

*OSAC Ukraine Country Council Q1 2017 Meeting
“Integrating Resilience into Business and
National Strategies”
Kyiv, 1 March 2017*

Ukraine

Risks Map 2017



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Risks, Threats and Opportunities

Risks Do Not Necessary Mean Direct Threats,

especially when it comes to the American business in Ukraine, given strong Kyiv's relying on the U.S. support.

Risks Often Provide For Additional Opportunities,

frightening away the less prepared competitors and making local authorities more inclined to create preferable conditions for the foreign investors

To Turn Risks Into Opportunities

the business need to have a clear vision of what it deals with, and to strengthen emergency planning and build resilience

*The purpose of our Risk Report is to provide you with a general **Vision of the Risks Environment for Doing Business in Ukraine.***

Major Risks Business Faces in Ukraine

RISKS CAUSED BY THE EXTERNAL FACTORS

-  **Military conflict in the East of Ukraine**
-  **Attempts of hybrid destabilization all over Ukraine**
-  **Terrorist attack risks**
-  **Cyber attack risks**

RISKS CAUSED BY THE INTERNAL FACTORS

-  **Political risks**
-  **Social instability risks**
-  **Violent and non-violent crimes**
-  **Corruption related risks**
-  **Environmental risks**

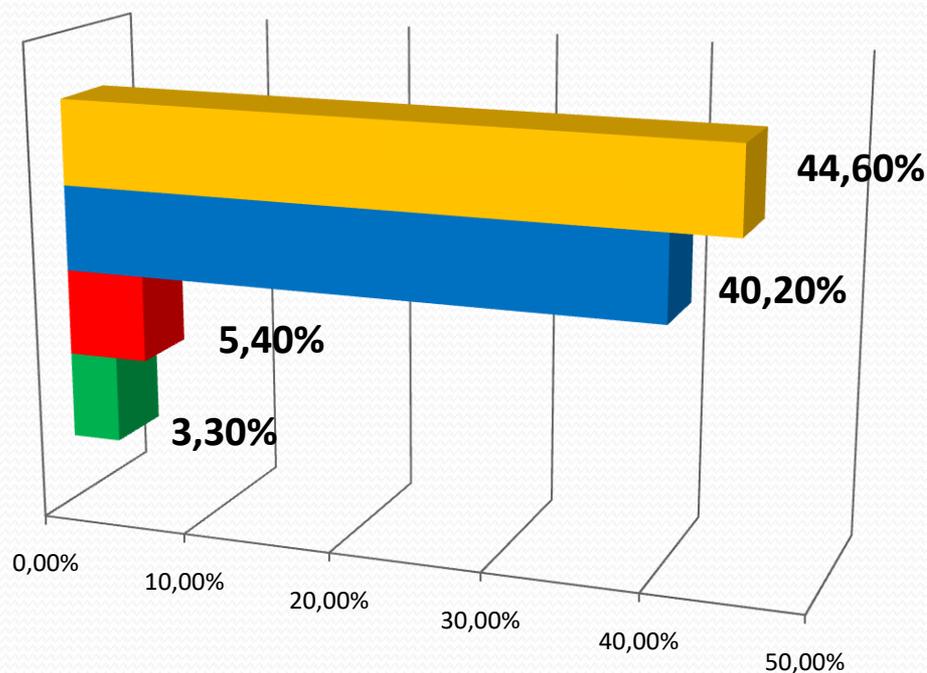
Military Conflict in the East of Ukraine

Strong negative impact on economic, social situation in Ukraine

- ➔ About **1/5 of Ukraine's economic** potential is destroyed or out of the Government control
- ➔ Billions of dollars **war expenditures** annually, without clear public control
- ➔ Any **employee can be mobilized** at any time without compensation to the business entity
- ➔ Well-educated and self-motivated **people tend to emigrate** due to uncertain prospects and constant risk of being mobilized at any time
- ➔ Flows of internal migrants and illegal weapons lead to **increase in crime**
- ➔ 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

Military Conflict in the East of Ukraine

Low probability of peaceful settlement in the short and middle term perspective



- Conflict will go on the same way as it is now
- Conflict will freeze but confrontation will go on
- Conflict will escalate to large-scale hostilities
- Conflict will be gradually settled and RU-UA relations restored

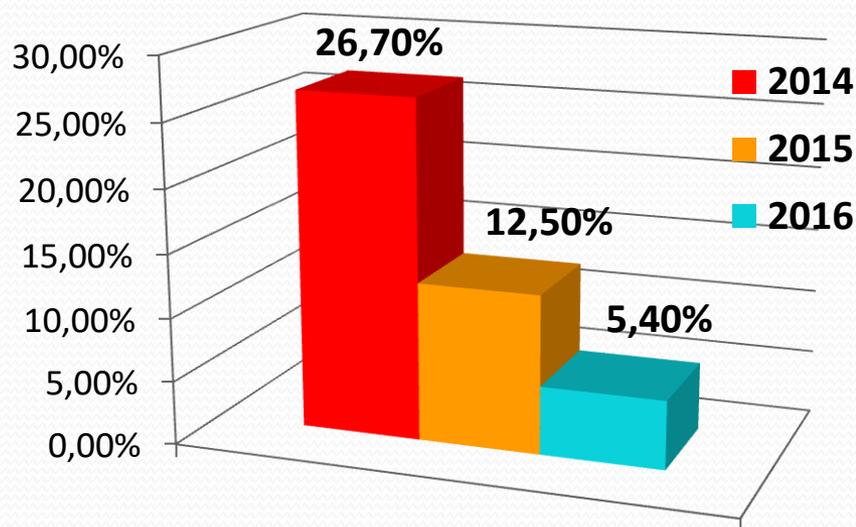
* Razumkov Centre experts survey, November 2016.

Military Conflict in the East of Ukraine

Probability of large-scale military escalation is 5 times lower than it was in 2014.

In Nov. 2016, only 5,4% experts believed in such development, compared to 26,7% in 2014.

In the short and mid-term, low intensity hostilities and local military operations will go on, as well as Russia's building up of its troops near Ukraine's borders, creation of new and upgrade of existing military bases aiming at keeping the turbulent political situation in Ukraine from stabilization.



* Razumkov Centre experts survey, November 2016.

Attempts of Hybrid Destabilization in Ukraine

Russia will go on with attempts of hybrid destabilizing Ukraine aiming at change of government and failure of reforms as a minimum goal.

Most probable focal points of hybrid destabilization:

💣* **Separatism**. Situation may deteriorate, if Russian vision of decentralization is implemented through the Constitutional reform in Ukraine.

Most vulnerable regions:

Kharkiv region (pro-Russian Kharkiv city authorities)

Odesa region (pro-Russian sentiments in Odesa city + Bessarabia area)

Zakarpattia region (Rusyns/Ruthenes)

💣* **Information influence** through Russia-controlled media

💣* **Economic deterioration** due to trade and transit bans

💣* **Political tensions** through Russia-backed parties and/or far-right movements

💣* **Cyber attacks**, data fraud, attacks on critical infrastructure

So far, Ukraine's resilience to hybrid destabilizations varies from low to medium.

Terrorist Risks

Many objects in Ukraine require special security regime: five **Nuclear Power Plants**, dozens of **Hydroelectric Power Plants**, **Chemical Plants**, storages of Chemical and **Toxic Waste**, etc. Several chemical plants and storages are located at the occupied areas and close to the military hostilities zone.

With that, the **probability of large-scale terrorist attacks is low** because:

- ✓ Ukraine is not a desirable object for religion fanatics and other international terrorist groups (ISIS and etc.);
- ✓ Russia is not interested in large-scale terrorist attacks as long as it hopes to return Ukraine into own sphere of influence;
- ✓ Separatists in Ukraine normally do not apply terrorism as a method.

BUT the **risks of minor terrorist actions remain actual** due to a large amount of illegal arms coming from the conflict zone. Such attacks can result from:

- ⚡ **political provocations,**
- ⚡ **criminal redistribution of business assets, or**
- ⚡ **individual actions of some mentally unstable war veterans.**

Cyber Attack Risks

In its study on Security Sector Reform (2016), RAND Corp. noted the lacks of the whole-of-government approach to cyber defense and security in Ukraine.

Cyber Security Strategy 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 compensate for insufficient state capabilities.**

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

⚡ In the short term, large-scale cyber attacks are highly possible within RU campaign on hybrid destabilization.

➡ The risks of information infrastructure breakdown & data theft should be properly considered.

In the mid-term perspective, the national reforms (including the implementation of the NSDC December 2016 decision On emergency measures to neutralize cyber threats), and cooperation with NATO should help to improve the situation.

Risks of National Governance Failure

Government's ability to effectively run the country is questioned by:

- ❖ **Weak rule of law** (70-90% of court decisions fail to be implemented)
- ❖ High **corruption** rate, low efficiency of newly created anti-corruption bodies
- ❖ Sharp **increase in serious crime** (+37% compared to 2013) amid decrease in crime detection (-54% compared to 2013)
- ❖ **Shadow economy** amounts at least 35% of GDP and 40% of the 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; to stop the **illegal amber mining** in Rivne and Zhytomyr regions
- ❖ External dependence and **vulnerability of energy supply**

❖ **Crisis of civic credibility to the public authorities:**

69% **do not trust** President

81% **do not trust** Parliament

74% **do not trust** Government

82% **do not trust** Courts

Social Instability Risks

Factors of deterioration in social situation:

- ✘ Sharp **decrease in welfare** standards (average monthly family budget is 2 times lower than it was in 2013)
- ✘ Shocking **increase in utility services rates** amid sharp **decrease in population income**, and inefficient subsidy system
- ✘ Shortage of quality employment opportunities; high **unemployment** level (9,5%); 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 social stratification; rising **lumpenization**
- ✘ Healthcare (temporal?) deterioration amid the ongoing reform

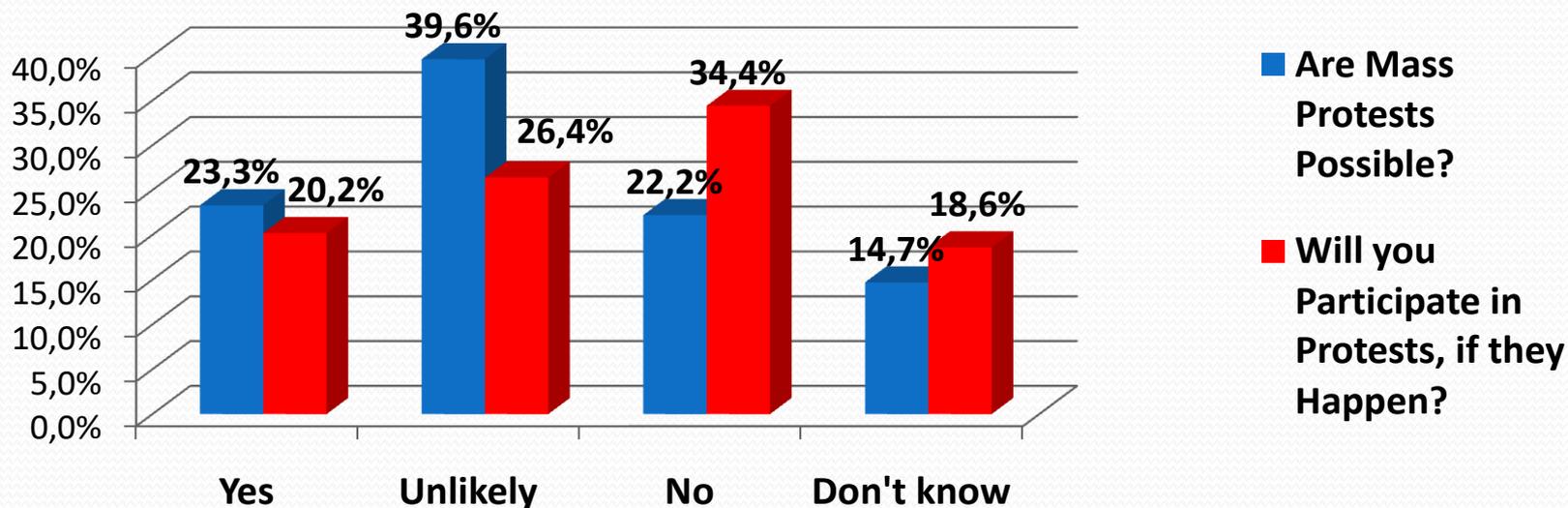
Slow reforms, high corruption, a lack of income growth ➡ open the door for rising populism, and appetite for early elections.

Appetite for the Protests. Revolution Risks

67% of the Ukrainians believe that country is developing in wrong direction.

39% believe that Maidan-3 Revolution is possible in 2017.

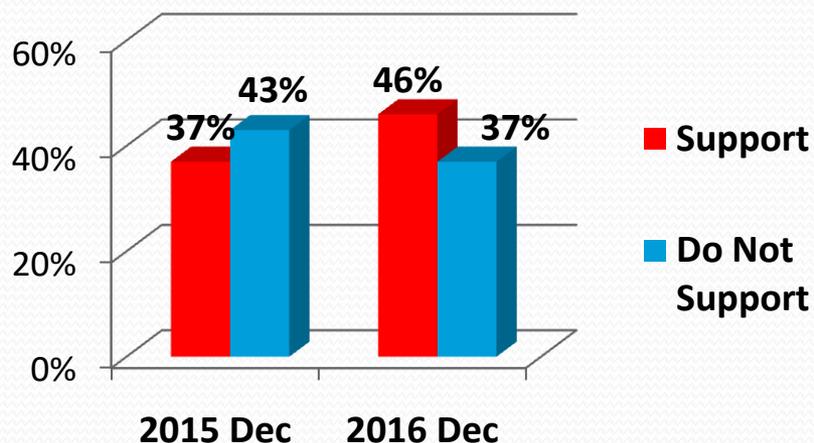
BUT only 20% are going to take part in mass protests, if they happen.



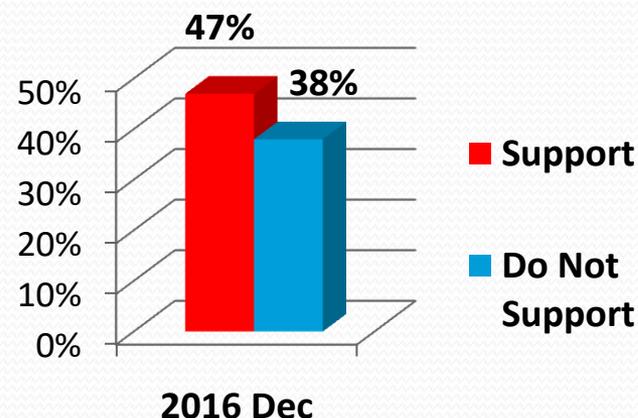
In the short-term, Risks of Maidan-3 Revolution or Mass Protests is low. However, mid-size protests are possible, most likely in the capital city.

Early Elections Probability

People's appetite for **early Parliamentary elections** considerably rose in 2016:



Appetite for **early Presidential elections** is also high

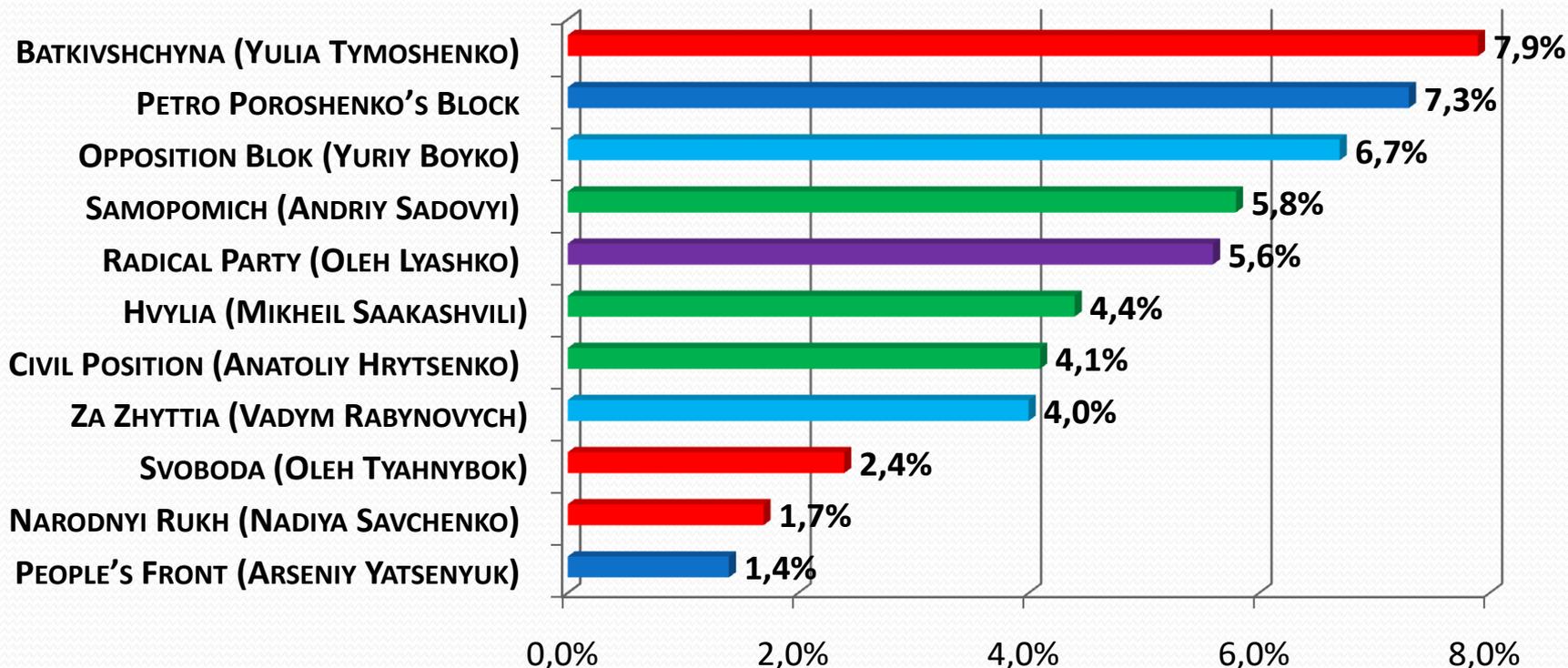


However, **only 4 of 55 surveyed experts** consider that early Parliamentary elections may be held in 2017, not to speak about the Presidential elections.

*Under the Ukrainian legislation, **appointment of the early elections primarily depends on the President's will, and as long as he can control the Parliamentary majority, the probability of early elections is low.***

People's support for political parties

DECEMBER 2016

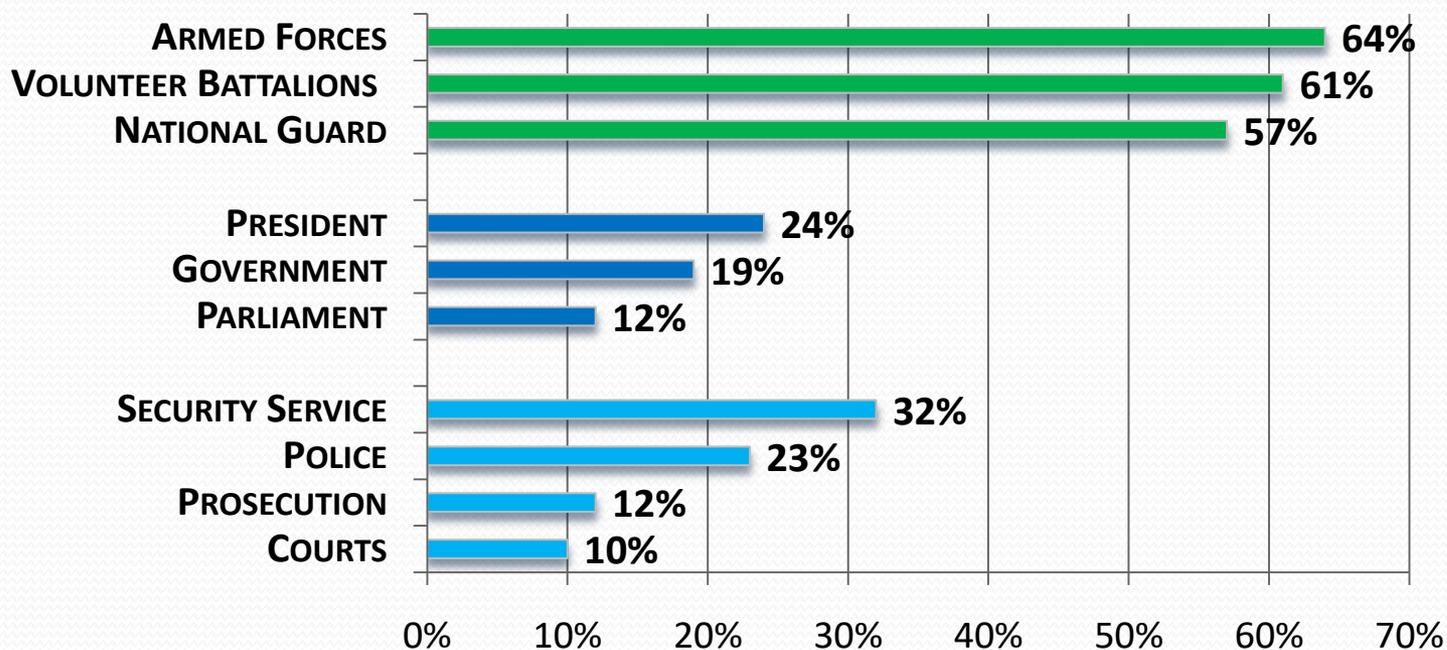


It should be noted that only half of 450 peoples deputies are elected through the party lists, the other 225 deputies are elected in the single-mandate constituencies, where representatives of current authority usually win.

* Democratic Initiatives & Razumkov Centre national public opinion poll, December 2016.

Military Coup Risks

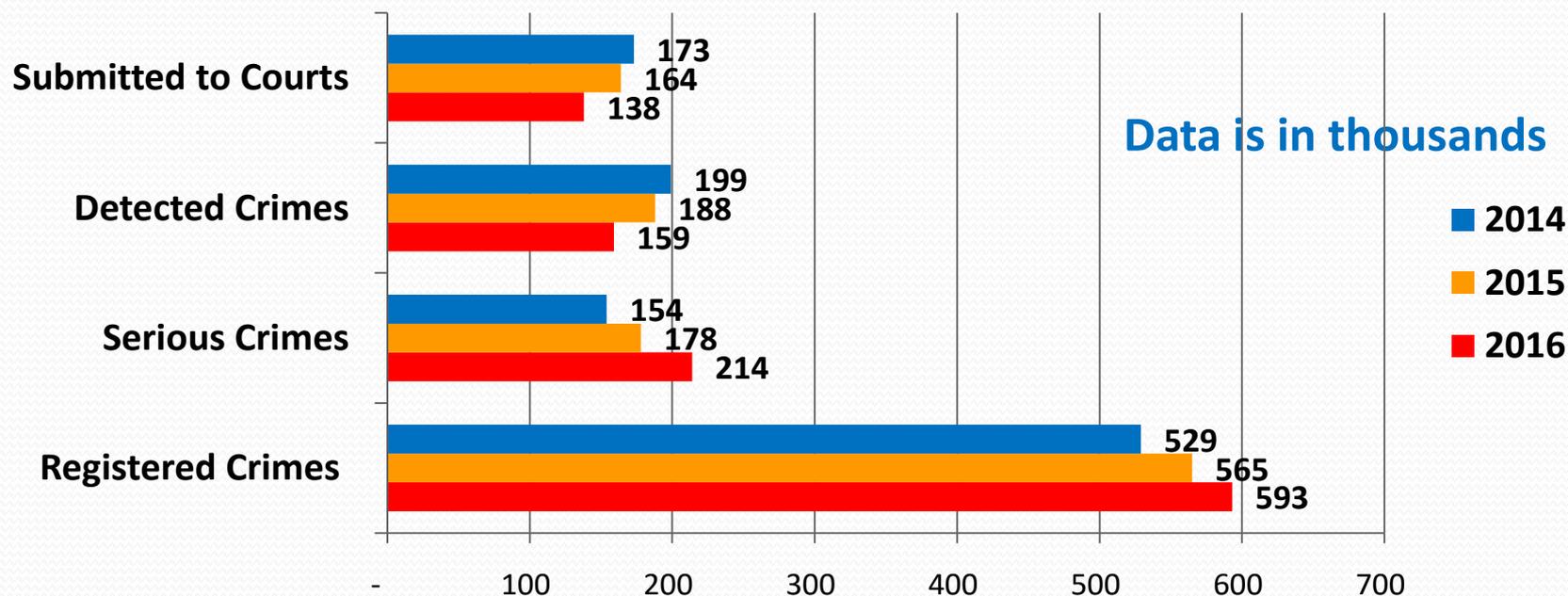
The Ukrainians' confidence in **Militaries** is **several times higher** than confidence in **Public Authorities** and **Law Enforcement Authorities**



Some forces may fall into false temptation of belief that people can agree to transfer the powers to the so-called “strong hand”. Still, military coup is a **low probability threat** due to special attention of the security services to this risk.

Violence and Crime Dynamics

2014-2016 trends: Increase in Crime, Decrease in Crime Detection



+12% Increase in Crime

+38% More Serious Crimes

- 25% Decrease in Crime Detection

- 25% Less Cases Submitted to Courts

Top in number of crimes: Kyiv, Dnipro, Kharkiv, Odesa and Zaporizhia regions.

Top increase in crime: Volyn, Ivano-Frankivsk and Chernivtsi regions.

Crimes against Life and Property in 2016

5 992 intentional **murder** criminal cases,
15% (914 cases) of which were submitted to court with indictment.

2 256 intentional **grave bodily injury** criminal cases,
63% (1 425 cases) of which were submitted to court with indictment.

Crimes against property are the most common (**70%** of all crimes), and **very poorly detected** (decisions are taken only in **21%** of cases).

- ⚡ **46 019 fraud cases** (only 14% of cases submitted to courts with indictment)
- ⚡ **27 204 residential burglaries** (only 17% of cases submitted to courts)
- ⚡ **27 199 robbery offenses** (only 22% of cases submitted to courts)
- ⚡ **12 205 car thefts** (only 19% of cases submitted to courts)

+30% Increase in Crime Against Property in 2014-2016

Top in crimes against property: Kyiv, Zaporizhia, Kharkiv, Dnipro and Lviv regions.

Top increase: Volyn and Zhytomyr regions.

Top in car thefts: Kyiv, Odesa and Dnipro. Top increase: Cherkasy, Rivne, Kirovograd.

Corruption Related Risks

Corruption Perceptions Index 2016 by Transparency International rates **Ukraine at 131 place of 176 possible**. Slightly better than in 2015 (#136), but still worse than highly corrupted Moldova, Mexico and Azerbaijan (#123), Colombia (#90), and Bulgaria (#75)...

✘ **Ukrainian people (57-66%) name corruption among major state problems.**

✘ **Ukrainian experts name anticorruption among TOP-5 failed reforms.**

In 2016, law enforcement agencies registered **2 175 cases** of corruption, but only **303 persons were arrested**, none of them was high-ranking public official.

National Anti-Corruption Bureau of Ukraine started its work in late 2015.

So far, no significant impact on eradication of corruption: only 12 persons arrested (no one top-ranking public official), 50 cases submitted to courts.

In the short and mid-term, Corruption will remain among major problems.

Good lawyers, keeping in touch with diplomatic mission, publicity and contacts with media should assist business in coping with related problems.

International Risks Environment

MAJOR INTERNATIONAL ENVIRONMENT **RISKS**

-  **EU political instability / elections impact on Ukraine**
-  **New U.S. Administration policy / less attention to Ukraine**
-  **Possible deterioration in Ukraine's relations with Poland, Hungary, Slovakia**
-  **Russia-Ukraine conflict impact on neighboring countries**
-  **Russia regional assertiveness**
-  **Possible new conflicts in the Eastern Europe, the Balkans:**
 -  Threats to Belarus independence
 -  Moldova drift to Russia / Transdnistria problem
 -  Security deterioration in the Baltics
 -  Serbia/Kosovo; Bosnia and Herzegovina; Montenegro instability

EU Political Instability

Elections:

- 📅 Spring elections in **France** – no favorable option for Ukraine
- 📅 Spring elections in the **Netherlands** – deterioration is possible
- 📅 September elections in **Germany** – no major change for Ukraine expected
- 📅 Rise in **populism and nationalism** all over the EU ➡ national egoism

In general, no principal change in situation for Ukraine, although some deterioration is possible, while no reason to hope for any improvement.

Extension of sanctions against Russia becomes more questionable in 2017.

If visa-free regime is postponed, sanctions against Russia are not extended, and no financial support from the EU is expected ➡ 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 an excuse for curtailing reforms and uncomfortable environment for business.

New U.S. Administration

Given the sympathies and support of 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 on Ukraine and Russia-Ukraine conflict.**

In case of attempts to make a *big deal* with Russia at the expense of Ukraine, the U.S. entities may face a risk of less favorable business environment in UA.

BUT 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.

More likely risks are the following:

- ❖ Failure to quickly **adapt Ukraine's foreign policy to a more pragmatic approach** of the new U.S. Administration (strict demands for getting support)
- ❖ **Attempts to use Trump's victory in Ukraine's domestic political struggle** can reduce political stability and limit Ukraine's foreign policy maneuverability.

Russia Regional Assertiveness

- ✦ **Russia's military expenditures** (\$66 billion) are 2,5 times as much as combined military expenditures of all the Eastern European countries. In the region, only Polish military budget (\$10,5 billion) can be considered as relatively significant.
- ✦ European Allies are very cautious in strengthening NATO Eastern flank; the **largest EU countries are reluctant to use force** to defend Allies in case of Russian aggression: in Germany 58% are against use of force, France - 54%, Italy - 51%.
- ✦ Aggressive international stance is an essential **pillar of the Kremlin domestic policy**.

These factors make Russia's new military adventures probable, most likely through the hybrid scenarios.

Risk zones:

- ✦ Belarus
- ✦ Moldova / Transdniestria
- ✦ The Baltic States
- ✦ Serbia/Kosovo; Bosnia and Herzegovina; Montenegro

Ukraine Risks 2017 and Beyond

HIGHLY PROBABLE SHORT AND MID-TERM RISKS:

- ⚡ Military hostilities in Donbas of low/average intensity
- ⚡ Weakening Ukraine's international stance / Decreasing West's attention to UA
- ⚡ 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; ⚡ Cyber attacks

MEDIUM PROBABILITY:

- 💣 Aggravating military confrontation with RU
- 💣 Authoritarian trends
- 💣 Social instability and Mass protests
- 💣 Early Parliamentary elections
- 💣 Environmental risks (floods; chemical pollution)

LOW PROBABILITY:

- 💣 Large-scale conflict with RU
- 💣 Terrorist attacks
- 💣 Separatism
- 💣 Governance Failure
- 💣 Revolution / Military Coup

Ukraine Risks ≠ Business Risks

Not all Ukraine risks are challenging for the Business, especially American one

Critically challenging risks are mostly those of low probability (such as *Large-scale Conflict with Russia* or *Military Coup*).

Low intensity *Military Hostilities* in Donbas are very unlikely to spread to other regions of Ukraine.

Possible early *Parliamentary Elections* or *Mass Protests* hardly would be challenging to the U.S. business, as long as the majority of Ukraine's politicians strongly relies on the U.S. support – political, financial, and in countering Russian aggression.

Risks possessing immediate threats to the business:

✦ Corruption ✦ Cyber attacks ✦ Crime

To cope successfully with the related problems, it is advisable to consider:

✓ **Effective Risk Mitigation Strategy and Emergency Planning including Data Protection; ✓ Keeping in touch with Diplomatic mission; ✓ Publicity and good contacts with Media; ✓ Following the rules of Personal Safety.**

Thank You for Your Time!

East European Security Research Initiative Foundation

- ✓ Expert's assessments on current security threats and potential challenges
- ✓ Recommendations for addressing security threats on regional and national levels
- ✓ Expertise on regional security and confidence building measures, security sector reform and management
- ✓ Facilitation of the international security dialog among the experts, academia and officials
- ✓ Promotion of better public awareness on security developments in the Eastern European countries and region as a whole

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