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Foreword

Democratic elections represent a mechanism for manifesting the people's will. The newly elected President is called to translate this will into state policy and channel government activity to achieve society's goals. The success of the President's policy will depend on the people's trust and support.

During November 1999, the International Centre for Policy Studies, in cooperation with the Freedom of Choice Coalition of non-government organisations and the Coordination and Analysis Center for Ukrainian Business Associations, conducted a series of discussions on key issues of government policy in Ukraine. This joint work involved representatives of the government, non-government organizations, scientific and educational institutions, and the private sector from all regions of Ukraine. The project "Ukraine's Future: A Plan for the President" was supported by the Freedom House Partnership for Reform program, which is funded by the United States Agency for International Development (Cooperative Agreement # 121-A-00-98-00614-00).¹

The discussions led to an understanding of the necessity to elaborate the government's reform strategy as a consistent process aimed at achieving society's goals. Recommendations on such a strategy are represented in the document "Ukraine's Future: A Plan for the President", organised in the form of a report to Ukraine's newly elected President. The text of the document was developed at the International Centre for Policy Studies based on the results of the conducted seminars.

The report to the President was supported by the Association of Small, Medium, and Privatised Businesses, the Trade Union Federation for Employees of Cooperatives and Other Forms of Business, the New Generation Ukrainian NGO, and the Freedom of Choice Coalition.

Besides the text of the report, we present the summarised results of the seminars conducted in the framework of the project "Ukraine's Future: A Plan for the President". We also add recommendations on policy analysis developed by the "Centres for Policy Excellence" project. In our opinion, in-

¹ The opinions expressed during the discussions and presented in this document do not necessarily reflect the views of Freedom House or USAID.

roducing a proper methodology for policy analysis in the government will ensure the transparency, efficiency, and consistency of governmental decisions.

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Ukraine's Future: A Plan for the President

Dear Mr. President

The will of the people has conferred on you a great burden of responsibility. As you take office, you will have the best interests of all Ukrainians at heart. Your challenge is to translate these good wishes into an economic strategy that brings sustainable gains in the living standards of the Ukrainian people. To implement this strategy effectively, you will need the support of broad sections of Ukrainian society.

This unprecedented document, A Plan for the President, reflects months of research, analysis, and wide-ranging discussions by Ukrainian specialists, both inside and outside government, in cooperation with international partners. It summarises evaluations and expectations regarding Ukraine's most promising path towards a stable, prosperous market economy, firmly anchored in Europe.

Executive summary

Mr. President, the discussions confirmed our common vision of Ukraine's future as a prosperous European country. Society is ready to accelerate the reforms declared in your program. The proposals expressed herein on economic policy correspond to recommendations based on the best international experience has to offer.

From the first days of its independence, the Ukrainian government has received recommendations on economic reforms, prepared by excellent foreign specialists. Textbook-perfect sets of measures have been repeatedly proposed, with the aim of addressing Ukraine's most acute problems. Nevertheless, the expectations of the international community for the implementation of these measures have not been realised. At the end of 1999, the disappointment has increased, since postponing reforms has put Ukraine in a position of possibly not fulfilling its foreign debt liabilities.

Why were the proposed reform measures not implemented, or why could they not be?

Under the Soviet regime, the government performed exclusively administrative functions, which did not envisage matching its actions with overall society's objectives. The Ukrainian government has therefore lacked the capacity to develop a strategy for state policy as a consistent action plan aimed at achieving society's goals. Consequently, the recommendations of the international community were not ac-

cepted, since they were not planned as an integrated governmental strategy.

In a democratic society, government should undertake new functions—developing and implementing policy decisions—taking into consideration the existence of democratic societal institutions such as freedom of speech, an independent parliament, political parties, and opposition. Every decision needs to be justified, showing its advantages over other options and analysing its consequences. In other words, analytical underpinnings must be created and social support must be won.

A series of seminars conducted within the framework of the project “Ukraine’s Future: A Plan for the President” served as an excellent demonstration of creating a democratic mechanism for achieving consensus on a societal development strategy. Working groups included experts from non-governmental organisations together with government representatives and international advisors. Participants set themselves the objective of determining relationships among problems, measures to overcome them, and society’s goals, as well as elaborating a consistent plan of reforms and assessing resources and constraints in their implementation.

Mr. President, the discussions testified to our common vision of Ukraine’s future as a prosperous European country, and society’s readiness to accelerate reforms, which are declared in your program. The proposals expressed herein on economic policy correspond to recommendations based on the best in international experience.

In order to implement reforms, day-to-day activity of the government should be in line with reconciled priorities that will ensure achieving society’s goals in the most effective way. The joint work during discussions resulted in recognition of the following priorities for transforming Ukrainian society:

- **REFORMING THE GOVERNMENT.** Government should become an effective tool for developing, adopting, and implementing policy decisions. Analytical justification of political decisions requires the development of new procedures, functions, and skills within the government.
- **PROMOTING ENTREPRENEURIAL INITIATIVE.** Freedom of economic activity under defined and competitive “rules of game” will channel people’s energy towards creating wealth to improve their own welfare.
- **ENSURING EFFICIENCY OF PUBLIC EXPENDITURES AND**

TARGETED SOCIAL SECURITY. The lack of mechanisms for controlling expenditures carries the risk of excessive resource withdrawal from the economy, and low efficiency of public expenditures threatens commitments to protect vulnerable strata of society.

- **INSTILLMENT OF RELEVANT SKILLS.** Development of a market economy and democracy requires new approaches in education, aiming at ensuring consistency between training programs and the knowledge required in a market environment.

Most of the problems faced by Ukraine have no simple solutions. In order to start addressing existing problems, an integrated reform strategy must be elaborated. We hope that this document will help you be successful during your presidential term.

Developing strategy

Identifying society's objectives

Discussion participants recommend that the overall strategic goals of Ukrainian society should be to strengthen democracy and increase welfare and societal equity by ensuring sustainable economic growth. In order to achieve these goals, you should announce the strategic priorities for the country, communicating them to the Parliament and the general public. You will establish the credibility of your policies by ensuring that all policy actions are consistent with the declared national strategic priorities.

Decisions on the objectives of government policy are ultimately political—decisions made by the President and Verkhovna Rada. However, participants of the seminars recommend that overall strategic goals of Ukrainian society should be to strengthen democracy and increase welfare and societal equity by ensuring sustainable economic growth. Economic growth will bring greater opportunities and will pave the way for Ukraine into Europe.

Mr. President, you have frequently and eloquently expressed Ukraine's desire to be a part of modern Europe, and have taken important steps on that path. Still, there is much work to be done. First and foremost, Ukraine's economy has not adjusted to European standards. Increasing prosperity and, as a result, strengthening our European integration will reinforce the democratic path of Ukraine's development.

This path is consistent with Ukraine's constitution. Article 1 of the Constitution of Ukraine declares that Ukraine is a democratic, social state abiding by the rule of law. This definition illustrates Ukraine's preference for the European model of economic development—a market-based economy matched with protection of the most vulnerable groups in society.

Setting priorities

During its transition to a market-oriented democracy, Ukraine has faced problems on many fronts, so it is important for you, Mr. President, to identify key priorities for your policy. No matter how pressing everything may seem, only some issues can be resolved first. If you do not prioritise, you will risk ending up in a purely reactive mode, lurching from one crisis to another.

In order to enlist the support of the people, you should publicly announce the strategic priorities for the country, communicating them to the Parliament and the general public. You will establish the credibility of your policies by ensuring that all policy actions are consistent with the declared overall strategic priorities. Your very first actions should become an indicator for the electorate, showing that you will faithfully follow your policy till the end of your term.

Over the past three years, a great deal has been done both by Ukrainian and foreign specialists to prepare the country for reform. Intensive work in government and non-government organisations, and with the international community, has produced a significant body of research and draft reform measures. However, even when clear advice is available on what to do, the government will be unable to implement such advice unless reforms are planned as part of an integrated governmental strategy.

During the discussions held as part of this project, participants identified problems that hamper the development of all sectors of the economy: the impossibility of making investments, the difficult situation in the social sphere, the inefficient using of public resources, corruption, and the lack of specialists to meet new objectives. In order to solve these problems, we determined four priority areas for urgent action:

1. Create an effective government machine and eliminate corruption.
2. Remove administrative barriers and foster private initiative.
3. Ensure the efficiency of public expenditures by strengthening the strategic function of the budget.
4. Instill relevant skills through reforming the system of education.

In our opinion, positive changes in these areas are the most important, considering the following arguments:

- they will enable the creation of a transparent and effective government machine which serves society (not the other way around);
- they will improve the business and investment climate in Ukraine;
- they will set in motion a mechanism for economical and responsible behaviour of society, reducing the risk of financial crisis;
- they will promote economic growth, allowing support of the most vulnerable societal groups;
- they will enhance Ukraine's international reputation, and ensure the support of the international financial community.

Using the honeymoon period to implement the strategy

The first months of a new administration are an unrivalled opportunity to use the political goodwill earned from the elections to make the difficult changes needed to set Ukraine on the road to prosperity.

The renewed energy associated with an electoral win should be concentrated on translating political will into specific policy actions. Ukraine's experience since independence shows that political will alone is not enough to ensure effective implementation of declared policies. Indeed, leaders have to rely on government institutions to implement their decisions. One of the key questions facing you as you take the presidential office is how best to invest this ephemeral political capital in order to make the government work for you, and to maintain control over the course of events.

During the first days of your new presidential term, all your steps will be carefully observed by the electorate, international community, and political opposition. Despite the different interests of these groups, they are all counting on your firm position concerning the extirpation of corruption at all levels of power. This position will influence the effectiveness of your actions on transforming the government, the possibilities for reforming the budget process, and ensuring competitive rules of the game in the economy.

Priority 1: Transforming government

During the first months of your presidential term, the government machine should be fundamentally reformed. It must be translated from a tool of totalitarian administration into a mechanism for managing a market economy in a democratic society. Functions of the government as a participant of economic processes should be discontinued, to be replaced by new functions—developing strategy and imposing transparent and fair regulations.

New role of the government

Your success in managing economic reform will depend on the ability of Ukrainian government employees to take on a wholly new (for them) role of strategic planning. Strategic planning requires prioritising goals, sorting out the critical few from the many important issues. It implies justifying key areas for policy interventions, considering options, and assessing risks and opportunities. Developing the strategic role of the government requires strengthening its analytical functions and skills.

The Ukrainian government machine is currently unable to fulfill this strategic role. Since Soviet analytical departments were never assigned the task of assessing the implications of alternative policy options, and state leaders never worried about justifying their decisions to the public. After the collapse of the totalitarian regime, the Soviet-style government turned out to be unable to cope with the new challenges of transformation, either substantively (“what to do?”) or managerially (“how to make it happen?”).

The Ukrainian government has not worked effectively because:

- **THE POLITICAL LEVEL OF THE GOVERNMENT HAS NOT BEEN SEPARATED FROM THE EXECUTIVE LEVEL.** Decision-making functions have not been delineated from the analytical justification of policy options. Therefore, decisions do not represent a deliberate policy choice among alternatives, but result from successful promotion of prepared justifications of an option which is beneficial to someone. Consequently, there is a lack of responsibility for implementing declared policies, as well as a likelihood of inconsistencies occurring in their implementation.

Your success in managing economic reform will depend on the ability of Ukrainian government employees to take on a wholly new (for them) role of strategic planning—prioritising goals and sorting out the critical few important issues. Strategic planning implies justifying key areas for policy interventions, considering options, and assessing risks and opportunities.

- **THE FUNCTION OF POLICY ANALYSIS HAS NOT BEEN INTRODUCED.** New skills of the professional bureaucracy have not been developed, preventing them from being able to evaluate policy options, and procedures for ensuring that all decisions made by the government conform to its objectives have not been elaborated. Government officials have no experience in weighing the costs and benefits of various options, and foreign advisors have actually been reluctant to lay out and justify different options, for fear of “confusing” the authorities. Similarly, there has been a reluctance to address the risks and benefits of various policy proposals, in order not to undermine the “commitment” to reform.
- **TECHNICAL ASSISTANCE HAS TURNED OUT TO BE INEFFECTIVE** (except in the rare cases that it was specifically oriented at building a new concept for bureaucracy, developing skills, or establishing new procedures). International assistance was beneficial when it was aimed at institutional capacity building, for instance, to the National Bank and State Treasury of Ukraine. However, little or no attention has been paid to providing employees in the government with new practical tools of policy analysis that could allow them to effectively participate in the redesign of their own institutions.

Policy analysis function

The sudden development of democracy in Ukraine has prompted the necessity for the government to be able to defend its policy in front of the opposition and enlist widespread public support for implementing the policy. Lack of capacity on the part of government institutions for persuasive justification of policy decisions has been one of the main causes of the slow pace of reform in Ukraine. The government will be unable to develop and implement effective economic policy unless it has the skills for analysing the adequacy of each reform measure and effective procedures for wide-ranging public consultations.

In order to be effective politicians, ministers must receive analytical support which has not been available to them in the past. A bureaucratic environment for developing policy recommendations must be created, with the fundamental objective of enabling elected politicians to make choices among policy options. Public servants, then, have two tasks:

- to provide political decision makers with analysis of different policy options and their possible effects; and
- to faithfully implement whichever option the political decision makers finally decide to adopt.

Changing role and functions of the government

Summarised proposals on the reform of public administration:

- *Separate political and executive duties.*
- *Form the Cabinet of Ministers as a small collegial body that makes strategic decisions, via implementation of the Law "On the Cabinet of Ministers of Ukraine".*
- *Adopt a Government Action Program as a document which represents the priority goals and objectives of state policy. Elaborate procedures for developing the agenda of Cabinet of Ministers meetings, ensuring that all questions on the agenda are aimed at fulfilling priority objectives and do not contradict the declared policy.*
- *Develop requirements and recommendations concerning the preparation of explanatory notes to draft decisions of the Cabinet of Ministers, and carry out training programs on policy analysis within the government.*
- *Foster a highly professional public service through elaboration of training and advanced training programs, reforming the system of labour remuneration for public servants according to the principles of motivating qualified personnel.*
- *Introduce procedures for joint work and reconciliation of draft laws with the Verkhovna Rada.*
- *Ensure openness and transparency of the procedures for approving government decisions, and publicity of draft decisions for discussion by non-governmental organisations.*

While making decisions, ministers and politicians rely on analysts' recommendations concerning options, trade-offs, and consequences of alternative options. This advice should include analysis of available resources and potential difficulties in adopting and implementing alternative policies. In addition, well-prepared analysis makes it possible to evaluate the results of future decisions.

The only way to get good analysis is to require that policy papers properly consider various options, and to refuse to put on the Cabinet agenda any item that is not accompanied

by an analytical paper of sufficient quality. Typically, there is more risk from making a wrong, badly considered decision than from postponing a decision until the government feels able to weigh all the costs and benefits properly.

Control over the policy implementation process

Mr. President, in order to ensure control over policy implementation, we suggest the following measures:

- **FOCUS YOUR ATTENTION ON A SMALL NUMBER OF STRATEGIC ISSUES.** Only in this way will you be able to ensure that all actions in areas of primary concern are consistent with the main strategy.
- **THE GOVERNMENT SHOULD MAKE DECISIONS ONLY ON PRIORITY ISSUES.** Otherwise, the government risks being swamped in making short-term, unbalanced, and inconsistent decisions. Governments are able to make only a limited number of decisions. If the Ukrainian government does not prioritise issues, then the really vital problems will not be overcome.
- **YOU NEED TO ASSURE YOURSELF THAT ALL SPECIFIC GOVERNMENTAL MEASURES ARE IN LINE WITH YOUR STRATEGY.** This will require setting up an analytical group whose sole task is to alert the President to measures which are not in line with the overall direction that has been adopted. If this sounds a little like the ideology department of the old Communist Party Central Committee, it is precisely because that group's purpose was also to ensure consistency of particular decisions with a set of general principles.
- **CONTROL OVER THE AGENDA OF CABINET OF MINISTERS MEETINGS MUST BE ESTABLISHED.** Each meeting should serve a purpose as a step in the gradual approach to addressing problems.
- **THE TEAM YOU CHOOSE TO CONDUCT REFORMS SHOULD NOT ONLY SUPPORT YOU, BUT ALSO SHARE YOUR VIEWS OF PRIORITY OBJECTIVES.** In the past, the technical ability of ministers to execute decisions was highly appreciated. But now you need to have political ministers share your views on the future path of Ukraine, supported by highly qualified advisors, in order to transform your vision into specific actions.

- **COMMUNICATION OF YOUR POLICY TO THE ELECTORATE AND THE PUBLIC SHOULD BE SEEN AS A CRITICAL TASK.** Announcing many policies and intentions in order to be seen to be busy addressing problems is a tried and failed approach. It is much better to concentrate on a small number of key measures which are fully understood and accepted by the public.

Priority 2: Promoting entrepreneurial initiative

Every person who has made a decision to go into business needs to be provided the opportunity to work and prosper, for the sake of the nation's welfare. Active persons with initiative are the driving force of economic growth in any country. Rich people in Ukraine must be lauded and encouraged, instead of being persecuted and crowded out of legitimate society.

Promoting competition

Individuals' attempts to improve their own welfare in a competitive environment leads them to search for the most effective way of using available resources. It allows individuals to make the best use of their talents, skills and knowledge. Effective utilisation of human capital and private investment, resulting from the existence of freedom in making economic decisions, will ensure sustainable economic growth.

The lack of a regulatory system for protecting competition is impeding the efficient use of resources in Ukraine. Today's regulations act as barriers to starting up and running businesses, thus limiting private initiative. Various government bodies interfere in the day-to-day activities of businesses, imposing "death by a thousand cuts". Most regulations are not transparent and tend to treat different businesses unequally, which reduces competition among businesses.

Article 42 of the Constitution of Ukraine declares that the government's objective is to ensure competition in entrepreneurial activities. That is why there is an urgent need to finish developing an integrated market regulation system which ensures contract enforcement and property accountability for all (without exception) market participants, regardless of ownership form, and prosecutes willful interference of state bodies in business activity.

Individuals' attempts to improve their own welfare in a competitive environment leads them to search for the most effective way of using available resources. Effective utilisation of human capital and private investment will ensure sustainable economic growth. The greater the number of small and medium businesses, the more diversity, competition, and innovation.

• *Promoting competition in agriculture* •

Summarised proposals on promoting competition in the agricultural sector:

- *Adopt integrated legislation aimed at establishing market relations in the sector, in particular through the institution of private land ownership, and ensuring competitive rules of the game.*
- *Elaborate and implement competitive procedures for farmers' access to inputs providing equal conditions for state and private suppliers.*
- *Introduce transparent mechanisms for the state support of agricultural enterprises on a competitive basis, prohibiting state commodity loans.*
- *Decrease the dependence of farmers on the state concerning produce sales (storage and transport), in particular through privatising grain elevators and grain-receiving enterprises.*
- *Reform the Ministry of the Agroindustrial Complex, reinforcing its policy development functions and discontinuing its economic functions.*
- *Develop a program for promoting the agricultural cooperative movement, the organisation of integrated production and processing companies, and agricultural credit unions.*

• *Promoting competition in the power sector* •

Summarised proposals on promoting competition in the power sector:

- *Adopt integrated legislation, in particular including laws "On natural monopolies" and "On the major principles of wholesale energy market functioning".*
- *Create a single Ministry of Fuel and Energy, to fulfill political functions rather than economic ones.*
- *Privatise energy companies, legislatively ensuring market participant responsibility for contract fulfillment.*
- *Restrict administrative interference in the work of the sector, and develop a transparent system for economic regulation, through ensuring the independent status of the economic regulatory body in the power sector (National Electricity Regulatory Committee).*
- *Suspend Minenergo's administrative authority over the energy system operator and the Energorynok enterprise.*
- *Restrict government interference in the activity of enterprises of the fuel and energy complex at the legislative level.*
- *Abolish privileges to specific consumer categories and introduce targeted benefits to citizens.*
- *Unconditionally apply bankruptcy procedures to debtors.*

The so-called "big capital" should be rehabilitated and included in public policy. We have no doubt that the big capital is interested in recognition of its driving role in society's development and is willing to renounce tactical benefits that have no future; after all, with big money it is not possible to hide anywhere in the world anymore. The so-called "oligarchs" should publicly propose their vision of Ukraine's future and of their role in the transition process.

Unleashing small business potential

Development of small and medium enterprises is an important prerequisite for adjusting the Ukrainian economy to those of the EU countries. The greater the number of small and medium businesses, the more diversity, competition, and innovation are achieved. In the European Union, small and medium enterprises account for about 70% of employment, while in Ukraine in 1998 they contributed less than 6% to total employment.

Unleashing the potential of small and medium businesses

Summarised proposals on the policy for encouraging small and medium businesses:

- *Elaborate and approve in the government a strategy for the state policy on small business development.*
- *Elaborate a program for regulatory reform, aiming at creating a favourable environment for business development and forming competitive rules of the game.*
- *Develop a draft law of Ukraine which determines the procedures for registering, re-registering, and liquidating business entities.*
- *Adopt integrated legislation on enterprise activities.*
- *Reform the system for licensing activities, introducing non-government agencies for licensing.*
- *Improve the legal base for simplified systems of taxation, accounting, and reporting for small business entities, thus decreasing their operating expenditures.*
- *Create small business training programs at technical and vocational schools.*
- *Develop an action plan for establishing infrastructure and mechanisms for supporting loans to small business and for encouraging innovative activity in small business.*
- *Promote positive public opinion on the role of entrepreneurship through the mass media.*

Society benefits from the development of small- and medium-sized business, since it:

- channels peoples' energy towards creating income and wealth in order to improve their own economic welfare;
- generates employment opportunities, thus softening the shocks from restructuring large state enterprises; and
- enhances the efficiency of human resource allocation by letting people realise their entrepreneurial abilities.

Mr. President, a critical challenge for you will be to promote policies that create a favourable environment for the activities of small and medium enterprises (SMEs), and to relax external and internal constraints on SME development. Relaxing external constraints implies providing SMEs with access to loans, promoting competition, and canceling entry barriers to monopolized sectors of the economy. Internal constraints emerge from the lack of relevant skills and information to run a business. To eliminate these constraints, special training programs and information exchange programs for SMEs should be designed.

Priority 3: Ensuring efficiency of public expenditures

The lack of mechanisms for controlling expenditures carries the risk of excessive resource withdrawal from the economy, and low efficiency of public expenditures threatens commitments to protect the most vulnerable strata of society.

The existing system of public administration completely lacks a strategic function for the budget—using public resources for achieving society's goals. As with a poor master all Ukraine's budget money disappears for "contingency expenses", while not improving the societal situation.

Reforming the budget process

In Ukraine, inadequate processes of budget planning, formation, and implementation have consistently led to expenditures being set at too high a level relative to actual budget revenues. The consequence is a higher fiscal deficit, growth in budget arrears, and sequestration of government expenditures.

When expenditures are cut from year to year without changing economic policy, the government loses control over how those funding cuts feed through to the delivery of public services to the Ukrainian people. Under these circumstances, the government's policy becomes backward-looking, and the President loses the ability to initiate positive

changes. Public expenditures are channeled not to achieving future goals, but to solving existing problems. Moreover, if spending cuts are made via sequestration, there is no guarantee that these cuts will be made in low-priority areas.

Increasing the efficiency of public expenditures

Summarised proposals on improvement of the budget process:

- *Strengthen the analytical underpinnings for budget decisions: increase the quality of forecasts of the macroeconomic indicators and introduce analysis of public expenditure efficiency.*
- *Narrow the list of major spending agencies to ministries and central authorities.*
- *Determine spending agencies' functions and objectives, and set criteria to evaluate the efficiency of conducted expenditures.*
- *Ensure transparency of budget formation and fulfillment, expanding treasury execution of budgets, and eliminate mutual debt offsets and bill-of-exchange operations.*
- *In order to form an integrated taxation policy, introduce a Taxation Code which envisages establishing equality among taxpayers through cancellation of tax privileges, decreasing the number of taxes and deductions, and simplifying procedures for their charging and payment.*

Increasing the efficiency of social security

Summarised proposals on reforming the social security system:

- *Conduct reform in social security administration; create an integrated system of agencies providing social assistance; establish simple and transparent procedures for receiving and providing social assistance.*
- *Elaborate procedures to ensure targeted assistance.*
- *Revise criteria and terms for assignment of social benefits and assistance.*
- *Develop and approve poverty criteria, as well as a state program for overcoming poverty.*
- *Cancel socially unjustified and economically ungrounded privileges.*
- *Elaborate documents that determine the legal framework for development of a non-governmental social security system.*

Until expenditures are allocated according to defined governmental programs, and mechanisms for evaluating their efficiency are developed, even your best policy will be foiled by unreasoned decisions at lower levels of the government. Without expenditure control, Mr. President, you will not be able to achieve overall budget control.

Ways of improving the efficiency of public expenditures

While much effort in Ukraine has been made to establish control over the proper use of funds—for instance, the Auditing Chamber was established and the system of the State Treasury was developed—there has been insufficient attention to evaluating the effectiveness of public spending. In order to achieve the greatest benefits for society at the lowest cost, efficiency of public expenditures can be increased in the following ways:

- **SETTING PERFORMANCE CRITERIA TO EVALUATE THE ACCOMPLISHMENTS OF SPENDING AGENCIES IN THE CONTEXT OF GOVERNMENT OBJECTIVES.** According to Ukrainian legislation, spending agencies are required to provide justification for their expenditures at the beginning of the fiscal year. However, there has been no procedure to evaluate whether the spending agency actually met these objectives. Evaluation of the accomplishments of spending agencies will allow to ensure more careful planning for the following fiscal year. Imposing performance criteria for spending agencies promotes better management responsibility and accountability. In addition, elaboration of performance criteria requires a clear definition of spending agencies' functions, which will reinforce the process of matching the structure with government functions.
- **RAISING PRODUCTIVITY OF EXPENDITURES ON SOCIAL SECURITY** in order to reduce the impact of shrinking budgets on the most vulnerable groups in society. While the Ukrainian Constitution and legislation define broad state responsibilities to protect those who are at risk, the lack of efficiency in the social security system hinders the implementation of these requirements. Efficiency in providing social security envisages providing targeted benefits to those who really need them. To simplify mechanisms for providing social assistance, strengthen targeted assistance, and raise quality in the provision of social services, administrative infrastructure should be improved. The procedures for obtaining social assistance should become simple and transparent. Over the longer run, accumulation of wealth due to economic growth will allow the implementation of effective social insurance schemes that will increase the responsibility of peo-

ple for their own welfare, and reduce public expenditures on social security.

Priority 4: Reforming education – a prerequisite for economic reform

During the seminars all participants, regardless of the discussion topic, affirmed that the lack of new skills and knowledge and the acute deficit of specialists, both in the private sector and in government, are the main restraining factors of reforms today. Everybody agreed that unreformed Ukrainian education keeps producing the Soviet product.

The Soviet system of education established one of the best educational infrastructures in the world, and was widely acknowledged to be successful as regards quality of training. But educational institutions were putting out “widgets” for the totalitarian regime—poor people who have no opportunity to “make their fortune” or use their property rights to advantage.

The main factors restraining reforms are the lack of new skills and knowledge, and the acute deficit of specialists. Reforming education is a prerequisite for economic reforms, a mechanism to ensure Ukraine's competitiveness in the 21st century.

Increasing the quality of human capital

Summarised proposals on educational reform:

- *Promote the internationalisation of the educational system, including it into the system of international standards.*
- *Develop principles and structure for a governmental-public management system in the sphere of education.*
- *Decentralise the management system in the sphere of education; strengthen the role of regional communities in educational policy development.*
- *Revise the structure and functions of the Ministry of Education, strengthening its role as an educational policy developer.*
- *Formulate a new content for education, according to the requirements of a market economy and a democratic society.*
- *Reform and strengthen the system of lifelong learning.*
- *Implement a program approach to educational institutional financing which would enable combining state and private funds.*
- *Establish a system of government loans and grants in the sphere of education.*
- *Conduct public discussions of education budgets.*
- *Introduce new criteria for assessing teachers' work.*
- *Promote the development of private forms of education.*

Today, the old methods of education and state standards are inconsistent with international requirements. Instead of talking about an anti-democratic and anti-market Ukrainian mentality, the system of education should be promptly reformed based on its positive historical achievements—a developed infrastructure and an overall favourable, even respectful, attitude towards education.

The lack of a strategic approach to developing human capital is a threat for Ukraine's future. Reforming education is a prerequisite for economic reforms, a mechanism to ensure competitiveness of Ukraine in the 21st century. Development of democracy and a market economy requires achieving consistency between the content of education and the skills and knowledge demanded in a market economy.

Conclusion

Public opinion has already crystallised in Ukraine concerning existing problems in economic policy and urgent decisions which need to be made. Regardless of political preferences, people are unanimous on the most destructive aspects of our society today—corruption of state officials, wastage in the use of public resources, and lack of strategic thinking about the future. These problems generate distrust in the authorities and discourage social initiatives.

Mr. President, any generally acknowledged success of your foreign policy will be worth little without visible changes on the domestic front. You know that the strength of a chain equals that of its weakest link. Today, the unreformed Soviet-style government machine is preventing people from creating wealth and is wasting what has been earned. Transforming the government is the key to improving the quality of state policy.

We wish you luck. Everyone in Ukraine needs you to succeed.

Reports on the results of discussions conducted within the framework of the project “Ukraine’s Future: A Plan for the President”

During November 1999, the International Centre for Policy Studies, in cooperation with the Freedom of Choice Coalition and the Coordination and Analysis Centre for Ukrainian Business Associations, conducted a series of seminars on the following key issues of state policy in Ukraine:

- public administration and budget reform;
- development of small and medium business;
- promoting competition in agriculture;
- promoting competition in the power sector;
- reforming the social security system;
- reforming education.

During the discussions of presentations and group work, seminar participants focused on the following objectives:

- define the strategic goals of Ukrainian society;
- develop objectives for reforming particular sectors of the economy (evaluate their role in the long run);
- analyse problems in the sectors and their causes;
- propose specific measures for overcoming the problems;
- forecast short- and long-term consequences of these measures;
- develop an agenda and assess resources and constraints in its implementation.

The discussions led to an understanding of the necessity to elaborate the state reform strategy as a gradual process, aimed at achieving society’s goals. Below we present the list of strategic goals of Ukrainian society determined by seminar participants, as well as summarised reports of group work on the indicated objectives.

Strategic goals of Ukrainian society

- Build a civil society.
- Increase the living standards of citizens.
- Provide sustainable economic growth.
- Develop an efficient market economy.
- Ensure social security for the most vulnerable social groups.
- Integrate into the European community.

1. Public administration and budget reform

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • secure economic growth; • efficiently distribute resources; • render state services to the citizens of Ukraine. 	<p><i>Public administration:</i></p> <ul style="list-style-type: none"> • Soviet government machine cannot provide politicians with proper analyses of implementing various political decisions; • absence of a political bloc interested in carrying out reforms; • insufficient qualification of public servants; lack of strategic vision and thinking; • absence of legitimate institutions capable of elaborating strategies, as well as absence of transparency and feedback; • vagueness of state priority goals; • vagueness of responsibility and evaluation criteria for decision implementation; • absence of constructive opposition; • insufficient public control over decision approval and implementation. <p><i>Budget:</i></p> <ul style="list-style-type: none"> • unrealistic state budget; • non-transparent itemisation of expenditures; • violation of the bottom-up principle of budget formation; • inconsistency between needs and possibilities; • absence of public control over budget spending.

Necessary measures	Resources (+) and Constraints (-)
<p><i>Public administration:</i></p> <ul style="list-style-type: none"> • create a qualitatively new state apparatus, capable of developing and justifying decisions, as well as evaluating their possible effects; • form a new type of political parliamentary bloc that will be responsible for administrative reform and reforms in general; • form government structures according to functional principles at all levels of the executive authority; • form the Cabinet of Ministers as a political body whose ministers clearly understand their strategic goals and are able to justify the expediency of such goals to others; • create institutional capacity to analyse decisions; • create a state apparatus which is sensitive to the goals of society; • promote citizen involvement in the decision-making process; • prioritise state goals, focusing the government on their achievement; • logically divide state and private services, with the state to render public services only; • introduce clear-cut responsibilities of officials for making decisions, as well as division of authority and responsibilities. 	<ul style="list-style-type: none"> + concern of people who are interested in creating a state machine which is sensitive to society's objectives; - resistance to change both on the part of civil service and society; - absence of experience and knowledge for effective management; - lack of consensus on reforms; - absence of responsibility for conducting reforms; - huge inefficient government machine.
<p><i>Budget</i></p> <ul style="list-style-type: none"> • provide justification of public expenditures, planning them on the basis of real revenues; • carry out taxation reform; • budget formation from bottom to top. 	

1. Developing small and medium business

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • improve the competitive environment; • channel people's talents to creating wealth to improve their own economic status; • decrease unemployment through providing job opportunities; • transfer resources from the shadow to the legal economy; • increase the efficiency of human resources utilisation. 	<ul style="list-style-type: none"> • misunderstanding of the role of small business as a driving force for achieving societal objectives; • inefficient and untransformed regulatory system; • unfavourable taxation system; • instability of legislation and the normative-legislative base that regulate entrepreneurship and investment; • lack of domestic and foreign investment; • inadequate lending system, lack of a program for micro-lending to small business; • limited access to information resources; • lack of an attitude towards entrepreneurs as active and useful members of society; • insufficient level of entrepreneurs' education; • restraints on innovative activity of small businesses.

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Necessary measures	Resources (+) and Constraints (-)
<ul style="list-style-type: none"> • government approval of a new concept and strategy for state policy on small business development; • establish a market regulatory system; • develop simplified taxation methods; • stimulate different forms of small business loans; • further cancellation of barriers for entering, conducting, and exiting business; • promote public awareness of the role of entrepreneurship through mass media; • provide information for small business entities; • develop an efficient market infrastructure; • encourage innovative activities of small and medium business. 	<ul style="list-style-type: none"> + labour force; + land; + large domestic market; + legalisation of the shadow economy; - lack of funds; - unfavourable business climate; - lack of specialists.

1. Agricultural sector

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • ensure food security for the country; • increase export potential; • develop the domestic market. 	<ul style="list-style-type: none"> • unclear role of the state in creating conditions for sector development; • undefined functions of government bodies regarding agriculture in the process of transforming from an administrative management system to a market-oriented one; • lack of “rules of the game” and mechanisms for ensuring reforms; • limited access to resources which should be allocated on a market basis, and monopolies on inputs supply and produce sales.

Necessary measures	Resources (+) and Constraints (-)
<ul style="list-style-type: none"> • develop legislative acts that correspond to the criteria of increasing agriculture's investment attractiveness; • establish a market environment in the rural sector by developing productive relations, in particular through private land ownership, and ensuring competitive rules; • reinforce policy development functions of the Ministry of the Agroindustrial Complex and discontinue its economic functions; • promote the agricultural cooperative movement, the organization of integrated production and processing companies, and agricultural credit unions; • promote business approaches in agricultural activity, business plans, marketing and management systems; • train market-oriented specialists, expand computerisation, provide access to information. 	<ul style="list-style-type: none"> + people's interests reinforced by the prospect of introducing private land ownership; + people's readiness to manage the land; - lack of information in rural areas; - absence of a legal framework; - lack of a mechanism for ensuring implementation of adopted strategy by the executive authorities; - interests of people who benefit from the lack of transparent reforms.

1. Power sector

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • ensure optimal satisfaction of consumer demand for electricity, taking into account consumers' ability to pay for electricity, and promote energy saving; • promote competition in the sector in order to set economically grounded electricity prices; • develop export potential. 	<ul style="list-style-type: none"> • lack of consumers' financial responsibility for electricity non-payments; • incomplete reform of ownership relations in the power sector; • absence of competition among generating companies, since their majority stocks belong to the Ministry of Energy; • cancellation of the independent status of the NERC; • excessive number of privileges (65 categories); • problems in tariff setting for different groups of generating companies; • incomplete legislation; • poor electricity metering system (losses cannot be determined or eliminated).

Necessary measures	Resources (+) and Constraints (-)
<ul style="list-style-type: none"> • create a single Ministry of Fuel and Energy, fulfilling political functions rather than economic ones (suspending Minenergo's administrative authority over the Energorynok enterprise); • ensure independent status of the regulatory body in the power sector; • create an independent operator of the electrical energy system; • pass comprehensive legislation (adopt the Law "On natural monopolies"); • restrict government interference in the activity of enterprises of the fuel and energy complex at the legislative level; • abolish privileges to enterprises of the fuel and energy complex and increase targeted benefits to citizens; • reinforce debtor responsibilities through bankruptcy procedures. 	<ul style="list-style-type: none"> + independent energy suppliers are interested in the existence of competitive market; - lack of a well-organised societal force interested in creating a competitive electricity market; - consumers do not realise their potential benefit from competition in the energy market.

1. Social security

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • increase people's welfare; • avoid and overcome the poverty phenomenon; • protect the most vulnerable societal groups and facilitate their social adaptation; • ensure targeted state assistance. 	<ul style="list-style-type: none"> • lack of an elaborated strategy for social security system development; • non-targeted and inefficient social assistance; • opacity of the present social security system; • lack of funds for social security, and the residual principle for social sphere financing; • inefficient spending of budget resources; • lack a definition of "poverty", and of impartial information on poverty and social processes; • difficult demographic and technogenous situations; • poor public participation in dealing with social security problems.

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Necessary measures	Resources (+) and Constraints (-)
<ul style="list-style-type: none"> • conduct prompt reforms in social security administration; • ensure targeted assistance; • revise criteria and terms for assignment of social benefits and assistance; • develop and approve poverty criteria and a state program for overcoming poverty; • cancel socially unjustified and economically ungrounded privileges; • develop non-governmental social security systems; • provide training programs for officials involved in reform of the social security system. 	<ul style="list-style-type: none"> + potential legalisation of the shadow economy; + potential attraction of private business; + potential development of non-governmental social security systems; - passivity of public thinking; - people's mistrust of the government and of changes; - unreformed management system.

1. Reforming education

Goals of government policy in this sector	Problems in this sector
<ul style="list-style-type: none"> • education must perform the function of expanding nation's intellectual resources and creating conditions for individual spiritual self-actualisation; • in modern society, education is big business where new humanitarian technologies are developed, and an instrument for acquiring skills and knowledge which are in demand in the world labour market; • education is a tool for developing a civil society. 	<ul style="list-style-type: none"> • absence of a strategic vision of the prospects for educational development under new conditions; • no education policy aimed at meeting world education market demands, and no strategies for integrating the education system into the world community, have yet been worked out in Ukraine; • changes in living conditions are not taken into account while drawing up strategic plans for education; • private sector is not accepted as a strategic resource; • existing system provides only the accumulation of knowledge but does not teach how to apply such knowledge in practice; • the system of educational management has not yet been transformed; • the final product does not correspond to the needs of society; • society does not understand the role of education; • existing system of education creates conditions for corruption; • absence of effective systems for assessing the quality of teacher and institutional work; • education sphere is insufficiently financed.

Necessary measures	Resources (+) and Constraints (-)
<ul style="list-style-type: none"> • establish educational policy-making institutions which could ensure sustainable development of the educational sector and implementation of economic reforms; • institute a system for retraining all managers in the sphere of education; • decentralise the education management system; • increase the role of parents' boards in defining school policies; • increase budget funds for education; • promote public discussion of education budgets; • reform the system for teacher training and retraining; • introduce new criteria for assessing teachers' work; • develop private forms of education; • establish a system of governmental loans and grants for education. 	<ul style="list-style-type: none"> + people's readiness to obtain knowledge and skills according to the requirements of a market economy; + potential of private educational institutions; - insufficient teacher qualification to work in accordance with new approaches.

Guide to Policy Analysis

This chapter is drawn from the course notes developed as part of the Centres of Policy Excellence (CoPE) program on budget policy. They represent extracts from "Policy Analysis: Concepts and Practices" by David L. Weimer and Aidan R. Vining.

1. Defining policy analysis

What is policy analysis?

- Client-oriented advice relevant to public decisions and informed by social values.

Looking at the components of that definition:

- The product of policy analysis is advice.

It may be simple advice. For example, passage of Bill A will result in X.

Or more complex advice. Passage of Bill A, which can be achieved with greatest certainty through legislative strategy S, will result in social costs of B and social benefits of C. But it will have disproportionate costs for group one and disproportionate benefits for group two.

- Policy analysis is intended to inform a decision.

Policy analysis helps decision makers by estimating the impact of alternative decisions. This allows decision makers to know the consequences of a particular course of action.

To compare alternative consequences we need a clear idea of what policy makers are trying to achieve.

- Policy advice relates to public decisions and is informed by social values.

Not all advice is policy advice.

The advice must relate to social problems. These problems will relate to how to improve the standard of living of Ukrainian people.

- Policy analysts have clients who participate in public decision making.

Sometimes policy analysts will work in private organisations. Businesses often want to know potential impacts of legislative changes on them.

But the majority of policy analysts are in government or non-profit organisations that seek to influence public decision making.

Policy advice should cover the full range of social consequences. As a result, policy analysts must implicitly place a value on the welfare of others.

Who undertakes policy analysis?

Policy analysis is undertaken in:

- federal, state, and local agencies and legislatures;
- consulting firms;
- research institutes;
- trade associations and other interest group organisations;
- business;
- non-profit corporations.

2. Policy analysis and other professions

We can gain an understanding of policy analysis by comparing it to other professions.

Differences between policy analysis and other professions are highlighted in Table 1.

Differences between policy analysis and other professions:

- *Academic research.* Progress in academic research does not necessarily reflect the demands or needs of society. Researchers develop theories that contribute to our understanding of society: the search for "truth". The new theory or empirical test may not directly relate to a policy problem and will not directly help a policy maker to reach a decision. However, academic research does provide a base for more narrowly specified research of greater relevance.
- *Policy research.* Policy research takes us a step closer to policy analysis. It focuses on social problems and variables that can be manipulated by public policy. The output of social research will be: if government does x, y is expected to result. The difference between policy analy-

sis and policy research is the strength of client orientation: policy researchers are less closely tied to public decision makers. This means they often do not translate their findings into policies that can be directly implemented—that requires practical considerations about how to implement policy.

Table 1 Policy analysis and related professions

Profession	Major objective	Client	Common style	Time constraints	General weaknesses
Academic social science research	Developing theories to understand society	“Truth” as defined by disciplines and scholars	Rigorous methodology to construct and test theories	Rarely external time constraints	Often irrelevant to information needs of policy makers
Policy research	Prediction of impacts of changes in variables that can be altered by government	Actors in the policy arena; related disciplines	Applications of formal methods to policy relevant questions	Sometimes deadline pressure	Difficulty in translating findings into government action
Classical planning	Defining and achieving desirable future state of society	“Public interest”	Established rules and professional norms; specification of goals and objectives	Little immediate time pressure because deals with long-term future	“Wishful thinking” in plans
The “old” public administration	Efficient execution of programs established by political processes	The mandated program	Managerial and legal	Routine decision making; budget cycles	Exclusion of alternatives external to program
Policy analysis	Analysing and presenting alternatives to political actors for solving social problems	Specific decision maker or collective decision maker	Synthesis of existing research and theory to estimate consequences of alternative decisions	Completion of analysis usually tied to specific decision point	Myopia caused by client orientation and time pressure.

Source: Weimer and Vining, “Policy analysis concepts and practice”, 2nd edition, 1997.

- *Classical planning.* The general approach to planning is to specify goals and objectives and then determine the most efficient way of achieving them.
- *Public administration.* Traditionally, public administration is simply the implementation and efficient administration of politically mandated programs. "Old" public administrators do not seek to influence the choice of programs but focus on doing well what has already been chosen. Policy analysts must also be concerned about organisational design and administrative feasibility, but they also help politicians make decisions about what programs will be undertaken.

3. The client orientation

It is the focus on the client that often distinguishes policy analysis from other related disciplines.

Policy analysis needs to be client-driven.

Answer the client's question

To be client-driven you must address the issue that the client poses. It is almost always better to answer with uncertainty the question that was asked than to answer with certainty a question that was not asked.

For example, your client needs to make a reduction in expenditure. Let's assume he/she faces a choice between cutting spending on program A or program B. The client needs you to tell him/her what the implications or consequences of cutting spending on each of the two different programs are.

Perhaps you know that cutting spending on program A or B will increase unemployment. But you cannot predict accurately which will have the biggest impact on unemployment. However, you know that cutting spending on program C, which is unable to be cut, will not increase unemployment.

What should you tell your client?

You can tell the client that cutting program C will have lower costs than cutting program A or B. But if your client cannot cut spending on program C, you are not helping him or her to make a decision.

You need to tell your client about the uncertainty and indicate the factors that will determine whether cutting program

A or B will have the biggest impact on unemployment. That way, they can assess the risk involved in choosing between the two options. You may be able to suggest an option that minimises the risk by combining cuts in both programs.

In policy analysis, it is better to highlight ambiguities than to suppress them. If your client does not hear about ambiguities from you, they will hear them from analytical or political opponents.

This is not an excuse for vague or unresearched analysis. In fact, it is often harder to organise competing theories and facts in a useful way. Highlighting uncertainty does not absolve you from drawing analytical conclusions. Instead, you need to tell your client the evidence on both sides and then draw your conclusion, highlighting the weaknesses of the data and the risks to the strategy you propose.

Policy analysts do not serve their client well when they hide uncertainty—clients need to know the risks when they make a decision.

Getting the question right

Sometimes your client may need help in identifying problems or formulating the question.

Clients will often ask questions that are not well-formulated. A client may present you with:

- symptoms rather than the underlying problem, for example, “The cost of paying unemployment benefits keeps increasing.”
- a policy solution rather than problem, for example, “Should the state reduce unemployment benefits?”

To help the client make a good decision, you need to help them redefine their question. For example, perhaps the cost of unemployment benefits is increasing because poor economic growth is reducing employment. The underlying problem is a weak economy. Instead of focusing on the cost of unemployment benefits, the policy analyst needs to give the politician ideas about how to improve economic activity and employment prospects.

A narrow focus on unemployment benefits could exacerbate the problem. For example, cutting benefits may lower consumer demand in the economy and reduce economic growth and employment further.

If you think your client has not put the question in the right way, you need to work with them to redefine the question. You need to do this at the early stages of your work, rather than waiting until you deliver what your client thinks is an answer to his or her original question.

Importance of effective and timely communication

Analysts must be able to explain their work in language that can be understood by their clients. Clients can have short attention spans and often have limited time, so writing must be concise and convincing to be effective. Timeliness is also crucial—advice is worthless after a decision is made.

4. Skills needed for policy analysis

The skills a policy analyst needs include:

- how to gather, organise, and communicate information in situations where deadlines are strict and access to relevant people is limited;
- perspective for putting perceived social problems in context;
- technical skills to enable you to predict and evaluate the consequences of alternative policies;
- understanding of political and organisational behaviour in order to predict, and perhaps influence, the feasibility of adoption and successful implementation of different policy options.

5. Steps in the policy analysis process

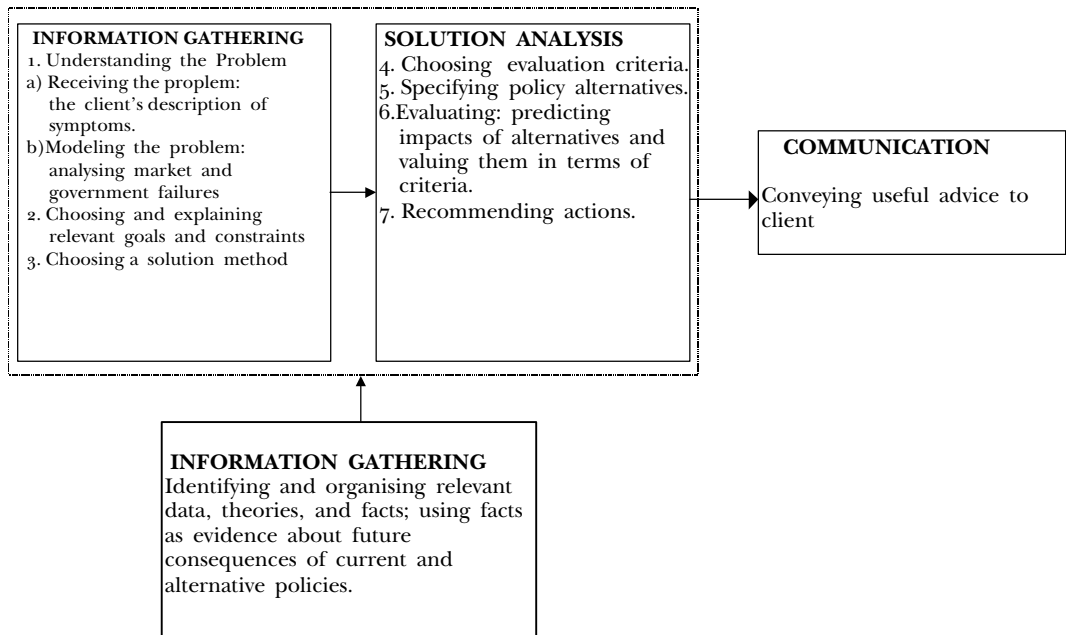
Policy analysis involves formulating and communicating useful advice. The main purpose is to help decision makers make better choices than they would otherwise have made.

The process can be broken down into a series of steps:

- *Problem analysis.* This includes understanding the problem, choosing objectives, identifying constraints, and selecting a solution method.
- *Solution analysis.* This involves choosing evaluation criteria, specifying policy alternatives, evaluating alternatives, and making recommendations.
- *Communication.* Conveying useful advice to clients.

Note that in reality these steps are inter-related. The real world is far more complicated and is not composed of tidy, neat steps. We are imposing steps on a reality that is more complex, fluid, and interactive. We divide policy making in this way to illustrate what must be done to develop useful advice. However, it is not a conveyor belt with agenda setting taking place at one end of the line and implementation and evaluation occurring at the other.

Steps in the policy analysis process



6. Problem analysis

Problem analysis consists of three main steps:

- understanding the problem;
- choosing and explaining policy goals and constraints;
- choosing a solution method.

7. Understanding the problem

Clients tend to specify problems in terms of undesirable conditions or symptoms rather than underlying causes. As a policy analyst your task is to assess the symptoms and provide an explanation of how they arise.

Assessing symptoms involves determining the underlying cause of the symptoms. The first step is to determine their empirical basis:

- Locate data that helps put the symptoms in quantitative perspective.
- Become familiar with current public discussion about the symptom (read the newspaper).
- Become familiar with the history of existing policies that are generally perceived as being relevant to it.

This assessment of symptoms will help you put the problem in context: it identifies the relative importance and urgency of the problem. It also begins to establish your credibility as someone who is knowledgeable about it.

The next step is to identify causal relationships that link the symptoms to factors which can be changed by public policy. In other words, you must model the problem.

A framework often used to think about problems is the concept of market and government failure. These concepts are based on the idea that in most cases individual self-interest will lead to the best outcome for society as a whole. However, in some situations, due to market or government failure, this will not be the case.

In this sense, the best outcome for society is the one that maximises economic welfare. This is, of course, not the only goal of public policy. You will need to incorporate other goals and constraints into your analysis. But it is useful to start by focusing your attention on efficiency.

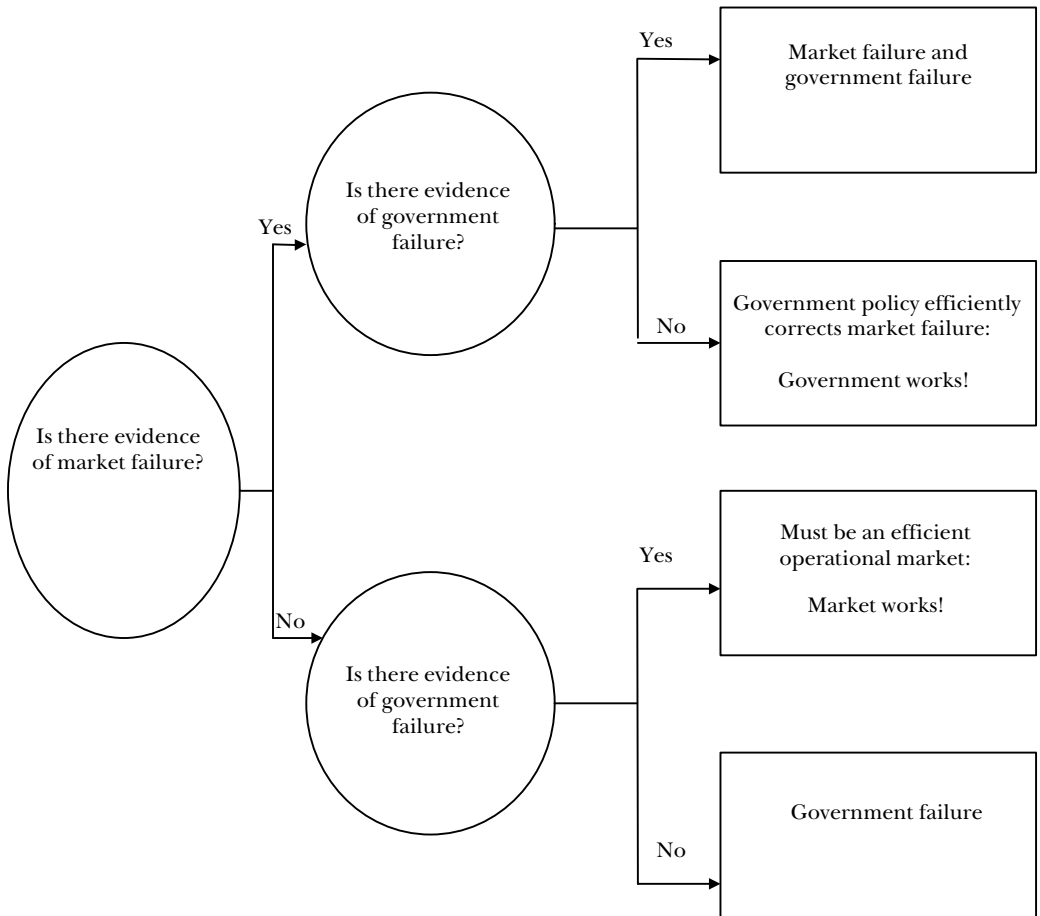
Under this framework you should follow these steps:

- Is there market failure? You need to decide whether a market exists to accommodate individual preferences. This can be a difficult decision—there is a complex continuum from free markets to the complete absence of markets. A useful working rule is: if prices legally exist as signalling mechanisms (no matter how extensively regulated), treat the situation as if it is a market.
- If a market exists, is there market failure? Is there reason to believe that the existing market is not allocating resources in the most efficient way?
- If there is no market failure, you must also consider the possibility of government failure. Is there any govern-

ment intervention that may be leading to less efficient outcomes?

- If there is market failure, there may also be government failure. The combination of market and government failure arises when government recognises a problem in the market but intervenes ineffectively. Or there may be foregone opportunities for effective interventions.

Problem analysis: market failure and government failure



- If a market is not operational, then you need to work through the steps above to determine if a market could be made operational and the extent to which it would likely fail. In this case, you are answering a “what if?” question, so direct evidence may not exist to inform your answer. Then, you must draw on theory, evidence from other countries, or similar problems.

The analysis is a lot simpler if we are only concerned about maximising total social welfare. But government often cares about other goals, such as distributional consequences. You need to decide whether distributional consequences are relevant to your policy problem.

Defining efficiency and equity

Efficiency means that society is getting the most it can from scarce resources. There are two types of efficiency:

Productive efficiency: *when goods and services are produced in the most effective way possible. In other words, we maximise the output we get for a given amount of inputs. In this case, efficiency can be improved by moving production from a high-cost to a low-cost producer.*

Allocative efficiency: *when goods and services are consumed by the buyers who value them the most. In this case, moving consumption of the good from a buyer with a low valuation to a buyer with a high valuation will raise efficiency or economic welfare.*

In most cases, the free market will produce the most efficient allocation of resources to achieve both productive and allocative efficiency. This occurs by allowing prices to reflect the true value of goods or services. That is:

- *Free markets allocate the demand for goods to the sellers who can produce them at the least cost.*
- *Free markets allocate the supply of goods to the buyers who value them the most highly, as measured by their willingness to pay.*

However, in addition to efficiency, governments also care about equity or the fairness of the distribution of well-being among the members of society. Equity involves normative or value judgements that go beyond economics.

8. Choosing and explaining goals and constraints

Setting goals or objectives is difficult. You may often face multiple, conflicting, and vague objectives.

Specifying goals requires you to decide what you want to achieve. This is difficult and inherently controversial. There are two main ways you can help your client establish appro-

appropriate goals that make trade-offs apparent and also realistically reflect available policy alternatives:

- Accept that goals are the outputs of analysis as well as the inputs.
- Clarify the distinction between goals and policies.

Goals as outputs

Decision makers often do not have clear goals. Even when they do, they have good reasons why a client will not reveal them. They are even less likely to have measures in mind that can readily identify achievement of their goals.

Resist the temptation to elicit goals from clients at the beginning of the policy process. It will be more valuable to work with your client to identify objectives after you have provided your own initial explanation of the problem. They need your analysis to help them identify what the goals should be—it does not make sense to want something until you know what is going on.

When deciding on goals, you should explicitly take into account efficiency and equity. You should also consider whether there are other goals that should be considered. If your analysis is not going to include goals that various stakeholders in the policy environment consider important, you should explain why.

Goals can be broken down into two broad categories:

- *Substantive goals* represent values, like equity and efficiency, that society wishes to secure for their own sake.
- *Instrumental goals* are conditions that make it easier to achieve substantive goals, for example, political feasibility and budget availability. Instrumental goals are often stated as constraints: constraints are simply a goal that must be satisfied.

Distinction between goals and policies

Goals: the values we seek to promote.

Policies: the alternatives and strategies for promoting them.

You need to be careful not to state policies as goals. Goals should be used to evaluate alternative policies. If a policy is stated as a goal, then you cannot evaluate it. Stated this way, any policy is self-justifying.

Therefore, you need to keep a separation between goals and policies. To do this, start by formulating goals as abstractly as possible and policy alternatives as concretely as possible.

At a high level, the distinction between goals and policies seems clear-cut. But as analysis proceeds, the distinction can become cloudy. This is because we define concrete proxies to measure achievement of our abstract goals. It is important that these criteria correspond well to ultimate objective.

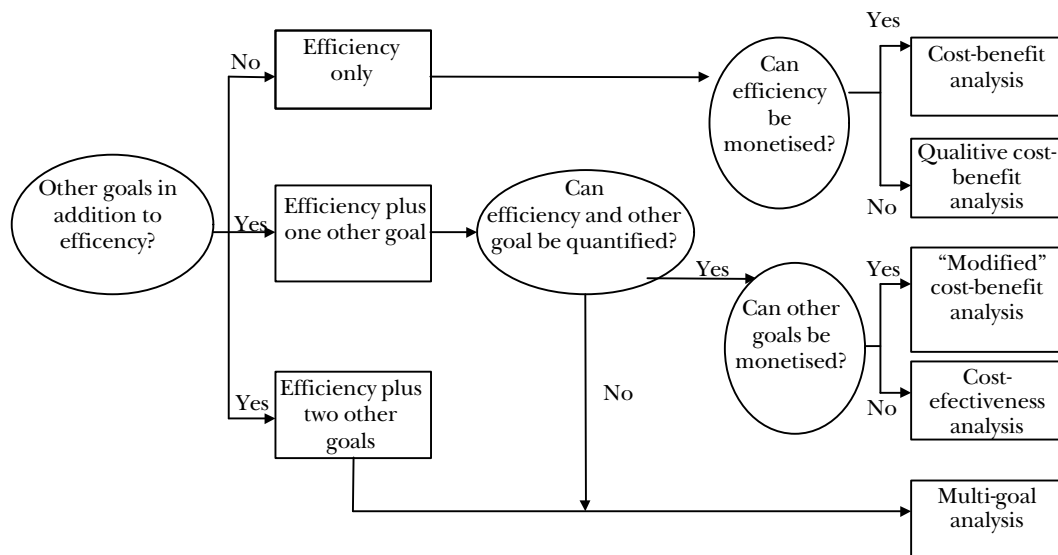
9. Choosing a solution method

You must decide which goals are relevant to your analysis before you can begin to consider solutions systematically. The number of goals will determine the solution method.

There are five basic approaches to policy analysis:

- standard cost-benefit analysis;
- qualitative cost-benefit analysis;
- modified cost-benefit analysis;
- cost-effectiveness analysis;
- multi-goal analysis.

Choosing a solution method



Cost-benefit analysis

You should use cost-benefit analysis when you think efficiency is the only relevant goal.

Cost-benefit analysis reduces all the impacts of a proposed alternative to a money value. This allows all the impacts to be aggregated: you can add up the money value of the costs and benefits and subtract the costs from the benefits to determine the net money return from an alternative. Therefore, you can recommend the alternative with the largest net benefits.

Putting a money value on costs and benefits can be difficult. Market prices often do not reflect true costs, due to distortions created by market failures and government interventions. There are many impacts that cannot be "monetarised" by estimates based on direct observation of markets. Considerable skill and judgement must be exercised to assess the costs and benefits of these impacts in a reasonable way.

Qualitative cost-benefit analysis

Even if efficiency is the only goal, sometimes you may not be able to monetarise all the efficiency impacts. Often a money value cannot be put on impacts because of technical difficulties in making valuations, such as limitations in time, data, or other resources.

In that situation, qualitative cost-benefit analysis is the appropriate solution. Like standard cost-benefit analysis you must still start by identifying or predicting the impacts of the alternatives. If you are unable to monetarise one or more of these impacts, then you cannot directly calculate the money value of net benefits. Instead you must make qualitative arguments about the magnitude of the various impacts.

If you are not able to even judge the order of magnitude of costs and benefits, you may have to work with the non-monetarised impacts as if they were separate goals. For example, you may have to decide how to compare certain program costs with highly uncertain benefits. In that case you must use multi-goal analysis.

Modified cost-benefit analysis

If you conclude that efficiency and one other goal are relevant, and you are able to monetarise both goals, you can employ modified cost-benefit analysis. In other words, you must be willing to assign money values to various levels of achievement of the other goal. For example, if the other goal is equity, you would have to weight the costs and benefits accruing to the different groups.

This approach allows you to come up with a single measure to rank alternatives. However, merging the distributional weights into the aggregate net benefit measure has its dangers. You must take special care to communicate to your client the significance of the particular weights used.

Cost-effectiveness analysis

Cost-effectiveness is appropriate where both efficiency and the other goal can be quantified, but where you cannot put a money value on the other goal, that is, the impacts of alternatives on the two goals cannot be aggregated.

We can approach cost-effectiveness analysis in two ways:

- Choose a given level of expenditure and find the policy alternative that will give the greatest gain.
- Specify a given level of benefit and then choose the policy alternative that achieves the benefit at lowest cost.

Note that cost-effectiveness cannot tell you whether a particular alternative is worth doing—that requires cost-benefit analysis. But if a decision has been made to redistribute or achieve some other goal, it can help in deciding which policy alternative will do so most effectively.

Multi-goal analysis

When three or more goals are relevant, multi-goal analysis is the appropriate solution. It is also the appropriate method when one of two goals cannot be quantified. All other solution methods are special cases of multi-goal analysis.

10. Choosing criteria

The first step in solution analysis involves moving from general goals to more specific criteria for evaluating the desirability of alternative policies.

Criteria can be stated as objectives or constraints. For example, the general goal of equity may be stated as:

- an objective, such as “minimise the variance in service consumption across income groups”;
- a constraint, such as “families with incomes below the poverty line should be given full access to the service”.

Good criteria provide a basis for measuring progress towards achieving a goal. Not every goal can be quantified by a single

objective or constraint. You need to specify criteria that cover all the important dimensions of a goal.

For example, the substantive goal of police investigation is to reduce crime. An instrumental goal may be to contribute to the arrest, conviction, and punishment of those who have committed crimes. Police departments will often put this into use by using the criterion "maximise the number of reported offenses for which a suspect has been identified".

However, this performance criterion could lead to a situation in which investigators may help suspects get a lenient sentence in return for confessions that solve reported offenses. We might get a situation where those who have committed more crimes get a less severe punishment. This suggests that the criterion does not pick up all the dimensions of the objective. Therefore, we should also use the criterion: "maximise both the number of convictions and the sum of sentences given to the convicted".

As you usually need more than one criterion to measure progress towards a goal, you also have to decide the appropriate weights for these criteria. That is, you have to decide how important each criterion is as a measure of the achievement of your objectives.

You need to exercise considerable care in selecting criteria to measure the achievement of goals. Ask yourself: how closely do high scores on the criteria correspond to progress towards goals? This is important because it is tempting to focus attention on those criteria that can be easily measured. This may lead us astray, when the easily measurable criteria fail to cover all the important dimensions of a goal.

The policy arena in which you operate may also put pressure on you to select a skewed set of criteria. The political process will often give more weight to impacts that are concentrated, tangible, certain, and immediate than to impacts that are diffuse, intangible, uncertain, and delayed. Trade policy represents a good example of this. Public discussions about reducing trade barriers tend to focus on employment effects in easily identifiable domestic industries directly competing with imports, rather than diffuse employment effects in the wider economy.

One of your responsibilities as an analyst is to propose criteria that provide a more comprehensive treatment of effects.

For some goals, it will not be possible to develop quantitative measures. Sometimes you will have to make a qualitative as-

assessment of progress towards your goals. Limited time, information or resources may also force you to use qualitative assessments. But you should at least spend some time thinking about quantitative measures, to make sure that you have not overlooked measures readily at hand.

The most important thing to remember is: *the set of criteria should capture all the important dimensions of the relevant goals.* Quantitative measures are highly desirable, but you should choose qualitative criteria that closely match goals over quantitative criteria that match goals poorly or incompletely.

1.1. Specifying policy alternatives

When developing policy alternatives, you should try to be creative. There are four main sources of ideas for developing policy alternatives:

- *Existing policy proposals.* These should be taken seriously, as some other analysts have found them to be plausible responses to policy problems. They may be the products of earlier analyses, or attempts by interest groups to draw attention to policy problems by forcing others to respond to concrete proposals.
- *Generic policy solutions.* There are a number of standard approaches to addressing market and government failures. You may be able to tailor one of these generic approaches to fit your policy problem. These generic policies can be grouped into five main categories: (1) freeing, facilitating, and simulating markets; (2) using taxes and subsidies to alter incentives; (3) establishing rules; (4) supplying goods through non-market mechanisms; and (5) providing insurance and cushions (economic protection). One example is the apparent overuse of a natural resource; it can be modeled as a common property problem. In this case, it is natural to look at generic policy solutions to this problem, such as private ownership, user fees, and restrictions on access.
- *“Modified” generic policy solutions.* Once you develop a portfolio of generic solutions, you can begin to modify them to fit the particular circumstances of your policy problem. Modified alternatives can be formed by combining elements of generic policy solutions or by introducing new features.
- *Custom-made solutions.* You may also be able to come up with a unique policy alternative. It may be based on eco-

conomic literature or come from your imagination. This is one area of policy analysis where you should stretch your imagination. Be creative—you can always weed out failures when you begin your comparative evaluation. However, be warned that creative alternatives are likely to be controversial.

Some things to keep in mind when crafting alternatives:

- *You should not expect to find a dominant or perfect policy alternative.* Policy analysis generally deals with complex problems and multiple goals. It is unlikely that any policy is going to be ideal in terms of all goals.
- *Do not contrast a preferred alternative with a set of “dummy” or “straw-man” alternatives.* It is often very tempting to make an alternative that for some reason you prefer look attractive by comparing it to unfavourable alternatives. This approach does not usually work and misses the point of policy analysis. It rarely works because even inexperienced clients will be aware of policy proposals advocated by interested parties. Your credibility can be seriously eroded if the client realises that alternatives have been faked. It misses the point of policy analysis, as such an approach assumes that the critical component of analysis is the recommended alternative. However, the process of policy analysis itself is equally as important.
- *Don't have a favourite alternative until you have evaluated all the alternatives in terms of all the goals.* This may seem obvious, but it is easy to approach the problem with preconceived ideas about the right solution. Try to stay open-minded when evaluating alternatives.
- *Ensure that your alternatives are mutually exclusive; that they are real alternatives.* Alternatives are not mutually exclusive if you can combine all the features of alternative A and alternative B and come up with alternative C. You almost always face an infinite number of potential policy alternatives. If one of your policy alternatives is to build 10,000 units of low-income housing, mutually exclusive alternatives include 9,999 units and 10,001 units. An infinite number of policy alternatives is a few too many. Given clients' limited attention spans, and your limited time, somewhere between three and seven policy alternatives is a reasonable number. Keep in mind that one of the alternatives should be the current policy—otherwise you introduce a bias for change.

- *Avoid “do everything” alternatives.* Such alternatives are usually incomprehensible and unfeasible. If you find yourself proposing a “do everything” alternative, take a close look at all the constraints your client faces. Does your client have the budgetary, administrative, and political resources to pay for it? If not, then it is probably not a valid alternative.
- *Alternatives should be consistent with available resources.* If you believe you need to formulate an alternative for which your client does not have the resources, it needs to be orientated around the set of steps your client needs to take to generate the additional resources.
- *Remember that policy alternatives are concrete sets of actions.* Alternatives should be well-specified sets of instructions, so the client knows exactly what he/she is choosing and how it will be executed. To prepare these instructions, you need to determine what resources will be needed during implementation and how these resources are to be secured from those who control them. In effect, you must be able to create a scenario that shows how policy can be moved from concept to reality.

12. Evaluating alternatives

Once you have specified your evaluation criteria and policy alternatives, you must bring them together in a way that helps you choose between them. You face three tasks:

- Predict or forecast the impact of alternatives.
- Value the impacts in terms of the criteria.
- Compare alternatives across disparate criteria.

Predicting impacts

Before you can evaluate alternatives, you must predict their impact. Here is where your model of the policy problem becomes especially important. Your model helped you to understand and explain current conditions. It should also help you to predict what would happen in the future under the current policy.

For example, assume that the policy problem is rush-hour traffic congestion in the central city, and that your model is that crowding results because people base their commuting decisions on the private costs and benefits of the various transport modes. Because drivers do not pay for the delay

costs that their presence inflicts on everybody else also driving in the central business district during rush hour, too many people commute by car from the perspective of social costs and benefits. Your model suggests that changing conditions, such as growing employment in the central business district, will affect future congestion. By projecting changes in conditions, you can predict future congestion levels under the current policy. You would make predictions about congestion under alternative policies by determining how they would alter the costs and benefits of different methods of transport. For example, higher parking fees would raise the cost of commuting by car.

Policies almost always have multiple impacts. Try a two-stage procedure for making predictions:

1. Use your model, your specification of the alternatives, and your common sense to list as many different impacts as you can. Each of the impacts you identify should be relevant to at least one of your evaluation criteria. If it is not, then your set of criteria is probably too narrow.
2. Go through your criteria to make sure you have a prediction for each one. If a policy does not seem to have an impact relevant to a particular criterion, then predict "no difference from current policy". Make sure you predict the effects of each alternative on every criterion.

You can force yourself to be comprehensive in your prediction of impacts by constructing a matrix that lists alternatives on one axis and impact criteria on the other.

Do not try to suppress uncertainty in your predictions. You do not need to fill in cells with single numbers where ranges may be more appropriate. The times when your uncertainty is so great is when a qualitative rather than quantitative entry would be appropriate.

Sometimes your predictions will depend crucially on certain assumptions. In this situation, you may want to construct scenarios. To test the sensitivity of their predictions to any particular assumption, keep unchanged all assumptions except one and construct a new prediction matrix. Each set of assumptions represents a different scenario.

Valuing impacts

A prediction matrix typically expresses impacts in units that are not directly comparable. Sometimes, some of the impacts can be expressed in the same units. You should try to make

the impact criteria as comparable as possible without distorting their relationships to the underlying goals. This makes it easier to compare alternatives.

Keep in mind the objectives you are trying to achieve. For instance, in our congestion example program revenues are transfers from parkers to the city. If you are interested in maximising social welfare, it may not be appropriate to offset it against program costs to get a net money measure of each alternative.

Comparing alternatives across incommensurable criteria

In most situations, different alternatives will do better on different criteria. Rarely will you find that a single alternative ranks highest on all criteria. Your task is to make explicit the trade-offs among criteria implied by the various choices, so that your client can easily decide whether she/he shares the values you brought to bear in choosing what you believe to be the best alternative. In other words, you should be overt about the values you used in evaluation.

You should also be explicit about uncertainty. If your predictions are based on statistical or mathematical models, then your best guess may correspond to sample means and you may be able to estimate variances as measures of your confidence in them. More often your best guesses and levels of confidence in them will be based on your subjective assessment of available evidence. If you feel generally confident about your best guesses for the major evaluation criteria, a brief discussion of the likely outcomes and risks may suffice.

Some ways of dealing with uncertainty are:

- If there is uncertainty about relevant conditions in the future, you can construct a number of scenarios that cover the probable range. You can then choose the best alternative under each scenario. If one appears to dominate under all scenarios, then you can choose it. If no alternative dominates, then you can make your choice either on the basis of the best outcomes under the most likely scenario or on the basis of avoiding the worst outcomes under any plausible scenario. In either case, you should discuss why you think your approach is the appropriate one.
- Sometimes your confidence in your predictions will vary across alternatives. One approach is to conduct a “best

case” and “worse case” evaluation for each of the alternatives with very uncertain outcomes. You must then decide which case is most relevant for comparisons with other alternatives. Another approach is to create a new evaluation criterion that gauges how probable it is that the actual outcome will be substantially less favourable than your best guess.

There is an abstract decision rule which can be useful for simplifying the choice between alternatives. This is the “go, no go” rule. To apply it, set a threshold level of acceptability for each criterion. You can then eliminate the alternatives that fail to pass any of the thresholds.

13. Presenting recommendations

The final step is to give advice. You should clearly and concisely answer 3 questions:

- What do you believe your client should do?
- Why should your client do it?
- How should your client do it?

Some guidelines to presenting your recommendations are:

- Your recommendation should follow from your evaluation of alternatives.
- You should briefly summarise the advantages and disadvantages of the policy that you recommend.
- Provide a clear set of instructions for action. You need a list of specific actions that your client should take to secure adoption and implementation of the policy.

14. Communicating the analysis

Clients will vary widely in their levels of technical and economic sophistication. You should take this into account when you write your analysis. However, clients generally share several characteristics:

- They usually want to play some role in shaping the analysis (but they do not want to do the analysis).
- They are busy and face externally driven timetables.
- They are nervous about using the work of untested analysts when they have to take responsibility for decisions.

Structuring interaction

Often you can involve your client in the analysis productively by sharing a preliminary draft. You should do so early enough so that you can make use of your client's comments, but not so early that you appear confused or uninformed. By trying to prepare full drafts of your analysis at regular intervals over the course of your project, you force yourself to identify major gaps that you still need to fill. Giving your client the opportunity to comment systematically on one of those immediate drafts will usually be more effective than ad hoc oral interactions. However, if your client is a better listener than reader, you may find oral progress reports, perhaps structured by a prepared agenda, to be more effective. Be flexible—use whatever type of communication seems to work best.

Written reports should be carefully structured to be effective. Follow two general guidelines:

- Decompose your analysis into component parts.
- Make the presentation within the components clear and unambiguous.

These guidelines also promote effective communication at intermediate stages by allowing your client to focus on those components which seem weak or unconvincing. Decomposition and clarity also tend to crystallise disagreement between you and your client. This may seem like a disadvantage but it is not. Crystallising disagreement at an early stage of the project helps you determine which of your client's beliefs can be changed with further evidence and which are rigid. This reduces the chances that your analysis will ultimately be rejected.

You should structure your report as if you began with problem definition and undertook all the steps in order. However, you should not necessarily try to write (as opposed to present) the components of your preliminary drafts in strict order. Very early in your analysis you should try to write a draft of each of the components as best you can. This approach helps you to anticipate the sort of information you will need to make the final draft effective.

You should arrange your material so that a client who reads sequentially through analysis encounters the most important material first. Usually, a ten-page analysis is not nearly as useful to a client as a five-page analysis with five pages of appen-

dices. By breaking the analysis into text and appendices, you take responsibility for prioritising the information.

Keeping your client's attention

Your written analysis needs to keep in mind your client's limited time and attention.

Timeliness is crucial. If you are trying to inform some decision, you need to communicate your advice before the decision must be made. While you should always strive for excellence, keep in mind that an imperfect analysis delivered an hour before your client must make a decision will almost always be more valuable to your client than a perfect analysis delivered an hour after the decision has been made.

You can make your communication more effective by following a few simple rules:

- *Provide an executive summary.* Rather than holding your client in suspense, tell him/her the recommendations at the very beginning in an executive summary. It should be a concise statement of the most important elements of your analysis including a clear statement of your major recommendations. In a short analysis of a few pages, your first paragraph can serve as an executive summary. An analysis of more than a few pages should have a separate executive summary that stands on its own. It should be a statement that conveys the essence of your advice.
- *Provide a table of contents.* This enables your client to see at a glance where your analysis is going. It presents the structure of your report so that the client can focus on aspects of particular interest.
- *Use headings and subheadings.* This allows your client to move through the analysis much more quickly. Headings should roughly correspond to the steps in the policy analysis process. They should, however, be concise and tell a story. Use subheadings freely—even a few pages of unbroken text can lose your client's attention.
- *Use other presentational devices to make your analysis readily useful to your client.* Indenting, numbering and careful use of italics can all be used to highlight and organise important points in your text. The key is to draw attention to the information that deserves it. Bullets can also be a useful approach. However, be wary of a long series of bullets or lists that deny the reader adequate explanation and fail to highlight the really important points.

- *Use diagrams graphs and tables for illustrating, summarising, and emphasising information.* However, only use them to draw attention to important information. Their titles should tell a story and all elements should be labelled so that they can be understood with little or no reference to the text.
- *Be succinct.* Keep the text focused on the logic of your analysis. Relegate tangential points or interesting asides to your files. If you think they might be useful to your analysis, put them in footnotes or appendices.
- *Do not use jargon.* Only use technical terms that your client will understand. If you need to include technical terms to prepare your client for debate with others, make sure you explain the terms in the clearest possible manner.
- *Try to write crisp text.* Start paragraphs with topic sentences. Favour simple over complex sentences. Use active rather than passive voice: "I estimate the cost to be..." rather than "The cost was estimated to be..." Allow yourself time to edit your own text, especially if you tend to be wordy.

Establishing credibility

Unless you have established a track record as a credible analyst, you should expect your clients to be nervous about relying on your analysis. Therefore, if you want your analysis to be influential, you must establish its credibility.

There are several ways to enhance your credibility:

- Cite your sources completely and accurately.
- Flag uncertainties and ambiguities in theories, data, facts, and predictions. Hiding uncertainty means your client will be unable to deal with others in the policy arena who have more sophisticated views. While you must highlight uncertainties, you must resolve them to the extent necessary to get on with your analysis. Sometimes a balance of the evidence will be the best you can do. Where your recommendations are very sensitive to the particular resolution, you should probably report on the implications of making a range of resolutions.
- You should be overt about the value judgements you have made in your analysis. Clearly set out the important goals and explain why you believe they are important.

15. Summary of steps in the policy analysis process

We have identified seven steps in the policy analysis process:

- understanding the problem;
- choosing and explaining goals and constraints;
- choosing a solution method;
- choosing evaluation criteria;
- specifying policy alternatives;
- evaluating alternatives;
- recommending actions.

These steps promote an analysis process which is logical and comprehensive. However, rather than viewing them as the sequence you should follow to produce analysis, you should think of them more as an outline for your final product. When undertaking policy analysis, it is actually normal to jump and iterate between these steps.

Why should you work like this? Rarely do you know what information is available before you start gathering it—one source leads to another. You may not be able to specify realistic goals until you have considered the range of feasible policy alternatives. Ideas for new alternatives may not emerge until you start to evaluate the ones you have initially designed. Evaluating alternatives may help you to understand the problem better.

A useful approach is to begin your analysis by starting a file for each of the seven steps in the policy analysis process. As you gather information, write insights down in the appropriate file. Even if they do not survive in the final analysis, they help you get started and provide a record of how your thinking has progressed.

This approach will also reduce the anxiety you face in writing to meet deadlines. If you have a start on each of the components, pulling together the final analysis will be easier. It is also a good idea to occasionally go through the files to convert your insights and information into paragraphs. This forces you to confront weak links in your arguments, thereby helping you focus your attention on critical questions and required information.

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