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## *Analyst's Notebook*

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### *Parliament Goes Haywire*

It's never pleasant admitting to having called something wrong. That goes double when it's something as important as who will form the government. And in my first report as an analyst, no less.

Nevertheless, I stand by almost everything I wrote (see "Orange Reunion," June 27). And as each day passes I hope it's becoming increasingly clear to everyone that an Orange coalition with Yulia Tymoshenko at its head would have been far better than wherever we are heading now. When I started writing this report yesterday it looked like a compromise was in the works and Yuri Yekhanurov was going to stay on as prime minister with a Regions-dominated cabinet. By last night the situation had changed and all the parties were back at loggerheads. Maybe the situation will have changed again by the time you read this.

I still maintain that from the perspective of the vast majority of Our Ukraine MPs, a Tymoshenko government was the best outcome they could have realistically achieved given their party's weakened position. Where I clearly went wrong was to take the Socialists' commitment to the Orange coalition for granted.

It was well known that the Socialists' leader, Olexander Moroz, had coveted the position of speaker of parliament since he was squeezed out of the job by the former president, Leonid Kuchma, back in 1998. Moroz laid claim to the speaker job as soon as the Orange coalition negotiations started and he relented only last month after Our Ukraine threatened quit the Orange coalition and form a coalition with the Regions party. So the simple explanation of Moroz's recent switch is that he regretted giving up his claim on the speaker position. Through his new alliance with Regions, Moroz outfoxed Our Ukraine and got the job he wanted.

But nobody I've talked to believes the simple explanation. For what it's worth, the gossip going around says \$250m changed hands. There is no hard evidence to support that allegation. There is only the suspicious way that every Socialist, Communist and Regions MP who took part in last Thursday night's speaker election displayed their marked ballots to party leaders before placing them in the urn. Until that morning, Regions had been blockading parliament for a week demanding, among other things, that the speaker be elected by secret ballot.

There are also rumors going around within Our Ukraine that Yushchenko approved, or even took part in, the deal with Moroz to disband the Orange coalition. This theory doesn't make sense to me since Yushchenko could have struck a much better deal with Regions last month than he could ever get now. But people who have been with Yushchenko for many years are giving the theory credence, so I can't rule it out.

But enough about the past, let's look at what's coming ...

#### **The two most likely outcomes**

One is the compromise I mentioned: Yuri Yekhanurov would stay on as prime minister, or some Yushchenko-friendly non-party figure would take over as prime minister (perhaps Arseny Yatsenyuk, the economy minister), with a Regions-dominated cabinet. Yushchenko would also probably get the interior minister and Regions would agree to confirm pro-Nato defense and foreign ministers. Moroz would stay on as speaker and his party would keep the agriculture ministry and probably the state property fund. Everything else of real substance would go to Regions. The prime minister, foreign minister, defense minister and president would give the new administration a thin pro-western, pro-

reform veneer. The Communists would be dropped from the coalition, to be replaced by small numbers of Our Ukraine and Tymoshenko Bloc MPs (the Regions-Socialist alliance is only nine deputies short of a majority). Our Ukraine would split and most of its MPs would fall into Tymoshenko's orbit.

This option isn't bad for business, especially for the short term. It offers a government able to make important decisions, which we haven't had for more than three months (six if you count the pre-election campaign period). It is a weak option for the medium term, since Regions and Yushchenko would inevitably come to loggerheads again within a year, no substantial reforms or privatization would be carried out, fiscal discipline would likely weaken and World Trade Organization membership would be delayed.

The potential economic value of Russian goodwill to be gained from a pro-Russian party dominating the government shouldn't be estimated too highly. Russia's gas price pressure is driven mainly by its goal of gaining control of Ukraine's gas pipelines, which Yushchenko won't surrender, while Russia's trend towards restricting Ukrainian imports is driven mainly by worries about "Dutch Disease" hitting Russian producers' relative competitiveness. There is no hope that Russia would allow the gap between Ukraine's gas prices and world gas prices to increase, as Russia did during Yanukovich's 2002-2004 term as prime minister.

In the longer term this option looks better as it would unify the Orange camp and set it up for likely victories in the next presidential and parliamentary elections (2009 and 2011, respectively). The last presidential and parliamentary elections show Orange with a 4-6% lead over Blue, which is a very difficult hurdle to overcome in a presidential election. Moreover, Blue voters on average are older, die younger and have less children, so the hurdle is only going to get higher as time goes. However, Tymoshenko and other Orange leaders would be re-radicalized during their time in the opposition.

The compromise option also seemed to be the most likely as of yesterday afternoon. But today confrontation is escalating and it's unclear if either side can back down. A couple thousand Orange supporters – this time wearing blue and yellow – have gathered around the parliament, replacing the Regions supporters who were there in similar numbers in the morning. A few tents have gone up on the Maidan in central Kiev. Not even Yushchenko's closest allies are eager to come out publicly in support of a compromise right now. Tymoshenko could make things much more difficult for Yushchenko if she called on her supporters to protest. So far only some of the various descendents of the old Pora movement are making such calls.

The other likely outcome is new elections. Tymoshenko would head an Orange bloc with her old rival from Our Ukraine, Petro Poroshenko, and two top former Socialists, Yosyp Vinsky and Yuri Lutsenko, in prominent roles. Regions might form a joint bloc with the Socialists, who would otherwise struggle to win seats on their own.

The main advantage of new elections would be that it would bring immediate clarity to elections. The political scene would coalesce into something close to a two-party system around Tymoshenko and Yanukovich.

But a new election would be a crapshoot. The new parliament might be better or it might be worse. In the last election, Our Ukraine, Tymoshenko and the Socialists were lucky to win a narrow collective majority – they were aided by the very narrow failure of two small parties, the radical leftist People's Opposition and centrist Lytvyn Bloc. This time it would be essentially a race between Tymoshenko and Yanukovich, but again the outcome would hinge largely on the results of the inevitably numerous minor parties that would run, since the minimum vote needed to win seats is only 3%. The minor parties might well deny a majority to either side, making coalition negotiations tricky and the coalition unstable. In any case new elections would mean another six months of uncertainty and weak government until the new parliament was seated and the new government formed.

So which do we like better, the big gamble or the mediocre compromise? Most of us here at Concorde Capital prefer the compromise. I'm up for the gamble, but then my only investment here is an apartment, which is as safe as it gets.

Anyway, the calculations of an investment analyst won't get anyone's ear in today's political climate. The decision will be made based on hopes for the future, convictions about history, and emotions about what has happened over the last week.

### Other possible outcomes

There is a small possibility that Yanukovich could end up as prime minister if Regions stays firmly behind him and Yushchenko adamantly rules out new elections. Tymoshenko would likely try to use protests to block Yanukovich's government from being appointed, but those might fizzle since many of their former supporters would feel that they already gave the Orange camp its chance and the chance was wasted. Tymoshenko might decide it's not in her interest to block Yanukovich from taking power, as he would only run up against Yushchenko's vetoes and wear out his support.

There is a debate over whether Yushchenko can legally block Yanukovich's nomination. The procedure for nominating the prime minister says that the majority coalition makes the nomination (which happened today), the speaker forwards the nomination to the president (which also happened today), and "the president forwards the nomination to parliament in not less than 15 days." Yushchenko's staff interpret that last line to mean that the president has 15 days to decide whether or not to approve the nomination. Yanukovich and Moroz interpret it to mean that the president is obliged to forward the nomination within 15 days, whether he approves or not. If Yushchenko doesn't forward it, the only thing Yanukovich and Moroz could do is appeal to the Constitutional Court, which usually takes several months to decide cases and currently lacks a quorum.

Meanwhile Yushchenko could skirt the issue by dissolving parliament. The constitution allows him to dissolve parliament if it hasn't formed a cabinet within 60 days of the resignation of the last cabinet. That date falls on July 24. Yanukovich was nominated today, July 11. So Yushchenko's right to dissolve parliament is secured – all he has to do is sit on the nomination until July 24.

There is a distant possibility of a renewed Orange-Blue coalition, with most of the Our Ukraine party including Poroshenko and his allies, and without Moroz, who would be removed as speaker. The Regions party is for now at least unwilling to consider this option.

Even less likely is a renewal of the Orange coalition in the current parliament. The Socialists' deal with Regions wasn't the kind they can simply walk away from. The only way I can imagine an opportunity arising would be if Regions offered to dump the Socialists and give the speaker position to Poroshenko, and then after that talks between Regions and Our Ukraine broke down.

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