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Doing Business in Ukraine: Yesterday, Today & Tomorrow

**Opera Hotel
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Anders Ostlund:

Your excellencies and honored speakers, we are delighted to see such a fantastic group of people here tonight at Fryday W at the Opera Hotel. We extend a great thanks to Mr. Mohren and his colleagues at the Opera Hotel for hosting us and for extending your excellent service level to Fryday W's



guests. We express our gratitude to the partners of this event, the Sophiyskiy Fitness Center, First Business Channel, Parker, Ukraine Consulting, Socialite and Business Ukraine.

Tonight, we have the honor of the presence of Mr. Yuriy Yekhanurov and Mr. Alexander Paskhaver as our speakers. We also have our partner, Alex Frishberg of Frishberg & Partners, who will lead the discussion and moderate this event.

Alex Frishberg:

Thank you very much for attending. We have an interesting presentation called “Doing Business in Ukraine: Yesterday, Today & Tomorrow”. We are very fortunate to have the opportunity to work with Fryday W, which is extremely successful in organizing these types of events. Afterward this presentation, there will be a question and answer session during which you may ask as many direct and blunt questions as you wish.



By way of introduction, whenever you elect a president in America or in Europe, your life essentially stays the same. You still go to work, you fill your car with gas, you have dinner and you go to sleep. In Ukraine, on the other hand, it is extremely important who becomes the president

because your individual life will change drastically in a matter of months after the election. This is a reality for both local and foreign investors alike.

Yesterday, we had Kravchuk, who was a transition from the Soviet period to the new modern system. Next we had Kuchma, who introduced



reforms, including large-scale privatization. These gentlemen, sitting next to me, were the ultimate insiders during those formative years, when ordinary people became billionaires and oligarchs overnight. For instance, Mr. Yekhanurov was chairman of the State Property Fund and Mr. Paskhaver was advisor to the State Property Fund and co-author of many primary laws that governed large-scale and small-scale privatization. He also co-authored many of the sub-legislative instructions.

In the third stage of “yesterday,” there was a rather peculiar and dysfunctional team of Victor Yushenko and Yulia Tymoshenko, which effectively meant absence of any government whatsoever. Of course, this was fantastic for business, because when government doesn’t interfere, business blossoms and grows. In those years, everyone was complaining about Yushenko and Tymoshenko, not knowing how wonderful they really had it. The local economy was booming, foreign investors came in droves and the price of all real estate went sky-high, including industrial property, commercial and residential real estate, etc.

And now we have today - beginning with the 2008 economic crisis and compounded by the Yanukovich administration. Today, we have no foreign investors and we have no booming economy. In summary, that was yesterday and today. What about tomorrow?

Tomorrow, we have presidential elections upcoming in 2015. The question is whether we will continue the swamp-like status-quo or, if Ukraine will find some sort of direction to follow, whether it be the European direction or the Russian direction, the American direction or total isolation. This is the issue that is still on the table. Ukraine could still easily become a second Belarus. Unlike in most other civilized countries, it is very important to predict the future in Ukraine because it changes everything here practically overnight.



This brings us to today's discussion and our speakers because they are the ones who will look into the crystal ball and tell us what we can expect tomorrow. We will first have a 10-15 minute presentations by our speakers. Mr. Paskhaver will go first and Mr. Yekhanurov will follow. Then, each one will respond to what the other has said. Finally, we will

have a question and answer period when you will have the opportunity to ask any question you wish, and you will receive honest responses.

As a quick introduction to our speakers, Mr. Paskhaver was not just advisor to the State Property Fund, but he was also advisor to many presidents – to President Kuchma in his formative years, to President Yuschenko during the anarchy days, etc.

We are extremely fortunate to have with us Mr. Yuriy Yekhanurov, who occupied the top tier of the government during the formative years of the early 90s. He was not only the chairman of the State Property Fund when all of large-scale privatization took place, but he was also Prime Minister of Ukraine. Mr. Yekhanurov is still very much active in Ukraine's economic growth and development.

With this in mind, I would like to turn the floor over to Mr. Paskhaver, who will provide his views on where Ukraine has been and where it is going.

Mr. Alexander Paskhaver:

I don't know if I am able to predict the future, but I know for certain that I will not analyze the current economic atmosphere in Ukraine and I will not advise as to which type of reforms we should now undertake to improve Ukraine's



situation. These two tasks have ceased to be of interest to me; I simply don't think that they produce any results.

In regard to the tendencies we are currently observing, I will begin with my conclusions. As a result of 22 years of development, we are now at a social and economic crossroads.



I wouldn't say that we are alone in this position if we are speaking about former Soviet republics, but we are worse off than all of our neighbors. On the one hand, we don't do anything and let things move along as they are, but, on the other hand, everyone feels the need to do something about the current situation.

I would like to say a few words about this situation. Let's begin with the fact that Ukrainian citizens are unhappy with their lives. More than that, they have practically given a failing grade to all of the governments that have run this country so far. I readily admit they are unhappy with the level of their lives, but they do not reject this social order that we are witnessing. For instance, if you bring up the example of corruption, Ukrainians view corruption as an "acceptable sin". This attitude toward our social order is the main reason we are at where we are today.

I have already mentioned that we don't have a unique situation in comparison with other former Soviet republics. Leading economists, winners of the Nobel Prize in economics, such as Douglas [Joseph]



North, have described this situation as a "natural state of government". They have determined the existing policies of these governments as the "conspiracy of the elite," aimed at obtaining benefits from monopolizing the largest economic spheres. They confirm that most countries in the world were at some point in time just like this, with

the exception of a small number of countries in Western Europe. Countries in South East Asia and even North-West Europe resemble this type of government. It is a very small number of countries, but what is interesting is that the authors of this research stated that they don't know how this came about. Why did this small number of countries begin to live differently?



From a viewpoint of Westerners, if you take a look at Ukraine, it is completely and thoroughly corrupt. But, if you take a look from an internal point of view, this is a natural order. This is exactly why I say that Ukrainians look at what is going on in Ukraine as an acceptable order. Under these conditions the liberal reforms, which Ukraine is constantly being advised to take, cannot be implemented as a matter of principle because they contradict the main interests of the current elite ruling the country.

Not too long ago, I was talking with a famous liberal politician, who for many years was dealing with deregulation. She stated that she will no longer deal with deregulation because it is simply torture (you can also say “impossible task”). If you take a look at the official reports, for example from the Institute of Strategic Research, you will find a complete itemized list of recommendations that it would take to liberalize this economy. It repeats itself year after year. In other words, it is a dead-end. However, the world is built in such a way that unless you develop and innovate, you will degrade.



This is what we are observing that's happening to Ukraine now.

There are two more questions, which are more or less individually peculiar to Ukraine. First, why are we worse off than others? Worse than those countries, which surround us? Second, how are we degrading? How are we going backwards? What does this mean?



When it comes to why we are worse off than others, I am not going to trouble you with all kinds of numbers. The UN conducted a research of the economic development of 207 countries from 1991 to 2011. Ukraine occupied the next to last place in measuring the economic growth of these 207 countries overall on an average from 1991 to 2011. I would like to remind you that these 207 countries included many different types

of countries with their own catastrophies – those at war, etc. If you take a look at the rating of Ukraine in relation to institutions, then you will see that our place is the worst in Europe – not just the worst in Europe, but one of the worst in Africa! This is one of the reasons why we are worse off than everyone else.

This is not an easy question but, briefly speaking, the Ukrainian population has spent 300 years without its own government. In response, this population has developed a characteristic of survivability. This is not the best characteristic upon which to build a civilized society. It is distrust toward the government leaders. It is distrust toward laws and the judicial system. It is distrust toward any social structure that falls outside of your immediate family and friends. This is what you call “amoral self-preservation”. Under these conditions it is not so easy to build a civilized government.

In addition, the population has come from Soviet times, and it suffered in such a way that the most productive layers of this society were destroyed. Like Alex Frishberg, I myself am also Jewish and, therefore, I know very well what a Holocaust is. The Holocaust destroyed approximately 40% of the Jewish population. However, if you look at the population as if it was a pie, it destroyed a large piece and layers of the pie from top to bottom. And, pieces of some layers were preserved in other regions. Moreover, the elite, even in European countries, was largely kept alive during World War II. In Ukraine, when we are talking about the Ukrainian people, it was destroyed by the Soviet Union from the top down, layer by layer. A lot less Ukrainian people died than Jews, but the mechanism of developing a new elite in Ukraine is a much more problematic issue than anywhere else.

I’ve already mentioned the role of traditions, and I can also add that there is one more significant issue preventing Ukraine’s development. Ukraine finds itself between two divisive civil societies –

the Russian society and the Western European society. This situation is not helpful for Ukraine. If you take a survey of any issue of the Ukrainian population, then you will find a 50/50 split between these two civil societies. These conditions make it understandable why it is difficult to emerge.

The second issue is connected with the current situation. Having mentioned Mr. North and his co-authors, they reviewed the development of so-called “natural” or “typical” government of the world. They simply showed a growth of this government. The theme of the newly open, transparent governments, such as those in Western Europe, is to have more independent organizations from the government. The more independent organizations in the social and economic spheres a country can tolerate, the more open and transparent the government will be.

The Soviet Union did not tolerate any organizations that were independent from the state – not in the social sphere, not in the economic sphere. Everything was derived from the government. Independent Ukraine in 1991, having been left with the old government infrastructure, moved quickly forward because it created a lot of non-governmental structures. Today, we are observing the tendency to go backwards. This means that the current administration is monopolizing the economic flow streams in the interests of the top leadership. It is centralizing power and making the government more authoritarian. This increases the share of expenses given over to enforcement organs. This is a typical step backwards in many countries.

The authorities in the country may change, but the monopolization that is taking place in Ukraine’s economy will force us for many years to work on trying to eliminate the monopolies, many years after the current government has gone.

This is my “optimistic” view of the current situation in Ukraine. The question is whether there is any escape from this situation? We can hope and rely on natural evolution, but I wouldn’t say this has served us particularly well over the last 22 years. No one can promise that the next evolution will work in the right direction.





The second path is to change the mentality of the population. This may sound surreal, but history shows many examples. I will focus on two in particular. The United States, in 20 years between 1960 and 1980, rid itself of apparent signs of racism. This is a very short period of time, and yet it was sufficient to change the deep racist mentality inherent in

the population. The other example is from Europe in the Middle Ages, where the population was dissatisfied with the Church. During that time, one could see what is going on now in Ukraine – the sale of indulgences which could liberate one from one’s sins. Martin Luther said “You cannot do this!” and a movement was built with and around him that changed the course of Europe.

In conclusion, I believe that the concept of changing individual mentality (and not social structures) and simple discussions can result in changing the character of people. This not only evokes positive reactions, but enthusiasm amongst the people who are hungry for change. I’m not going to discuss the practical aspects of how to organize this movement, but it is possible to organize it. This basically involves the unification of small groups into larger groups, and I think that this is one of the solutions to the current situation.

Yesterday, I met with a representative of the World Bank. I said that if you came here to give us more recommendations about which types of reform we should undertake, then it is highly doubtful that your recommendations will work. Let’s find other alternatives and mainly the ones I just talked about.

Thank you very much.

Alex Frishberg:

Now you can probably understand that Mr. Paskhaver is not just an economist but a moral compass for this country (and has been for a long time). Without wasting any time, I would like to turn over the podium to Mr. Yekhanurov.



Mr. Yuriy Yekhanurov:

I will continue in the same vein as Mr. Paskhaver. Today, many people are talking about the Ukrainian mentality and our culture, and whether our culture is even able to absorb the concept of normal capitalism and transparency. With great pleasure I heard that Mr. Paskhaver is working on these problems.

So what is a Ukrainian? Not too long ago in one discussion I said that a Ukrainian is a “philosopher with a weapon in his hand”.

And someone asked: “Is this like a Samurai?” So I explained, “Yes, but only a Samurai who doesn’t want to die.”

For centuries, Ukrainians have become used to living in a way that the authorities do not see their property. Believe it or not, a long time ago the entire southern part of Ukraine was steppes, and this steppe land stretched all the way from the Pacific Ocean to the West, where many tribes lived and crossed for thousands of years. All of these people would attack those who lived in forests and other regions, including the Kiev Region, so naturally everyone was accustomed to hiding whatever they owned. So, why are we surprised that 50% of the Ukrainian economy is a shadow economy? There is a Ukrainian word which everyone here knows – prybidnyatysya – which is to make yourself appear poorer than you really are. I don’t think you have this concept in the West.

So, in different economic accounts and reports, you will never see the full picture of the Ukrainian economy. I remember in 1994 or 1995 meeting with a Japanese delegation, which read a statistical analysis of Ukraine. They expected to see on Khreschatik people dying from hunger on the sidewalks. They were shocked at what they actually saw in our country.

As Alexander’s speech was given from a different nationality position, you can see that there are many nationalities in Ukraine. I have a real, objective viewpoint because half of my forefathers would ride on horses from the Pacific Ocean to the Atlantic Ocean. You see, my father is a Buryat

(from the Republic of Buryatia in Russia) and I, with great satisfaction, saw that there was a monument to Genghis Khan in Hyde Park, London. Little Mongolia sent it to London (because they said a Scottish person made the monument). Across from this monument is a huge horse head which actually reached the Atlantic Ocean! This is part of our history – part of Ukraine.

The second half of my predecessors from my mother’s side lived here in the forests. They survived the great Empire of Kyiv Rus. When they say that all roads lead to Rome, remember that language will lead you to Kyiv. This was the saying in those empires, that “your tongue will lead you to Kyiv.” Then, there was a 300-year interval, and only now we are re-establishing our connections and our history. In between there was Russia and Poland, and now 45 million Ukrainians are trying to find their way. We are only 22 years old as a nation!



So, what reforms do we need to undertake? Do we understand whether they even need to be undertaken? I participated in authoring about 15 reform programs. And recently I thought that I need to become an author, so once again I took a leave of absence from the government and I wrote a program called “The Pragmatic Choice”. I travelled all over Ukraine, handed out my program left and right,

and gave a lecture called “Why I Am Against Populism”. We, in Ukraine, know what to do. The research done by the previous and current administrations are technically speaking excellent. It is difficult to find fault in them because everything was grammatically done. The only question was, and remains, how do you actually implement them?

I believe that the first question about reforms in Ukraine is do reforms work in Ukraine and are they being conducted. These are the questions about administrative reforms – can we show even one indicator of whether they are undertaken or not? There are always loopholes in administrative reform. The catalyst is “de-politicizing” the government bureaucrats. Believe me, 10 years ago reforms were undertaken in Ukraine. Remember there were state secretaries; there was an attempt to divide political leadership from the governmental leadership? But, then the actual hands-on control of the government slips away. In May of 2011 there was an attempt, and it was set forth in the 2nd



draft reading, to codify that government bureaucrats could not be political activists and could not be members of any political party. However, even this little seed disappeared – and this was a very important disappearance. We will see reforms only when we will depoliticize the government. If not, there will be no reforms.

Regarding the structure of the government, I’ve always said that each government bureaucrat should sign a separate 5-year contract on government service and be neutral or calm in terms of politics. Let the politicians come with their own people. There is a famous book “Yes, Mr. Prime Minister”, and it shows that a government bureaucrat can work while understanding that politicians don’t last long and, in looking at a politician, he will already keep in mind that the next politician will come along soon.

The third question related to administrative reforms is self-regulation. In Ukraine, 70% of the population lives in cities. This tendency will continue and optimally 80% will live in cities and 20% will live in the countryside. Although for farming, it is quite sufficient to have half of that number in the countryside.

All political parties promised that the cities will have self-governance and will be able to delegate authorities. This is being promised by every single political party, until it comes to power, which ends the promises of self-governance. Did you notice that mayors of cities are asking the people to demonstrate on the streets to ask for their money back that the city has? These are only small amounts of money. In talking about self-governance of the cities, did you know that Kyiv has been a self-governing power since the 15th century? And what does Kyiv have now?





As President Kravchuk stated, “We have what we have”.

The next topic is private ownership. How do our political powers view private ownership? The Party of Regions is in favor of private ownership if it is personified by them. The Communist Party is also a ruling party, which brings shame

to us all, and they are also in favor of private ownership, but confidentially – so that no one knows it. The Communist Party itself was born underground, and therefore they are used to underground movements. So everyone agrees that yes, there should be private ownership and we should make money, but at the same time we need to say at the elections that everyone is equal. It looks like “Udar” (Klitchko’s political party) is obviously a party on the rise – it is the party for the middle class, the bourgeoisie. The Svoboda Party is still determining itself – they accidentally got into the Parliament and now they don’t know their stance on ownership. Both “Udar” and “Svoboda” really can’t tell you what they feel about ownership; they first need to grow up and learn about ownership. It would be really nice if they would accept private ownership. In regard to “Batkivschina”, they are closer to the Party of Regions in their view of ownership rights.

And how does Ukraine as a whole view private ownership? A deep respect toward personal ownership can be found only if on this parcel or small factory the name of the owner is written. However, if it is corporate ownership and there are a lot of owners, then the post-Soviet individual will look upon it as if it is state ownership. You shouldn’t be surprised when Ukrainian managers don’t understand what it means to work for profit. They believe that the most important thing is to receive income; they don’t care about the expense side – and this is a big problem.

Regarding the issue of ownership, unfortunately, our laws really do not clearly define ownership. The most frightening thing is that there seems to be no demand to describe the status of private ownership. I had a discussion with one of the chief executives of a large metallurgical factory about the Law “On Joint Stock Companies” (I was dealing with this issue in 1998 – and at one time I was chairman of the committee of the Parliament in this profile – I worked on this issue for 6 years). This individual said to me “What are you doing? In 2007 or 2008 we will adopt that law. Before that time, we need to



break everything down and see where everything is.” And he was right: the law was passed within 10 years, and all questions were aimed at working with the ownership issues. We still need to develop and work on these topics for everyone’s benefit, but there is no political will-power that would like to deal with this complicated issue.

As Alexander mentioned, there is an issue of a lack of trust in Ukrainian society, which to me is the most frightening element. It will take a lot of years to teach Ukrainians how to trust each other. The Soviet government “taught” Soviet citizens that you cannot trust the authorities, and now Ukrainian society needs to be re-educated.

When we begin to say to Ukrainian people that you have to accept capitalism, trust me, we understand how it should be presented and how to explain everything. However, the educated people will look at the development of capitalism and say: I’ve read about capitalism in England, the USA and other countries, and what we are doing today in Ukraine doesn’t allow people to even pick their own noses! You need to look at the history and development of those capitalist countries at the point when they were still in development. We need to within one year catch up to 10-20 years of development. In such circumstances, it is very difficult to accomplish and change a person’s psychology. This is the most difficult thing to break through.

A very interesting example today in Parliament is Mr. Akhmetov. We expect that in the next Parliament Cabinet there will not be big-time businessmen. Instead, they will bring in groups of their people. In this case, we will have to strictly require that parliamentarians be physically present to cast their votes so that our big business leaders don’t just send their lawyers and representatives. To work in Parliament, a parliament member should work



from morning until night. Right now, 80% of the work in Parliament is invisible. This complicates Parliament's work and it is not being carried out because these big businessmen do not dirty their hands with substantive work. They wait until the bell rings and they can go home to start their business.

Changes will, of course, occur in the future, but we need to learn leadership skills. This topic is extremely important. I'll be happy to discuss it further in the question and answers session. For now, we have a relatively calm society today. There are sometimes little "splashes" here and there – like the play by Anton Chekhov – everyone is sitting around the stage, drinking tea, playing dominoes, until someone leaves the stage, shoots himself...and everyone still continues to drink their tea and play dominoes, and life continues.

Thank you.

Alex Frishberg:



Thank you, Mr. Yekhanurov, for this realistic overview of where Ukraine is today and what we can expect in the near future. And now, with your permission, ladies and gentlemen, let's hear the speakers' thoughts about each other's presentation prior to moving on to the question and answer period.

Mr. Alexander Paskhaver:

I would like to note that there is a very good reason why we have worked with Mr. Yekhanurov over the last 20 years. One way or another, formally or informally, I was his advisor. Maybe this doesn't exactly fit into today's



topic, but I remember when Mr. Yekhanurov was Prime Minister every month or month and a half he would invite me to visit his office and would demonstratively say to his secretary to hold off all phone calls except the President. By the end, we would have discussions for an hour or hour and a half about the current events. We would develop a general approach to almost everything. It is important to me that he said the most important thing is to change consciousness. I am working on this right now.

I would also like to say that research has shown that a comparatively small portion of the population, 5-7%, maybe, is the most passive part that is ready to follow anyone. I am unable to criticize Mr. Yekhanurov, as much as I try, but I have a paradoxical example. When Russia lost the revolution in 1905-1907, it was suppressed. Subsequently, the Communists were trying to find different forms of influencing the society, and they found it. They created hundreds of thousands of small groups of people and these small groups were prepared to adapt to a new philosophy of life. I think that shows good future perspectives here.

Mr. Yuriy Yekhanurov:

The only critique that I can offer to Mr. Paskhaver relates to the topic he is now working on – the ability to introduce capitalism into Ukraine given Ukraine’s mentality. Admittedly, it is being undertaken slowly right now, and that’s why it’s nice to receive some recommendations for going about this.



With reference to the question of private ownership, I understand that this society doesn’t look at this issue with sufficient responsibility. Post-Soviet mentality simply doesn’t allow this. The demand from the government that the government owes something to our citizens, this social populism which still exists in this country, is our own fault.

Alex Frishberg:

Thank you, Mr. Yekhanurov, for this overview. It was very informative, indeed. And now we have the opportunity to move into the question and answer session. Who has the first question?

Question #1:

My company comes from Italy. I want to ask you about doing private business in Ukraine: what sectors do you find most promising?

Mr. Yuriy Yekhanurov:

One of the most interesting spheres is raw materials, which are not related to the metallurgy industry. Italy used to manufacture wonderful tiles. I am a builder, so I will talk about this in the first place. If you come with your equipment and build your own factory, you will find that we have an abundance of raw materials for your tiles. Another sphere is agriculture – this is most definitely an open field in Ukraine.

**Mr. Alexander Paskhaver:**

I can't be the one to tell the owners of capital what to do with their money, but there is an interesting saying by a businessman that has been doing business in Ukraine for the last 20 years. I asked him once: how can you work in these difficult conditions? He answered, "it is just a matter of profit. If there is profit after considering all risks, we work."

Question #2:

My name is Alexander Panchenko. There is an impression that the current administration has everything under control for itself. Do you feel that for the business of the future there is the energy and, mainly, the desire to make changes? If so, what will they change?

Mr. Alexander Paskhaver:

There are two lines of answers for this question. When it comes to the actual power of the authorities, they simply focus on the accumulation of as much wealth as possible. It is highly doubtful that they will want to change anything. On the other hand, the economy itself reacts towards monopolies in a negative manner. That is, the power to develop is usurped. It is here that I see a limitation on the duration of the current authorities. This is not political intrigue – this is the collapse of the economy. A change of political administration usually follows economic collapse. There are many signs that this collapse will occur in the near future. In essence, the current authorities only work to increase the national debt. There are no internal sources for the effectiveness of the economy.

Mr. Yuriy Yekhanurov:

From a reforms point of view, the answer from the government would be as follows: “It is difficult to change without changing anything, but we have demonstrated this perfectly well.” By the way, out of all government officials, I spent the most amount of time on 19th Street in Washington, DC – in the World Bank and the IMF. When I was responsible for the Ukrainian economic sphere of the Ukrainian government in 2000-2001 and 2005-2006, we did not take one cent in loans from these two respectable organizations. [Applause from the audience]. I only had one request from them: give us confirmation that our guys are properly working. I am proud of the award presented to me by the World Bank. It is a painting of me standing at the podium giving a presentation and I hold one dollar in my hand, stating “give me one dollar and tell me that I am properly doing my job”. I will show this painting to all of my grandchildren.



Question #3:

I am Jana Zikmundova, the Ambassador of Belgium in Ukraine. Lately, we see in the international press a lot of information about the possible balance payment crisis in Ukraine. This will not be good for exporters. Belgian exports to Ukraine have been growing about 30% almost every year, which is about the top of the pro-medium amounts of our exports in the world. Of course, we view this information with concern. On a deeper level, I ask myself if indeed there is a major balance of payment crisis in Ukraine, if it would not be a shock that would lead, finally, to deeper reforms of the framework conditions here and of the economy in general. Thank you.

**Mr. Alexander Paskhaver:**

The issue of a negative balance of our import-export trade is a natural consequence of what I was referring to earlier. Your question is whether this will be the root problem of the economic difficulties as a movement towards changes. There can be two answers. Either the authorities will understand that this problem exists and change their policies or the economy will demand that the authorities will change. I will repeat, my prediction is that the authorities in power now are



not in a position to change their opinion. Therefore, it is more likely that these difficulties that you mention will lead to a change of leadership.

Mr. Yuriy Yekhanurov:

As I understand it, there will be no serious changes in the authorities prior to 2015.

There will simply be a decrease in the hard currency reserves in the country and the hryvnia will be stable. This, of course, will be artificially done. There will be mutual borrowings from different markets and it will not make any difference how much these credits will cost. Over the next 1-2 years, on the graphs the economy will be leveled.

And, madam Ambassador, of course, you are absolutely correct about your question and its implications for us all.

Question #4:

I have the following question. We are observing a steep decline in small and medium business. From New Year until now, there have been an abundance of small firms closing down. So, my question is what will happen in the future. Is it worth it to start small and medium businesses?



Mr. Yuriy Yekhanurov:

I have, since June 14, 1990, been the head of an organization which helps small and medium size enterprises. The first small enterprise was created by a construction company in December



of 1989. Therefore, it is very painful to me to answer such questions. The last meeting of the council of the Union of Small and Medium Enterprises showed that there is a stable decrease in the number of enterprises, and the number of members in unions is deteriorating. Many people are asking just to attend our meeting, but they can't afford to pay the dues because their enterprises are closing.

Right now, you are seeing a serious monopolization of the economy. Unfortunately, small enterprises are built into these large-scale conglomerates, which are being created today. This is an enormous problem – for me especially because I’ve always positioned myself as a person who lobbies the interests of small and medium size businesses. I’ve always stated this openly even when I worked in the government.

Small and medium businesses completely fall within the interests of society as a whole. This decrease in such businesses will eventually become a big problem. We need to get the message clear to all of the parties which will participate in the next elections.

Mr. Alexander Paskhaver:

I would just add that you must understand the psychology of the current authorities to understand why this is happening. The current authorities have certain properties that may be characterized as follows: these people have the mentality of medium-level managers of industrial regions – Soviet-like regions. In this connection, they don’t really understand the need for small businesses. The current Prime Minister confirmed this when he was told that his policies are problematic for small businesses. He replied, “What’s the problem? Go work for large factories.”

This is a philosophy that the current authorities are espousing. Small businesses are not necessary for their plans. The issue that small businesses are a factor of stability for the country is ignored because mid-level managers don’t know how to manage the government. They think that the government can be run like a commercial enterprise, whereas the government can’t be run like a company because the government makes decisions which affect society. This is what you have described. Whether it is good or bad is completely irrelevant at this stage.



Question #5:

Messrs. Yekhanurov and Paskhaver, in your presentations, you spoke about the national elite and their negative qualities. How should the national elite prepare to assist the Ukrainian people? Should they take part in American or European educational programs? Or can they prepare on their own in Ukraine?

Mr. Alexander Paskhaver:

The national elite cannot be prepared separately from the population. Our elite has not “occupied” our people; it is a part of the population. In order to create the national elite, the viewpoint of the people must change with respect to the elite. Only then will the people be able to select the elite that the people believe will be useful for the nation. The question is not how to educate our elite. I would like to say that the people governing our country can be taught anything you like; however, they have their own interests, which they work to fulfill. Therefore, my opinion is that in order to change the attitudes of the active percentage of the population towards our country, they need to feel the Western-European spirit. This is possible, and the elite want this. This must be a moral, not a political, movement. These are precisely the type of successful mass movements have happened in the histories of other countries.

Of course, there is an alternative – when some great person, with a “bigger-than-life” personality, changes the country in a totalitarian manner. We specifically analyzed the positive histories in South East Asia, for example. But, we discovered that in such cases the authoritarian leader was also limited in his actions by traditions - traditions of serving in the military or government, traditions of bureaucracy, moral traditions, etc. However, these conditions do not exist in Ukraine. Therefore, I came to the conclusion that the authoritarian path of changing the country could not be useful to Ukraine. And, therefore, all we have left are moral movements from below.

Mr. Yuriy Yekhanurov:

Finally, I do not agree with Mr. Paskhaver. I believe that you need to educate the leadership. Therefore, one year ago, a group of people undertook this difficult task. Today, I can name two groups - the International Center for Perspective Research, which is developing this program, and the Center for the Development of Leadership, which is handling the practical aspects of this issue. The goal is to educate the politicians, bureaucrats and businessmen. These are different programs. I am grateful to the international organizations, which have so far stated that these programs are on the right path. These international organizations have



promised to monitor these programs and support these programs in the future. We have already had the first courses with the government bureaucrats and educated them how to relate to people, how they should find their way out of complicated situations.



In particular, I like the examples that the trainer used when he explained how the mayor of New York should have behaved on September 11th or how one of our Ministers should have behaved when a rocket hit a house in Brovary or how the head of Kyiv should have behaved during the massive snow storm this past winter. The training session was a success, albeit the government bureaucrats are still

afraid to learn. They need to get permission to take any decisive actions. Politicians say, “Yes, we need to learn, but please find us the money so that we can learn.”

Secondly, politicians and bureaucrats are too busy. They don’t have the time to learn – they need to visit this or that region or the city council or stop this or that demonstration. For them, to learn the structure of local budgets is simply incomprehensible. Therefore, the leaders don’t have this type of knowledge, even popular leaders with small groups under them.

Since I am in this type of public movement for many years, I can say that these “wild” groups that emerge under one charismatic leader (i.e., 10-12 people who protest against something) should also be educated. In other words, we are trying to do something and no one is interested. Over the last few years I have only been occupied with teaching in Shevchenko University. I try to develop my students to become leaders and I also learn a lot from my students. It turns out that in Ukraine proper leadership is a big problem. For better or worse, I completely understand that leadership, management and organization are sorely needed in Ukraine.

Mr. Alexander Paskhaver:

It is a big problem of how to educate the bureaucrats. When you analyze the behavior of any bureaucrat, the first thing that comes to your mind is that they make incredibly stupid decisions. But bureaucrats don’t make stupid mistakes - quite the opposite, they act in a very clever manner, but they only do so in their own self-interests. If you try to teach a bureaucrat to behave otherwise, he will simply laugh at you.

We also had various expectations in the sphere of administrative reforms about which Mr. Yekhaurov spoke. Enormous amounts of money were allocated to us to educate the bureaucrats. We taught them very many correct aspects of behavior, but no one from the bureaucrats did anything to harm their own interests. The only thing they learned is how to correctly phrase their words.

Question #6:

Hello, I am from Canada, where there are very many large and successful Ukrainian diaspora. With regard to the Arab Spring, what do you think the effect, if any, will be on the expectations of the average Ukrainian?



Mr. Alexander Paskhaver:

Many Ukrainians expected changes for the better from protest movements. However, I am certain that protest movements deteriorate the situation. Even the most effective protests lead to the leadership of cynicism. It doesn't get better. The main question always remains: why doesn't the population ever choose honest people? It is not a question of what type of protest movement occurs, whichever type it is, the result is that honest people never come to power. Therefore, the importance is in the people, not in the protest movement. The biggest disappointment in the 22-year history of Ukraine was the Orange Revolution because it did not change anything. This is a good lesson that you have to move changes through in another way – change the consciousness of the people, the electorate.



We also know very well from history the kind of people who came to power after the Great Revolution...anyone at all, except the honest people.

Mr. Yuriy Yekhanurov:



We are very lucky that we don't have oil. Therefore, we won't have a real revolution. 15 years ago, when I was serving in the Cabinet of Ministers, in some city in The Netherlands I was talking about the Muslim threat and people were skeptical, because they thought it was so far in the future and it didn't relate to the time's reality.

Ukraine is located in a triangle of civilization – West, Asian and Muslim. Unfortunately, we are not the ones doing the choosing, we are the chosen. Ukraine is being told which civilization it should adhere to in the future. Thankfully, our Crimean Tartars, so far, have been calm. But, hundreds and thousands of their children are being taught free of charge in Turkish madrasahs (schools). My Crimean Tartar friend gave an example of a 16 year old boy, who came home on holiday and told his mother he wouldn't eat until his mother dresses like a Muslim woman should. This may be a small matter, but we feel this in Ukraine. We feel foreign civilizations, we feel Asian rhythms, and we have always lived on the border with Muslims. Even Hetman Doroschenko tried to join Ukraine with Turkey.

Ukrainians are a tranquil people by nature, and I think that our experience, especially the experience in 2004, should be a topic of serious conversations in this society. Unfortunately, it has yet to rise to that point. It turns out that our society was capable of making one single push, which was the Orange Revolution, but it didn't have enough in it to finish the job. Therefore, if we sign an association agreement with the European Union in Vilnius, then we should expect extremely complicated daily tasks. If we do not sign the agreement, then we will go into a union with chronically ill countries, and we will become like they are. This is the choice that Ukraine itself doesn't choose, we are being chosen in this situation...and this is very sad.

Question #7:

I am Berenice Rendón Talavera, the Ambassador of Mexico and, of course, I see things from very far away. Just taking the last elements of the conversation, how do you explain the lack of social participation [in Ukraine]? We understand that there was disappointment with the Orange Revolution. People and organizations are always speaking about the



problems of the country, but why doesn't anything happen? The young people don't participate, but the older people try to make things happen. For example, the recent events in Nikolaev, where people really stood up and are voicing themselves. Or, 2 or 3 years ago, when the tax code was discussed, the small enterprises protested and achieved changes in the new tax code. I am not saying that there should be something like the Arab Spring, but why is there no participation? People are not happy, but they don't seem to do anything about it.

Mr. Alexander Paskhaver:

Madam Ambassador, at the time of the Arab Spring or the Orange Revolution, did you really feel that it would achieve something in favor of the people? Our history is such that the people do not trust the institution of the government. Therefore, the Ukrainian people's nature, educated by history, shows that it is much better to concentrate on your own survival than to participate in mass movements. The Orange Revolution was an exception to this rule, and an isolated one at that.

We should just analyze why the Orange Revolution occurred in the first place. However, the creation of permanent pressure on the authorities is beyond the reach of Ukrainian traditions. I always say that one should not criticize the authorities. The authorities are an adolescent, who always looks for the opportunity to increase its irresponsibility. The adult is the society which controls that adolescent. The authorities merely serve their own interests. The tradition of control is the uneducated history of Ukrainians.

There are two things you cannot do: first, you cannot change the traditions of the people with the help of education. The people must evolve themselves. Second, you cannot change politics with the help of educating the bureaucracy, because the bureaucrats only pursue their own interests. Educating the bureaucrats does not bring any results. The only alternative is to change ourselves as a society.

Mr. Yuriy Yekhanurov:

I carefully studied 19 of 21 reforms proposed by the President. I usually signed off on all of them. And that brings me to the question about civil society. Why does civil society permit that the President's reforms are never implemented? Who are the people that sit in Parliament? Why don't they implement what the President elected by the people asks them to do?!



I'm not calling for demagogy, but believe me the people who wrote these programs are very well educated. Everything was written and submitted in the correct manner. Of course, there are personal interests. I support my colleague, Mr. Paskhaver, in that afterwards it is our society's responsibility. Why do they tolerate that the President's programs are not enforced? Not everything is as simple as it is in school. Many students believe that when they will become teachers they will give high grades to everyone. However, the reality turns out otherwise. When you have a Ministry or a government, then you are limited from all sides. Only strong pressure will force them to move in one direction or another.

Under Ukrainian conditions, there is the topic of how many leaders Ukraine should have. Why are there so many political leaders, but so few managers? In 2006, I was number one in the electorate of my party, but no one saw my face anywhere in Ukraine and no one recognized me. A leader should be political, while all of the others in the team should be managers. In Ukraine, for any question that is voted on, for example what color is this folder, 48% will say that it is black, while the other 52% will see a shades (light or dark gray, etc.), and this will be a debate on the table.

Non-profit organizations, which receive grants, were all finished when the money ran out. As the President of the Union [of Non-profit Organizations], I can say that like most non-profit organizations, we exist on membership dues, but we still exist and we are fighting and our Union is a member in all non-profit councils, all regional administrations, all ministries and government agencies, all



parliamentary committees, etc. We are everywhere, and we are trying to make an impact. How did one proletarian poet say it? The voice of one is less than a squeal.

Mr. Alexander Paskhaver:

I'd like to add a suggestion for those who want to be entertained: keep a close watch on the desperate fight of the government against corruption.

Question #8:

My name is Zenon Zawada and I write for Ukrainian Weekly, the newspaper for Ukrainians in the US. As a journalist, Mr. Yekhanurov, I can't let you go without one hard-hitting question. When people think of the office of the Prime Minister of Yuriy Yekhanurov, they think of one word: "RosUkrEnergO". As someone who claims to support capitalism, free markets and Western values, how could you, Mr. Prime Minister, have allowed this opaque, non-transparent natural gas transits to emerge in the Ukrainian economy, drawing sharp criticism from Western governments?



Mr. Yuriy Yekhanurov:



I will always remember the 1st of January 2006. It was around 8:30 am, and I was in the dispatcher's office of our gas workers. It was reported that there was different gas pressure on the border of Russia, and that there was a real question of whether we would have to turn off certain branches. It seemed at that time that I was left alone by the entire world. An hour later, the

President arrived and we began to take certain measures, and the first "Gas War" began. Yes, we probably didn't solve the problem in the most efficient way, but we had a temporary resolution. I wrote down all of the events of that time and I think that in maybe ten years I will write about these events as they happened.

Why is "RosUkrEnergo" so interesting? I really didn't care at that time who would take that position. However, certain people really wanted it to be "Itera" because they had properly acting founders. If you look at the U.S. Senate from those times, you will find certain people there who were interested in "Itera". One of the newspapers at that time that organized an attack on me (I can say that a book has come out by Sergei Aveschenko about Pavel Lazarenko, which states that 40% of the newspaper was owned by Mr. Lazarenko) organized hunting season on me. Due to the influence of the founders, the society swallowed the bait. The question was about which intermediary company would be the correct company at the time, and which would be the wrong one.

I can say that there were always 5 gas players in Ukraine, maybe less, that knew all of the issues inside and out. Therefore, if you are interested in the history of this question, I can suggest some people and which documents you should dig through. Objectively, however, on July 1, 2005, there were no documents signed by the Russian Federation in accordance with the agreement Ukraine had with Russia. The Protocol was only signed in the following year. December 31, 2005, saw the end of the 15-year gas agreement with Turkmenistan, and from January 1, 2006, there was no agreement in place. I personally met with Turkmen Basha, and we did everything in our power to extend the

agreement with Turkmenistan. However, Gasprom already had bought out all of the gas for many years ahead of time. We only found out about this a week after my visit. The country was put into a very difficult situation by serious gas players. This is why “RosUkrEnergO” was a game played by these major players. I can’t say anything more about this. These games continue.

Question #9:

My name is Sergey Utipov. In your presentation, you stated that the main path for the development of Ukraine is to change the mentality of the people. How did you come to this conclusion?



Mr. Alexander Paskhaver:

There is a parallel process, as there usually is. One the one hand, we have the experience of reforms in Ukraine. I have vast experience in this area, and they were all distorted in the interests of the authorities. On the other hand, there was the Washington consensus, which recommended to developing countries how to best transition and behave in the development of the free market economy and free prices. It turned out that the results were completely different than what were expected. Then, the post-Washington consensus concept was created by the World Bank, which implied that it was better not to focus on the economy but on institutions. The idea was that well-built institutions would lead to a market economy.



This was surprising to me at the time, because I mentioned that anti-trust laws should have been created before trusts existed. In the end, these research projects also arrived at the conclusion that institutions cannot be simply adapted to a society that does not have corresponding values. In other words, you cannot borrow institutions if you also do not borrow

the values, the environment of the nation where these institutions were created. These two converging paths created a strong theoretical movement which is as follows: culture has a meaning and countries may change only in this way, by taking into considerations their cultural peculiarities. You cannot do it otherwise, by using artificial means of setting up institutions here and there.

Mr. Yuriy Yekhanurov:

Since today's discussion turned toward how to integrate modern, transparent capitalism with Ukraine's concept of capitalism, I'll touch upon core values of Ukrainians in relation to ownership, because the concept of ownership, and stability implied in it, is quickly eroding here. Unlike the Western entrepreneurs/capitalists, who always try to "make it big," Ukrainians need three basic things for private ownership: your own little garden, your own little orchard and your own little tool shed. We need to start from the bottom of here to get to a general consensus in society on what an owner is. It is done like this everywhere else in the world.



How little time has actually passed! I remember at an Adam Smith Conference, I asked one of the banks to photocopy an enormous book on wealth of the people and twenty two years have lapsed since I have kept this book at home. Time is condensed for us all in this development, the development of emerging markets. That is why the main

issue is the attitude of Ukrainians towards ownership. I repeat that Ukrainians understand private property, but they do not care about the ownership of serious corporations. If someone raided a factory, then Ukrainians are only interested in the suffering of the workers. They don't care about the factory as property, or about its owners. So, the politicians who complain about raids or mergers do not reach the average person who could not care less about the ownership issues.

You still need to educate the people, and explain to them what private ownership is. I, as a fairly successful person, who exactly 50 years ago came from a small Siberian village (because my

grandfather was sent by Stalin from Zhitomir to an exile in Siberia), live in Kyiv since I was 15 years old. I am grateful that I was given the opportunity to become successful. Now it is time to give back and, therefore, I continue to travel around and give lectures. I explain to people that it is bad to steal and I can still walk around in my country without any security. I am proud that the World Bank valued the first privatization wave in Ukraine as calm and without scandals. I didn't like voucher privatization, but those were the conditions of the time. It was a purely managerial issue to me at that time. You are successful people, gathered here tonight. I always say to the members of my Union to invest money into your own education and determine how much you can spend to educate yourself. Thereafter, teach your children, and even more frightening, give money to teach others' children.

We are going to be celebrating 1,025 years of the baptism of Kyiv Rus. Vladimir the Great said at that time that it was necessary for all to give 10% of our earnings for general society's needs. Let's go back to what he said and try to implement these values in the future.

Mr. Alexander Paskhaver:

Why does the word "teach" evoke such negative feelings in me? I have a large group of friends with many grown-up children, and no matter how many times you tell your children how to properly act, it doesn't influence them one way or the other. They will always do as you do not as you say. If your actions and your words conflict, your children will not respect you



at all. Therefore, I believe that simply teaching is not what's necessary for children (a.k.a. the government) but teaching by showing examples, leading by example.

Mr. Alex Frishberg:

Well, unfortunately we have run out of time, so I will do a quick wrap-up. Both of our respected speakers agreed that Ukraine finds itself in a very peculiar position in terms of politics and



economy, one that is very difficult to reverse. While everyone knows what must be done, nothing is being undertaken for several fundamental reasons, including historical tendencies and current administration's policies and aspirations. And with the upcoming Presidential elections in 2015, economic reforms (if any) will be postponed yet again, unless some intervening act occurs. For instance, Ukraine may take steps to join EU, which would trigger a number of welcome changes in Ukraine's economy, but unless something this drastic occurs, there are no major changes for the better in the near future.

In conclusion, I have moderated such round table discussions for nearly 20 years, and you can read all the transcripts on our website (see <http://frishberg.com/index.php/en/transcripts>), but I have not yet heard such pessimistic analysis of the current state of affairs from such highly-placed people as our speakers tonight. Still, I hope you found these presentations informative and useful. And now, it's time to enjoy the rest of the evening over a glass of wine and stimulating conversation. You may, of course, approach these two gentlemen anytime at your own leisure. Once again, thank you very much for coming, and we hope to see you soon!

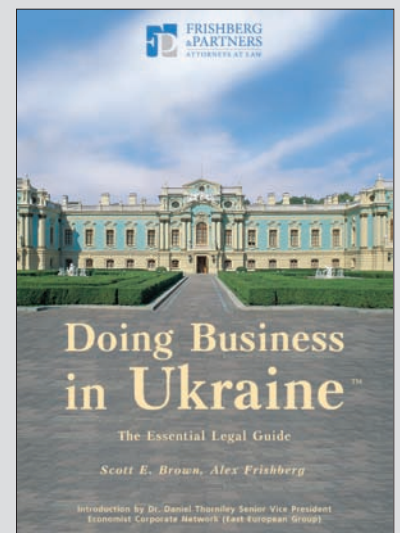
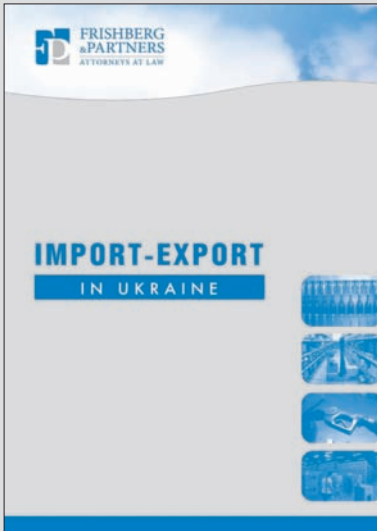
Mr. Anders Ostlund:

Fryday is extremely grateful to have such distinguished guests as Mr. Yekhanurov and Mr. Paskhaver, thank you! We also like to extend our gratitude to Mr. Alex Frishberg and Frishberg & Partners for partnering with us at this event. It would not have been possible without you. Also to the Opera Hotel we like to extend our gratitude, you have been most gracious in hosting us and, as always, Mr. Mohren and his team has delivered service at the highest level.



Also, a great thank you to the most distinguished guests. We are very happy to see so many of you here!

We are very much looking forward to seeing speakers, partners and guests at our coming events. Please follow us at www.fryday.net for more details.



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