risks of information infrastructure breakdown and data theft should be properly considered.

In the mid-term perspective, the national reforms, including the implementation of the National Security and Defense Council's Decision of December 2016 on Emergency Measures to Neutralize Cyber Threats, as well as cooperation with NATO in this sphere should help to improve the situation.

## Terrorist risks

Many objects in Ukraine require special security regime, including five nuclear power plants (four acting and one closed), dozens of hydroelectric power plants, chemical plants, storages of chemical and toxic waste and etc. It is alarming that several chemical plants and storages are located at the occupied areas close to the military hostilities zone.

With that, the probability of large-scale terrorist attacks remains relatively low due to the following factors: Ukraine is not a desirable object for religion fanatics and other international terrorist groups; Russia is not interested in the large-scale terrorist attacks as long as it hopes to return Ukraine into its sphere of influence; separatists in Ukraine normally do not apply terrorism as a method.

But the minor terrorist actions in large cities are possible due to the large amount of illegal arms coming from the conflict zone. Most probably, such attacks can result from political provocations, criminal redistribution of business assets, or individual actions of some mentally unstable war veterans.

## Political and Social Instability Risks

During the last three years, social situation deteriorated due to the sharp decrease in welfare standards (in 2016, average monthly family budget was two times lower than in 2013); shocking increase in utility services rates amid sharp decrease in family income and inefficient subsidy system; shortage of qualitative employment opportunities and brain-draining; poor social adaptation and psychological adjustment of the internally displaced persons as well as war veterans and wounded

persons; deep income disparity and rising lumpenization; and healthcare deterioration. Slow reforms, high corruption rate and the lack of income growth open the door for rising political populism and appetite for early elections.

Government's ability to effectively run the country is questioned by the weak rule of law (according to the experts' estimations, about 70-90% of court decisions fail to be implemented); high corruption rate; sharp increase in serious crime (+37% compared to 2013) amid decrease in crime detection (-54% compared to 2013); large shadow economy that amounts at 35% of GDP and 40% of labor market; absence of clear perspective for conflict settlement in the East of Ukraine; inability to prevent the unauthorized political and civil actions, such as trade blockades; inability to stop the illegal amber mining in Rivne and Zhytomyr regions; vulnerability of energy supply; and crisis of civic credibility to the public authorities (69% of the Ukrainians do not trust President, 74% do not trust Government, 81% do not trust Parliament, and 82% do not trust Courts<sup>2</sup>).

### Appetite for the protests and early elections

In December 2016, 67% of the Ukrainians believed that the country was developing in a wrong direction, and 39% believed in the possibility of the Maidan-3 Revolution, **but** only 20% said they would take part in mass protests if they happened – compared to 42% ready to take part in the protests in January 2015<sup>3</sup>. Thus, in the short-term, the risks of mass protests will be low. However, the mid-size protests are possible, most likely in the capital city.

People's appetite for the early Parliamentary elections considerably rose, from 37% in December 2015 to 46% in December 2016. People's appetite for the early Presidential elections is also high, with 47% supporting this idea, and 38% against. However, the probability of early elections remains low, and only 4 of 55 surveyed experts consider that early Parliamentary elections may be held in 2017<sup>4</sup>. Under the Ukrainian legislation, the appointment of early elections primarily depends on the President's will, and the latter does not seem to have any reasons to appoint such elections, given that his political course is supported by the current Parliament majority.

## Crime and Safety Situation

### Increase in Crime, Decrease in Crime Detection

Trends of 2014-2016 in crime and crime detection are not optimistic. With about +12% general increase in crime since 2013 (including +38% in serious crimes), the official rate of crime detection decreased at about -25%.

Kyiv, Dnipro, Kharkiv, Odesa and Zaporizhia are the TOP regions in quantity of crimes, while Volyn, Ivano-Frankivsk and Chernivtsi regions are ahead in crimes increase.

### Crimes against Life and Property

In 2016, 5 992 intentional murder criminal cases were registered in Ukraine, only 15% (914 cases) of which were submitted to the courts with indictments. 2 256 intentional grave bodily injury criminal cases were registered, 63% (1 425 cases) of which were submitted to the courts with indictments.

Crimes against property are the most common (70% of all crimes in 2016), and very poorly detected (decisions are taken only in 21% of the registered cases). In 2016, 46 019 fraud cases were registered (only 14% of these cases were submitted to the courts with indictments); 27 204 residential burglaries (only 17% of the cases were submitted to the courts); 27 199 robbery offenses (only 22% of cases were submitted to the courts); and 12 205 car thefts (only 19% of the cases were submitted to the courts).

Kyiv, Zaporizhia, Kharkiv, Dnipro and Lviv are TOP regions in quantity of crimes against property, while Volyn and Zhytomyr regions are ahead in crimes increase. Besides, Kyiv, Odesa and Dnipro are TOP regions in car thefts, while Cherkasy, Rivne and Kirovograd regions are ahead in crimes increase.

The employees working in Ukraine are advised to strictly follow the rules of personal safety, including such basic things as keeping the apartment doors closed, parking cars in guarded places, avoiding poorly illuminated and empty streets especially in the evening, carrying not large sums of cash, etc.

## Corruption Related Risks

The Corruption Perceptions Index 2016 by Transparency International rates Ukraine at #131 of 176 positions, that is slightly better than in 2015 (#136), but still worse than many countries which are considered to be highly corrupted, such as Moldova, Mexico and Azerbaijan (#123), Colombia (#90), and Bulgaria (#75).

The Ukrainian people name corruption among the major state problems, while the experts name anticorruption reforms among the TOP-5 failed reforms. In 2016, Ukrainian law enforcement agencies registered 2 175 cases of corruption, but only 303 persons were arrested, none of whom was a high-ranking public official.

The National Anti-Corruption Bureau of Ukraine started working in late 2015, and so far has not influenced significantly the situation with corruption, with only 12 persons arrested, and 50 cases submitted to the courts. According to the statements of the National Anti-Corruption Bureau officials, in many cases the courts are delaying trial considerations.

In the short and mid-term, the corruption will remain among major Ukraine's problems. Qualified lawyers, communication with diplomatic missions, publicity and good contacts with media should assist business in successful coping with the related problems.

## International Risks Environment

The developments in Ukraine may be influenced by the risky international environment, including the EU political instability, still unclear position of the new U.S. Administration, possible deterioration in Ukraine's relations with Poland (due to the nationalistic sentiments of the Polish ruling party), as well as possible new conflicts in the Eastern Europe and the Balkans.

### EU political instability / elections impact on Ukraine

The upcoming spring 2017 elections in the Netherlands and France are not promising for Ukraine, as the chances of more Russia-favorable forces coming into power are high. Fortunately, the September 2017 Germany elections should not bring major change in Berlin's stance on Ukraine, but in general, the all-over the EU trend of rising populism and national egoism may result in decrease of the Western attention to Ukraine, reduce in the financial assistance, and increase in the Western pressure to implement Minsk agreements on Russia's terms. Extension of sanctions against Russia may become more questionable in 2017.

If the launch of EU visa-free regime for the Ukrainian citizens is postponed again, sanctions against Russia are not extended, and/or no significant financial support from the EU is provided, then a risk of increasing anti-European sentiments in Ukraine may arise, to be utilized by Russian propaganda as well as domestic populists. It may also become a convenient excuse for curtailing reforms and maintaining uncomfortable environment for the business.

### New U.S. Administration policy towards Ukraine

Given the sympathies of the Ukrainian establishment to Hillary Clinton as well as the election rhetoric of Donald Trump, Kyiv is anxious about possible negative change in the new U.S. Administration's policy towards Ukraine and Russia-Ukraine conflict. In case of attempts to make a 'big deal' with Russia at the expense of Ukraine's interest, the U.S. entities may face a risk of less favorable business environment in Ukraine. Fortunately, such developments is unlikely due to its mismatching with the U.S. interests, as well as Russia's unreliability and its domestic reasons to keep international tensions high at least until the next shift of power.

However, Ukraine faces the risk of possible failure to quickly adapt foreign policy to a more pragmatic approach of the new U.S. Administration, as well as the risk of attempts to use Trump's victory in Ukraine's domestic political struggle that can undermine stability and negatively impact the country's maneuverability in foreign policy.

### Russia regional assertiveness and possible new conflicts

Russia's willingness to use force to achieve domestic and foreign policy goals, amid the reluctance of the largest European NATO members to take additional risks for the sake of their Eastern Allies, not to speak about the non-member countries, makes new military adventures in the region probably, most likely through the hybrid scenarios. Threats to the Belarus independence are considerable, as well as the risk of Moldova's drift toward Moscow and increase in the role of Russian military contingent in Transdnistria breakaway region. Security situation in the Baltics may deteriorate, and Russia's hybrid attempts to aggravate instability and provoke new conflicts in the Balkans are also possible.

Further deterioration in the region stability and security may negatively impact the business climate, but it is not only about Ukraine, but the whole region; and the most negative scenarios are low probable.

## Conclusions

The Russia-sponsored conflict in the East of Ukraine, as well as corruption, crime and inconsistent reforms cause a wide range of risks, but far not all of them pose direct threats to the U.S. business. The critically challenging risks are mostly those of low probability (such as the risks of large-scale military conflict with Russia or new revolution). The low intensity military hostilities in Donbas are unlikely to spread to other regions of Ukraine. Even such highly probable short and mid-term risks as cyber attacks, corruption and crime, which pose immediate threats to the business, may be successfully coped with, if effective risk mitigation strategy and emergency planning is shaped.

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<sup>1</sup> Razumkov Centre experts' survey, November 2016.

<sup>2</sup> Democratic Initiatives & Razumkov Centre national public opinion poll, December 2016.

<sup>3</sup> Democratic Initiatives & Razumkov Centre national public opinion polls, January 2015, December 2016.

<sup>4</sup> Democratic Initiatives expert poll, December 2016.