

Between “Elite original sin” and External Conditions: Ukraine’s Foundational Bargain and the Rent Swamps of the Post-Soviet Transition

Margarita M. Balmaceda
(School of Diplomacy, Seton Hall University)

**Presented at the 2015 Annual Danyliw Research Seminar,
Chair of Ukrainian Studies, University of Ottawa, 22-24 October 2015**

Draft: Not to be Cited Without Permission

Ukraine’s dire situation in mid-2015 – with a growing portion of its territory under separatist control or outright annexed by Russia, its currency in free fall and a bleak economic prognosis – has highlighted the dire effects of Russian aggression: without Russian military help, leaders in the so-called “Donetsk People’s Republic” and “Luhansk People’s Republic” would not have been able to hold their ground for long. Russia’s resources, both military, economic, and covert ones, are incommensurably superior to those available to Ukraine.¹ At the same time, limitations in Ukraine’s ability to mount a matching response go beyond the issue of resources, and can also be traced back to longstanding weakness in the Ukrainian state.² How to make sense of this weakness? This article engages this question from the perspective of the relative role of structures and actors in Ukraine’s post-independence state building. Approaching the issue from the perspective of the Ukrainian experience can also contribute to a deeper understanding of similar processes affecting the Soviet successor states as a whole.

Ukraine’s ability to respond to the external aggression it faced in 2014-2015 was greatly compromised by the chronic underfunding, lack of effective state control, and contested legitimacy of the very institutions entrusted with safeguarding the survival of the state. First among these are the armed forces and the police, where these problems can often be traced back to widespread corruption (see D’Anieri et al 1999, 248-249),³ which also opened such institutions to infiltration by Russian intelligence.⁴ Corruption or the perception of it also

¹ An earlier version of this paper was presented at the Symposium on “Ukrainian Foreign Policy @ Twenty,” Harvard Ukrainian Research Institute, Harvard University, April 23, 2012.

² Authors such as D’Anieri (2012, 454), echoing a two-level games argument, have argued that Ukraine’s weak state may actually help in resisting external pressure, as “in order for Ukraine as a whole to be effectively coerced, the government needs to submit to external pressure, and then it needs to bring the country along with it” which in “Ukraine’s case (...) has rarely been possible.” While this argument may hold true for attempts to influence Ukrainian policy-making to adopt certain policies and not others, it does not hold true in situations (such as that in 2015) where the main aim of external influence is to weaken the state rather than to get it to adopt certain proactive policies.

³ Examples of such corruption abound. For instance, in March 2015, at the height of operations against Russian-backed separatist forces, several high government officials were arrested for the purchase of fuel for government-owned vehicles at inflated prices in exchange for bribes. See *The New York Times*, 26 March 2015.

⁴ The extent and high level of this infiltration was made clear by the arrest of over 300 “people working in the military sphere,” between the start of the conflict and early February 2015.

contributed to widespread lack of trust in the military, as reflected in tensions between volunteer battalions and the official army, and lack of popular trust in the latter.

Yet the military was far from the only institution facing a legitimacy problem. Widespread corruption in other institutions, such as the judiciary, could not but affect the level of loyalty the Ukrainian state – at least in the form it existed until 2014 – could command from its citizens. The issue of citizen's loyalty to a state is, indeed, a complex matter which should not be approached lightly. In the case of Ukraine, it also exhibits regional differences.⁵ Moreover, a distinction must be made between trust in specific institutions or leaders in power at particular times, and the legitimacy of the state as a whole.⁶

Yet it is impossible to deny that such problems — at play throughout Ukraine's entire post-independence period — also came to weaken trust in the state as a whole. Indeed, the blatant corruption and abuse of power evident under Viktor Yanukovich's presidency (2010-2014) and which served as a rallying call in the Euromaidan movement can be seen less as an anomaly than as a development exposing pre-existing weaknesses (Kudelia 2012, 426) also present – if in milder form – in all post-1991 regimes.⁷ (As will be discussed below, however, this does not imply a static picture of Ukraine's development.)

Ukraine's weakness: existing explanations

Ukraine's situation in 2015 forces us to rethink theories large and small about the sources of state strength and weakness and about state behavior under external pressure -- be it the pressure of economic dependency, or the more direct pressure of external aggression.⁸ How do we explain this weakness? Explanations of Ukrainian state weakness tend to focus on either external factors or domestic actors. A significant strand in the literature has emphasized the role of external factors, in particular, Russia's targeted policies specifically intended to do so, in undermining Ukraine's sovereignty. Such perspective emphasizes issues such as Russia's use of energy supplies, their pricing and periodical cut-off, as well as repeated bans on the importation of specific Ukrainian goods, as means to both exert influence on Ukraine and also weaken the country.

⁵ For representative polls trust in various institutions, see the European Social Survey data online (<http://www.europeansocialsurvey.org/>)

⁶ In other words, the fact that many Ukrainians saw the military, the judiciary and/or entire regimes as highly corrupt or even illegitimate does not mean that they would call into question the legitimacy of Ukrainian statehood; in the face of Russian aggression, most Ukrainian citizens have united to defend their country's independence.

⁷ On society's lack of trust in government, as a longstanding issue also related to Soviet legacies, see Taras Kuzio, "Twenty years as an independent state: Ukraine's ten logical inconsistencies." *Communist and Post-Communist Studies* 45.3 (2012): 429-438.

⁸ On state weakness and state strength more generally, see Joel S. Migdal, *Strong societies and weak states: state-society relations and state capabilities in the Third World*. Princeton University Press, 1988. This article will not use Migdal's criteria directly, but uses the concept of state weakness more broadly.

While Russia's role in undermining Ukraine's sovereignty has been repeatedly highlighted, other authors (Kuzio 2012 among others) have focused on domestic actors, noting the nefarious effects of elites that clearly prioritized their personal interests over Ukraine's national interests and institution-building. Evidence from the energy sector, for instance, tells us that the primacy of private interests, combined with faulty governance structures that more often facilitated rather than constrained rent-seeking, weakened the state and its ability to develop proactive responses to key policy challenges, including Russian pressure.⁹

Other authors have focused on structures and their role in enabling elite behavior privileging personal over national interests. Here the emphasis has been on issues such as representative institutions and the constitution. Ukraine's Soviet-era parliament (Verkhovna Rada) remained in office until 1994, and Ukraine's Soviet-era constitution -- albeit repeatedly amended-- remained in force until 1996 (D'Anieri 2007, 75). There are several pathways through which structural-institutional factors such as these can help determine later outcomes. In addition to the problems created by the incongruence between the new political reality of independence and the continuation of Soviet-era institutions, institutions can play a role by allowing old elites to remain in power despite broader political changes (as in the case of the Soviet-elected Verkhovna Rada), and by allowing old and new elites to use a first wave of reform to actually block further reforms (Hellman 1998). More generally, when formal institutions are not working properly, this facilitates reliance on informal institutions, which can in turn be manipulated by specific leaders for their own goals. As noted by Kudelia on the example of long-serving president Leonid Kuchma (1994-2005), this can turn into a vicious circle, as his "reliance on informal institutions" of rent-seeking, patronage and coercion (often referred to as "administrative resources") to maintain dominance "prevented the development of key institutions found in a modern state such as an autonomous bureaucracy, the rule of law and accountability mechanisms" (Kudelia 2012, 422).

A focus on elite behavior makes a number of positive contributions to our understanding of Ukraine's political development. In particular, it brings a refreshing breath to discussions which have been largely dominated by a view of Ukraine as victim of Russian aggression, with little agency of its own. But a focus on domestic actors and their behavior is only one part of the story. How can we explain this primacy itself of private interests in elite behavior? How do we explain the origins of such elite behavior? Needless to say, this question is far from unique to Ukraine, but key to state-building in all the post-Soviet states and beyond.

Is this particular role of Ukrainian elites chronic rather than opportunistic? Is it simply the result of elite greed and inability to think beyond their personal interests and in terms of national interest? While many would feel sympathy with such a statement, we still need to go beyond that. Some authors have hinted at the connection between identity issues and the existence (or lack of) of constraints on elite power. Following Way (2005), Riabchuk (2012) points to the impact of identity splits -- and related divisions on how to interpret a common past -- in hindering the consolidation of a strong political system able to constrain personal interests. Such identity

⁹ In particular, corruption and rent-seeking made it harder for Ukraine to manage its energy dependency on Russia, limiting the country's ability to use its elements of counter power vis-à-vis Russia (transit role, crucial infrastructure, importance as a market) in a proactive way (see Balmaceda 2008 and Balmaceda 2013).

divisions, argues Riabchuk, weakened the democratic camp by fostering internecine wars within it (Riabchuk 2012, 245), preventing the consolidation of a democratic camp and, and, ultimately, of a political regime. (See also Almond and Verba (1963) on how a congruent political culture is necessary for any regime to function.)

Other perspectives link the issue of elite responsibility, identity, and social mobilization. Gould and Hetman, for example, have argued that a major reason for different outcomes in Ukraine on the one hand and in the Baltic and Central European states, on the other, has to do with the level of societal mobilization –as opposed to elite bargaining– preceding the political transition and independence: in the Baltic and Central European states, it is argued, incumbent regimes were displaced by “highly mobilized societies” (Gould and Hetman 2008, 6) as opposed to elite coalitions. The implied argument here is that those highly mobilized societies could put more of a restraint on elite behavior than less mobilized ones which were also more passive recipients of elite decisions.

In this article, I propose enriching an actor-centered perspective in three ways: First, by offering a means of moving beyond the apparent disjunctive of actors vs. structures; second, by paying greater attention to the specificities of the concrete situation at the time of Ukraine’s independence and initial post-Soviet “foundational bargain”; third, by bringing into the picture the political economy side of the equation, hitherto largely unexamined. In order to do this, to understand the pressures faced by the Ukrainian state in 2015, we need to go back to 1991.

Structures and actors: their complex interactions in the initial post-independence period

Moving beyond actors vs. structures

To move beyond the apparent disjunctive of actors vs. structures, it is useful to reassess our understanding of “structure”: analyzing structures is not only about understanding their role in constraining the self-interested behavior of elites, but about explaining the development of these structures and why there were –or not– able to play such a role. In our case, this means taking a step back and looking at the specific circumstances at the time of the Soviet dissolution, a key foundational moment for the establishment of post-Soviet states, including Ukraine. The importance of such foundational moments in setting the tone for further developments has been discussed in literature on other political systems, but has eluded the attention of analysis of post-Soviet statehood.

Bringing in the concrete situation at the time of the “foundational bargain”

Actor-centered explanations of Ukraine’s weakness throughout the post-independence year have tended to relate this weakness to what some have seen as the “original sin” of Ukraine’s statehood, namely a foundational bargain between members of the Soviet establishment and emerging elites whereby --as argued by authors such as Kuzio and van Zon-- these established elites acquiesced to accepting Ukraine’s independence in 1991 without a mayor confrontation but in exchange for retaining the highest possible degree of influence (see Kuzio and Wilson 1994), meaning that, as stated by van Zon, “[W]hen Ukraine became independent, loyalty of the elite to the state was promoted by the fact that the state was the most lucrative

feeding ground and it gave elites the opportunity for career advancement and self-enrichment”¹⁰ In other words, this foundational bargain could also be seen as the “original sin” of Ukrainian statehood, making possible its legal establishment but also creating the basis for its hallowing out (see also Polokhalo, 1993, 18).¹¹

In order to understand such “foundational bargain,” we need to analyze how the specific structural conditions surrounding the Soviet dissolution affected the nature of actors’ expectations and interest-definition choices at the time and, through it, of the initial “bargain” between elites. It is on these *actors’ expectations and interest-definition choices after the dissolution of a common central state* that this article concentrates.

Bringing back the political economy side of the transition

Key among the framing factors at the time of the Soviet dissolution were those related to political economy structures and practices and how they were changing under the dual pressure of political and economic changes. Such structural elements have played an important role in allowing self-interested elites to play a key role in Ukraine’s development, but in a different manner than until now discussed in the literature. While some authors have made reference to “structural conditions” affecting the behavior of Ukrainian elites, the emphasis has been mainly on political issues; little attention has been paid to the political economy aspects of these. Yet the way new elites emerged, how old and new elites interacted, and the way both defined their choices, cannot be understood without taking into consideration broader political economy conditions during this period, including trade and economic growth patterns and status of property rights.¹² In the next section, we take a closer look at this early post-Soviet period as a means to understand the structure of choices open to these elite actors at the time. While Ukraine’s political development went through significant changes in 2004-2005, 2010, and 2014, these early choices would leave a significant imprint on the choices made by Ukrainian economic and political elites throughout the following period.

Structural Conditions: the “Rent swamps of the Post-Soviet Transition”

To reassess the foundational bargains of the post-Soviet successor states, it makes sense to focus on one particular and often neglected aspect of the political economy of the early post-Soviet period: how the particular conditions in place at that time affected both the *incentives*

¹⁰ Hans van Zon, *The Political Economy of Independent Ukraine*, New York: St. Martin’s Press, 1994, p. 44. Let us remember, however, that the electorate seemed to support at least some elements of this bargain with their votes: In 1991 only one third of voters voted for a non-nomenklatura (either former dissident Viacheslav Chornovil or minor anti-communist candidates) candidate.

¹¹ While in many ways this may remind us of an elite pact situation, the informal nature of Ukraine’s elite bargain in the early 1990s means it cannot be categorized as a pact, as it was mainly informal in nature. Pacting situations, in contrast, are characterized by formal agreements.

¹² Following Borzel and Frye, I use a broad definition of property rights as “the bundle of rights that include the power to use, transfer, and generate income from assets, including land, labor, and capital” (Barzel 1992, 2 cited in Frye 2006, 480).

available for rent-seeking (the booty), and the *ease* of engaging in such behavior without much constraints or being called to responsibility. The synergies between these conditions are best captured by the term “rent swamps of the post-Soviet transition.” The term “rent swamps” refers to areas of economic activity where, under particular circumstances, a significant amount of money is exchanged (relative to the country’s GDP, for example), *and* where opportunities for rent-seeking are easily available. These “rent-seeking swamps” not only allow rent-seeking to take place, but attract and foster it,¹³ distorting incentives, crowding out value-adding activity, leading to structural deterioration and, ultimately, spreading to other areas of the economy.¹⁴

All post-Soviet states where, in one way or another, affected by the “rent swamps” situation. Yet there were some differences depending on each specific area’s political economy and the way the various “multiple transitions” (statehood, political, economic) (see also Offe 1991¹⁵) coincided in each of them. On this basis, several main groups can be discerned: (1) energy-poor states such as Ukraine, discussed here; (2) energy-rich states such as Russia, and, (3) de facto state formations that emerged in the area around the time of the Soviet dissolution (Transnistria, Abkhazia, South Ossetia, and Nagorno-Karabakh).¹⁶ Although space constraints prevent a full discussion of each of these groups, it is important to note that such “rent swamps” played an important role within the former USSR as a whole. In each of these groups, the combination of factors discussed above took place in a slightly different manner. For example, despite rent-seeking also being strong in Russia, it did not lead to a similar weakening of the state as in Ukraine, in part because of the fact that Russia de facto inherited the central Soviet state structures, whereas Ukraine, in contrast, inherited weak formal institutions (see below). The discussion below focuses on the first group of states and especially Ukraine; I plan to compare the three groups of states in a separate publication.

The emergence of “rent swamps” of such magnitude during this specific period (the birth and first years of the new post-Soviet states, 1991-1995 and more specifically 1991-1992) hinged on a very specific confluence of factors coming together at the time of the Soviet dissolution. These factors fall into three main categories: Soviet legacies, the early post-independence policies of the new states, and the policies of the dominant regional power and heir of central Soviet economic structures, Russia.

¹³ “In addition to energy trade- related rents as an easy (in fact, “too easy”) source of external rents for the economy, other cases of “rent-seeking swamps” discussed in the literature include those related to gambling in Macao (where the overwhelming role of (legal) gambling in the economy created enormous rent-seeking opportunities which ended up creating a context that “offers too much to sectional interests to allow an independent anti-corruption agency to be fully independent or effective”), and possibly, the case of the Philippines (income from US military bases and from “preferential access for Philippine products in American markets”). The sudden influx of large and illegal drug-trade revenue to Bolivia in the early 1980s presents another possible example. See ,” Lo, “Bureaucratic Corruption”; Doig and McIvor, “Corruption and its control;” Hutchcroft, “Booty Capitalism;” and Johnston, “The Political Consequences”.

¹⁴ On a related issue, see Babanin et al, *Ukraine: The Lost Decade*, 29 (Footnote 10).

¹⁵ See Claus Offe (1991), “Capitalism by Democratic Design? Democratic Theory Facing the Triple Transition in East Central Europe, *Social Research*, 58 (4): 865-892.

¹⁶ Chechnia existed as a de-facto state between c. 1996 and 1999, but its emergence well after the Soviet dissolution produced a different set of political economy conditions as in the case of the other de-facto states.

Soviet legacies

The first set of factors has to do with Soviet legacies. Three important Soviet policy legacies crucial for the consolidation of post-1991 rent-seeking opportunities had to do with issues of *pricing*, the *limited policy role of republican-level policy-making institutions*, and *information asymmetries*.

Pricing

The first legacy, concerning pricing, has to do with an economic system where pricing had little to do with supply and demand, providing few reliable signals on relative scarcity, but was based on a system of multiple-price systems for different sets of buyers. Related to this was the longstanding policy of providing commodities (such as energy) at prices set below market levels for at least a portion of the market (i.e., a system of multiple-price systems for different sets of buyers). Leaving aside the obvious impact of below-market pricing on the development of a wasteful resource-use culture, the crucial element here is that as long as there is a system based on multiple prices for different buyers, this opens the possibility of rent-seeking through the arbitrage gains accessible by buying a good (energy, for example) at still-administratively-controlled low prices and reselling it at far higher prices to other markets or segments of the market.¹⁷ (For example, subsidized oil and gas could be sold at a much higher price to foreign markets.) Although arbitrage gains are not necessarily synonymous with corruption, in the post-Soviet context where access to these was made possible by access to administrative resources, this created strong incentives for corruption. In addition, other areas where administratively-set regulations can create incentives for rent-seeking and corruption¹⁸ include regulation via licenses and permits, exchange rate regulations, tax laws, privatization requirements, and the interest rates at which preferential, state-backed credits could be accessed, all of which helped amplify the arbitrage gain and rent-seeking potential of such price differentials.¹⁹ An additional factor had to do with the legacies of barter as a means of adapting to liquidity problems, which led to later difficulties in terms of accounting for energy trade volumes and in making sense of nominal prices. This also affected post-Soviet rent-seeking possibilities, as it fostered lack of transparency in the area.

Limited economic policy role of republican-level policy-making institutions

A second key Soviet legacy had to do with the limited policy-making power of republican-level institutions, i.e., institutions at the level of each Union Republic. Soviet practices helped strengthen both *Union-level* ministries with significant economic influence in

¹⁷ The term “arbitrage gains” refers to the possibility of making a profit out of manipulating price differentials for the same good between various markets of within sectors of the same market.

¹⁸ See Jonathan Hopkin, “States, markets and corruption: a review of some recent literature,” *Review of International Political Economy* 9 No. 3 (2002), pp. 574-590, here p. 582.

¹⁹ For an early discussion of the connection between governmental restrictions on the economy, rent-seeking, policy-making and institutional development, and of how “wedges” between the market value of a good and its controlled price allow for price manipulations and rent-seeking, with a welfare cost to society, see Anne Krueger, “The Political Economy of Rent-Seeking Society,” *The American Economic Review* 64, no. 3 (1974). On the general phenomena, see Oleh Havrylyshyn, *Divergent Paths in Post-Communist Transformation*. Basingstoke, Hampshire: Palgrave MacMillan, 2006. pp. 180 ff.

each Union Republic (as important industries were largely managed directly from Moscow by branch-specific Union ministries), as well as more informal regional groupings within individual republics (such as the Donetsk area in Ukraine, where a strong lobby existed already during the Soviet period). On the other hand, *republican-level* institutions remained weak and vulnerable (“little more than mailboxes for orders from Moscow”²⁰), with responsibilities often too large for them to handle in the immediate aftermath of independence. This affected the possibility of rent-seeking, as the new states (inheritors of these republican-level institutions) had little power to oppose the powerful (albeit seldom formally organized) interests of large company managers and other rent-seekers (on Ukraine see Kudelia 2012, 420).

The direct control of key industries by Moscow ministries and weakness (and in some areas, such as regulation, absence) of *republican-level* state institutions created serious organizational problems which also hindered the conceptualization and implementation of *national* foreign economic policy. Thus, for example, one organizational issue hindering the development of national policy on the crucial issue of energy transit was the fact that Ukraine’s two major gas transit pipeline systems (the Druzhba and Transnester systems) remained independent and administratively unrelated until 2001²¹ -- a direct legacy of the Soviet system that subordinated each pipeline system vertically to the state company exploiting their respective source fields.

While authors such as D’Anieri have argued that one key Soviet legacy affecting Ukraine was the concentration of power in the Communist Party, which in his view translated into an overconcentration of power in the executive, this does not undermine the argument, as an overconcentration of power in the executive (be it, de-facto, the CP or presidential administrative machines after independence) is not the same as empowering republican *institutions*. In fact, this overconcentration of power in the CPSU was indeed important, but perhaps in a different way: through the way in which it fostered key informational asymmetries.²²

Information asymmetries

A third Soviet legacy had to do with *information asymmetries* and the availability of insider (market) knowledge to well-connected members of the political elite, which could also be traced back to the power monopoly of the CPSU and its closed nature as an institution.²³ This affected post-Soviet rent-seeking possibilities, as it allowed well-connected actors (such as “red directors” and party functionaries-turned-entrepreneurs²⁴) to use their privileged access to

²⁰ Volodymir Pokokhalo, *The Political Analysis of Post-Communism*. Kyiv, 1995., p. 166.

²¹ On rent-seeking manipulations around each of them, and on the factors leading to their unification in Transnafta in 2001, see Margarita M. Balmaceda, *Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia’s Power, Oligarch’s Profits and Ukraine’s Missing Energy Policy, 1995-2006*. London and New York: Routledge, 2008, pp. 93-95 and Footnote 69 (p. 176).

²² (At the same time it could be said that the Soviet system (party, ministerial bureaucracies) imposed some constraints that, once lifted, opened new opportunities for a free for some rent-seeking.)

²³ On patrimonialism as a principal mode of elite relations inherited from the Soviet state see Gerald Easter, *Reconstructing the State: Personal Networks and Elite Identity in Soviet Russia*. (Cambridge University Press: Cambridge 2000).

²⁴ Key among these were, indeed Komsomol members and functionaries, like Donetsk Governor Volodymyr Shcherban (see Kuzio 2014, 198). On Komsomol members’ use of information asymmetries in central Soviet institutions, see Steven L. Solnick, *Stealing the State: Control and Collapse in Soviet Institutions*. Cambridge, Harvard U. Press, 1998.

information for personal gain and to transform political into economic power through privatization deals, arbitrage, and other rent-seeking opportunities not open to other groups.²⁵ The effects were not simply a transformation of political into economic power, but came full circle, as these actors were able to transform their political connections and insider knowledge to take control of new economic opportunities, then use these “to recapture political power” (Kupatadze 2012, 58, paraphrasing Los and A. Zybertowicz 2000). Soviet-period elites quickly came to understand that they could use these information asymmetries to transform political into economic power, and swiftly moved to grab this opportunity through taking control of those rent-rich areas of the economy where important rents could be accessed via insider-knowledge deals. This especially took place through the privatization process, through the use of so-called insider privatization and use of administrative resources to acquire and control assets. Thus, the effects of some Soviet legacies would only be “activated” by later events, such as the swift change in property relations at the time of the Soviet dissolution.

Sequencing and internal logic of economic policies in the first years of independence

A second set of factors concerns the economic policies of the newly-independent states in the first post-independence years, in particular the *speed and sequencing* of economic reforms. We know that the time lag between the legalization of private activity and the elimination of multiple-price systems for different sets of buyers regulated by the state allowed for price manipulations and often corrupt arbitrage gains (see Havrylyshyn 2006). The goods subjected to differential pricing (and thus the possibility of corrupt manipulation) included not only commodities such as oil and gas but even money itself, as preferential credits at interest rates much lower than the inflation rate made money exponentially cheaper –almost free– for well-connected actors.²⁶

Some of the literature on reform sequencing has pointed to the fact that it is often the “winners” of the first round of transition reforms that have a vested interest in freezing reforms at a point allowing them to maintain their gains and rent-access possibilities (Hellman 1998).²⁷ Moreover, we also know that, in this kind of situation, rent-seekers may want not only to

²⁵ On the larger process of transformation of political into economic power at the time of the Soviet dissolution, see Solnick, *Stealing the State*, R. J. Kelly, R. Schatzberg, and P. J. Ryan, “Primitive capitalist accumulation: Russia as a Racket,” *Journal of Contemporary Criminal Justice* 11, no. 4: 257-275., S. Handelman, *Comrade Criminal* (New Haven: Yale University Press, 1995) and L. I. Shelley, “Russia and Ukraine: Transition or Tragedy?,” in R. Goodson (ed.), *Menace to Society: Political-Criminal Collaboration Around the World* (Piscataway, NJ: Transaction Publishers, 2003). For related processes in the former Soviet-bloc countries, see among others M. Los and A. Zybertowicz, *Privatizing the Police State: The Case of Poland* (London: St. Martin’s Press, 2000). On “limited access orders” specifically intended to “create limits on access to valuable political and economic functions as a way to generate rents,” see D. North, J. Wallis, S. Webb, S. and B. Weingest, 2007. Limited access orders in the development world: A new approach to the problems of development. Policy Research Working Paper 4359. Washington, DC: World Bank, 2007, p. 3.

²⁶ For part of the early 1990s, credits to enterprises were provided at low interest rates (20%), while the overall inflation rate was running at over 10,000 per cent, amounting to de-facto free money. See Rosaria Puglisi, “The Rise of the Ukrainian Oligarchs,” *Democratization* 10 no. 3 (2003): 99-123, here p. 104. On credits see also Aslund 2009.

²⁷ For examples of such developments in 1991-1995 Ukraine, see Kudelia 2012, 419-421.

safeguard their continued access to rents, but to create mechanisms to “create” rents which otherwise would not have existed. In doing so, they may seek to create “bad institutions” (Sonin) which, in the medium term, could also have consequences in terms of the development of the political system. This helps explain developments such as the predominance of personalistic political parties, often built around the interests of a single actor and lacking both structure and a strong unifying agenda.

Russian policies towards the former Soviet republics in the first post-1991 years

The rent-seeking potential of Soviet legacies and early post-Soviet policies also synergized with Russia’s policies towards the former Soviet republics in the first post-Soviet years. Russia’s continued strategic, political, economic, and cultural interest in the other post-Soviet states, and the importance of infrastructure located within these states for the value-added chain of important Russian economic actors were important factors contributing to the continuation of rent-seeking opportunities. Most importantly, the continuation of differential, not market-based pricing for a variety of commodities for which former Soviet states remained dependent on Russia played a key role. In particular, the export of Russian oil and gas to the post-Soviet states at prices well-below those charged Western European states²⁸ for most of the early post-Soviet period, played an important role in maintaining multiple-price systems in the energy-dependent states, with a variety of short-, medium-, and long-term effects. Because of the close linkages with a variety of important value chains (such as with metallurgy, the chemical industry, and fertilizers, all key sectors of the Ukrainian economy), such pricing policies also affected much broader sectors of the economy.

Table 1 gives us a sense of these price differentials as they affected the overall import price for gas paid by Ukraine; Table 2 gives us a sense of the domestic price scissors associated with this situation by presenting the differences between prices charged industrial and household users.

Table 1: Pricing of Gazprom’s gas to Ukraine and selected FSU States, in \$/tcm (thousand cubic meters), and Germany, 1991- 1995

Year	Ukraine prices	Moldova Prices (for comparison)	Russian natural gas border price in Germany, \$/tcm
1991	\$0.25 (IEA)	0.25	112.32
1992	\$6.59	N/A	86.04
1993	\$23.53 (IEA)	N/A	91.80
1994	\$22.30 (IEA)	N/A	84.60
1995	\$56 (IEA)	58	99.70

²⁸ We refer to European prices (for which the price at the German border is often used as proxy) and not “market prices” for gas, as, in the absence of a worldwide unified market for natural gas, there is no single quotable price for gas.

Source: Table 4.3 in Balmaceda 2013, 124. For years where two separate sources give different prices for Ukraine, the prices reported by the IEA (International Energy Agency) are the ones reported (see Ibid.)

Table 2 Gas prices for Ukrainian residential and industrial users, per tcm, in US\$, 1991-1995

	Import price	Household price	Budget-financed public organizations price	Industry price
Year				
1991	0.25	0.45	N/A	0.98
1992	9.30	0.60	N/A	7.00
1993	49.80	3.05	N/A	10.98
1994	22.30	2.53	N/A	24.26
1995	56	41.53	N/A	80.00

Note: Residential prices are for households without meters. Budget-financed organizations received preferential pricing, but the exact data is not available for these years.

Source: Adapted from Table 4.1 in Balmaceda 2013,104.

A number of authors have asked: why did Russia continue to supply oil and (especially) gas to these states at well below European prices for most of the period until 2005? How best to answer this question is a matter of debate. One answer would focus on how continued low prices were used as a means of keeping states such as Ukraine and Belarus “hooked” on low-cost Russian energy, solidifying dependency on Russia, not only in a general sense, but also very concretely to keep the country from looking for alternative energy sources until Russia’s new oil and gas export pipeline projects (i.e. the NordStream gas pipeline and the Baltic Pipeline Systems 1 and 2 for oil) would be completed and these states’ counter-power as transit states would be greatly diminished. Others would emphasize how the corrupt practices made possible by these low prices benefited Russia by weakening these states’ political fabric.²⁹ Ultimately, the answer cannot be reduced to a single factor -- Russia’s pricing policies resulted from a combination of factors including the Russian political elites’ continued interest in the other post-Soviet states, as well as the importance of infrastructural facilities located within these states for the value-added chain of important Russian economic actors (for example in terms of transit and oil refining³⁰), and these state’s importance as sale markets.³¹ At the same time, strategic and

²⁹ See Margarita M. Balmaceda, “Energy Business and Foreign Policies in Belarus and Ukraine,” presentation at the conference on “Economic Interests and Foreign Policy Choices: the Case of Slavic Triangle,” University of Toronto, January 26-27, 2006, and Paul D’Anieri, “Ukrainian-Russian Relations: Beyond the Gas,” presentation at the conference on “The Ukrainian-Russian Gas Crisis and its Fallout: Domestic and International Implications,” Harvard University, February 5-6, 2006 (streaming video available at <http://www.huri.harvard.edu/na/na_gas_conf_2006.html> (accessed June 15, 2006).

³⁰ For example, although Ukraine moved relatively quickly (by late 1994) to largely market prices for oil and oil products, in practice most oil purchases between refineries located in Ukraine and their mother companies in Russia were made at intra-corporate prices, usually lower than market prices. (Mikhailo Honchar (ed.) *Naftogazoviy sektor Ukraini: prozorist’ funkcionuvannia ta dokhodiv*. Kyiv: Anna-T, 2008. P. 85-86.)

³¹ Until c. 2010, Ukraine remained among one of the world’s top six gas importers.

military interests prompted Russia to initiate agreements such as that leading to 1997's Black Sea Fleet agreement giving Russia control of most of the Fleet in exchange for forgiveness of gas-related debt.³² Fear that a collapsing economy – given that most post-Soviet states saw their GDP's decline by over 40% between 199q and 1995 – would send large numbers of economic refugees to the Russian Federation) can also help explain Russian elites lack of immediate interest in applying to post-Soviet states full-fledged European prices which would have serious consequences for economies already weakened by the post-dissolution recession. In addition, the motivation for maintaining these multiple-pricing schemes came not only from policies specifically targeted towards these new states, but also from the maintenance of below-market prices for gas (and oil) in Russia itself and how this related to the relationship between the state and Gazprom, Russia's largely state-owned gas monopolist.³³

Whatever their motivation – specifically intended to keep former Soviet states tied to Russia, or simply the chance end result of a combination of domestic Russian and external factors – these pricing practices and deep discounts for energy supplies (in particular natural gas) had long-term effects, as they allowed for a system of multiple pricing to remain in place for longer than could be expected under other circumstances, creating new arbitrage and rent-seeking opportunities.³⁴

Legacies, domestic policies, Russian policies: understanding their synergies

Thus, in energy imports-dependent post-Soviet states such as Ukraine an important combination of factors took place: Soviet legacies that weakened the meaning of important commodity prices, institutional factors promoting corruption and rent-seeking (such as the large role played by licensing and often artificially-created barriers as well as use of “administrative resources”) Russia's continued interest in the region, plus the existence of an economically very significant area where rents could be easily accessible – energy and especially gas trade and importation. The issue of barter provides a good example of how these three elements synergized to create new rent-seeking opportunities. The legacies of a whole economic system where pricing did little in terms of signaling the relationship between supply and demand meant that once a collapse in exports (as a result of the disintegration of centralized Union-level procurement and

³² As part of the 1997 Black Sea Fleet agreements on the division of the Fleet on a fifty percent-fifty percent basis, Ukraine received, in exchange for a 20-year contract leasing Black Sea Fleet bases in Crimea to Russia at a reduced rate, a \$526 million relief on its debt to Gazprom, plus a further \$200 million debt relief in connection with the 1992 transfer of nuclear weapons to Russia; a subsequent agreement gave Russia an additional share in the Fleet in exchange for additional energy debt relief, bringing the Russian total to 81.5% of the Black Sea Fleet. See Alyson J. K. Balies, Oleksyi Melnik, and Ian Anthony, “Relics of Cold War: Europe's Challenge, Ukraine's Experience,” *SIPRI Policy Paper*, no. 6 (Stockholm, November 2003), p. 39, available at http://editors.sipri.se/pubs/RAPPORT_RELICSOFCOLDWAR.pdf (accessed May 5, 2006) and Mikhail A. Molchanov, *Political Culture and National Identity in Russian-Ukrainian Relations*. College Station TX: Texas A&M University Press, 2002, p. 232-233.

³³ See chapter 3, “Domestic Contradictions, Foreign Energy Policy Levers, and Trans-border rent-seeking: the Domestic Russian Background to the Role of Energy in Relations with Ukraine, Belarus and Lithuania” in Balmaceda, *The Politics of Energy Dependency*.

³⁴ For example, by late 2005, the domestic price for Russian natural gas was c. \$37.00 per 1000 cubic meters, while it was being sold to Belarus for \$46.68, to Ukraine for c. \$50.00-80.00, and to Western European markets such as Germany for \$230.00. In assessing these numbers, however, we must keep in mind that raw prices are not the ultimate indicator, because –in situations where barter arrangements have been important—their real meaning will depend on the trade values involved in the specific barter relationships used.

markets) led to a crisis of liquidity, it was easy to fall back into barter as means of dealing with this situation. In turn, the market-distorting elements of barter as a system were potentiated by Russia's continued interest in maintaining political influence on the post-Soviet region, which led to its acquiescence with the maintenance and extension of such arrangements, which in turn created new opportunities for arbitrage gains and corruption. All of this led to the development of easily-accessible rent-seeking opportunities – the “rent-seeking swamps” of the post-Soviet transition. Regardless of whether this coincidence of factors was a matter of chance or not, once it happened, and exactly at the time of the establishment of post-Soviet states and other entities (see below), it would have a significant impact on their development.

What did these “rent swamps” mean in terms of the parameters they set for the choices post-Soviet elites found themselves confronted with at the time of independence? In the case of Ukraine, it not only increased the opportunities available for rent-seeking, but increased the influence of already well-positioned groups, such as directors of large state-owned companies (“red directors”) and communist-era politicians.

The Ukrainian experience in the context of multiple post-Soviet rent swamps

Within this post-Soviet context, how unique was Ukraine? Comparative work on energy politics, for example, has analyzed how different post-Soviet states, reacted differently to largely similar initial conditions.³⁵ What was special in structural terms, also affecting the structure of incentives affecting Ukrainian elites? One important Ukrainian specificity concerns its dual role as both a large energy importer and energy transit route, which made it especially prone to rent-seeking opportunities (“energy poor but rent-rich”). Among the energy-poor states of the former USSR, it was the state with the largest economy, largest transit role, and largest amount of energy-related funds changing hands yearly.³⁶ These framing conditions also heightened the impact of Ukraine's sudden transformation – virtually overnight – from being a crucial part of a single energy-rich state to being a separate energy-poor entity heavily dependent on Russia, which exacerbated the conditions discussed above, in particular the conditions created by the coexistence of multiple prices for a single commodity.

From 1991 to 2015: The rent swamps of the post-Soviet transition, Ukraine, and Ukrainian elites

The conditions discussed above created a unique situation in terms of the interest-definition choices post-Soviet elites found themselves face to face with at the time of the Soviet dissolution. We know that, in situations of economic transition, elites with the political power to set up rules may find it advantageous to create “artificial scarcities” that may allow them, not only to continue to accrue rents, but to create new rent-seeking opportunities.³⁷ Access to policy-making power is essential for the creation of such “artificial scarcities,” as rents can be easily

³⁵ See for example Abdelal 2001, Tsygankov 2001, and Balmaceda 2013.

³⁶ For a comparison of potential natural gas rents in three energy-dependent post-Soviet states, Ukraine, Belarus, and Lithuania, see Balmaceda 2013, 20.

³⁷ See James M. Buchanan, “Rent-seeking and Profit-seeking,” in *Toward A General Theory of the Rent-Seeking Society*, eds. J.M. Buchanan, R. D. Tollison and G. Tullock. Texas: Texas A & M University Press, 1980, and Joel S. Hellman, “Winners take all: The Politics of Partial Reform in the Postcommunist Transition,” *World Politics* 50, no. 2 (1998): 203-234. See Przeworski, (1991, 12) on how new institutional agreements almost always reflect the existing balance of power.

created by state regulations limiting market access for goods and services, regulations which also affect the size of “arbitrage rents” that can be accessed. The factors analyzed in this article led to a situation where the political elites from these newly-independent states quickly came to understand that they could exchange political power for economic advantage, and quickly moved to grab this opportunity, especially through taking control of those rent-rich areas of the economy where important rents could be easily accessed, such as the gas sector. So, after all, it *is* about structures and actors: structures both inherited from the Soviet system and made possible by the unique synergies of the multiple transition, and actors ready to take advantage of them.

But, how do the processes of 1991-1995 continue to influence Ukrainian state-building? Does emphasizing the key role of these foundational years imply a static picture of Ukraine’s political and political-economy development? Not necessarily: while undoubtedly rent-seeking and corruption have affected Ukraine’s political development, the concrete ways in which this situation has manifested itself have varied, and the geometry of such elite power has changed. The particular political economy situation of the immediate post-Soviet period helped solidify the power of communist-era “red directors.” Later on – in the mid-1990s – these came to be gradually substituted by more regionally-based Business-Administrative Groups combining economic and political power, whose competition for resources (and rent-seeking opportunities) along the cleavages of personalistic parties lacking a strong agenda helped guarantee a minimum of contestation while within a system that gave little policy-making voice to non-elite groups. This helps explain developments such as the predominance of personalistic political parties, often built around the interests of a single actor and lacking both structure and a strong unifying agenda. If during the Kuchma period (1994-2004) this allowed for a virtual balance of power between (rent-seeking) groups, during the Yanukovich presidency (2010-2014), control of the state by one particular group became a reality. Yet even within this period, even if such control led to some apparently concerted actions in some specific areas (such as in terms of taking the first steps towards energy diversification after the sharp increase in the price of Russian gas starting 2011), in the medium term it did not lead to a strengthening but a weakening of the state’s ability to defend itself.

Returning to the question about structures and actors posed at the beginning of this article: it was not simply about chronically “poisoned” Ukrainian elites, but about a unique combination of circumstances facing Ukraine at the very start of its independent statehood. How we answer this question has, indeed, key policy implications: if we see such elite behavior as chronic and unrelated to specific circumstances, then we have little hope of any changes in the situation. If, by contrast, we also pay attention to enabling factors for such behavior, this gives us at least the theoretical hope that we will be able to affect developments in the future.

Bibliography

- Aslund, A., 2009. How Ukraine Became a Market Economy and Democracy. Petersen Institute of International Economics, Washington, DC
- Verba, Sidney, and Gabriel Almond. "The civic culture." *Political Attitudes and Democracy* (1963).
- Balies, Alyson J. K., Oleksyi Melnik, and Ian Anthony, "Relics of Cold War: Europe's Challenge, Ukraine's Experience," *SIPRI Policy Paper*, no. 6 (Stockholm, November 2003), available at http://editors.sipri.se/pubs/RAPPORT_RELICSOFCOLDWAR.pdf (accessed May 5, 2006).
- Babanin, Olexander, Vladimir Dubrovskiy, and Olexyi Ivaschenko. *Ukraine: The Lost Decade and the Coming Boom*. Kyiv: CASE Ukraine 2002.
- Balmaceda, Margarita M. *Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's Power, Oligarch's Profits and Ukraine's Missing Energy Policy, 1995-2006*. London and New York: Routledge, 2008.
- Balmaceda, Margarita M., *Living the High Life in Minsk: Russian Energy Rents, Domestic Populism and Belarus' Impending Crisis*. Budapest, Central European University Press, 2014.
- Balmaceda, Margarita M., *The Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure*. Toronto: University of Toronto Press, 2013.
- Balmaceda, Margarita M., "Some Thoughts on Rents of Energy Dependency, 'Rent-seeking Swamps,' and Political Development: the Ukrainian case in Comparative Perspective," Workshop on Post-Communist Politics and Economics, Harvard University, March 13, 2006. Available at <http://www.fas.harvard.edu/%7Epostcomm/papers/2005-06/Balmaceda.pdf> (accessed May 25, 2006).
- Berenson, M.P., 2010. Less fear, little trust: deciphering the whys of Ukrainian tax compliance. In: D'Anieri, P. (Ed.), *Orange Revolution and Aftermath: Mobilization Apathy and the State*. Woodrow Wilson Center Press and Johns Hopkins University Press, Washington DC and Baltimore, pp. 193-228.
- Buchanan, James M. "Rent-seeking and Profit-seeking." In *Toward A General Theory of the Rent-Seeking Society*, eds. J.M. Buchanan, R. D. Tollison and G. Tullock, Texas: Texas A & M University Press, 1980.
- Barzel, Yoram, *The Economic Analysis of Property Rights* (New York: Cambridge University Press, 1982), 2.
- D'Anieri, Paul, *Economic Interdependence in Ukrainian-Russian Relations*. Albany NY: SUNY Press, 1999.
- D'Anieri, Paul, *Understanding Ukrainian Politics, Power, Politics and Institutional Design* (Armonk, NY: M.E. Sharpe, 2007)
- D'Anieri et al *Politics and Society in Ukraine* (Westview, 1999)
- D'Anieri, Paul, "Ukrainian-Russian Relations: Beyond the Gas," presentation at the conference on "The Ukrainian-Russian Gas Crisis and its Fallout: Domestic and International Implications," Harvard University, February 5-6, 2006 (streaming video available at http://www.huri.harvard.edu/na/na_gas_conf_2006.html) (accessed June 15, 2006).
- Dubrovskiy, V. et. al. "Reform Driving Forces in a Captured State." First draft. CASE Ukraine 2004.
- Easter, Gerald (2000). *Reconstructing the State: Personal Networks and Elite Identity in Soviet Russia*. (Cambridge University Press, Cambridge.)

- Frye, Timothy, "Original Sin, Good Works, and Property rights in Russia," *World Politics* 58 (July 2006), 479–504
- Gould, John A. and Hetman, Yaroslav (2008) "Market Democracy Unleashed? Business Elites and the Crisis of Competitive Authoritarianism in Ukraine," *Business and Politics*: Vol. 10: Iss. 2, Article 1.
- Havrylyshyn, Oleh. *Divergent Paths in Post-Communist Transformation*. Basingstoke, Hampshire: Palgrave McMillan, 2006.
- Hellman, Joel S. "Winners Take all: The Politics of Partial Reform in Postcommunist Transitions." *World Politics* 50, no. 2 (1998): 203-234.
- Hopkin, Jonathan, "States, markets and corruption: a review of some recent literature," *Review of International Political Economy* 9 no. 3 (2002).
- Honchar, Mikhailo (ed.) *Naftogazoviy sektor Ukraini: prozorist' funkcionuvannia ta dokhodiv*. Kyiv: Anna-T, 2008.
- Hutchcroft, Paul. "Booty Capitalism: Business-Government Relations in the Philippines." In *Business and Government in Industrializing Asia*, edited by Andrew McIntyre. Ithaca: Cornell University Press, 1994.
- International Energy Agency (IEA). *Ukraine Energy Policy Review 2006*. Paris: OECD/IEA, 2006.
- Kelly, R. J., R. Schatzberg, and P. J. Ryan, "Primitive capitalist accumulation: Russia as a Racket," *Journal of Contemporary Criminal Justice* 11, no. 4: 257-275.
- Krueger, Anne, "The Political Economy of Rent-Seeking Society." *The American Economic Review* 64, no. 3 (1974): 291-303.
- Krasnov, Gregory V., and Josef C. Brada. "Implicit Subsidies in Russian-Ukrainian Energy Trade." *Europe-Asia Studies* 49, no. 5 (1997).
- Kudelia, Serhiy, "The sources of continuity and change of Ukraine's incomplete state," *Communist and Post-Communist Studies* 45.3 (2012): 417-428.
- Los, M. and A. Zybertowicz, *Privatizing the Police State: The Case of Poland* (London: St. Martin's Press, 2000).
- Kuzio, Taras. "Crime, politics and business in 1990s Ukraine," *Communist and Post-Communist Studies* 47 (2014): 195-210
- Lo, Shiu-hing. "Bureaucratic Corruption and its Control in Macao." *Asian Journal of Public Administration*, Vol. 15, No. 1 (1993): 32–58.
- Molchanov, Mikhail A., *Political Culture and National Identity in Russian-Ukrainian Relations*. College Station TX: Texas A&M University Press, 2002.
- Przeworski, Adam. *Democracy and the market: Political and economic reforms in Eastern Europe and Latin America*. Cambridge University Press, 1991.
- Polokhalo, Volodymir. *The Political Analysis of Post-Communism*. Kyiv, 1995.
- V. Polokhalo, "Neototalitarnye transformatsii postkommunisticheskoi vlasti v Ukraine," *Politicheskaia mysl'*, 1993, no. 3, p. 18

Puglisi, Rosaria. "The Rise of the Ukrainian Oligarchs," *Democratization* 10 no. 3 (2003): 99-123.

Riabchuk, Mikola. "Ukraine's 'muddling through': National identity and postcommunist transition," *Communist and Post-Communist Studies* 45.3 (2012): 439-446

Solnick, Steven L., *Stealing the State: Control and Collapse in Soviet Institutions*. Cambridge, Harvard U. Press, 1998.

Stern, Jonathan, Simon Pirani, and Katja Yafimava. *The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment*. NG27. Oxford: Oxford Institute for Energy Studies, 2009. Available at www.oxfordenergy.org/pdfs/NG27.pdf (accessed June 1, 2010).

Van Zon, *The Political Economy of Independent Ukraine*. New York: St. Martin's Press, 2000.