The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Yanukovych Vetoes Tax Code After Protests

November 30, 2010

Yanukovych speaking to reporters Tuesday at Kiev's Borispol Airport after backing down on unpopular tax reforms. **Andrei Mosienko**

KIEV — Ukrainian President Viktor Yanukovych scrapped a new tax code on Tuesday, caving in to the largest opposition protest since his election in February.

Thousands of entrepreneurs have been rallying across the country for weeks protesting a reform passed by the parliament that would have ended generous tax breaks.

"I vetoed [the tax code] today," Yanukovych told reporters after a government meeting.

The move shows his unwillingness to sacrifice popularity for the sake of reforms, analysts said. It could also mean that other painful measures, especially those required by an International Monetary Fund program, will be delayed or canceled.

He said his office, together with the government and representatives of small businesses, would draft a new version of the bill and submit it to the parliament by Thursday.

The rallies have coincided with the sixth anniversary of the Orange Revolution — a series of protests that led to the failure of Yanukovych's first bid for the presidency in 2004 — and were seen as his first major political challenge.

Ukraine needs to cut its budget deficit to 3.5 percent of gross domestic product in 2011 from the 5 percent to 5.5 percent expected this year under its $15 billion deal with the IMF.

While neither the government nor the IMF expected the tax code to immediately boost budget revenues, extending tax breaks for small businesses could make it harder for Ukraine to achieve the deficit target and sets a dangerous precedent.

"This is negative for Ukraine," said Citi analyst Luis Costa. "The market consensus was that Yanukovych was going to approve it despite popular resistance we have seen over the last couple of weeks."

"The fact that he's backtracking on the tax code shows that he may be scared of burning political capital in order to push through unpopular reforms," he said.

Next year, under the IMF deal, Ukraine needs to start gradually raising the retirement age for women to 60 from 55 and continue increasing the price of gas for households.

Ukraine's bond spreads rose 42 basis points Tuesday to 585 as measured by JPMorgan's EMBI Plus index, making it the worst emerging market performer. The overall index rose by just 11 basis points, or 0.11 percent.

Costa said the veto was also a blow to Prime Minister Mykola Azarov, Yanukovych's ally whose Cabinet drafted the tax code.

"This raises another red flag in terms of political instability on the Cabinet level," Costa said.

Shortly after Yanukovych's announcement, one of the groups behind street protests said "cosmetic" changes to the tax code would not be enough and demanded a thorough review of the bill — as well as Azarov's sacking.

"On Thursday, we will celebrate victory here and see what happens next to the tax code and to the people responsible for it," said activist Oksana Prodan on Kiev's main square.

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